

**BANCODE ESPAÑA**

Control, Budget and Accounting Department

**April 2005**

**Harmonisation of the Notes to Annual Accounts: Proposal for action**

Inés Fortis Pita

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**BANCODE**ESPAÑA  
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## **Harmonisation of the Notes to Annual Accounts<sup>1</sup>**

### **1. Purpose**

This document was written as a contribution to the next X Meeting of the Committee on Central Bank Accounting and Budgetary Aspects for Latin America and the Caribbean and sets out a proposal for the harmonisation of the data to be included in the notes to annual financial statements with the aim of enabling greater comparison while increasing transparency.

### **2. Harmonisation under IFRSs of the notes to annual accounts**

There is an acknowledged need for the international harmonisation of accounts to make financial information more comparable by bringing the different bodies of accounting legislation more closely into line. In recent years, considerable international effort has been made to establish a set of standards that satisfy two main objectives, namely to provide sufficiently homogenous information as to enable comparison of financial statements and to increase the transparency of these statements.

The report on the financial statements and/or notes to the annual accounts (henceforth the "Notes"), together with the financial statements themselves, combine to offer a true and fair view of a company's position, activity and results. The function of these Notes is to describe and permit the interpretation of the figures given in the balance sheet and the income statement, providing additional information for the proper understanding of the company's economic reality, which cannot be obtained solely by reading the balance sheet and the income statement.

A number of benefits are to be had by harmonising the Notes:

- Comparisons can be drawn between the annual accounts of different companies that harmonise their information to achieve a more accurate vision of their actual circumstances.
- Strategic information can be obtained, thus making decision-making easier.
- Information can be published more quickly and in a more structured way.
- Improved relations with analysts and investors, who have greater confidence in corporate management and transparency, etc.

*International Accounting Standard 1 on the presentation of financial statements* requires that, in the context of the Notes, companies:

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<sup>1</sup> The views expressed in this document and the accuracy of the data reproduced are the sole responsibility of the author and, as such, do not represent the official position of the Banco de España.

- (a) present information about the basis of preparation of the financial statements and the specific accounting policies used for transactions and significant events;
- (b) disclose the information required by IFRSs that is not presented in the other constituent parts of the financial statements;
- (c) provide additional information that is not presented in the main part of the financial statements but is relevant to an understanding of them. The notes to the financial statements contain detailed descriptions of items included on the balance sheet, income statement, cash flow statement and statement of changes in equity, as well as additional information on contingent liabilities, unrecognised contractual commitments, etc. They also include information that the IASs require or recommend companies to present, together with other types of data needed to give a true and fair view;
- (d) present the Notes in a systematic manner, so that each item on the balance sheet, income statement and cash flow statement is cross-referenced to any related information appearing in any note.

*International Accounting Standard 30 on disclosures in the financial statements of banks and similar financial institutions* sets out specific requirements for information on contingencies and commitments, off balance sheet items, maturities of assets and liabilities, losses on loans and advances, general banking risks, assets pledged as security, etc., to be included in the Notes.

### **3. Accounting policy of the central banks of the Eurosystem**

The accounting policy obligatorily followed by all of the central banks of the Eurosystem is set out in the Guideline of the European Central Bank on the legal framework for accounting and financial reporting in the European System of Central Banks. Since it was first published on 1 December 1998, this Guideline has been amended on several occasions and the latest version is dated 5 December 2002.

The Guideline aims, on one hand, to achieve a high degree of harmonisation in the accounting standards applied by the central banks of the Eurosystem in the preparation of their financial statements and, on the other, to ensure that the standards meet the criteria of prudence, transparency and a true and fair view.

Although Eurosystem accounting standards are obligatory for the presentation of financial statements consolidated in the Eurosystem, the central banks are not legally bound to prepare their annual accounts in line with the balance sheet format used for consolidation. In practice, however, all of them do essentially apply both this format and that recommended for presenting their income

statements. The national central banks (NCBs) can also decide what information to include in the notes, although almost all adhere to a minimum list of information to be included in every explanatory note that refers to a balance sheet item<sup>2</sup> relating to Eurosystem operations. This minimum information requirement is specific and determined by the criteria of transparency and the minimum information set that can be disclosed while maintaining transparency. The NCBs can, of course, include any additional information they consider appropriate for a better understanding of the financial statements.

#### **4. Accounting criteria for central banking in Latin America and the Caribbean**

The CEMLA Committee on accounting and budgetary issues has prepared a document on accounting criteria (henceforth the “Criteria”) in which it sets out recommendations on the recording, valuation and presentation of financial statements for the central banks of Latin America and the Caribbean. The Criteria aim to define the underlying structure of accounting and financial theory embodied by the fundamental concepts that make up the accounting activities of a central bank, namely:

- (a) accounting standards or principles
- (b) the specific criteria relating to the concepts behind financial statements, and
- (c) compliance with the principle of prudence in the application of the specific criteria.

The Criteria indicate that the aim of financial statements is to report on the financial situation of an entity as at a specific date, as well as its operating results and changes in its financial situation, in such a way that the information contained in the financial statements satisfies the needs of both in-house and external users. However, while in the context of the financial statements a bank must present there are references to the balance sheet, income statement, statement of changes in equity and statement of changes in the financial situation or cash flow statement, no express mention is made of the Notes.

#### **5. Analysis of the annual accounts of a number of central banks in Latin America and the Caribbean**

An analysis of the annual accounts of a large number of the region’s central banks<sup>3</sup> reveals that almost all banks include a balance sheet, an income statement and Notes thereto. Most of them, in their Notes, also refer with varying degrees of precision to the accounting framework used to prepare the financial statements and offer a variety of detailed information for a better understanding of the

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<sup>2</sup> The recommendations for the disclosure of a minimum set of common information do not apply to the Income Statement since its format is recommended, unlike that of the Balance Sheet.

various items in the financial statements. It should be noted that the results of the analysis may be imprecise on account of the different terminology used by each bank and our own understanding of it. Further clarification is therefore needed to verify the accuracy of the data.

Nevertheless, there are considerable differences in the data provided in the detailed content of the Notes.

By way of example, a comparison of the Notes corresponding to three different balance sheet items shows just how much the 13 reports consulted differ from one another:

a) Balance sheet item – Gold:

<b>Gold</b>	<b>No of banks making references</b>
Value in national currency .....	11
Amount in ounces .....	3
Exchange rate applied .....	8
Explanation of change on previous year .....	1

b) Balance sheet item – Balances with banks, security investments and other external assets:

<b>Balances with banks, security investments and other external assets</b>	<b>No of banks making references</b>
Value in national currency .....	12
Explanation of change on previous year .....	2
Information on currencies in which assets are denominated .....	7
Maturities	
Exchange rate applied .....	7

c) Balance sheet item – Government securities:

<b>Government securities</b>	<b>No of banks making references</b>
Year-end balance .....	8
Explanation of change on previous year .....	0
Information on types of securities .....	6
Maturities	4
Returns	3

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<sup>3</sup> The analysis was based on the annual reports of the central banks of Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Honduras, Nicaragua, Paraguay, Peru, Uruguay and Venezuela, obtained from the banks' websites. Where specific information was not available, the organic law of the respective country was consulted.

The annex to this document contains a detailed table showing the data provided by different banks on the material aspects of each balance sheet item<sup>4</sup>.

Admittedly, the harmonisation of the formats of financial statements (balance sheet, income statement, etc.) may entail further difficulties, since some banks may be bound by definitions set out in their respective national legislation. Yet there seems to be no obstacle preventing all banks from providing minimum common information in their Notes to explain the content of each item. Clearly, the aim would not be to propose a recommendation on the literalness or form in which to draft explanatory Notes for each item on the balance sheet, rather that all Notes should disclose specific data that would increase transparency. For example (referring to the item "Gold"), the Notes of all banks that follow the recommendations of the Committee would indicate the number of troy ounces and an explanation of why holdings (purchases, sales, changes in criteria, etc) have varied. This harmonising approach would not be costly to implement, nor would it seem to be incompatible with the legal standards applicable in each country.

## **6. Proposal for harmonisation**

Were the Committee to consider this proposal worthwhile and appropriate, groundwork along the following lines would be necessary for its practical implementation:

- a) A survey would be conducted to update the data set out in the annex to this document, which was taken from reports for the 2003 accounting period by Banco de España staff. Such a survey would be an opportunity not only to update the data to include the 2004 accounting period but, more importantly, to call on the central banks to say themselves what they include and do not include in the Notes, thus avoiding errors in interpretation.
- b) The survey would be sent by the Committee to the Head of the Accounting Departments of all the central banks for completion. The format used could be practically the same as the one set out in the annex, albeit with no details or breakdown by bank.
- c) Following the period set for the completion and return of the surveys by the central banks, all the ensuing data would be arranged in a matrix. This would identify the common minimum relevant data included in the Notes, those data that should be considered necessary or advisable to increase transparency, and those thus recommended for future inclusion.

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<sup>4</sup> For this purpose, the balance sheet format recommended by the CEMLA Committee on accounting and budgetary issues was used.

- d) The Banco de España has offered to provide logistical support for the field work relating to the activities described above, to send the surveys and tabulate the resulting data, and to contact the central banks if further clarification is required, should the Committee consider it appropriate.
- e) Once the results had been obtained, all the information, together with the complete matrix resulting from the tabulation of all the data, would be sent to the Committee with an itemised proposal on the specific minimum data to be included in the Notes to annual accounts.
- f) Finally, as and when the Committee considered appropriate, it could formulate the appropriate recommendations.



	Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Guatemala	Honduras	Nicaragua	Paraguay	Peru	Uruguay	Venezuela
Asset maturities													
Description of returns													
<b>Contributions to international organisations</b>													
Year-end balance	X	X			X			X			X	X	
Explanation of change on previous year		X			X			X					
<b>Fixed assets</b>													
Year-end balance	X	X			X			X	X	X	X	X	X
Explanation of change on previous year	X					X		X			X	X	
<b>Other assets</b>													
Year-end balance	X	X			X			X	X	X	X		X
Explanation of change on previous year	X												
<b>Monetary base</b>													
Year-end balance	X	X	X	X	X		X	X	X	X	X		
Breakdown of balance	X	X	X	X	X		X	X		X	X		
Explanation of change on previous year		X	X										
<b>International reserve liabilities</b>													
Year-end balance	X	X	X	X			X	X	X	X	X		
Explanation of change on previous year			X			X		X					
Info. on currencies in which liabilities are denominated			X										
Liability maturities			X					X	X		X		
Exchange rate applied		X	X	X			X			X			
<b>General government liabilities</b>													
Description	X	X	X				X	X			X		
Year-end balance	X		X				X	X		X			
Explanation of change on previous year			X										
<b>Securities issued by the central bank related to monetary policy operations</b>													
Description	X		X				X	X	X				
Year-end balance	X		X	X			X	X				X	
Explanation of change on previous year													
Return on these liabilities	X		X					X					
Liability maturities	X		X	X				X					
<b>Other liabilities related to mon. pol. operations</b>													
Description													
Year-end balance		X											
Explanation of change on previous year													
Return on these liabilities													
<b>Liabilities to financial institutions</b>													
Description			X				X	X				X	

	Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Guatemala	Honduras	Nicaragua	Paraguay	Peru	Uruguay	Venezuela
Year-end balance		X	X				X	X		X	X	X	
Explanation of change on previous year													
Return on these liabilities			X					X					
<b>Liabilities to international organisations</b>													
Description					X		X						
Year-end balance		X			X		X			X			
Explanation of change on previous year													
Return on these liabilities													
<b>Other liabilities</b>													
Year-end balance	X	X	X					X		X	X		
Explanation of change on previous year	X												
<b>Counterpart of SDRs allocated by the IMF</b>													
Description	X	X						X			X	X	
Year-end balance	X	X	X	X			X	X		X	X		
Explanation of change on previous year								X					
Return on these liabilities		X						X			X		
<b>Reserves</b>													
Description		X	X		X		X	X			X		X
Year-end balance			X	X	X		X	X		X			X
Explanation of change on previous year					X	X					X		X
Possibility of increasing these reserves								X		X	X		
<b>Capital</b>													
Year-end balance		X		X	X		X	X		X	X	X	
Explanation of change on previous year				X				X		X		X	
<b>Result for the accounting period</b>													
Explanation of change on previous year								X					
Explanation of transfer to / from provisions										X	X		
Allocation of result		X			X						X		X