BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

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Request for views on effective dates and transition methods

Dear Sir David

The Committee welcomes the opportunity to comment on the International Accounting Standards Board's *Request for Views on Effective Dates and Transition Methods* (hereafter referred to as the "Request for Views"). The Committee has a strong interest in high quality financial reporting by banking organisations. We encourage both the IASB and the FASB to continue developing a single set of high quality accounting requirements that would be beneficial to supervisors, investors and other users across the globe.

Major changes to accounting standards should be introduced in a measured way in order to minimise the disruption to preparers, users and supervisory authorities. The projects subject to the Request for Views have material implications for prudential requirements and reporting at regulated institutions. Furthermore, the accounting changes resulting from these projects will likely lead to policy, systems and process changes that will require some time for supervisors to implement. There are also implications for staff training at supervisory authorities. Thus, these projects have potentially significant consequences that require the selection of reasonable and appropriate effective dates and transition methods.

We have carefully considered this Request for Views because accounting information presented in banking organisations' financial reports is generally the starting point for evaluating the condition, performance and risk profile of individual financial institutions at supervisory authorities. Accounting information also serves as the foundation for critical prudential ratios, such as minimum requirements for capital, leverage, and liquidity as well as investment and transaction limits. Furthermore, this information provides critical input for supervisors' early warning analysis and systems used to monitor industry trends and overall financial stability. Our careful consideration of the Request for Views has also been driven by the potential impact of several expected International Financial Reporting Standards (IFRS) on the comprehensive set of supervisory reform measures known as Basel III, which were developed by the Basel Committee on Banking Supervision to strengthen the regulation, supervision and risk management of the banking sector. Basel III will be implemented in phases between 2013 and 2018.[1]

Although the Request for Views assumes that the nine projects within the scope of the request will be complete by 30 June 2011, the final content of several standards has yet to be determined and the actual timing of completion of these projects remains uncertain. Some of the nine projects are being conducted jointly with the FASB under the two Boards' Memorandum of Understanding. Moreover, for more than two years, the G20 leaders have emphasised the importance of achieving a single set of high quality improved global accounting standards in several areas including provisioning and valuation, and completing the Board's convergence projects. Accordingly, the IASB should seek to establish a reasonable lead time (eg three years from 30 June 2011[2]) that best balances all competing factors against the objective of implementing the projects subject to the Request for Views as soon as practicable. Such a balanced approach should provide banking organisations and supervisors with adequate lead time for a smooth transition to the revised accounting standards and minimise disruption as these organisations adopt the new Basel III capital rules.

To reduce disruption and promote more transparency over trend information, we prefer a single adoption date approach to the projects subject to the Request for Views. However, if a single adoption date cannot be achieved, then different adoption dates for different cohorts of standards could be used. The cohorts should be chosen after considering the relationships among the topics within the standards and operational issues that entities are likely to face.[3] The Committee recognises that the early adoption option endangers the comparability of financial statements and the uniform application of prudential ratios.[4] In cases when early adoption is permitted, pro forma note disclosures should be required that enable users and supervisors to make adjustments and obtain comparable financial information across all institutions.[5]

Our responses to some of the specific questions outlined in the Request for Views are set out in Appendix A below. We trust you find these comments helpful.

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[1] The measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source; improve risk management and governance; and strengthen banks' transparency and disclosures. The reforms target bank-level or microprudential regulation, which will help raise the resilience of individual banking institutions to periods of stress; and macroprudential system-wide risks that can build up across the banking sector as well as the procyclical amplification of these risks over time. These two approaches to supervision are complementary as greater resilience at the individual bank level reduces the risk of system-wide shocks. Additional information about implementation is included in the Appendix (see Question 3) with complete details on Basel III available from the Bank for International Settlements website: www.bis.org.

[2] The 30 June 2011 date is chosen as the Request for Views and the IASB work plan indicate a number of the IASB projects are expected to be completed by that date.

[3] Please also see our response to questions 5 and 6 in the attached Annex.

[4] Not permitting early adoption under either the single date or sequential approach would provide better comparability and allow for a "stable platform" for preparers and users (existing IFRS reporters and first-time adopters) to make systems changes, and train personnel in the time leading up to the date of adoption of these new standards.

[5] Please also see our response to questions 5 and 6.

These comments have been prepared by the Committee's Accounting Task Force, chaired by Sylvie Mathérat, Deputy Director General at the Banque de France. If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat (+33 1 4292 6579) or Rob Sharma at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely,

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Appendix A: Responses to specific questions

Background information

Q1.	Please describe the entity (or the individual) responding to this Request for Views. For example:
(a)	Please state whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor or other user of financial statements (including regulators and standard-setters). Please also say whether you primarily prepare, use or audit financial information prepared in accordance with IFRSs, US GAAP or both.
(d)	If you are an investor, creditor or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer/standard-setter), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialise in, if any.
(e)	Please describe the degree to which each of the proposed new IFRSs is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).

(a) The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques to promote common understanding. The Committee uses this common understanding to develop guidelines and supervisory standards. In this regard, the Committee is best known for its international standards on capital adequacy; the Core Principles for Effective Banking Supervision; and the Concordat on cross-border banking supervision.

The Committee's members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States and the European Central Bank. Austria and the European Commission are observers on the Committee’s Accounting Task Force.

(d)-(e) Accounting standards provide a widely accepted basis for the recognition and measurement of assets, liabilities and equity. Bank supervisors use accounting information from general purpose financial reports and/or prudential reports as the starting point for evaluating the condition, performance, and risk profile of banking organisations. Accounting information also provides supervisors with the foundation for conducting early warning analysis; monitoring industry trends; determining compliance with regulatory standards; considering applications; and calculating assessments. Finally, accounting data are also used for key prudential calculations, which includes minimum standards for regulatory capital, leverage, and liquidity, and investment and transaction limits (e.g. dealings with affiliates or insiders).

Changes to IFRSs such as *Financial Instruments*, *Fair Value Measurement, Leases, Insurance Contracts, Consolidation* and *Joint Arrangements* will have immediate and ongoing implications for the banking industry, individual institutions, and supervisory authorities. These implications can vary widely, depending on an institution's business activities, the composition of assets and liabilities and their capital structures.

For some banking organisations, the implications will be mainly a change in the presentation of their financial statements. For others the implications involve changes to: reported financial performance and financial position, the scope of future capital management, operational and risk management practices and the ability of reporting systems to capture required information. These changes will also require banking organisations to develop effective communication with their investors and other users of their financial statements to ensure these parties understand the impact of the new accounting standards on the organisations. Finally, banks are also users of financial information as creditors and accounting changes may require changes to their lending practices to ensure that they are able to properly evaluate the new financial information as part of their credit granting process.

Supervisors may need to alter their prudential and reporting requirements as well as their supervisory practices for these changes to IFRS. From a supervisory perspective, these changes should be undertaken in a way that minimises disruption and avoids unintended consequences on regulated entities, eg, financial instability. Updating supervisory guidance, training staff, and making necessary process and system changes at supervisory authorities will require significant investment in terms of financial and human resources. Supervisors and other users should be allowed sufficient lead time to enable a smooth transition.

Preparing for transition to the new requirements

Q2. Focusing only on those projects included in the table in paragraph 18 above:

(a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?

(b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

(a) Our response to this question considers the impact on bank supervisory authorities. We have prioritised the projects subject to the Request for Views in order of the expected extent of change arising from each new standard compared to current practice. We believe that the first five are likely to require more significant investment and present greater challenges in terms of training personnel, planning and implementation than the other four:

1. *Financial Instruments;*
2. *Fair Value Measurement;*
3. *Leases;*
4. *Consolidation;*
5. *Joint Arrangements;*
6. *Insurance Contracts;*
7. *Presentation of Items in Other Comprehensive Income;*
8. *Revenue Recognition; and*
9. *Post-Employment Benefits.*

(b) The costs that bank supervisors are likely to incur in planning and adapting to the new requirements are twofold. Firstly, there are *costs associated with prudential and supervisory policies and* prudential *reporting requirements*. Specifically, changes to financial statement recognition, measurement, and presentation must be assessed to determine the need for, and extent of, revisions to specific elements of the overall supervisory framework. The results of these assessments may take the form of changes to: data collected in prudential reports and related reporting instructions, prudential rules and supervisory policy guidance, and supervisory and surveillance tools. Such changes generally require consultation with industry before they can be introduced. Secondly, there are *financial costs associated with IT system changes and training supervisory personnel*.

These costs vary considerably from one supervisory authority to another because each supervisory authority tends to follow its own consultative approach to policymaking and has its own distinctive statutory mandate.

Q3. Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

Basel III Implications

The Basel Committee's oversight body – the Group of Central Bank Governors and Heads of Supervision (GHOS) – have agreed on transitional arrangements for implementing the new standards under Basel III, which are outlined in the 16 December 2011 publication of the Basel III rules. These transitional arrangements will help ensure that the banking sector can meet the higher capital standards through reasonable earnings retention and capital raising, while still supporting lending to the economy.[6]

National implementation by Basel Committee member countries will begin on 1 January 2013. Banking organisations will conduct a parallel run of existing standards in Basel II and standards in Basel III commencing 1 January 2013 and running until 1 January 2017. Disclosure of the leverage ratio and its components will start 1 January 2015. Based on the results of the parallel run period, any final adjustments will be carried out in the first half of 2017 with a view to finalise the introduction of the new capital regime on 1 January 2018 based on appropriate review and calibration.

The Committee will put in place rigorous reporting processes to monitor the ratios during the transition period and will continue to review the implications of the new prudential standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary.

Auditing Standard Implications

The new financial instruments, fair value measurement and other standards[7] have specific implications for auditing standards and the auditing procedures performed to implement

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[6] The phase-in arrangements are set out in Annex 4 of Basel III: A global regulatory framework for more resilient banks and banking systems, which is available at www.bis.org.

[7] This includes Leases, Revenue Recognition and Insurance Contracts.

these standards. Because clear and reliable financial information supported by quality audits are important elements in enhancing market confidence, we recommend that changes to key accounting standards on financial instruments and fair value measurement be coordinated with the International Auditing and Assurance Standards Board (IAASB). This would allow the revised accounting framework to be audited in a robust and effective manner.

Q4.	Do you agree with the transition method as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantages of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

The Committee believes that changes to key accounting standards mentioned in the response to Question 2 should be introduced in a manner that balances the need for preparers of financial statements to have sufficient time to adapt their accounting processes with the needs of users that seek high quality, decision-useful financial reporting information.

Retrospective application when implementing new accounting standards is intended to provide comparability of financial information over time. We would encourage the Boards to consider the benefits and costs of each transition approach in relation to each accounting standard. With the retrospective approach, careful consideration should be given to allowing for a retrospective approach (eg as laid out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) only where possible. We also note that retrospective application can often be costly (for example given the systems implications), difficult to implement due to the need to gather relevant historical data, and in some cases can even be impracticable for the reporting entity.

In relation to specific accounting standards, the Committee proposes that the impairment and hedging phases relating to the IAS 39 Replacement Project for financial instruments be introduced in the following way.[8]

Impairment (Phase II) – We believe that the impairment phase should be introduced on a prospective basis as this phase emphasises forward looking information. Substantial judgment is needed to estimate impairment loss on the financial statement date and organisations generally have access to sufficient supporting data to make well-reasoned judgments about these estimates. However, there may be limited quantitative and qualitative data available for prior period modifications, which could render retrospective application costly and result in less meaningful information.[9]

Hedging (Phase III) – We welcome the IASB's proposal in the December 2010 Hedge accounting Exposure Draft for the hedge accounting requirements to be adopted on a prospective basis. This is because the hedge accounting requirements introduce a more

[8] The effective date for the classification and measurement phase is for annual periods beginning on or after 1 January 2013. However, there is an incentive for early adoption built within the transition arrangements whereby an entity that adopts this IFRS for reporting periods beginning before 1 January 2012 need not restate prior period comparative financial statements (IFRS 9 *Financial Instruments,* paragraph 8.2.12).

[9] As noted in the Committee's 30 June 2010 *Impairment* comment letter, it is not appropriate that comparative information should be restated to reflect the proposed requirements. The Committee's views on transition for impairment are set out in its responses to Questions 8 and 9 of the 30 June 2010 *Impairment* comment letter. The letter is available from the link: http://www.bis.org/bcbs/commentletters/commentletters.htm.

forward looking hedge effectiveness testing concept, and therefore hedging transactions can only be designated prospectively.

In relation to *Fair Value Measurement*, *Insurance Contracts*, *Consolidation, Joint Arrangements* and *Leases,* the proposed transition method in paragraph 18 of the Request for Views remains appropriate.[10]

Effective dates for the new requirements and early adoption

Q5.	In thinking about an overall implementation plan covering all of the standards that are the subject of this Request for Views:
(a)	Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).
(b)	Under a single date approach and assuming the projects noted in the introduction are completed by June 2011, what should the mandatory effective date be and why?
(c)	Under the sequential approach, how should the new IFRSs be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs.
(d)	Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages
Q6.	Should the IASB give entities the option of adopting some or all of the new IFRSs before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

As noted above, the Committee proposes introducing the new requirements on a single adoption date (for all IFRS and for those US standards on the two Boards' convergence agenda) as soon as practicable. The Committee recognises that the early adoption option endangers the comparability of financial statements and the uniform application of prudential ratios.[11] However, in cases when early adoption is permitted, pro forma note disclosures should be required that enable users and supervisors to make adjustments for analytical purposes, including for Basel III implementation calculations, and obtain comparable financial information across all institutions. If a single adoption date cannot be achieved for all standards, then different adoption dates for different cohorts of standards could be used (eg

[10] In addition, the Committee's views on *Presentation of Items of Other Comprehensive Income* are set out in its 30 September 2010 comment letter to the IASB. In that letter, the Committee encouraged the IASB to undertake a more fundamental conceptual project to develop guiding principles that would enable a clear distinction between Other Comprehensive Income (OCI) and Profit and Loss items. The IASB could then reconsider the role of OCI in each of the accounting standards where it currently appears – as well as those where its use might be appropriate in future – before any changes are made to presentation. The comment letter is available from the link: http://www.bis.org/bcbs/commentletters/commentletters.htm.

[11] Not permitting early adoption under either the single date or sequential approach would provide better comparability and allow for a "stable platform" for preparers and users (existing IFRS reporters and first-time adopters) to make systems changes, and train personnel in the time leading up to the date of adoption of these new standards.

Financial Instruments, Revenue Recognition and *Insurance* on one date, *Consolidation* and *Joint Arrangements* on another date and so on). Under this approach, banking organisations in all jurisdictions that adopt these new standards and are applying Basel III phase-in requirements are likely to be affected in the same way and with minimal disruption.

International convergence considerations

Q7.	Do you agree that the IASB and FASB should require the same effective dates and transition methods for their comparable standards? Why or why not?

The Committee believes the IASB and FASB should continue to work together on their comparable standards and ideally require the same effective dates and transition methods for these standards. This approach would facilitate convergence.