

**INTERNATIONAL FINANCIAL REPORTING STANDARDS AND THEIR
APPLICATION TO CENTRAL BANKS**

IX MEETING ON CENTRAL BANK ACCOUNTING AND BUDGETARY ASPECTS

Santiago, Chile
Cemla, Banco Central de Chile
20th-22nd October 2004

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INTRODUCTION

The subject of this paper¹ is one of the key elements of the current accounting debate. Words such as globalisation and transparency imply attempts at comparison and, in turn, efforts to initially harmonize and subsequently standardise. This forum has not remained on the sidelines of this debate and has at various moments pronounced generally on the need for specific accounting criteria for recording, valuation and presentation in financial statements the operations of a Central Bank². Precisely for that reason, CEMLA has, since 1995, promoted various meetings, like this one, to establish such criteria.

However, if that is the case and, as already mentioned, such accounting criteria refer to "the specific operations of a central bank", it might be asked why the application of International Financial Reporting Standards (hereinafter IFRSs),³ to central banks should be discussed if it has already been agreed to have specific accounting policies? Have their objectives and/or nature changed? Have their economic or financial circumstances changed? The clear answer is no. What has changed is the world of accounting and financial information which is being encouraged, urged I would say, to apply harmonised international accounting practices. Thus:

- a) As a consequence of globalisation, there has in recent years been a broad consensus among experts, institutions, markets, etc. regarding the urgent need to have a harmonised accounting framework to be applied by firms. Thus, the IFRSs,

¹ The content of this paper cannot be considered complete without the verbal comments and explanations that will be given at its presentation. This document reflects the views of its author and should not be considered to be the official position of the Banco de España.

² See for example the documents: "Criterios Contables Banco Central. América Latina y el Caribe"; "Resumen de conclusiones y recomendaciones de la Comisión I" at the III Meeting on Central Bank Accounting and Budgetary Aspects", etc., available at www.cemla.org.

³ When this text refers to IFRSs, it is referring to international accounting standards in general, including also the standards issued by the International Accounting Standards Committee until 2001, which is now called the International Accounting Standards Board.

with at present the odd exception in the field of banking, have been prescribed by the European Union for the consolidated financial statements of listed companies from 2005⁴. Also, governments, regulators, accounting professionals, etc. of very different countries are facing this need and analysing how they can reduce the differences between the IFRSs and the accounting standards established by local laws⁵.

- b) For different reasons, including the numerous scandals arising from the application of "creative accounting" techniques, investors, regulators, markets, the media and the general public are much more interested in companies' economic and financial information, especially on considering the implications it has for the establishment of quality comparisons among financial statements⁶.
- c) International agencies and, in particular, the International Monetary Fund (IMF) are insisting on compliance with international standards as part of their economic

⁴ In 1995, an agreement was signed between the International Accounting Standards Board (IASB) and the International Organization of Securities Commissions (IOSCO), whereby it was agreed to revise the International Accounting Standards so that they could be applied in a harmonised way by listed companies.

Subsequently, the 2000 Lisbon European Council highlighted the need to accelerate the improvement of the Single Market for financial services, setting a deadline of 2005 for the introduction of the IFRSs.

To this end, the European Union Regulation on the application of the International Accounting Standards was passed in 2002. This regulation requires all entities listed on organised markets in the European Union to prepare consolidated accounts, from 1 January 2005, in accordance with IFRSs, authorising the Member States to allow or require the application of IFRSs in the preparation of individual annual accounts, as well as for groups without an official listing.

⁵ For further information see the "GAAP Convergence Report 2002 – A Survey of National Efforts to Promote and Achieve Convergence with International Financial Reporting Standards" at www.ifad.net.

⁶ As an example of the foregoing the comments of Paul Volcker, Chairman of the Trustees of the IASC Foundation (2001) are significant: "*the rapid development of global financial markets has greatly reinforced the desirability of -indeed now demands- international consistency in accounting standards*".

Also relevant are the comments of the European Union Single Market Commissioner in relation to the application of IFRSs: "*The adoption of a common financial reporting language for listed companies throughout Europe will greatly benefit both companies and investors in bringing about more transparency and a higher degree of comparability*".

programmes and assistance to developing countries. Among such standards are the IFRSs issued by the International Accounting Standards Board⁷.

Until a few years ago central banks remained outside this debate perhaps because of their unique status in each country, but now they are fully involved in it. A significant event for central banks has been the creation in the European Union of a single monetary space, the European System of Central Banks, a practically unique occurrence historically that has required the issuance of mandatory standards for its members, among those standards stand out the accounting.

In addition, there is also greater interest in the functions of central banks and in how they are executed, especially in the transparency of their accounts and in the financial information they provide. In this context the real possibility cannot be ruled out that governments or other sectors of society may ask why these institutions are not following the IFRSs.

Accordingly, and given the harmonisation drive referred to, it would seem opportune to highlight and explain the reasons that might justify the use of specific accounting criteria, so that some of the IFRSs would not be applied in the accounting systems of national central banks.

SUITABILITY OF IFRSs FOR CENTRAL BANKS. ARE THERE ANY REASONS FOR DEPARTING FROM THEM?

Having mentioned the reasons that justify the use of standardized international accounting rules, we shall now analyse the reasons why, in my opinion, strict application of the IFRSs could, in certain cases, have adverse effects on the central banks; since the nature, objectives and operational characteristics of central banks differ from those of commercial companies for which the IFRSs have been designed. The strict application of all these standards may, in certain circumstances, lead to central banks not having either the ability or the resources to safeguard their financial

⁷ See, for example, "International Standards: Strengthening Surveillance, Domestic Institutions and International Markets" (International Monetary Fund and World Bank, March 2003).

independence or to achieve the objectives of the functions they have been charged with⁸.

a) Profit maximisation versus the objectives of NCBs

The first aspect to consider in this analysis is that the IFRSs have been developed to be applied by commercial companies, especially those listed on organised markets, and that the nature and objectives of such companies differ radically from those of central banks.

It could be possible to establish, more or less clearly, the division of central banks into those whose primary objective is the maintenance of price stability and those that, along with this objective, are equally required to contribute to the country's economic development.

These main objectives can be expressed in many different ways, stressing the fundamental aim (price stability), but mentioning at the same level the support of general economic policy⁹. Apart from these basic objectives they normally perform other functions that are also very important (banking supervision, payments system, etc.).

It could be said, therefore, that the essence of the ordinary business of central banks is to maintain price stability. In the case of most financial, industrial, commercial and services companies, their main objective is profit maximisation. The determination of such profit will depend on the accounting standards applied; hence their relevance.

By contrast, the implementation of monetary policy should be carried out irrespective of the profits involved for the institution charged with its execution, which may mean that it has to expose itself to structural risks that cannot be

⁸ "The average inflation for the financially weakest central bank group is 26% or twice as high as the average inflation for the strong group". "Why central banks need financial strength (pag. 27)" by Peter Stella.

⁹ A case in point is the definition of the Banco de España's own objectives: Article 7.2 of its Law of Autonomy establishes that "Without prejudice to its main objective of maintaining price stability and fulfilling its duties as a member of the European System of Central Banks in accordance with the terms of Article 105 (1) of the Treaty, the Bank shall support the general economic policy of the government".

managed by conventional means. In some cases, national laws establish that such objectives must be achieved with an efficient use of resources¹⁰, but there does not seem to be any law requiring profit maximisation¹¹. As a result, the profit recorded at year end may, in the case of NCBs, have a very different meaning and consequences from those in the case of private companies.

b) Transparency and comparability¹²

The second fact to highlight relates to the reasons why accounting standards need to encourage transparency and comparability for financial statements.

The adoption of IFRSs is a response to the desire to ensure a high degree of transparency and comparability of company financial statements and an efficiently operating capital market.

The IFRSs are thus intended to ensure the supply of harmonised financial information to help investors take their economic decisions. In this respect, the way in which the annual results are determined and comparisons between the results obtained by different listed companies are of the utmost importance.

Central banks are generally not listed companies¹³. From the viewpoint of the supply of useful information to investors on organised markets, it is therefore not important how their annual profit is determined.

At the same time, owing to the singularity of central banks, any possible comparison between their financial statements and those of any other company would be totally irrelevant. The only useful comparison might be one between the financial statements of different central banks.

¹⁰ An efficient use of resources does not necessarily imply the existence of profits, merely that the objectives are achieved at the lowest possible cost.

¹¹ In fact, the positive relationship between seignorage income and inflation creates a potential conflict of interest for central banks if it is not fully ensured that a central bank's primary goal is price stability.

¹² For more information "Transparency and dissemination of central bank accounting information" by Jose Miguel García Hernando. CEMLA 2002.

¹³ There are cases in which the shares that make up the capital of a central bank are held, at least in part, by private shareholders. The most significant example of this situation is the US Federal Reserve. In other cases, these shares may even be listed. In Europe, this is the case of the central banks of Greece and Belgium.

However, it should not be thought, because there are usually no investors who might participate in the capital of central banks and because it only makes sense to compare their financial statements with those of other central banks (this is especially true in the case of supranational agencies, regional development banks, etc.), that they should not abide by principles of transparency and comparability; quite the contrary¹⁴. However, compliance with these principles should take into account the specific characteristics and the singular situation of central banks, so that their application should not simply involve the adoption of all the accounting standards designed for private companies, when there are reasons, such as those we shall mention below, why in certain cases specific standards should be applied that differ from those commonly accepted.

c) **Independence**¹⁵

The third area in which national central banks differ from other companies relates to their financial independence.

In a market economy, companies are free to take their own economic and financial decisions. Accordingly, there are no restrictions on private companies as regards the payment of dividends or the recognition of reserves charged to profits. On the other hand, national regulations usually require a minimum volume of own funds (higher in the case of credit institutions) to encourage the recognition of these reserves. The determination of the accounting profit does not therefore imply that

¹⁴ In this respect, for example, the words of Alan Greenspan, at the Bank of England's Tercentenary Symposium are significant: "... If we are going to have independent central banks then implicit in that independence is accountability. You cannot in a democratic society have an institution which has powers that central banks inherently have. So the question really amounts to how does one position the central bank with respect to the issue of disclosure and accountability - which are related questions.

The position that we [the Federal Reserve] take is that the burden of proof is against the central bank: that is, we have to demonstrate that either delayed disclosure or non-disclosure is a policy which is required for us to implement our statutory goals. We have struggled with this, and have concluded that we should make available to the electorate what it is we think, why we are doing what we are doing and in a general way under what conditions we would behave differently."

¹⁵ The independence of the NCBs has long been studied, from various standpoints. However, as pointed out by Martínez Resano (Central Bank Financial Independence, Occasional Paper No 0401, Directorate General Economics, Statistics and Research, Banco de España) less attention has been paid to the factors that influence and/or determine the financial independence of these institutions.

this will automatically be distributed in the form of dividends; in some circumstances this would entail the decapitalisation of the company.

For these reasons the IFRSs disassociate the recognition of profits from their distribution, regulating the former, but not the latter, since it is understood that companies have sovereign power to decide on the distribution of profits and that they will not take decisions that prevent the attainment of their objectives. To avoid the adoption of such decisions causing damage to third parties, national regulations usually even provide for actions to be taken in the event of losses at year end in private companies (covering them with reserves or with payments by shareholders, reducing capital, or declaring technical insolvency in extreme cases).

As regards central banks, one of their basic characteristics for achieving the objective of maintaining price stability is their independence. This independence should be manifest in different senses including, obviously, in the financial sense. A situation of more or less permanent losses could provoke to arrive to a negative net equity, reducing its credibility and creating difficulties in the achievement of the mentioned primary target¹⁶.

Central bank profits, in accordance with local laws, are normally paid, to a greater or lesser extent, to the Treasury of the State to which they belong. In many central banks all the profits obtained are distributed in this way. The possibility of recognising reserves with a charge to profits is normally regulated by law, this possibility being restricted in a considerable number of cases. The volume of capital, not including revaluation accounts and provisions for future risks, may, in these cases, be very low.

Given the relationship, in the case of central banks, between the recognition of profits and their distribution there should not be a symmetric treatment for the former and an asymmetric one for the latter. A symmetric treatment in the first case is understood as one in which both unrealised gains and losses are taken to the profit and loss account. However, when the profit and loss account shows a profit there are almost always legal provisions requiring its distribution, but when the

¹⁶ Central banks independence has been widely analyzed from different perspectives. From financial point could be consulted, among others: International Monetary Fund, working paper 97/83; Central Bank Financial Strength, FMI WP/02/137"; Why central banks need financial strength", by Peter Stella; "Why Central Banks need capital", by Robert Pringle; "The role of central bank capital revisited", ECB E/42 and 58", by Bindseil, Manzanares y Weller; "Central bank financial independence", by Martinez Resano, Banco de España DO/0401"

opposite occurs, there are almost never provisions requiring governments to cover losses, even when such losses exceed net equity¹⁷.

Here a question arises that could itself be the subject of a paper: how should central bank losses be covered? Leaving this debate open, I would at least dare to say that when the results show a permanent deficit causing a negative net equity hampering the prices stability target, the Government should be obliged to restore the central bank resources, and therefore they should legally recognise that obligation..

In short, we can say that where the recognition of profits is closely tied to their distribution, the related accounting rules should not be considered in isolation but rather taking both aspects into account. Any change in the former would require its impact on the latter to be analysed carefully and, where applicable, the promotion of a tightening of the latter, which could require, in turn, the amendment of local laws. While this is not possible, the application of, for example, IAS 21 "The Effects of Changes in Foreign Exchange Rates"¹⁸ and IAS 39 "Financial Instruments: Recognition and Measurement"¹⁹ would not appear to be acceptable.

As we know, one factor that can affect the volatility of central banks' results is exchange rate movements, which may give rise to unrealised gains and losses²⁰. If the unrealised gains are recognised in the profit and loss account (in many cases they would then have to be paid to the Treasury as dividends) then, clearly, in the event of any adverse movement in exchange rates, central banks will be in a financial position that could ultimately make it difficult for them to implement an appropriate monetary policy. For this reason, the most logical alternative would be

¹⁷ According to Vaez-Zadeh [1991] revision of central banking laws in some 60 countries almost one third do not have any specific provisions regarding the treatment of losses. Furthermore, Pringle and Courtis [1999] found that most of the 27 central banks they surveyed provide rules for the distribution of profits but they don't mentioned any kind of rules for losses.

¹⁸ Under IAS 21 unrealised exchange gains must be recognised in the profit and loss account.

¹⁹ IAS 39 establishes that unrealised gains and losses arising from fluctuations in the market prices of securities should be recognised in the profit and loss account (in the case of the securities held for trading) or in the balance sheet (in the case of securities available for sale) providing for a symmetrical treatment in both cases.

²⁰ Unrealised gains and losses are understood to be the differences between the book value and the value obtained using the market exchange rate of the currency in question as at the date of the end of the financial year to which the financial statements refer.

to isolate this effect, recording unrealised gains in revaluation accounts, keeping them on the balance sheet and not recognising these amounts in the profit and loss account. There would be no objection to the application of the aforesaid IAS if central banks are free to recognise reserves with a charge to profits equal to the amount of the revaluations made, so avoiding their distribution.

As for the possibility of including both unrealised gains and unrealised losses in the balance sheet (which the abovementioned IFRSs would not allow either), distributing as the case may be, the current profits of the year may also in certain circumstances erode the capital of central banks and could even result in profits being paid when capital is negative. This could be considered monetary financing in the first case and even a loan to the government in the second. At the same time this situation would reduce the credibility of the central bank and might lead to citizens' losing confidence in its currency. Also the possibility of capitalising losses would make the recognition of provisions more difficult.

The clear differences manifest so far in relation to the nature, objectives, transparency and comparability, as well as the independence of central banks vis-à-vis companies in general provide sufficient arguments to warrant the divergence of central bank accounts, in certain aspects, from the IFRSs. Specifically, I have mentioned the fact that one can reasonably defend the non-application of IFRSs to central banks: in the recognition of income (when and how unrealised profits/losses are incorporated into the profit and loss account). In fact, the European System of Central Banks does not follow the IFRSs in this case²¹.

There are situations in which the application by central banks of IFRSs in these cases would not contravene the principle of prudence (those in which there is no restriction on central banks retaining profits in the form of reserves, so that they can fully cover the risks of incurring losses, especially those that may arise from exchange rate movements). However, this is not exactly the usual situation since, as I have already mentioned, on one hand, central banks may not be authorised to retain profits to cover such risks and, on the other hand, it is not usual for their shareholders to cover losses when they arise. The application of IFRSs in these

²¹ The accounting standards applicable to the accounts of the ESCB (see the "Guideline of the ECB on the legal framework for accounting and financial reporting in the European System of Central Banks" of 5 December 2002).

circumstances would generate a high degree of vulnerability incompatible with the principle of prudence necessary to preserve their financial independence.

I am now going to focus on what I consider to be the most paradigmatic case: the convenience/need to depart from international standards when national regulations do not permit the recognition of reserves to cover exchange rate risk. Strict application of the IFRSs in these circumstances might lead to loss by the central bank of its financial stability and, as a result, its independence, which would also entail loss of the ability to achieve its fundamental objective.

d) The recognition of provisions for future risks at central banks

IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" establishes that the recognition of provisions is only acceptable if, among other conditions, there is a reasonably possibility foreseen of future losses arising as a consequence of past events. Thus under this standard it would not be possible to recognise provisions for possible future losses (so-called rainy-day provisions) on positions taken by central banks resulting from exchange rate and interest rate fluctuations.

Commercial banks take foreign-currency positions to generate trading profits, anticipating short-term exchange-rate movements, or acquire currencies to cover their commercial payments. In such circumstances it would seem more acceptable not to distinguish between realised and unrealised gains and losses and not to permit the recognition of provisions for these future risks.

By contrast, central banks' currency holdings are not generally, or not primarily, intended to be used in operations on the markets in order to obtain profits. In fact, such a possibility is seriously limited by other more important objectives, namely monetary policy and the maintenance of the external value of the currency.

At the same time, although there are cases in which currency foreign are very limited, the truth is that most central banks usually maintain large and static foreign currency positions in their balance sheets. Moreover, precisely because of their size and implications it is not easy, or even possible in many cases, to cover the future risks arising from this situation through hedging transactions.

In situations in which the local laws applicable to central banks require them to distribute all their profits without recording reserves, it may only be a question of time before a situation of financial weakness arises, as can be readily observed by anyone who analyses past exchange rate movements. It is only possible to cover such future risks through the recognition of sufficient provisions, albeit it should be understood that their level had to be based, to be defensible, on the application of the most objective possible measurement instruments (e.g. durations for interest rates, VaR, etc.)

ACCOUNTING STANDARDS APPLIED AT EUROSISTEM NCBs²²

a) Origin, regulation and objectives

The creation of the European Monetary Union in 1999 and, consequently, of the European System of Central Banks, advised commencing the work that concluded with the approval of the ECB Guideline of 1 December 1998 on the legal framework of accounting and reporting in the ESCB. This includes the accounting standards to be applied by the Central Banks of the euro area as from the onset of Monetary Union and has been subject to subsequent amendments, resulting in the current version of 5 December 2002²³.

The Guideline, drafted by accounting experts from ESCB central banks, details highly specific standards, the application of which is mandatory when balance sheet items deemed specific to the Eurosystem (External Assets, Transactions with Marketable Securities, Loans and Deposits relating to Monetary Policy, Banknotes in Circulation, etc.) are involved, and voluntary for the rest (Fixed Assets, Long-Term Financial Investments and, generally, less significant items).

The objectives pursued by the Guideline are, first, to achieve a high degree of harmonisation in the accounting standards used by Eurosystem central banks to prepare their financial statements; and further, that the standards applied should comply both with the transparency and true and fair view principles and with the

²² The document supplementing the International Monetary Fund's Code of Good Practices on Transparency in Monetary and Financial Policies (IMF Executive Board, 24-7-2000) provides, as part of these Good Practices, for the application of the accounting standards established by the ECB for the central banks of the Eurosystem.

principle of prudence valuation which ensures, as far as possible, the existence of sufficient capital at central banks to provide them with an appropriate level of coverage of future risks arising from fluctuations in asset values.

The reasons for the need for harmonised standards to be applied at all central banks are manifold: the need to obtain and publish a consolidated balance sheet of the Eurosystem for monetary policy reasons; the desirability of obtaining comparable central bank balance sheets and profit and loss accounts; and the need to use the data provided by the accounts for different purposes, such as the analysis of system liquidity developments, calculations relating to the determining of monetary income, and the supply of data for statistics, inter alia.

The basic characteristics of the standards in the Guideline, relative to financial assets (position in foreign currency, marketable securities and derivatives) and gold, may be summarised as follows:

They are valued at the market prices and exchange rates prevailing as at the balance sheet date.

The capital gains arising in the valuation for each currency, type of security and gold are reflected in revaluation accounts in the balance sheet without any netting of gains or losses on a currency, security code or gold.

Unrealised capital losses arising in the year-end valuation are recorded as losses in the profit and loss account. If these losses are recouped in subsequent valuations, their amount is recorded in revaluation accounts (on balance sheet), and this is therefore not recoverable as a profit in the profit and loss account until the position is liquidated. This asymmetrical treatment of unrealised gains and losses is what is known as Scenario III within the Eurosystem.

Finally, another significant aspect of the standards applied in the Eurosystem is the fact that it is permitted to recognise provisions for future risks not arising from past events with a charge to the profit and loss account.

b) Comparison between IFRSs and the accounting standards applied by Eurosystem central banks

²³ For further information this Guideline can be viewed at www.ecb.int.

The greater degree of specificity of Eurosystem standards compared with IFRSs and the greater scope of the latter vis-à-vis the former hinder comparison between both groups of standards. However, it is possible to highlight the main points of coincidence and divergence and those standards included in IFRSs which, owing to the aspects they regulate, are not directly applicable to Eurosystem central banks.

1. Main similarities.

The main similarities between IFRSs and Eurosystem standards relate to the valuation and presentation in the balance sheet of the main financial assets and liabilities.

Thus, both groups of standards propose using fair value for the position in currency (monetary assets and liabilities denominated in foreign currency), the trading portfolio and derivatives. That entails the presentation of these financial instruments in the balance sheet at their market value (in the case of derivatives, they are presented in the balance sheet at the net market value of the open positions). Likewise, the position in gold is presented at its fair value (market value).

Fixed financial assets, equivalent to held to maturity investments regulated in IFRSs, are valued at amortised cost and marketable equities at market price (recommended standards in the Eurosystem).

Loans and deposits related to monetary policy operations are recorded at their cost at origin (talk of amortised cost in subsequent valuations is out of place here, as what are involved are short-term transactions in which the initial cost and the redemption value coincide).

In the recording of securities repos, assets assigned are not removed from the balance sheet as the risks and benefits associated with them are not transferred, as provided for in IFRSs.

Operations are recorded as at their trade date (applicable in the Eurosystem as from 2007, this treatment being permitted under IFRSs).

2. Main differences.

The main differences between IFRSs and the Eurosystem's accounting standards (summary in Annex) arise from the greater importance attached by the latter to the principle of accounting prudence, trying to make compatible, as far as possible, with the presentation of the true and fair view of central banks' financial and net worth position.

Accordingly, one fundamental difference between both groups of standards lies in the different treatment given to unrealised capital gains and losses arising on assets and financial positions in respect of their being recorded, or not, as part of the results for the period in which they come to light. Thus, IFRSs record valuation differences arising on the currency position, the trading portfolio and derivatives (except hedging operations, which receive a specific treatment) as profits or losses in the profit and loss account. Unrealised gains and losses on available-for-sale financial assets (which are not part of the trading portfolio nor of the held to maturity portfolio) shall be recorded directly in the balance sheet, according to IFRSs, until the sale of the asset comes about, at which point they will be carried to the profit and loss account. Consequently, one of the main differences in IFRSs in relation to unrealised gains and losses on this type of asset is that of their symmetrical treatment, with both being carried to the profit and loss account or to the balance sheet depending on the type of asset or financial position involved.

Conversely, and as earlier discussed, Eurosystem standards, in application of the prudence principle, only record unrealised losses in the profit and loss account, posting gains in revaluation accounts in the balance sheet, without any netting of gains and losses and without carrying the recouping of losses in subsequent years to income, until the related financial position is liquidated.

Another significant difference between both groups of standards lies in the possibility of recognising provisions for the coverage of future risks and expenses with a charge to the profit and loss account; this possibility is permitted in Eurosystem standards and expressly prohibited in IFRSs. Once again, this difference arises from the preponderance of the prudence principle applied in Eurosystem standards versus the prevalence of the true and fair view in IFRSs.

We should also mention the differences in the balance-sheet and profit-and-loss-account presentation formats, specific formats having been defined in the ECB Guideline for central banks. In this respect, and with specific regard to the balance sheet, the format defined classifies the different items in terms of currency, residence of the counterparty and the nature of the asset or liability involved.

3. Standards in IFRSs not applicable to Eurosystem central banks.

One of the characteristics of IFRSs is their would-be universal scope, having been defined so that they might be applied to all institutions irrespective of the sector or region to which they belong. However, as discussed, there is a series of standards included in IFRSs which, owing to the particularity of the activity performed by central banks and of the financial and net worth positions arising from such activity, are not applicable to central banks.

Thus, for instance, IFRSs require the presentation, in the annual accounts, of a cash flow statement and a statement of changes in financial position. Eurosystem standards do not envisage these statements, considering both of them not relevant for central banks. Even in the standards relating to the presentation of the financial statements, there is a series of aspects regulated by IFRSs that are difficult or impossible to apply at central banks, such as the calculation of earnings per share or segmented data.

Regarding the regulation of macro-hedging operations, it was concluded that European central banks have not been conducting such operations to date, or have conducted them residually; accordingly, it was not necessary to include specific standards regulating them in the Guideline.

Other aspects regulated in IFRSs, such as the treatment of goodwill or the standards on the consolidation of corporate groups, are not applicable or are applicable only to a very limited extent to European central banks, and are not envisaged in the ECB Guideline.

4. Aspects regulated by IFRSs that may be applicable to central banks but which have not been included in Eurosystem standards.

There are a significant number of standards in IFRSs regulating aspects or economic events that arise or may arise at central banks in a similar fashion as they do at other institutions. Such aspects or events have not, however, been addressed (or have been treated in a very limited way) by the ECB Guideline. The reason for this lack of regulation in Eurosystem standards lies in the fact that what are involved are events not related to central banks' specific operations, it having therefore been considered unnecessary to regulate them as generally accepted accounting standards could be applied to record them. In this respect, and given the prevalence of IFRSs within the European Union, it seems reasonable that central banks should apply this set of standards in their accounting systems.

This set of economic events includes most notably the following:

Operations with tangible or intangible fixed assets.- The ECB Guideline solely recommends that these assets be valued at cost (an option envisaged by IFRSs), setting tentative terms for the depreciation of these elements. Consequently, aspects such as the capitalisation of costs relating to the development or own-production of assets (e.g. IT applications), the analysis of impaired assets, the replacement, renewal and extension of fixed assets, swaps, leasing, etc. are not regulated in the Eurosystem standards.

The recording of expenses.- In this respect, the only applicable reference included in the Guideline is that of the application of the accrual principle, with specific principles not being established for the recording of specific types of expenses such as employee remuneration (in the short and long run, and post-employment benefits) or defined-contribution pension schemes.

Provisions for pensions and other expenses.- The Eurosystem standards do not include specific principles for determining the need or not for recognising these provisions, and for calculating the amounts to be recognised.

Treatment of errors and changes in accounting estimates.- Not regulated by the ECB Guideline.

Information in notes to financial statements.- At the Eurosystem level, a list of minimum recommendations based on central banks' specific financial positions has been drawn up. However, specific aspects such as the information to be detailed in connection with related-party transactions, remuneration, etc. have not been regulated.

Other events not regulated by the ECB Guideline which may affect European central banks are the recording of stocks, the treatment of impaired assets, the recording of subsidies and of income to be distributed over several years, etc.

CONCLUSIONS

- 1^a. Accounting standards should take into account, indissociably, the economic, financial and legal circumstances of central banks. While there are specifically legal obstacles for central banks potentially preventing or hampering the attainment of their objectives, the application of harmonised accounting standards not conceived for these institutions and potentially incompatible with the foregoing would not seem advisable.

Accordingly, the use among Latin American and Caribbean central banks of the best possible set of accounting standards should be promoted, taking into account, as indicated, their economic, legal and financial circumstances. The application of IFRSs in those few but significant cases where their use might endanger attainment of the objective to which they owe their very existence should be questioned.

The exceptions refer essentially to IAS no. 21 on "The Effects of Changes in Foreign Exchange Rates"; no. 37, on "Provisions, Contingent Liabilities and Contingent Assets" and no. 39 on "Financial Instruments: Recognition and Measurement", in the aspects previously highlighted in this paper.

Other possible exceptions would be the standards for valuing gold, in its capacity as a monetary asset (an aspect not addressed by IFRSs) or the changes proposed for

IAS no. 8 on “Net Profits or Loss for the Period, Fundamental Errors and Changes in Accounting Policies”²⁴.

- 2^a. In cases (such as that analysed in connection with the recognition of provisions for future exchange rate or interest risks) where, for the reasons indicated, it is necessary to deviate from IFRSs, the application of specific principles should be based on measurement instruments that allow for quantitative determination on bases that are as objective and reliable as possible.
- 3^a. The non-use of an IFRS should not lead to not applying the principle of economic reality nor to a lack of transparency in the financial statements. The use of market price at the end of the year and the presentation of revaluation accounts and provisions in the balance sheet allow compliance with both principles.
- 4^a. The exceptions mentioned aside, the most extensive possible application of IFRSs should be recommended, especially in those areas in which the conduct of the NCBs does not specifically differ from companies in general. In this respect, the momentum that can be given to this objective, in fora such as ours today, may exert a highly favourable influence.

However, the process of harmonisation in the use of IFRSs, when the standard itself allows different alternatives, should not entail avoiding the possibility of using these options, retaining the freedom to use that which contributes, in each case, to best reflecting a true and fair view.

- 5^a. The Notes to the financial statements (i.e. in the annual accounts) should provide sufficient information so that, without disclosing matters that might have unwanted influence on the markets, users may obtain appropriate knowledge of the financial reality of central banks and of their operations. To contribute to this objective, various recommendations could be adopted.

²⁴ This IAS indicates that the effects of errors that are material or derived from changes in accounting policies relating to prior years should not be carried to the profit and loss account for the current year but recognised directly in the balance sheet.

- a. The notes should refer clearly to the accounting framework applied, avoiding ambiguous wording that hinders users' understanding and masks the true scope of the accounting framework.
 - b. If all IFRSs are not complied with, those or the specific points of those which have not been followed should be indicated.
 - c. The revision of the annual accounts by independent external auditors should be promoted. Even when the participation of internal auditors is absolutely relevant and necessary, this should not be considered sufficient. The external auditors should be changed periodically.
- 6^a.** It would be appropriate for this Forum to perform an exercise to harmonise the minimum information that the area's NCBs' annual accounts should contain, as this would contribute to enhancing their comparability.

MAIN DIFFERENCES BETWEEN EUROSISTEM ACCOUNTING RULES AND IAS/IFRS

	EUROSISTEM	IAS/IFRS
Applied accounting principles	Preponderance of the prudence principle, assuring compatibility with the transparency and true and fair view criteria.	The prudence principle is subordinated to the transparency and true and fair view of the institution.
Foreign currency position valuation	Use of market exchange rates for valuation. Unrealised gains are shown in Equity. Unrealised losses are shown in Profit and Loss (and cannot be reverted in subsequent valuations). (Scenario III).	Use of market exchange rates for valuation. Unrealised gains and losses are shown in Profit and Loss.
Securities	<ul style="list-style-type: none"> ▪ Quoted fixed income securities: market value (Scenario III). ▪ Unquoted fixed income securities and fixed financial assets: amortised cost. ▪ Quoted equity instruments: market value (Scenario III). ▪ Investments in subsidiaries: underlying book value. 	<ul style="list-style-type: none"> ▪ Financial assets at fair value through profit and loss: market price valuation with differences shown in Profit and Loss. ▪ Held-to-maturity: amortised cost. ▪ Available-for-sale: market price valuation with differences shown in Equity.

	EUROSYSTEM	IAS/IFRS
	<ul style="list-style-type: none"> Unquoted equity instruments: cost. 	
Derivatives	Use of market prices for valuation following Scenario III. Gains are losses are not considered realised until termination of the contract.	Use of market prices for valuation with differences shown in Profit and Loss (except for some hedging transactions).
Gold	Market value following Scenario III.	Gold is described as a commodity, and therefore it cannot be considered as a monetary asset as regards its valuation.
Provisions	The setting-up of provisions for future exchange rate and price risks is allowed.	Only provisions arising from past events which imply a probable outflow of resources in the future are allowed.
Booking date for transactions	Currently settlement date is used. From 2007 agreement date will be used (economic approach).	Either agreement or settlement date are allowed. In case settlement date is used, valuation differences that might arise between both dates are shown in Profit and Loss.
Financial statements presentation	Both balance sheet and profit and loss account have been standardised. As regards the notes to the accounts, minimum requirements have been established.	Both the cash flow statement and the statement of changes in equity must be included amongst the financial statements, and disclosure of earnings per share and segment information is compulsory.