

## RECOMMENDATION ON HARMONIZING NOTES TO ANNUAL FINANCIAL STATEMENTS

### STATEMENT OF MOTIVES

Compliance with the goals assigned to central banks requires that said institutions enjoy a sufficient degree of credibility among the economic agents, markets and society in general. Obtaining this level of credibility will be boosted if the central banks maintain a suitable transparency policy by offering society enough information to correctly understand the central banks' economic-financial activity and the results of their management. Part of this information is reflected in their financial statements that compile, in a simplified manner, the whole range of their actions.

Together with the financial statements, the information furnished in the Explanatory Notes is a key element to understand them better, and without which they could not be analyzed or compared. This information is what makes it possible to correctly understand the data appearing in the financial statements.

The conviction that the information provided by the Notes is essential to understand financial statements has meant that they are regarded as a basic piece of information, as is recognized in various accounting standards, which include the International Accounting Standards (IAS/IFRS); the orientation on the legal framework and financial information in the European Central Bank System, issued by the European Central Bank, as well as recommendations by international organizations and academic sectors.

CEMLA's Accounting and Budgeting Aspects Committee, which shares the criteria quoted, has been adopting various initiatives to improve the financial reporting that the Central Banks of the Latin American and the Caribbean Area attach to their financial statements. As a result of said initiatives, in the X Meeting held in Brazil in September 2006, the Committee proposed the harmonization of Notes which was supported by the central banks attending the said Meeting and the Committee was given the task of drafting the proposal as a Recommendation for all the central banks of the area, as well as, if so required by circumstances, taking the subsequent

steps in order to make progress on the path taken towards improving transparency. In compliance with this, in 2006 the first Recommendations were drawn up that were to be applied to the annual financial statements corresponding to said fiscal year 2006.

Later, in the **XI Meeting held in Buenos Aries in October 2008**, considering that the conditions were suitable, and the recommendation by the CEMLA Board of Governors that the Committee should continue with its efforts to promote initiatives that lead to the production of uniform, comparable and high-quality information<sup>1</sup>, it was agreed to expand the contents of the 2006 Recommendation, while once again calling on the area's central banks to adopt exact compliance measures. This new Recommendation therefore covers the standards established in the Recommendation of 2006, which it replaces, and the new complementary ones.

Throughout this new Recommendation, the general set of narrative descriptions that accompany the financial statements will be called "Notes" and each specific narrative description referring to a given subject or a specific item of the financial statement will be the "notes".

## RECOMMENDATION

Consequently, the CEMLA Accounting and Budgeting Aspects Committee considers that the minimum information that must be disclosed in the Notes to the annual financial statements of the central banks of the Latin America and Caribbean area, is as follows:

**ONE.** The financial statements must be clearly identified so that they can be distinguished from any other information published in the same document. Additionally, the following information must be clearly stated: a) the name of the central bank; b) the date of the financial statements or the period covered; c) the date on which they were prepared as well as the approving authority; d) the currency of the presentation and e) the level of aggregation and rounding-out used to present the figures in the financial statements.

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<sup>1</sup> In the meeting held in Washington on October 19, 2007, the CEMLA Board of Governors analyzed the document prepared by the Central Bank Accounting and Budgeting Aspects Committee titled: "Assessment of the application of international accounting standards in central banks", which includes a chapter on the importance of standardizing the notes to the annual financial statements.

**TWO.** The annual financial statements must be accompanied by Notes, which are understood as the narrative descriptions that permit adequate understanding by the public. These narrative descriptions will cover at least the accounting bases and criteria used in preparing said statements, as well as complementary explanations and specific explanations for each of the significant headings.

**THREE.** The bases used to prepare the financial statements are the sources (legislative texts, organization statutes, national provisions, etc.) from which they emanate or where the accounting policies and criteria used have been established. If the central bank has adopted the International Financial Reporting Standards (IFRS) it will make an explicit and unreserved declaration of its compliance in the Notes, but it will not declare compliance with said IFRS unless there is compliance with all the requirements established in the said IFRS.

**FOUR.** The Notes must also contain sufficient descriptions of the policies, accounting criteria, evaluation standards and the criteria for the recognition of income and expenditure used in preparing the annual financial statements. Sufficient description may be understood as those that permit reasonable understanding of the accounting criteria and evaluation standards used. The disclosure of particular accounting policies will be especially useful for users when these policies have been selected from among the alternatives permitted in the accounting standards.

**FIVE.** The information that is necessary to understand the balance or the results statement must always be included in the Notes to the financial statements. When the central bank presents a statement of changes in net equity or a cash flow statement in its financial statements, the application requirement would be identical.

**SIX.** Any changes in the accounting estimate that may have caused effects in the current fiscal year, or which are expected to cause them in future fiscal periods must be reported in the Notes. If this estimate cannot be made, there shall be a note to this effect.

When an error in a previous fiscal year is declared, the following must be disclosed: a) nature of the error and b) the amount of the adjustment as far as possible. If it is not possible to calculate said adjustment in a particular previous period, the reasons for not being able to do so will be reported, together with a description of how and when the error was corrected.

If after the date of the balance, the bank receives information about the relevant conditions that already existed on said date, the disclosures related to said conditions will be updated pursuant

to the information received. In any case, when the events after the balance date do not imply adjustment but are of major importance for the bank: a) the nature of the event must be reported and, b) an estimation will be provided of the financial effects or an explanation will be given for the inability to make said estimation.

**SEVEN.** The annual financial statements will be presented in accordance with the format authorized by each central bank in which all the data on the closing of the previous fiscal year must appear. Additionally, crossed references must be used to permit unequivocal identification of each heading of the financial statements with its specific explanatory note.

The system of crossed references will consist of assigning the number to all the important headings of the financial statements and each explanatory note will be preceded by the number allocated to the corresponding financial statement heading. Consequently, there must be specific explanatory notes for all of the headings referenced in the financial statements.

**EIGHT.** The presentation and classification of the items in the financial statements will be continued from one fiscal year to another unless it is stated that another presentation or classification is better.

When said presentation changes are made, the comparative information will be reclassified and the following must be reported: a) the nature of the reclassification, b) the amount of each heading or group of items reclassified and c) the reason for the reclassification.

If it is impossible to reclassify the comparative amounts, the bank must disclose: a) the reason for not reclassifying the amounts and b) the nature of the adjustments that would have been made if the amounts had been reclassified.

**NINE.** Each specific explanatory note of a given heading or item must contain: a) a description of the meaning of the heading in question; b) detailed information about its composition and c) an explanation of the causes of its variation in the period.

The description of the meaning of the heading is to facilitate knowledge about its nature, and thus avoid confusion about the real meaning and scope.

Regarding the composition, each note must explain and provide: a) quantitative and comparative information concerning the previous fiscal year; b) the main constituent items and to the extent that they are applicable:

- Exchange rates used to evaluate year-end foreign currencies.
- Currencies in which assets and foreign currency liabilities have been invested.
- Stocks of gold, in troy ounces or kilograms and the price applied in the year-end evaluation.
- Fees for participation in international institutions or organizations (IMF, BIS, IDB, etc.)
- Breakdown by maturity of assets/liabilities.
- Percentage yield on assets and remuneration of liabilities.
- Explanation of various government securities included in the balance.
- Explanation of why the provisions have been constituted.
- Information on the constitution of reserves and distribution of profits and losses.

Finally, each note should also explain the causes behind the variation in the heading compared with the previous year, if important.

**TEN.** In the specific case of financial instruments, the following information will be provided:

- The importance of using financial instruments for the bank.
- The purposes determined for their use.
- The criteria followed for recognition, measurement and discontinuance.
- The methodology used to determine the reasonable worth, stating whether the direct observable market price format or specific evaluation techniques have been used.
- Sales and purchases are accounted by using the purchase date or settlement date method.
- Guarantees given or received, if applicable.

**ELEVEN.** In reference to market risks (understood as those derived from possible adverse movements in exchange and interest rates and prices) and to credit risks, quantitative and qualitative information must be furnished that make it possible to determine the nature and scope of same to which the bank is exposed on the date of preparing the financial statements.

The following information must therefore be disclosed:

- Management, measurement, coverage and risk control policies.
- Degree of exposure to market risks.
- Credit exposure by classification, concentration and sector.
- Composition by currency and list of coverage operations.
- Any change compared with the previous period that occurred in the above points:

**TWELVE.** The bank's relationship with the Treasury, Government or other public organizations must be reported in the Notes to the financial statements. If there have been transactions with said parties, at least the following must be reported:

- The amount of the transactions carried out and if there have been non-remunerated or below market cost transactions
- The amount of outstanding balances and their terms and conditions, including whether they are secured, as well as the nature of consideration established for settlement and the details of any guarantee given or received
- Value corrections made during the fiscal year on the amounts includes in outstanding balances.

**THIRTEEN.** If the central bank has sizeable operations with unrelated parties other than those indicated in section TWELVE above, it will report them under the same terms already indicated, especially so when concerning the expenditure made during the period and on any bad or non-performing debts that may exist.

**FOURTEEN.** The explanatory note on personnel expenses will include information about total amounts for wages and salaries, company benefits, pension plans and enrollment in obligatory or voluntary company benefit plans granted by the central bank to employees. The total number of employees working for the bank will also be reported.

**LIFE.** The Committee will call on the Accounting Managers of the Central Banks of the Latin American and Caribbean Area to apply this Recommendation to the annual financial statements corresponding to the fiscal year 2008 and later.