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CAN THE OECD BANK PROFITABILITY DATABASE SATISFY DATA NEEDS FOR FINANCIAL SOUNDNESS INDICATORS?

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Executive summary

1. The decision to publish data on bank operating accounts and balance sheets, once a year, was taken by the OECD's Committee on Financial Markets in 1981. Data for 1978-1982 were compiled and sent to the OECD for the first time in December 1983, following long discussions on the exact coverage of this new publication, on its usefulness, and on the comparability of national data. Since 1987, the OECD has regularly compiled and published on an annual basis country data on income statements, balance sheets, and solvency of banks. It has done so on the basis of the information available in all OECD member countries.

2. In the late 1990s, the IMF launched the Financial Soundness Indicators (FSI) project and developed a methodology to compile such indicators. This methodology is reflected in the IMF's *Compilation Guide for Financial Soundness Indicators (IMF Guide)*. The IMF's project aims at enhancing soundness analysis of countries' financial systems conducted both by the IMF and by the countries themselves as well as increasing the comparability of information on the soundness of countries' financial systems. The first data will be collected with reference date end-2005 in the context of a coordinated compilation exercise (CCE) for 62 countries conducted as a pilot project by the IMF. Nevertheless, it is uncertain whether all countries will be able to provide all the information requested according to the *IMF Guide's* definitions.

3. The work undertaken by the IMF gives the OECD an opportunity to review the "Bank Profitability" statistics and to increase their usefulness by making the OECD database better fit the needs of the compilation of FSIs. Moreover, in meeting data reporting requirements of international organizations, the revision of the OECD Bank Profitability database with a view to compile FSIs has the potential of being an efficient way of minimizing countries' reporting burden while at the same time increasing the cross-country data comparability and its overall usefulness for users.

4. This paper tries to identify the current gaps in the OECD database that constrain the compilation of FSIs and investigates the improvements necessary for the OECD database to be able to compile at least the IMF's 'core set' of FSIs. This paper does not discuss the changes needed to also compile the IMF's 'encouraged set' of FSIs.

5. The paper submits this strategy to the WPFS for decision

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Issues for consideration of the WPFS

1. The improvement of the OECD database will be beneficial for both organizations and for users. Researchers and analysts will be able to access information which would be more comparable across countries and if the enhancements also cover the long back series of the OECD database, they will be able to compile the FSIs for past periods and assess their trend over time.

2. The envisaged enhancements would be a way to encourage the countries to continue their FSI compilation efforts beyond the IMF pilot compilation exercise, which is being conducted in 62 countries (29 of which are reporting OECD profitability data). Moreover, the *Compilation Guide for Financial Soundness Indicators (IMF Guide)*, which currently represents a benchmark in a new field of macroeconomic statistics, would be more widely used and may become an international standard. However, the changes in coverage and list of variables proposed below will involve some costs for countries.

Question 1: *Do Delegates agree that the OECD should adapt its Bank Profitability database to increase its usefulness, relying on the work on Financial Soundness Indicators (FSI) undertaken by the IMF so that it better meets the requirements for the compilation of FSI?*

3. Considering that WPFS delegates are aware that the work undertaken by the IMF gives the OECD an opportunity to review the “Bank Profitability” statistics with the aim of improving its usefulness, and anticipating their reply to question 1, the Secretariat envisages to launch an Electronic Discussion Group (EDG) to look into a number of remaining issues (listed below).

Question 2: *Do Delegates agree to start an EDG with volunteering experts to discuss all issues that are necessary to ensure a better convergence of Bank Profitability on the IMF Guide?*

Accounting rules

4. It appears that the application of well defined accounting rules, such as the accrual basis as defined in the *IMF Guide*, should be recommended for the Bank Profitability data. On the other hand, the implementation of the new International Accounting Standards (IAS) might have consequences on the data requested in this database, at least for European countries; therefore, further investigation might be useful in this field before any change is made to the database.

Issue 1: *Are Delegates favourable to a further investigation regarding the application of the new IAS rules before recommending any specific new accounting rules inspired by the IMF Guide?*

Data frequency and timeliness of OECD data

5. OECD data on income statements and balance sheets are collected every year on an annual basis with a lag of 5-12 months after the end of the year, while the *IMF Guide* encourages the compilation of FSIs on a quarterly basis. Mainly because of a lack of staff resources, there is a low probability that quarterly data are collected by the OECD in the foreseeable future. Therefore, without a financial help from Member countries, it would be proposed to continue to collect annual data and to improve the data timeliness with a three-month to six-month lag after the end of the year.

Issue 2: *Would Delegates be favorable to a quarterly collection of data? Do they agree to reduce the time-lag in the transmission of data to the OECD?*

Methodological background

6. A better consistency between the OECD and IMF on their data coverage and definitions would be beneficial for the work on financial stability. In this regard, it would be appropriate that Table 1 (income statement and balance sheet) of the OECD publication *Bank Profitability – Financial statements of banks* presents data that are needed for compiling FSIs for ‘deposit-takers’, according to the IMF *Guide*’s definitions. The concept of ‘deposit-takers’, which includes banks and other deposit-taking institutions, except central banks and money market funds, is more extensive than the currently used concept of ‘all banks’ in the OECD database.

Issue 3: Do Delegates agree that the OECD should collect income statement and balance sheet data for the ‘Deposit-Takers’ sector as a whole and publish them in Table 1 of the OECD publication?

7. Once the differences that might exist between definitions given in the OECD questionnaire for some of the items of the income statement and balance sheet and the IMF *Guide*’s definitions are checked, it might be appropriate, as much as possible, to use the latter which are quite detailed and should allow data to be comparable between countries and between International Organisations.

8. The application of a cross-border consolidation as defined in the IMF *Guide* should be recommended. Moreover, more precise and comparable information on the consolidation made by countries should be provided by respondents.

Issue 4: Do Delegates accept the principle of using in priority definitions and recommendations given in the IMF Guide?

List of core series

9. In order to increase the usefulness of the OECD database for the compilation of Financial Soundness Indicators (FSIs), a number of new series could be added to the OECD questionnaire relating to Bank Profitability. Delegates are invited to comment on the idea of increasing the scope of Bank Profitability, and in this regard to consider relevant items to be included in the OECD database.

10. Concerning the income statements, the main differences between the IMF *Guide* and the OECD standard framework concern four series: *Gross interest income*, *Provisions for accrued interest on non-performing assets* (both included in Interest income), *Pro-rated earnings* (included in Non-interest income) and *Extraordinary items*. These series, in bold in Table 2 of Chapter 3, are used in the calculation of FSIs.

11. Concerning the balance sheets, at least sixteen additional series are necessary to calculate the indicators belonging to the IMF ‘core set’ (see table 1 in Chapter 2, below). These new series are highlighted in table 3 of Chapter 3 (see below). However, it might be necessary that the whole set of new series to be included in the OECD questionnaire as well as the priorities in the list of FSI indicators are discussed and agreed within an EDG (electronic discussion group) with voluntary experts.

Issue 5: Do Delegates agree that the list of variables should be expanded in order to include the missing core set of variables relating to Income Statement and Balance Sheets in the OECD questionnaire and that this should be discussed and decided by an EDG with volunteering experts?

Background report

Chapter 1 - The OECD database, a methodological overview

1.1. Introduction

1. The OECD compiles annual statistics on member countries' banking sectors, including financial statements (income statements and balance sheets), as well as data on the structure of OECD countries' financial systems, and presents them in the annual publication named "*Bank Profitability – Financial Statements of Banks.*" This publication was first issued in 1987 and, up to now, constitutes a unique tool for providing information on the state of health of national banking systems and for analyzing developments in bank profitability in the thirty OECD Member countries.

2. Data are available between 5 and 12 months after the end of the reference fiscal year, which can be different across countries. Traditionally, 'Bank Profitability' data used to be published at the end of the year following the reference date, i.e., by Y + 12m at the latest. However, for various reasons, there has been some delay in publishing data for the last two years.

3. Data are provided on the basis of a standard framework for income statements, balance sheets, and supplementary information for a selection of financial institutions. However, the institutional coverage of the tables is largely dictated by the availability of data in various countries. A separate publication complements national data in order to facilitate their comprehension and interpretation. In effect, given discrepancies between national accounting systems used in Member countries and deviation from the OECD standard framework and definitions, countries are requested to provide descriptive notes regarding the institutional coverage, the geographical coverage, the degree of consolidation, and the activity of the banks, as well as a reconciliation table showing the correspondence between national data and OECD published data. These country notes are available in the separate publication *Bank Profitability - Methodological Country Notes*.

4. Over the years, *Bank Profitability -Financial Statements of Banks* has been widely used not only by national supervisors but also by banking analysts and researchers. The broad interest in the publication suggests, and user feedback confirms, that the current framework has been successful, providing users with valuable information. However, since the last review of the publication was undertaken by the OECD Task Force on Bank Profitability in the mid-1990s, the financial services sector has continued to evolve and the demand for better and more detailed information regarding financial stability has increased. In such a changing environment, characterised by larger financial institutions with increasing levels of product and functional overlaps, and given the current high interest in and demand for financial stability indicators, including the IMF-FSI project, it now seems a good time to update the existing reporting framework and to review the OECD *Bank Profitability -Financial Statements of Banks* publication thoroughly.

5. Some changes were discussed by the Working Group on Financial Statistics (WPFS) at the October 2002 meeting with a view to improving the usefulness of the OECD *Bank Profitability* database for compiling financial soundness indicators (FSI) as proposed in the IMF's FSI project. In particular, the WPFS recommended that all Member countries forward information on already agreed measures (selected items of the income statement and balance sheet) and for all financial institutions requested. Moreover, it considered that, in the context of a deeper review of Bank Profitability, several refinements and additions, including more information regarding regulatory capital and solvency as well as FSIs, would be useful in the process of analyzing financial health.

6. At that time, the WPFS noted that there was almost a line-to-line correspondence between the accounting framework adopted by the IMF and the OECD framework, and advised the Secretariat to work closely with the IMF to resolve any remaining differences between the concepts and definitions of the OECD *Bank Profitability* and those in the IMF *Guide*. It also directed it, upon achieving conformity with the definitions used in the finalised IMF *Guide*, to prepare a metadata questionnaire.

7. A restructuring of OECD financial activities at the end of 2002 has prevented the Secretariat from implementing that decision. The time has now come for the OECD to review the *Bank Profitability* database with a view to harmonising as much as possible the OECD work on bank profitability with the IMF *Guide*.

1.2. *Statistical coverage*

8. The annual publication *Bank Profitability - Financial Statements of Banks* provides statistics on financial statements of banks in OECD Member countries. National reports are reclassified according to a standard OECD framework on income statements (23 items) and balance sheets (18 items), as agreed by the WPFS. In addition, these data series are supplemented by information on the capital adequacy (5 items) as well as the number of reporting institutions, the number of their branches and the number of their employees (3 items).

9. The statistics also include data on the structure of the financial systems in OECD countries: each country reports information regarding the whole financial institutions sector (corresponding to the S12 sector as defined in the System of National Accounts (SNA)) and covering the number of reporting banks, their branches, the staff employed by these institutions, as well as the total assets and total financial assets. Classification of the banking sector's assets and liabilities in domestic and foreign currencies, broken down by residents and non-residents, are also included in a separate table.

1.3. *Institutional coverage*

10. In principle, the statistics are intended to cover all institutions that conduct ordinary banking business, i.e., institutions that primarily take deposits from the public at large and provide financing for a wide range of purposes. Given structural and regulatory differences between national systems, it is difficult to provide statistics based on a uniform concept of institutional coverage of credit institutions for all OECD countries. Moreover, the availability of the underlying data also has an impact on the coverage of the statistics.

11. Data relating to the income statements, balance sheets, and capital adequacy (presented in Table 1 of the OECD publication) are requested for the following list of standard banking groups, without any reference to SNA. No precise definition of these groups is given in the questionnaire:

- All banks
- Commercial banks
- Large commercial banks *as a sub-set of commercial banks*
- Foreign commercial banks *as a sub-set of commercial banks*
- Savings banks
- Co-operative banks
- Other banks, *reported for countries where applicable.*

12. While separate data for each of these groups are requested, not all countries provide OECD with the complete set of data. Moreover, although data are published under the standard framework according

to the headings listed above, the coverage (composition and definition) of banking groups may vary across the reporting countries; it is defined in accordance with national criteria.

13. Countries are also requested to provide data on the structure of their financial system (limited to a very small number of variables: number of institutions, number of branches and number of employees, total assets, and total financial assets), using the following standard framework, which is not linked with SNA definitions. Countries report data according to the structural and regulatory features of their national banking system, adding specific national institutions or replacing those listed below, when necessary:

- *Central bank*
- *Other monetary institutions*
 - Commercial banks
 - Foreign-owned banks
 - Savings banks
 - Co-operative banks
- *Other financial institutions*
 - Mortgage credit institutions
 - Development credit institutions
 - Finance companies
 - Other miscellaneous financial institutions
- *Insurance institutions*
 - Insurance companies
 - Pension funds and foundations
 - Other insurance institutions
- *All financial institutions*

14. It should be noted that the group “*Other financial institutions*” listed above may include depository corporations, i.e., institutions that primarily take deposits from the public at large and provide financing for a wide range of purposes. However, these institutions are not covered in data presented in Table 1 of the OECD publication, which are generally limited to the above group ‘*Other monetary institutions*’.

1.4 *Consolidation*

15. The OECD recommends that data included in its statistics should be consolidated world-wide, i.e. foreign branches of reporting banks as well as domestic/foreign subsidiaries should be included. This implies that data should cover banks, branches and subsidiaries operating in the reporting country plus the domestic banks’ foreign branches and subsidiaries (the latter may be banks or non-banks). Countries are requested to explain the degree of consolidation of accounts of the institutions covered; in other words, they have to provide the OECD with clear definitions on the institutional coverage regarding foreign branches and subsidiaries of national-owned banks operating outside the reporting country and branches and subsidiaries of foreign-owned banks operating inside the reporting country. In regard to sector-wide consolidation and adjustments, the OECD does not provide any recommendation.

Chapter 2: The Compilation Guide on Financial Soundness Indicators, a methodological benchmark for compiling cross-country comparable FSIs

2.1 Introduction

16. In response to the 1997 financial crises in South-East Asia, the IMF launched its work on FSIs with the aim of developing a methodology to produce cross-country comparable information on the soundness of countries' financial systems.

17. This is necessary as (1) the lack of timely and good quality data contributes to failure in detecting financial system problems early; (2) data are not comparable across countries due to lack or inconsistency in the statistical methodologies used by countries; and (3) existing macroeconomic statistics are not sufficient for assessing financial system soundness.

18. As a result, FSIs are a new body of economic statistics in which experience is still relatively limited, a variety of measurement systems are drawn upon, and new data sources are needed.

19. As a methodological benchmark for the compilation of cross-country comparable FSIs, in July 2004 the *Compilation Guide on Financial Soundness Indicators (IMF Guide)* was finalised following extensive consultations through eight regional outreach seminars with its member countries, a series of expert group meetings (from IMF member countries and international and regional organizations), and a public comment period on the draft *IMF Guide*.²

20. The *IMF Guide* aims to promote compilation of cross-country comparable FSIs by providing guidance on the concepts and definitions, data sources, and compilation techniques. The *IMF Guide* recommends the compilation of 12 core indicators and encourages the compilation of an additional 27 indicators. Table 1 below shows the list of core and encouraged indicators. The *IMF Guide* encourages the dissemination of data and metadata.

² The finalised *IMF Guide* is available on the IMF website under www.imf.org/external/np/sta/fsi/eng/fsi.htm. It will also be available as a paper publication (expected in 2005). There will also be translations of the *IMF Guide* into Arabic, Chinese, French, Russian, and Spanish (expected in 2006).

Table 1: Financial Soundness Indicators: The Core and Encouraged Sets

Core Set	
Deposit-takers	
<i>Capital adequacy</i>	Regulatory capital to risk-weighted assets Regulatory Tier 1 capital to risk-weighted assets Nonperforming loans net of provisions to capital
<i>Asset quality</i>	Nonperforming loans to total gross loans Sectoral distribution of loans to total loans
<i>Earnings and profitability</i>	Return on assets Return on equity Interest margin to gross income Noninterest expenses to gross income
<i>Liquidity</i>	Liquid assets to total assets (liquid asset ratio) Liquid assets to short-term liabilities
<i>Sensitivity to market risk</i>	Net open position in foreign exchange to capital
Encouraged Set	
Deposit-takers	
	Capital to assets Large exposures to capital Geographical distribution of loans to total loans Gross asset position in financial derivatives to capital Gross liability position in financial derivatives to capital Trading income to total income Personnel expenses to noninterest expenses Spread between reference lending and deposit rates Spread between highest and lowest interbank rate Customer deposits to total (noninterbank) loans Foreign-currency-denominated loans to total loans Foreign-currency-denominated liabilities to total liabilities Net open position in equities to capital
Other financial corporations	Assets to total financial system assets Assets to GDP
Nonfinancial corporations sector	Total debt to equity Return on equity Earnings to interest and principal expenses Net foreign exchange exposure to equity Number of applications for protection from creditors
Households	Household debt to GDP Household debt service and principal payments to income
Market liquidity	Average bid-ask spread in the securities market Average daily turnover ratio in the securities market
Real estate markets	Real estate prices Residential real estate loans to total loans Commercial real estate loans to total loans

2.2 *The pilot phase*

21. The implementation of the recommendations of the *IMF Guide* is currently in its pilot phase. The IMF has launched a Coordinated Compilation Exercise (CCE) in order to develop countries' capacity to compile FSIs, promote cross-country comparability of FSIs, and disseminate the FSI data and metadata to promote greater transparency and strengthen market discipline.

22. Participation by IMF member countries in the CCE is voluntary. Sixty two participating countries (including 29 out of the 30 countries reporting to the OECD Bank Profitability Database) agreed to compile the 12 core FSIs, with end-2005 as the reference date, and provide the indicators to the IMF along with the underlying data and the relevant metadata (by end-July 2006). The data and metadata would be reported using standard report forms and disseminated to the public at end-2006 by the IMF.

23. Participating countries are also encouraged to compile some or all of the encouraged indicators, together with metadata and other information (sectoral financial statements, measures of dispersion and concentration, historical data series).

24. On November 18-19, 2004, there was a meeting of CCE Coordinators and FSI Compilers from the participating countries. Participants discussed the draft terms of reference of the CCE and provided comments, reviewed the results of an inventory survey of the CCE participating countries' pre-CCE practices of compiling FSIs, discussed the draft standard report forms for the CCE before their finalization, and addressed a wide range of FSI compilation issues and other modalities of the CCE.

25. While the *IMF Guide* has been finalized and endorsed by the IMF Board and is now used as the reference for the CCE, a number of compilation issues could be reviewed by the IMF's Executive Board after the completion of the CCE in 2007, in light of the experience gathered in the exercise. Such issues could inter alia include the consolidation approach and adjustments recommended in the *IMF Guide* and the implications of the development of International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) and supervisory standards (Basel II) for the compilation of FSIs.

26. In a meeting on November 17, 2004, international and regional institutions strongly supported the CCE and expressed their willingness to help ensure the success of the exercise. In that meeting, the IMF also created a reference group comprising these institutions with a view to providing feedback to IMF staff on issues that may arise in the CCE and, in particular, serve as a sounding board when the IMF staff addresses issues pertaining to FSI methodology and compilation practices after the CCE. International institutions have also expressed an interest in working with countries in their jurisdictions that are not participating in the CCE with a view to supporting them in their FSI compilation and dissemination efforts.

27. Recently, the IMF has created an electronic discussion forum for the CCE compilers and international and regional institutions (Financial Soundness Indicators Web Board (FSIB)).³ The purpose of the FSIB is to promote dialogue and exchange of views on issues in the context of the CCE among countries participating in the CCE as well as the concerned regional and international institutions. FSIB contains conferences and topics that are the organizing principle of the site and it is designed to be simultaneously accessible by all authorized users to facilitate exchange of views on issues of common interest. FSIB also includes an announcement board to which the Fund staff are posting background materials on the CCE as well as various announcements regarding this exercise.

³ See <https://www-forums.imf.org>. Qualified users must send their registration requests to Ms. Sangeeta Srivastava at SSRIVASTAVA@imf.org

2.3 *The IMF Guide*

2.3.1 Objectives

28. The primary purpose of the *IMF Guide* is to provide guidance on the concepts and definitions, as well as sources and techniques, for the compilation and dissemination of the FSIs identified by the IMF's Executive Board (see Table 1 above). The *IMF Guide* is intended to encourage compilation of FSIs and promote cross-country comparability of these data, as well as assist compilers and users of FSI data, for the purpose of supporting national and international surveillance of financial systems. Using the *IMF Guide's* framework, compilers can construct FSIs, which are aggregate statistics suitable for assessing current vulnerabilities and strengths of the financial sector. As FSIs are an input into macroprudential analysis (MPA), the *IMF Guide* also discusses the use of FSIs in MPA.

2.3.2 Structure

29. The *IMF Guide* is presented in four parts and complemented by a number of appendices. The first part deals with the conceptual framework (definitions of institutions and markets, accounting principles, sectoral financial statements, aggregation and consolidation of data); the second part discusses specification of FSIs (guidance on how to calculate FSIs for deposit takers, other sectors, financial markets, and real estate markets); the third part provides practical advice on compilation and dissemination of FSIs; the last part discusses the analytical use of FSIs. In this regard, the *IMF Guide* is a comprehensive document that explains not just how to compile the core and encouraged FSIs but also sets out the conceptual frameworks from which the data series required to calculate the FSIs could be drawn.

30. The *IMF Guide* covers primarily deposit-takers, including banks and other deposit-taking institutions, except central banks and money market funds. The *IMF Guide* also focuses on other sectors such as other financial corporations (OFCs), non-financial corporations (NFCs) and households (HHs), as well as on financial markets and real estate markets.

2.3.3 Conceptual framework

31. The compilation of FSIs employs a new statistical framework whose concepts and definitions are drawn selectively from other international standards such as the 1993 SNA, the MFSM, the IAS/IFRS, the Basel Accords, and other BCBS standards. Because of the specific nature and purpose of the FSIs, the *IMF Guide's* definitions could not be entirely drawn from these existing international standards and, therefore, some differences exist between the definitions in the *IMF Guide* and other international standards.

32. FSIs are aggregate financial soundness statistics because aggregate, systemic behaviour can differ from the behaviours of individual units, which are affected by different policies. Furthermore, aggregate measures convey information about the interaction of the deposit taking sector with other sectors of the economy.

33. Most FSIs are presented in the form of ratios derived to a large extent from internally consistent balance sheets and income statements for deposit-takers and other sectors. Calculating FSI ratios from internally consistent financial statements enhances their analytical usefulness and contributes to quality control due to the well-established inter-linkages between financial statement items. Consistency in account classification and recording by creditor and debtor units within a sector is needed so that meaningful sector-wide data can be aggregated and consolidated. To ensure such consistency, the *IMF Guide* provides guidance on accounting principles for compiling sectoral financial statements for FSIs.

The accounting principles cover definitions of flows and positions, and issues such as time of recording, valuation, residence, maturity, foreign currency accounts and exchange rates for their conversion.

34. Data consolidation is a key feature of FSIs as recommended in the *IMF Guide*. For compiling FSIs in accordance with the *IMF Guide*, data consolidation needs to be made at two levels—at the reporting group level and at the sector level. For deposit-takers, the *IMF Guide* recommends the compilation of data covering domestically controlled deposit-takers on a cross-border consolidated basis for soundness analysis (*IMF Guide*, paragraph 5.31). The *IMF Guide* also discusses several other consolidation bases that compilers may use as supplementary approaches (see table under Section 2.3.4 below).

35. To enhance analytical usefulness, the *IMF Guide* also suggests focusing on data for sub-aggregate “peer groups” of units that share some characteristic (large banks, mortgage banks, etc.). The *IMF Guide* discusses the compilation of FSIs for peer groups as well as the use of descriptive statistics (concentration and dispersion measures) for the analysis of the data.

36. In reviewing the analytical use of FSIs, the *IMF Guide* points out that FSIs are part of a larger body of information used in the analytic framework for financial stability. Therefore, for financial stability analysis, it is important to analyze the linkages among FSIs, e.g., between corporate leverage and asset quality, and between asset quality and capital adequacy, as well as the macrofinancial linkages between deposit-takers and other sectors. Moreover, the *IMF Guide* encourages compilers to carry out stress testing exercises, and use Basel core principles and information on financial infrastructure, etc. as additional tools to enhance the interpretation of FSIs.

2.3.4 Key methodological issues

37. The FSI methodology is designed to derive FSI data that reflect a realistic assessment of the current health and soundness of financial systems. The appropriate application of this methodology across reporting entities and FSI compilers would ensure that the financial statements including income and expense statement and balance sheet used in the FSI compilation are internally consistent and FSIs compiled from these data are comparable across countries. Key FSI methodological issues include the following:

- Aggregation and consolidation
- Time of recognition of flows and positions
- Provisioning and nonperforming loans
- Valuation
- Foreign-currency-denominated instruments and exchange rate for conversion
- Maturity
- Recording of gains and losses on financial instruments

Aggregation and consolidation

38. Aggregation refers to the summation of data on gross positions or flows. Under an aggregation approach, there is no elimination of positions and flows between units within a group or between reporting entities within a sector. In contrast, consolidation refers to the elimination of positions and flows between units that are grouped together for statistical purposes. Consolidation can arise at various levels of grouping.

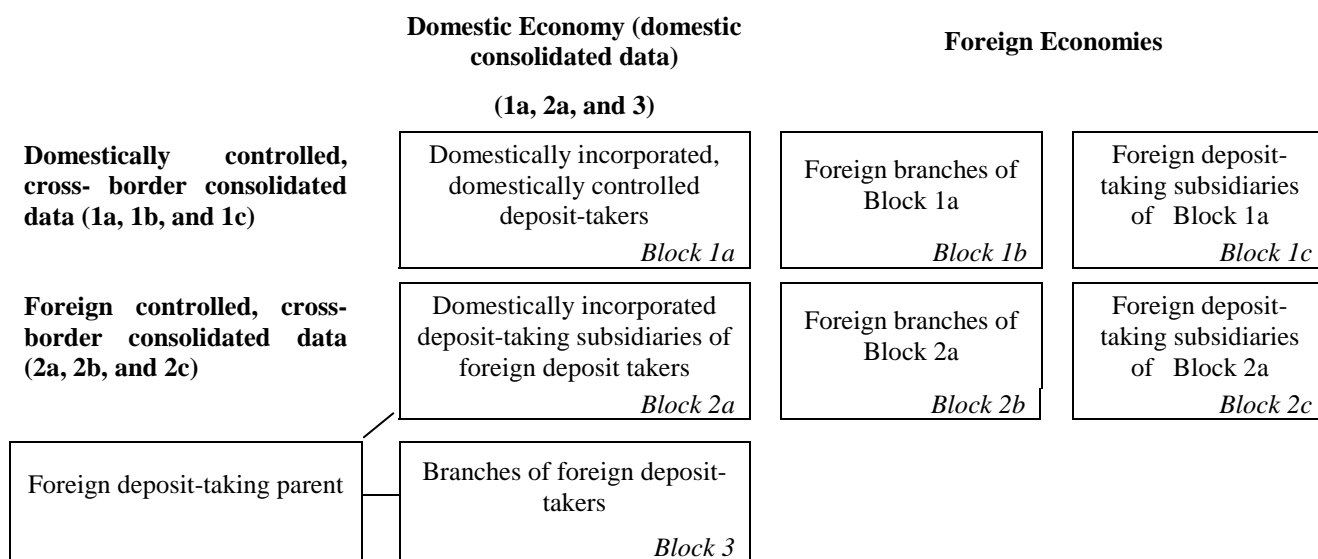
39. The first step in the compilation of FSIs requires the consolidation of accounts (balance sheets and income and expense statements) at the reporting group level. The consolidation at the group level involves the netting out of all transactions and positions between all units (parent, branches, and subsidiaries) within a reporting group. Normally, these consolidation adjustments are made by the reporting entities.

40. The scope of the consolidation depends on the institutional coverage or consolidation basis used by countries. Data compiled using different consolidation bases convey different information about exposures, vulnerabilities, and strengths of the financial system. For compiling FSIs for deposit-takers, the *IMF Guide* recommends that the domestically controlled cross-border consolidation basis (DCCB) be used as it is believed to provide the most realistic assessment of the current health of the financial system, while other consolidation approaches may be used as supplementary approaches. Under the DCCB, any transactions and positions among a domestically controlled deposit taker parent and its domestic and foreign branches and subsidiaries are eliminated on consolidation. This and other potential consolidation bases for deposit-takers are presented in the diagram below.

41. The domestic consolidated approach (DC) can be used as a supplementary approach. To compile domestic consolidated data, flows and positions of the resident deposit-takers are consolidated with their branches and deposit-taking subsidiaries (if any) resident in the domestic economy. This approach produces data that provide a link to other macroeconomic datasets, such as the national accounts and monetary aggregates. The *IMF Guide* describes also other possible consolidation approaches that may prove useful under specific country circumstances, such as the cross-sector consolidation of domestically controlled institutions, the cross-border and cross-sector consolidation of domestically controlled institutions, and the cross-border consolidation of all domestically incorporated institutions.

42. The second step necessary to compile internally consistent financial statements for the deposit-taking sector and the other sectors of the economy is the aggregation of data on individual consolidated reporting groups to sector level totals. Aggregation is necessary as the analytic focus of FSIs is on sector-level behaviour, vulnerabilities, and strengths, which differs from the traditional supervisory focus on individual units. However, in addition to the aggregation of the sector-wide data, the *IMF Guide* recommends that sector-level consolidation adjustments be made to produce the sector-wide data for FSI compilation. At this sector level, all transactions and positions, except debt and financial derivatives, between the units in the reporting population are to be eliminated in the consolidation.

Schematic Presentation of Levels of Consolidation



Time of recognition of flows and positions

43. The guiding principle in the *IMF Guide* is that flows and positions should be recorded using the accrual basis of accounting. On this basis, flows are recognized when economic value is created, transformed, exchanged, transferred, or extinguished and interest should be accrued at the effective yield agreed at issuance of the underlying instruments. However, interest should not be accrued on nonperforming loans and other assets. Finally, interest that has accrued but not yet payable should be included in the value of the underlying instruments.

Provisioning and nonperforming loans

44. The *IMF Guide* also focuses on nonperforming loans (NPLs) and other impaired assets as the prompt identification of impairment or non-performance is key for the identification of vulnerabilities. The *IMF Guide* recommends the use of a 90-day overdue criterion to define NPLs, but accepts stricter national practices. Moreover, the *IMF Guide* recognises that interest should not be accrued on NPLs and that specific provisioning is appropriate. The *IMF Guide* relies on national practices in identifying loan loss provisions and distinguishing between specific and general provisions, but recommends that such practices be clearly documented.

Valuation

45. Valuation methods are important as different methods have different impact on the assessment of the value of instrument at any moment in time. The *IMF Guide* recommends that tradable instruments should be valued at market or fair value (approximation of market value). For non-tradable instruments, the *IMF Guide* acknowledges that nominal value may provide a more realistic assessment of value than the application of fair value as the latter may involve a high degree of subjectivity.

Foreign-currency-denominated instruments and exchange rate for conversion

46. The impact of movements in foreign exchange rates on the current health of financial systems can be significant and, therefore, issues regarding foreign currency instruments and exchange rates for conversion are among the accounting issues that the *IMF Guide* covers. In the *IMF Guide*, foreign currency instruments are defined as those payable in a currency other than the domestic currency and foreign-currency-linked instruments, which are defined as those payable in domestic currency but with the amounts to be paid linked to a foreign currency. Domestic currency instruments are those instruments payable in the domestic currency and not linked to a foreign currency. The *IMF Guide* recommends that the midpoint between market buying and selling exchange rates be used for conversion of position data denominated in foreign currencies into the unit of account.

Maturity

47. In the *IMF Guide*, short-term is defined as a maturity of one year or less and long-term as a maturity of more than one year (or no stated maturity). Maturity is determined on a remaining maturity basis, although original maturity is a (more limited) alternative.

Recording of gains and losses on financial instruments

52. Regarding the treatment of gains and losses on financial instruments, the *IMF Guide* recommends to recognize in the income and expense statement all realized and unrealized gains and losses arising each period on all financial instruments valued at market or fair value in the balance sheet. The aim of such treatment of gains and losses on financial instruments is to observe volatility in the profitability of reporting institutions, regardless of whether financial instruments are held for trading or until maturity.

This method exposes the actual underlying conditions of the reporting institutions and is considered by the *IMF Guide* important for analysing the condition of the sector.

2.3.5 Strategic, managerial, and legal issues

48. The *IMF Guide* addresses strategic and managerial issues for FSI compilation. In particular, it recommends that the compilation of FSIs be coordinated by a lead agency, through a system of inter-agency cooperation. This is important to maximize the effectiveness of the coordination of the work on FSIs, ensure the consistency in the concepts, definitions, and framework used by different agencies to compile FSI data, and facilitate the dissemination of FSIs in a single centralized website and in regular publications.

49. The *IMF Guide* also reviews legal and other aspects of data collection, processing, and dissemination, such as data confidentiality, and stresses the importance of an ongoing consultation with data reporters and users, with the aim of improving data sources and data quality control.

Chapter 3: Gaps between the current OECD database and data requirements for compiling FSIs

3.1. Introduction

50. Having reviewed the reporting scheme and the definitions behind the OECD database in Chapter 1, and the methodology to compile FSIs in Chapter 2, this Chapter aims at identifying the main gaps that need to be addressed if OECD data are to be used for the compilation of FSIs as recommended in the *IMF Guide*. The main gaps concern (1) data frequency and timeliness; (2) institutional coverage; (3) number and definition of variables; (4) consolidation; (5) accounting rules. This chapter also lists the amendments or measures that could be proposed to adapt the OECD database so that it better meets the data needs of FSI compilation in accordance with the *IMF Guide*.

3.2. Data frequency and timeliness

Identified gaps

51. The OECD data are annual and based on the fiscal year which can vary across countries. They are collected and published every year, within about 12 months after the reference date. The timeliness of the OECD data should improve as from 2006, when new developments in OECD database management and in statistics dissemination are completed. Meanwhile, the *IMF Guide* recommends that FSIs be compiled with a quarterly frequency and published within 3 months after the reference date.

Potential measures to close the gaps

52. Taking into accounts the limited resources devoted to the collection and dissemination of Bank Profitability data and any development work on methodology, the OECD has currently no plan to collect quarterly data in the near future. However, the issue of the different fiscal year should be addressed in a practical manner and other solutions might be proposed.

53. To solve the issue resulting from the existence of different fiscal years in OECD countries, it might be suggested that countries where the fiscal year does not end at end-December, but where end-December data are available, compile two data series: one with reference to the end of the fiscal year, another with reference to the end of December.

3.3 Institutional coverage

Identified gaps

54. The OECD statistics cover all institutions which conduct ordinary banking business. The institutions covered in Table 1 of the OECD *Bank Profitability – Financial Statements of Banks* (commercial banks, cooperative banks, and savings banks) are part of the S122 SNA sector. The institutions covered in Table 2 are more numerous (monetary institutions, other financial institutions and insurance institutions) and belong to sector S122 as well as to sectors S123 and S125 (see Chapter 1, § 1.3. Institutional coverage). However, the coverage of banking groups in the OECD database is defined following national criteria for each country and described in the individual country notes.

55. On the other hand, the IMF *Guide* covers the ‘Deposit-takers’ sector as a whole, which corresponds to a broader concept than ‘banks’. It also covers other relevant sectors (NFCs, OFCs and HHs). The definitions of institutional sectors and sub-sectors in the IMF *Guide* are consistent with the 1993 SNA, except where explicitly stated otherwise. In particular, the definition of deposit-takers corresponds to the SNA definition of ‘Other depository institutions’ (Sector S122), excluding certain offshore banks and money market funds which have to be separately identified as investment funds within other financial corporations.

56. Commercial banks, cooperative banks, and savings banks (as requested in the OECD framework – Table 1) typically fall under the definition of deposit-takers. In addition, development banks, credit unions, investment banks, mortgage banks, building societies, micro-finance institutions and any other financial institution that take deposits also fall under the definition of deposit-takers.⁴

Potential measures to close the gaps

57. As the coverage of the banking sector under the current OECD framework is smaller than the coverage of ‘Deposit-takers’ in the IMF *Guide*, it would be useful, and probably feasible for most countries, to extend the coverage of financial institutions presented in both Table 1 and Table 2 of the OECD publication. In that context, in addition to data currently provided to the OECD, countries could be required to send income statement and balance sheet data for ‘deposit-takers’ as a whole. This additional category covers not only those currently reported in the OECD framework – Table 1, but also development banks, credit unions, investment banks, mortgage banks, building societies, micro-finance institutions and any other financial institution that fall in the category of deposit-takers. To facilitate the implementation of this measure and to ensure comparability and consistency across countries, the new list of the institutions to be covered in the Table 1 ‘*Income statement and balance sheet*’ of the OECD *Bank Profitability – Financial Statements of Banks* publication should be established based on the IMF *Guide*’s definition.

58. It would then be also necessary to have a common standard framework for Table 2 ‘*Structure of the financial system*’ with reference to categories and sub-categories of the 1993 SNA where applicable. This framework would include all or the main deposit-takers as well as other financial corporations, in particular some other financial intermediaries and insurance companies and pension funds (see the possible list below). However, because the coverage of subcategories is largely dictated by national definitions and

⁴ If some institutions are banks in a legal sense but not deposit-takers as described above, in following the IMF *Guide* they should still be classified as “deposit-takers,” but in any associated description of the FSI data the status of these institutions should be explained, with some indication of their importance to the data disseminated. Conversely, if there are any other groups of institutions that meet the IMF *Guide*’s definition of a deposit-taker, but are not banks or similar institutions under the legislative approach, they should be separately identified so their importance to the information disseminated can be judged.

data availability, and as it is more difficult to obtain consistent definitions for subcategories, it might be necessary to allow some flexibility so that a more realistic picture of national systems is presented, but to insist on precise explanation of the departures from the IMF *Guide*'s definitions, which would also inform cross-country comparisons.

59. A draft proposal of sectors and sub-sectors to be covered in the database might be the following. Data should be requested for the major sectors and for a selection of the sub-sectors listed below, Table 1 'Income statement and balance sheet' of the OECD *Bank Profitability – Financial Statements of Banks* publication would concentrate on corporations belonging to Deposit-takers, other than Central bank, while Table 2 'Structure of the financial system' would cover most financial corporations:

<i>Financial corporations</i>	<i>SNA 12</i>
▪ <i>Central bank</i>	<i>SNA 121</i>
▪ <i>Deposit-takers, other than Central bank</i>	<i>SNA 122</i>
▪ Commercial banks	
▪ Savings banks (including trustee savings banks, loan associations)	
▪ Credit co-operatives	
▪ Mortgage banks	
▪ Building societies	
▪ Post office savings banks	
▪ Other deposit-takers (<i>to be specified</i>)	
▪ <i>Other financial intermediaries except insurance corporations and pensions funds</i>	<i>SNA 123</i>
▪ Investment corporations (including money market funds)	
▪ Corporations engaged in financial leasing	
▪ Consumer credit institutions	
▪ Other intermediaries (<i>to be specified</i>) (including those offshore banks that do not fall in the category of deposit-takers)	
▪ <i>Financial Auxiliaries</i>	<i>SNA 124</i>
▪ <i>Insurance corporations and pensions funds</i>	<i>SNA 125</i>
▪ Insurance companies	
▪ Autonomous Pension funds	

3.4. Number and definition of variables

Identified gaps

60. The OECD collects 49 variables: 23 for the income statement, 18 for the balance sheet, 5 for capital adequacy purposes, and 3 for structural purposes. A significant overlap exists between the income statement variables required by the IMF *Guide* and the OECD framework. However, this is not the case for balance sheet variables.

61. While definitions were adopted at the time of the creation of the OECD database, differences among OECD countries regarding structural and regulatory features of national banking systems, accounting rules and practices, and reporting methods make international comparisons particularly difficult. On the other hand, the IMF *Guide* gives detailed definitions for all variables and indicators (see Chapter 4 of the IMF *Guide*) which should be used by compilers as a reference, so that data collected by the IMF are more consistent and comparable across countries.

62. In order to compile financial soundness indicators, i.e. specific key-ratios that highlight the banking sectors' financial health and address revenue as well as risk and capital, the collection of additional variables as recommended in the IMF *Guide* relating to income statements and balance sheets of 'banks' (current Table 1 of the OECD *Bank Profitability – Financial Statements of Banks* publication)

should be necessary. Moreover, giving that it is highly important to have a good knowledge of the structure of national financial systems, it could be beneficial to also increase the information requested in Table 2 of the OECD publication.

63. The main differences between the series reported in the income and expense statement set out in the IMF *Guide* and the series reported in the income statement under the OECD framework concern four series,. These items are indicated in bold in the right-hand side of table 2 below): *Gross interest income*, *Provisions for accrued interest on non-performing assets* (used for calculating Interest income), *Pro-rated earnings* (included in Non-interest income), and *Extraordinary items*.

64. In addition, there are differences in the presentation and definitions of *Non-interest income*, *Gross income*, and *Non-interest expenses* between the OECD framework and the framework of the IMF *Guide*: *Non-interest income* in the OECD framework, is shown on a net basis (item 4) and broken down by income and expense, while *Non-interest income* in the framework of the IMF *Guide* is reported on a gross basis. Item 5 in both frameworks does not cover exactly the same items: it is the sum of *Net interest income* plus *Net non-interest income* in the OECD table, while *Gross income* in the FSI table is not net of *Fees and commissions payable*. Inconsistency is also found for item 6 which is referred to as *Operating expenses* in the OECD table, while it is referred to as *Non-interest expenses* (which also cover *fees and commissions payable*) in the IMF *Guide*'s income and expense statement. (see Table 2 below)

Table 2: List of OECD and IMF income statement series

	OECD		IMF Guide
	INCOME STATEMENT		INCOME AND EXPENSE STATEMENT
1.	Interest income	1.	Interest income (item 1 (i) minus item 1 (ii))
		(i)	Gross interest income
		(ii)	Provisions for accrued interest on non-performing
2.	Interest expenses	2.	Interest expenses
3.	Net interest income (item 1 minus	3.	Net interest income (item 1 minus item 2)
4.	Net non-interest income	4.	Non-interest income
a.	<i>Fees and commissions receivable</i>	(i)	<i>Fees and commissions receivable</i>
b.	<i>Fees and commissions payable</i>		
c.	<i>Net profits/loss on financial</i>	(ii)	<i>Gains or losses on financial instruments</i>
		(iii)	Pro-rated earnings
d.	<i>Other net non-interest income</i>	(iv)	<i>Other income</i>
5.	Net interest & non-interest income	5.	Gross income (item 3 plus item 4)
6.	Operating expenses	6.	Non-interest expenses
a.	<i>Staff costs</i>	(i)	<i>Personnel costs</i>
b.	<i>Property costs</i>		
c.	<i>Other operating expenses</i>	(ii)	<i>Other expenses</i>
7.	Net income before provisions (item 5		
8.	Net provisions	7.	Net provisions
a.	<i>Provisions on loans</i>	(i)	<i>Loan loss provisions</i>
b.	<i>Provisions on securities</i>		
c.	<i>Other net provisions</i>	(ii)	<i>Other financial asset provisions</i>
9.	Income before tax (item 7 minus	8.	Net income (before extraordinary items and taxes)
		9	Extraordinary items
10.	Income tax	10.	Income tax
11.	Net income after tax (item 9 minus	11.	Net income after tax (item 8 minus (items 9 + 10)
12.	Distributed profit	12.	Dividend payable
13.	Retained profit (item 11 minus item	13.	Retained earnings (item 11 minus item 12)

65. Concerning the balance sheet and the solvency data, the differences between the OECD database and the IMF *Guide*'s recommendations are much greater as the IMF *Guide* requires much more detail, including a number of memorandum series. The table below (right side) shows in bold the list of additional balance sheet items and memorandum items necessary to calculate the twelve core FSIs of the IMF *Guide*.

Table 3: List of OECD and IMF balance sheet series

OECD		IMF	
BALANCE SHEET		BALANCE SHEET	
		14.	Total assets (items 15 + 16 = item 31)
		15.	Non-financial assets
	<i>Assets</i>	16.	Financial assets (items 17 to 22)
14	Cash and balance with Central bank	17.	Currency and deposits
15	Interbank deposits		
16	Loans	18.	Loans (after specific provisions)
		<i>(i)</i>	Gross loans
		<i>(i.i)</i>	Interbank loans
		<i>(i.i.i)</i>	Resident
		<i>(i.i.ii)</i>	Non-resident
		<i>(i.ii)</i>	Non-interbank loans
		<i>(i.ii.i)</i>	Central bank
		<i>(i.ii.ii)</i>	General government
		<i>(i.ii.ii)</i>	Other financial corporations
		<i>(i.ii.iv)</i>	Non-financial corporations
		<i>(i.ii.v)</i>	Other domestic sectors
		<i>(i.ii.vi)</i>	Nonresidents
		<i>(ii)</i>	Specific provisions
17	Securities	19.	Debt securities
		20.	Shares and other equity
		21.	Financial derivatives
18	Other assets	22.	Other assets
	<i>Liabilities</i>	23.	Liabilities (items 28 + 29)
19	Capital and reserves		
20	Borrowing from Central bank	24.	Currency and deposits
22	Customer deposits	<i>(i)</i>	Customer deposits
21	Interbank deposits	<i>(ii)</i>	Interbank deposits
		<i>(ii.i)</i>	Resident
		<i>(ii.ii)</i>	Non-resident
		<i>(iii)</i>	Other currency and deposits
		25.	Loans
23	Bonds	26.	Debt securities
24	Other liabilities	27.	Other liabilities
		28.	Debt (items 24 to 27)
		29.	Financial derivatives
		30.	Capital and reserves
		<i>(i)</i>	o/w narrow capital and reserves
	<i>Balance sheet total</i>	31.	Balance sheet total (items 23 + 30 = item 14)
25	End-year total		
26	Average total		

MEMORANDUM ITEMS		MEMORANDUM SERIES	
	Assets		
27	<i>Short-term securities</i>		
28	<i>Bonds</i>		
29	<i>Shares and participations</i>		
30	<i>Claims on non-residents</i>		
	Liabilities		
31	<i>Liabilities to non-residents</i>		
		<i>Other series required to calculate FSIs</i>	
	<i>Capital adequacy</i>	<i>Supervisory series</i>	
32	<i>Tier 1 Capital</i>	32.	Tier 1 Capital
33	<i>Tier 2 Capital</i>	33.	Tier 2 Capital
		34.	Tier 3 Capital
34	<i>Supervisory deductions</i>	35.	Supervisory deductions
35	<i>Total regulatory capital</i>	36.	Total net capital resources (items 32 to 34 minus
36	<i>Risk-weighted assets</i>	37.	Risk-weighted assets
		38.	Number of large exposures
		<i>Series that provide a further analysis of the balance sheet</i>	
		39.	Liquid assets (core)
		40.	Liquid assets (broad measure)
		41.	Short-term liabilities
		42.	Non-performing loans
		43.	Residential real estate loans
		44.	Commercial real estate loans
		45.	Geographic distribution of loans
		46.	Foreign currency loans
		47.	Foreign currency liabilities
		48.	Net open position in equities
		49.	Net open position in foreign currency for on-
		<i>Balance sheet-related series</i>	
		50.	Total net open position in foreign currency
		51.	Exposures of largest deposit-takers to largest
		52.	Exposures to affiliated entities and other
		53.	Duration of assets
		54.	Duration of liabilities

Potential measures to close the gaps

66. The OECD definitions should be compared with the IMF *Guide*'s definitions and countries should be requested to provide data according to the definitions set out in the IMF *Guide*. Then, in the methodological country notes, countries could describe deviations of their definitions from the standard definitions in the IMF *Guide*, if any. This would help compare the definitions used across countries.

67. Based on the information already collected by the IMF on the availability of data needed for compiling the core set of FSIs, the OECD could incorporate additional requests in its annual questionnaire on Bank Profitability for income and balance sheet data that are not required under the current OECD framework, but are needed for compiling FSIs set out in the IMF *Guide*. Some of the indicators listed in the FSI core set, such as *Tier 1 capital ratio* (Tier 1 capital as a ratio of risk weighted assets) and the *Solvency ratio* (Tier 1 and 2 capital as a ratio of risk weighted assets), can be calculated using the series already collected by the OECD.

68. However, to calculate some other useful key-ratios, such as *Asset quality ratio* (Non-performing loans to total gross loans) or *Liquid asset ratio* (Liquid assets to total assets), some new series would need to be added. Among them are basic data, such as non-performing loans or liquid assets, which were already proposed by the OECD in 2002 and were agreed to by the WPFS experts.

3.5. Consolidation basis and consolidation adjustments

Identified gaps

69. The OECD recommends that data included in its statistics should be consolidated world-wide, i.e. including foreign branches of reporting banks as well as domestic/foreign subsidiaries but it does not provide any recommendation in terms of intra-group and intra-sector consolidation adjustments.

70. On the other hand, the *IMF Guide* recommends applying a cross-border consolidation for domestically controlled deposit-takers as the required consolidation basis for compiling FSIs for deposit-takers. As regards consolidation adjustments to produce the sector-wide data, the *IMF Guide* recommends that all intra-sector flows and positions, except debts and financial derivatives, should be netted out. The gross data on intra-sector debts and financial derivatives are needed to allow monitoring of contagion risks. At the group level, the *IMF Guide* recommends that all flows and positions between units within the group, comprising parent, its branches and subsidiaries, are to be eliminated.

Potential measures to close the gaps

71. A cross-border consolidation of the domestically controlled deposit-takers (as defined in the *IMF Guide*) could be recommended. Intra-group and intra-sector adjustments could also be made. Even if countries do not opt to follow the recommendations of the *IMF Guide*, more precise and comparable information on the consolidation adjustments (at the group and sector levels) made by countries could be requested and included in the *OECD Bank Profitability - Methodological country notes* publication.

3.6 Accounting rules

Identified gaps

72. The OECD questionnaire does not provide any specific recommendations as to what accounting rules should be applied by countries. The *IMF Guide* provides guidance on the accounting rules pertaining to the valuation of financial instruments, the use of accrual accounting, recording of realized and unrealized gains and losses etc. to be used by reporting entities and compilers. The use of these accounting rules will ensure that the sectoral financial statements are produced in a consistent manner.

Potential measures to close the gaps

73. The application of the accounting rules set out in the *IMF Guide* should be recommended to countries for compiling the *Bank Profitability* data following a more in-depth exploration by the EDG of volunteering experts of the implications of the implementation of the new International Accounting Standards (IAS). In addition to data, countries should be requested to provide information on the accounting rules that they use and identify if there are any departures of their practices from the *IMF Guide*'s recommendations.

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