

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: September 22–25, 2015

Agenda Item 3

For:

☐ Approval

☒ Discussion

☒ Information

Public Sector Specific Financial Instruments

Objective(s) of Agenda Item

1. The objective of this session is to **consider** key issues in this Issues Paper and **review the draft** Consultation Paper (CP) on Public Sector Specific Financial Instruments; and to **provide directions** for further developing the CP.

Material(s) Presented

Agenda Item 3.1	Draft Issues Paper, Public Sector Specific Financial Instruments
Agenda Item 3.2	Draft Monetary Gold Chapter of the CP, Public Sector Specific Financial Instruments (mark-up version available upon request)
Agenda Item 3.3	Draft Currency in Circulation Chapter of the CP, Public Sector Specific Financial Instruments (mark-up version available upon request)

Objective of the Issues Paper

2. The objective of this session is to **consider** key issues in this Issues Paper and **review the draft** Consultation Paper (CP) on Public Sector Specific Financial Instruments; and to **provide directions** for further development of the CP.

Agenda Item

3.1

Issues Paper, Public Sector Specific Financial Instruments

Background

1. At its June 2015 meeting, the IPSASB discussed a revised draft of the monetary gold chapter and a new draft chapter on currency in circulation. The IPSASB provided directions to staff regarding the further development of the CP.
2. Revised draft monetary gold and currency in circulation chapters have been included as Agenda Item 3.2 and 3.3. Mark-up versions of the drafts are available upon request.
3. This Issues Paper seeks the IPSASB's views on the key issues identified in revising the draft chapters.

Key Issues

Monetary Gold - Definitions

4. The IPSASB agreed in June 2015 with the modification of the definition of tangible gold—see paragraph 3.18.
5. However, the IPSASB directed that more information be included in the CP explaining whether financial instruments which are contractual and can result in the physical delivery of gold are considered in scope of guidance. This has been included in paragraph 3.21.

Matter(s) for Consideration

1. The IPSASB is asked to **confirm** the amendment clarifying whether financial instruments which may result in delivery of gold in paragraph 3.21 are in scope, or suggest amendments.

Monetary Gold – Preliminary View and Development of SMCs

6. The IPSASB agreed in June 2015 that SMCs should be developed as each chapter progresses and not while finalizing the CP overall.
7. Staff proposes, that consistent with other IPSASB projects, each chapter should have a PV related to the proposed definitions. The PV developed and included in the monetary gold chapter is:

Preliminary View – Chapter 3

Monetary gold is tangible gold held by monetary authorities as reserve assets.

The other key definitions are:

- (a) **Tangible gold** is physical gold that has a minimum purity of 995 parts per 1000.
- (b) **Monetary authority** is the entity or entities including the central bank or a department(s) of the central (national) government, which carry out operations usually attributed to the central bank.
- (c) **Reserve assets** are assets held by monetary authorities, which are readily available for international payment needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.

Matter(s) for Consideration

2. The IPSASB is asked to **indicate** whether it agrees with including a PV on the definitions in the chapter.
8. Staff considered the key issues related to the chapter and proposes the following SMCs. The key issues on which constituents' views are sought are:
- (a) Which of the two measurement options presented in the chapter are appropriate; and
 - (b) Should the IPSASB prescribe one of the options presented, or allow preparers to select an option based on their intention in holding monetary gold.
9. The proposed SMCs are as follows:

Specific Matter for Comment—Chapter 3–1

- (a) Please provide the reasons for your support of:
- (i) Option 1: Measurement at market value in an open, active and orderly market; or
 - (ii) Option 2: Measurement at historical cost.
- Please provide reasons for your views, including the conceptual merits and weaknesses of each option; the extent to which each option addresses the objectives of financial reporting; and how the different options might provide useful information to users.

Specific Matter for Comment—Chapter 3–2

- (a) Please provide the reasons for your support of:
- (i) Alternative 1: The IPSASB to prescribe accounting requirements based on one of the options; or
 - (ii) Alternative 2: Allow preparers to designate an option based on their intentions.
- Please provide reasons for your views, including the conceptual merits and weaknesses of each alternative; the extent to which each alternative addresses the objectives of financial reporting; and how the different alternatives might provide useful information to users.

Matter(s) for Consideration

3. The IPSASB is asked to:
- (a) **Indicate** whether it agrees with the staff view to include SMC–Chapter 3–1;
 - (b) **Indicate** whether it agrees with the proposed wording of SMC–Chapter 3–1, or suggest amendments;
 - (c) **Indicate** whether it agrees with the staff view to include SMC–Chapter 3–2 in the chapter; and
 - (d) **Indicate** whether it agrees with the proposed wording of SMC–Chapter 3–2, or suggest amendments.

Chapter 2 – Currency Issued by the Entity: Definitions and Scope

10. In June 2015 the IPSASB directed that the definition of “Currency in Circulation” be modified as follows:

- (a) The defined term should be amended to “Domestic Currency in Circulation” to make the label more clear and to better align with GFS terminology.
- (b) Modify the definition to include “authorized”, in addition to “issued” to deal with the cases where monetary authorities may use a third party to produce and/or distribute currency.
- (c) Consider replacing “economy” with “jurisdiction”.
 - (i) Staff has considered replacing “economy” with “jurisdiction” and believes that “economy” should remain in the definition for the following reasons:
 - a. From the Balance of Payments and International Investment Position Manual—Sixth Edition (BPM6) and GFS reporting perspective, economy is a defined term with a specific meaning and is not interchangeable with jurisdiction. BPM6 indicates an economy consists of all the institutional units that are resident in a particular economic territory. From a statistics perspective a jurisdiction may be a small portion of an economy.
 - b. From the perspective of the IPSASB’s existing literature, the term “economy” and “economic environment” are used in a similar context to that proposed in this chapter. IPSAS 10, *Accounting for Hyperinflationary Economies*, uses economy¹ consistently with how it is proposed in the currency chapter. In addition, IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, when defining functional currency² refers to the primary economic environment, which staff believes is consistent with the proposed use of economy in the chapter. Both IPSAS 4 and IPSAS 10 can be seen as having particular relevance to monetary authorities and accounting for currency. Therefore, based on the use of economy in both BPM6 and IPSAS literature, staff recommends leaving “economy” in the definition.

The proposed revised definition and proposed PV to include in the chapter is:

Preliminary View – Chapter 2

Domestic Currency in Circulation is physical notes and coins with fixed and determinable values that are legal tender issued by the monetary authority, or by a third party that is authorized to do so, that is, either that of an individual economy or, in a currency union to which the economy belongs.

¹ IPSAS 10.1A: “An entity prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to the primary financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.”

² IPSAS 4.10: “Functional currency is the currency of the primary economic environment in which the entity operates.”

Matter(s) for Consideration

4. The IPSASB is asked to:
 - (a) **Confirm** if it agrees with the revisions to the definition of domestic currency in circulation or suggest amendments; and
 - (b) **Indicate** whether it agrees with including a PV for the definition in the chapter.

Chapter 2 – Currency Issued by the Entity: Financial Liability vs. Liability to Maintain

11. Based on feedback received at the June 2015 meeting staff and the TBG discussed whether there is more than one viable approach to accounting for notes, by considering the nature of the liability. It was determined that the two approaches discussed, the financial liability approach and the obligation to maintain the liability for notes in circulation approach, are interrelated and essentially the same.
12. Regardless of whether the liability is considered to be financial or not, a liability should not be recognized prior to notes being issued by the monetary authority. Laws and regulations may give rise to an obligation to maintain currency. However, that obligation does not result in the recognition of a liability until the notes are issued. Until the notes are issued by the monetary authority and held by a third party, there is no counterparty to the transaction and therefore there cannot be an outflow of resources or a past event (outflow of resources is the exchange of new notes for old notes when presented by the holder and past event is the issuance of the notes). Therefore, even though an obligation may exist, a liability should not be recognized until currency is issued.
13. The discussion added to the chapter in regards to the obligation to maintain notes is included in paragraphs 1.24–1.28.

Matter(s) for Consideration

5. The IPSASB is asked to:
 - (a) **Indicate** if it agrees with Staff and TBG view that the financial liability and the obligation to maintain the liability for notes in circulation are interrelated and therefore one approach; and
 - (b) **Indicate** if it agrees with the discussion in regards to the obligation to maintain notes included in paragraphs 1.24–1.28, or provide alternative directions.

Chapter 2 – Currency Issued by the Entity: Financial Liability

14. The IPSASB directed staff to consider the nature of the liability for notes in circulation and if it is a financial liability. Staff added paragraphs 1.36–1.42 discussing the nature of the liability.
15. Staff concludes that cash is a financial instrument, and a financial liability, because the substance of the transaction is contractual and, once issued, holders of notes have rights and monetary authorities have obligations.
16. To determine whether cash is contractual, current IPSAS guidance was considered. IPSAS 28.AG20 states: *substance rather than the legal form of an arrangement is considered by an entity in determining whether a “contract” exists under IPSAS and describes contracts as generally having the following:*

- Contracts involve willing parties entering into an arrangement; the distribution of banknotes is an exchange transaction between two willing parties to the arrangement (notes).
 - The terms of the contract create rights and obligations for the parties in the contract, and those rights and obligations need not result in equal performance for each party; Holders of banknotes have rights as they can go to the monetary authority and exchange notes for new notes or other consideration. The monetary authority has an obligation to accept banknotes presented and furnish new notes or other equal consideration.
 - The remedy for non-performance is enforceable by law. The remedy for non-performance is enforceable by law, as each jurisdiction has currency regulations which mandate the requirements of monetary authorities in relation to notes issued.
17. Cash is considered a financial liability when it is: *a liability that is a contractual obligation to deliver cash or another financial asset to another entity*. In most cases regulations and laws related to currency in a jurisdiction state that monetary authorities must provide an equal amount of consideration to the face value of the notes received when presented by holders. In such an arrangement cash appears to satisfy the definition of a financial liability.
18. If the nature of the liability is financial, the transaction to issue currency results in an exchange of financial instruments. Therefore, accounting consistent with IPSAS 28–30 requirements appears appropriate with classification as fair value through surplus or deficit. Initial recognition is at fair value with transaction costs expensed as incurred in the statement of financial performance and subsequent measurement at fair value. Accounting for currency liabilities at amortized cost, is inappropriate, as cash does not have a maturity date or interest payments. Therefore, it may be more appropriate to account for currency liabilities at fair value through surplus or deficit, which would be at face value.

Matter(s) for Consideration

6. The IPSASB is asked to:
- (a) **Indicate** if it agrees with the discussion in paragraphs 1.36–1.42, that cash is a financial instrument and a financial liability (from the monetary authority perspective), or provide alternative directions.
 - (b) **Indicate** if it agrees the proposal for consistent accounting to that in IPSAS 28–30 for a financial liability classified as fair value through surplus or deficit, as discussed in paragraphs 1.40–1.42, or provide alternative directions.

Chapter 2 – Currency Issued by the Entity: Coins – Recognition

19. Unlike notes, there is variation in accounting for coins in circulation. Some monetary authorities recognize a liability for coins in circulation, while others do not.
20. The TBG discussed the nature of notes in circulation vs. coins in circulation. It was noted that the different nature of transactions for coins is related to the following:
- (a) The monetary authority may not have an obligation to maintain coins, because there are no requirements in law to do so and there has not been any past practice of maintaining coins; and

- (b) The monetary authority may not view the possibility of an outflow of resources to be probable and therefore does not recognize a liability;
 - (i) The overall value of the coins in circulation may not be material for the particular monetary authority; or
 - (ii) The monetary authority may estimate that because coins are made of metal, they are harder to damage and will require replacement less often. Even when damaged coins are exchanged they can be recycled and reused to produce new coins, reducing the potential outflow of resources.
- 21. When the recognition criteria are not met because of the lack of laws and regulations to maintain currency or because it is not probable there will be an outflow of resources to do so, a liability should not be recognized and the nature of the transactions for coins differ compared to notes.
- 22. Staff and the TBG agreed that when a monetary authority has an obligation and a liability is recognized to maintain coins for a jurisdiction, the accounting requirements should be the same as for notes in circulation liabilities because the nature of the transactions is the same (financial liability due to the legislation in regards to currency).
- 23. When an obligation related to coins does not exist, the nature of the transaction to distribute coins is different because there is no continuing obligation related to the coins. Therefore, staff's view is that coins are put into circulation through an exchange transaction which should result in the recognition of revenue when coins are distributed, as discussed in paragraph 1.65.

Matter(s) for Consideration

- 7. The IPSASB is asked to:
 - (a) **Indicate** if it agrees with the view that when a liability for coins is recognized, it should be consistent with the liability for notes in circulation, or provide alternative directions; and
 - (b) **Indicate** if it agrees with the staff view that when an obligation does not exist for coins, the transaction results in recognition of revenue (as noted in paragraph 1.65), or provide alternative directions.

Chapter 2 – Currency in Circulation – Examples

- 24. Staff spoke with representatives from a national government finance department (jurisdiction 1) and an IMF representative who previously worked for a central bank (jurisdiction 2) to better understand how currency in circulation is accounted for in each jurisdiction.
- 25. Staff confirmed the following for each jurisdiction:
 - (a) Jurisdiction 1 – recognizes a liability for notes in circulation. No liability is recognized for coins. This is because of the requirements of the currency act which requires the monetary authority to maintain notes, but not coins (see appendix A to Issues Paper).
 - (b) Jurisdiction 2 – recognizes a liability for notes and coins in circulation. Jurisdiction 2's currency regulations require the monetary authority to exchange notes and coins when presented by the holder.
- 26. Staff and the TBG discussed if specific country examples or generic examples referencing the currency laws and the accounting requirements for specific jurisdictions should be added. It was

agreed that such detailed examples, while informative, should not be included in the CP. Staff and TBG prefer to include generic examples, such as those included in the draft chapter, which are based on the nature of the transactions only. The view was that focusing on different jurisdictions laws and regulations and specific accounting for transactions, distracts from considering the nature of the transactions and the appropriate approaches to accounting for them, which should be underpinned by the Conceptual Framework and existing IPSAS literature.

Matter(s) for Consideration

8. The IPSASB is asked to **indicate** if it agrees with the staff and TBG view to include the current generic examples in the appendix to the CP, as opposed to more specific jurisdiction-specific examples, or **provide** alternative directions.

Chapter 2 – Currency in Circulation - SMCs

27. Staff considered the key issues in the chapter in developing SMCs. The key issues which constituents views would be helpful are as follows:
- (a) Should measurement of the liability for currency in circulation be at face value of the currency issued? Also, do constituents agree with the analysis of the historical cost and market value measurement bases specified in the Conceptual Framework, and agree they result in recognition at face value.
 - (b) If a liability is recognized for both notes and coins, the view is that the accounting for the liability should be consistent;
 - (c) When no liability is recognized for coins in circulation, should a transaction to distribute new coins result in the recognition of revenue?
28. The proposed SMCs are as follows:

Specific Matter for Comment–Chapter 2–1

Do you agree with the following:

- (a) The economic nature of transactions to issue currency in circulation are best represented by measuring the liability for notes in circulation at the face value of the currency issued; and
- (b) Use of the Conceptual Framework measurement bases of historical cost and market value results in measurement at the face value of currency issued.

Please provide reasons for your views, including the conceptual merits and weaknesses; the extent to which your preferred view addresses the objectives of financial reporting; and how the preferred view provides useful information to users.

Specific Matter for Comment–Chapter 2–2

- (a) Do you support consistent accounting for the liabilities for notes and coins in circulation, when a liability exists and is recognized for both?

Please provide reasons for your views, including the conceptual merits and weaknesses; the extent to which your views address the objectives of financial reporting; and how the views might provide useful information to users.

Specific Matter for Comment—Chapter 2–3

- (a) Do you believe when a liability for coins in circulation is not recognized, the substance of the transaction results in the recognition of revenue?

Please provide reasons for your views, including the conceptual merits and weaknesses; the extent to which your views address the objectives of financial reporting; and how your preferred view provides useful information to users.

Matter(s) for Consideration

9. The IPSASB is asked to:

- (a) **Indicate** whether it agrees with the staff view to include SMC–Chapter 2–1 in the chapter, and, if so, confirm the wording, or suggest amendments;
- (b) **Indicate** whether it agrees with the staff view to include SMC–Chapter 2–2 in the chapter, and, if so, confirm the wording, or suggest amendments; and
- (c) **Indicate** whether it agrees with the staff view to include SMC–Chapter 2–3 in the chapter, and, if so, confirm the wording, or suggest amendments.

Appendix A: Examples for Information Purposes – Currency in Circulation

Item 1: Information from Discussion with National Department of Finance on Currency Accounting

Jurisdiction 1 recognizes a liability for notes in circulation, but does not for coins, in accordance with the requirements of the Jurisdictions Bank Act and the Currency Act.

The Bank Act – states: *The Bank has the sole right to issue notes and those notes shall be a first charge on the assets of the bank.* The liability for notes results from the bank's obligation to issue notes, and that notes are a first charge on the assets of the bank. The Bank Act further requires the bank to redeem all notes issued by the bank (even those pre-dating the establishment of the central bank).

The Currency Act – states: *The governor in council may make regulations for the redemption by the Minister of coins of the currency of jurisdiction that are or that have at any time been current in the jurisdiction.* For coins, the currency act notes that the government “may” make regulations for the redemption of coins, but does not require it. Further, it does not include wording stating that coins shall have any standing as a charge against the government or bank assets.

Coin Production, Distribution and Sale Process in Jurisdiction:

The jurisdiction delegates authority to a Government Business Enterprise (GBE)³ which is responsible for the production and distribution of coins. The GBE produces coins under contract with the government. The transactions are as follows:

Step 1: Production of coins: The GBE produces coins for the government and holds the coins until sold to commercial banks to put into circulation. For example, the government contracts the mint to produce 100,000 \$0.25 face value coins, with a production cost of \$0.15 a coin.

Dr – Coin Inventory (equal to the cost of production by the GBE) – 15,000

Cr – Cash – 15,000

Step 2: Sale and distribution of coins: The GBE sells the coins on behalf of the government to commercial banks for distribution into circulation. Coins are sold at their face value.

Dr – Cash – 25,000

Dr – Cost of Coins Issued – 15,000

Cr – Coin Inventory – 15,000

Cr – Revenue (seigniorage⁴) – 25,000

Other Discussion Points

The government of the jurisdiction – Department of Finance employee – confirmed that the process for notes is generally similar to the jurisdiction 2 example. Except for the following:

- Step 3 below – the notes produced by the central bank are recognized as inventory at the cost of production, until issued into circulation. Unclear if this difference relates to the fact that it produces notes in house compared to the central bank for Jurisdiction 2 which uses a third party.

³ ED 56, The Applicability of IPSASs proposes the deletion of the term Government Business Enterprise.

⁴ Seigniorage is the term used to describe earning revenue from the issuance of currency (notes and coins) by an entity with the mandate to do so and is the difference between the cost of producing the currency and the amount received from issuing the currency (notes or coins).

- Jurisdiction 1 does not derecognize old series of notes, as the governing legislation allows for any old notes to be returned and exchanged.
- The inventory of coins and the revenue generated by the sale of coins, is generally considered to be immaterial to the Department of Finance and is small in comparison to notes.
- When the government of Jurisdiction 1 decided to stop producing and distributing the 1 cent coin, a specific provision was set up for those 1 cent coins expected to be exchanged only (not all 1 cent coins outstanding). The provision, estimated the total expected outflow of resources as a result of the penny being no longer considered legal tender (production of coins of this denomination has ceased) and considered the expected residual value of metal recovered by the pennies redeemed. The provision was very small.

Item 2: Information in regards to accounting for banknotes and coins by the monetary authority in jurisdiction 2.

Monetary Authority (MA) is responsible for the issuance and maintenance of banknotes and coins for its jurisdiction. Below is an example showing how each step in the currency process is accounted for in that jurisdiction. MA accounts for banknotes and coins consistently, with a liability recognized for both. Jurisdiction 2's regulations require the monetary authority to exchange domestic currency, both fit and unfit for circulation with clean (new) currency in the same denomination or another denomination and exchange demonetized currency.

1. MA purchases materials/supplies for banknotes and/or coins:

Debit		Credit	
Banknotes/Coins supplies at MA	xx	MA Account at Commercial Banks Or Cash	xx

2. When MA places order to third party which produces banknotes on contract of the MA, to produce banknotes:

- a. Record the changes in supplies for banknotes

Debit		Credit	
Banknote supplies at 3 rd party contracted to produce notes	xx	Banknotes supplies at MA	xx

- b. Record the cost/expenses for printing banknotes

Debit		Credit	
Cost/expenses for printing banknotes – Equity (part of current year profit/losses)	xx	Banknotes supplies at 3 rd party contracted to produce notes	xx

3. When 3rd party finishes production and printing and banknotes delivered to MA

Debit		Credit	
Cash (to record currency issued/printed) -- Assets	xx	Account for currency issuance (Liabilities)	xx

4. When MA circulates the banknotes through commercial banks:

Debit		Credit	
Banks current account at BI (liabilities)	xx	Cash (to record currency issued/printed)	xx

5. Currency in circulation is calculated as the difference between “Account for currency issuance” minus the outstanding “cash (to record currency issued/printed)”. Currency in circulation is included as the component of reserve money (monetary base).

1 Introduction and Objective

- 1.1 IPSASs do not provide requirements or guidance on how to account for a number of monetary items that have been termed “public sector specific financial instruments”. The lack of guidance for these transactions leads to reporting that is inconsistent between entities and may be inappropriate. As a result, users may not have the information they need for accountability and decision-making purposes. This lack of guidance is a significant gap in the IPSASB’s literature.
- 1.2 This Consultation Paper (CP) is an important step in determining the appropriate reporting for public sector specific financial instruments. The CP considers the issues related to these instruments and possible approaches to accounting for them. The objective of the CP is to initiate a debate about matters such as:
- The types of instruments considered to be public sector specific financial instruments;
 - Approaches to recognition, measurement and derecognition; and
 - Presentation and disclosure of information.

History of the Project

- 1.3 The project to develop IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*, identified several items, some of which may meet the definition of a financial instrument but have certain public sector specific characteristics. Others do not strictly meet the financial instrument definition, but are similar to financial instruments. Items identified during the initial financial instruments project as “public sector specific financial instruments” were:
- Monetary gold;
 - Special Drawing Rights;
 - Reserve position in the International Monetary Fund (IMF);
 - Currency in Circulation;
 - Financial guarantee contracts; and
 - Concessionary loans.
- 1.4 Two public sector specific issues—concessionary loans and large-scale financial guarantee contracts—were addressed in application guidance in IPSAS 29. Both these instruments meet the definitions of a financial instrument. The guidance has been applicable since January 1, 2013.
- 1.5 The IPSASB agreed to address the remaining issues through a further public sector specific financial instruments project.
- 1.6 In December 2013, the IPSASB identified additional issues to those noted in paragraph 1.3—statutory receivables, statutory payables and certain types of securitization transactions unique to the public sector. The IPSASB considers that it is in the public interest to consider these additional topics.

- 1.7 All of the topics have public interest implications given their significance to the public sector and the service delivery objectives of most public sector entities. Considering these issues from a public sector perspective is important in meeting the information needs of users; specifically information related to assessing the ability of public sector entities to deliver services effectively, to manage the resources used and available to provide services, and to assess the liquidity and solvency of key institutions in the public sector.
- 1.8 Some topics in scope of the CP, apply mainly to specific entities, such as central banks, which may apply national standards or international standards for the private sector. Because of the key role of central banks in the public sector, developing guidance for these entities is important for the IPSASB. Further, central banks form part of the public sector as they are controlled and consolidated into the financial accounts of the central government in many jurisdictions, regardless of whether they apply national standards or international standards for the private sector.
- 1.9 The IPSASB decided to manage the project by separating it into phases. The initial phase of the project will deal with the topics which apply to central banks and central governments only. The next phase will deal with the other topics which have broader application.

Approach taken in this CP

- 1.10 The final output of this project has not been determined by the IPSASB at this time. The project may lead to the development of a single standard or several standards and/or additional application guidance to existing standards.
- 1.11 The CP for this phase of the project has the following structure:
- Chapter 1: Introduction and Objective;
 - Chapter 2: Currency in Circulation;
 - Chapter 3: Monetary Gold; and
 - Chapter 4: IMF Special Drawing Rights and Other IMF Transactions;

Conceptual Framework

- 1.12 The Conceptual Framework was published in October 2014. This development influences the CP in the following ways:
- The objectives of financial reporting, the qualitative characteristics and the constraints on information included in general purpose financial reports (GPFRs), provide guidance necessary for assessing the needs of users and the attributes of such information in developing accounting considerations for each chapter;
 - The definitions of elements and the recognition criteria provide guidance for evaluating transactions and determining whether they should be recognized in financial statements.
 - The measurement objective provides a framework for assessing the information needs of users and which measurement basis appropriately meet such needs; and
 - The concepts for presentation and disclosure provide guidance on information selection, location and organization.

Objectives of financial reporting and qualitative characteristics

- 1.13 The objectives of financial reporting are set out in paragraph 2.1 of the Conceptual Framework.

“The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes (hereafter referred to as “useful for accountability and decision-making purposes”).”

- 1.14 The CP considers how well the options for accounting put forward in each chapter satisfy the objectives of financial reporting and meet users’ information needs.

Objective of measurement

- 1.15 The CP identifies viable measurement bases and assesses how well they meet the information needs of users.

Concepts of presentation

- 1.16 The CP considers how the information needs of users can be enhanced through presentation and disclosure.

Consideration of Government Finance Statistics (GFS)

- 1.17 The IPSASB considers it important to reduce differences with the statistical basis of reporting where appropriate. The Preface to the Conceptual Framework states that the removal of differences between GFS reports and IPSAS financial statements can provide benefits to users in terms of report quality, timeliness and understandability. Further, the IPSASB has published a policy paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs* in February 2014¹ (GFS Policy Paper), which has been considered in developing this CP.
- 1.18 Informed by the Conceptual Framework and the GFS Policy Paper, the IPSASB reviewed the definitions and descriptions related to each topic in scope of the project. The IPSASB considered the *System of National Accounts 2008* (SNA), *Government Finance Statistics Manual 2014* (GFSM) and *Balance of Payments and International Investment Position Manual—Sixth Edition* (BPM6). The guidance from the applicable manuals related to each topic will be considered by the IPSASB in developing accounting guidance to minimize unnecessary differences.

2 Chapter 2: Currency in Circulation

See separate document - currency in circulation chapter

3 Chapter 3: Monetary Gold

Introduction

- 3.1 Physical gold has a long history as a reserve asset. Historically, currency was produced from precious metals (typically gold and silver). As economies advanced, paper money became more prevalent; however, it would typically be exchangeable for a precious metal. Gold played a more direct role in the monetary system until the early 1970’s, when the US dollar², was allowed to float freely. Although currencies are no longer linked to gold, central banks and governments continue to hold physical gold, because it has intrinsic value and there is a global liquid market for it.

¹ <http://www.ifac.org/sites/default/files/publications/files/IPSASB-GFS-Policy-Paper.pdf>

² The US dollar was the last currency which was exchangeable for a fixed amount of gold.

- 3.2 Public sector entities, such as central government departments and/or central banks hold gold as a reserve asset. The unique characteristics of gold make it an important reserve asset for such entities, for the following reasons:
- Economic security—Gold does not deteriorate or decay. It has a high density, so small amounts have high value. It is physical and therefore is not a liability of another party (no counterparty risk);
 - Risk diversification—Gold is transacted in a large global market, but a unique market to those of other reserve assets (gold markets often move inversely to key global currency markets, such as the US dollar);
 - Confidence—Currency is no longer backed or exchangeable for gold. However, confidence in currency and central banks often can be linked to gold holdings; and
 - Asset available for unexpected liquidity needs—In periods of uncertainty, high inflation or large negative economic events, gold becomes a critical asset as it can be sold for foreign currency reserves, used directly for international payments or as collateral for borrowings.
- 3.3 Accounting for monetary gold is inconsistent in the public sector, with a range of measurement bases used.
- 3.4 This chapter of the CP considers the approaches to, and issues arising in, accounting for monetary gold. The objective is to initiate a debate about matters such as:
- (a) The nature of different types of gold assets and how they are used by monetary authorities; and
 - (b) The appropriate way to measure monetary gold assets in order to provide the best information to users.

Chapter Objective

- 3.5 The IPSASB proposes the following objective for future guidance on accounting for monetary gold:

An entity shall account for monetary gold in a manner that helps users of its financial statements assess:

- The types (different categories and characteristics) of monetary gold held by the entity;
- The impact of monetary gold on the entity's financial performance and financial position; and
- The nature and extent of risks arising from holding monetary gold, and how the entity manages those risks.

- 3.6 To achieve the objective in paragraph 3.5 and considering the characteristics of gold as stated in paragraph 3.2, it is important to identify the intentions for which monetary authorities hold monetary gold as reserve assets. The two main intentions identified, for which monetary authorities hold gold assets, are as follows:
- Intention 1: Monetary gold intended to be held for its contribution to financial capacity because of its ability to be sold, in the global liquid gold trading markets. Therefore, information on the current market value of gold is important; and

- Intention 2: Monetary gold intended to be held for an indeterminate period of time, because it provides confidence in the monetary authority's financial strength and ability to carry out its activities. Further, there may be prohibitions or restrictions placed on these monetary authorities which limit the ability to sell monetary gold assets. Therefore, when monetary gold is held with this intention, the quantity and the price paid to acquire it is important, but with less concern as to the current market value.
- 3.7 The CP identifies two options to account for monetary gold; both options are linked to the intentions monetary authorities have in holding it, as described in paragraph 3.6. In assessing these options, the IPSASB will consider how well they satisfy the objectives of financial reporting and meet users' information needs.
- 3.8 The CP also considers how well each option satisfies the qualitative characteristics (QCs) set out in the Conceptual Framework.

Scope and Definitions

- 3.9 This section of the CP addresses the scope and definitions for any future guidance on monetary gold.

Consideration of GFS

- 3.10 As noted in the introduction, the IPSASB considers it important to reduce differences with the statistical basis or reporting where appropriate. The most comprehensive guidance on statistical accounting for monetary gold, can be found in BPM6.
- 3.11 BPM6 notes in paragraph 6.78: *Monetary gold is gold to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and is held as reserve assets. It consists of gold bullion (including gold coins, ingots, bars with a purity of at least 995/1000, and gold bullion held in allocated gold accounts, regardless of the location of the account) and unallocated gold accounts with nonresidents that give title to claim the delivery of gold. Gold bullion is usually traded on organized markets or through bilateral arrangements between central banks. To qualify as reserve assets, gold accounts must be readily available upon demand to the monetary authorities.*
- 3.12 BPM6 explains the relationship of monetary gold to non-monetary gold in paragraph 5.78: *In contrast to monetary gold, which is a financial asset, nonmonetary physical gold is a good. (Paragraphs 10.50–10.54 deal with nonmonetary gold in the goods and services account.) Similarly, other precious metals are goods and not financial assets. Monetary gold is treated differently because of its role as a means of international payments and store of value for use in reserve assets.*
- 3.13 BPM6 notes in paragraph 6.64: *Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing).*
- 3.14 BPM6 notes in paragraph 6.66: *The functional concept of monetary authorities is essential for defining reserve assets. Monetary authorities encompass the central bank (which subsumes other institutional units included in the central bank subsector, such as the currency board) and certain operations usually attributed to the central bank but sometimes carried out by other government institutions or commercial banks, such as government-owned commercial banks. Such operations include the issuance of currency; maintenance and management of reserve assets, including those*

resulting from transactions with the IMF; and operation of exchange stabilization funds. In economies with extensive reserve assets that are held outside of the central bank, supplementary information should be provided on the institutional sector of holdings of those reserve assets.

Definitions and Descriptions

- 3.15 Considering the above definitions and descriptions from BPM6, the IPSASB proposes the definitions and supporting guidance in paragraphs 3.16–3.30, discussed below.
- 3.16 **Monetary gold** is defined as follows:
- “Tangible gold held by monetary authorities as reserve assets.”
- 3.17 The definition is restricted to those gold assets held by monetary authorities as reserve assets, as these are the assets available to monetary authorities in carrying out their mandates. Gold assets not held by monetary authorities or those held by monetary authorities but not as reserve assets, would not be considered to be held to assist in achieving the core mandate of monetary authorities and therefore are not within the definition.
- 3.18 **Tangible gold** is defined as follows:
- “Physical gold that has a minimum purity of 995 parts per 1000.”
- 3.19 Gold which does not meet the minimum purity requirements of 995 parts per 1000, is not considered to be in saleable form, according to the internationally accepted rules³ for trading on markets and exchanges.
- 3.20 The main requirement to be in saleable form is to meet the minimum purity requirement of 995/1000. However, assets should also be in a form which facilitates a timely transaction, meaning a form⁴ of tangible gold which is quantifiable⁵, in a standard size and form. This allows for gold to be easily identified and measured, as required to facilitate market transactions.
- 3.21 Contracts which permit settlement in physical gold may be considered in scope of guidance as discussed in paragraphs 3.33(c) and 3.35. Because monetary authorities in some instances, hold these types of financial instruments with the intention of taking physical delivery of gold.
- 3.22 The definitions have been developed with reference to BPM6 and statistical accounting guidance. However, certain terms used in the statistical guidance, such as the reference to monetary gold being a financial asset⁶ have not been included in the proposed CP definitions. This is because monetary gold does not meet the IPSAS definition of a financial asset because of its physical nature.

³ The international standard for transacting in physical gold, are the rules of the London Bullion Exchange.

⁴ A specific standardized shape and size of gold asset is not proposed, as there are many different standards for shapes and sizes used in various gold markets globally.

⁵ Physical gold sold by central banks and refineries, are normally in bar form and stamped with identifiable markings noting weight, purity and where gold was produced or refined.

⁶ IPSAS 29.9 states a *financial asset* is any asset that is: (a) Cash; (b) An equity instrument of another entity; (c) A contractual right: (i) To receive cash or another financial asset from another entity; or (ii) To exchange financial assets or liabilities with another entity under conditions that are potentially favorable to the entity; or (d) A contract that will or may be settled in the entity's own equity instruments; or (i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed number of the entity's own equity instruments...

3.23 **Monetary authority** is defined as follows:

“The monetary authority is the entity or entities including the central bank or a department(s) of the central (national) government, which carry out operations usually attributed to the central bank.”

3.24 In limited circumstances a monetary authority may be (or include) an international or regional entity⁷.

3.25 Monetary authorities have a broad mandate to oversee various aspects of the economy, such as the issuance and maintenance of currency, management of reserve assets and operation and administration of exchange rate stabilization funds.

3.26 **Reserve assets** are defined as follows:

“Assets held by monetary authorities, which are readily available for international payment needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.”

3.27 Reserve assets comprise monetary gold, foreign currency, highly liquid investments, and Special Drawing Rights (SDRs).

3.28 To be effective, reserve assets must be readily available for trading.

3.29 Monetary gold is one particular type of reserve asset. It is held by monetary authorities for its intrinsic value as a precious metal and because a global liquid trading market exists. Monetary gold is similar to foreign exchange holdings, another key type of reserve asset. The characteristics of monetary gold help monetary authorities to achieve their objectives. Therefore, monetary gold has an economic substance that differs from tangible gold holdings held for other purposes such as use in operations, manufacturing and/or because such holdings have historical or cultural significance.⁸

3.30 The definition excludes other precious metals (silver or platinum). Unlike gold, non-gold precious metals are not considered a store of value, or as a medium for international payments, in the manner that gold is. Because of this central banks do not hold non-gold precious metals as reserve assets. The IPSASB noted that none of the central bank financial statements examined accounted for or disclosed any holdings of precious metals, other than gold.

Preliminary View – Chapter 3

Monetary gold is tangible gold held by monetary authorities as reserve assets.

The other key definitions are as follows:

- (a) **Tangible gold** is physical gold that has a minimum purity of 995 parts per 1000.

⁷ An example of an international entity which holds reserve assets to provide stability to the global monetary system is the IMF, which has significant monetary gold assets. An example of a regional entity which holds reserve assets to provide stability to the European monetary system is the European Central Bank. Both of these entities work in a capacity similar to national governments and central banks in terms of their use of reserve assets, such as monetary gold.

⁸ Some monetary authorities may hold physical gold for the purpose of facilitating trading with banks or commodity brokers (to facilitate trading in the markets). Monetary authorities may also hold physical gold for use in manufacturing for items such as gold coins.

- (b) **Monetary authority** is the entity or entities, including the central bank or a department(s) of the central (national) government, which carry out operations usually attributed to the central bank.
- (c) **Reserve assets** are assets held by monetary authorities, which are readily available for international payment needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.

Scope

- 3.31 Monetary gold must meet the definition set out in paragraph 3.16 and must be held to achieve the intentions of a monetary authority.
- 3.32 Gold, can have a range of purities, from low to high gold content⁹ and can take many forms¹⁰. However, only gold which satisfies the definition of monetary gold, as defined in paragraph 3.16, should be in scope of guidance. Monetary authorities have a number of options for holding gold as discussed in the following paragraphs.
- 3.33 Gold can be held directly by monetary authorities or stored with a third party in an allocated or unallocated gold account; as explained below in paragraphs 3.33–3.37:
 - (a) Gold held directly by monetary authorities with a purity greater than or equal to 995/1000 which is held for use as reserve assets, satisfies the definition of monetary gold and should be in the scope of guidance;
 - (b) Gold held in an allocated account, is gold which is stored with a third party for safekeeping. Gold assets are specifically identified and segregated in the third party's storage facilities. Monetary authorities can demand delivery of the specific gold, or instruct the third party to undertake transactions on their behalf. The rights and obligations of owning the gold assets have not been transferred as the third party is an agent providing safekeeping services. Therefore gold held in an allocated account, meets the definition of monetary gold; and
 - (c) Gold held as a deposit in an unallocated account, is gold deposited by the monetary authority with a third party (in a manner similar to how cash is deposited at a bank). Deposits of gold assets are not segregated or identified. Monetary authorities have the right to request on call delivery¹¹ of the deposited gold. Gold assets held in unallocated accounts have different risks than those held directly by monetary authorities or in allocated accounts. However, such deposits are still denominated in gold and allow for the delivery of a specific quantity. Therefore, gold assets held in unallocated accounts, which meet the definition of monetary gold, should be included in the scope of guidance.
- 3.34 Gold coins which are minted from gold, either as commemorative gold coins or as legal tender gold coins, as described below:

⁹ Tradable physical gold requires a purity of 995 parts per 1000 or greater gold content.

¹⁰ Physical form of gold can be in the form of bars of various shapes and sizes. Sometimes physical gold exists in the form of nuggets. Also, gold bars are sometimes referred to as ingots.

¹¹ Similar to cash held by banks as deposits, banks holding monetary gold in unallocated gold accounts, would not in the normal course of operations hold enough gold to deliver to all depositors on demand. This is one of the risks and key differences between gold held in allocated gold accounts versus unallocated gold accounts.

- (a) Commemorative gold coins derive their value based on the gold content or the numismatic¹² value. Commemorative gold coins are not legal tender and are not considered cash. The value of such coins may be greater than the intrinsic value of the gold. Because of this, monetary authorities may be less likely to use these as reserve assets, as it would be unlikely such coins would be sold through the gold commodity markets, given higher values could be achieved through other non-commodity markets. However, if the monetary gold definition is satisfied and monetary authorities do hold commemorative gold coins for use as reserve assets, then they should be included in the scope of guidance. Alternatively, if they are held because of their numismatic value or used for purposes other than as reserve assets, they should not be in the scope of guidance; and
- (b) Legal tender gold coins are legal tender in a particular jurisdiction, such as the Canadian Maple Leaf, and China Panda gold coins. The legal tender face value is less than the value of the gold content in the coins. Such coins are legal tender and therefore cash. Some legal tender gold coins, do not contain a high enough gold content to satisfy the requirements of the definition¹³. However, those legal tender gold coins which meet the monetary gold definition and which are held for use as reserve assets should be included in the scope of guidance.

3.35 The banking and gold industries have developed a range of securities linked to gold. The main categories of gold-related instruments are discussed below:

- (a) Gold loans are debt agreements for borrowings where gold is posted as collateral to secure the loan. These types of debt agreements are not monetary gold, as they do not meet the definition of monetary gold, as they are a contractual instrument and not tangible gold in saleable form. The fact that a loan is secured by gold, does not mean that such gold is available to monetary authorities for use as reserve assets and therefore should not be in scope of guidance;
- (b) Gold exchange traded funds (ETFs) are securities (investment instruments and funds) traded on public markets which are linked to an underlying amount of gold, to the market price of gold, or which hold underlying securities of entities which produce gold. Gold ETFs are financial instruments as they result from a contract, which gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The majority of these types of instruments should be accounted for as financial instruments using IPSAS 28–30, and would not be considered in scope of monetary gold guidance. However if these instruments allow for settlement in physical gold on demand, these gold assets satisfy the monetary gold definition and the monetary authority has the intention of taking delivery of gold, such instruments may be considered monetary gold¹⁴;

¹² Numismatic value is the value of money or coins, based on collector value, as opposed to the face value or underlying value of precious metals they are comprised of.

¹³ The South African Krugrand, American Gold Eagle and British Britannia are all legal tender gold coins. However, their gold content is lower than the definition requirements of 995/1000.

¹⁴ Staff view is that any instrument that allows for delivery of a fixed quantity of physical gold, which are held by monetary authorities as reserve assets, could meet the scope exclusion of IPSAS 29.4: which states: *...contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.*

- (c) Gold forward/futures are derivative contracts for the exchange of a quantity of gold at a future date at a specified price. Gold derivatives are financial instruments as they result from a contract, which gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. However, in some instances monetary authorities may hold such instruments with the intention of taking physical delivery of gold. When these instruments allow for settlement in tangible gold on demand, and the gold assets satisfy the monetary gold definition, they may be considered monetary gold and should be in scope guidance; and
- (d) Gold equities are common and preferred shares of companies which explore, develop and mine gold. These are companies which generate revenue through the exploration, development and mining of gold. Gold equities are financial instruments as they result from a contract, which gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Gold equities are not tangible in nature and the value of such gold equities is related to the combined operations of the entity, and not an underlying amount of gold. Therefore, gold equities are financial instruments, IPSAS 28–30 should be applied and they should not be in scope of monetary gold guidance.
- 3.36 Gold antiques are cultural and historical items which contain gold. These items have value arising from their gold content, as well as their historical and/or cultural value. Gold antiques are likely to be held by government entities because of their cultural and/or historical significance and are unlikely to be held as reserve assets. Even if such items are held by monetary authorities and the gold items meet the purity requirements, it is unlikely they would be in saleable form and therefore would not satisfy the definition requirements. Gold antiques are not considered to be in scope of monetary gold guidance¹⁵.
- 3.37 Gold assets in scope of monetary gold guidance, should be only those items which satisfy the definition and those which are intended to be held by monetary authorities as reserve assets. The following types of gold assets should be included:
- Tangible gold (including gold held directly, in allocated and unallocated gold accounts);
 - Commemorative and legal tender gold coins; and
 - Some financial instruments which allow for physical settlement in gold on demand and for which monetary authorities have the intention of taking physical delivery.

Recognition and Measurement

Recognition

- 3.38 Monetary gold should be recognized in the statement of financial position when it meets the definition in paragraph 3.16 and the definition of an asset in the Conceptual Framework which states “*an asset is a resource presently controlled by the entity as a result of a past event*” and the recognition criteria¹⁶.

¹⁵ In 2015 the IPSASB has initiated a project to consider accounting for Heritage Assets.

¹⁶ The Conceptual Framework states in chapter 6.3: *The recognition criteria are that:*

- *An item satisfies the definition of an element; and*
- *Can be measured in a way that achieves the qualitative characteristics and takes into account the constraints on information in General Purpose Financial Reports.*

- 3.39 The Conceptual Framework provides recognition guidance in paragraph 6.7, which requires consideration of measurement uncertainty. When applying this guidance to monetary gold, because the asset is tangible and the existence of the global market for trading it, the risk of measurement uncertainty is minimal.
- 3.40 Control over monetary gold arises through acquisition which normally results from a purchase. Control can be exercised even if the gold is not directly held by the entity, as it is common for entities to store gold with another monetary authority or international banking institution for safe keeping, as discussed in paragraph 3.33.

Measurement

- 3.41 Monetary authorities are inconsistent in how they measure monetary gold. Some apply historical cost, others use fair value/market value and a further group uses statutory rates¹⁷.
- 3.42 Chapter 7 on measurement in the Conceptual Framework, paragraph 7.2, states the *objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account and for decision-making purposes*. Paragraph 7.3 further elaborates *that selection of a measurement basis contributes to meeting the objectives of financial reporting in the public sector by providing information that enables users to assess:*
- (a) *The cost of services provided in the period in historical or current terms.*
 - (b) *Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and*
 - (c) *Financial capacity—the capacity of the entity to continue to fund its activities.*
- 3.43 The nature of monetary gold and its use by monetary authorities for reserve purposes, means that information on the contribution to financial capacity is relevant. Monetary gold is not used directly in operations or to directly provide services, like other tangible assets. However, the acquisition cost and information on cost of services, provides relevant information for users, when monetary gold assets are intended to be held for an indeterminate period of time.
- 3.44 Measurement bases that provide information on financial capacity are relevant, because they enable users to assess the ability of monetary authorities to provide stability and liquidity into the monetary system or to support the provision of services in future periods through physical and other resources. Monetary authorities may have different intentions for holding monetary gold, which impacts whether information on financial capacity is useful to users.
- 3.45 Measurement bases that provide information on cost of service may also be relevant, when monetary authorities have the intention of holding gold assets for an indeterminate period of time. Because they enable users to assess the cost of acquiring monetary gold assets and holding them. Only when monetary gold assets are sold or impaired will their impact on costs of services will be recognized in the statement of financial performance which may provide users with useful information.

¹⁷ Two examples of monetary authorities using statutory rates to measure monetary gold are the US Federal Reserve Bank and the South African Reserve bank. The US Federal Reserve measures monetary gold at the statutory rate set by law at \$42.22 per fine troy ounce. The South African Reserve Bank measures monetary gold at the market price taken at 14:30 on the reporting date.

- 3.46 Monetary authorities have a variety of different reserve assets available for use to achieve their objectives. Depending on management of such reserves by monetary authorities, monetary gold may be held for a specific intention, as discussed in paragraph 3.6. If the intention of holding monetary gold is trading purposes, such as use for international payments, to influence the money supply and/or to provide liquidity and stability to the economy, then a measurement basis which provides information on financial capacity may be relevant.
- 3.47 Alternatively, if the intention in holding monetary gold is to hold it for an indeterminate period, because it provides confidence in the ability of monetary authorities to carry out their activities, then a measurement basis which provides information on cost of services may be relevant.
- 3.48 Monetary authorities currently measure monetary gold either on a historical cost basis, or fair value/market value basis¹⁸. A smaller group of monetary authorities also use a statutory rate. While statutory rates and their application vary between jurisdictions, monetary authorities using this method have a common aim of reducing the volatility caused by changes in gold prices. Use of a statutory rate is not a basis discussed in the Conceptual Framework.
- 3.49 The IPSASB considered the Conceptual Framework and noted that of the six potential bases available, only historical cost and market value in an open, active and orderly market, are practical to consider:
- (a) Historical cost, as it is an entry value which provides information on the resources exchanged to acquire monetary gold assets, which are available to provide services in future periods. Such information allows users to assess the minimum service potential monetary gold assets can provide to monetary authorities.
 - (b) Market value in an open, active and orderly market, as it is a current value measurement basis which provides users with the information required to assess the ability of monetary gold to contribute to the financial capacity of monetary authorities.
- 3.50 Other measurement bases were not considered appropriate by the IPSASB for the following reasons:
- Market value in an inactive market is not appropriate as a global liquid, active market exists for gold;
 - Replacement cost is not appropriate, as monetary gold held for reserve purposes is not consumed in operations. Further, replacement cost would be equal to the amount to purchase gold in the market, which would be market value in open, active and orderly market;
 - Net selling price is generally more useful when an open, active and orderly market does not exist and needs to reflect constraints on a sale and is therefore not appropriate; and
 - Value in use is most useful for entity-specific asset valuations, such as, assets of a specialized nature used for a specific purpose, where the service potential or ability to generate economic benefits creates more value to the entity than, the value using replacement cost. Gold is a commodity and is held for its intrinsic value and global liquid trading market and therefore is not used in a specialized way. Value in use therefore does not appear to be an appropriate basis.

¹⁸ Only measurement bases consistent with the conceptual frameworks guidelines are discussed, which is why a statutory rate, is not referred to here.

3.51 The Conceptual Framework paragraph 7.4 states, *that selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the Qualitative Characteristics (QCs)*. The IPSASB determined that historical cost and market value in open, active and orderly market, are the appropriate measurement bases available for consideration, and has analyzed these against the QCs in paragraphs 3.52 and 3.53.

Historical Cost

3.52 An assessment of the information provided by measuring monetary gold using historical cost for each of the QCs is summarized as follows:

- Relevance—Historical cost information provides information on the minimum resources available to provide future services, based on their acquisition cost of monetary gold;
- Faithful Representation—Historical cost provides a faithfully representative view of the transaction price to acquire monetary gold, providing information on the minimum service potential but not information on the contribution to financial capacity it provides;
- Understandability—Historical cost information is not complex. It provides information on the cost to acquire (entry value of) monetary gold;
- Timeliness—Historical cost information is timely, because transaction prices are easily obtainable and the carrying amount is stable between accounting periods unless monetary gold is acquired, sold or impaired;
- Comparability—Historical cost does not provide comparable information from one entity to another, as the value is based on the timing of the purchase of the gold by each entity and not the current economic value. However, it does provide comparable information from period to period for an individual entity, as changes in carrying amounts are stable, unless gold is acquired, sold or impaired; and
- Verifiability—Historical cost information for monetary gold is transaction based and easily verifiable.

Market Value

3.53 An assessment of the information provided by measuring monetary gold at market value for each of the QCs is summarized as follows:

- Relevance—Market value is a relevant measure that provides information on the contribution of monetary gold to financial capacity;
- Faithful Representation—Market value provides a faithfully representative view of the financial capacity monetary gold provides as it represents the exit value and is an objective price, available in a transparent, liquid market. Market value is also an entry value, because of the open, active and orderly market for gold, and therefore provides a faithfully representative view of operational capacity as well;
- Understandability—Market value information is understandable; the valuation of monetary gold using a spot rate is not complex;
- Timeliness—Market value provides measurement information in a timely manner. The gold markets are transparent and prices are available in real time. Information required for financial statements can be prepared quickly using simple calculations;

- Comparability—Market value provides measurement information which allows direct comparability of monetary gold assets with other assets, and between different monetary authorities; and
 - Verifiability—Market value provides information which is verifiable, because there is an open, active and orderly market.
- 3.54 Both historical cost and market value provide information which is useful to users when evaluated against the QCs. Monetary authorities may hold monetary gold assets to aid in achieving different intentions as discussed in paragraph 3.6. Depending on the primary intention a monetary authority has in holding monetary gold, there may be benefits for using historical cost over market value as a measurement basis, or vice versa.
- 3.55 Monetary authorities with the main intention of holding monetary gold for use in a manner similar to foreign currency, may prefer an exit value measurement basis. In this case, market value may be more useful for measuring monetary gold, because it provides relevant information to assess the financial capacity of the entity. The best exit value measure is market value because there is an open, active and orderly market for gold, which is non-entity specific. By using market value to measure the value of monetary gold, it allows for the faithful representation of the contribution of monetary gold to an entity's financial capacity.
- 3.56 Monetary authorities with the main intention in holding monetary gold for an indeterminate period of time, may prefer an entry value measurement basis. Some monetary authorities hold large quantities of monetary gold and do not have a history of sales. Also some monetary authorities may have restrictions on selling monetary gold assets. Therefore, a historical value measurement basis may be more appropriate, as it reflects the value to acquire monetary gold assets. It also allows users to assess the cost of acquiring/holding monetary gold and the service potential provided, by reference to an actual transaction. Using historical cost to measure monetary gold also avoids introducing volatility into the statement of financial position, which is consistent with some monetary authorities' intention in holding gold assets. Gold prices change significantly over time and the impact of using a market value measurement basis, can impair users' ability to assess the real cost of providing services.
- 3.57 Considering the different intentions for which monetary authorities hold gold, the CP proposes two measurement options:
- Option 1: Measurement at market value in an open, active and orderly market; and
 - Option 2: Measurement at historical cost.

Option 1: Market Value in Open, Active and Orderly Market

- 3.58 Measurement of monetary gold at market value gives rise to two sub issues—accounting for changes in value and transaction costs. The IPSASB considered the Conceptual Framework in developing the accounting alternatives for each issue. Additionally, relevant IPSAS standards are also considered.
- 3.59 Market value measurement requires monetary gold assets recognized in the statement of financial position to be revalued based on the spot rate. This provides users information to assess the financial capacity of monetary authorities. However, it does give rise to the issue of the appropriate place to recognize unrealized (and therefore possibly temporary) gains and losses, attributable to revaluations.

- 3.60 There are different approaches for dealing with the recognition of unrealized losses. One approach is to recognize all gains and losses in the statement of financial performance. Another approach is to recognize unrealized gains or losses directly in net financial position (net assets/equity), until realized.
- 3.61 Some may view recognition of all gains and losses due to changes in value in the statement of financial performance to be appropriate because IPSAS 1 requires this, unless an IPSAS specifies otherwise. Further, Chapter 7¹⁹ of The Conceptual Framework notes that *revenue from providing services reported in the financial statements is measured on the basis of prices current in the reporting period. Thus the surplus or deficit for the period includes prices movements that take place over the period during which assets and liabilities are held, and no profit or loss is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, the existence of the market provides assurance that the entity would be able to realize the market value (and no more) at the reporting date: it is therefore unnecessary to postpone recognition of changes in value until a surplus is realized on a sale.* The Conceptual Framework does not link revenues and expenses to specific financial statements.
- 3.62 However, some may view the approach to recognize unrealized gains or losses directly in net financial position (net assets/equity), as appropriate because it is consistent with IPSAS 29, which requires unrealized gains and losses for financial assets designated as available-for-sale (AFS) to be recognized directly in net financial position, until realized.
- 3.63 Further, Chapter 5 of the Conceptual Framework notes that *revenue and (expenses), are increases (decreases) in the net financial position of the entity other than increases (decreases) arising from ownership contributions (distributions).* Changes in fair value of monetary gold assets, both unrealized (temporary) and realized will give rise to revenue or expense as they result in changes in the net financial position (net assets) of the entity which are not ownership contributions or distributions. Therefore, recognition of unrealized losses directly in net financial position (net assets) or in the statement of financial performance may be appropriate when considering the guidance on recognition of elements in the Conceptual Framework.
- 3.64 The global markets for trading gold can be very volatile. The volatility can cause significant changes in the value of monetary gold assets. Some may argue that recognizing unrealized gains or losses in the statement of financial performance, may prevent a faithfully representative view of the cost of services for the period presented. Further, some view that this impairs the objectives of financial reporting by presenting information to users which does not reflect the true cost of services for the period, or the change in financial capacity provided by holding monetary gold assets. Because of this it may be more appropriate to recognize unrealized gains or losses directly in net financial position (net assets/equity) until they are realized.
- 3.65 Another consideration in determining the appropriate approach to recognition of unrealized gains or losses relates to the relationship of a monetary authority with the central government. Many monetary

¹⁹ The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities states in paragraph 7.32 “...revenue from providing services reported in financial statements is measures on the basis of prices current in the reporting period. Thus the surplus or deficit for a period includes price movements that take place over the period during which assets and liabilities are held, and no profit or loss is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, the existence of the market provides assurance that the entity would be able to realize the market value (and no more) at the reporting date: it is therefore unnecessary to postpone recognition of changes in value until a surplus is realized on sale. However, where assets used to provide services are not traded on open, active and orderly markets, or a close approximation to markets, the relevance of revenue and expense related to changes in market value is more questionable.”

authorities are required to pay dividends to the central (national) government based on accounting profits. Dividends paid based on unrealized gains or losses may lead to insufficient capital levels. As monetary authorities have an important role in the economy, it is important that they have adequate capital available. When monetary authorities are not properly capitalized, they may not be able to perform their role effectively.

- 3.66 The approach to recognize unrealized gains and losses directly in net financial position (net assets/equity) and only realized gains and losses in surplus or deficit for the period addresses the issue of dividend distributions. It also ensures that surplus and deficit for each period reflects actual realized changes in capital (financial capacity) of monetary authorities. This allows users to evaluate the impact on surplus or deficit related to the sale and derecognition of monetary gold assets, and is consistent with the purpose monetary authorities hold gold assets for trading purposes. This approach is also consistent with how available-for-sale (AFS) financial assets are accounted for in IPSAS 29, *Financial Instruments: Recognition and Measurement*.

Consistency with Current IPSAS

- 3.67 Guidance for accounting of financial assets are included in IPSAS 29 and based on the classification of the financial instrument, with different requirements for initial recognition, treatment of transaction costs and subsequent changes in value.
- 3.68 Monetary gold held with the intention of trading is similar to the IPSAS 29 requirements for financial assets classified at fair value through surplus or deficit (FV) or available-for-sale (AFS).
- 3.69 Fair value in current IPSAS, is the amount for which assets could be exchanged between knowledgeable, willing parties in an arm's length transaction. In the case of monetary gold this would be the spot rate of gold. Fair value for monetary gold assets is the same regardless of whether it is classified as FV or AFS.
- 3.70 IPSAS 29 requires initial transaction costs to be expensed as incurred in the statement of financial performance when classified as FV. Transaction costs directly attributable to the acquisition of AFS assets are included as part of the initial cost of the assets (fair value plus directly attributable transaction costs).
- 3.71 The classification of FV and AFS for financial assets also impacts how subsequent changes in value are accounted for. For those assets classified as FV, all changes in value, both realized and unrealized, are recognized in the statement of financial performance. For those assets classified as AFS, unrealized changes in value are recognized directly in net financial position. For changes in value which are realized (due to derecognition of the assets), or when the financial assets are impaired, the cumulative gain or loss is recognized in the statement of financial performance.
- 3.72 Market value—in an open, active and orderly market provides information on the contribution that monetary gold makes to financial capacity.

Option 2: Historical Cost

- 3.73 Monetary authorities may hold monetary gold for different intentions, as noted in paragraphs 3.55–3.57. Under such circumstances, use of an entry value measurement basis such as historical cost is appropriate, when the main objective in holding gold is for its service potential.
- 3.74 From an accounting perspective accounting for monetary gold at historical cost is simple and straight forward compared to market value.

- 3.75 Historical cost is normally recognized at the fair value at the time of acquisition plus transaction costs as these are part of the cost of acquiring the asset. Changes to historical cost of monetary gold assets only result from an impairment, when the price of gold decreases below the acquisition price. Losses due to impairment are recognized in the statement of financial performance, with a corresponding decrease in the carrying amount.
- 3.76 Historical cost reflects the cost to acquire the gold assets and the minimum service potential provided by holding it. Monetary authorities with the intention of holding monetary gold, are often more concerned with the quantity of gold held. Therefore, changes in the historical cost values on the statement of financial position would directly relate to either increases or decreases in the quantity of monetary gold assets, or impairments of monetary gold assets; all changes which relate to the service potential of the assets. The historical cost approach also addresses the issue of ensuring the unrealized gains and losses are not distributed as dividends by monetary authorities.

Specific Matter for Comment–Chapter 3–1

(a) Please provide the reasons for your support of:

- (i) Option 1: Measurement at market value in an open, active and orderly market; or
- (ii) Option 2: Measurement at historical cost.

Please provide reasons for your views, including the conceptual merits and weaknesses of each option; the extent to which each option addresses the objectives of financial reporting; and how the different options might provide useful information to users.

Specific Matter for Comment–Chapter 3–2

(a) Please provide the reasons for your support of:

- (i) Alternative 1: The IPSASB to prescribe accounting requirements based on one of the options; or
- (ii) Alternative 2: Allow preparers to designate an option based on their intentions.

Please provide reasons for your views, including the conceptual merits and weaknesses of each alternative; the extent to which each alternative addresses the objectives of financial reporting; and how the different alternatives might provide useful information to users.

Consistency with Current IPSAS

- 3.77 There are many current IPSASs which use a historical cost measurement model. The appropriate measurement model to consider, depends on if monetary gold is viewed as a tangible asset or as a financial asset. The most appropriate applications of the historical cost measurement model in IPSAS are as follows:

- IPSAS 12, *Inventories* requires measurement at the lower of cost and net realizable value, except where inventories are acquired in a non-exchange transaction or where inventories are likely to be distributed at no or nominal charge (not likely in the monetary gold case). The cost of inventories includes all costs of purchase, plus costs of conversion and other costs incurred in bringing inventories to their present location and condition. For monetary gold, this would be fair value plus initial transaction costs. However since IPSAS 12 is intended for goods

purchased and held for resale, it may not be appropriate for monetary gold assets held for an indeterminate period of time.

- IPSAS 17, *Property, Plant and Equipment* requires that an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost. Cost includes purchase price, plus non-refundable duties and taxes, net of rebates, plus any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, plus any estimate of the costs of dismantling and removing the item and restoring the site is located, for which the obligation related to such costs has been recognized. For monetary gold, this would be fair value plus initial transaction costs. Using IPSAS 17 by analogy to measure monetary gold assets, is similar to how the standard treats land. Land is measured at its initial fair value plus transaction costs and is not amortized.
- IPSAS 29 requires that financial assets classified as AFS for which there is not a quoted market price in an active market and which cannot be reliably measured, are required to be measured at cost²⁰. Although, an active market for gold does exist, this does demonstrate the use of the historical cost model in the IPSASB's financial instrument standards. Monetary gold assets held for an indeterminate period of time by monetary authorities, without a history of selling such assets, may be considered similar transactions to thinly traded or illiquid equity securities, which lack a market price.

3.78 Monetary authorities with the intention of holding monetary gold for an indeterminate period of time, historical cost measurement provides information on the cost to acquire and hold the assets and their minimum service potential.

Derecognition

3.79 The Conceptual Framework in chapter 6.10 notes that *derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred.*

3.80 Other than an outright transfer or sale, given the tangible nature of monetary gold, any sale of an interest or percentage of gold, or use of gold for collateral would be contractual and give rise to a financial asset of one entity and a financial liability or equity instrument of another entity, and therefore be assessed under IPSAS 28–30.

Presentation and Disclosure

3.81 This section of the CP discusses at a high level the information to be presented in respect of monetary gold. It does not propose specific requirements. These requirements are linked to decisions regarding the approach to recognition and measurement, and therefore will be determined once the IPSASB has considered the responses to this chapter of the CP.

3.82 The information to be presented will need to be useful for accountability and decision-making purposes to ensure it meets the objectives of financial reporting. Information will need to be consistent

²⁰ IPSAS 29.48(c) notes that *Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to an must be settled by delivery of such unquoted equity instruments, shall be measured as cost.*

with the QCs set out in the Conceptual Framework. Decisions about the information to include will also need to take into account the constraints on information included in general purpose financial reporting.

Chapter 2: Currency in Circulation

Introduction

- 1.1 Although laws vary between jurisdictions, monetary authorities generally are responsible for maintaining currency in circulation. All of the financial statements of monetary authorities examined recognized a liability at the face value of the notes in circulation. However, for coins, some monetary authorities recognize a liability while others do not. Where a liability is recognized, it is measured at the face value of the coins issued.
- 1.2 This chapter of the CP considers the approaches to, and issues arising in, accounting for currency in circulation. The objective is to initiate a debate about matters such as:
 - (a) The different types of currency in circulation;
 - (b) The recognition of revenue for currency issued into circulation; and
 - (c) The accounting options for recognition, measurement and derecognition of liabilities related to currency in circulation in order to provide the best information to users.

Chapter Objective

- 1.3 The IPSASB proposes the following objective for future guidance on accounting for currency in circulation:

An entity shall account for currency in circulation in a manner that helps users of its financial statements assess:

- The impact of currency in circulation on the entity's financial performance and financial position;
- The nature and extent of risks arising from distributing currency in circulation, and how the entity manages those risks; and
- The types (different categories and series) of currency in circulation issued by the entity.

- 1.4 The CP identifies options for accounting for currency in circulation (both notes and coins).
- 1.5 The options identified, relate to the type of currency, the stage in the development and distribution process, as well as the obligations monetary authorities incur in distributing and maintaining currency. The IPSASB will consider how well each option satisfies the objectives of financial reporting and meets users' information needs.

Scope and Definitions

- 1.6 This section of the CP addresses the scope and definitions for any future guidance on currency in circulation.

Consideration of GFS

- 1.7 The IPSASB considers it important to reduce differences with the statistical basis of reporting where appropriate. The most comprehensive guidance on statistical accounting for transactions of monetary

authorities, is found in the Balance of Payments International Investment Position Manual–Sixth Edition (BPM6).

- 1.8 BPM6 notes in paragraph 3.95: *For an economy, a domestic currency is distinguished from foreign currency. Domestic currency is that which is legal tender in the economy and issued by the monetary authority for that economy; that is, either that of an individual economy or, in a currency union, that of the common currency area to which the economy belongs. All other currencies are foreign currencies.*
- 1.9 BPM6 notes in paragraph 5.36: *Currency consists of notes and coins that are of fixed nominal values and are issued or authorized by central banks or governments.*
- 1.10 BPM6 notes in paragraph 11.53: *Notes and coins are treated as liabilities at full face value. The cost of producing the physical notes and coins is recorded as government expenditure and not netted against the receipts from issuing the currency.*

Scope, Definitions and Descriptions

- 1.11 Having considered the above definitions and descriptions from BPM6, the IPSASB proposes the following definitions and supporting guidance.
- 1.12 **Domestic Currency in Circulation** is defined as:
“Physical notes and coins with fixed and determinable values that are legal tender issued by the monetary authority, or by a third party that is authorized to do so, that is, either that of an individual economy or, in a currency union to which the economy belongs.”
- 1.13 Legal tender is a medium of payment, recognized by a legal system as a valid form of payment. In the context of currency in circulation, this is physical notes and coins issued as legal tender.
- 1.14 A monetary authority may directly produce and distribute currency or it may contract out to a third party the production and/or distribution of currency.
- 1.15 Domestic currency is distinguished from foreign currency. Domestic currency is that which is legal tender in the economy and issued by the monetary authority (or third party) for that economy; that is, either that of an individual economy or, in a currency union, that of the common currency area to which the economy belongs. All other currencies are foreign currencies.
- 1.16 Adoption of a foreign currency as legal tender by a monetary authority, does not give rise to currency in circulation liabilities. For example, some monetary authorities, for countries other than the United States of America (US), use the US dollar as legal tender, a process sometimes referred to as dollarization¹. Adoption of a foreign currency in this manner does not meet the definition of domestic currency in circulation, as these are notes and coins issued by a foreign monetary authority for another economy. Therefore, accounting for such currency is not in the scope of this CP². Further, some countries which have adopted a foreign currency as legal tender, also issue their own domestic currency, which may have a fixed interest rate linked to another foreign currency, and use both the domestic currency and a foreign currency as legal tender. When a mix of domestic and foreign

¹ Dollarization is when a country officially or unofficially uses a foreign country's currency as legal tender for conducting transactions. Usually a country will do so because of the greater stability in the value of the foreign currency over the domestic currency.

² IPSAS 4, *The Effects of Changes in Foreign Currency Rates*, is the applicable guidance to account for foreign currency transactions.

currencies are legal tender for an economy, only the domestic currency issued by the monetary authority will give rise to liabilities related to currency in circulation.

Preliminary View – Chapter 2

Domestic Currency in Circulation is physical notes and coins with fixed and determinable values that are legal tender issued by the monetary authority, or by a third party that is authorized to do so, that is, either that of an individual economy or, in a currency union to which the economy belongs.

Accounting for Currency in Circulation – Notes

1.17 Issues related to currency in circulation will be examined through the cycle of transactions for three steps:

- (a) The purchase and production of notes and coins;
- (b) The distribution of notes and coins into circulation; and
- (c) The removal of notes and coins from circulation.

1.18 A full cycle transactional approach is useful for understanding the potential accounting implications for each step in the process.

Purchase of Materials and Production of Notes

1.19 This step entails the purchase of raw materials to produce notes. It also includes labour and overhead costs related to the production of notes³. Transactions related to the purchase and production of notes should be accounted for in accordance with IPSAS 12, *Inventories*⁴, because notes and coins are produced and held by monetary authorities for the issuance and maintenance of the amount of currency in circulation⁵.

1.20 BPM6 notes in paragraph 11.53: *notes and coins are treated as liabilities at full face value. The cost of producing the physical notes and coins is recorded as government expenditure and not netted against the receipts from issuing the currency.*

1.21 According to the guidance in BPM6, the statistical accounting approach is that the cost of producing notes and coins is recognized as an expense.

1.22 The main issue related to IPSAS 12 is the appropriate timing of recognition of the expense. The appropriate recognition point is likely to be when the notes are issued and removed from inventory. Another important issue is how to account for production costs that exceed the face value⁶. This issue arises mainly for coins as a result of the lower face value of coins. IPSAS 12 requires measurement

³ Some monetary authorities may outsource the production of notes and coins, in such cases purchases of finished notes and coins would be accounted for by applying IPSAS 12, *Inventories*.

⁴ IPSAS 12.11 notes that inventories encompass goods purchased and held for resale... Inventories also encompass finished goods produced, or work-in-progress being produced, by the entity. Inventories also include (a) material and supplies waiting use in the production process, and (b) good purchased or produced by an entity...

⁵ IPSAS 28.AG10 notes that IPSAS 12.13 should be applied to account for unissued currency.

⁶ The issue of production costs exceeding face value, is generally limited to smaller denominations of coins, which have low face values.

at the lower of cost and net realizable value⁷. Therefore when cost exceeds face value, the inventory value recognized should be equal to the face value of the coins (See Appendix A & B, for examples of the transaction and journal entries related to the purchase of materials, production and distribution of notes, as well as adjustments for net realizable value of coins when cost exceeds face value.)

- 1.23 The key issues related to accounting for currency in circulation arise after the purchase and production process, when the notes and coins are ready to be put into circulation.

Recognition of Liability for Notes

- 1.24 Monetary authorities are responsible for the production and distribution of notes and coins in circulation⁸. Accounting for notes in circulation requires consideration of the nature of the liability. Is the liability a financial liability or a liability which arises as a result of the obligation of monetary authorities to maintain the amount of currency in circulation? Depending on the nature of the liability, there may be different accounting consequences.
- 1.25 From the financial statements examined, monetary authorities currently recognize a liability for notes in circulation. This is consistent with requirements under GFS reporting guidelines. Because a liability is recognized equal to the face value of the notes in circulation, revenue and seigniorage (surplus) is not recognized.

Recognition of a Liability – Unissued Notes

- 1.26 The IPSASB considered the nature of the liability for notes in circulation by considering the steps related to producing and distributing currency and whether a liability arises due to the general obligation monetary authorities have to produce, issue and maintain currency in circulation.
- 1.27 Regardless of whether the liability is considered to be financial or not, the IPSASB does not believe that a liability is recognized prior to currency being issued by the monetary authority. As discussed in paragraphs 1.19–1.23, the production of notes should be accounted for in accordance with IPSAS 12, *Inventories*. When notes are printed and ready for issuance into circulation, but not yet issued, they should continue to be accounted for as inventory, without any recognition of a liability related to the obligation to maintain currency.
- 1.28 It is clear that currency not yet issued does not satisfy the definition of a liability in the Conceptual Framework⁹, because until currency is issued and is held by a third party, there is no counterparty to the transaction and therefore there is no past event and there cannot be an outflow of resources. Any liability related to the unissued currency would be to the monetary authority itself (issuance gives rise to the past event as well as the potential outflow of resources to the third party holding the currency). Therefore, a liability should not be recognized before the currency is in circulation.

Recognition of a Liability – Issued Notes

- 1.29 A liability for notes issued, arises due to the obligations of monetary authorities to maintain legal tender for their respective jurisdiction. The legal wording varies by jurisdiction, however, in most cases legislation requires monetary authorities to produce and maintain notes in circulation.

⁷ IPSAS 12.15 states that inventories shall be measured at the lower of cost and net realizable value.

⁸ In some jurisdictions production and distribution of notes and/or coins, may be contracted out to a third party which acts in an agent capacity for the monetary authority.

⁹ The Conceptual Framework, notes that a liability is: *A present obligation of the entity for an outflow or resources that results from a past event.*

- 1.30 Because of the requirement to maintain currency in circulation, a present obligation exists once notes are issued. The obligation arises because monetary authorities are required to maintain currency by exchanging new currency for old or damaged notes. The replacement of notes requires issuance of new notes equal to the face value of those being exchanged, or an equivalent amount of another financial asset. The liability related to the obligation is not recognized until the currency is actually issued to a third party.
- 1.31 Therefore, whether a liability has been recognized, requires consideration of the different types of transactions which arise through the issuance of new notes.
- 1.32 The distribution of new notes, can result from the following transactions:
- (a) Transactions to increase the amount (cumulative face value) of notes in circulation; and
 - (b) Transactions with no change in the amount (cumulative face value) of notes in circulation, by exchanging old notes for new notes.
- 1.33 An increase in currency in circulation, occurs when notes are issued and consideration in the form of a financial asset—other than domestic notes, is received; for example, issuance of new notes for an equal amount of government securities. Therefore, the liability increases as more notes exist in circulation. (See Appendix A, for an example and related journal entries.)
- 1.34 A transaction which results in no change in currency in circulation occurs when old notes are exchanged for new notes. Because old notes are exchanged for new notes, the total outstanding liability for currency in circulation does not change. (See Appendix A, for an example and related journal entries.)
- 1.35 If monetary authorities do not have an obligation to maintain notes in circulation, then issuance of notes may lead to recognition of revenue or an increase in net financial position. This surplus is referred to as seigniorage¹⁰.

Nature of Liability - Financial

- 1.36 Notes in circulation are similar to a financial instrument because they provide similar rights and obligations as a bearer instrument, such as a cheque. From the issuer perspective a cheque is a promise to pay a fixed amount of money, when presented by the holder. Because of the legislation related to notes in most jurisdictions, monetary authorities have an obligation to deliver cash or another financial asset to holders of notes on demand, similar to how a cheque is used. Therefore the characteristics of notes in circulation are similar to a cheque, which is a financial instrument and a financial liability from the perspective of the issuer.
- 1.37 However, for the liability to be financial, the banknotes issued need to satisfy the definition of a financial instrument, which is: *a financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity*. Therefore notes issued in circulation need to have the characteristics of a contract. IPSAS 28.AG20 notes that the *substance rather than the legal form of an arrangement is considered by an entity in determining whether a “contract” exists under IPSAS and describes contracts as follows:*
- *Contracts involve willing parties entering into an arrangement;*

¹⁰ Seigniorage is the term used to describe earning revenue from the issuance of currency (notes and coins) by an entity with the mandate to do so and is the difference between the cost of producing the currency and the amount received from issuing the currency (notes or coins).

- *The terms of the contract create rights and obligations for the parties in the contract, and those rights and obligations need not result in equal performance for each party; and*
- *The remedy for non-performance is enforceable by law.*

1.38 The following factors indicate that cash may be considered a contract under IPSAS:

- (a) Banknotes are issued by the monetary authority to another party (counterparty). The distribution of banknotes is an exchange transaction between two willing parties to the arrangement (notes).
- (b) Holders of banknotes have rights as they can exchange them with the monetary authority for new notes or other consideration. The monetary authority has an obligation to accept notes presented and furnish new notes or other consideration equal to the face value, because of the requirements of laws or regulations.
- (c) The remedy for non-performance is enforceable by law, because currency laws and regulations mandate the requirements of monetary authorities in relation to notes issued. As a result of the discussion in (a)-(c) notes have the substance of a contract and therefore may be financial instruments.

1.39 A financial liability is defined as *a liability that is a contractual obligation to deliver cash or another financial asset to another entity*. Because of laws and regulations which require monetary authorities to provide an equal amount of notes or other consideration when presented with notes by holders, they have the appropriate characteristics to be a financial liability.

1.40 IPSAS 28.AG10 explicitly notes that currency issued as legal tender from the perspective of the issuer, is not addressed in the standard (financial instrument standards). However, considering the above analysis in paragraphs 1.38–1.39, indicates notes in circulation have the characteristics of a financial instrument and a financial liability. IPSAS 28–30, sets out requirements for recognition and subsequent measurement for financial liabilities as follows:

- (a) Financial liabilities classified as loans and receivables, are initially recognized and measured at fair value plus transaction costs, and subsequently measured at amortized cost; and
- (b) Financial liabilities classified as fair value through surplus or deficit are initially recognized at fair value with transaction costs expensed as incurred in the statement of financial performance with subsequent measurement at fair value.

1.41 Accounting for notes at amortized cost, may be inappropriate, as they do not have maturity dates or interest payments. Therefore, accounting for currency liabilities at fair value through surplus or deficit may be more appropriate, which would result in measurement at face value, as discussed in paragraph 1.46.

1.42 If the nature of the liability recognized is a financial liability, the transaction to issue currency results in an exchange of financial instruments, with the monetary authority exchanging notes for financial instruments equal to the face value of the notes issued. As discussed in paragraph 1.41, measurement of the financial liability appears most appropriate at fair value through surplus or deficit. Consideration of the measurement bases included in the Conceptual Framework is discussed in detail below in paragraph 1.46.

Measurement of Liability for Notes in Circulation

- 1.43 GFS requires measurement of the liability for notes in circulation at the cumulative face value of the notes issued.
- 1.44 Monetary authorities' financial statements examined also measure liabilities at the face value of notes in circulation. Therefore current accounting practice and GFS requirements are consistent with no variation noted.
- 1.45 The Conceptual Framework provides guidance for selecting an appropriate measurement basis by considering the nature of the liability and settlement options available.
- 1.46 An analysis of the different potential measurement bases for the liability for notes in circulation are discussed below:
- (a) Historical Cost is defined in the Conceptual Framework as: *The consideration received to assume an obligation, which is the cash or cash equivalents or the value of other consideration received, at the time the liability is incurred.* As noted in the example included in Appendix A, when a liability is incurred, the consideration received equals the face value of the notes issued into circulation. Therefore, it may be appropriate for the liability to be measured at the face value of currency in circulation. Distribution of notes, to either increase the amount of currency in circulation or maintain the current amount of currency in circulation (exchange old notes), results in consideration received, equal to the face value of the notes issued.
 - (b) Cost of Fulfillment is defined in the Conceptual Framework as: *The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming it does so in the least costly manner.* The Conceptual Framework notes that for this measurement basis, when it is dependent on uncertain future events, all possible outcomes are taken into account. If we assume the least costly manner to fulfill the obligation is the cost of producing new notes and not related to the face value of the notes produced. This may indicate that the value when using cost of fulfillment is limited to the cost of producing replacement notes. However, if the view is taken that the cost of fulfilling the obligation is based on the value of the notes or financial assets exchanged, the cost of fulfillment may lead to measurement at face value of the notes issued.
 - (c) Market Value is defined in the Conceptual Framework as: *The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.* This may also be appropriate, as the face value of currency issued would only be exchanged for an equal amount of currency at face value, or a financial asset—other than currency of equal value received. For example, a one hundred currency unit note (100CU) in circulation, would only be exchanged for another one hundred currency unit note (100CU), or alternatively a financial asset—other than notes with a value of one hundred currency units (100CU).
 - (d) Cost of Release is discussed in the Conceptual Framework as follows: *refers to the amount of an immediate exit from the obligation, or the amount a creditor will accept in settlement of the claim.* This measurement basis is inappropriate as monetary authorities have little to no ability to seek recourse to exit the obligation. However, even if they had the ability to do so, it is unlikely that the settlement would be at an amount less than face value of the notes issued, as holders of notes would not likely agree to an exchange at a discount.

- (e) Assumption Price is discussed in the Conceptual Framework as follows: *The amount that an entity would rationally be willing to accept in exchange for assuming an existing liability.* This measurement basis is inappropriate, as the obligation to maintain currency is not considered transferrable from the monetary authority.

1.47 Historical cost and market value may both result in measurement of the liability at the face value of the notes issued. Considering the nature of the transactions to distribute currency and the guidance in the Conceptual Framework, it appears appropriate to measure the liability for currency in circulation at the face value of currency in circulation.

Specific Matter for Comment—Chapter 2–1

Do you agree with the following:

- (a) The economic nature of transactions to issue currency in circulation are best represented by measuring the liability for notes in circulation at the face value of the currency issued; and
- (b) Use of the Conceptual Framework measurement bases of historical cost and market value results in measurement at the face value of currency issued.

Please provide reasons for your views, including the conceptual merits and weaknesses; the extent to which your preferred view addresses the objectives of financial reporting; and how the preferred view provides useful information to users.

Derecognition of Liability for Notes in Circulation

1.48 The Conceptual Framework states that *derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred.* There are two issues related to derecognition of liabilities for notes in circulation:

- (a) For transactions to decrease the amount (cumulative face value) of currency in circulation, notes are removed from circulation, it is appropriate to derecognize the related liability as those notes are no longer outstanding; and
- (b) A further issue relates to notes issued and in circulation for many years (old series of notes). Monetary authorities do not appear to derecognize notes in circulation for very long periods of time. Even those series which have been issued many years in the past and which are unlikely to be exchanged and may even no longer be legal tender.

1.49 Transactions to decrease currency in circulation occur when notes are received as consideration for a financial asset—other than notes. Therefore, the liability for currency in circulation decreases as there is a lower cumulative face value of notes in circulation. (See Appendix A, for an example and related journal entries.)

1.50 Many monetary authorities do not derecognize old series of currency, regardless of the likelihood that they will be redeemed. This is because of the laws and regulations, which in many jurisdictions allow for redemption of old currency, even if it is no longer legal tender. For example, Canada has never derecognized any series of banknotes because the Bank of Canada Act requires that all old notes be redeemable indefinitely. In Canada derecognition of the liability only occurs when a specific note is received and removed from circulation, rather than a complete series.

1.51 In some jurisdictions, existing notes or legal tender are replaced with new legal tender. There are different reasons why this occurs, some examples are:

- (a) When existing domestic currency is replaced with a new domestic currency as legal tender, such as when the European Monetary Union (EMU) introduced the Euro to replace the individual domestic currencies of the members of the EMU;
 - (b) When a domestic currency is no longer produced and distributed and ceases to be legal tender, such as the case when the production and distribution of lower denomination notes ends; or
 - (c) When a domestic currency series is replaced with a new series, which may happen for different reasons, such as aesthetics or improvements in note technology (e.g. plastic polymer notes replacing paper notes).
- 1.52 When there is a change in legal tender, which occurred with the introduction of the Euro, the old domestic currency has a fixed rate of exchange set to the new currency. When the old notes are received, new notes are issued. The liability for old notes specifically received is derecognized and replaced with the liability for the new notes issued. It is not clear if in all cases old currency is derecognized after a period of time¹¹, or if the old currency may be redeemed for the new currency indefinitely¹². However, the liability for the old notes specifically exchanged is derecognized and replaced with a liability for the new currency issued.
- 1.53 When a specific series of notes is no longer produced and distributed, such as the case when a small denomination note is discontinued, the liability for the specific notes received is derecognized, and replaced by the new notes issued. For example, if 1CU notes are discontinued, holders of those notes can redeem these at the monetary authority for higher denomination notes, such as 2CU notes. The 1CU note liabilities are derecognized and replaced by the new 2CU note liabilities.
- 1.54 Similar to the discussion in paragraph 1.53, when old paper notes are replaced with polymer notes, holders of the paper notes can redeem the old notes for new notes. The specific liability for the old paper notes received is derecognized and replaced with the liability recognized for the polymer notes issued¹³.
- 1.55 However, if derecognition of liabilities for currency in circulation does occur and no consideration is received to settle the liability. An issue may arise as to the appropriate place in the financial statements to recognize the resulting credit related to the surplus.

Accounting for Currency in Circulation – Coins

- 1.56 Unlike notes in circulation, the practice of accounting for coins by monetary authorities is inconsistent. Monetary authority financial statements examined indicate that some do not recognize a liability for coins in circulation, while others do.
- 1.57 For those monetary authorities which do not recognize a liability for coins in circulation, one reason may be because another government entity recognizes the liability. To confirm if this may be the case, some jurisdictions which do not recognize a liability and which have whole of government accounts, were considered to ascertain whether a liability was recognized. One such jurisdiction

¹¹ French franc banknotes, ceased to be legal tender on 17 February 2002 and were able to be exchanged until 17 February 2012. In June 2012 the amounts concerned were paid to the French Treasury and are no longer recognized in the Banque de France's accounts.

¹² The Deutsche mark ceased to be legal tender on 28 February 2002. Deutsche marks however, can be exchanged for Euro's indefinitely.

¹³ Such as occurred recently in Canada when new polymer notes began to be introduced to replace old paper notes.

which does not recognize a liability for coins is the UK. The UK does produce whole of government accounts, the most recent available are for the year ended 31 March 2014. The disclosures in the financial statements noted that coins in circulation were considered a remote contingent liability. A remote contingent liability is a future event that is less likely to occur than a contingent liability. This concept does not exist in IPSASB's literature.

- 1.58 The circumstances which may result in some jurisdictions not recognizing a liability for coins, are as follows:
- (a) The monetary authority may not have an obligation to maintain coins, because there are no requirements in law to do so and there has not been any past practice of maintaining coins; and
 - (b) The monetary authority may not view the possibility of an outflow of resources to be probable and therefore does not recognize a liability, for the following reasons;
 - (i) The overall value of the coins in circulation may not be material for the monetary authority; or
 - (ii) The monetary authority may estimate that because coins are made of metal, they are harder to damage and will require replacement less often. Even when damaged coins are exchanged they can be recycled and reused to produce new coins, reducing the potential outflow of resources.
- 1.59 Some monetary authorities may not have an obligation to maintain coins, as currency laws and regulations do not require them to do so. Because there is no obligation to maintain coins, there is no probable outflow of resources, therefore, the recognition criteria in the Conceptual Framework¹⁴ cannot be satisfied because the liability definition is not met.
- 1.60 A liability may also not be recognized because of the low probability for an outflow of resources, because of the following reasons:
- (a) The likelihood of an outflow of resources may differ for coins compared to notes. Notes, because of the material used to produce them (paper or polymer), have a higher likelihood of being damaged or ruined, compared to coins made from metal. Additionally notes have higher face values and are more valuable, so are more likely to be exchanged when damaged.
 - (b) Another possibility may be that monetary authorities may deem the liability for coins to be immaterial to the financial statements. If the size of the liability is immaterial, providing information would not be required as the absence of such information would not impact users' decision making or accountability judgments about the entity.
 - (c) When determining if an outflow of resources is probable, another consideration is the amount which may be recovered because of the residual value of damaged coins. A damaged note has little or no residual value. However, damaged coins have residual value because they are metal and recyclable and in some cases may have a value comparable to the face value of the coins, especially when considering older coins which sometimes contain more valuable metals

¹⁴ The Conceptual Framework states in chapter 6.3: *The recognition criteria are that:*

- *An item satisfies the definition of an element; and*
- *Can be measured in a way that achieves the qualitative characteristics and takes into account the constraints on information in General Purpose Financial Reports.*

(such as silver, copper and nickel). Monetary authorities may determine that an outflow of economic of resources may be limited because of the residual value of coins.

- 1.61 If a jurisdiction deems that an outflow of resources is not probable, for any of the reasons stated in paragraphs 1.59–1.60, the recognition criteria may not be satisfied and a liability for coins in circulation may not be recognized.

Accounting for Coins when a Liability is Recognized

- 1.62 Similar to notes, there are various steps in the process for coins. As for notes, transactions related to the purchase of raw materials and production of coins appear appropriate to be accounted for in accordance with IPSAS 12, *Inventories*¹⁵. (See Appendix B, for an example related to this step in the process.)
- 1.63 The variability in accounting for coins compared to notes, is a recognition issue. The Conceptual Framework sets out recognition criteria, and considering that criteria recognition is dependent on whether the definition of a liability is satisfied or not. In those jurisdictions where monetary authorities are not required by laws and regulation to maintain coins and there is no past practice of doing so, or it is not probable that an outflow of resources will occur—a liability should not be recognized as the recognition criteria have not been met. When an obligation exists and a liability is recognized for coins in circulation. The IPSASB believes that measurement and derecognition of liabilities for coins in circulation, should be consistent with notes as discussed above in paragraphs 1.43–1.55. (See Appendix B, for an example and journal entries.)

Specific Matter for Comment—Chapter 2–2

- (a) Based on your review of Chapter 2, do you support consistent accounting for the liabilities for notes and coins in circulation, when a liability exists and is recognized for both?
- Please provide reasons for your views, including the conceptual merits and weaknesses; the extent to which your views address the objectives of financial reporting; and how the views might provide useful information to users.

- 1.64 When coins are put into circulation and the monetary authority does not recognize a liability, consideration equal to the face value of the coins distributed is received. A question arises as to the appropriate place in the financial statements to recognize the credit related to the consideration received.
- 1.65 Seigniorage occurs when currency is issued by the monetary authority¹⁶ and revenue is recognized incremental to the cost (expense) of producing it. For notes, as a liability is recognized equal to the face value of the notes, seigniorage generally does not occur directly¹⁷. However, for coins, monetary authorities may recognize seigniorage revenue when a liability is not recognized for coins in circulation.

¹⁵ IPSAS 12.11 notes that inventories encompass goods purchased and held for resale...Inventories also encompass finished goods produced, or work-in-progress being produced, by the entity. Inventories also include (a) material and supplies waiting use in the production process, and (b) good purchased or produced by an entity.

¹⁶ Monetary authorities may directly issue and maintain currency or they may delegate the responsibility for doing so to a third party to act as an agent on their behalf.

¹⁷ There is a notion of indirect seigniorage for notes, when interest bearing securities are received as consideration for notes, which do not bear interest. Monetary authorities accrue interest on those interest bearing securities, which is interest revenue to the monetary authority.

Specific Matter for Comment—Chapter 2–3

- (a) Based on your review of Chapter 2, do you believe when a liability for coins in circulation is not recognized, the substance of the transaction results in the recognition of revenue?

Please provide reasons for your views, including the conceptual merits and weaknesses; the extent to which your views address the objectives of financial reporting; and how your preferred view provides useful information to users.

- 1.66 If a liability for coins is recognized, derecognition considerations should be consistent with those for notes as discussed in paragraphs 1.48–1.55.

Consistency with Current IPSAS

- 1.67 Another approach to consider for liabilities related to currency in circulation is adoption of accounting requirements under existing IPSAS standards.

- 1.68 IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets* requires that a provision shall be recognized when: (a) An entity has a present obligation (legal or constructive) as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognized. Applying IPSAS 19, the recognition of the liability depends on the existence of a present obligation as a result of a past event, which is probable and expected to result in an outflow of resources. IPSAS 19, requires recognition of a liability based on the requirements of the legislation (legal obligation) for currency in circulation or a past practice of exchanging currency by the monetary authority (constructive obligation). However, for the case when an obligation is not recognized, IPSAS 19 provides guidance on contingent liabilities. IPSAS 19 states contingent liabilities¹⁸ shall not be recognized and should instead be disclosed unless the possibility of an outflow or resources embodying economic benefits or service potential is remote.

- 1.69 The requirements of IPSAS 28–30, *Financial Instruments* are appropriate to consider as discussed in paragraphs 1.40–1.42. Further to the above discussion, the IPSASB considered if currency liabilities are an equity instrument, rather than a financial liability. IPSAS 28 defines an equity instrument as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Currency only gives the holder a claim to the face value of the currency held. It does not give any rights to any additional residual or variable interest in the monetary authority. Therefore, accounting for currency in circulation as an equity instrument seems inappropriate.

Presentation and Disclosure

- 1.70 This section of the CP discusses at a high level the information to be presented in respect of currency and coin in circulation. It does not propose specific requirements. These requirements are linked to decisions regarding the approach to recognition and measurement, and therefore will be determined once the IPSASB has considered the responses to this chapter of the CP.

¹⁸ IPSAS 19.18 defines a contingent liability as: (a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) A present obligation that arises from past events, but is not recognized because: (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or (ii) The amount of the obligation cannot be measured with sufficient reliability.

- 1.71 The information to be presented will need to be useful for accountability and decision-making purposes to ensure it meets the objectives of financial reporting. Information will need to be consistent with the QCs set out in the Conceptual Framework. Decisions about the information to include will also need to take into account the constraints on information included in general purpose financial reporting.

Appendix A: Currency in Circulation: Notes

Appendix A, breaks down the different stages in the process to produce, distribute and maintain notes in circulation by monetary authorities. The examples have been developed along with journal entries for each step of the process to demonstrate how transactions are accounted for.

Purchase Materials			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Purchase Materials - Journal Entry	<i>Purchase Material (Ink & Paper) for 1000, 100CU notes – cost 100CU</i>	<i>Purchase Material (Ink & Paper) for 1000, 100CU notes – cost 100CU</i>	<i>No new notes needed for this transaction.</i>
	DR Inventory 100	DR Inventory 100	
	CR Cash 100	CR Cash 100	
Production of Notes			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Production of Notes Journal Entry	<i>Production of 1000, 100CU notes. Production costs (Overhead & Labour) - cost 100CU</i>	<i>Production of 1000, 1000, 100CU notes. Production costs (Overhead & Labour) - cost 100CU</i>	<i>No new notes needed for this transaction.</i>
	DR Inventory 100	DR Inventory 100	
	CR Cash 100	CR Cash 100	

Distribution of Notes			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Journal Entry to Recognize Financial Asset Received for Notes Distribution	<i>Distribution of 1000, 100CU notes, total cumulative face value 100,000CU. Transaction to Increase the amount of notes.</i>	<i>Transaction to exchange old notes for new notes. Distribution of 1000, 100CU notes, total cumulative face value 100,000CU. Net impact of transaction Nil - exchanging old notes for new notes.</i>	<i>No new notes distributed for this transaction.</i>
	DR Financial Asset (Other than domestic notes) 100,000	DR Cash (old notes) - 100,000	
	CR Liability for Currency Issued 100,000	CR Liability for Currency Issued 100,000 ¹⁹	
Journal Entry to Recognize Cost of Notes Issued	DR Cost of Notes Issued - 200	DR Cost of Notes Issued - 200	
	CR Inventory 200	CR Inventory 200	

Removal of Notes From Circulation			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Derecognition of liability due to removal of notes from circulation	<i>No notes being removed from circulation. No transaction to record.</i>	<i>Net change is nil, as old notes exchanged for new notes. Therefore, no impact on liability recognized.</i>	<i>Notes being removed from circulation; must exchange a financial asset other than domestic notes. Assume 1000, 100CU face value notes removed from circulation.</i>
			DR Liability, Currency in Circulation 100,000
			CR Financial Asset (other than cash) 100,000

¹⁹ After old damaged notes are removed from circulation, they would usually be destroyed. At that point, the amount of cash is reduced accordingly and the liability is reduced. For example, the journal entry would be DR Liability for Currency Issued (old notes) – 100,000, CR – Cash (old Notes) – 100,000. Regardless of whether the cash is destroyed and permanently removed, any domestic notes held by the monetary authority are offset against the liability for currency in circulation, because such notes are not in circulation.

Appendix B: Currency in Circulation: Coins

Appendix B, breaks down the different stages in the process to produce, distribute and maintain coins in circulation by monetary authorities. The examples have been developed along with journal entries for each step of the process to demonstrate how transactions are accounted for.

Purchase Materials			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Purchase Materials - Journal Entry	<i>Purchase Material (metal) for 1000, .25CU coins. Cost of 100CU.</i>	<i>Purchase Material (metal) for 1000, .25CU coins. Cost of 100CU.</i>	<i>No new coins needed for this transaction.</i>
	DR Inventory 100	DR Inventory 100	
	CR Cash 100	CR Cash 100	

Production of Coins			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Production of Coins Journal Entry	<i>Production of 1000, .25CU coins. Production costs (Overhead & Labor) - cost 100CU</i>	<i>Production of 1000, .25CU coins. Production costs (Overhead & Labor) cost 100CU</i>	<i>No new coins needed for this transaction.</i>
	DR Inventory 100	DR Inventory 100	
	CR Cash 100	CR Cash 100	

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Distribution of Coins – Liability Recognized			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Journal Entry to Recognize Financial Asset Received for Coins Distribution	<i>Distribution of 1000, .25CU coins, total cumulative face value 250CU. Transaction to Increase amount of coins.</i>	<i>Transaction to exchange old coins for new coins. Distribution of 1000, .25CU coins, total cumulative face value 250CU. Net impact of transaction Nil - exchanging old coins for new coins.</i>	<i>No new coins distributed for this transaction.</i>
	DR Financial Asset (Other than cash) 250	DR Cash (old Coins) - 250	
	CR Liability for Currency Issued 250	CR Liability for Currency Issued ²⁰ 250.	
Journal Entry to Recognize Cost of Coins Issued	DR Cost of Coins Issued - 200	DR Cost of Coins Issued - 200	
	CR Inventory 200	CR Inventory 200	

²⁰ After old damaged coins are removed from circulation, they would usually be destroyed. At that point, the cash balance is reduced accordingly and the liability is reduced. For example, the journal entry would be DR Liability for Currency Issued (old coins) – 250, CR – Cash (old coins) – 250. Regardless of whether the cash is destroyed and permanently removed, any domestic notes held by the monetary authority are offset against the liability for currency in circulation, because such notes are not in circulation.

Removal of Coins From Circulation – Liability Recognized			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Derecognition of liability due to removal of coins from circulation	<i>No Coins being removed from circulation. No transaction to record.</i>	<i>Net change is nil, as old coins exchanged for new coins. Therefore, no impact on liability recognized²¹.</i>	<i>Coins being removed from circulation, must exchange a financial asset other than cash. Assume 1000, .25 face value coins removed from circulation.</i>
			DR Liability, Currency in Circulation - 250
			CR Financial Asset (other than cash) 250

Distribution of Coins – No Liability Recognized ²²	
Transaction	Increase Currency in Circulation
Journal Entry to Recognize Financial Asset Received for Coins Distribution	<i>Distribution of 1000, .25CU coins, total cumulative face value 250CU. Transaction to Increase amount of coins.</i>
	DR Financial Asset - 250
	CR Revenue - Distribution of Coins - 250
Journal Entry to Recognize Cost of Coins Issued	DR Cost of Coins Issued - 200
	CR Inventory - 200

²¹ When old coins are received, there may be a journal entry to recognize the residual value of the metal received as inventory which has not been included. However, for coins, monetary authorities would receive old coins which would have residual value due to the scrap metal.

²² No liability is recognized because there is a lack of a requirement to do so. Therefore only the transaction to put coins into circulation has been included.

Cost of Materials and Production Exceed Face Value of Coins	
Transaction	Inventory
Journal Entry to record cost of production.	<i>Purchase Material (metal) for 1000, .25CU coins for cost of 100CU. As well as production costs for 1000, .25CU coins – cost of 200CU. Total cost of production equal to 300CU</i>
	DR inventory – 300
	CR Cash - 300
Journal Entry to write inventory down to the lower of cost and net realizable value.	Because the 300CU inventory cost is higher than the face value of the notes (the net realizable value of the notes) an adjustment needs to be recorded to write down the inventory value to the 250CU realizable face value of the coins (1000, 0.25CU coins = 250 CU face value)
	DR Inventory Impairment loss (lower of cost and net realizable value) - 50
	CR Inventory - 50