

Chapter 2

THE FINANCIAL REPORTING FRAMEWORK AND POLICIES OF THE NATIONAL BANK OF CAMBODIA

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1. Overview of the National Bank of Cambodia

1.1 A Brief Historical Chronology of the National Bank of Cambodia

After Cambodia gained independence from France and after the Indochina Printing Institution was closed, the National Bank of Cambodia (NBC) was established as the nation's Central Bank on 23 December 1954. At the same time, the national currency, the "Riel" was issued by NBC to terminate the use of monetary alliance with the Vietnamese and Laos currencies.

Since the inception, the NBC had been gradually reformed in conformity with the national building policy of the Sangkum Reastre Niyum in order to develop the national economy. Regrettably, NBC's operations were discontinued during the civil war and the entire banking system was completely destroyed.

The historical chronology of the NBC can be divided into three stages:

1. 1954 to 1975: NBC had independence for operations as well as autonomy for printing the Riel as the national currency as well as to manage the banking system in Cambodia.
2. 1975 to 1979: NBC ceased operations and the entire banking system and the whole economy were totally destroyed.
3. 1979 to Present: NBC was revived and has gradually strengthened to gain recognition from the international community.

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Even though the banking system was entirely destroyed during from 1975 to 1979, the NBC has progressively rebuilt the banking system and has contributed to national economic advancement by vigilantly implementing the monetary policy framework and prudently regulating banks and financial institutions.

1.2 The National Bank of Cambodia's Objectives and Main Activities

As mandated in the Law on the Organization and Conduction of the National Bank of Cambodia, the principal mission of NBC is to determine and implement monetary policy aimed at maintaining price stability. The Central Bank Law was promulgated by the National Assembly on 26 January 1996. In addition, the Central Bank Law explicitly specifies the functions and duties of NBC as the following:

1. To determine monetary policy objectives, in consultation with the Royal Government and consideration of the framework of the economic and financial policy of the Kingdom;
2. To formulate, implement and monitor monetary and exchange policies aimed at the determined objectives;
3. To conduct regular economic and monetary analysis, make public the results, and submit proposals and measures to the Royal Government;
4. To license, de-license, regulate and supervise banks and financial institutions and other relevant establishments such as auditors and liquidators;
5. To oversee payments systems in the Kingdom, and to enhance interbank payments;
6. To act as the sole issuer of national currency of the Kingdom;
7. To undertake and perform, in the name of the Kingdom, transactions resulting from the participation of the Kingdom in public international institutions in the banking, credit, and monetary spheres;
8. To establish the balance of payments;
9. To participate in the management of external debt and claims;
10. To participate in the formation and supervision of the money and financial markets;
11. To license, de-license, regulate and supervise all those operating in the securities and foreign exchange markets, the market for precious stones and precious metals; and,
12. To set interest rates.

The NBC is a public entity of a commercial and industrial nature, and is permanently empowered to operate autonomously.

2. The National Bank of Cambodia's Financial Reporting Framework

2.1 Legal Provision of the National Bank of Cambodia's Financial Reporting Framework

The NBC maintains its accounting records and prepares its financial statements in accordance with the Law on the Organization and Conduct of the National Bank of Cambodia promulgated by Royal Kram NS/RKM/0196/27 dated 26 January 1996. This central bank law requires that the accounts and records of the National Bank of Cambodia reflect accurately its financial conditions in accordance with generally accepted accounting principles which are applicable to central banks. In absence of generally accepted accounting principles for some transactions and events which are unique to the nature of the central bank, the central bank law empowers the NBC's Board of Directors to adopt accounting policies and principles which, in the opinion of the Board of Directors, are appropriate to the nature of operations of the NBC. Articles 18 and 19 of the Central Bank Law set out the process for the distributions of the net income of the NBC for each financial year.

The amendment of Article 57 of Central Bank Law in 2006 requires the financial records of NBC to be verified by the board of directors and audited by National Audit Authority.

2.2 The Purposes of the National Bank of Cambodia's Financial Statements

The purpose of the NBC's financial statements is to demonstrate its accountability in achieving its objectives and missions. This will reveal information on the impact of the NBC's policies on the financial position and the statement of results. With reference to the Central Bank Law, the NBC is responsible to both the National Assembly and the Royal Government of Cambodia. Thus, the NBC is obliged to report its implementation and results of the mission to both National Assembly and the Royal Government of Cambodia.

2.3 Basic Principles Underlying the Financial Reporting

The following principles are significant accounting practices adopted by the NBC in accordance with the generally accepted accounting principles applicable for central banks.

2.3.1 Measurement Base

The financial statements of the NBC are prepared using the historical cost convention, except for trading and available-for-sale financial assets and gold which are measured at fair value; and fixed assets, which have used both the revaluation model and cost model.

2.3.2 Functional and Presentation Currency

The financial statements of the NBC are presented in the national currency of the Kingdom of Cambodia, the Khmer Riel (“Riel”), which is the NBC’s functional and presentation currency.

2.3.3 Income Taxes

The International Accounting Standard 12 Income Taxes is not applicable to the NBC since the article 58 of the Central Bank Law exempts the NBC’s assets, property, income, operations and transactions from all duties and taxes.

2.3.4 Fee Income

Fee income earned from provision of services is recognized in the Income Statement on an accruals basis as the services provided.

2.3.5 Currency in Circulation

Currency issued by the NBC represents a claim on the central bank in favor of the holder. The liability for currency in circulation is recorded at face value of notes in the Statement of Financial Position.

2.3.6 Production Costs of Banknotes and Coins

The costs of banknotes and coins are capitalized and amortized over six and a half years using the straight-line method. Costs consist of those associated with printing and minting, carriage, freight landed at the Bank’s premises and other related costs.

2.3.7 Intangible Assets

Intangible assets, which comprise computer software licenses and related costs, are stated at cost less accumulated amortization and impairment loss. Acquired computer

software licenses are capitalized on the basis of the cost incurred to acquire the specific software and bring it to use. These costs are amortized over three to five years using the straight-line method. Costs associated with maintaining computer software are recognized as expenses when incurred.

2.3.8 Property, Plant and Equipment

Land and buildings are stated at revalued amount less depreciation. Revaluation gains arising from the appraisal are taken to the Revaluation Surplus Account, which is part of the NBC's equity. Upon disposal, the revaluation gains or losses included in the Revaluation Surplus Account in respect of the related land and buildings are considered to have been realized. Depreciation is provided on a straight-line basis to write down the cost of each asset to its residual value over the expected useful lives as follows:

Number of years	
Buildings	25, 40
Machinery	3, 5, 10
Vehicles	5
Office equipment	3
Computer equipment	3, 5

Property, plant and equipment with a value of less than US\$10,000 is capitalized and depreciated over one year. Freehold land is not depreciated. Assets under construction are not depreciated until they are brought into use. Repair and maintenance costs are charged to the income statement during the financial year in which they are incurred. Costs relating to major renovation, improvements and renewals are capitalized. Gains or losses on disposals, which are determined by comparing the disposal proceeds with the carrying amount, are included in the income statement.

2.3.9 Foreign Exchange Translation

Monetary assets and liabilities denominated in currencies other than the Khmer Riel are translated into the Khmer Riel at the exchange rates prevailing at the balance sheet date. Non-monetary foreign currency assets and liabilities are reported using the exchange rates effective at the dates of the transactions. Both realized and unrealized foreign exchange gains and losses are credited or charged to the Special Reserve Account, which is an equity account, in accordance with the Article 32 of the Central Bank Law. The Law explicitly determines that neither net gains nor net losses arising from exchange differences shall be included in the annual income statement of the NBC which is contradicted to International

Accounting Standard 21 on The Effects of Changes in Foreign Exchange Rates. This standard requires the realized and unrealized gains or losses from translation foreign currency to be reported to profit and loss statement. Therefore, IAS 21 is not applicable to the NBC.

2.3.10 Gold

Gold is initially recognized at cost and subsequently re-measured at the market value based on international market's average rates per ounce of gold prevailing at the balance sheet dates. This gold is considered as a part of central bank reserves and for which the NBC has no intention to sell. The unrealized gains or losses arising from changes in the market value are, in accordance with the Central Bank Law, credited or charged to the Special Reserve Account, which is part of NBC's capital and reserves.

2.3.11 Investment Securities Carried at Fair Value

Fair Value of Financial Instruments The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Financial instruments are priced with reference to a quoted market price for that instrument.

Financial Assets at Fair Value through Equity Investment securities carried at fair value are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. These investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates or bond prices. These investments are initially recognized at fair value plus transaction costs. These investments are derecognized when the rights to receive cash flows from the financial assets have expired or where the NBC has transferred substantially all risks and rewards of ownership. Gain or loss is recognized in income statement when they are sold. These investments are subsequently carried at fair value. Gains and losses arising from changes in the fair value of these investments are recognized directly in equity, until the financial asset is derecognized or impaired.

2.3.12 Investment Securities Carried at Amortized Cost

Investment securities carried at amortized cost are non-derivative financial assets with fixed or determinable payments and fixed maturities. These investments are initially recognized at fair value plus transaction costs. These investments are subsequently carried at face value less unamortized purchase discount road back unamortized purchase premium, and less provision for impairment. Purchase discount or premium is amortized using the straight-

line method over the period of the financial assets. These investments are derecognized when the rights to receive cash flows from the financial assets have expired or where the Central Bank has transferred substantially all risks and rewards of ownership. Gain or loss is recognized in income statement as income from investment securities when they are sold.

2.3.13 Impairment of Financial Assets

The financial assets are subject to impairment assessment under IAS 39. The NBC employs the “incurred loss model” to assess whether assets are impaired. Because the Central Bank only hold debt securities, the loss events could be from the deterioration in creditworthiness or the underlying assets are re-ranked below the investment grades.

2.3.14 Pension Fund – Defined Benefit Scheme

The NBC adopts an internal edict in which entitles retired employees to continue receiving a monthly pension from the NBC. The value of pension paid is determined at a certain percentage of the final monthly salary upon retirement if an employee has provided service to the NBC for a range of predetermined number of years. The NBC does not recognize the net defined benefit liability or asset in its statement of financial position for this pension scheme. Thus, there is no need for the work to estimate present value of defined benefit obligation (projected benefit obligation), that is, no actuarial valuation has been undertaken to accrue for the potential future liability discounted back to the balance sheet date. The reason for this, conversely, is that the NBC’s management believes that the accumulated fund (plan assets), which is periodically contributed by the NBC, will be sufficient to cover in full the potential liability and to pay its retired employees their post-employment benefits. Moreover, benefits will only be paid out to eligible pensioners if the NBC has the financial resources to do so, as reflected by the balance of the accumulated fund (plan assets).

2.3.15 Leases

Assets leased out under operating leases are included in the property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income is recognized on a straight-line basis over the lease term.

2.3.16 Capital

The NBC's capital is determined by a sub-decree. This capital amount may be changed when deemed necessary. All of NBC's capital is subscribed and held exclusively by the Royal Government and is not transferable or subject to encumbrance. With reference to the Central Bank Law, whenever the NBC is in a net liability position, the Royal Government shall transfer, within sixty days of publication of the balance sheet, its government securities to the NBC in order to remedy the deficiency. The securities shall be negotiable and shall bear interest at the refinancing rate.

3. Recommendation and Conclusion

Having a set of accounting standards applicable to central banks among the SEACEN economies is a promising undertaking which is consistent with the ASEAN community's plan to achieve economic integration. Nevertheless, further cooperative researches among SEACEN members are necessary to determine the costs and benefits of adopting identical accounting standards for the preparation of central banks' financial statements. In addition, central banks' local laws may be different from each other and requirements under those laws may contradict proposed accounting standards. This would require and put pressure on some central banks to amend the laws, which can be a time consuming process.

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