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"Scoping of Problem" Document

Project: Assessing the impact of IFRS implementation on the Banking regulatory framework

Section 1
Project information

PUBLIC-PRIVATE FINANCIAL SECTOR MODERNIZATION MATRIX					
Italian Banking Association CRITERIA	**European Central Bank CRITERIA**				
	Asymmetric information reduction	*Completeness of the market*	*Increased opportunities to engage in financial transactions*	*Reduced transaction costs*	*Increased competition*
Business development					
Industry competitiveness	X				
Industry reputation					

Short description of the context [from project matrix]: In May 2008, the Ministry of Finances issued a decree that made obligatory the application of International Accounting Standards and International Financial Reporting Standards since January 1st 2008. Banks, as business entities, have to start with the application and implementation of the new standards. In order to facilitate the transition process, Bank of Albania, as the banking system supervisory authority, has to adjust the banking legislative framework and align it with the new accounting and reporting standards.
Stakeholder proposing the project: Bank of Albania
Other Stakeholders involved (sponsors): AAB and Banking community, Ministry of Finance, Financial Supervision Authority, National Council of Accountants and Auditing Companies.
Project objectives: **1. To interpret the Decision of the Ministry of Finance on the timing of the full application of IFRS standards.** **2. To assess the impact of IFRS implementation in banking regulatory framework by preparing a list / identifying the affected laws, bylaws, regulations and guidelines.** **3. To assess the main areas of impact and the general sense of the changes to be brought to the regulations.**

Description of the project contribution toward financial modernization: By reaching the project's objectives, BoA would identify more accurately the main areas of impact and the general need for change on the banking regulations as consequence of IFRS implementation. Consequently, the existing regulatory framework would be adopted to reflect the new international accounting and reporting standards and would address with more efficacy all users needs.
Project Working Group: Bank of Albania (Project Owner & Project Manager) Banka Popullore (Deputy Project Manager) Raiffeisen Bank (member) First Investment Bank (member) Banka Kombetare Tregtare (member) Emporiki Bank (member) Alpha Bank (member) International Commercial Bank (member) American Bank of Albania (member) Ministry of Finance (member) National Accounting Council (member) FSA (member) KPMG (member) Deloitte (member) PWC (member) Ernst & Joung (member)

The EU Better Regulation Approach	
Steps	**Purpose**
Scoping of problem	
1. Problem identification	To understand if a market/regulatory failure creates the case for regulatory intervention.
2. Definition of policy objectives	To identify the effects of the market /regulatory failure to the regulatory objectives.
3. "Do nothing" option	To identify and state the status quo.
4. Alternative policy options	To identify and state alternative policies (among them the "market solution").

Section 1: Scoping the problem

1.1. Problem identification

[Background section from ToRs]

In May 2008, the Albanian Ministry of Finance issued a decree making obligatory the application of International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) since January 1st 2008. Banks, as business entities, have to start with the application and implementation of the new standards.

In order to facilitate the transition process, Bank of Albania, as the banking system supervisory authority, has to adjust the banking regulatory framework and align it with the new accounting and reporting standards.

IFRS are considered a "principles-based" set of standards in that they establish broad rules as well as dictating specific treatments.

International Financial Reporting Standards comprise:

- *International Financial Reporting Standards (IFRS)* **-** standards issued after 2001
- *International Accounting Standards (IAS)* **-** standards issued before 2001
- *Interpretations originated from the International Financial Reporting Interpretations Committee (IFRIC)***-issued after 2001**
- *Standing Interpretations Committee (SIC)* **-** issued before 2001

There is also a *Framework for the Preparation and Presentation of Financial Statements* which describes some of the principles underlying IFRS.

The framework states that the objective of financial statements is to provide information about the financial position, performance and changes in the financial position of an entity that is useful to a wide range of users in making economic decisions.

The underlying assumptions used in IFRS are:

- ***Accrual basis -*** the effect of transactions and other events are recognized when they occur, not as cash is received or paid;

- ***Going concern*** - the financial statements are prepared on the basis that an entity is a going concern and will continue in operation for the foreseeable future.

The Framework describes the qualitative characteristics of financial statements as being

- Understandable,
- Relevant,
- Reliable, ***and***
- Comparable.

IFRS are used in many parts of the world, including the **European Union**, **Hong Kong**, **Australia**, **Pakistan**, **India**, **GCC countries**, **Russia**, **South Africa**, **Singapore** and **Turkey**. As of March 28, 2008, about 75 countries require the use of IFRS, or some form of modified IFRS.

All listed EU companies (including banks and insurance companies) have been required to use IFRS since 2005.

1.2. Market/regulatory failure analysis (nature and evidence)

According to art. 72 law "On banks", the supervision function of BoA, among others, is based on: The regulative framework; and The financial analysis of the data periodically reported by the banks.

The current banking regulatory framework and the periodical reports are based on national accounting standards and principles. The application of new international principles and standards in accounting requires that the Regulatory Authority adapts the banking regulatory framework accordingly. The identified regulatory failure is in this case "Regulation wrongly prescribed for the market".

1.3. Policy Goal(s) threatened by the failure [e.g. financial stability, market integrity, market confidence, consumer protection, facilitating innovation, enhancing competition]

The regulatory failure described above generates uncertainty and confusion among the market participants, delays innovations and integration with the international markets.

Furthermore, according to the Law "On banks" art. 73.3, the balance sheet and financial reports of banks are prepared in accordance to the Law "On accounting and financial statements" and to the international accounting standards. Despite BoA's powers to define format, type, methodology and content of the financial reports (Law "On Banks", art. 47.4 On financial reports), BoA has also the legal obligation to accept, recognize and use the financial information generated by the international accounting standards, adjusted with the prudential concerns.

In addition, the financial stability policy goal could also be affected in case BoA cannot fulfill properly its supervisory functions.

1.4. “Do nothing” option

1.4.1 Possible medium-term (max 2 years) self – corrective market actions (e.g. mechanisms through which the “Do Nothing” option would address the market/regulatory failure).

The non-revision of all banking regulations with the international accounting principles would make banks to maintain two evidences of their activity: one based on national accounting standards, in order to comply with banking regulatory provisions, and one based on international standards, in order to comply with the general legal requirements. This situation would involve additional costs for banks and confusion among the market participants.

1.4.2. Impact of the “Do Nothing” option to the various stakeholders
(to be filled only if the “Do Nothing” option could be taken into further consideration)

Impact on regulated firms/ banks:
-

Impact on consumers:
-

1.5. Alternative policy option(s)

1.5.1. Broad description of the regulatory or self-regulatory action(s) needed to remedy the market or regulatory failure and hence achieve the policy goal(s)

The banking regulations must not be conflicting with the general legal provisions, therefore the discrepancies between the general and the specific regulations have to be corrected in order to allow BoA to **supervise the banking activity** and to ensure the banking system stability.

1.5.2. Possible operational regulatory or self-regulatory actions to achieve the policy goal

- to identify the regulations affected by the change in the general legal provisions.
- to perform a banking survey in order to assess banks’ readiness to implement IFRS.
- to set up the implementation process of the regulatory changes.

1.5.3. General description of various Options

Option 1: To modify the specifics of banking regulations, and

Option 2: To issue a general decree stating that references to national accounting standards are replaced with references to IFRS.

1.5.3.1 Detailed description of Option 1:

To modify the all affected banking regulations in order to correctly reflect all the changes brought by IFRS implementation. In order to get the package of banking regulations to be amended, PWG will browse through all banking regulatory framework and will prepare a list

of all the regulations related to the regulation and supervision of the banking activity. The list will be analyzed and regulations will be arranged according to 3 categories: regulations that need important changes, regulations that require slight changes and regulations not affected by IFRS implementation. For the heavily impacted regulations, specific changes will be indicated, while for the less affected only the general sense of the changes. The banking survey will indicate banks' readiness to implement IFRS or, in other words, the time needed for full implementation of IFRS provisions, to be used as indication for BoA regulatory further actions.
1.5.3.2 Detailed description of Option 2 To issue a provisional regulation that will state that all the references to the national standards will be replaced with the international standards, having as legal ground the Decree on IFRS. The PWG will set up an implementation timeline for the regulatory changes.

Summary Problem Scoping			
Auction procedures under foreclosure for immovable collateral			
Market failure			
Asymmetric information	Market power	Positive externalities	Negative externalities
(Existing) Regulatory failure			
Regulation wrongly prescribed for the market	Regulations succeeded in addressing the failure; a different market failure (e.g. side effect)	Regulation made it worse	Regulation so far has failed to work; maybe in due course
X			