Current trends in central bank financial reporting practices

October 2012

kpmg.com
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>1</td>
</tr>
<tr>
<td>About this study</td>
<td>2</td>
</tr>
<tr>
<td>Acknowledgements</td>
<td>2</td>
</tr>
<tr>
<td>Executive summary</td>
<td>3</td>
</tr>
<tr>
<td><strong>1 Understanding policy instruments</strong></td>
<td>4</td>
</tr>
<tr>
<td>1.1 Lending in domestic currency and market interventions</td>
<td>5</td>
</tr>
<tr>
<td>1.2 Gold and foreign currency assets</td>
<td>7</td>
</tr>
<tr>
<td>1.3 Banknotes in circulation</td>
<td>9</td>
</tr>
<tr>
<td><strong>2 Accounting frameworks and policies</strong></td>
<td>12</td>
</tr>
<tr>
<td>2.1 Financial reporting frameworks</td>
<td>12</td>
</tr>
<tr>
<td>2.2 Securities and lending</td>
<td>14</td>
</tr>
<tr>
<td>2.3 Gold and foreign exchange</td>
<td>15</td>
</tr>
<tr>
<td>2.4 Other financial instrument-related issues</td>
<td>17</td>
</tr>
<tr>
<td>2.5 Analysis of income and expenses</td>
<td>18</td>
</tr>
<tr>
<td>2.6 Presentation of cash flow statements</td>
<td>20</td>
</tr>
<tr>
<td><strong>3 Capital management</strong></td>
<td>22</td>
</tr>
<tr>
<td>3.1 Capital</td>
<td>22</td>
</tr>
<tr>
<td>3.2 Reserves</td>
<td>24</td>
</tr>
<tr>
<td>3.3 Profit remittance and treatment of losses</td>
<td>25</td>
</tr>
<tr>
<td><strong>4 Government interactions</strong></td>
<td>26</td>
</tr>
<tr>
<td>4.1 Transactions with government</td>
<td>26</td>
</tr>
<tr>
<td>4.2 Other relationships</td>
<td>29</td>
</tr>
<tr>
<td><strong>5 Financial instrument disclosures</strong></td>
<td>30</td>
</tr>
<tr>
<td>5.1 Fair value disclosures</td>
<td>31</td>
</tr>
<tr>
<td>5.2 Credit risk</td>
<td>31</td>
</tr>
<tr>
<td>5.3 Liquidity risk</td>
<td>32</td>
</tr>
<tr>
<td>5.4 Market risk</td>
<td>32</td>
</tr>
<tr>
<td><strong>6 Other risk management disclosures</strong></td>
<td>34</td>
</tr>
<tr>
<td>6.1 Collateral</td>
<td>34</td>
</tr>
<tr>
<td>6.2 Contingencies</td>
<td>36</td>
</tr>
<tr>
<td>6.3 Other fiduciary functions</td>
<td>36</td>
</tr>
<tr>
<td>Appendix A</td>
<td>38</td>
</tr>
<tr>
<td>Glossary</td>
<td>39</td>
</tr>
<tr>
<td>Notes</td>
<td>40</td>
</tr>
</tbody>
</table>

© 2012 KPMG International Cooperative (“KPMG International”), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. All rights reserved.
Open a newspaper these days and it seems impossible to avoid news about the global financial crisis, the eurozone debt crisis, the stalling recovery of the US economy and the slowdown of growth in emerging markets. Continuing pressures from various sources, following the collapse of Lehman Brothers in 2008, have increased the fragility of economies worldwide. In setting and executing monetary policy, central banks have been forced to extend their role and intervene in markets to levels never seen before.

Although these activities reflect macroeconomic factors of a far broader scope than simply the central bank itself as an institution, the financial statements of a central bank do shed some light on the impact of policy instruments and the risks related to the various measures implemented. A financial reporting framework that portrays the central bank’s financial position and results may enable stakeholders to assess the state of local conditions in more concrete terms.

Against the backdrop of these developments and our 2009 study Central bank accountability and transparency, we now consider it worthwhile to review again the current status of financial reporting practices amongst central banks. Central banks inevitably face a challenge of comparability, given the uniqueness of each institution and of the environment in which they operate. The continued move towards worldwide adoption of IFRS has influenced the selection of financial reporting frameworks by central banks and the extent to which they comply with IFRS, yet challenges still exist given the unique operations of central banks.

Whilst this publication is primarily written for central bankers in financial reporting roles, we hope that the analysis of our findings will also be of interest to other stakeholders and provoke informed discussion on some of the key issues faced by central banks today and how these can be reflected in a central bank’s financial reporting practices.

Jeremy Anderson
Global Head of Financial Services
KPMG in the UK

Ricardo Anhesini
Chair of the Central Bank Network Advisory Group
KPMG in Brazil
About this study

The purpose of this study is to give an overview of the key financial reporting practices of central banks. With no common framework in use by all central banks, it is often difficult to determine whether the figures and other information reported are in fact comparable, and where any differences may lie. We aim to identify the common themes where variety is found in practice, and to highlight some ‘outliers’ which are of particular interest. We also aim to provide industry context for our results to help shed light on their significance.

Our study is based solely on the financial statements of the central banks included in our population and observations are made to the extent that information was included in those financial statements. We did not take into account information that was available from other sources – e.g. from other parts of the annual report, the central bank law, or from other documents on a bank’s website – as doing so goes beyond the requirements of financial reporting frameworks.

Our study is based on a population of 18 central banks, selected in accordance with various criteria – these included the financial reporting framework used, geographical region, whether an English language version of the statements was available, and whether recent financial statements were already available at the time we initiated our research; for most of the central banks, the financial statements for years ending in the calendar year 2011 were available, but in some cases we used 2010. The complete list of our population is included in Appendix A.

Our study did not benchmark reporting practices against any one specific framework and assess compliance. It instead provides an overview of current industry practice based on the various frameworks used by the central banks included in our population. Inevitably, repeated reference is made to widely-used frameworks, such as IFRS or the ECB Accounting Guideline, but this is simply to contrast the differences in standards and practices against a basis that most readers can relate to, and our goal is not to conclude on the relevance or appropriateness of such frameworks.
Executive summary

This study looks at six areas in central bank financial reporting: policy instruments and how they have changed during the financial crisis; accounting frameworks and policies; capital management; government interactions; financial risk disclosures; and other disclosures relating to risk management.

As the financial crisis has evolved, central banks have become more active in their local economies. They have implemented new policy instruments and expanded various programmes. Our study found that, although the financial statements included varying degrees of disclosures on these types of instruments, most central banks with significant market interventions provided key details. These significant movements and balance sheet expansions can however impact the historical ratios of the balance sheet with respect to central banks’ other key instruments, such as gold and foreign currency assets. Despite this new focus, issuing banknotes remains a key function, and represents the most significant liability on the balance sheet.

However, identifying these various new measures or policy instruments is not always straightforward, as there is no consistent financial reporting framework used across all central banks. IFRS as a reporting framework is increasingly being used, but national legislation in certain jurisdictions still permits central banks to select their accounting framework. Accordingly, some central banks select IFRS as a starting point and modify certain requirements given their specific and unique function. Even with these modifications, and with the use of various other frameworks, accounting policies for the significant assets and liabilities are largely consistent, and fair value measurements are quite common.

Moreover, central bank capital remains an undefined concept, and no practical guidance exists for calculating appropriate levels of capital. Because of this, there was a clear correlation between the accounting framework in use, the profit remittance model, and accounting for reserves. Where flexibility exists in the accounting framework, central banks will often use liability accounts to provide for reserves with respect to financial instrument revaluations and other general risks. However, central banks whose accounting frameworks have tighter rules over the recognition of liabilities will use equity allocations.

Given the relationship that central banks have with their government, and the expectation that central bank profits are in most cases distributed to the government, central banks often included disclosures about the relationship and transactions with the government. In very limited cases, central banks actually lend to their government, but the terms of these agreements were clearly disclosed. Although not common, some central banks have external shareholders, but they generally have appropriate mechanisms to limit external influence on the management of the bank. These often include strict dividend policies and restrictions on external shareholder involvement in determining or participating on the management board.

As expected, the extent of financial instrument disclosures was mainly driven by the relevant financial reporting framework. Fair value disclosures varied, but most had information available throughout the financial statements. In addition to disclosures about specific risks, as required by IFRS, several central banks also disclosed information on value-at-risk, which is often a key measure for commercial banks. With increased collateralised lending, disclosures on collateral were usually incorporated. However, the extent of these disclosures was usually correlated to the amount of risk disclosures on financial instruments. Lastly, in addition to monetary policy, central banks often perform other fiduciary functions and they often disclosed risks arising from these activities, including any potential contingencies.
The past five years have seen tough economic times for financial markets, and in many cases central banks have stepped in with a variety of unconventional measures in order to provide stability and liquidity to the market.

These market interventions play an important role in a central bank’s financial position as they have led to a significant expansion of central bank balance sheets. Figure 1.1 shows the average percentage change in total assets since 2008, using 2007 as a baseline. It indicates that there was a significant increase in total assets in 2008 when compared with 2007. This is consistent with the fact that 2008 marks the start of the sub-prime crisis and central banks’ first unconventional responses to that crisis. There was also a significant increase in 2010 and is consistent with the onset of the European debt crisis, which continued to affect 2011.

Figure 1.1: Average increase in total assets

<table>
<thead>
<tr>
<th>Year</th>
<th>Change as a % of 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>48%</td>
</tr>
<tr>
<td>2009</td>
<td>49%</td>
</tr>
<tr>
<td>2010</td>
<td>60%</td>
</tr>
<tr>
<td>2011</td>
<td>63%</td>
</tr>
</tbody>
</table>

Source: KPMG IFRG Limited, 2012
Figures 1.2 and 1.3 provide examples of how the level and timing of interventions by central banks varied depending on issues faced in local markets. Discussion of the various measures adopted and examples of these are in section 1.1.

1.1 Lending in domestic currency and market interventions

To increase liquidity, a number of central banks have been making greater use of reverse repurchase agreements and other forms of collateralised lending in their domestic markets. Figure 1.4 shows the percentage of total assets represented by lending in domestic currency for the past five years.

A dramatic spike in domestic lending can be seen for these banks. This increase specifically appears in 2008 and 2009 and is consistent with the fact that some central banks used domestic lending as a tool to increase market liquidity at the peak of the sub-prime crisis.

On the other hand, Figure 1.5 shows a gradual decline in domestic lending for Banque de France, Deutsche Bundesbank and the Swiss National Bank. However, only looking at domestic lending does not reflect the fact that liquidity provision measures have taken on new forms.

---

1. These central banks were not selected as a representative sample of the population, but only to demonstrate a trend noted amongst some banks.
For example, the Eurosystem introduced bond buying programmes (discussed below) that involve central banks directly buying assets in exchange for cash. This gives the impression that liquidity is no longer being provided because the volume of domestic lending decreases. However, the difference is in the fact that Eurosystem central banks now carry the risk of the purchased assets rather than the risk of the loans made to the commercial banks.

Figure 1.5: Domestic lending – Europe

![Graph showing domestic lending as a percentage of total assets from 2007 to 2011 for Banque de France, Deutsche Bundesbank, and Swiss National Bank.]

Source: KPMG IFRG Limited, 2012

Specific examples of crisis intervention disclosures

With a few exceptions, there were no explicit statements on crisis responses taken due to market conditions. The Bank of England and the Central Bank of Kenya disclosed some information on market support and its impact on financial reporting. For example, the Bank of England stated that “In exceptional circumstances, as part of its central banking functions, the Bank may act as ‘lender of last resort’ to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases, confidence can best be sustained if the Bank’s support is disclosed only when conditions giving rise to potentially systemic disturbance have improved. Accordingly, although the financial effects of such operations will be included in the Banking Department’s financial statements in the year in which they occur, these financial statements may not explicitly identify the existence of such support.” In addition, other noteworthy disclosures are discussed below.

Bond buying programmes of the Eurosystem

The Securities Markets Programme (SMP) was introduced by the Eurosystem as a way to intervene in public and private debt securities markets in the euro area to stabilise the markets and improve liquidity conditions when certain areas of the euro debt securities market were malfunctioning. The covered bond programmes were intended to ease funding conditions of credit institutions, and encourage and expand lending to customers. For all three programmes, the European Central Bank disclosed the intended purpose of the programme at a high level, with a specific reference to the press release providing the complete details. Additionally, it disclosed that it holds debt securities issued by the Hellenic Republic, and discussed the impact of the private sector involvement initiative announced in 2011. This initiative was considered to be a voluntary restructuring of private sector debt, and as such, the European Central Bank did not expect any resulting changes to the contractual cash flows associated with their holdings. Consequently, it did not record any impairment losses on these debt securities.

As a result of these programmes, national central banks are exposed to the risk of loss based on the mechanisms that exist within the Eurosystem. To that effect, the Deutsche Bundesbank stated, in relation to the SMP, that “all risks from these operations, provided they materialise, are shared among the Eurosystem national central banks in proportion to the prevailing ECB capital key shares.”

Federal Reserve Banks financial stability activities

The Federal Reserve Banks provided significant disclosures in the ‘Financial Stability Activities’ note, which included five pages of detailed explanations. Activities disclosed included the following two significant interventions.

- Large-scale asset purchase programmes and reinvestment of principal payments: Since 2009, the Federal Reserve Banks have purchased securities worth approximately USD 1 trillion in a series of acquisitions intended to help improve...
conditions in private credit markets. These investments are held under reverse repurchase agreements. An additional USD 134 billion of assets were sold under repurchase agreements. In addition, the Federal Reserve Bank of New York was authorized to purchase up to USD 175 billion in fixed rate non-callable government-sponsored enterprise debt securities and USD 1.25 trillion in fixed-rate federal agency and government-sponsored enterprise mortgage-backed securities. The purchases were completed in March 2010.

- **Support for specific institutions:** Several variable interest entities (VIEs) used loans to buy assets of the Bear Stearns Companies, Inc. (Bear Stearns) and American International Group, Inc. (AIG). These assets are consolidated in the balance sheet of the Federal Reserve Banks because the bank retains an economic interest in the VIEs.

### Bank of England interventions

The Bank of England intervened in its local market, and provided the following disclosures on programmes that were new in previous years.

- **Bank of England Asset Purchase Facility Fund (BEAPFF):** In 2009, it established the BEAPFF to buy high-quality assets to improve liquidity in credit markets.
- **Bank of England Special Liquidity Scheme (SLS):** The SLS was introduced in 2008 to provide rapid liquidity assistance to banks by allowing them to exchange mortgage-backed and other securities for UK Treasury Bills.
- **Bank of England Special Liquidity Scheme (SLS):** The SLS was introduced in 2008 to provide rapid liquidity assistance to banks by allowing them to exchange mortgage-backed and other securities for UK Treasury Bills.

### Swiss National Bank Stabilisation Fund

The Stabilisation Fund manages the illiquid assets taken over from UBS during 2008. Asset purchases are financed through a loan from the Swiss National Bank, and the bank presents both non-consolidated and consolidated financial statements. The outstanding loan to the fund recorded in the bank’s non-consolidated financial statements amounted to CHF 7.6 billion at 31 December 2011. Assets taken over by the fund primarily included loans and securities, and in some cases of default the bank took ownership of the related collateral or underlying assets.

#### 1.2 Gold and foreign currency assets

**Gold**

Historically, it was essential for central banks to hold gold because under a ‘gold standard’ the value of a unit of currency was defined in terms of a certain weight of gold and issued banknotes could be redeemed for gold. Although the gold standard is no longer in use today, central banks are still, in aggregate, amongst the world’s largest holders of gold, even though the amount of gold held varies widely by bank. Furthermore, significant increases in the price of gold have created challenges for central banks because of the use of fair value and the resulting accounting revaluations, as discussed in section 2.3.

**Changes in the quantities of gold held**

There is much debate over how much gold a central bank should hold. Gold in itself is not directly tied to country risk (although the world market price is quoted in US dollars). Therefore, if a country’s currency is not actively traded in currency markets, the safety of gold is often sought instead of creating specific exposure to other world currencies. However, gold reserves tend to lay untouched in the vaults of central banks, producing little or no income while incurring significant custodial costs. Given the large gold holdings of central banks, any attempt to sell even a small portion could drive down the world price of gold. It is therefore interesting to note that the Banque de France disclosed that in 2009 an agreement was renewed for a five-year period between the Eurosystem, the Swiss National Bank, and the Sveriges Riksbank (Swedish National Bank), which sets an annual limit on the amount of gold that can be sold. It is also noteworthy that in 2009 the IMF set aside approximately 403 metric tons of gold to sell. A portion of this was earmarked for sales to central banks at market prices. Of this, 200 metric tons was sold to the Reserve Bank of India and a further 2 metric tons was sold to the Bank of Mauritius.

---

2. For more information, see Bank of England’s Asset Purchase Facility. [http://www.bankofengland.co.uk/markets/Pages/apf/default.aspx]
3. For more information, see Bank of England’s Special Liquidity Scheme. [http://www.bankofengland.co.uk/markets/Pages/sls/default.aspx]
4. The Eurosystem refers to the European Central Bank and the 17 national central banks that have adopted the euro.
5. For more information, see the IMF’s Factsheet - Gold in the IMF. [http://www.imf.org/external/np/exr/facts/gold.htm]
Price of gold

The price of gold has increased dramatically in recent years, as seen in Figure 1.6. Based on data published by the World Gold Council, the price of gold per troy ounce increased from approximately USD 637 on 1 January 2007 to USD 1,600 on 1 January 2012, an increase of 150%. Most banks surveyed account for gold at fair value, and fluctuations in the price of gold can have a significant effect on the carrying value of assets and on net income. Consequently, net income usually includes unrealised gains and encourages the adoption of financial buffers; see section 3.2 for further discussion.

Figure 1.6: Spot gold price in USD

Source: World Gold Council (http://www.gold.org)

Gold as an asset class

The exposure to fluctuations in the price of gold depends on the percentage of total assets made up by gold holdings. Figure 1.7 shows the number of banks with gold as a percentage of total assets falling within each range, up to the highest value noted of 17%. Some of the banks surveyed had no holdings at all. This may be due to their governments not legislating that the central bank itself must hold national gold reserves. Of the 18 banks surveyed, gold holdings made up an average of 6% of total assets. This figure is up from approximately 5% in 2007. However, these increases are not always in line with the overall gold price increases. Possible reasons include the fact that some central banks – e.g. the Federal Reserve Banks – record gold at a fixed historical value rather than at fair value, and the fact that there have been significant balance sheet expansions during this period.

Figure 1.7: Gold as % of total assets

Source: KPMG IFRG Limited, 2012

Foreign currency assets

In addition to gold, central banks generally hold significant foreign currency-denominated assets, although the portion of total assets represented by these assets can vary widely between individual central banks. Figure 1.8 shows the average percentage of total assets made up by gold and foreign currency assets. As demonstrated, the ratio has varied between 48% and 59% since 2007. This ratio can be affected by various factors, including foreign exchange rate revaluations against local currencies or, as described in section 1.1, significant movements in the local currency asset positions.

The Bank of Canada is one of four banks surveyed with no gold or foreign currency reserves, and therefore its balance sheet is sheltered from foreign currency risk. In contrast, some of the banks surveyed maintained the majority of their assets in foreign currency and gold; this may be the case when local currencies are not extensively traded on international markets. For example, the Bank of Mauritius held foreign currency assets making up approximately 85% of its balance sheet, and gold for a further 6% – bringing the combined total to 91%.
1.3 Banknotes in circulation

Background

A defining characteristic of central banks is their general monopoly under local laws to issue banknotes in their respective countries. All of the central banks surveyed presented their banknotes in circulation as a liability on the balance sheet.

The table below shows the typical calculation to arrive at the balance sheet liability for banknotes in circulation.

<table>
<thead>
<tr>
<th>Opening balance of notes in existence</th>
</tr>
</thead>
<tbody>
<tr>
<td>(+) New banknotes printed and received in the year</td>
</tr>
<tr>
<td>(-) Banknotes destroyed during the year</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Closing balance of banknotes in existence</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Banknotes on hand</td>
</tr>
</tbody>
</table>

**Banknotes in circulation liability**

Based on the above, banknotes on hand are accounted for as a reduction of the balance of notes in circulation, on the basis that the bank does not have an obligation for notes that are not in circulation.

The following may lead to the accumulation of this balance:

- banknotes in a central bank’s vault or other stock locations received from the printers and yet to be issued into circulation;
- banknotes that were in circulation but have been received back from commercial banks; and
- banknotes removed from general circulation and earmarked for destruction.

Accordingly, banknotes in circulation are typically presented on the face of the balance sheet by deducting notes on hand from notes in existence. When newly printed notes are received from the printer, their face value is added to the balance of notes on hand until they are put into circulation.

**DR Notes on hand**
**CR Notes in existence**

The production costs of these notes are expensed because they have been received and are available for circulation.

**DR Expenses**
**CR Accounts payable**

When they are issued into circulation – e.g. a commercial bank has requested physical cash for its deposits – the notes on hand account is reduced for the face value, thereby increasing the net balance of notes in circulation.

**DR Deposits – commercial banks**
**CR Notes on hand**

Two of the banks surveyed disclosed a different accounting treatment for newly printed banknotes that have not yet been put in circulation. In these cases, their face value was not initially recognised, and the cost of production of these banknotes was recognised as a separate asset. As a result, the face value of the banknotes is only added to the liability and production costs are only expensed when the notes are issued for the first time.

For example, the Swiss National Bank presented notes on hand as an asset, and its financial statements disclosed the accounting treatment as follows: “Freshly printed banknotes which have not yet been put into circulation are recognised as assets at acquisition cost and stated under banknote stocks. Development costs that qualify for recognition as an asset also fall under this balance sheet item. At the time a banknote first enters into circulation, its cost is recognised as banknote expenses.”
The increase in banknotes in circulation is generally expected to follow such factors as the trend of a country’s GDP and inflation. However, this may not always be the case because of various market conditions. For example, the recent crisis created an unusual increase in demand in various countries as cash was withdrawn from commercial banks. Additionally, emerging economies continue to show increased use of ATMs, which also increases the demand for banknotes. Figure 1.9 shows the average ratio for all central banks of notes in circulation as a percentage of total assets. Additionally, the distribution of the average ratio over the 5-year period (see Figure 1.10) demonstrates varying ratios on an individual basis.

**Coins in circulation**

Some central banks are responsible for issuing coins as well as banknotes when legislation grants the coin privilege to the central bank rather than to the government. Of the central banks surveyed, eight had the right to issue coins and therefore include coins issued as a liability – often grouped with banknotes in circulation for presentation purposes. However, four banks surveyed did not have the right to issue coins and consequently recognised their coin holdings as an asset. For example, the Deutsche Bundesbank disclosed that “coins are received from the federal mints at their nominal value for the account of the Federal Government.” Local laws may stipulate an upper limit on the amount of coins that the bank may purchase from a government, as excess purchases could be seen as providing financing to the government.

**Demonetised banknotes**

A number of factors make it difficult to accurately estimate the amount of demonetised banknotes still in circulation. This in turn could, over time, accumulate into a significant overstatement or understatement of banknotes in circulation. For example, banknotes that are lost or destroyed without the bank’s knowledge – e.g. through natural disasters – may overstate the balance sheet liability. Conversely, the liability may be understated when banknotes that are destroyed include undetected forged banknotes.

Generally, banknotes are issued in series that are printed and circulated for a limited period of time. When a new series is issued, the old series is usually still considered legal tender, either for a stated period of time or indefinitely. The financial statements of the central banks surveyed show that accounting for banknotes from an old series is greatly affected by whether or not such banknotes have a time limit to their validity as legal tender, and the likelihood that they would actually be exchanged for the newer series.

For example, the Bank of Canada included old series notes in its balance of notes in circulation, and did not remove them because they remain legal tender. The Bank of Israel, however, recorded a gain of ILS 220 million in its 2010 financial statements (about USD 62 million at that time) for the face value of notes that had passed the legal date for exchange and were no longer valid for use.
This issue is also highlighted by the introduction of the euro and subsequent removal from circulation of national currency banknotes. For example, the balance sheet of the Deutsche Bundesbank included a liability for Deutsche mark notes still in circulation. However, its notes disclosed that in 2004 a portion of the notes were taken off the balance sheet and recorded as income, because it was deemed highly unlikely that these would ever be exchanged for euros. The Banque de France still recognised French franc banknotes as a miscellaneous liability, instead of notes in circulation, because the notes were no longer legal tender but could still be exchanged until 17 February 2012.

**Future developments**

- We expect domestic lending to continue playing an important role, although new types of programmes and interventions may emerge.
- Continued disclosures on these new programmes will promote transparency and understanding of the central bank’s role in market interventions.
- Policies for foreign currency assets, gold and banknotes in circulation may remain consistent, but their share of central banks’ balance sheets may continue to vary as domestic currency operations further develop.
2.1 Financial reporting frameworks

As IFRS becomes the recognised framework in many countries, this trend is reflected in the financial reporting framework adopted by central banks. Adoption of IFRS by central banks allows comparison between these unique institutions. However, due to their special legal status, central banks may not be required to implement IFRS – even in jurisdictions that have adopted IFRS as the financial reporting framework for other types of entities (such as publicly listed companies).

Of the central banks surveyed, 10 adopted IFRS or a financial reporting framework that was based on IFRS (‘IFRS-based framework’). The remaining eight reported under local GAAP or their own specific legislation, which includes the Eurosystem accounting principles and rules set out in the ECB Accounting Guideline for central banks of the eurozone.

Figure 2.1: Reporting frameworks

Source: KPMG IFRG Limited, 2012
Of the 10 banks that reported under IFRS or an IFRS-based framework, four disclosed IFRS as a basis for their own individual framework, modifying certain requirements to better reflect the specific needs of their legislative environment. Such modifications are often attributed to the special nature of central bank activities and the perceived incompatibilities of IFRS with the profit remittance model of central banks. Appendix A lists the specific frameworks used by each central bank.

Main differences between IFRS and the ECB Accounting Guideline

The ECB Accounting Guideline is a prominent example of a framework that arises from specific central bank legislation, and is used by all Eurosystem central banks. The table below summarises major differences between the ECB Accounting Guideline and IFRS.

<table>
<thead>
<tr>
<th>Issue</th>
<th>IFRS</th>
<th>ECB Accounting Guideline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classification of financial assets</td>
<td>Requires classification in categories defined as initially designated at fair value through profit or loss (FVTPL), held-for-trading, available-for-sale, held-to-maturity, and loans and receivables.</td>
<td>Available classification options are similar to IFRS except that there are specific requirements for illiquid equity shares and other equity held as permanent investments.</td>
</tr>
<tr>
<td>Measurement of financial assets</td>
<td>• Loans and receivables are measured at amortised cost.</td>
<td>• Loans are measured at nominal value.</td>
</tr>
<tr>
<td></td>
<td>• Unrealised gains and losses on FVTPL and held-for-trading financial assets are included in profit or loss.</td>
<td>• Illiquid equity shares and other equity held as permanent investments are measured at cost subject to impairment.</td>
</tr>
<tr>
<td></td>
<td>• Unrealised gains and losses on available-for-sale financial assets are recorded in other comprehensive income, except for foreign currency differences on monetary assets and impairment.</td>
<td>Asymmetric treatment whereby:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Unrealised gains are not recognised in profit or loss, but are recorded in a liability revaluation account.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Unrealised losses are included in the profit or loss account if they exceed previous revaluation gains, thereby reducing net income.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(This applies to both fair value measurements and foreign exchange fluctuations.)</td>
</tr>
<tr>
<td>Financial instrument disclosures</td>
<td>Comprehensive requirements to disclose:</td>
<td>Specific disclosures are not explicitly identified but harmonised disclosures of items of common interest to the Eurosystem are recommended. (These disclosures are undefined in the ECB Accounting Guideline.)</td>
</tr>
<tr>
<td></td>
<td>• the significance of financial instruments for an entity’s financial position and performance.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• qualitative and quantitative information on exposure to risks arising from financial instruments (further discussed in section 5).</td>
<td></td>
</tr>
<tr>
<td>Provisions for liabilities</td>
<td>Provisions are only allowed when the following conditions are met:</td>
<td>Provisioning rules are less prescriptive and are determined by the specific legislation that applies to each member of the Eurosystem. General provisions are usually permitted for:</td>
</tr>
<tr>
<td></td>
<td>• an obligation exists as a result of a past event;</td>
<td>• foreign currency;</td>
</tr>
<tr>
<td></td>
<td>• it is probable that an outflow of resources will be required to settle the obligation; and</td>
<td>• interest rates;</td>
</tr>
<tr>
<td></td>
<td>• the amount can be reliably estimated.</td>
<td>• gold price; and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• credit risk.</td>
</tr>
<tr>
<td>Components of financial statements</td>
<td>A complete set of financial statements includes a cash flow statement and a statement of comprehensive income.</td>
<td>Does not require a cash flow statement and statement of comprehensive income.</td>
</tr>
</tbody>
</table>
The Eurosystem has considerable authority to set its own accounting rules, and in this respect is similar to those central banks which have adopted a IFRS-based framework that is adapted to take into account the unique function of a central bank.

**IFRS modifications**

Although the introduction of IFRS allows for greater comparability, a number of central banks have made modifications to IFRS on the basis that the objectives and structure of their institution differs from those of commercial banks and therefore modified accounting and disclosures are appropriate. Generally, these modifications are determined by the individual bank and follow a defined legal process.

The four central banks that were classified as using an IFRS-based framework generally departed from IFRS in respect of credit risk disclosures, accounting for foreign exchange and gold, and/or the recording of provisions. These areas are discussed in greater detail in sections 2.3, 3.2 and 5.2. The following table summarises the IFRS departures that were described in the financial statements.

<table>
<thead>
<tr>
<th>Central Bank</th>
<th>Disclosed IFRS departures related to:</th>
</tr>
</thead>
</table>
| Bank of England              | • Constituent elements of the income statement  
• Income and expenses  
• Operating segments  
• Contingent liabilities and guarantees  
• Information on credit risk  
• Related parties.          |
| Bank of Chile                | • Ability to record global or individual provisions based on risk for certain investing operations.  
• No statement of comprehensive income, statement of changes in equity or statement of cash flows. |
| Reserve Bank of New Zealand  | • Inventory [banknotes] acquired at no cost or nominal consideration is measured at current replacement cost instead of the lower of cost and net realisable value. |
| South African Reserve Bank   | • Realised and unrealised gains and losses on gold and foreign exchange are not included in profit or loss, because they are for the account of the government.  
• Gold is valued per section 25 of the South African Reserve Bank Act at the statutory gold price and is recognised as a financial asset.  
• Omissions related to IFRS 7 disclosures, including sensitivity analysis and credit quality.  
• Assets and liabilities related to securities lending activities are disclosed but presented on a net basis. |

Similarities can be seen between the IFRS departures noted above and those of the ECB Accounting Guideline, highlighting the areas of IFRS that are perceived by some central banks to be difficult to apply in the context of central bank activities, notwithstanding that IFRS is a general purpose framework.

### 2.2 Securities and lending

**Local and foreign currency assets**

A broad range of financial instruments were held by the central banks surveyed. Some strictly held domestic currency instruments, while others held a high proportion of foreign
currency instruments. Accounting for these instruments varied widely. Accordingly, there was no common practice for the classification of the instruments across all central banks. In general, equity securities are classified into categories measured at fair value, and loans and similar instruments at amortised cost. The key accounting issues for these instruments relate mostly to the treatment of gains and losses when the instruments are revalued – i.e. due to changes in market values or foreign exchange movements. This is discussed in section 2.3.

Reverse securities repurchase agreements

The volume of reverse repurchase agreements used by some central banks has increased in recent years, following the increase in demand for liquidity in markets. Accounting for these instruments as balance sheet assets was mostly consistent, as presented in Figure 2.2, and amortised cost was the preferred valuation method. In these cases, a central bank would also not recognise the collateral received.

Figure 2.2: Accounting for reverse repurchase agreements

As an example, the Reserve Bank of Australia disclosed specific information on collateral, including the amount of collateral that must be pledged. It also disclosed an acceptable haircut range of between 2 and 10%, which increases with the risk profile of the securities.

Invariably, the value of collateral accepted is higher than the cash lent. Further discussion of collateral disclosures is included in section 6.

Securities repurchase agreements

Central banks may also borrow money from commercial banks and give collateral in ‘securities repurchase agreements’. Central banks may enter into these agreements when there is excess liquidity in the market, typically by taking a collateralised loan for a short period of time. The treatment of this type of loan was largely consistent, with most recognising a liability and not derecognising the assets pledged. Figure 2.3 summarises the number of central banks using each treatment.

Figure 2.3: Accounting for repurchase agreements

Source: KPMG IFRG Limited, 2012

2.3 Gold and foreign exchange

Gold

Of the 14 banks surveyed that held gold reserves (see section 1.2), 13 held gold bullion or coin either as the sole form of gold holding or in combination with gold receivables. The Federal Reserve Banks only reported gold receivables, because they hold gold certificates issued by the Secretary of the US Treasury – these are backed by gold owned by the Treasury and are valued in the financial statements at a fixed rate set by law (USD 42 2/9 per fine troy ounce, or about 3% of market value at 31 December 2011).

These 13 banks measured gold on a fair value or fair value-related basis, although there were some variations in the method used and the source of the market price. Several central banks valued their gold holdings using the London PM gold fixing, quoted in US dollars, but there was some diversity in practice. For example, the Reserve Bank of India

---

7. The term ‘reverse repurchase agreement’ is used throughout this study, and is used interchangeably with ‘collateralised loans’. These are usually loans having short- to medium-term maturities with principal repayment at the end of the term and provide market liquidity. They are usually secured with marketable securities as collateral.

8. This includes amounts classified as loans and receivables and as held-to-maturity, because they result in the same measurement under IFRS. It also includes amounts recognised at nominal amount plus accrued interest, because the accounting result is the same.

9. ‘Haircut’ refers to the percentage reduced from the collateral’s fair value, based on the risk associated with the collateral received.
valued its gold at 90% of the daily average price quoted at London for the month, while the Bulgarian National Bank disclosed its treatment of gold as follows: “With regard to the set characteristics of the monetary gold, the management considers that IFRS does not provide a reliable base for the reporting of this asset. Therefore, pursuant to the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, the Bank defines the recognition and valuation of the monetary gold as a financial asset reported at fair value through profit or loss as the most reliable and appropriate basis for subsequent valuation of this financial asset.”

However, banks used different methods to recognise changes in fair value.

- fair value through profit and loss (FVTPL)
- fair value through other comprehensive income (FV OCI)
- fair value with changes recorded to liability accounts (FVL).

Figure 2.4 shows the number of banks that elected to use each method. The most common method for recognising the changes in fair value was FVTPL, followed by FVL. Many central banks treated gold valuation adjustments consistently with foreign currency translation adjustments.

**Figure 2.4: Accounting for gold**

![Bar chart showing number of central banks using different methods for accounting for gold]

Source: KPMG IFRG Limited, 2012

**Treatment of foreign exchange gains and losses**

Foreign currency assets and liabilities may make up a considerable portion of a central bank’s balance sheet, so the accounting treatment of gains and losses on those instruments is usually a significant accounting policy for them. Of the banks surveyed, 11 accounted for gains and losses on foreign exchange through profit or loss – i.e. the income approach – and this accounting treatment was driven by the fact that banks reporting under IFRS are required to follow this method.

Under the income approach, banks generally present realised and unrealised foreign exchange gains and losses in the income statement. However, if a bank applies IFRS, then the accounting for foreign exchange translation on non-monetary items requires the remeasurement to follow the instrument – i.e. for an available-for-sale asset that is revalued through other comprehensive income, any change that relates to changes in foreign exchange rates is also recognised in other comprehensive income.

The liability approach differed in its application among the remaining seven banks; however, all were similar in that primarily, foreign exchange fluctuations were recorded in a balance sheet liability account. In some instances, gains and losses were not treated symmetrically. For example, the Banque de France (along with the Deutsche Bundesbank and the European Central Bank) disclosed that unrealised gains on foreign currency are recorded as liabilities in the revaluation account, while unrealised losses in excess of gains are recognised in net income; valuation is performed on a currency-by-currency basis and different currencies are not netted against each other. The South African Reserve Bank treated foreign exchange profits and losses somewhat similarly because they were “for the account of government and, consequently, all these profits and losses are transferred to the [gold and foreign exchange contingency reserve account].” This effectively means that the gains and losses are not to be distributed along with other profits to external shareholders.

**Figure 2.5: Treatment of foreign exchange gains and losses**

![Pie chart showing distribution of banks using income and liability approaches]

Source: KPMG IFRG Limited, 2012

---

10. Gains and losses through a liability account. See section 3.2 for a related discussion on reserves.
2.4 Other financial instrument-related issues

Accounting for holdings of BIS shares

The Bank for International Settlements (BIS) acts as a bank for central banks, providing banking services, as well as being a forum for collaboration. The BIS currently has 60 member central banks, all of which hold shares in the BIS that give them representation and voting rights at general meetings. Of the 18 banks surveyed, 16 had shareholdings in the BIS, and there was variation in the accounting policies that they used to measure these shares.

Figure 2.6 shows how the surveyed banks accounted for these shares. Of the banks reporting the BIS shares at fair value, three different approaches were noted. As shown in Figure 2.7, three banks used a discounted net asset value to determine the fair value; the remaining two used other methods, including a dividend yield model, because the BIS shares are subject to a yearly dividend. The discounted net asset value method discounts the shares’ net asset value by 30%. This takes into account a decision by the International Court at The Hague relating to a share repurchase by the BIS in 2001, which has since been used as the basis for setting the transaction price when new shares are issued. This method considers that the legal decision has ultimately set the assigned value if shares were to be traded, because the legal precedent encourages a purchaser to buy at a price not higher than that value, while a seller would not sell below that value.

Central bank issuance of debt

A central bank may have the right to issue debt securities, and of the 18 central banks surveyed, six had actually done so. The instruments issued primarily consisted of bonds and promissory notes. In comparison to other instruments used by central banks, the volume of own debt issued was typically relatively small, although there were exceptions. For example, the Central Bank of Chile’s debt securities balance was greater than that of banknotes and coins in circulation and represented more than half of its total assets.

For the banks surveyed, there was either no disclosure at all on the reason for issuing debt, or the disclosure was very brief. For example, in its accounting policy note, the Bank of Mauritius states that its savings bonds, bills and notes are “issued for liquidity management.”

Accounting for impairment of assets

Central banks have traditionally only invested in lower risk financial assets – e.g. very highly-rated money-market instruments, T-bills, and government bonds. But with the crisis, they have moved away from this basic policy, and have therefore taken on more risk by advancing longer-term loans, expanding the eligibility of collateral, or making outright purchases of corporate bonds. In addition, many previously highly-rated instruments have suffered downgrades in credit quality. Because of these new developments, the impairment of financial instruments has become more important. Of the banks surveyed, 11 disclosed an impairment policy.
The European Central Bank held investments under the SMP, and valued them at amortised cost subject to impairment. Annual impairment tests were performed to estimate the recoverable amount at the 2011 year end, and no impairment losses were recorded. Notably, the bank maintained a provision for foreign exchange rate, interest rate, credit and gold price risks, and at 31 December 2011 it transferred an amount of EUR 1.2 billion to the provision out of income arising from securities purchased under the SMP and from euro banknotes in circulation. Thus, the bank may be able to provide for possible future losses associated with the SMP portfolio, even though none have been incurred at year end. This reflects a fundamental concept in the bank’s model for recording provisions as a financial buffer (as discussed in section 3), contrasting with a pure incurred-loss model that is required under IFRS.

2.5 Analysis of income and expenses

Traditionally, the analysis of a central bank’s financial statements has focused on the balance sheet rather than the income statement because, unlike a commercial bank, a central bank’s main objective is not to generate profits. Nonetheless, the income statement is a useful tool, because the transparency of significant items that affect net income can help readers to understand a central bank’s activities and its use of resources.

Income statement presentation

The structure of the income statement varied amongst central banks, with each style of presentation emphasising different measures of performance. For the banks surveyed, income statements were generally presented in one of the following forms:

- **Traditional**: total revenues less total expenses to arrive at net profit.
- **Net**: income and expenses of a similar nature are grouped and presented on a gross basis, with several ‘net’ subtotals.
- **Hybrid**: a mixture of the traditional and net presentation, usually with a particular focus on the net position from interest.

<table>
<thead>
<tr>
<th>Traditional</th>
<th>Net</th>
<th>Hybrid</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest revenue</td>
<td>XX</td>
<td>Interest revenue</td>
</tr>
<tr>
<td>FX gains</td>
<td>XX</td>
<td>Interest expense</td>
</tr>
<tr>
<td>Other, etc.</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>XX</td>
<td>Net interest income</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>line 1</td>
<td>(XX)</td>
<td>Other income</td>
</tr>
<tr>
<td>line 2</td>
<td>(XX)</td>
<td>Expense 1</td>
</tr>
<tr>
<td>line 3</td>
<td>(XX)</td>
<td>Expense 2</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>(XX)</td>
<td></td>
</tr>
<tr>
<td><strong>Net profit</strong></td>
<td>XX</td>
<td>Net profit</td>
</tr>
</tbody>
</table>

11. For the purposes of this section, we have ignored the statement of other comprehensive income for central banks that report under IFRS.
Among the 18 banks surveyed, the net method was the most commonly used (see Figure 2.8). The European Central Bank, Deutsche Bundesbank, and Banque de France have adopted this presentation method because the ECB Accounting Guideline sets out standard formats for the balance sheet and profit or loss account. The advantages of a net presentation are an increased focus on each type of activity and the ability to assess the impact of each activity on the bank’s results – e.g. the result from lending and borrowing (net interest), financial transactions, or foreign exchange operations. The hybrid method places a similar focus on net interest, while maintaining a traditional presentation for other streams of income and expenses.

Figure 2.8: Income statement presentation

![Bar chart showing the number of central banks using different presentation styles](chart.png)

Source: KPMG IFRG Limited, 2012

**Segment information**

There was no indication that any of the surveyed central banks classified any of their activities into operating segments (as defined by IFRS 8 Operating Segments). None reported segment information, although the Bank of England and the Reserve Bank of India had unique presentation approaches as discussed below. The split of activities between domestic currency operations and foreign currency operations was often an important consideration. Four of the surveyed banks segregated foreign and domestic assets on the balance sheet. For example, the Bank of Mauritius had a separate heading and subtotal of foreign assets presented first on the balance sheet, followed by domestic assets. This is consistent with the fact that the majority of its balance sheet was held in foreign currency.

As for segmental reporting that serves a similar purpose to IFRS 8, The Bank of England presented two separate sets of financial statements – one for the Banking Department and one for the Issue Department. In effect, this presentation earmarks the specific assets that it holds against the liability of banknotes in circulation (thereby giving an indication of seigniorage income), and groups the remaining operations under the Banking Department. Notably, this presentation was adopted to satisfy statutory requirements dating back to 1928.

The Reserve Bank of India had a similar segregation, although it presented one set of financial statements and only broke down the balance sheet between the two functions. In both cases, the liabilities on the issue department’s balance sheet consisted exclusively of banknotes in circulation. The assets were slightly more diverse, and consisted of various local and foreign currency assets – including gold, government securities and other securities.

**Income line items**

On average, the surveyed central banks displayed five income line items, ranging from one (two banks) to 19 (one bank). Nearly every bank presented a specific line for interest revenue, and occasionally this was broken down into more detailed levels of interest revenue, such as interest on foreign assets and interest on domestic assets. The focus on interest revenue is not surprising given the importance of interest-bearing assets for central banks, since they comprise the majority of their assets held.

Given the significance of foreign currency assets to many central banks, foreign exchange gains and losses are also important, with many banks reporting them as a separate line item. Dividend income was also commonly found on the income statement; however, it was often relatively immaterial, because central banks generally do not hold significant volumes of equity instruments. Dividends from the BIS shares were often the only source of dividend income.

**Expense line items**

Of the 18 central banks surveyed, the average number of expense line items disclosed was seven and ranged from one (one bank) to 17 (one bank). Similar to interest revenue, interest expense is important to most central banks, with 16 of the 18 banks surveyed presenting interest expense as a separate line.

Producing and issuing banknotes is a primary function of central banks, and these costs are also commonly presented. Eight of the surveyed banks presented this as a specific line on the face of the income statement.

The majority of central banks surveyed also presented operational and general and administrative expenses such as staff costs and depreciation in varying levels of detail. However, the presentation was generally similar to that for typical profit-oriented entities.

---

12. IFRS 8 is only applicable for entities with debt or equity instruments in the public markets or that are in the process of issuing such instruments.
Supporting income statement disclosures

Additional information was often disclosed in the notes to the financial statements, to provide more background information on central bank operations – particularly for less detailed income statements.

The notes were sometimes used to provide a different perspective of the income statement items presented on the face of the statement. For example, the revenues and expenses of two central banks were categorised by nature on the face of the income statement but were categorised by function in the notes. Functional presentation helps the reader to assess how resources are used in the various functions of the central bank, such as monetary policy, financial system supervision, currency management and operations, and payment and settlement services.

The Bank of England presented only one line – profit before tax – in the income statement of the Banking Department (not including tax expense), but the notes included a more detailed breakdown of income and expenses by type. This resembled the traditional breakdown, with revenues listed by type followed by expenses.

The most common trend noted was the tendency to include a moderate level of detail on the face of the income statement, and supplemental information in the notes. The notes often included a narrative description of the sources (by type of instrument) of revenue and expenses and in some cases analysis of the changes in the balance.

2.6 Presentation of cash flow statements

The presentation of a cash flow statement varied among the banks surveyed, depending largely on the reporting framework adopted. Figure 2.9 shows the percentage of central banks surveyed that did not present a cash flow statement and, for those that did, the split between use of the direct method (i.e. presenting gross cash receipts and gross cash payments) and the indirect method (i.e. starting with net income and making adjustments for non-cash items). IFRS requires a cash flow statement, and all banks reporting under IFRS included the statement. Those that did not present a cash flow statement commonly gave one of two explanations. The first was that the statement provides no additional information beyond what is already presented on the face of the financial statements. The second was that, given the unique role of central banks as the ultimate source of domestic liquidity, a cash flow statement is not meaningful.

Future developments

- As more countries adopt IFRS, the number of central banks reporting under IFRS or IFRS-based frameworks is likely to increase.
- The new financial instruments standard (IFRS 9, which is expected to be applicable in 2015) will be significant for central banks, because most balance sheet items fall within the scope of these requirements.
- The International Accounting Standards Board is currently deliberating a new expected loss impairment model, which is more focused on forward looking information than the current requirements and may impact central banks’ assessments.
As more countries adopt IFRS, the number of central banks reporting under IFRS or IFRS-based frameworks is likely to increase. The new financial instruments standard (IFRS 9, which is expected to be applicable in 2015) will be significant for central banks, because most balance sheet items fall within the scope of these requirements. The International Accounting Standards Board is currently deliberating a new expected loss impairment model, which is more focused on forward looking information than the current requirements and may impact central banks’ assessments.
3 Capital

3.1 Capital

Capital management for central banks can be challenging. Laws governing their operations often require annual profits to be remitted to the government, limiting the amount of capital that can be accumulated as retained earnings. This has been particularly challenging for central banks that have moved to IFRS and that have suffered fluctuations in profits due to certain unrealised gains and losses being taken into income. Central banks generally manage their capital by using discretionary and non-discretionary reserves (equity capital) and provisions and revaluation accounts (liabilities) to offset unrealised gains and losses, and to cover risks that may crystallise in the future – thereby avoiding the potential for negative equity. Central banks’ capital structures are often directed by specific, and possibly unique, legislation in each country; however, on closer inspection common patterns emerge, as the following results show.

Overall capital levels

Capital can generally be broken down into three categories: stated capital\textsuperscript{13}, retained earnings\textsuperscript{14} and reserves. In general, stated capital is set by the central bank law and is established on creation. Retained earnings accumulate when a bank is not required to remit all of its earnings to shareholders, and therefore results in a build-up of capital. Reserves can often be used to manage the effect of yearly variations in profit or loss and net earnings to be remitted to the government as a shareholder.

\textsuperscript{13} This includes statutory reserves, as these types of reserves are usually fixed by legislation.
\textsuperscript{14} This includes dividends (declared but not yet paid), as some central banks present them as a separate line in the financial statements.
The average breakdown of capital for the banks surveyed is shown in Figure 3.1. The actual breakdown for individual banks varied significantly due primarily to differences in statutory requirements and capital management strategies. However, some trends emerged when looking across the population surveyed.

The breakdown in Figure 3.1 highlights the significance of reserves in relation to total capital. Reserves may be seen as tools to manage the distributable profit and the amount remitted to the government. By allocating amounts to reserves, either before or after arriving at net income (as described in section 3.2), banks manage the timing of their remittances to shareholders, so that accounting results do not conflict with the overall remittance model.

### Minimum capital levels

Figure 3.2 shows the ratio of capital to total assets. The bars represent the number of banks whose ratio falls into each range. The ‘<0%’ range accounts for banks with negative capital. As expected, central banks with a higher percentage of profit remittance to their government generally had lower levels of capital.

The capital levels of commercial banks have come under recent scrutiny. Banks are usually required to maintain minimum regulatory capital ratios, often established by their central bank. However, central banks are generally not monitored by external bodies in this way. Commercial banks are moving towards adopting the Basel III requirements as set out by the Financial Stability Board (FSB). Basel III was developed as a response to the crisis and, amongst other things, aims to improve the capital position of banks for potential future shocks and improve their overall risk management. This type of formalised structure may be a starting point for central banks to determine their own capital targets.
3.2 Reserves

Source and types of reserves

A reserve (or financial buffer) can be general or specific, depending on its intended use. Examples of reserves commonly identified included reserves for:

- general risks;
- unrealised gains/losses (foreign currency, changes in fair value of investments and gold);
- revaluation of property, plant and equipment; and
- actuarial gains and losses arising on the remeasurement of the net defined benefit liability.

Specific reserves are set aside for a precise purpose – for example, to accumulate unrealised foreign exchange gains to offset possible future unrealised foreign exchange losses (at least to a certain extent). Specific reserves accounted for approximately 70% of total reserves set aside by the banks surveyed. General reserves, accounting for the remaining 30%, tend to have more flexibility – for example, to cover any general risks inherent in the activities of a central bank.

General and specific reserves can be further broken down into discretionary and non-discretionary reserves. Discretionary reserves are determined by each central bank at its discretion, while allocations of funds to non-discretionary reserves are based on predetermined calculations. Most central banks had a combined structure to calculate reserves, in that some reserves were calculated using a specific formula, while the remainder were allocated at the central bank’s discretion. Figure 3.3 summarises the number of central banks surveyed that had either a combined, entirely non-discretionary or entirely discretionary structure to account for reserves.

The Banco Central do Brasil used a non-discretionary approach, whereby 25% of net income (excluding foreign exchange equalisation) was recorded in an income reserve, and amounts recorded for the revaluation of assets made until 2004 were recognised in a revaluation account. The Swiss National Bank used a purely discretionary approach, whereby an amount determined by the Bank Council was transferred to the provision for currency reserve. The fact that the Bank Council determines the level of provisions once a year is the factor that distinguishes the reserve as discretionary and allows the greatest flexibility in determining the appropriate level of reserves.

The Central Bank of Kenya had both discretionary and non-discretionary reserves, classifying it under the combined method. Every year, at least 10% of net annual profits (adjusted for certain items) are transferred to a general reserve fund. The fact that this is quantified as at least 10% implies that there is an allowance for discretion when determining the reserve allocation. In addition, a revaluation reserve was maintained within equity for the revaluation surplus resulting from the adjustment to fair value of property and equipment. The benefit of the combined approach is that it allows for specific reserves to absorb fluctuations in market prices of specific assets, while also providing a buffer for general risks that could cause a net loss in a future year.

Accounting for reserves

Of the banks surveyed, the accounting treatment for reserves (which serve as financial buffers) can broadly be categorised into one of two methodologies.

- **Equity allocation**: Reserves are allocated and earmarked within equity as part of the appropriation of net income.
• **Liabilities:** Reserves are recorded as liabilities, either to a general liability account to provide for general risks, or to specific liability accounts to provide for unrealised gains and losses (or possibly just unrealised gains).

The equity allocation approach was the method used by all 10 banks reporting under IFRS or IFRS-based frameworks, because of the specific requirements of the accounting for financial instruments, foreign exchange and non-financial liabilities. In particular, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* contains strict criteria for recognising provisions and prohibits an entity from recognising provisions to cover general risks. This can cause challenges when a central bank adopts IFRS, because profit remittances are generally stipulated by law based on net income. Furthermore, many of these laws were put in place before the requirements of IFRS on recognising unrealised gains and losses in profit or loss became more established. Accordingly, a change to a financial reporting framework such as IFRS without a corresponding change to legal remittance requirements results in requiring a bank to base actual cash remittances to the government on non-cash profits and losses.

The **Bank of Canada** faced this problem on conversion to IFRS in 2011, and the accounting change resulted in government approval of changes to the process for determining remittances. Remittances are now net of newly created reserves whose purpose is described by the bank as to remove "unrealised or non-cash losses that would expose the Bank to the risk of negative capital."

Of the remaining eight banks, five used the liability approach. Under their adopted financial reporting framework, the **European Central Bank** and other banks in the Eurosystem can use the liability approach to create financial buffers for general risks and revaluations for unrealised gains on both asset and foreign exchange remeasurements. By removing these unrealised gains prior to arriving at a net income figure for distribution to shareholders, they have effectively removed the risk of remitting non-cash items prematurely. This helps them to avoid some of the risks of a downturn in prices affecting capital. Although the liability and equity allocation approaches are different in terms of balance sheet presentation and items recorded in profit or loss, they are designed to help banks manage their capital by guarding against future risks and by remitting primarily realised profits.

### 3.3 Profit remittance and treatment of losses

As already noted, most central banks remit all – or at least a significant portion – of their net income (after allocating amounts to their reserves or financial buffer accounts) to their respective government. However, the treatment of a net loss is generally not as transparent from the financial statements.

Of the 18 banks surveyed, only four clearly disclosed what happens in the event of a net loss in the year. In a further five cases, the financial statements provided sufficient information for partial understanding of how losses are treated, based on the nature and purpose of reserve accounts and their related disclosure. For example, **Banco Central do Brasil** explicitly stated that profit or loss is determined semi-annually and transferred to the National Treasury in the case of net income, or otherwise covered by the National Treasury as a liability owed to the central bank in the event of a net loss.

Most of the other banks provided some information that partially helps to explain the treatment of losses. For example, some disclosed that a net loss is first applied against reserves until the balance is brought to nil. However, there was no explicit statement on the treatment of any remaining losses if the reserves were to be completely used up.

---

**Future developments**

- As markets continue to create pressure for central banks to intervene, calls for certain capital levels may gain traction.
- We may see an increase in the level of reserves and financial buffers that are set aside for future risks, and governments may even legislate for increased levels of such reserves.
4 Government interactions

Key issues & findings

- Related party disclosures often included a description of the relationship with the government.
- In very limited cases, central banks lend to the central government but the terms of the agreements were generally well described.
- Some central banks have external shareholders, but apply very strict dividend policies and other restrictions to limit external influence on the bank’s management.
- Several central banks disclosed the remuneration of key management personnel, which includes the governor.

4.1 Transactions with government

The government is often the primary, if not the sole, shareholder of the central bank with all or a portion of net earnings being remitted annually. Interactions with the government vary from bank to bank and include profit remittances, the treatment of income tax and a variety of other operational interactions.

Treatment of income tax

Of the central banks surveyed, four were directly subject to income tax. Given that profits are normally remitted to the government anyway, it seems unnecessary to have central banks remit taxes separately to their government. However, all four of the banks subject to taxes are not bound to remit 100% of net profit. Income taxes, in essence, enable the government to claim a certain amount of profit from the bank prior to the final remittance calculation, and therefore increase the effective remittance. The Bank of England acknowledges this interaction in its financial statements and its tax calculation includes tax relief for the remittance to the treasury. The decision on whether to charge taxes is usually driven by legislation in the respective countries, and the 14 banks not subject to income tax usually provided a specific disclosure to that effect.

Governments as related parties

A central bank’s relationship with its government varies between countries but independence from government (or ‘independence within government’) is a key issue for most central banks. However, given the nature of a central bank’s activities, interactions with the government typically occur on an extensive and regular basis. Questions therefore arise over the financial reporting of interactions with the government as a related party.
Of the 18 banks surveyed, six explicitly presented the government as a related party. A further four disclosed sufficient information regarding transactions with the government to determine that a ‘related-party-like’ relationship exists. For example, the Bank of Israel included separate notes to disclose items such as government deposits and interest paid/payable to the government. The remaining eight made no mention of their governments as a related party (see Figure 4.1). 19 The banks reporting under IFRS or IFRS-based frameworks follow IAS 24 Related Party Disclosures, and accordingly, all ten included some form of disclosure on government transactions. It appears that many applied the government-related entity exemption under IAS 24, but only the Bank of Canada explicitly disclosed the use of this exemption. The Banco Central do Brasil provided significant details in its disclosures, and included amongst other things:

- a description of its relationship with other government entities;
- details on the settlement of the bank’s results (profit remittance);
- details on purchases of government securities; and
- a table of main operations undertaken during the year between the bank and the government.

**Lending to governments**

Government financing is a key issue for central banks, and there may be restrictions on such financing in a country’s legislation. Two of the banks surveyed provided disclosures on loans to their government. The Central Bank of Kenya presented a detailed note on its loan to the government explaining that it had arisen from overdrawn accounts prior to 1997 when the Central Bank of Kenya Act was amended. After the amendment, the government has only been able to draw an overdraft up to a limit of 5% of its gross audited revenue and is charged interest. The disclosure included:

- the percentage of available credit that has been drawn
- a payment schedule
- the interest rate charged
- security against the loan
- an impairment analysis.

The Bank of Israel also disclosed a loan to its government, explaining that the loan arose prior to 1988 and that during the reporting year (2010) an agreement was reached on its settlement and repayment. Because of the terms and conditions of the agreement, the Bank of Israel realised a loss on the loan, which was already provided for in the prior year.

---

19. Note that the European Central Bank was included in the “no disclosure” category because, unlike other central banks, they have no central body that can be considered equivalent to a national government.
4.2 Other relationships

Non-government shareholders

Central banks principally exist due to national legislation, and fulfill tasks in the interests of the state; their shares are typically held exclusively by the government. Of those surveyed, four banks disclosed non-government parties as shareholders.

<table>
<thead>
<tr>
<th>Central Bank</th>
<th>Description of non-government shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Central Bank</td>
<td>Capital shares are held by national central banks (NCBs) of the European Union (EU). Non-euro area NCBs are required to pay up only 3.75% of their share in the subscribed capital and are not entitled to any share in the profits, nor are they liable to fund any loss of the ECB. Given that the shareholder of each individual NCB is its own government, ECB profits are effectively distributed via Eurosystem NCBs to Eurosystem national governments.</td>
</tr>
<tr>
<td>Federal Reserve Banks</td>
<td>Member banks of each of the 12 Reserve Banks. Member banks are national and other state-chartered banks. Profits are distributed to the member banks at a fixed rate of 6% of their paid-up capital. The remaining profit is transferred to the surplus account in accordance with a stipulated maximum, and the balance is paid to the treasury.</td>
</tr>
<tr>
<td>South African Reserve Bank</td>
<td>Facilitates an over-the-counter market for the trading of its shares [as of 31 March 2011, 663 shareholders]. In addition, of the total two million shares issued, approximately 2% are held by directors. Dividends are paid up to a maximum of 10 cents per share per annum. 90% of the remaining profit is remitted to the government.</td>
</tr>
<tr>
<td>Swiss National Bank</td>
<td>37% of shares are owned by private shareholders, while the remaining 63% are owned by public sector shareholders including cantons and cantonal banks. Private shareholders’ voting rights are limited to 100 shares and therefore control could never be achieved externally. Dividends are paid from the profit distribution balance, and may not exceed 6% of the share capital. The remaining balance is distributed to the Confederation and the cantons at a 1:2 ratio.</td>
</tr>
</tbody>
</table>

As the table above shows, the European Central Bank is unique in being the central institution of a currency union. In the three other instances of private shareholders, including the 100% private ownership of shares in the Federal Reserve Banks, there are mechanisms in place to limit the profits that can be distributed to private shareholders, and restrictions on the rights associated with share ownership. These mechanisms aim at retaining the key characteristics of central banks, being free of external influence and the pressure to maximise profits.

Remuneration of key management personnel

Remuneration of key management personnel (KMP) can be a sensitive topic given the high profile of the governor and others in key decision-making roles. IAS 24 provides a basis to determine who are key management personnel by defining them as “those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.” We considered this definition, and whether banks disclose information for individuals or groups of individuals in positions similar to those defined in IAS 24. Twelve banks disclosed information related to KMPs, although there was variation in the positions held by the individuals identified and the type of information disclosed. In addition, the disclosures were mostly presented in aggregate, and individual-specific information was less common.

Future developments

- Pressure may increase to disclose government relationships as governments increase their reliance, either directly or indirectly, on the central bank to provide market liquidity, which may be seen, in some cases, as budget financing.
- New types of arrangements may be disclosed as central banks intervene or transact in unconventional ways.
Financial instrument disclosures

Key issues & findings

- Financial instrument disclosures were mainly driven by the adopted financial reporting framework.
- Not all central banks included specific notes on fair value disclosures, but most disclosed this information in some form in other notes to the financial statements.
- Several banks disclosed value-at-risk measures.

The evolving financial turmoil has placed increased emphasis on risks and on how banks manage those risks. Central banks do not tend to have large exposures to mortgage-backed securities and other types of securitisation vehicles that led to significant market losses during the sub-prime crisis; however, they are still exposed to extensive financial risks due to their significant holdings of financial assets (cash, loans and securities) on the balance sheet. The very nature and fulfilment of their function means that central banks are rarely in a position to hedge away all financial risks. As central banks responded to the crisis, it became increasingly important for stakeholders to understand the increasing risks that they were exposed to, and the new types of risks being taken on.

Without a common financial reporting framework, it is difficult to compare and evaluate the robustness of risk disclosures. Generally, banks that complied with IFRS or IFRS-based frameworks provided significantly more detailed quantitative and qualitative disclosures on risks arising from financial instruments than those that reported under other frameworks. This is due to IFRS 7 Financial Instruments: Disclosures, which requires extensive disclosure of significant risks arising from financial instruments. However, several banks that did not disclose such information in the financial statements instead disclosed it outside of the financial statements – e.g. in the annual report.20

---

20 IFRS 7 permits risk disclosures to be incorporated by cross-reference (in the financial statements) if the disclosures are made outside the financial statements. No such cross-references were noted in our study, so they were not considered.

© 2012 KPMG International Cooperative (“KPMG International”), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. All rights reserved.
In March 2012, the FSB held roundtable talks to discuss risk disclosures by financial institutions and it was generally noted that more consistent risk disclosures would improve comparability and increase transparency. Principles-based disclosures, such as those required by IFRS 7, were seen as a key foundation for the type of disclosures being sought.21

5.1 Fair value disclosures

Of the banks surveyed, all of those using IFRS or IFRS-based frameworks included disclosures on fair value. The eight remaining banks that used other frameworks had varying degrees of disclosures. In most of these instances, the measurement basis of their financial assets was fair value, and fair value information was, at least to a certain extent, available in various places in the notes. However, the reliability of the inputs into the measurements may not always be apparent when compared to disclosures provided under IFRS 7. IFRS 7’s three main quantitative fair value disclosure requirements are:

- fair value for each class (type) of financial instruments;
- comparison of those fair values to their carrying amounts; and
- classification within the three-level fair value hierarchy.22

11 banks disclosed the fair value hierarchy, of which five did not have any Level 3 measurements, and of the six that did, the highest exposure of Level 3 assets was only 5.32% of total assets. The relatively small amounts of Level 3 measurements are consistent with the typical central bank policy of investing in instruments that are considered relatively safe and liquid – i.e. money-market instruments, bonds and T-bills – which are generally Level 1 or 2 measurements.

5.2 Credit risk

10 of the banks surveyed disclosed information on credit risk, and included a qualitative description of the risks and how they were managed – e.g. internal process or procedures. Some central banks disclosed the composition of their risk management committees and overall risk strategy.23 Some also described the effects of current events on their credit risk policies. As an example, the Bulgarian National Bank disclosed that issues faced by governments in the euro area made it essential to introduce a ban on the purchase of debt instruments issued by certain euro area countries.

IFRS 7 also requires quantitative disclosures, including at a minimum:

- maximum exposure
- credit quality of exposures
- concentrations of risk
- impairments (see section 2.4).

When disclosing concentrations of credit risk and the credit quality of exposures, the analysis is often in three different forms.

<table>
<thead>
<tr>
<th>By counterparty</th>
<th>Exposure by type (nature) of issuer</th>
</tr>
</thead>
<tbody>
<tr>
<td>By geography</td>
<td>Exposure by country or region</td>
</tr>
<tr>
<td>By credit quality</td>
<td>Exposure by the credit quality of the issuers based on credit agency ratings</td>
</tr>
</tbody>
</table>

There was a varying degree of quantitative credit disclosures amongst the central banks that disclosed credit risk. Seven disclosed at least two of the above quantitative measures, and three banks disclosed all three types. Figure 5.1 reflects the basic IFRS 7 requirement of disclosing credit quality and some form of concentration.

21. For more information, see the FSB’s press release on enhancing risk disclosure practices. (http://www.financialstabilityboard.org/press/pr_120320.pdf)
22. IFRS uses a three-level hierarchy to classify fair value measurement disclosures, and requires this disclosure for fair values recognised in the statement of financial position. Level 1 measurements are unadjusted quoted prices in active markets; Level 2 measurements include inputs other than quoted prices that are observable; and Level 3 measurements have inputs that are not based on observable market data.
23. A discussion on collateral is included in section 6.
The type of concentration disclosed was driven by the activities and exposures specific to the central bank. For example, central banks with a higher proportion of foreign currency assets tended to focus on geographical exposure, whereas central banks with a higher proportion of domestic currency operations tended to focus on the type of counterparty risk.

**Figure 5.1: Credit risk disclosures**

<table>
<thead>
<tr>
<th>Basis of disclosure</th>
<th>Number of central banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counterparty</td>
<td>6</td>
</tr>
<tr>
<td>Geography</td>
<td>7</td>
</tr>
<tr>
<td>Credit quality</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: KPMG IFRG Limited, 2012

### 5.3 Liquidity risk

In addition to the 10 IFRS or IFRS-based banks, both the Swiss National Bank and the Federal Reserve Banks provided some form of liquidity risk disclosures. IFRS 7 requires, amongst other things, a qualitative assessment of exposure to liquidity risk, summary quantitative data, and a maturity analysis of financial liabilities. Of those that disclosed information on liquidity risk, 10 provided the maturity analysis of financial liabilities required by IFRS 7.

Additionally, seven provided a maturity gap analysis, calculated as the net difference of gross assets and liabilities maturing in specified time bands. This disclosure – i.e. assets as well as liabilities – helps users to assess liquidity risk exposure. However, in view of a central bank’s capacity as a currency issuer and liquidity provider, it may be exposed to different types of risks not necessarily entirely captured by this analysis.

For example, the Bank of Canada (whose balance sheet consisted almost exclusively of domestic currency items) provided a maturity gap analysis but also noted that:

i) it could settle unexpected banknote redemptions by selling liquid assets; and

ii) being the ultimate source of liquid funds to the domestic financial system, it is able to create domestic-currency liquidity in unlimited amounts at any time.

The **Banco Central do Brasil** (which has significant foreign currency reserves) provided a similar explanation concerning its domestic monetary policy; however, it also described the liquidity risk management policy for its international reserves, and provided a maturity gap analysis for its foreign currency assets and liabilities.

### 5.4 Market risk

In general, market risk encompasses currency, interest rate, and other price risk – e.g. equity price risk. There are varying degrees of disclosures relating to market risk and this may be driven by the specific requirements of IFRS. IFRS 7 requires disclosure of a sensitivity analysis for each type of market risk to which an entity is exposed at year end. This analysis should show how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date. Alternatively, an entity may disclose value-at-risk (VaR) information in place of the basic sensitivity analyses, reflecting interdependencies between market risk variables, if such information is used by the entity to manage financial risks. The total number of different market risk disclosures by the banks surveyed is shown in Figure 5.2.

It is worth noting that only three banks disclosed exposure to other price risk, which derives from changes in equity prices. Exposure to this risk is typically limited to shares in the BIS as central banks generally do not invest significantly in equity markets.

**Figure 5.2: Market risk disclosures**

<table>
<thead>
<tr>
<th>Disclosures included</th>
<th>Number of central banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency risk</td>
<td>11</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>10</td>
</tr>
<tr>
<td>Other price risk</td>
<td>3</td>
</tr>
<tr>
<td>Value-at-risk</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: KPMG IFRG Limited, 2012
Currency risk

Currency risk was the most commonly disclosed risk, with 11 banks providing some form of qualitative and quantitative disclosure. Although a few central banks had no or very little foreign currency exposure on their balance sheets, a central bank’s responsibility typically includes managing foreign reserve assets. Currency risk is therefore highly relevant to these central banks’ results.

Of particular interest is the South African Reserve Bank, which disclosed that its exposure to currency risk from holding gold and foreign exchange reserves is limited, because all foreign exchange gains and losses are for the account of the government in accordance with its local legislation. This is reflected in the bank’s accounting policy, whereby all foreign exchange gains and losses were recognised in a liability account and not in profit or loss (see section 2.3).

Interest rate risk

Given the significance of interest income and expense to net earnings, interest rate risk is typically of high importance to central banks. Seigniorage income, arising from the fact that banknotes in circulation are a non-interest bearing liability, is a main driver of central bank profits. And for central banks with significant foreign currency reserves, the interest received on these assets is a key factor in determining yearly profits.

Concerning the management of interest rate risk, the Reserve Bank of New Zealand, for example, disclosed interest rate risk policies for its domestic and foreign reserves, stating that its own government securities portfolio is not dynamically managed, because of the intent to hold the securities to maturity.

A common disclosure was the repricing table, which presents all assets and liabilities subject to interest rate risk categorised by maturity date, and therefore presents a net repricing risk for each time period. Additionally, IFRS 7 requires a sensitivity analysis that considers the effects of a reasonably possible change in interest rates. Most central banks disclosed a change of 100 basis points, with the Swiss National Bank disclosing a change of 1 basis point, and the Central Bank of Kenya disclosing a 1,000 basis point change.

Value-at-risk

As with many commercial banks, VaR was sometimes disclosed. Four of the banks surveyed disclosed VaR. However, they did not use it as a substitute, but provided it as an additional disclosure. For example, the European Central Bank acknowledged that it uses a VaR concept when setting provisions. IFRS 7 explicitly permits market risk disclosures based on methods that reflect interdependencies between risk variables (as VaR does), as opposed to the risk measures for separate areas of market risk as previously discussed.

Various disclosures with respect to VaR are possible – for example, the Reserve Bank of New Zealand disclosed:

- risk management limit
- value at year end
- low and high values during the year
- average value for the year.

For all four of the banks making VaR disclosures, the year-end value was disclosed as well as the average for the year. The qualitative disclosures on VaR varied amongst the banks surveyed but all included some description of how it is used, its limitations, and their policies to manage their VaR. Additional disclosures included the confidence level used, being either 95% or 99%, and the assumed holding period, which was between one and 10 business days.

Future developments

- Financial instrument disclosures may play a growing role in understanding risk exposures arising from the implementation of new policy instruments.
- Regulatory reform affecting commercial banks may influence the type of disclosures made by central banks.
6 Other risk management disclosures

Key issues & findings

- Collateral disclosures were usually incorporated with financial instrument disclosures and there was a correlation between the disclosures made on financial instruments and those made on collateral.
- Most central banks disclosed ‘other’ contingencies and off-balance sheet activities.
- Several banks perform other fiduciary functions in their capacity as a central bank and disclosures about potential risks were included in the financial statements.

In addition to risks arising from financial instruments recognised as assets and liabilities, central banks often perform certain off-balance sheet activities, which may give rise to various risks. As for financial transactions, central banks usually conduct significant amounts of collateralised lending transactions, and understanding the type and quality of collateral accepted to protect against credit risks has become increasingly important. A central bank’s other functions – i.e. those unrelated to monetary policy and balance sheet financial instruments – will also often lead to risks that may have a material impact on operations. Although these functions are often not directly presented in the financial statements, they still give rise to risks or liabilities that are contingent on future events, either directly or indirectly impacted by the bank’s management decisions.

6.1 Collateral

Recent economic conditions have increased the focus on the quality of collateral that central banks accept for liquidity-providing operations. As central banks move away from conducting low-risk or ‘risk-free’ operations, the availability of acceptable collateral has become a major issue and understanding the key elements of these arrangements assists in comprehending the overall risk position of the bank. Unlike commercial banks, the encumbrance of the balance sheet (whether there are sufficient assets that are not pledged remaining to cover liabilities) is generally not a major concern given that the total amount of repurchase agreements, even if undertaken, are not material to the balance sheet. But, by providing disclosures on all collateral and risk management policies, a central bank increases the information available on its exposure to risk and thus increases the transparency of its reporting.
IFRS 7 *Financial Instruments: Disclosures* includes specific disclosure requirements for collateral received, including:

- a description of the collateral and its financial effect in respect of the amount that best represents the maximum exposure to credit risk; and
- when, provided that the owner is not in default, the bank is permitted to sell or repledge that collateral:
  - fair value of collateral held
  - fair value of any such collateral sold or repledged
  - terms and conditions associated with its use.

Additionally, if collateral is pledged, required disclosures include:

- carrying amount of financial assets pledged
- terms and conditions relating to the pledge.

Common transactions subject to collateral requirements include overnight lending, reverse repurchase agreements (where collateral is received), and repurchase agreements (where collateral is pledged). In some cases, securities lending was also disclosed. The level of detail disclosed with regard to collateral varied, but banks using IFRS or IFRS-based frameworks generally provided more information. The *Reserve Bank of New Zealand* provided one of the most comprehensive disclosures, which included the items in the following table.

<table>
<thead>
<tr>
<th>Collateral received</th>
<th>Breakdown between: reverse repurchase agreements on residential mortgage-backed securities, asset-backed securities and asset-backed commercial paper; and marketable securities.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Principal amount of reverse repurchase agreements.</td>
</tr>
<tr>
<td></td>
<td>Fair value of collateral held against those principal amounts.</td>
</tr>
<tr>
<td></td>
<td>Haircut applicable for each type of collateral.</td>
</tr>
<tr>
<td></td>
<td>Terms and conditions on the ability to repledge or sell the collateral.</td>
</tr>
</tbody>
</table>

| Collateral pledged  | Carrying amount of pledged securities.                                                                                                                                                             |

| Other collateral    | Cash collateral received and recognised.                                                                                                                                                           |
|                     | Value of securities lent under its securities lending programme.                                                                                                                                   |
6.2 Contingencies

Information on contingencies plays an important role in understanding potential risk exposures faced by a central bank and the impact of future commitments on its operations. Of the banks surveyed, six made no explicit mention of contingencies, while the remaining 12 had significant variations in the nature and depth of such disclosures. Given that contingency exposures tend to be unique to any specific bank, diversity in the type of information disclosed can be expected. Common disclosures included the following.

<table>
<thead>
<tr>
<th>Type of disclosure</th>
<th>Number of banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential obligation to pay the uncalled capital of the BIS</td>
<td>7</td>
</tr>
<tr>
<td>Requirement to pay uncalled participation rights in other international or regional organisations</td>
<td>4</td>
</tr>
<tr>
<td>Exposure to legal claims and proceedings</td>
<td>3</td>
</tr>
<tr>
<td>Potential obligations for the maintenance of employee pension funds</td>
<td>2</td>
</tr>
<tr>
<td>Swap facilities with other central banks</td>
<td>2</td>
</tr>
<tr>
<td>Credit facilities extended through various organisations</td>
<td>1</td>
</tr>
<tr>
<td>Guarantees of the local equivalent of the payment and settlement system</td>
<td>1</td>
</tr>
<tr>
<td>Contingency on demonetised currency</td>
<td>1</td>
</tr>
</tbody>
</table>

Eight banks disclosed either their role as fiscal agent of the government or their involvement in the local real-time gross settlement system, or both. This often involves executing the issuance of new government securities, or carrying out administrative and central depository services.

The European Central Bank, for example, disclosed its administrative and operational roles with respect to loans from the EU to certain EU countries under the medium-term financial assistance mechanism, the loan facility agreement between eurozone member states and Greece, and loans provided to Portugal and Ireland under the European Financial Stabilisation Mechanism and the European Financial Stability Facility.

The Reserve Bank of New Zealand and the Bank of Canada had disclosures on their local payment settlement systems and how they are managed. The Bank of Russia also disclosed its role in the Customs Union with Belarus and Kazakhstan and in providing compensation payments to depositors of bankrupt banks uncovered by the deposit insurance system.

The Banque de France operates the Prudential Supervisory Authority, the local authority for licensing and supervising banking and insurance, while the Bank of England operates the treasury’s exchange equalisation account as agent.

These activities are not conducted for each bank’s own account, but even so, disclosure alerts the reader to the possibility of additional operational risk because of the significance of the transactions involved.

6.3 Other fiduciary functions

Beyond its typical functions such as issuing banknotes, conducting monetary policy, and managing foreign reserves, a central bank may also be involved in other activities and take on additional roles depending on its particular mandate. Guarantees (whether explicit or implicit) that arise from these activities and roles may expose the central bank to additional risks.

Future developments

- We expect to see an increased emphasis on other risk disclosures as off-balance sheet activities increase unconventional or non-evident risks.
- Activities that were previously considered low-risk may not, in fact, be as sheltered as previously thought. Disclosures may reflect these changing market conditions.
### Population of central banks

<table>
<thead>
<tr>
<th>Central bank name</th>
<th>Financial statements reporting date</th>
<th>Financial reporting framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve Bank of Australia</td>
<td>30 June 2011</td>
<td>IFRS</td>
</tr>
<tr>
<td>Banco Central do Brasil</td>
<td>31 December 2010</td>
<td>IFRS</td>
</tr>
<tr>
<td>Bulgarian National Bank</td>
<td>31 December 2010</td>
<td>IFRS as adopted by the EU</td>
</tr>
<tr>
<td>Bank of Canada</td>
<td>31 December 2011</td>
<td>IFRS</td>
</tr>
<tr>
<td>Central Bank of Chile</td>
<td>31 December 2010</td>
<td>Policies of presentation and preparation of financial reports of Central Bank of Chile, consistent with IFRS, with disclosed exceptions</td>
</tr>
<tr>
<td>European Central Bank</td>
<td>31 December 2011</td>
<td>Accounting policies that the Governing Council of the ECB considers to be appropriate to the nature of central bank activity (Decision ECB/2010/21 of 11 November 2010, OJ L 35, 9.2.2011)</td>
</tr>
<tr>
<td>Bank of England</td>
<td>28 February 2011</td>
<td>Banking Department: Companies Act and the measurement and recognition requirements of IFRS as adopted by the EU. IFRS and the Companies Act have been used as a model for presentation and disclosure. Issue Department: Currency and Bank Notes Act 1928 and the National Loans Act 1968</td>
</tr>
<tr>
<td>Banque de France</td>
<td>31 December 2010</td>
<td>Financial statements template set by Order of the Minister of the Economy, Finance and Industry. Accounting and valuation methods laid down by the Monetary and Financial Code including the methods set by the Governing Council of the ECB</td>
</tr>
<tr>
<td>Deutsche Bundesbank</td>
<td>31 December 2011</td>
<td>Section 26 and 27 of the Bundesbank Act and the “accounting principles of the Deutsche Bundesbank”, which are the principles adopted by the Governing Council of the ECB</td>
</tr>
<tr>
<td>Reserve Bank of India</td>
<td>30 June 2011</td>
<td>Reserve Bank of India Act</td>
</tr>
<tr>
<td>Bank of Israel</td>
<td>31 December 2010</td>
<td>Israeli GAAP, adapted for the special activity of a central bank and consistent with practice of other central banks</td>
</tr>
<tr>
<td>Central Bank of Kenya</td>
<td>30 June 2011</td>
<td>IFRS</td>
</tr>
<tr>
<td>Bank of Mauritius</td>
<td>30 June 2011</td>
<td>IFRS</td>
</tr>
<tr>
<td>Reserve Bank of New Zealand</td>
<td>30 June 2011</td>
<td>New Zealand IFRS24</td>
</tr>
<tr>
<td>Bank of Russia</td>
<td>1 January 2011</td>
<td>Federal Law On the Bank of Russia, Federal Law On Accounting, and Bank of Russia regulations</td>
</tr>
<tr>
<td>South African Reserve Bank</td>
<td>31 March 2011</td>
<td>South African Reserve Bank Act</td>
</tr>
</tbody>
</table>

---

24. New Zealand IFRS as applicable for Public Benefit Entities.

25. The financial statements used for the purposes of this study are only those of the Swiss National Bank (parent company) and not the available consolidated financial statements, which include the SNB StabFund Limited Partnership for Collective Investment.

26. The financial statements used for the purposes of this study are the combined financial statements of the Federal Reserve Banks, which are the twelve Federal Reserve Banks forming the Federal Reserve System.
### Glossary of terms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>Eurosysterm</td>
<td>The <em>European Central Bank</em> and the 17 national central banks who have adopted the euro</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FSB</td>
<td>Financial Stability Board</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>KMP</td>
<td>Key management personnel</td>
</tr>
<tr>
<td>NCB</td>
<td>National central banks within the Eurosystem</td>
</tr>
<tr>
<td>SMP</td>
<td>Securities Markets Programme established by the <em>European Central Bank</em></td>
</tr>
<tr>
<td>VaR</td>
<td>Value-at-risk</td>
</tr>
<tr>
<td>VIE</td>
<td>Variable interest entity</td>
</tr>
</tbody>
</table>