

Meeting: International Public Sector Accounting
Standards Board

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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 chapters on Currency in Circulation and Monetary Gold Chapter of the CP, Public Sector Specific Financial Instruments (mark-up version available upon request)

Issues Paper, Public Sector Specific Financial Instruments

Background

1. At the September 2015 meeting, the IPSASB discussed revised drafts of the monetary gold and currency in circulation chapters of the consultation paper (CP) and provided directions on their development.
2. Revised drafts of the chapters on Monetary Gold and Currency in Circulation are included as Agenda Item 3.2.
3. The appendix to this Issues Paper discusses some key issues related to the development of Chapter 4, Reserve Position in the IMF and Special Drawing Rights (SDRs).
4. This Issues Paper seeks the IPSASB's views on the key issues identified in revising the draft chapters.

Key Issues

Monetary Gold—Definitions

5. It was noted at the September meeting, that the proposed reserve asset definition may not sufficiently align with GFS.
6. Staff and the TBG considered potential revisions to the definition. However, reservations were expressed in using some of the GFS terms because they may have unintended consequences and interpretations from an accounting perspective. Therefore, it was decided to include a further description to support the definition to more closely align with GFS terminology. The definition and additional supporting description are as follows:

Reserve assets are defined as follows:

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

Additional description (included in paragraph 3.28 of the CP)

When a reserve asset has a counterparty, it must be a foreign counterparty. Tangible gold, because of its physical nature, does not have a counterparty.

7. Feedback received from the IMF noted that the above definition and description do not sufficiently narrow down what constitutes a reserve asset. To ensure alignment with GFS it is recommended that the requirement for a foreign counterparty be introduced directly into the definition. Further, it was noted that the reference in the current definition to 'international payment needs', is a wider concept than "for balance of payments financing needs" used in the statistical guidance.
8. The IMF provided modifications to the above definitions to align with the statistical guidelines. Staff has included the proposed alternative wording in boxed text following paragraphs 3.26 and 3.28 respectively. The proposed text is as follows:

Reserve assets are defined as follows:

“Are those external assets held by monetary authorities that are readily available for balance of payments financing needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.”

External assets are those that have a foreign (nonresident) counterparty, when they have one. Tangible gold, because of its physical nature, does not have a counterparty.

9. Staff is of the view that if the intention is to align with GFS, wording similar to that proposed by the IMF will need to be adopted.

Matter(s) for Consideration

1. The IPSASB is asked to **Indicate** which of the two proposed definitions and descriptions is preferred, those included paragraphs 3.26 and 3.28, or, the alternative proposed by the IMF (in the text boxes following paragraphs 3.26 and 3.28).

Monetary Gold—SMC

10. The IPSASB directed staff to combine the two proposed SMCs for the monetary gold chapter, into a single SMC, with a sub-option.
11. Staff discussed with the TBG and has developed the following SMC for inclusion in the monetary gold chapter:

Specific Matter for Comment—Chapter 3–1

- (a) Should the IPSASB prescribe measurement requirements in accordance with:
- (i) Option 1: measurement at market value in an open, active and orderly market; or
 - (ii) Option 2: measurement at historical cost?
- (b) Should the IPSASB allow preparers to designate an option based on their intentions in holding the assets?
- Please provide reasons for your views, including the conceptual merits and weaknesses of each.

Matter(s) for Consideration

2. The IPSASB is asked to **confirm** if it agrees with the revised SMC, or suggest amendments.

Currency—Types of Currency Arrangements

12. The chapter in September 2015 discussed the standard types of currency arrangements—those where the monetary authority issues currency for its own economy and those where the monetary authority adopts a foreign currency. The IPSASB identified other types of arrangements to be added to the chapter.
13. The types of currency arrangements identified and explained in the CP are as follows:
- (a) Dollarization – when a non-US economy adopts the US dollar as legal tender. This is discussed in paragraph 2.16 of the CP.

- (b) Use of a foreign currency mixed with a domestic currency. This is when a foreign currency is adopted as legal tender but a domestic currency is also issued. This is discussed in paragraph 2.17 of the CP.
- (c) Currency union – when a common currency is developed and used by a group of countries. This is discussed in paragraph 2.18 of the CP.

Matter(s) for Consideration

3. The IPSASB is asked to **confirm** if the various types of currency arrangements are appropriately identified and explained in the CP, or, if not, suggest amendments.

Currency— Nature

- 14. At the September meeting, the IPSASB requested staff to revise the CP to include a discussion that considers if there is a difference in purpose and function between notes and coins.
- 15. Staff has included this discussion on the purpose and function of notes and coins in paragraphs 2.19–2.23 in the CP. The analysis concludes that notes and coins derive value because they are legal tender and accepted as a medium of exchange and therefore serve the same purpose and function in the economy.

Matter(s) for Consideration

4. The IPSASB is asked to indicate if it agrees with the analysis and conclusion in paragraphs 2.19–2.23 in the CP that coins and notes have the same function and purpose.

Currency – Conceptual Options

- 16. Appendix C of the CP sets out a decision tree used to determine the appropriate place in the financial statements to recognize the credit when currency is issued. The paper proposes two options, recognition of a liability and recognition of revenue. Staff also considered a third option which has not been included in the CP, but is discussed in paragraphs 36–37 below.

Option 1 – Liability

- 17. The liability option is discussed in paragraphs 2.31–2.60 in the CP.
- 18. The discussion focuses on the Conceptual Framework definition of a liability as *a present obligation of the entity for an outflow of resources that results from a past event*.
- 19. The issuance of currency gives rise to the past event, so the key issue relates to the existence of a present obligation for an outflow of resources.

Legal vs. non-legal

- 20. The discussion in the CP focuses on the factors which may give rise to a legal or non-legally binding obligation.
- 21. While laws vary by jurisdiction, they usually set out requirements and responsibilities of monetary authorities in relation to currency in circulation, as follows:
 - (a) Manage the amount of currency in an economy;

- (b) Exchange damaged or mutilated currency for new currency;
 - (c) Carry out monetary policy with the objective of stable inflation and exchange rates; and
 - (d) Requirements that currency is a first call on the monetary authorities' assets.
22. A legal obligation gives rise to a present obligation, when such laws exist that set out the responsibility and requirements for monetary authorities in relation to currency in circulation.
23. The CP discusses the factors that give rise to a legally binding obligation in paragraphs 2.36–2.41.
24. When such laws in relation to currency in circulation do not exist, an entity considers the existence of a non-legally binding obligation.
25. For a non-legally binding obligation to give rise to a liability there must be:
- (a) An indication to others that the entity will accept certain responsibilities;
 - (b) The creation of a valid expectation; and
 - (c) Little or no realistic alternative to avoid an outflow of resources.
26. The CP considers the factors related to non-legally binding obligations in paragraphs 2.43–2.52.

Matter(s) for Consideration

5. The IPSASB is asked to:
- (a) **Confirm** if it supports the analysis related to the option to recognize a liability; and
 - (b) **Confirm** if it supports the analysis in regards to the factors which give rise to a legal or non-legally binding obligation.

Measurement

27. An analysis of the Conceptual Framework measurement bases is included in paragraphs 2.53–2.59.
28. Based on the analysis in the CP, staff is of the view that the following measurement bases may be appropriate:
- (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.* The liability for currency is incurred when it is distributed. Currency is distributed for consideration equal to the cumulative face value of the amount issued. Therefore, if historical cost is the basis used measurement appears appropriate at the cumulative face value of the currency 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. It appears that both the timing and amount may be uncertain when considering currency. Use of this measurement bases would require consideration of a broad range of possible outcomes. However, the least costly manner to fulfill the obligation would likely be based on the cost of producing the expected amount of future currency needed, and not the cumulative face value

of all currency issued. This indicates that measurement using cost of fulfillment is limited to the expected cost of producing replacement currency.

- (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 cumulative face value of currency issued is exchanged for an equal amount of currency, or other consideration.
- 29. The nature of the obligation (legal vs. non-legally binding) may impact which measurement basis is appropriate. Legal obligations, because of their contractual nature appear to be more appropriately measured using historical cost or market value. Because both result in measurement at the cumulative face value of the currency issued, which is the contractual amount of the obligation.
- 30. Non-legally binding obligations because they are less certain and non-contractual may be more appropriately measured at cost of fulfillment. Cost of fulfillment measurement would result in recognition of the least costly amount of settling the liability. This amount would likely be the estimated cost of producing the expected amount of future currency required to settle the outstanding currency in circulation. This would likely be less than the amount of the cumulative face value of the currency in circulation.

Matter(s) for Consideration

- 6. The IPSASB is asked to:
 - (a) **Confirm** if it supports the analysis related the various measurement bases; and
 - (b) **Indicate** if it has a view as to which measurement basis is most appropriate.

Option 2—Revenue

- 31. If an obligation does not exist, the CP considers whether the credit is revenue. This option is discussed in paragraphs 2.61–2.66.
- 32. The discussion focuses on the Conceptual Framework definition of revenue which is *increases in net financial position of the entity, other than increases arising from ownership contributions.*
- 33. Issuance of currency is an exchange transaction that results in increases in net financial position. Therefore, according to the Framework guidance, the credit resulting from currency issuance would be revenue, as long as it is not an ownership contribution. Ownership contributions are *inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.*
- 34. Issuance of currency results in inflows from external parties. However, it is unlikely that those external parties are acting in an ownership capacity or establishing an interest in the net financial position of the entity. When an external party acquires currency, it is agreeing to receive a fixed amount of currency for a fixed amount of consideration. The external party does not acquire an interest in the net financial position of the monetary authority. Therefore, the revenue definition is satisfied.
- 35. Revenue appears appropriate to be measured at the cumulative face value of currency issued, which is equal to the amount of consideration received in exchange when issued.

Matter(s) for Consideration

7. The IPSASB is asked to:
- (a) **Confirm** if it supports the analysis related to the option to recognize a revenue; and
 - (b) **Confirm** if it supports measurement at the cumulative face value of the currency issued.

Option 3—Other Obligation

36. A further option to recognize the resulting credit when currency is issued, as other obligations was considered. However, when staff and the TBG considered this option and it did not seem viable.
37. The Conceptual Framework notes in chapter 5, *that the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element defined in the Conceptual Framework needs to be recognized in the financial statements*. Considering this guidance it would seem that for option 3 to be viable, the credit resulting from currency issuance would have to not satisfy the definitions of a liability or revenue. Staff and the TBG did not believe that there was a situation when currency issuance would not result in either a liability or revenue. Therefore, the other obligation option was not included.

Matter(s) for Consideration

8. The IPSASB is asked to confirm if it agrees with the decision to not include the other obligation option for accounting for the credit when currency is issued in the CP.

Chapter 4: Reserve Position in the IMF and Special Drawing Rights (SDRs)

38. The appendix of this Issues Paper, provides information to consider for the development of the final chapter in the CP, for this phase of the project.
39. A.1 sets out the proposed structure and approach for this chapter.
40. A.2–A.11 are included for information purposes, to provide a brief description of the IMF and SDR transactions which will be considered in the chapter.
41. A.12–A.14 consider high level issues related to the development of accounting options for SDR assets, SDR liabilities and the IMF quota subscription.

Matter(s) for Consideration

9. The IPSASB is asked to:
- (a) **Discuss** and provide directions on the issues identified in Appendix A.

Appendix A: Special Drawing Rights (SDRs) and IMF Quota Subscriptions

Proposed SDR Chapter Structure

- A.1 Staff proposes a similar approach to that of the currency in circulation chapter be adopted? Similar to the currency chapter, the SDR chapter will consider the following:
- (a) Possible accounting options for each issue from a Conceptual Framework point of view;
 - (b) Considers the guidance and requirements in GFS;
 - (c) Consider the accounting options against the current IPSAS literature; and
 - (d) Consider current practice of preparers.

Background – SDRs and IMF Quota Subscription

- A.2 SDRs are international reserve assets, created by the IMF in 1969 to supplement IMF member countries' official reserves. The value of a unit of SDR is based on a basket of four currencies (Euro, Japanese Yen, Pound Sterling and US Dollar). The US dollar-equivalent value of the SDR is posted daily on the IMF's website and is calculated as the sum of the specific amounts of the four basket currencies, on the basis of exchange rates quoted at noon each day in the London market. The IMF allocates SDRs to IMF member countries based on their IMF quotas (see below). These allocations provide each member with an unconditional international reserve asset on which interest is neither earned nor paid. However, if a member's SDR holdings rise above their allocations; it earns interest on the excess. Conversely, if a member holds fewer SDRs than allocated, it pays interest on the shortfall. The IMF cannot allocate SDRs to itself or to non-IMF members.
- A.3 The SDR is neither a currency, nor a commitment from the IMF. Holders of SDRs can obtain foreign currencies in two ways, either through the arrangement of voluntary exchanges between members or by the IMF designating members with strong external positions to purchase SDRs from members with weak positions. The SDR also serves as a unit of account of the IMF and some other international organizations, in addition to its role as a supplementary reserve asset.
- A.4 To be allocated SDRs or to participate in borrowing arrangements of the IMF, a country needs to be an IMF member. To become an IMF member a country needs to fund its quota subscription in full by paying 25% of its value in SDRs or widely accepted currencies (such as the Euro, US Dollar, Pound Sterling or Japanese Yen). The remaining balance is generally funded by a non-interest bearing demand note payable to the IMF in the member country's own currency.
- A.5 Dealings with the IMF are usually the responsibility of the monetary authority. However, in some countries dealings with the IMF occur through government directly, or by the government (usually the department of finance or treasury) with the central bank as an intermediary.

Accounting for SDR assets

- A.6 When SDRs are initially allocated to IMF members, they are granted based on the relative size of each member's economy. SDRs are granted based on being IMF quota members and do not require any consideration to be provided (other than being a member of the IMF). When SDRs are allocated, members also agree to provide financing equal to the amount of SDRs received. This financing is not required to be paid to the IMF upon allocation, but the member agrees to provide that amount if called upon to do so by the IMF. Therefore, when SDRs are initially granted an SDR asset is recognized

with an offsetting SDR allocation liability – which is a promise to pay the SDR initial allocation back on demand.

- A.7 SDRs are not a currency and do not have a physical form. They can only be used by members of the IMF and certain international organizations¹ the IMF allows to participate in the SDR system. SDRs cannot be used to buy physical goods. They can only to be used to exchange with other IMF members to increase reserve assets.
- A.8 Further consideration of measurement should reference IPSAS 29: *Financial Instruments: Recognition and Measurement*. IPSAS 29.51 states that the best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. IPSAS 29.AG103 notes a financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. Staff propose assessing whether the SDR market meets this description of an active market.

Accounting for SDR Obligations

- A.9 On initial allocation of SDRs a liability is recognized (in practice) equal to the value of SDRs granted.
- A.10 SNA 2008 notes that SDRs are assets with matching liabilities but the assets represent claims on the participants collectively and not on the IMF. A participant may sell some or all of its SDR holdings to another participant and receive other reserve assets, particularly foreign exchange, in return. GFSM also notes that SDRs (along with monetary gold) are exceptions as they are financial assets without a corresponding claim (liability) on other units².

Accounting for the investment in the IMF

- A.11 It is clear that most entities see the fee paid to the IMF as an asset and many classify it as a financial asset. However, overall, the disclosures related to the investment in the IMF were limited. If guidance is developed, further analysis of the IMF member quota agreement (assuming all agreements are standard) is needed to understand the extent to which IPSAS 28–30 and IPSAS 34–38 cover accounting for such agreements.

Accounting Issues

SDRs

- A.12 Issues related to accounting for SDRs are as follows:
- Do SDRs satisfy the definition of an asset in the Conceptual Framework?
 - Any other elements in the Conceptual Framework which they may qualify as?
 - Similar to reserve assets and possibly a financial instrument under current IPSASs.
 - In practice, accounted for like a foreign currency - revalued based on the amount of the underlying currencies (market value measurement).

¹ The IMF has granted a number of regional banks and development banks 'prescribed holder' status, such as the European Central Bank, the Asian Development Bank and the Bank of International Settlements.

² GFSM states that financial assets are mainly claims on other institutional units and therefore have counterpart liabilities (except for monetary gold and SDRs).

SDR Obligations

A.13 Issues related to accounting for SDR obligations are as follows:

- Do SDR obligations satisfy the definition of a liability in the Conceptual Framework?
- Any other elements in the Conceptual Framework which may they qualify as?
- Appears to be similar to a loan and possibly a financial instrument under current IPSASs.
- In practice, accounted for as if they are a loan denominated in a foreign currency. Historical cost – revalued based on the changes in SDRs.

IMF Quota Subscription

A.14 Issues related to accounting for the IMF Quota Subscriptions are as follows:

- Does the IMF Quota subscription satisfy the definition of asset or an ownership contribution in the Conceptual Framework?
- Any other elements in the Conceptual Framework which may they qualify as?
- Similar to financial investment, maybe an equity instrument, however, appear to be financial instruments under current IPSASs.
- In practice, appear to be accounted for as if they are financial assets.

1 Introduction and Objective

- 1.1 IPSASs do not provide requirements or guidance on how to account for a number of monetary items that the IPSASB has 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 and measurement; and
 - Presentation and disclosure of information.

History of the Project

- 1.3 The project¹ to develop IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*, identified several items² which have public sector specific characteristics. Some items identified may meet the definition of a financial instrument, while others may not. The 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 loans³ and financial guarantee contracts issued through non-exchange transactions⁴—were addressed in application guidance in IPSAS 29. Both instruments meet the definition of a financial instrument. The guidance has been applicable since January 1, 2013.

¹ The IPSASB has a separate project on its agenda to update IPSAS 28–30 the suite of IPSAS financial instruments standards.

² Some items identified as public sector specific financial instruments may satisfy the definition of a financial instrument as defined in IPSAS 28.9.

³ IPSAS 29.AG84–AG90 contains application guidance related to accounting for concessionary loans.

⁴ IPSAS 29.AG92–AG97 contains application guidance related to accounting for financial guarantees issued through a Non-Exchange Transaction.

- 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 believes dealing with these topics is important to the public interest.
- 1.7 The items included in this project have public interest implications because of their significance to the public sector and the service delivery objectives of public sector entities. These issues are important because they allow users to assess public sector entities ability to do the following:
- To deliver services effectively;
 - To manage the resources used and available provide services; and
 - To manage liquidity and solvency.
- 1.8 Some topics in scope of the CP, apply to specific entities such as central banks, which may apply national standards or international standards for the private sector. Central banks are important to the public sector, and it is therefore important for the IPSASB to consider developing guidance for these entities. In some jurisdictions central banks form part of the public sector as they are controlled and often consolidated into the financial accounts of the central government, 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 broader application topics.

Approach taken in this CP

- 1.10 The final output of this project has not been determined by the IPSASB. 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 and 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 2014⁵ (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 appropriate definitions and descriptions related to each topic included in 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 IPSASB will consider the applicable manuals related to each topic when developing accounting guidance to minimize unnecessary differences.

⁵ <http://www.ifac.org/sites/default/files/publications/files/IPSASB-GFS-Policy-Paper.pdf>

2 Chapter 2: Currency in Circulation

Introduction

- 2.1 Although laws vary between jurisdictions, monetary authorities generally are responsible for maintaining currency in circulation⁶. All of the monetary authority financial statements examined, recognized a liability equal to the cumulative face value of the notes in issued. However, for coins, some monetary authorities recognize a liability, while others do not. Where a liability is recognized, it is measured at the cumulative face value of the coins issued.
- 2.2 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

- 2.3 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.

- 2.4 The CP identifies options for accounting for currency in circulation.
- 2.5 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

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

Consideration of GFS

- 2.7 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).

⁶ In some jurisdictions the responsibility for currency is delegated to commercial banks.

- 2.8 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.*
- 2.9 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.*
- 2.10 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

- 2.11 Having considered the above definitions and descriptions from BPM6, the IPSASB proposes the following definitions and supporting guidance.
- 2.12 **Currency in Circulation** is defined as:
- “Physical notes and coins with fixed and determinable values that are legal tender issued by, or on behalf of the monetary authority, that is, either that of an individual economy or, in a currency union to which the economy belongs.”
- 2.13 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.
- 2.14 A monetary authority may directly produce and distribute currency, or it may use a third party to produce and/or distribute currency.
- 2.15 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.
- 2.16 Adoption of a foreign currency as legal tender by a monetary authority, does not give rise to currency liabilities. For example, some monetary authorities, for countries other than the United States of America (US), use the US dollar as legal tender. The adoption of the US dollar by a country other than the US is called dollarization⁷. Use of a foreign currency in this manner does not meet the definition of currency in circulation, because the currency is issued by a foreign monetary authority for another economy. Therefore, accounting for such currency is not in the scope of this CP⁸.
- 2.17 Some countries which have adopted a foreign currency as legal tender, also issue their own domestic currency. When a mix of domestic and foreign currencies are legal tender, only the domestic currency issued by the monetary authority for that economy, should be considered currency in circulation and in scope of this CP.

⁷ 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.

⁸ IPSAS 4, *The Effects of Changes in Foreign Currency Rates*, is the applicable guidance to account for foreign currency transactions.

- 2.18 Some regions have developed currency unions, where a number of countries agree to develop a single currency. That single currency is issued by a monetary authority as legal tender and is considered domestic currency for the union. Such currency in circulation arrangements are in scope of the CP.

Preliminary View – Chapter 2

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

Accounting for Currency

Nature of Currency

- 2.19 Physical currency issued by the entity comprises notes and coins. It is important to consider whether notes and coins have a different function or purpose, which may justify different accounting treatments.
- 2.20 All physical currencies are now fiat currencies—this means they are currencies which have no intrinsic value. In the past currencies were made of precious metals or were exchangeable for a fixed amount of an underlying precious metal such as gold. Since the early 1970s when the United States became the last country to follow the gold standard, all currencies have derived their value based on their acceptance as a medium of exchange—meaning they are accepted for making payments.
- 2.21 The requirement to accept coins and notes as payment is established through laws that establish such as legal tender. As noted in paragraph 2.13, legal tender is the legally acceptable form of payment for an economy.
- 2.22 Notes and coins do have different physical characteristics which may impact how long they last or their residual value if damaged. Because they are made of metals, coins often last longer and have some underlying residual value compared to notes made from paper or plastic. However, notes and coins are used in the same manner for payments, as both are accepted as consideration equal to their face value in exchange for purchases.
- 2.23 Notes and coins are physical currency and derive their value because they are accepted as a medium of exchange and approved as legal tender for an economy. Therefore, the purpose and function of notes and coins appears to be the same.

Currency Inventory

- 2.24 Currency inventory comprises the cost of purchase of raw materials and related production costs including labor and overhead or the cost of purchasing notes and coins produced by a third party⁹.

⁹ 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*.

This CP takes the views that transactions related to the purchase and production of currency should be treated in accordance with IPSAS 12, *Inventories*¹⁰.

- 2.25 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.*
- 2.26 According to the guidance in BPM6, the statistical accounting approach is to recognize the cost of producing currency as an expense.
- 2.27 The main accounting issue for currency inventory is the appropriate timing for the recognition of the expense. The appropriate recognition point appears to be the issuance of currency.
- 2.28 A further issue is how to account for production costs that exceed the face value¹¹. This issue relates to coins mainly. It arises because of the lower face value of coins compared to the cost of production. IPSAS 12 requires measurement at the lower of cost and net realizable value¹². Therefore when cost exceeds face value, the inventory value of currency 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 currency, as well as adjustments for net realizable value of coins when cost exceeds face value).

Issuance of Currency

- 2.29 The main accounting issue relates to where to account for the resulting credit in the financial statements, when currency is distributed into circulation.
- 2.30 This CP considers the different options for accounting for the credit related to issuing currency in the financial statements. The options consider the guidance of the Conceptual Framework and are described below.

Option 1: Liability

Introduction

- 2.31 Appendix C, summarizes the decision points in determining the appropriate place in the financial statements to recognize the credit when currency is issued. This option considers the Conceptual Framework guidance related to the recognition of a liability.
- 2.32 Chapter Five of the Conceptual Framework includes the following:

¹⁰ 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...

¹¹ The issue of production costs exceeding face value, is generally limited to smaller denominations of coins, which have low face values.

¹² IPSAS 12.15 states that inventories shall be measured at the lower of cost and net realizable value.

Definition

5.14 A liability is:

A present obligation of the entity for an outflow of resources that results from a past event.

A Present Obligation

5.15 Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

2.33 The key factors which determine recognition of a liability by an entity when currency is issued are as follows:

- Has a past event occurred?
- Does issuance of currency give rise to a present obligation?
- Does the entity have little or no realistic alternative to avoid an outflow of resources?

2.34 The past event occurs when currency is issued into circulation by the entity. This is the most straight forward factor when examining if a liability should be recognized.

2.35 To determine if there is a liability, an assessment of whether a present obligation exists needs to be undertaken. If so, the next step is to determine if the entity has a legal obligation or non-legally binding obligation, that it has little or no realistic alternative to avoid.

Factors to be Considered

2.36 For legal obligations, the present obligation arises when legislation exists setting out requirements and responsibilities for monetary authorities in relation to currency in circulation.

2.37 The laws which set out the requirements and responsibilities for monetary authorities in relation to currency in circulation can vary. However, such laws may include one or more of the following requirements or responsibilities of monetary authorities:

- (a) Manage the amount of currency in an economy;
- (b) Exchange damaged or mutilated currency for new currency;
- (c) Carry out monetary policy with the objective of stable inflation and exchange rates; and
- (d) Explicit statement that currency is a first call on the monetary authorities assets.

2.38 The key consideration is if that obligation is legally enforceable in law¹³. The Conceptual Framework notes that enforceable obligations may arise from a variety of legal constructs and that exchange transactions are usually contractual in nature and therefore enforceable by law or an equivalent authority or arrangement. Issuance of currency is an exchange transaction because consideration is received equal to the cumulative face value of the currency distributed.

2.39 When laws and regulations exist and set out the requirements and responsibilities of monetary authorities, a legal obligation is present and therefore it is appropriate to consider if a legal liability should be recognized.

13 Conceptual Framework, paragraph 5.20.

- 2.40 The last consideration for a legal liability for currency in circulation, is if the present obligation may result in an outflow of resources. For currency in circulation, if the past event has occurred and currency laws exist that set out the requirements and responsibilities of monetary authorities, there is likely to be an outflow of resources required to discharge those obligations¹⁴.
- 2.41 When legislation results in responsibilities and requirements of monetary authorities, currency has been issued which is likely to result in an outflow of resources; the Conceptual Framework definition of a liability appears to be satisfied.
- 2.42 The absence of currency laws and regulations that establish responsibilities and requirements for monetary authorities indicates that an entity does not have a present legal obligation. The entity therefore considers if a non-legally binding obligation may be present. In order for a non-legally binding obligation to give rise to a liability there must be:
- An indication to others that the entity will accept certain responsibilities;
 - The creation of a valid expectation; and
 - Little or no realistic alternative to avoid an outflow of resources.

These are discussed below.

Indication to others that the entity will accept certain responsibilities

- 2.43 The definition of a non-legally binding obligation requires that an entity indicate acceptance of certain responsibilities to others. The Conceptual Framework¹⁵ considers what actions might provide such an indication. It gives the examples of past practice, published policies and sufficiently specific current statements. In the public sector environment, published policies and specific statements could refer to:
- Making a political promise such as an electoral pledge;
 - Announcement of a policy;
 - Introduction (and approval) of the budget (which may be two distinct points); and
 - The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).
- 2.44 The Conceptual Framework notes that announcements made in the early stages of implementing a policy are unlikely to give rise to non-legally binding obligations. This includes a number of the examples in the previous paragraph. This is because of the other criteria that need to be satisfied for a non-legally binding obligation to give rise to a liability.
- 2.45 Governments may incur currency obligations despite the absence of legislative requirements. The monetary authority may agree to exchange currency despite the lack of legal provisions.

¹⁴ Regardless of the specific terms of currency laws, monetary authorities will incur costs to meet the legal requirements.

¹⁵ Conceptual Framework, paragraph 5.23.

Creation of a valid expectation

- 2.46 The definition of a non-legally binding obligation not only requires an entity to have engaged in various actions. It also requires those actions to have created a valid expectation in the other parties that it will discharge the responsibilities accepted.
- 2.47 For a valid expectation to be created, announcements that an entity will accept certain responsibilities need to be sufficiently precise and certain. Policies that are enshrined in legislation are more likely to create a valid expectation prior to an individual satisfying the entitlement requirements.
- 2.48 A non-legally binding obligation does not exist solely because an individual has a valid expectation that the entity will accept certain responsibilities and has relied on that expectation. The entity must also have little or no realistic alternative to avoid an outflow of resources.

Little or no realistic alternative to avoid an outflow of resources

- 2.49 An entity also must have little or no realistic alternative to avoid an outflow of resources. Interpreting this requirement in the context of non-legally binding obligations is difficult.
- 2.50 The IPSASB considers that reporting obligations in the financial statements in accordance with the legal framework in place and in accordance with past practice at the reporting date is more likely to provide useful information to users of the financial statements and meet the objectives of financial reporting¹⁶. For currency in circulation the main factor to consider when determining whether an entity has little or no realistic alternative to avoid an outflow of resources, is the entity's past practice. When the entity has a past practice of exchanging currency when presented by holders in the absence of a legal obligation to do so, this establishes that the entity has little or no realistic alternative to avoid an outflow of resources.
- 2.51 Whether an entity has little or no realistic alternative to avoid an outflow of resources, should be assessed for non-legally binding obligations. If an obligation exists, but the entity has a realistic alternative to avoid an outflow of resources, a liability is not recognized.

Summary of factors to be considered

- 2.52 The three factors should not be considered in isolation. They are inter-related. An entity must give a sufficiently precise indication to others that the entity will accept the responsibility to exchange currency. This indication creates a valid expectation that the entity will discharge those responsibilities. The result of creating that valid expectation is that the entity has little or no realistic alternative to avoid an outflow of resources.

Measurement

- 2.53 The discussion of Option 1 considers when to recognize a liability for currency issued by the entity. It also considers whether the nature of the liability arises from a legal or non-legally binding obligation. This section considers how the liability should be measured.
- 2.54 Chapter 7 of the Conceptual Framework discusses a number of measurement bases for liabilities. The Conceptual Framework provides guidance for selecting an appropriate measurement basis by considering the nature of the liability and settlement options available.

16 See the Basis for Conclusions to Chapter 5 of the Conceptual Framework, paragraphs BC5.32 and BC5.33.

2.55 The following measurement bases from the Conceptual Framework may be appropriate:

- (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.* The liability for currency is incurred when it is distributed. Currency is distributed for consideration equal to the cumulative face value of the amount issued. Therefore, if historical cost is the basis used measurement appears appropriate at the cumulative face value of the currency 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. It appears that both the timing and amount may be uncertain when considering currency. Use of this measurement basis requires consideration of a broad range of possible outcomes. However, the least costly manner to fulfill the obligation would likely be based on the cost of producing the expected amount of future currency needed, and not the cumulative face value of all currency issued. This indicates that measurement using cost of fulfillment is limited to the expected cost of producing replacement currency.
- (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 cumulative face value of currency issued is exchanged for an equal amount of currency, or other consideration.

2.56 The IPSASB believes that for currency liabilities not all measurement bases in the Conceptual Framework are appropriate. The following measurement bases are not considered appropriate;

- (e) Cost of release is discussed in the Conceptual Framework as follows: *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 immediate exit from the obligation, as it can only be settled when currency is presented by the holder, which is in the control of the holder. Even if the entity had the ability to immediately settle the obligation it is not likely that it could do so at an amount less than face value of the currency issued, as holders of currency would be unlikely to agree to settle at a discount.
- (f) 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 not appropriate as the obligation to maintain currency is not likely to be transferrable from the monetary authority.

2.57 The nature of the obligation which gives rise to the obligation (legal vs. non-legally binding), may impact which measurement bases are appropriate.

2.58 A present legal obligation, arising from a contract or similar arrangement appears appropriate to be measured at historical cost or market value. The legal nature of the liability indicates that settlement is expected at the amount legally enforceable by law. Regardless of whether historical cost or market value are thought to be more appropriate, the actual amount of the liability would be the same, because both would give rise to liabilities equal to the cumulative face value of currency issued.

- 2.59 Non-legally binding obligations arising because of past practices and an expectation for an outflow of resources, may be more appropriately measured using the cost of fulfillment. This is because the future settlement of currency in circulation is uncertain in both time (when it will be exchanged) and amount (how much currency will be redeemed) will be settled. Considering the nature of this type of non-legally binding obligation, cost of fulfillment would seem appropriate. It could be argued that a legal obligation related to currency in circulation, also has the same uncertainty in terms of timing and amount of currency to be exchanged. However, the key difference is the contractual nature of currency in this case means that the obligations are enforceable by law.

Summary

- 2.60 If the monetary authority assess that a present obligation does not exist, because of the absence of a legal or a non-legally binding obligation, an alternative option must be considered to determine the appropriate accounting for the credit related to the issuance of currency.

Option 2: Revenue

Introduction

- 2.61 Appendix C, summarizes the decision points in determining the appropriate place in the financial statements to recognize the credit when currency is issued. This option considers the Conceptual Framework guidance related to the recognition of revenue.

Definitions relating to Revenue and Ownership Contributions

- 2.62 Chapter Five of the Conceptual Framework includes the following:

Definition

- 5.29 Revenue is:

Increases in the net financial position of the entity, other than increases arising from ownership contributions.

- 5.31 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and ability to generate economic benefits through impairments. Revenue and expense may arise from individual transactions or groups of transactions.

- 5.33 Ownership contributions are:

Inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

- 2.63 Issuance of currency by monetary authorities is an exchange transaction that results in increases in net financial position. Therefore, according to the guidance of the Conceptual Framework, issuance of currency would qualify as revenue, as long as that issuance is not considered an ownership contribution.
- 2.64 Issuance of currency results in inflows to the monetary authorities and those contributions are from external parties. However, it is unlikely that those external parties are acting in an ownership capacity or establishing an interest in the net financial position of the entity. When an external party acquires

currency, it is agreeing to receive a fixed amount of currency for a fixed amount of consideration. The external party does not acquire an interest in the net financial position of the monetary authority.

- 2.65 Therefore, if option 1 does not result in the recognition of a liability, then the credit from the issuance of currency, should be recognized in the financial statements as revenue because the definition of revenue is satisfied.

Measurement

- 2.66 It appears appropriate to measure revenue at the cumulative face value of currency issued, which is equal to the amount of consideration received in exchange.

Current Practice

- 2.67 The following discussion, considers how monetary authorities currently account for currency in circulation compared with the above analysis of the conceptual options and current IPSASB literature.
- 2.68 All the monetary authorities universally considered recognize a liability for notes in circulation¹⁷. Seigniorage¹⁸ is not recognized because a liability is recognized equal to the face value of the notes in circulation.
- 2.69 The practice of accounting for notes by monetary authorities is consistent with option 1 for legal obligations. In practice, monetary authorities account for the cumulative face value of notes in circulation, which is consistent with option 1 for legal obligations.
- 2.70 Monetary authorities do not consistently account for coins in circulation. The financial statements of monetary authorities examined demonstrate that some do not recognize a liability for coins in circulation, while others do. When a liability for coins is not recognized seigniorage is often recognized.
- 2.71 For those monetary authorities which do recognize a liability for coins in circulation, the liability is recognized at the cumulative face value of coins in circulation.
- 2.72 The accounting for coins when a liability is recognized appears consistent with option 1 for legal obligations.
- 2.73 Those monetary authorities which do not recognize a liability for coins, it is not clear from their financial statements why this is so. It may be because the monetary authority does not a legal obligation as their jurisdiction does not have laws in place setting out requirements and responsibilities for monetary authorities in regards to coins.
- 2.74 A liability for coins may not be recognized because the monetary authority may have determined that they have not incurred a non-legally binding obligation.
- 2.75 There currently do not seem to be any monetary authorities recognizing a non-legally binding obligation for coins and measuring the liability at the cost of fulfillment, as discussed in option 1. All monetary authorities which recognize an obligation account for them at the cumulative face value of the currency issued.

¹⁷ Based on a sample of monetary authority financial statements examined, it was noted that all recognized a liability at the cumulative face value of notes in circulation.

¹⁸ Seigniorage arises from the issuance of currency (notes and coins) by an entity and is the difference between the cost of producing the currency and the amount received from issuing the currency (notes or coins).

- 2.76 Monetary authorities which do not recognize a liability for coins in circulation, appear to account for coins consistent with option 2 and recognize the credit as revenue equal to the cumulative face value of the amount issued.

Consistency with Current IPSASs

- 2.77 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 a 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, which is similar to Option 1, when accounting for a non-legally binding obligation. 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 liabilities¹⁹ 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.
- 2.78 IPSAS defines a financial liability as *a liability that is a contractual obligation to deliver cash or another financial asset to another entity*. Because of laws and regulations which compel monetary authorities to exchange currency when presented by holders, such an obligation appears to have the characteristics of a financial liability. This would also appear to be consistent with the legal obligation approach discussed in Option 1.
- 2.79 IPSAS 28.AG10 explicitly notes that currency issued as legal tender from the perspective of the issuer, is not addressed in that standard. However, as noted in paragraph 2.78 currency does appear qualify as a financial liability. IPSAS 29, 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.
- 2.80 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. This would result in measurement at face value.
- 2.81 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

¹⁹ 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.

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. This is consistent with the analysis in Option 2, where it was determined that issuance of currency does not give rise to ownership contributions (equity contribution).

Presentation and Disclosure

- 2.82 The CP does not propose specific requirements for presentation and disclosure. 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.
- 2.83 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.

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 dollar²⁰, 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.
- 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:

²⁰ The US dollar was the last currency which was exchangeable for a fixed amount of gold.

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

- (a) The types (different categories and characteristics) of monetary gold held by the entity;
- (b) The impact of monetary gold on the entity's financial performance and financial position; and
- (c) 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, it is important to identify the intentions for which monetary authorities hold monetary gold as reserve assets. The two main intentions identified 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 3.16–3.31, 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 rules²¹ 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 form²² of

²¹ The international standard for transacting in physical gold, are the rules of the London Bullion Exchange.

²² 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.

tangible gold which is quantifiable²³, 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 3.34(c) and 3.36. 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 asset²⁴ 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.

3.23 **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 entity²⁵.

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 those assets readily available for international payment needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.”

Reserve assets are defined as follows:

“Are those external assets held by monetary authorities that are readily available for balance of payments financing 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).

²³ 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.

²⁴ 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...

²⁵ 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.

- 3.28 When a reserve asset has a counterparty, it must be a foreign counterparty. Tangible gold, because of its physical nature, does not have a counterparty.

External assets are those that have a foreign (nonresident) counterparty, when they have one. Tangible gold, because of its physical nature, does not have a counterparty.

- 3.29 To be effective, reserve assets must be readily available for trading.
- 3.30 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 gold holdings held for other purposes such as use in operations, manufacturing or because such holdings have historical or cultural significance.²⁶
- 3.31 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.
- (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 those assets 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

- 3.32 Monetary gold must meet the definition set out in paragraph 3.16 and must be held to achieve the intentions of a monetary authority.
- 3.33 Gold, can have a range of purities, from low to high gold content²⁷ and can take many forms²⁸. 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.

²⁶ 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.

²⁷ Tradable physical gold requires a purity of 995 parts per 1000 or greater gold content.

²⁸ 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.

3.34 Gold can be held directly by monetary authorities or stored with a third party in an allocated or unallocated gold account; as explained below:

- (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 in an unallocated account, is that which is 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 delivery²⁹ of the deposit. Such gold deposits 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.

3.35 Gold coins which are minted from gold, either as commemorative gold coins or as legal tender gold coins, as described below:

- (a) Commemorative gold coins derive their value based on the gold content or the numismatic³⁰ 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 definition³¹. 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.

²⁹ 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.

³⁰ 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.

³¹ 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.

3.36 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 gold³²;
- (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 of 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.

3.37 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

³² the IPSASB 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.*

satisfy the definition requirements. Gold antiques are not considered to be in scope of monetary gold guidance³³.

3.38 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

3.39 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 criteria³⁴.

3.40 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.

3.41 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 3.34.

Measurement

3.42 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 rates³⁵.

3.43 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*

³³ In 2015 the IPSASB has initiated a project to consider accounting for Heritage Assets.

³⁴ 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.*

³⁵ 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.

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.*

- 3.44 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.
- 3.45 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.
- 3.46 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.
- 3.47 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.
- 3.48 Alternatively, if the intention in holding monetary gold is to hold it for an indeterminate period, because it provides confidence in the in ability of monetary authorities to carry out their activities, then a measurement basis which provides information on cost of services may be relevant.
- 3.49 Monetary authorities currently measure monetary gold either on a historical cost basis, or fair value/market value basis³⁶. 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.
- 3.50 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:

³⁶ Only measurement bases consistent with the Conceptual Frameworks' guidelines are discussed, which is why a statutory rate, is not referred to here.

- (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.

3.51 Other measurement bases were not considered appropriate by the IPSASB for the following reasons:

- (a) Market value in an inactive market is not appropriate as a global liquid, active market exists for gold;
- (b) 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;
- (c) 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
- (d) 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.

3.52 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 3.53 and 3.54.

Historical Cost

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

- (a) Relevance—Historical cost information provides information on the minimum resources available to provide future services, based on their acquisition cost of monetary gold;
- (b) 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;
- (c) Understandability—Historical cost information is not complex. It provides information on the cost to acquire (entry value of) monetary gold;
- (d) 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;

- (e) 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
- (f) Verifiability—Historical cost information for monetary gold is transaction based and easily verifiable.

Market Value

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

- (a) Relevance—Market value is a relevant measure that provides information on the contribution of monetary gold to financial capacity;
- (b) 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;
- (c) Understandability—Market value information is understandable; the valuation of monetary gold using a spot rate is not complex;
- (d) 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;
- (e) Comparability—Market value provides measurement information which allows direct comparability of monetary gold assets with other assets, and between different monetary authorities; and
- (f) Verifiability—Market value provides information which is verifiable, because there is an open, active and orderly market.

3.55 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.

3.56 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.

3.57 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 and the statement of financial performance, 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, such as ensuring monetary stability.

3.58 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

3.59 Measurement of monetary gold at market value gives rise to two further 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.

3.60 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.

3.61 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.

3.62 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 a specific IPSAS states otherwise. Further, Chapter 7 of the Conceptual Framework notes the following: *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.*

3.63 However, some 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.

3.64 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.

- 3.65 The global markets for trading gold can be very volatile. The volatility can cause significant changes in the value of monetary gold assets. Some argue that recognizing unrealized gains or losses in the statement of financial performance, may not provide 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.
- 3.66 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 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 an erosion of capital to insufficient 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.
- 3.67 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)³⁷ financial assets are accounted for in IPSAS 29, *Financial Instruments: Recognition and Measurement*.

Consistency with Current IPSAS Guidance

- 3.68 Guidance for accounting of financial assets in IPSAS 29 is based on the classification of the financial instrument, with different requirements for initial recognition, treatment of transaction costs and subsequent changes in value.
- 3.69 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).
- 3.70 Fair value in IPSASs is defined as 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 is the spot rate of gold. Fair value for monetary gold assets is the same regardless of whether it is classified as FV or AFS.
- 3.71 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

³⁷ The project to update IPSAS 28–30 for IFRS 9, *Financial Instruments* may introduce changes to classification terminology.

assets are included as part of the initial cost of the assets (fair value plus directly attributable transaction costs).

- 3.72 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.
- 3.73 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

- 3.74 Monetary authorities may hold monetary gold for different intentions, as noted in paragraphs 3.56–3.57. 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.
- 3.75 Accounting for monetary gold at historical cost is less complex compared to using market value.
- 3.76 Historical cost is normally the fair value at the time of acquisition plus transaction costs (as these are part of the cost of acquiring the asset). Changes to the historical cost of monetary gold assets only result from impairments, when the market 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 of the monetary gold assets on the statement of financial position.
- 3.77 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 because of its service potential, are often more concerned with the quantity of gold held. Therefore, changes in the historical cost values on the statement of financial position directly relate to either increases or decreases in the quantity of monetary gold assets, or impairments of monetary gold 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) Should the IPSASB prescribe measurement requirements in accordance with:
- (i) Option 1: measurement at market value in an open, active and orderly market; or
 - (ii) Option 2: measurement at historical cost?
- (b) Should the IPSASB allow preparers to designate an option based on their intentions in holding the assets?
- Please provide reasons for your views, including the conceptual merits and weaknesses of each.

Consistency with Current IPSAS Guidance

- 3.78 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:

- (g) 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.
- (h) 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.
- (i) 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 cost³⁸. 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.

3.79 For 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

3.80 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.*

3.81 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.

³⁸ 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.*

Presentation and Disclosure

- 3.82 The CP does not propose specific requirements for presentation and disclosure. 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.
- 3.83 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

4 Chapter 4: Reserve Position in the IMF and Special Drawing Rights (SDRs)

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	

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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 ³⁹	
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

³⁹ 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 ⁴⁰ 250.	
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	

⁴⁰ 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 recognized⁴¹.</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 ⁴²	
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

⁴¹ 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.

⁴² 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

Appendix C: Decision Tree – Currency in Circulation

