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Working Group on Accounting Issues

**Scope of Accounting Harmonisation;  
The Accounting Methodology of the ESCB;  
The Method of Calculating Monetary Income;  
and some Related Issues**

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**TABLE OF CONTENTS**

	PAGE
<b>Executive Summary</b> .....	4
<b>Chapter 1: Introduction</b> .....	12
<b>Chapter 2: Harmonisation of Accounting Rules and Standards</b> .....	14
2.1 Treaty Provisions .....	14
2.2 Proposed scope of harmonisation .....	15
2.3 Proposals cover the ECB .....	16
2.4 Published accounts of national central banks .....	17
<b>Chapter 3: Accounting Methodology for the ESCB</b> .....	19
3.1 Main issues requiring decision .....	19
3.2 Summary of accounting considerations .....	20
3.3 Monetary Income considerations.....	22
3.4 Recognition of realised foreign exchange gains and losses.....	24
<b>Chapter 4: Accounting for banknotes</b> .....	26
4.1 Scope.....	26
4.2 Legal Issuer of banknotes .....	26
4.3 Non-repatriation of banknotes .....	27
<b>Chapter 5: Intra-System Settlement Issues</b> .....	29
5.1 Scope .....	29
5.2 Transaction types/participants .....	29
5.3 Accounting aspects .....	30
5.4 Pooling and Re-distribution of Monetary Income .....	31
<b>Chapter 6: Methods of Calculating Monetary Income</b> .....	33
6.1 Frame of Reference.....	33
6.2 Legal Basis.....	34
6.3 Definition of income.....	35
6.4 Prerequisites for any method under Article 32.2 .....	35
6.5 Methods of calculation.....	36
6.6 Accounting Issues related to different methods.....	39
6.7 Conclusions.....	40

	PAGE
<b>Chapter 7: Transitional issues on the commencement of the ESCB .....</b>	<b>42</b>
7.1 Scope .....	42
7.2 Background.....	42
7.3 Valuation of assets.....	42
7.4 Provisions and Reserves .....	44
7.5 Prior Losses .....	45
<b>Chapter 8: Future work programme of the Working Group on Accounting Issues .....</b>	<b>46</b>
8.1 Work Schedule .....	46
8.2 Implementation lead times .....	46

**ANNEXES**

1	Classification of an NCB's balance sheet between "system" and "non-system" activities .....	48
2	Accounting Policy issues relating to asset valuation and income recognition .....	50
3	Treatment of gold (and other illiquid assets).....	57
4	Accounting implications of the principle of non repatriation of banknotes .....	58
5	Work Programme for 1996/97.....	63

## EXECUTIVE SUMMARY

### 1. INTRODUCTION

The Working Group on Accounting Issues has drawn up the present report in compliance with its initial mandate dated April 1992, and in accordance with the work programme submitted to the EMI in 1994 (as outlined in the EMI's Master Plan; fiches G.1 and G.3).

As stated in its interim report in September 1995, the Working Group has interpreted this mandate as meaning the preparation of a set of accounting policies and techniques for use by both the ECB and NCBs in respect of System assets and liabilities and for use in the calculation of monetary income. The Group has also considered other related accounting issues that have emerged either during its own deliberations or as a result of work conducted by other Working Groups and Sub-Committees, notably those on Payment Systems and on Printing and Issuing a European Banknote.

**In this summary, the issues for decision or discussion are presented in italics. The Working Group asks the EMI Council to express its views on these issues.**

### 2. HARMONISATION OF ACCOUNTING RULES AND STANDARDS

This chapter of the report addresses the scope of harmonisation required in the annual financial accounts of the ESCB (consolidated accounts), the ECB and individual NCBs (company accounts). At a later stage, the weekly and other financial statements will be addressed.

Article 26 of the Statute of the ESCB provides that the consolidated balance sheet of the ESCB must comprise the items used in the performance of the System's monetary functions and operations. The proposals of the Working Group on the harmonisation of accounting standards and reporting by NCBs are aimed at ensuring that this consolidated balance sheet can be easily constructed.

The Working Group expects that the assets, liabilities, income and expenditure relating to System operations will account for a substantial proportion of individual NCB (and ECB) balance sheets and profit and loss accounts.

*The Working Group therefore proposes a practical working hypothesis that it will develop a single set of accounting policies for all assets, liabilities, income and expenditure that may be considered material to the System. Accordingly, for activities related to the System, and in particular the calculation of monetary income, it recommends that the proposed accounting policies must be adopted by all national central banks in the ESCB.*

*For those (material) activities not within the System the Working Group will develop accounting policies which will serve as a recommendation to NCBs.*

It is recognised that the ESCB Statutes do not impose any compulsion on NCBs to adopt the harmonised rules for their own published annual accounts. Nevertheless, in practice the Group strongly believes that producing two (perhaps very different) sets of accounts for each NCB (one according to national practices and another following the chosen accounting methodology for the ESCB) would be rather confusing and problematic, not least for Governments. This could lead to anomalies, such as one set of financial accounts producing a loss whilst the other shows a profit (with the ensuing possibility of profit disbursement to the government).

***Accordingly, the Working Group recommends that NCBs only produce one set of financial accounts so that their local accounts should be consistent with those produced for the ESCB.***

The legal aspects of the implementation of the recommendations will be elaborated at a later stage together with the Working Group of Legal Experts in the context of the overall legal and regulatory framework for the ESCB.

### **3. ACCOUNTING METHODOLOGY FOR THE ESCB**

With regard to a proposal for a uniform accounting methodology for balance sheet valuation and income recognition, there is currently no unanimity within the Working Group. All members of the group are agreed that a prudential approach to income recognition and profit distribution needs to be adopted. The majority favour methods where this is transparent in the balance sheet; a minority do not wish to reveal the underlying position in the balance sheet. This largely reflects differences in national accounting standards and legislative requirements upon which NCBs base their policies and to a lesser extent historical factors of a local nature.

The Working Group have agreed on the following requirements for the choice of a basis for valuation and income recognition:

(a) a monetary policy with the priority "to maintain price stability" could tend to lead to valuation losses on foreign reserve assets over time as central banks are not in a position to hedge their foreign exchange exposure. This calls for a prudent approach regarding unrealised exchange rate gains as these, at least in most cases, should be considered temporary.

(b) the risks in the foreign exchange assets portfolio and other volatile assets could require a buffer created by a general risk provision, a non-distributable revaluation account or a low valuation policy (or a combination of these) to absorb possible losses.

*As regards the basic choice of a valuation principle, a large majority of the Working Group is in favour of valuing assets and liabilities using market values; a minority is in favour of the "lower of cost or market" principle. The major difference between the two is that, in using market value, the unrealised positive discrepancy between cost and market value will be reflected in the balance sheet;*

under the "lower of cost or market" principle, it will not. However, the proponents of market values opt at the same time for including unrealised gains in a revaluation account to be shown in the balance sheet. Consequently, these two methods of valuation will not, in principle, give rise to major differences in income in the annual accounts over a period of time.

Accordingly the difference is in essence one of balance sheet presentation. Under the "lower of cost or market" principle, the existence of positive valuation differences will lead to the creation of hidden reserves, potentially giving rise to the question whether the financial position is adequately shown. On the other hand, the use of market values could lead to revaluation reserves being presented in the balance sheet which, so the minority holds, could be seen by the shareholders (i.e. Governments) as reserves eligible for distribution. Distribution of such reserves - and here the Working Group is unanimous - could impair the System's overall credibility and is not proposed.

The use of market values, and the ensuing possibility of creating revaluation reserves, permits a number of scenarios, with regard to income recognition. However the choice to be made here logically depends on the basic decision on balance sheet valuation. Accordingly the Working Group will develop a definitive proposal on income recognition following this decision.

*The Working Group would request guidance as to which basic valuation criteria should be adopted, i.e. "lower of cost or market value" or "market value". In the context of the estimated lead time to develop and implement the Group's proposals (and also bearing in mind the statutory obligation of the EMI to specify the organisational framework for the ESCB by end 1996) it would be desirable that a decision on this fundamental issue be taken as soon as possible.*

#### 4. ACCOUNTING FOR BANKNOTES

As regards accounting for banknotes, two principal issues need to be resolved:

(i) **Who will be the legal issuer of banknotes?** Article 16 of the Statute of the ESCB provides for three possibilities (to be decided by the ECB Council):

- (a) the ECB is the only legal issuer;
- (b) both ECB and NCBs are legal issuers;
- (c) only NCBs are legal issuers.

The decision as to which institution(s) is legally responsible for the issuance of banknotes should also have regard to the question where the assets backing the note issue will be held. Three possible solutions and some of their effects are described in this report.

It would appear that the most appropriate accounting method that would enable NCBs to retain the assets (and income) backing the note issue while formally not being legal issuers would be to create

unremunerated claims by the ECB on individual NCBs in respect of net notes issued by the NCBs on the ECB's behalf.

*(ii) How to deal with the effect of banknote migration in the single currency area on the balance sheets of those NCBs which are net receivers of banknotes?* Bulk redistribution of banknotes for value between NCBs has been put forward as a solution to alleviate these effects.

The Working Group is aware that banknote issue is a political rather than an accounting issue and that there may be ramifications for other areas, such as banknote printing and the decentralised execution of monetary policy operations. It understands that a comprehensive issues paper on banknotes from EMI services is being prepared for discussion in early 1996.

## **5. INTRA-SYSTEM SETTLEMENT ISSUES**

Intra-System transactions could arise from such factors as payments through the TARGET system, banknote transfers, pooling/redistribution of monetary income and ECB profit distributions. The manner in which the resulting inter-NCB claims and liabilities will be accounted for (gross or net; bilateral or netted against the System; only for NCBs participating in stage three or also for other NCBs participating in the TARGET system; remuneration or not) and the manner in which the positions will be settled will require a number of accounting solutions.

Furthermore, intra-System positions and their manner of settlement could affect the calculation of monetary income by the individual NCBs, such as the volume of the monetary base and the composition of earmarked assets.

*The Working Group proposes to prepare a consultative paper on these issues in consultation with all interested parties. Due to the current preparation of the Interlinking user requirements by the Working Group on Payments Systems, some of the questions have to be addressed very early in 1996.*

## **6. METHOD FOR CALCULATING MONETARY INCOME**

In conformity with Article 32.2 of the Statute of the ESCB, the Working Group has based its development of methods of calculation on the definition that each national central bank's monetary income "shall be equal to its annual income derived from its assets held against notes in circulation and deposit liabilities to credit institutions. These assets shall be earmarked by national central banks in accordance with guidelines to be established by Governing Council." (so-called "direct method").

If, in the judgement of the ECB Governing Council, the balance sheet structures of the NCBs do not permit the application of the direct method, Article 32.3 provides for the use of an alternative method for a period of five years.

Two elements in the definition contained in Article 32.2 are of particular significance:

- certain assets must be earmarked;
- a continuous relationship should be established between notes in circulation plus liabilities to credit institutions (the monetary base), on the one hand, and the earmarked assets, on the other.

Article 32.2 does not provide indications as to the technical manner in which this relationship should be established. A method in accordance with the letter of Article 32.2 would in fact mean that there should be a continuous balance between the two aggregates, implying a fairly complex assignment. In implementation of one of the prerequisites formulated by the Working Group (a method of calculation should be fair, controllable and as simple and transparent as possible to understand and implement), the Group has defined four potential methods of calculation, all of which involve the assets side of the balance sheet in the calculations. As these methods are based on the asset side and actual income, the Working Group holds, for the time being, that these methods are compatible with (the spirit of) the above-mentioned provisions of Article 32.2. The legal experts will have to be consulted about the validity of this conclusion; in the recent EMI note on "Issues related to the determination of the ESCB's monetary income" , it is assumed that the ex post methods are among the alternative methods under Article 32.3.

*(a) dedicated portfolio (ex ante earmarking method)*

This method implies that the monetary base is tied to a specific portfolio of earmarked assets. In the event of imbalance between the two, periodic adjustment takes place. Such adjustment (rebalancing of the assets portfolio) could, in principle, be effected daily. However, in order to minimise operational difficulties, it is proposed for practical reasons that a so-called adjustment account should be used for a certain interim period. With the aid of this (remunerated) adjustment account, the monetary base and the assets portfolio are balanced daily. Together with income from the earmarked assets, interest income or expenditure on the adjustment account forms part of poolable income.

*(b) average method (ex post earmarking method)*

The first step in this method of calculation provides for an analysis of all earmarkable assets. These assets are classified into categories, and the categories are assigned a ranking order. After the end of the financial year, both the average of the monetary base and the averages of the various categories of earmarkable assets are calculated. Subsequently, the average of the monetary base is matched against the afore-mentioned assets according to the ranking order. The income generated by these assets is pooled.



*(c) proportional method A (ex post earmarking method)*

This method takes the ratio of the average monetary base to the average of earmarkable assets and applies this ratio to the whole of the income arising on the earmarkable assets.

*(d) proportional method B (with strata)*

The basis for this method is the average figure of the monetary base and the average figures for the various classes of earmarkable assets. A predetermined fixed percentage in relation to the monetary base would be allocated to every class of earmarked assets. The income resulting from each asset class has to be separated in the same proportion as its underlying "earmarked" assets to the total of this asset class.

The key element of each of these four direct methods is the manner in which the assets will be earmarked/earmarkable (dedicated designation, classification into categories, ranking order, etc.). The examination of these issues has been under way in recent months. With a view to this examination, proposals for follow-up work have been made in the earlier mentioned EMI note on monetary income. In addition, clarity will have to be obtained in respect of possible obstacles in terms of balance sheet structures to the application of the direct method: the bank note balance sheet questions; the definition of the monetary base; the treatment of collateral risk losses. Such clarity is required before the Working Group will be able to express a preference for one of the direct methods or for an alternative method.

*Alternative method (Article 32.3)*

This method does not involve the assets side of the balance sheet, but solely centres on the liabilities side. At the end of the financial year, the average of the monetary base is calculated. On this average, interest is calculated at a certain rate to be set later (e.g. an ex post benchmark rate). The resulting income is the monetary income to be pooled.

***The Working Group will continue its examination of the feasibility of the four methods in conformity with Article 32.2. At the same time, it will work on developing one or more alternative methods.***

## **7. TRANSITIONAL ISSUES ON THE COMMENCEMENT OF THE ESCB**

*Thus far, the Working Group has focused mainly on the problems of ongoing valuation and recognition of income. In addition, three major accounting issues have been identified relating to the transition to the ESCB. These are (i) valuation of assets, (ii) provisions and reserves, and (iii) prior losses. The Working Group proposes to develop these issues in a consultative paper in the second half of 1996.*

### (i) Valuation of assets

The valuation affects the calculation of monetary income under each of the direct methods. Generally, it is true to say that the lower the valuation, the higher the amount of assets to be earmarked/earmarkable, and the larger the contribution of the NCBs to the pool.

However, valuation below market as a transitional value involves several drawbacks. In the event that earmarking of the lower-valued assets cannot be effected in accordance with the capital key, the principal drawback is that such lower valuation does not meet criteria of fairness. The fact is that the transitional value becomes the cost to the System and the basis upon which monetary income will be calculated (and pooled) if a method in accordance with Article 32.2 is applied. This aspect would tend to push the argument in favour of a transition based on market price and current exchange rates. Further study will be necessary in this area, taking into account the link with the ongoing valuation method.

### (ii) Provisions and reserves (in an accounting sense)

At its outset the System will have no reserves. However, it is conceivable that monetary income in the early years could become negative, inter alia, on the level of foreign exchange assets that are earmarked. The absence of a system to offset these losses could give rise to presentational and technical problems. This issue will need further examination.

### (iii) Prior losses

It might be possible that, owing to devaluation on day one or to other prior losses, a particular NCB has to show a net capitalized loss in the balance sheet. This could lead to a shortage of earmarkable assets and could moreover be seen as a non-permissible form of government financing.

For these reasons, the Working Group is of the opinion that the System has a need for a (prudent) regulation to safeguard capital adequacy in the sense that the distribution of profit to government should not be resumed before the capitalized losses have been offset. The legal implementation of such a regulation will have to be discussed with the legal experts.

## **8 FUTURE WORK**

The chosen accounting principles and techniques must take effect from day one of stage 3. For the ECB they must take effect from the date of its establishment.

It is estimated that there will be a two year lead time for the implementation of the Group's detailed proposals, so therefore the bulk of the tasks to be completed on accounting principles and the calculation of monetary income will have an effective deadline by the end of 1996. A work programme which reflects this timescale is outlined in Annex 5.

*In this context it seems necessary to come to a decision on the basic valuation criteria at an early stage in 1996.*

## **CHAPTER 1: INTRODUCTION**

- (i) In compliance with its initial mandate dated April 1992, and in accordance with the work programme submitted to the EMI in 1994 (as outlined in the EMI's Master Plan in the relevant fiches G.1 and G.3), the Working Group on Accounting Issues has drawn up this report to prepare the ground for recommendations on the harmonisation of accounting rules and standards in the ESCB with particular regard to the statutory provisions on monetary income.

As stated in our interim report in September 1995, the Working Group has interpreted this mandate as requiring the preparation of a set of accounting policies and techniques for use by both the ECB and NCBs in respect of system assets and liabilities and for the purpose of calculating monetary income. The Group has also considered other related accounting issues that have emerged either during its own deliberations or as a result of work conducted by other Working Groups and Sub-Committees, notably on Payment Systems and on Printing and Issuing a European Banknote.

- (ii) The report is structured as follows. Following the Executive Summary and this Introduction, Chapter 2 reflects on the scope and extent of harmonisation of national central bank accounts considered by the WGAI; Chapter 3 deals with the central issue of an accounting methodology to underpin the accounts of the ESCB (including the ECB). In Chapters 4 and 5 specific issues of accounting for banknotes and settlement of inter-NCB and NCB-ECB balances are addressed. Chapter 6 focuses on the method of calculating monetary income in accordance with Article 32 of the ESCB Statute while Chapter 7 considers some transitional issues on the commencement of the ESCB. Finally Chapter 8 proposes a marching route for further action by the WGAI under all of the key headings.

Each of these topics is supplemented (where necessary) by annexes, which provide fuller detailed explanations of the issues involved.

- (iii) The Group also proposes to produce further reports (as specified in Annex 5) containing more detailed accounting principles and techniques; although much of this work has already been done, the Group cannot narrow down the range of alternatives until the central matters requiring decision have been resolved.

Outlined below are the key issues requiring decision before the recommendations of the WGAI can be finalised so as to allow for the establishment of the financial reporting system for the ESCB in Stage Three.

- (a) The scope of harmonisation (see Chapter 2)

- (b) Basis of balance sheet valuation; either at market price **or** lower of cost or market value (see Chapter 3)
- (c) Basis of recognition of income and treatment of gains and losses arising on valuation (see Chapter 3)
- (d) Method of calculating monetary income including specifically what kind of assets will be earmarked (see Chapter 6).

Further important decisions will also be required before the recommendations can be implemented, the most significant of which are:

- What assets and liabilities are to be included within the System? (see Chapter 2)
- What assets and liabilities will be on the balance sheet of the ECB rather than NCBs, e.g banknotes? (see Chapters 2 and 4)

These decisions need to be taken on a timely basis to allow for their implementation which will take an estimated two years. An indicative time scale for the decision making process is referred to in Annex 5.

## CHAPTER 2: HARMONISATION OF ACCOUNTING RULES AND STANDARDS

### RECOMMENDATIONS:

- 1) The same accounting policies must be adopted by all NCBs for those activities which are within the ESCB.
- 2) For those activities not within the ESCB the Working Group recommends that each NCB also adopt similar accounting policies.
- 3) The Working Group also recommends that each NCB should produce just one set of financial accounts so that their local annual accounts should be produced on a basis consistent with those of the ESCB but recognises that there is, at present, no full legal requirement to do so.

### 2.1 Treaty Provisions

The need for harmonisation under the Treaty is twofold:-

- (i) to enable meaningful consolidated balance sheets of the ESCB (“the System”) to be drawn up for analytical and operational purposes (as referred to under Articles 15 and 26 of the ESCB Statute<sup>1</sup>).
- (ii) to enable monetary income to be calculated on a consistent basis throughout the ESCB (under Article 32).

The Statute of the ESCB gives limited guidance as to which assets and liabilities will be included in the System. Nor is it known what assets will be generating the monetary income (i.e. the “earmarked assets” referred to in Article 32.2). Furthermore the classification between system and non-system balance sheet items would not appear to accord with the notional division of NCBs’ balance sheets as envisaged under Article 32.2 for the purpose of calculating monetary income. (This issue is further elaborated upon in Chapter 6). Article 26.3 clearly

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#### <sup>1</sup>ARTICLE 15

15.1. “The ECB shall draw up and publish reports on the activities of the ESCB at least quarterly”.

15.2. “A consolidated financial statement of the ESCB shall be published each week”.

#### ARTICLE 26

26.2. “The annual accounts of the ECB shall be drawn up by the Executive Board, in accordance with the principles established by the Governing Council.

The accounts shall be approved by the Governing Council and shall thereafter be published”.

26.3. “For analytical and operational purposes, the Executive Board shall draw up a consolidated balance sheet of the ESCB, comprising those assets and liabilities of the national central banks that fall within the ESCB”.

26.4 “For the application of this Article, the Governing Council shall establish the necessary rules for standardising the accounting and reporting of operations undertaken by the national central banks”.

envisages that the balance sheets of NCBs will be classified into “system” and “non-system” components”. The origin of this classification is found in the words “those assets and liabilities.....that fall within the ESCB” while the basis on which this distinction is to be made is found in the words “for analytical and operational purposes”. This is further elaborated upon in the Commentary which accompanied the draft Statute prepared by the Committee of Governors in April 1991. The text on Article 26 states:

*“As the System has no legal personality, all assets and liabilities relating to the System’s operations will be recorded in the balance sheets of the ECB and the national central banks. However, the conduct of a single monetary policy and the need for proper information on sources of money creation throughout the Community will require the consolidation of such assets and liabilities within a single balance sheet structure”.*

This commentary suggests that monetary policy considerations should be the primary determinant of which elements of NCBs’ balance sheets are to be included in the consolidated balance sheet drawn up under Article 26.3. It can be argued that since, in principle, movements in almost any NCB balance sheet item could affect liquidity, and hence the conduct and operation of monetary policy; there is a justifiable argument for an extensive interpretation of Article 26.3. It would also avoid the need to make decisions about the status of individual balance sheet items based on what might be an arbitrary interpretation of particular Articles in the Statute.

## **2.2 Proposed scope of harmonisation**

*The Working Group has, in view of the above, adopted a practical working hypothesis. It will develop accounting policies for all assets, liabilities, income (including capital gains and losses) and expenditure that may be considered material for the System. Accordingly, if these assets, liabilities, income or expenditure are material to the operation of the System then the proposed accounting policy must be adopted by all central banks. The proposed policy will also serve as a recommendation to cover NCB activities outside the System.*

With regard to *income and expenditure*, it could be argued that the rules are, strictly speaking, only mandatory for the purposes of calculating monetary income. However, the Group considers that for reasons of consistency the rules should be extended to cover all income and expense arising in relation to System assets, liabilities and transactions. In practice there may be few activities of NCBs outside the ESCB and consequently this may mean that NCBs end up adopting common accounting policies for nearly all their activities. A possible classification between what is considered ESCB and non-ESCB items has been made by the Group as a

working hypothesis in order to continue its work pending the resolution (by the Council) of the operational framework of the ESCB (see Annex 1).

The proposals will cover financial accounts, by which we mean accounts intended for publication (as a whole, or as part of consolidated figures). These cover both annual accounts and more frequently published data. The proposals also cover the accounting scheme that may be required to calculate monetary income. It may be helpful to summarise in tabular form the range of financial accounts that will be required of NCBs/ECB/ESCB in Stage Three.

TYPE OF REPORT	SOURCE OF LEGAL REQUIREMENT
<i><u>PUBLISHED</u></i>	
1. Annual accounts of the ESCB	Article 26.3 (of the ESCB Statute)
2. Quarterly report on the ESCB's activities	Article 15.1 (of the ESCB Statute)
3. Weekly financial statement of the ESCB	Article 15.2 (of the ESCB Statute)
4. Annual accounts of the ECB	Article 26.2 (of the ESCB Statute)
5. Annual accounts of NCBs	Domestic/local legislation
6. Weekly financial statement of the NCBs	Domestic/local legislation
<i><u>INTERNAL PURPOSES</u></i>	
7. Accounting scheme required to calculate monetary income	Article 32.2 (of the ESCB Statute)[or alternatively Article 32.3]
8. Daily financial information for the conduct of monetary policy of the ESCB	-

It should be emphasised that it is not within the mandate of the Group to cover internal (management) accounting. Nor is it intended to specify how a central bank keeps its books (e.g. accounting software, processing techniques etc.). The proposals in this report merely cover the output required as listed above.

### 2.3 Proposals cover the ECB

The proposals cover the ECB even though this was not specifically mentioned in the mandate. While it is recognised that, at this juncture, uncertainties exist as to the form, structure and exact



activities of the ECB, the fact that the ESCB under Article 1.2<sup>2</sup> of the Statute comprises both the ECB and the national central banks means that by default any proposed accounting policies would have to include the ECB. It would also avoid a possible duplication of work. Indeed, the Working Group is prepared, should the Council agree, to assist in the production of more detailed accounting techniques for the ECB than for the System as a whole, as the NCBs already have well established systems and procedures. The ECB in contrast will be a new body. The Group is also prepared to assist in setting up detailed reporting and control systems and the production of detailed procedures for the ECB.

#### **2.4 Published accounts of the national central banks**

From a legal point of view, it seems to be the case that the harmonised procedures need only be applied to accounts produced for system purposes, leaving NCBs to produce their own accounts under their domestic law and practice. Since the consolidated balance sheet of the ESCB drawn up under Article 26.3 would be strictly “*for analytical and operational purposes*”, such a balance sheet does not have legal implications for the ownership of NCB assets. In particular it does not necessarily imply that NCBs’ own balance sheets, published in accordance with domestic, legal and institutional requirements, need to contain a ‘system’ and ‘residual’ (or non system) division. (This interpretation is consistent with the Commentary which states that “*Article 26 does not preclude national central banks from presenting their own balance sheets in a manner consistent with existing national accounting practices*”). Nor need it imply that a fully consolidated balance sheet prepared under Article 26.3, which may include some or all of NCB’s capital and reserves, would have any legal implications for the ownership of the capital and reserves.

In summary the Statute imposes no compulsion on NCBs to adopt the harmonised rules for their own annual accounts and it does not seem to override national provisions. ***Nevertheless, in practice the Group strongly believes that producing two (perhaps very different) sets of accounts for each NCB (one according to national accounting practices and another following the chosen accounting methodology for the ESCB) would be rather confusing and problematic, not least for governments.*** For the public it would be difficult to understand if important aggregates like US\$-monetary reserves were translated in the consolidated balance sheet of the ESCB at market value but in the balance sheets of the individual NCBs using alternative measurements. In addition, in the profit and loss account, this could lead to

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<sup>2</sup>**ARTICLE 1.2** “*In accordance with Article 106(1) of this Treaty, the ESCB shall be composed of the ECB and of the central banks of the Member States (‘national central banks’). The Institut Monétaire Luxembourgeois will be the central bank of Luxembourg*”.

anomalies, such as one set of financial accounts producing a profit whilst the other shows a loss, which would not help the credibility of either the NCBs or the System. **Accordingly the Working Group recommends that national central banks only produce one set of financial accounts annually so that their local annual accounts should be consistent with those produced for the ESCB.** By consistent we mean that the same items in the accounts should be valued and reported on the same basis. However, detailed disclosure may remain according to national practice. An additional and similar conclusion with respect to the calculation of monetary income is included in Chapter 3 of this report.

The giving of legal effect to these recommendations has been considered in consultation with the EMI's Legal Division. While it would appear that a number of alternative measures exist which can be taken by the Council, including the possibility of a partial redraft of Article 26 of the Statute, the WGAI considers it appropriate to defer further debate on the legal aspects of implementing their recommendations until the overall legal and regulatory framework for the ESCB has been developed by the Working Group of Legal Experts (WGLE), following which this issue can be revisited.

## CHAPTER 3: ACCOUNTING METHODOLOGY FOR THE ESCB

### **RECOMMENDATION:**

1) With regard to a proposal for a uniform accounting methodology, for balance sheet valuation there is currently no unanimity within the Working Group. The **majority** are able to recommend a balance sheet valuation method on the basis of “market values”, whilst for the purposes of income recognition, unrealised gains (i.e. gains from revaluation of assets) do not form part of income. However a detailed proposal for the treatment and presentation of (un)realised valuation gains and losses can only be made following a decision on the method of balance sheet valuation.

2) A **minority** recommends the general principle of “lower of cost or market value”, thus implying that only decreases in value on the assets side (or increases in value on the liabilities side) are to be fully taken into the profit and loss account. Accordingly, all valuation losses are recognised in the profit and loss account whereas unrealised valuation gains are neither recognised in the profit and loss account nor on the balance sheet. Furthermore it recommends that, as far as the foreign exchange reserves are concerned, the valuation criteria should be the “lowest historical rate”<sup>3</sup>.

3) The Working Group recommends the adoption of similar accounting policies for the ongoing calculation of monetary income as will be adopted for the financial accounts of both the ESCB and NCBs’ local annual accounts. (This is in addition to the recommendation in Chapter 2).

### **3.1 Main issues requiring decision**

This chapter asks for a decision on the fundamental basis on which the (harmonised) published balance sheets and profit and loss accounts of the ESCB/NCB/ECB are to be prepared. The issues can be stated simply as:-

- (i) *Are assets (and liabilities) to be stated in the balance sheet on the basis of market prices (and exchange rates) or on the basis of the lower of cost or market value?*
- (ii) *How should gains and losses arising from valuation (including exchange rate differences) be treated for the purposes of income recognition?*

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<sup>3</sup> The lowest historical rate would be registered from the beginning of the ESCB (i.e. from 1st January 1999). This point is explored in further detail in Chapter 7 on Transitional Issues.

These two issues are interlinked and give rise to a broad range of possible combinations for balance sheet valuation and income recognition. At one end of the spectrum the use of the lowest historical rate for valuation results in the non recognition of unrealised gains (but recognition of unrealised losses) in the profit and loss account. Accordingly, valuation losses have to be treated as losses which can only be reversed on the actual sale of the asset while revaluation gains can only go to the profit and loss account if realised. From the viewpoint of balance sheet presentation it can be argued that this leads, in general, to the creation of hidden reserves which will serve as a buffer against future diminution in the value of assets. The other end of the spectrum uses market values for balance sheet valuation, with all (realised and unrealised) gains and losses taken to the profit and loss account (with perhaps a transfer to provisions/reserves to provide for exposure to fluctuations in the market). The arguments for and against the positions/questions have been well discussed within the Group and Annex 2 contains a more detailed outline of various scenarios. These issues are aspects of the different accounting philosophies amongst Member States and are not specific to central banks alone.

It should be noted that differences in valuation methods do not necessarily result in different accumulated profit figures over the long run; *the question is one of timing of profit recognition on a year to year basis.*

### **3.2 Summary of accounting considerations**

The main considerations regarding the choice of a basic valuation principle are as follows:

- (i) Accounting rules and standards should, as far as possible, help to preserve the overall credibility of the ESCB. In so doing an overriding requirement in the presentation of financial statements should be the desire to reflect economic reality so that readers can understand the message which should be delivered in a transparent manner.
- (ii) The extent to which the concept of prudence<sup>4</sup> is applied varies between central banks in relation to the degree of conservatism to be adopted in the calculation of profit and in the presentation of financial information. This largely reflects the differences in national accounting standards and legislative requirements upon which central banks base their policies and to a lesser extent historical factors of a local nature. A primary requirement in Stage Three of EMU must be the preservation of the wealth of the ESCB.

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<sup>4</sup>Prudence is one of the basic assumptions underlying the preparation of financial statements. Since uncertainties inevitably surround many transactions and other events this should be recognised in preparing financial statements by being careful in the valuation of assets and liabilities and the recognition of income to avoid undesired consequences.

- (iii) Since central banks have a structural foreign exchange exposure and other risky assets which they are not in a position to hedge, this implies that they could need considerable reserves or other buffers to absorb the effects of exchange rate movements and (valuation) losses on domestic assets. In the context of the determination of profit, this could be achieved by a low valuation policy, a non-distributable revaluation account or a general risk provision, or by a combination of these.
- (iv) Differences in valuation methods do not necessarily result in the profits paid to shareholders (i.e. Governments) varying to the extent that might be expected. While the distribution of profits to shareholders is not an issue for discussion by the WGAI it must be borne in mind that for reasons of public presentation and distribution to governments some form of profit smoothing may be desirable. This could be reflected in the chosen accounting principles and techniques
- (v) In the ESCB a large part of its forex assets will generally be held for the longer term and thus they are not likely to be realised in the short term. The mere recognition of unrealised valuation gains on such assets in the balance sheet, even if they are taken directly to a revaluation account, could be interpreted by some Governments to mean that they are actually available for distribution thus leading them to taking an over-optimistic assessment of the earning capacity of their central bank. On the other hand using the lower of cost or market value eliminates all possibility of showing such revaluation gains in the balance sheet.

Based on the foregoing considerations the primary choice for the basis of asset valuation <sup>5</sup> and income recognition should match the following requirements:

- Under normal circumstances, a monetary policy that has the priority "to maintain price stability" could tend to lead to valuation losses on its foreign reserve assets over time. This calls for a prudent approach regarding unrealised exchange rate gains as these, at least in most cases, should be considered as temporary.
- For reasons of consistency there could be an argument that the same approach should be followed regarding unrealised price gains for both foreign and domestic assets.

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<sup>5</sup> In the case of illiquid assets (e.g. gold) it could be considered appropriate to establish a particular accounting policy at other than cost or (full) market value, due to their unique characteristics. An elaboration of the rationale for this suggested approach with respect to gold valuation is given in Annex 3.

- The risks in the foreign exchange assets portfolio and other volatile assets could require a buffer created by a general risk provision, a non distributable revaluation account or a low valuation policy (or by a combination of these) to absorb possible losses.

### **Conclusion**

In making their assessment of the pros and cons of the different scenarios outlined in Annex 2 against the background of the considerations and requirements mentioned above the members of the WGAI presented diverging views.

Concerning the basic valuation principle a large majority would recommend the preparation of the balance sheet on the basis of market values while one member would recommend the lower of cost or market principle. The major difference between the two is that, in the case of using market values, the unrealised positive discrepancy between cost and market value will be reflected in the balance sheet; under the lower of cost or market principle it will not. However, the proponents of using market values at the same time opt for one of the scenarios for income recognition which will include, in some way, the transfer of unrealised gains to a revaluation account. Thus the difference is in essence one of balance sheet presentation.

Concerning the treatment and presentation of (un)realised valuation gains and losses the preferences of the WGAI members are not fully developed. However, within the context of the application of market values, about half of the members would tend to be in favour of scenario 3. This scenario essentially includes the direct transfer of unrealised gains to a revaluation account, the offsetting of unrealised losses against this revaluation account and for the remainder charged against the profit and loss account, whilst not reversing those losses recorded in the profit and loss account in future years (against new unrealised gains). However, as mentioned above, a final proposal on this matter can only follow the basic decision regarding the valuation principle.

## **3.3 Monetary income considerations**

3.3.1 One prerequisite for implementation of a method for calculating monetary income is the adoption of harmonised accounting standards. While monetary income is discussed in some detail in Chapter 6 it should be noted that with regard to the valuation of those assets which will yield monetary income in accordance with the requirements of Article 32, two main choices would need to be made: first, on the method to be adopted for their initial valuation (i.e. the valuation when the assets are first earmarked at the start of Stage Three); second, on the method for their ongoing valuation.

### **3.3.2 The initial valuation of assets**

To the extent that the earmarking of assets can be understood, in an economic sense, as a 'transfer' of assets from individual NCBs to the System, the initial valuation is important because it will become the 'selling' price for the NCB and the 'cost' price for the System.

Valuation differences after the transfer would accrue to the System. This means that the NCBs would have to account for pre-transfer and post-transfer revaluation amounts for the same assets. (This issue is further elaborated upon in Chapter 7 which deals with transitional issues on the commencement of the ESCB).

### 3.3.3 Ongoing valuation of earmarked assets

The method used for the initial valuation would, of course, also have implications for the subsequent calculation of income.. If the initial method is not based on current market prices but (for example) on the “lower of cost or market price principle”, this could mean that a similar method would need to be used for the ongoing valuation if the hidden reserves of NCBs accumulated prior to the start of Stage Three were not to be disclosed. Thus, unrealised gains would not be recognised and the ESCB could thereafter build up further hidden reserves. In any case, it would have to be clarified whether the NCBs or the ECB has the right to decide on the timing of any realisation of the hidden reserves of NCBs. Furthermore, particularly if the initial contributions of hidden reserves from NCBs to the ESCB are not provided according to the capital key, conflicts may arise on decisions regarding the sale of assets whenever these involve the realisation of hidden reserves.

On the other hand, if the initial valuation of earmarked assets is based on prevailing market prices, the ESCB, could not inherit hidden reserves from NCBs. Since however the ESCB would, in principle, be free to choose for the ongoing valuation within the ESCB either the same method or a more conservative one, this would still allow it to start to accumulate hidden reserves from the beginning of Stage Three.

3.3.4 As previously mentioned in Chapter 2, it is possible to conceive of a system to implement two different sets of accounting rules by NCBs, an internal one for the purpose of calculating annual monetary income on earmarked assets for the system, and another for the (published) financial reporting which would be used to derive the profits to be distributed to the respective governments. However, such a “double accounting” scheme would be costly, confusing and, moreover, it might be difficult to justify. It could lead to anomalies such as one set of financial accounts producing a profit whilst the other shows a loss, which would not help the credibility of either the NCBs or the System. **Accordingly the Working Group considers that whatever harmonised set of accounting principles and techniques are chosen to satisfy the**

**requirements of Article 26 of the ESCB Statute they should also be applied for the purpose of both the ongoing calculation of monetary income and the local accounts of NCBs<sup>6</sup>.**

### **3.4 Recognition of realised foreign exchange gains and losses**

3.4.1 A further question is **when** a gain or loss on a foreign exchange transaction is realised. There are essentially three possibilities:

- (a) Every foreign currency transaction, including those within a single foreign currency, is potentially capable of realising a foreign exchange gain or loss on translation.
- (b) Only transactions between any two different currencies can give rise to such a gain or loss. Transactions within a currency, which effectively replace one asset with another, do not give rise to an exchange gain or loss.
- (c) Only transactions between the domestic currency and a foreign currency can give rise to exchange rate gain or loss. Since a central bank usually has as an objective the maintenance of a certain average level of foreign currency assets its objective is not to make gains by moving into the domestic currency but to intervene to influence an exchange rate (albeit while day-to-day random movements occur in the level of foreign currency assets).

Each of these methods has valid arguments to support it. However, method (a) does not take account of the existence of a largely immobile foreign exchange portfolio in each of the currencies, particularly in the case of large NCBs which would have a large degree of inertia in their portfolios. At the other end of the spectrum, method (c) takes the portfolio approach to an extreme in that it does not distinguish movements in the different currencies comprising the forex assets. *For these reasons the Working Group has a preference for (b), which also allows a switch between currencies, a conscious management decision within the competence of a central bank, to be reflected in the accounts.*

3.4.2 Following on from the above point it should be considered whether or not realised gains on disposal of foreign currency assets should be distributed to shareholders. It can be argued that even if some gains can be deemed to be “realised” in a narrow accounting sense several reasons can be envisaged for having a different accounting treatment for realised foreign exchange rate gains and not accepting this portion of income as monetary income to be distributed to Government. Under EMU it would be expected that the maintenance of price stability will result in the single currency remaining strong against other currencies. In these circumstances the likelihood is that NCBs would be recording structural exchange rate losses. In the absence of provisions, these losses would be charged to the Profit and Loss account, and would therefore

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<sup>6</sup> This recommendation is only strictly necessary if a direct method (as referred to in Chapter 6) for calculating



reduce the monetary income to be pooled. There may therefore be an argument to retain realised gains as provisions at least in the initial stages of the ESCB in order to build up a buffer within the System. *The Working Group will examine these matters (in conjunction with other Sub-Committees and Working Groups) in the context of the development of a comprehensive set of accounting principles for the ESCB<sup>7</sup>.*

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monetary income is adopted

<sup>7</sup> This matter is also referred in Chapter 7 as it has implications for the transition to Stage Three on the commencement of the ESCB.

## CHAPTER 4: ACCOUNTING FOR BANKNOTES

### 4.1 Scope

This chapter summarises issues that have a bearing on the accounting method to be chosen to reflect holdings and movements of banknotes. *These issues are however of a policy nature not for determination by the WGAI per se and will need to be elaborated further and addressed in conjunction with other Working Groups during the coming year.* Consequently they are being drawn together and analysed in greater detail in a paper which is planned to be circulated to the Committee of Alternates by EMI Services in February 1996. The accounting methods to be used will depend on and reflect the decisions taken.

The principal issues are:-

- Who will be the legal issuer of banknotes in Stage Three;
- The practical consequences of non-repatriation of banknotes, and the need for bulk redistribution of notes between NCBs.

### 4.2 Legal Issuer of Banknotes

The question is legally governed by Article 16 of the ESCB Statute<sup>8</sup>. As worded this Article permits three possibilities<sup>9</sup>:-

- The ECB is the only legal issuer;
- Both ECB and NCBs are legal issuers;
- Only NCBs are legal issuers and not the ECB.

If the ECB is the sole legal issuer, then banknotes would be shown as a liability of the ECB and consequently three approaches are conceivable. Firstly, NCBs could “buy” banknotes from the ECB by transferring interest bearing assets to the ECB. Secondly the NCBs could incur a remunerated liability vis-à-vis the ECB against the value of the banknotes obtained from the ECB. Thirdly NCBs could incur a non-remunerated liability vis-à-vis the ECB.

With the first two approaches there is a shift of assets and/or income from the NCBs to the ECB and this could have the following effects:-

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<sup>8</sup> “In accordance with Article 105a (1) of this Treaty, the Governing Council shall have the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only notes to have the status of legal tender within the Community.”

<sup>9</sup> It should be noted that the ESCB, which has no legal corporate existence, cannot be a legal issuer of banknotes.

- The balance sheets of the NCBs could be denuded of assets necessary, inter alia, for the conduct of monetary policy operations on a decentralised basis (and a decision would be required in advance as to which assets, in what quantities, with what frequency and at what valuation should be transferred from NCBs to the ECB to back “its” note issue).
- Seignorage income would cease to be part of monetary income, as defined in Article 32.2 of the Statute, but would instead form part of the profits of the ECB; while the distribution rules are the same, part of these profits are subject to retention in a reserve in accordance with Article 33 of the ESCB Statute. This could result in a smaller amount of seignorage income being reallocated to NCBs, at least in the short term.

*It would appear that the appropriate accounting method that would enable NCBs to retain the assets backing the note issue while not being legal issuers would be to create unremunerated claims by the ECB on individual NCBs in respect of notes issued by the NCB on the ECB's behalf (net of repayments by the banking system related to that NCB).*

Finally, it should be noted that all of the three possible solutions would permit the physical issue and surrender of notes, and the corresponding banking transactions with the private sector, to be handled by both the ECB and NCBs.

#### **4.3 Non-repatriation of banknotes**

An informal understanding was reached at the ECOFIN meeting in May 1995 that there should be no repatriation of European banknotes in Stage Three. This means that all fit banknotes - whatever the country of original issue - would be re-issued by all national central banks (of participating countries). European banknotes would of course be legal tender throughout the single currency area. This not only ensures complete fungibility of all notes, whatever their origin within the Community (which is important for ensuring their acceptability to the public), but also eliminates the need for sub-sorting paid-in notes, complex stock recording and accounting, and transportation.

The principal issue arising from this approach is the effects of asymmetric and generally uni-directional cross-border flows of notes (due, for example, to tourism). These include on NCBs' balance sheets: -

- Possible shrinkage of the balance sheets of NCBs who are consistent net receivers of notes.

- The effect on the printing works of the net receivers and net issuers (e.g. if demand for notes can be met to a greater extent than anticipated by the re-issue of surplus paid-in-notes, or if extra new notes have to be printed to make up the total local supply required<sup>10</sup>
- Possible distortions in the monetary income earned throughout the system because of the location of the component assets on which that income arises even though such distortions would not necessarily affect the overall amount of ESCB monetary income.

This issue, and the possible solutions, which could involve the bulk redistribution of banknotes for value between NCBs were explored in a short note to the Council in June 1995 (attached as Annex 4).

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<sup>10</sup> This is not an accounting issue per se but is of relevance to the matter of non-repatriation .

## CHAPTER 5: INTRA-SYSTEM SETTLEMENT ISSUES

### SUMMARY

The type, size and frequency of intra-ESCB transactions is at present uncertain and is likely to remain so until the System is in operation. Such transactions may have implications for both monetary income and the operations of NCBs. The possible accounting treatment can only be confirmed when there is agreement in the first place on the general principles that give rise to these transactions including the settlement issue. *To that end, the WGAI proposes that a consultative paper on these issues be developed by the WGAI in co-ordination with the EMI Services and all other interested parties during 1996 so as to initiate wider debate in this area.*

### 5.1 Scope

Intra-ESCB transactions will become an important aspect of accounting in Stage Three. Open positions (i.e. bilateral claims and liabilities) will arise between participants within the monetary union and with other NCBs. These will probably give rise to settlement transactions which, when occurring between participating NCBs, will in themselves not affect either the size of the ESCB's total monetary base nor the overall value of the earmarked counterpart assets, but will result in changes to the balance sheets of the respective NCBs, and possibly also affect the composition of their earmarked assets. This in turn could affect the calculation of monetary income. Furthermore, it is possible in the context of a single monetary policy that the existence of large intra-ESCB balances, with the corresponding reduction in liquid assets, could also impair the ability of NCBs to influence the liquidity of their respective national banking systems.

### 5.2 Transaction types/participants

Intra-ESCB transactions will take place either between two participating NCBs or between a participating NCB and the ECB. A third category of transaction will arise between monetary union participants and EU-NCBs with a derogation. The types of transaction within these three categories could include:

- settlement of [net] positions between NCBs arising from asymmetric transfers between national RTGS systems over TARGET;
- transfers of banknotes if done for value between NCBs or between an NCB and the ECB;
- pooling and re-distribution of monetary income;
- distribution of the ECB's profits to NCBs;
- transfer of foreign reserve assets to the ECB (in accordance with Article 30 of the Statute).

The above are 'originating' transactions giving rise to intra-ESCB balances. The settlement of these balances (if required and however achieved) and the remuneration, if any, of the balances are in themselves transactions and also need to be accounted for.

### 5.3 Accounting aspects

#### Accounting

The registration in the accounting system of an NCB of the different categories of transactions/participants mentioned in Section 5.2 will, depending on the desired or required level of information, result in a number of separate accounts. For reasons of efficiency the WGAI is strongly in favour of using the TARGET-Interlinking infrastructure as a "vehicle" for the transfer of all the intra-system transactions. This question is part of a recent consultation from the Payment Systems Working Group to the WGAI.

From an institutional viewpoint (i.e. a group of system-related or jointly operating participants) the WGAI would propose to apply the techniques of "intercompany accounting". This means that at the end of the day all bilateral transactions will be taken together in one net claim or liability per participant.

#### Netting/settlement of balances per participant<sup>11</sup>

Balance sheet reporting of bilateral claims and/or liabilities will depend on the way these balances will be treated. Here, a number of policy issues arise, some of which will have accounting implications. The main questions are the following:

- (a) Should the bilateral positions be netted off in one claim or liability against the System in a main settlement account with the ECB and should the ECB and the EU-NCBs with a derogation be excluded from this netting arrangement?
- (b) Should bilateral and/or netted balances be settled regularly and if so how? This may depend on two factors:
  - the size of the net balances. If the flows within the System are such that the net balances are small or tend to reverse over time, there is probably no necessity to settle the balances by an exchange of assets. The size criteria may be different for each category of participants and will need to be developed in conjunction with the monetary policy experts. Among others, consideration should be given to the possibility that an intra-system claim could comprise a substantial proportion of an individual NCB's assets and

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<sup>11</sup> In answer to questions raised in early 1995 from the Payment Systems Working Group regarding the user requirements of the TARGET-Interlinking the WGAI recommended netting of bilateral positions of NCBs on a daily basis, resulting in a net claim or liability of each NCB against the System.

thus limit its scope for operations; and also to other aspects such as quality standards and liquidity characteristics of the settlement assets.

- the implications for the calculation of monetary income of the medium and frequency of settlement positions, with specific reference to the redistribution of monetary income.
- (c) Should such intra-system balances be remunerated or not? This question has some relationship with the foregoing question of netting/settlement. A preliminary conclusion of the WGAI would be that remuneration at a representative level will be necessary. Only under strict conditions of maintaining neutrality with regard to the income positions (monetary income; income of individual NCBs), could remuneration be prevented.

**The WGAI proposes to develop a consultative paper on these issues in co-ordination with the EMI services and all other interested parties in the course of 1996 so as to initiate a wider debate in this area.**

#### **5.4 Pooling and Re-distribution of Monetary Income**

5.4.1 The main accounting issue under this heading is the mechanism by which the pooling and re-distribution will take place. If a series of complex bilateral transactions is to be avoided, monetary income should be simultaneously pooled and reallocated via each NCB's main settlement account with the ECB (clearing).

5.4.2 There are also some subsidiary (non-accounting) issues related to the distribution of monetary income which will need to be addressed in conjunction with other Sub-Committees and Working Groups. They include:

Timing of reallocation - according to Article 32.1, allocation of monetary income shall take place at the end of each year, but since end-year financial accounts take time to produce, the actual transactions finally settling the income distribution will not occur until sometime after the year-end.

Payover to Governments - under present arrangements, the frequency of payover of "monetary income" (i.e seignorage) to governments varies considerably amongst NCBs. It is for consideration whether a harmonised approach is necessary and, if so, what it should be and whether NCBs should make payments on account of anticipated "profits", pending the final allocation of monetary income. It may be arguable that an ex ante distribution of profits to the government would not be permitted under the Treaty, as this could be construed as providing a direct loan to the government. The question, however, of when profits actually belong to an

NCB (and hence can be distributed to government) is primarily a legal matter on which the Working Group of Legal Experts should be consulted.



## CHAPTER 6: METHOD FOR CALCULATING MONETARY INCOME

### SUMMARY

- a) The Working Group has examined several variants of the Article 32.2 (direct) method for the calculation of monetary income. From an accounting perspective all are feasible. However, the Group recognises that the equity of any particular direct method of calculation depends upon how assets backing the monetary base are chosen - i.e. on earmarking. The practicality of direct methods depends upon the feasibility of controls on asset earmarking. This issue needs to be resolved for a direct method to be implemented.
- b) The issues concerning the acceptability or otherwise of earmarking guidelines are primarily not ones for the WGAI but for the Monetary Policy and Foreign Exchange Sub-Committees as they are closely related to the degree of control that might be required on the daily operations of individual national central banks.
- c) If no acceptable guidelines for earmarking assets can be agreed upon then a direct method of calculating monetary income will not be feasible. The WGAI intends to look at alternative methods which would be permitted in any event under Article 32.3 of the Treaty (at least for the first five years in case the balance sheet structures of the individual NCBs at the start of Stage Three do not permit the application of Article 32.2).
- d) Subject to the guidance of the Council, the WGAI proposes to continue working on specific aspects of monetary income listed in Section 6.7 below in conjunction with other SCWGs and the EMI Services.

### 6.1 Frame of reference

Article 32 of the ESCB Statute constitutes the frame of reference for addressing the determination and distribution of monetary income. It should be noted that any method of calculation of monetary income is closely linked and interdependent with several other key policy issues including the design of the overall monetary policy framework and the accounting principles to be used.

The purpose of developing an accounting technique for the calculation is to ensure that the income arising from the performance of the ESCB's monetary policy is calculated for distribution among the participating NCBs at the end of each financial year. Article 32.2 of the Statute defines monetary income for each NCB as being "*equal to its annual income derived from its assets held against notes in circulation and deposit liabilities to credit institutions*". However, Article 32.2 does not give any explicit guidance on how annual income should be derived from counterpart assets held against these monetary liabilities and according to which technique it should be calculated. It is the task of the WGAI to translate this Article into a practical and usable method, acceptable to all parties concerned.

This chapter gives an overview of possible methods for calculating monetary income which, subject to legal opinion, would comply with Article 32.2. Reference is also made to the alternative methods which could be used in accordance with Article 32.3.

## **6.2 Legal basis**

6.2.1 Monetary income is defined in Article 32.1 as “*the income accruing to the national central banks in the performance of the ECB’s monetary policy function*” As defined in Chapter IV of the Statute, the “monetary functions” include both domestic and foreign exchange operations. It can be said that this Article provides a generic definition of monetary income. However Article 32.2 restricts the definition of monetary income to that income derived from assets matching the monetary liabilities mentioned in Article 32.2. Thus, to the extent that monetary policy operations are performed using assets backing other liabilities, e.g. government and non-bank deposits, the income on these would be excluded. Similarly, where monetary policy operations affect the liability side, e.g. through the use of central bank paper, the income effects would also be excluded from monetary income as such liabilities do not form part of the monetary base as defined in Article 32.2. It is not clear to the Working Group if in drafting the Treaty this situation was taken into account<sup>12</sup>. This issue has significant implications for the method of calculating monetary income, and is another practical reason for the Group examining several possible methods.

To cope with the problem of having monetary policy operations being performed by balance sheet assets and liabilities which do not come within the strict definition of Article 32.2 it is possible to consider extending the items included in the calculation beyond the literal provision of Article 32.2. Such an approach would however appear to require amendment of the Statute.

6.2.2 Article 32.3 of the statute contains a provision for another method to be adopted, for up to 5 years, but only if, in the opinion of the ECB Council, the balance sheets of the NCBs do not permit a method in accordance with Article 32.2 to be used. The problem identified in Section 6.2.1 may be justification for using this provision in the initial years of the system<sup>13</sup>.

## **6.3 Definition of income**

The concept of income - in the context of monetary income - has not been defined in Article 32. From an accounting point of view, the Working Group has defined income as all income and

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<sup>12</sup> The same applies to intra-system balances (see Chapter 5) and to accounting related liabilities (e.g. revaluation accounts and accrued income).

<sup>13</sup> However, the papers produced in 1991 when the Statute was drafted implied that in such circumstances a benchmark or notional rate applied on an ex post basis to the monetary liabilities would be used to calculate each NCB’s monetary income.

expenditure resulting from the holding of financial assets. By this we mean that, in addition to interest income, the term income is also considered to comprise amortisation of premium and discount on securities and any profits and losses resulting from changes in both price and exchange rate valuation (subject of course to the accounting principles chosen).

Within this framework, the Council will have to take a decision about the treatment of unusual or infrequent costs or losses as to whether they should be shared. There are two methods possible under the Treaty. Such items (for example credit risk losses) could be regarded as being within the definition of monetary income, or alternatively using Article 32.4<sup>14</sup>, be treated as exceptional items to be offset against monetary income. The Monetary Policy Sub-Committee has recently made some proposals on this subject. The WGAI is aware that there may be other such special items which are under discussion by other groups of experts. In the view of the Working Group, income should not include the costs incurred by the NCBs in performing their functions, such as staff costs and overheads.

*As some elements of income which may be included in the definition of monetary income are under discussion by other experts, it is suggested that the establishment of a definition of monetary income be co-ordinated by EMI Services.*

#### **6.4 Prerequisites for any method under Article 32.2**

The WGAI considers that the calculation of monetary income in accordance with Article 32.2 demands a number of features which must be part of any method used. They are as follows:

- (i) Harmonised accounting rules and procedures should be adopted so as to ensure sufficient, necessary and homogeneous collection of the data needed to recognise what is to be defined as monetary income;
- (ii) The method should be fair, controllable and as simple and transparent as possible to understand and implement and, if considered appropriate, verify (This prerequisite would also apply to any alternative method adopted under Article 32.3);
- (iii) It should comply with (the spirit of) Article 32.2 of the ESCB Statute according to which monetary income shall be equal to the annual income derived from assets held against notes in circulation and deposit liabilities to credit institutions;
- (iv) Minimum standards must be developed for the earmarking of those assets from which monetary income is derived. These should specify (a) what types of categories or classes of asset may be

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<sup>14</sup> Article 32.4 states “The amount of each national central bank’s monetary income shall be reduced by an amount equivalent to any interest paid by that central bank on its deposit liabilities to credit institutions in accordance with Article 19. The Governing Council may decide that national central banks shall be indemnified against costs incurred in connection with the issue of bank notes or in exceptional circumstances for specific losses arising from monetary policy operations undertaken for the ESCB. Indemnification shall be in a form deemed appropriate in the judgement of the Governing Council; these amounts may be offset against the national central banks’ monetary income”.

- earmarked; (b) a preferential order of earmarking if there is a choice between several categories and possibly (c) limits on the proportions in which certain types of assets are held;
- (v) Earmarkable assets from which the monetary income is derived must always be at least equal to or greater than the monetary base and this requires the establishment of specific rules of procedure for earmarking additional assets to make up short- falls.

## 6.5 Methods of Calculation<sup>15</sup>

In the first place, monetary income will have to be determined on the basis of the principle set out in Article 32.2. This Article provides for the so-called **direct method**, which calls for a specific definition of the monetary base (i.e. banknotes in circulation and deposit to liabilities to credit institutions) and for the appurtenant earmarked assets to be held against the aforementioned monetary base; this means that a periodic balance between these assets and liabilities has to be struck. The manner and frequency in which this balance has to be struck is not specified. Since these monetary liabilities and the earmarked assets are both subject to continual change on an asymmetric basis, striking a continual balance between the two may be complex from an accounting and operational point of view. For this reason the Working Group is investigating methods which, although perhaps less strict in their compliance with the letter of Article 32.2, would be in line with its spirit. Any method eligible under Article 32.2 should meet the prerequisites listed in the previous section.

*In consequence of the foregoing, the Working Group has initiated discussion on four methods of calculation, based on Article 32.2.*

### (a) Dedicated portfolio method

This method is the one most closely in line with the literal text of the Article. The method implies that a balance is struck periodically, possibly daily, between the monetary base and the appurtenant earmarked assets. The method employs a (so-called) “dedicated portfolio” which must have been established for each individual national central bank at the start of Stage Three.

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<sup>15</sup> This report refers to methods of calculation by different titles than those used in the EMI note to the Committee of Alternates on “Issues related to the determination of the ESCB’s monetary income” dated 30th November 1995. For ease of reference they broadly correspond to one another along the following basis:

<b>WGAI Report</b>	<b>EMI Note</b>
a) Dedicated portfolio method.....	Direct method
b) Average method.....	Ex post earmarking
c) Proportional method - VARIANT A.....	Semi-Direct method
d) Proportional method - VARIANT B.....	Semi-Direct method
e) Alternative method - (Article 32.3).....	Indirect method

The WGAI considers methods a) to d) above to comply with the spirit of Article 32.2 while the EMI note suggests that only the dedicated portfolio method is strictly consistent with the definition of Article 32.2.

This would imply the division of NCBs' balance sheet items into two components- one part from which monetary income is derived and the other which is for the account of the individual NCB. (It should be emphasised that such a division would be done in notional terms solely for the purpose of this Article and would have no legal implications for the ownership of NCBs' assets and liabilities). Moreover - for each individual national central bank - additional assets must be defined in case the dedicated portfolio needs to be expanded. Striking this balance has a consequence that some assets must be periodically earmarked or disearmarked.

In order to minimise operational difficulties, the method actually developed by the Working Group is oriented towards a less frequent realignment of earmarked asset and monetary liability items. From the perspective of the WGAI it is necessary that some specific techniques are adopted to take into account the effect of disequilibrium which can arise during the year between earmarked assets and monetary liabilities and the corresponding effects on the calculation of monetary income. In particular:

1. During the year an imbalance can be accepted between the monetary liabilities and the (initially) equal amount of total earmarked assets. It can be treated as a type of intra company balance (maintained in a separate adjustment account) and accurately calculated on the basis of daily accounting data. The size of the imbalance would have to be determined but should not be large relative to the monetary base.
2. A suitable interest rate is to be chosen for the calculation of the economic impact produced by the aforementioned imbalance and this income (positive or negative) is to be included in the calculation of monetary income.

**(b) Average method<sup>16</sup>**

This is an ex post earmarking method which requires the hierarchical ranking of the various classes of earmarkable assets<sup>17</sup>. The averages for both the monetary base and the classes of assets are calculated at the end of each financial year. Then the earmarking of the classes of assets is made in accordance with the hierarchical ranking.

The calculation of the monetary income is based on matching the monetary base against the afore-mentioned classes of assets (following a given ranking order) in order to achieve the balance between the two parts; the income generated by the matching assets is considered monetary income.

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<sup>16</sup> It is the opinion of the WGAI that methods b), c) and d) are within the spirit of Article 32.2 as all of them are based on a correspondence between the monetary base and a set of matching assets in order to calculate the monetary income produced by these assets. If, however, the legal experts disagree with this interpretation then it is possible that these methods could be available for use under Article 32.3.

**(c) Proportional method - VARIANT A<sup>16</sup>**

This is another ex post earmarking method which requires taking the ratio of the monetary base to the earmarkable assets<sup>17</sup> and applying this ratio to the whole of the income arising on the earmarkable assets to give the monetary income. The ratio would be calculated using averages for the monetary base and earmarkable assets.

The difference compared with method (b) is that here (proportional method - Variant A) a proportional part of total income arising on the earmarkable assets is considered monetary income whereas method (b) considers monetary income as the income produced by each class of assets matching the monetary base according to a given ranking order.

**(d) Proportional method (with strata) - VARIANT B<sup>16</sup>**

The basis of this method of calculation is the average figure of the monetary base and the average figures for the various classes of earmarkable assets<sup>17</sup>. A fixed percentage in relation to the monetary base (to be predetermined by the ECB Council) should be allocated to every class of earmarkable assets with the same percentages being applied for all NCBs.

The income resulting from each asset class has to be separated in the same proportion as its underlying “earmarked” asset to the total of this asset class. This (separated) income is to be pooled.

To overcome the possibility that an NCB may on occasion have insufficient amounts of specific classes of assets available a hierarchical structure would have to be set up (at the outset) in order to substitute one asset class for another. Furthermore, if a substantial change in monetary policy occurs, then fixed proportions of earmarked assets would have to be adjusted throughout the system. Accordingly a prerequisite for this method is the existence of harmonised balance sheet structures of the individual NCBs.

The difference compared with method (b) is that here (method d) a fixed proportion in relation to the monetary base of each NCB is used to calculate the amount of the earmarked part of every class of “earmarkable” assets, whereas method (b) follows a hierarchical ranking order to establish the asset categories matching the monetary base.

**(e) Alternative method - (Article 32.3 of the ESCB/ECB Statute)**

The Treaty allows for the possibility of using an alternative method under Article 32.3 on a transitional basis for a maximum period of five years, if the balance-sheet structures of the individual NCBs do not permit the application of one of the methods complying with Article 32.2. As Article 32.3 is subject to the simplified amendment procedure provided for by Article

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<sup>17</sup> Non interest bearing assets (e.g. gold) could be included in the earmarkable assets in accordance with a generally accepted ratio (e.g. the key for capital subscription to the ECB).

41, it could be possible to adopt this procedure to extend the afore-mentioned five year period or even to adopt the method on a permanent basis. As far as the technical features of such a method are concerned, a possible approach (to be further investigated) would be to determine ex post the average amount of the monetary base on an annual basis and apply to this a benchmark interest rate to be set up by the Governing Council of the ECB. The resulting income would then be allocated to the pool as monetary income.

In 1991 when analysing the practical implementation of Article 32.2, the Economic Unit of the Committee of Governors conducted a study<sup>18</sup> of the balance sheet structures of the national central banks. The study showed that these structures differed substantially. Recently, the EMI conducted a similar study, focusing on the situation as at the end of 1994. Preliminary indications suggest that there remained substantial differences in balance sheet structures. Consequently, this might suggest that an alternative method might have to be prepared in case at the start of Stage Three, insurmountable difficulties still exist with the implementation of Article 32.2. Nevertheless, the practical implementation of the direct method (s) per Article 32.2 would still have to be fully examined.

## **6.6 Accounting issues related to different methods of calculating monetary income**

Irrespective of the decision to be taken as to the accounting method to be used, the calculation of monetary income by a method under Article 32.2 is a technically complex matter, not only in terms of control due to the fact that both assets and liabilities will be marked by continual changes, owing in part to discretionary acts (e.g. portfolio management) and in part to movements in market prices (both price and exchange rate). The resulting entries would necessitate a continual search for a new balance between the monetary base and the appurtenant assets, for the purpose of calculating monetary income.

Furthermore, the assets matching the monetary base may only be part of a portfolio of assets used in monetary policy operations. The problem is to calculate the appropriate element of the income that should be pooled since any class of assets (e.g. repos) used in operations could be said to be financed partly by the monetary base and partly by other liabilities. Finally the issue of risk sharing in implementing monetary policy must be borne in mind since losses from certain risk assets could be shared while losses on other risk assets may be for the account of individual national central banks. **The issue of the assets to be earmarked is inextricably linked to the method of calculating monetary income and must be resolved before coming to a final conclusion on the method of calculation**<sup>19</sup>. The aforementioned EMI note suggests

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<sup>18</sup> The Direct Method of Income Allocation - Report of the Economic Unit to the Committee of Governors, 18th December 1991

<sup>19</sup> The issues involved in earmarking, and in the whole of monetary income, include the degree of risk sharing that should exist within the ESCB, moral hazard problems arising from the implementation of monetary policy

ways of how to address these matters within an overall framework for the preparation of the ESCB.

The successful implementation of any method in accordance with Article 32.2 needs to consider a number of other accounting issues at a detailed level including those listed below. The WGAI has considered these and believes they can be practically resolved.

- (i) Positive and negative valuation differences;
- (ii) Realisation of valuation differences arising from transactions;
- (iii) Income generated by coupon payments, i.e. income on income; accrued income/discount instruments;
- (iv) Transactions between national central banks and the ECB; Transactions between national central banks; Transactions between national central banks and third parties (see also Chapter 5).

## **6.7 Conclusion**

6.7.1 The Working Group on Accounting Issues will continue to work on the development of all of the aforementioned models, in close relationship with other Sub-Committees and Working Groups and the EMI Services.

This work will involve:

- a) Criteria for the selection of earmarkable assets and their practical implementation
- b) Definition of the concept of monetary income;
- c) Accounting guidelines for the implementation of a method in accordance with Article 32.2.
- d) Examination of the possibility of extending the definition of the monetary base against which assets have to be earmarked.

6.7.2 In the opinion of the Working Group the goal to be achieved by end 1996 would be for all interested SCWGs, with the EMI Services providing the required co-ordination, to be in a position to make a definite proposal as to a preferred method of calculation in line with Article 32.2 and an alternative method in line with Article 32.3 for use if required at the Start of Stage Three. It is fully respected that such an approach should not preclude the ECB Council from choosing from a range of methods in 1998. Rather its intent is to ensure that there is a focus on the development of a co-ordinated work programme during 1996 to ensure that all aspects of this complex matter are addressed.

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operations in a decentralised way and, in particular, loss sharing from specific events such as counterparty failure and 'lender of last resort' activities. These issues are fundamental to the workings of the single monetary policy and are outside the mandate of the WGAI.



## **CHAPTER 7: TRANSITIONAL ISSUES ON THE COMMENCEMENT OF THE ESCB**

### **7.1 Scope**

The Working Group have identified the following significant accounting issues relating to the transition to the ESCB which it proposes to further develop in a consultative paper in the second half of 1996.

- (i) Valuation of assets;
- (ii) Provisions and reserves;
- (iii) Prior losses.

### **7.2 Background**

On the commencement of monetary union, the various accounting provisions start to apply,<sup>20</sup> in particular the requirement to produce System balance sheets and with it the need to:

- (i) decide what assets and liabilities are within the System;
- (ii) have harmonised accounting policies for the purposes of preparing the balance sheets.

The monetary income provisions will also come into force. Their impact will depend on what method of calculation is adopted and particularly whether or not the alternative (Article 32.3) method is to be used. These requirements apply from day 1 of Stage Three, and are not dependent on the actual speed of introduction of the single currency.

### **7.3 Valuation of assets**

7.3.1 The first issue is the value at which assets are stated at day one (i.e. midnight on the day the System begins). This affects two areas, namely the drawing up of the System balance sheets and the monetary income. The value affects the monetary income in two ways:-

- (i) the actual earmarking of assets to match the monetary base. The lower the valuation the more assets will be earmarked and hence the greater the income to be pooled and the greater the buffer to absorb possible losses;

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<sup>20</sup> All NCBS' balance sheets will be prepared in the single currency in line with the agreed changeover scenario. Even though the majority of NCBS' assets and liabilities will be initially principally denominated in the national currencies it is considered to be a relatively simple accounting exercise to denominate accounts in the single currency.

- (ii) the quantum of the gains and losses of the earmarked assets that will be taken as monetary income. If assets are “transferred” other than at market price, the gain or loss on subsequent realisation (which all falls to be shared amongst the System) will include an element of pre-system gain or loss, which belongs, in an economic sense, to the individual NCB (and the citizens of that country).

There are basically three options:

- (a) each NCB uses its own existing valuation method;
- (b) assets are valued at the same fixed price(s) across the system.
- (c) assets are valued at a market based/related price, if available and reliable;

It should be noted that the starting value becomes ‘cost’ for the purposes of calculating gains and losses after the System is in operation.

7.3.2 There are a number of disadvantages associated with option (a):

- (i) There are different methods currently employed by NCBs and their use would result in the same type of asset being stated at a variety of values;
- (ii) Even for NCBs using the same policy, the actual values will differ depending on when the assets were bought. These differences are the consequences of NCB’s actions and policies prior to monetary union and thus the resulting differences would have to be borne by that NCB;
- (iii) Any mandatory “transfer” of hidden reserves (see chapter 3.3.3) would need to be done according to stated criteria of fairness across NCBs, e.g. according to the capital key. Given the different size of hidden reserves across different types of assets and across NCBs, achieving such fairness could be difficult;
- (iv) The point mentioned under 7.3.1(ii) is also a disadvantage, namely that pre union gains (and losses) belong to the individual NCB (and the citizens of that country) in their entirety and should not be available to be shared with other countries.

7.3.3 The disadvantages of option (a) might lead towards the use of fixed prices across the System (i.e. option (b) above) assuming such (fixed) prices could be agreed for the various asset categories being transferred into the System. If this fixed price is at other than market price then the disadvantages (iii) and (iv) of option (a) above will again arise, in that part of pre-union gains and losses would be available for pooling post-system.

7.3.4 These disadvantages would tend to push the argument in favour of a transition based on market price and current exchange rates (i.e. option c). If the initial valuation is based on the market

price, all hidden reserves accumulated in the past would have to be revealed or shown in the NCBs' balance sheets as "open" reserves (revaluation account). In line with the proposed ongoing valuation method two revaluation accounts may exist - one for pre-System revaluation gains of the NCB and one for System revaluation gains starting with nil at day one of Stage Three. However, the disclosure of pre-System hidden reserves might be seen by some NCBs as undesirable or problematic.

7.3.5 In arriving at the "market price" to be used under option (c) it may be necessary to avoid the future results of the System being unduly influenced by the short term vagaries of the market<sup>21</sup>. In precisely defining market prices for each category of assets and liabilities in the lead up to day one of Stage Three it must be recognised that the use of spot rates could lead to distortions. It is possible that an average price over an agreed period should be adopted. The 'averaging' period could be consistent with that used for the locking of exchange rates. The use of the average over a period also reduces the scope for influencing the market values purely to benefit from the transition of assets and liabilities into the ESCB. *This is one of the major issues which must be addressed shortly before the commencement of Stage Three, at which time consideration should be given to the link with the ongoing valuation method.*

#### **7.4 Provisions and Reserves** (in their accounting sense)

At its outset the System will have no reserves as, while the Treaty refers to a range of assets and liabilities being part of the System, no reference is made to NCBs' reserves being part of the System. The only reserves that clearly will be within the System are those of the ECB itself; these will need to be built up over time from a zero base. It is conceivable that monetary income in the early years could be negative depending, inter alia, on the level of foreign exchange assets that are earmarked and on the income recognition criteria being adopted. The absence in the early years of system reserves to offset these losses could give rise to presentational and technical problems which will need further examination. In addition it is even more likely that the ECB may make losses due to its holdings of foreign exchange, which will have to be absorbed by NCBs within the System (i.e. offsetting against monetary income).

NCBs could of course build up an initial provision for general banking risks at day one which could be seen as a buffer for possible future losses caused by the transitional valuation of assets at market prices.

#### **7.5 Prior Losses**

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<sup>21</sup> See also Annex 3 with respect to the valuation of gold and other illiquid assets.

7.5.1 The need for an adequate buffer in the form of provisions/reserves could already become a pressing issue on day one of Stage Three for those NCBs which, owing to a possible devaluation of balance sheet items in the transition to Stage Three or owing to other prior losses, have to show a net capitalised loss in the balance sheet. This might be considered as a non-permissible form of Government financing under Article 104 of the ESCB Statute. Moreover a negative amount of equity (i.e. capital and reserves) of an NCB could lead to a shortage of earmarkable assets. Furthermore, capitalised losses of an NCB would appear to pose an impediment to the required financial independence of that NCB as a participant in the System. *For this reason, the WGAI is of the opinion that the System has a need for a (prudent) regulation to safeguard capital adequacy in the sense that the distribution of profit to the government should not be resumed before the capitalised losses have been offset. Such a regulation would have no bearing on the observations made in the previous paragraph about the accumulation of a further buffer of provisions/reserves.*

## CHAPTER 8: FUTURE WORK PROGRAMME

### 8.1 Work Schedule

8.1.1 *It must be noted that the chosen accounting principles and techniques must take effect from day one of Stage Three of EMU. For the ECB they must take effect from the date of its establishment which will have to be some time earlier.*

There are a number of tasks which still have to be completed before the Working Group has completed its mandate. It is the aim of the Group to have the bulk of these matters addressed by the end of 1996 which, for reasons given below, is the effective deadline. A work programme for dealing with them is outlined in Annex 5. (This programme does not include consultations from other Sub-Committees and Working Groups which can be expected to arise during the period). It is the intention of the Group to input this programme into the EMI's Master Plan.

8.1.2 It should also be noted that the EMI is legally required "*at the latest by 31st December 1996 to specify the regulatory, organisational and logistical framework necessary for the ESCB to perform its tasks in the third stage. This framework shall be submitted by the Council of the EMI for decision to the ECB at the date of its establishment*". [Article 109 (f) of the ESCB Statute].

This article specifically requires the EMI to "*prepare the rules for operations to be undertaken by the national central banks in the framework of the ESCB*". ***Given that the development of accounting principles are a fundamental element of this framework, it seems imperative that decisions be taken on the basic accounting principles at an early stage.*** The consequence of not arriving at an early decision on the most basic accounting principles will require the Working Group to maintain a range of possible options in developing the more detailed accounting principles and techniques.

### 8.2 Implementation lead times

8.2.1 The EMI's Master Plan is built on the implicit assumption that, after the final deliberation by the EMI Council on the issues listed therein, there will remain enough time for implementing the specific elements of preparatory work prior to the start of Stage Three.

The key factor determining the precise implementation time will be the method of calculating monetary income. The methods that are in line with the strict requirements of Article 32.2, will require a more extensive accounting information system to provide the necessary data and thus imply a longer implementation time. (It has been noted elsewhere in this paper that further investigative work on an acceptable method will continue during 1996.) It has been estimated

that this implementation lead time could be up to two years for some NCBs. Accordingly, it is the intention of the WGAI to return to the Council in December 1996 when further development, particularly with regard to the calculation of monetary income, should have been resolved. However, in the event that there is not sufficient time (before the start of Stage Three) to implement the Group's proposals in full then interim procedures could be required and adopted if necessary.

#### 8.2.2 Synchronisation with the work programme of the other Sub-Committees and Working Groups

The detailed development of the Working Group's recommendations will require a significant amount of close consultation and synchronisation with other Sub-Committees and Working Groups. It will be necessary to indicate at the earliest practical date a statement of requirements so that work can commence on the basic data essential for the start-up of operations of the ESCB. The Working Group on Accounting Issues proposes to initiate contact with most SCWGs during 1996 to give at least an indicative outline of the required accounting information which will serve as an input to the work of these Groups.

**CLASSIFICATION OF AN NCB'S BALANCE SHEET  
BETWEEN "SYSTEM" AND "NON-SYSTEM" ACTIVITIES**

While the Treaty clearly envisages that not all of each NCB's assets and liabilities will be part of the ESCB system (Article 26.3 for example) the division between 'system' and 'non-system' is not defined. Accordingly for the purpose of its work in developing accounting principles for each balance sheet item the WGAI has developed a *working hypothesis*.

The basis of this hypothesis is Chapter IV of the Protocol which specifies the functions and operations of the ESCB. These operations include open market and credit operations and other instruments of monetary control. Consequently the working hypothesis employed is that all assets and liabilities used for such operations and functions should be within the system.

Thus **the system may include:**

**Assets**

Loans and advances (including repos and inter-NCB/ECB A/Cs)

Securities (domestic and foreign)

Foreign Exchange assets other than securities

IMF position

Other assets used in market operations

Gold

**Liabilities**

Notes in circulation (or equivalent)

EU Bank deposits

Balances with other NCBs/ECB

Government Deposits - (Not a specified monetary liability per Article 32.2 but could be part of monetary operations and be in the System)

Central Bank paper issued

System-related provisions and reserves

**The following items are not considered part of the system:**

Capital and reserves

Fixed tangible assets

Fixed intangible assets

Participating interests (e.g. BIS and ECB shareholding)

Coins

Miscellaneous investments

Pension provisions (and matching assets)

Other provisions

**NOTE: This is a preliminary and inexhaustive list and has been developed solely to aid the Group's work.**



## ACCOUNTING POLICY ISSUES RELATING TO ASSET VALUATION AND INCOME RECOGNITION

### 1 Scope

1.1 The purpose of this annex is to give a more comprehensive outline of the arguments raised by the Working Group in deciding the basic balance sheet valuation and income recognition philosophy.

1.2 The central issues can be stated simply as:-

***Valuation:***

(i) *Are assets (and liabilities) to be stated in the balance sheet on the basis of market prices (and exchange rates) or on the basis of the lower of cost or market value?*

***Recognition of income:***

(ii) *How should gains and losses [both price and exchange rate] arising from the chosen method of valuation be treated for the purposes of income recognition?*

By **income recognition** accountants are referring to the process of incorporating an income item into the financial statements when it can be measured reliably. The process, to be enacted in accordance with the basic assumptions of transparency, prudence, reflection of economic reality and consistency, require decisions to be made both on the timing of recognition of income and expense and the presentation of the results in the financial accounts. It is important to bear in mind that these decisions have to be taken in conjunction with how assets (and liabilities) are to be valued in the balance sheet. Neither decision on asset valuation nor on income recognition can be made in isolation - the effect of one has an impact on the other and on the overall presentation of financial statements.

There is a divergence of views within the Working Group on the most appropriate asset valuation and income recognition policies, and because of that the WGAI has developed different scenarios as there exists a range of possibilities.<sup>22</sup> The advantages and disadvantages of these scenarios are analysed in greater detail in Section 3.

1.3 The primary factors which underlie the attitude of central banks towards these issues are:

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<sup>22</sup> It is important to recognise that there is no standard accounting practice across member countries of the EU.

- (i) **Balance Sheet:** Central Banks are not in a position to hedge their foreign exchange exposure since they (generally) bear the ultimate exposure for their own currencies.
- (ii) **Profit and Loss Account:** The asymmetric treatment of profits and losses with respect to the ultimate recipients i.e. Governments. Profits can be paid out as dividends but there is usually no corresponding reverse treatment for losses.

The first factor means that exchange rate exposure<sup>23</sup> exists between the assets and liabilities side of the balance sheet, as a central bank is not able to cover its exposure. The potential gains and losses due to exchange rate fluctuations can be very significant in relation to central bank's balance sheets and profit and loss accounts. Indeed the effects of exchange rate movements may exceed other profit and loss items such as income from investments. To the extent that a central bank backs its monetary base by foreign exchange assets exchange rate effects feed into the monetary income calculation. The second factor tends to lead towards an asymmetric treatment of capital gains and losses (including foreign exchange).

#### 1.4 Impact on Monetary Income

From a monetary income perspective the main accounting requirement is to assist in the development of a method of calculating monetary income and also to measure what is defined as income. *It is primarily for the monetary policy experts to make proposals, following analysis as to what risks and rewards should be shared by member central banks of the ESCB in the implementation of the single monetary policy and consequently what should be included in the calculation of monetary income.* Whatever income or expenses derives from such (pooled) risks will be measured on a harmonised basis by the accounting functions of each participating central bank in accordance with the WGAI recommendations (the central ones being those referred to in Section 1.2 above).

## 2 EMI Accounting Policies<sup>24</sup>

**For the EMI** the WGAI recommended a compromise between the two alternative basic principles noted above, in that:

- (a) Assets and liabilities were valued at market rates rather than cost, in line with the mark-to market principle, but;

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<sup>23</sup> It should be noted that off balance instruments can be used to manage exchange rate exposure.

<sup>24</sup> Proposal for an Accounting Method for the European Monetary Institute - Report of the WGAI to the Committee of Governors in July 1993.

- (b) Valuation (unrealised) gains were not treated as income but were transferred directly to a revaluation account, shown on the liabilities side.
- (c) Valuation (unrealised) losses were offset against previous years' revaluation gains with the remainder being taken to the Profit and Loss Account (EMI Scenarios I and II) but reversed in subsequent years if unrealised gains were made up to the purchase price (only EMI scenario II). This approach did not cause problems for the EMI as it is not a central bank and does not have open foreign exchange positions (it really only operates in DEM and ECU).

The Committee of Governors decided to accept Scenario II. The Committee noted at the time that this decision has no binding character for the decision to be made with respect to the ESCB.

### **3 Alternative Valuation and Income recognition scenarios**

The Working Group has undertaken a broad review of the various possibilities. The following is an inexhaustive range of scenarios for balance sheet valuation and income recognition.

	<b><u>Valuation</u></b>	<b><u>Recognition of Income</u></b>
<b>Scenario I</b>	Lower of cost or market value [with an exception - for foreign exchange reserves which are to be valued at the lowest historical rate]	- realised gains and (all) losses to the profit and loss account - unrealised (valuation) gains are not recognised at all; - unrealised losses to the profit and loss account;
<b>Scenario II</b>	Lower of cost or market value	Idem I
<b>Scenario III</b>	Market value	- realised gains and (all) losses to the profit and loss account - unrealised (valuation) gains are not recognised as income but transferred directly to a revaluation account; - unrealised (valuation) losses are taken to the profit and loss account, when exceeding previous revaluation gains registered in the revaluation

		account.
		- unrealised losses are not reversed in subsequent years against unrealised gains.
<b>Scenario IV<sup>25</sup></b>	Market value	- Idem III: however, the unrealised losses mentioned in Scenario III will be reversed in subsequent years if unrealised gains are made up to the purchase price
<b>Scenario V</b>	Market Value	- Idem IV for price gains and losses - For exchange rate gains and losses <ul style="list-style-type: none"><li>• No distinction is made between realised and unrealised gains and losses;</li><li>• All gains are transferred directly to a revaluation account;</li><li>• All losses are offset against the revaluation account</li><li>• The profit and loss account is affected by losses to avoid a debit balance on the (exchange rate) revaluation account</li></ul>
<b>Scenario VI</b>	Market value	- All realised and unrealised gains and losses to the profit and loss account; - Only unrealised gains are subsequently transferred to a revaluation account; - Subsequent realised and unrealised losses are offset against the revaluation account; - The profit and loss account is affected by losses to avoid a debit balance on the revaluation account

**NOTE:** *For all of the above scenarios it is understood that price and exchange rate effects are recorded separately and that (where applicable) separate revaluation accounts would be established for both items. Furthermore it is understood that there would be no offsetting between these two sets of revaluation accounts.*

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<sup>25</sup> This scenario was chosen for the EMI by the Committee of Governors

#### **4. Main Characteristics of the Scenarios**

##### **Scenario I**

- |                    |   |   |
|--------------------|---|---|
| Valuation          | - | Most conservative scenario due to the treatment of foreign exchange reserves  |
|                    | - | Leads to the creation of hidden reserves  |
| Income recognition | - | Most cautious   |
| Presentation       | - | Less transparency in the balance sheet and profit and loss account due to the use of historical cost figures (though market values can be disclosed in the notes to the accounts) |

##### **Scenario II**

- |                    |   |   |
|--------------------|---|---|
| Valuation          | - | Conservative<br>Leads to the creation of hidden reserves  |
| Income recognition | - | Conservative  |
| Presentation       | - | Less transparency in the balance sheet and profit and loss account due to the use of historical cost figures (though market values can be disclosed in the notes to the accounts) |

##### **Scenario III**

- |                    |   |  |
|--------------------|---|--|
| Valuation          | - | Recognise current (market) values<br>Reflects realisable values  |
| Income recognition | - | Conservative<br>Has the same effect on income as Scenario 2  |
| Presentation       | - | Transparent in the balance sheet but not in the profit and loss account.<br>Avoids any suggestion that unrealised gains may be distributable by by-passing the profit and loss account |

**Scenario IV**

- Valuation - Recognise current (market) values  
Reflects realisable values
- Income recognition - Less conservative than scenarios I - III  
due to the offsetting of unrealised losses  
against future unrealised gains
- Presentation - Transparent in the balance sheet but not in the profit and loss  
account.  
Avoids any suggestion that unrealised (valuation) gains may be  
distributable by by-passing the profit and loss account

**Scenario V**

- Valuation - Recognise current (market) values  
Reflects realisable values
- Income Recognition - Conservative because all exchange rate gains (realised and  
unrealised) are transferred directly into a revaluation account  
but less conservative compared to Scenario IV since all  
exchange rate losses can be offset against unrealised gains
- Presentation - Less transparent since realised gains do not go through the  
profit and loss but direct to the revaluation account;  
- the revaluation account also contains realised gains  
Avoids any suggestion that unrealised (valuation) gains may be  
distributable by by-passing the profit and loss account

**Scenario VI**

- Valuation - Recognises current (market) values  
Reflects realisable values. Effectively treats all gains as realised
- Income recognition - Less conservative (compared to scenario IV) since all losses can  
be offset against unrealised gains.  
- This scenario can be made more conservative through transfers  
to reserves and provisions

Presentation - Most transparent in the balance sheet and the profit and loss account since all gains and losses go through the profit and loss account

### **TREATMENT OF GOLD (AND OTHER ILLIQUID ASSETS)<sup>26</sup>**

The existing policies within the central banks with regard to gold, as summarised in the Inventory of Accounting Methods of January 1993<sup>27</sup>, show different valuation bases applied by the national central banks, ranging from cost price up to market price. Several central banks take an average price over a certain period, sometimes combined with a fixed discount percentage, while the extremes; lowest historical cost and full market price, are used by some national central banks. In any event it should be noted that unrealised revaluation gains are not paid out as profit by any national central bank.

In developing appropriate valuation principles there appears to be a specific problem related to the use of full market values for certain asset types. It can be argued that for certain asset types that the “realism” in applying a quoted market price at a given reporting date may be rather “illusory” in the sense that market price may not be remotely realisable. This principally arises due to either the illiquidity of the particular market for that asset or else the market share of the asset type being so large that almost every major transaction by an NCB is capable of influencing the latest market price. With the latter case an additional distorting factor is generated when trading by a central bank in a particular type of asset (regardless of the size of the trade) could be viewed by other market participants as indicative of which direction the “authorities” wish the market to move.

From an operational point of view it may be appropriate to restrict the use of below market prices to (pre-defined) asset types, the holdings of which are held for the long term, e.g. gold. While at times these valuations may yield what might be considered as too much conservatism in valuation policies and it can also be argued that the principle of transparency is violated, this should not be viewed as a means of creating hidden reserves, but rather a reflection of a more realisable value for the asset concerned.

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<sup>26</sup> In this instance we are referring to gold's marketability, because in an operational sense, it is not illiquid since it only does not earn income in the form of interest and it normally is held for a rather long term by central banks.

<sup>27</sup> “Inventory of Accounting Methods applied by the Central Banks of the Member States of the European Economic Community” - Report to the Committee of Alternates, January 1993 from the Working Group on Accounting Issues. This inventory was updated by the Working Group in December 1995.



Having studied the above arguments and analysed current practice the Working Group tends to prefer<sup>28</sup> a valuation principle for gold at a price below market value. It should be emphasised that this rule would be combined with the proposed general rule applying to the treatment of unrealised revaluation gains to ensure a strong buffer against a major downward price movement in the recognised market value of gold.

**ANNEX 4**

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<sup>28</sup> This preference (and the relevance of this section in the main report) is dependent upon the preferred general recommendation for asset valuation.

## **ACCOUNTING IMPLICATIONS OF THE PRINCIPLE OF NON-REPATRIATION OF BANKNOTES<sup>29</sup>**

### **I. Introduction**

Against the background of the discussions held in Versailles, there was broad agreement at the 2nd May EMI Council meeting that there should be no repatriation of European banknotes in Stage 3. This means that all fit banknotes - whatever the country of original issue - would be re-issued by all national central banks (of participating countries). European banknotes would of course be legal tender throughout the single currency area. The question was then raised at the 2nd May meeting as to the accounting implications for national central banks in the situation where banknotes are not repatriated.

### **2. Accounting Issues**

- 2.1. In the opinion of the Working Group on Accounting Issues (WGAI) there are no accounting issues arising for NCBs when banknotes are not repatriated. In particular the issue of non-repatriation does not in itself have any implications for monetary income. It is not necessary to distinguish between those banknotes produced and available for re-issue by one NCB and those produced and available for re-issue by all other NCBs within the ESCB. Furthermore it does not matter from an accounting perspective whether the issue and redemption of banknotes and the figures for banknotes are recorded on the balance sheets of the individual NCBs or on the balance sheet of the ECB or both. The issue of whether banknotes should be recorded on the balance sheets of the NCBs and/or on the ECB's balance sheet and the implications of this for monetary income will be included in a separate report by the WGAI. It is however assumed that the actual putting of notes into circulation will be performed by NCBs.
- 2.2. Once a banknote is put into circulation by an NCB it creates a liability on its balance sheet by promising to give value for the banknote at some future date. Within the ESCB all NCBs would recognise each other's common banknotes - in other words they would be prepared to give value for them when they are returned from the public via the commercial banks. Following their redemption banknotes cease to have value as they are no longer liabilities of the ESCB - they are assimilated to printing paper - and the NCB which redeems the notes has no claims against the original (NCB) issuers of the notes.

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<sup>29</sup> This note was submitted to the EMI Council for information on 6th June 1995.

2.3. The possibility may arise that one NCB will redeem a larger quantity of banknotes than it issues. This possibility is indeed likely but the scale of it is uncertain. In an extreme case (e.g. an NCB of a tourist country in southern Europe) an NCB could end up with a negative banknote figure on its balance sheet and experience a corresponding significant reduction in its monetary assets available to it. While this is not an accounting problem it requires resolution. It is possible that such an NCB could redistribute the excess to another NCB (within the ESCB) which has the opposite problem of needing to produce far more banknotes than it redeems in order to meet public demand (partly because of the movement of banknotes outside the country). This process of bulk redistribution of banknotes could be a bilateral exercise between two NCBs or involve a group of NCBs, but essentially the decision to proceed with it would be a logistical one.<sup>30</sup>

From an accounting perspective there are two alternative treatments<sup>31</sup> of such a redistribution which must be considered:

- (i) The bulk redistribution process would be regarded as a transfer of printing paper between NCBs with the accounting entries to deal with the costs of transport and sorting (if appropriate) only. The actual transfer of banknotes would be deemed to be at zero cost, i.e. no value would be ascribed to the individual banknotes themselves.
- (ii) An inter-NCB claim is set up for the value of the banknotes transferred. This has the advantage of overcoming the problem that the figure recorded in respect of banknotes on the NCB balance sheet will, over time, bear no relationship to the actual amount of banknotes in circulation. It would also contribute to eliminating the balance sheet problem at individual NCB level of possibly having a negative banknote figure.  
The question of settlement of the inter-NCB claim and the remuneration of the claim will require further consideration by the WGAI.

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<sup>30</sup> It is assumed that banknotes would not necessarily be sent back to their NCB of origin.

<sup>31</sup> The accounting entries for these two treatments are elaborated upon in Annex 1.

**ILLUSTRATION OF ACCOUNTING TREATMENTS FOR THE  
BULK REDISTRIBUTION OF BANKNOTES**

The most practical way of highlighting the different accounting treatments is by way of an example. To keep it simple let us assume that, in Stage Three when a single currency is in existence, NCB<sub>1</sub> has banknotes of 10,000 ECU while NCB<sub>2</sub> has a figure of 800 ECU and so their respective balance sheets might appear as follows:

NCB <sub>1</sub>				NCB <sub>2</sub>			
Assets	30,000	Banknotes	10,000	Assets	2,800	Banknotes	800
		Deposits	20,000			Deposits	2,000
	<b>30,000</b>		<b>30,000</b>		<b>2,800</b>		<b>2,800</b>

  

ESCB			
Assets	32,800	Banknotes	10,800
		Deposits	22,000
	<b>32,800</b>		<b>32,800</b>

**Inflow of “foreign” banknotes**

Now let us assume that a number of tourists from the country of NCB<sub>1</sub> visit the country of NCB<sub>2</sub>, spend 1,000 ECU and these notes are eventually lodged with NCB<sub>2</sub>. The accounting entries for these transactions would be as follows:

		<u>NCB<sub>2</sub></u>	
	DR <sup>32</sup> Banknotes	1,000	
	CR <sup>33</sup> Deposits		1,000
	DR Deposits	1,000	
	CR Assets		
			1,000

Assuming that the commercial banks will withdraw these low (non) interest bearing deposits.

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<sup>32</sup>Debit

<sup>33</sup>Credit

NCB <sub>1</sub> (no change)				NCB <sub>2</sub>			
Assets	30,000	Banknotes	10,000	Assets	1,800	Banknotes	(200) <sup>34</sup>
		Deposits	20,000			Deposits	2,000
	<u>30,000</u>		<u>30,000</u>		<u>1,800</u>		<u>1,800</u>

ESCB			
Assets	31,800	Banknotes	9,800
		Deposits	22,000
	<u>31,800</u>		<u>31,800</u>

### Bulk redistribution

Finally let us assume that NCB<sub>2</sub> having surplus notes in stock reaches an agreement with NCB<sub>1</sub> to the bulk redistribution of 1,000 ECU regardless of their particular source.

#### (i) No value given for the banknotes transferred

The bulk redistribution would generate no further value transfers except those possibly relating to the reimbursement of costs connected with the exercise. It will be necessary for each NCB to adjust in its internal records the stocks of banknotes held but this would have no impact on their financial accounts.

#### (ii) Value given for the banknotes transferred

The same accounting entries outlined above would again arise with additional entries to record the creation of an inter-NCB claim for the transferred banknotes. They are as follows:

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<sup>34</sup> The negative Banknotes figure could also be shown as an asset in the NCBs own accounts while still being netted off in the ESCB consolidated balance sheet.

NCB<sub>1</sub>

DR	Banknotes	1,000	
CR	NCB <sub>2</sub>		1,000

NCB<sub>2</sub>

DR	NCB <sub>1</sub>	1,000	
CR	Banknotes		1,000

NCB<sub>1</sub>

Assets	30,000	Banknotes	9,000
		Deposits	20,000
		NCB <sub>2</sub>	<u>1,000</u>
	<u>30,000</u>		<u>30,000</u>

NCB<sub>2</sub>

Assets	1,800	Banknotes	800
NCB <sub>1</sub>	1,000	Deposits	2,000
	<u>2,800</u>		<u>2,800</u>

ESCB

Assets	31,800	Banknotes	9,800
		Deposits	22,000
	<u>31,800</u>		<u>31,800</u>

**WORK PROGRAMME  
OF THE WORKING GROUP ON ACCOUNTING ISSUES FOR 1996/97**

1. In developing the future work programme of the Working Group a number of key factors must be considered which will determine the timescale for the completion of the WGAI recommendations and their subsequent implementation. The known factors are the following:
  - i) The method of calculating monetary income will have an impact on the accounting techniques which will be required by NCBs in Stage Three. Given that the WGAI propose that just one set of financial accounts to be published it is therefore critical that the accounting techniques have to be consistent with the decision on a) the method of allocation of monetary income b) the definition of “income derived” from earmarked assets (Article 32.2) and c) the distribution of different kinds of risks of different assets (for example, Tier 1 and Tier 2 assets as suggested in the Monetary Policy Sub-Committee Report of November 1995 on “Eligible Paper for Mobilisation and Pledging in Stage Three”).

Furthermore it has been noted from Chapter 6 that implementation of a dedicated portfolio method for calculating monetary income would entail more detailed accounting requirements than if other Article 32.2 methods or an alternative method in line with Article 32.3 were to be adopted.

- ii) Implementation of accounting recommendations:
  - (a) Some changes to existing NCB accounting systems will be required. The extent to which NCB accounting systems will be affected will largely be driven by the monetary income requirements. The balance sheet requirements of the various statements is largely to give a list of assets and liabilities.
  - (b) The ECB will require a complete accounting system to be set up. It is impossible to specify these until it is known what type of assets and liabilities it will have and what transactions the ECB itself will do.
- iii) Clarification as to what activities of the NCBs will be part of the ESCB. While Chapter IV of the ESCB Statute specifies the various functions and operations of the ESCB it does not refer to specific assets and liabilities. Pending clarification of this the WGAI will continue to adopt as a

working hypothesis that all assets and liabilities that could be used for “Chapter IV” operations should be within the System.

- iv) The legal requirement [Art. 109 (f) ESCB Statute] for the EMI to specify by 31st December 1996 at the latest the regulatory, organisational and logistical framework necessary for the ESCB to perform its tasks in Stage Three.
  - v) It will be necessary for the legal experts, in conjunction with the WGAI, to specify the appropriate legal instrument(s) for harmonisation of accounting rules and define the sources of law and legal criteria to be employed by the WGAI when fulfilling its mandate. In addition the adaptation of national legislation to the Treaty to ensure its compatibility with the Treaty’s requirements will be required.
2. In developing the Group’s future work programme a critical path for the implementation of the major items within its competence has been prepared. Working from a starting date of 1st January 1999 for Stage Three, the following timescale would appear to present a realistic picture of the implementation process of the Group’s recommendations.



## CRITICAL PATH

<u>DATE</u>	<u>EVENT</u>	<u>WGAI WORK REQUIRED</u>
31st December 1999	First monetary income calculation	Method of calculation must be agreed
	First annual accounts	Formats must be agreed
During 1999	The interim accounts are published	Formats, scope and contents to be agreed
1st January 1999	EMU started	Procedures and systems to produce interim reports must be agreed
	First accounts of the ECB	Format, scope and contents must be agreed
During 1998	ECB in operation	Some accounting techniques must be in place. Others could still be evolving depending on the functions of ECB
Early 1998	ECB established	Basic accounting techniques must be implemented.
During 1997	Legislation approving EMU being adopted	The necessary clauses covering the accounting must be available for inclusion.
Early 1997	Preparation for the establishment of the ECB	Basic accounting techniques for both the ESCB and the ECB to be agreed
1st January 1997	Start of legislative process	Basic accounting principles agreed Scope of ECB's activities to be defined

3. Based upon the above critical path and taking account of currently agreed/suggested work commitments the WGAI have identified the following tasks which must be addressed by the

WGAI during the course of 1996/97. (Those to be originated by the WGAI are in bold type while the others will arise out of (known) consultations from other SCWGs and EMI Services).

<u>Issue originated by</u>	<u>Issue for deliberation</u>	<u>Deadline</u>
<b>WGAI</b>	<b>Intra-System Settlement Issues</b>	<b>APRIL 1996*</b>
PAY <sup>35</sup>	Detailed specification of the Interlinking System	MAY 1996*
EMI	Rounding Issues (i.e. rounding amounts expressed in monetary units)	MAY 1996
<b>WGAI</b>	<b>Monetary Income - earmarking of assets</b>	<b>JUNE 1996*</b>
WGS <sup>36</sup>	“Phasing in” of the ESCB statistical system	JULY 1996*
<b>WGAI</b>	<b>Transitional Issues to Stage Three - preparation of discussion paper on accounting issues</b>	<b>SEPTEMBER 1996</b>
<b>WGAI</b>	<b>Approval of accounting principles for the ESCB/ECB?</b>	<b>NOVEMBER 1996*</b>
WGIS <sup>37</sup>	Information Systems support for the exchange of data in the ESCB for non-statistical purposes	NOVEMBER 1996* AND DECEMBER 1997*
<b>WGAI</b>	<b>Monetary Income (including) - accounting requirements for the implementation of Article 32 methods</b>	<b>DECEMBER 1996*</b>
EMI	Capital of the ECB	DECEMBER 1996*
<b>WGAI</b>	<b>Detailed accounting techniques for the ESCB/ECB</b>	<b>MARCH 1997*</b>

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\* Indicates a report is being sent to the EMI Council/Committee of Alternates

<sup>35</sup> Payment Systems Working Group

<sup>36</sup> Working Group on Statistics

<sup>37</sup> Working Group on Information Systems

<u><i>Issue originated by</i></u>	<u><i>Issue for deliberation</i></u>	<u><i>Deadline</i></u>
EMI	Monitoring reports on adaptation of NCBS' regulations/practices in preparation of Stage Three	MARCH 1997* SEPTEMBER 1997* AND MARCH 1998*
<b>WGAI</b>	<b>Format of the periodic statements of the ESCB</b>	<b>JULY 1997*</b>
PAY	Implementation of the Target System	NOVEMBER 1997*
EMI	Simplified amendments to the ESCB/ECB Statute	DECEMBER 1997
<b>WGAI</b>	<b>Format of the annual accounts of the ECB and ESCB</b>	<b>MARCH 1998*</b>