

**Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** New York, USA

**Meeting Date:** March 8-11, 2016

## Agenda Item 8

For:

☐ Approval

☒ Discussion

☒ Information

### Public Sector Specific Financial Instruments

<b>Project summary</b>	Development of a Consultation Paper on recognition and measurement of public sector specific financial instruments: monetary gold, currency issued by the entity, IMF quota subscription and IMF special drawing rights.	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Decisions required at this meeting</b>	1. Objective for IMF chapter	8.1.1
	2. IMF chapter scope and definitions	8.1.2
	3. Nature and function of the IMF quota subscription and SDR holdings and allocations	8.1.3
	4. IMF quota subscription – Recognition & Measurement	8.1.4
	5. SDR holdings – Recognition & Measurement	8.1.5
	6. SDR allocations – Recognition & Measurement	8.1.6
	7. Appendix A: IMF Chapter Illustrative Examples	8.1.7
	8. Appendix B: IMF Information	8.1.8
	9. Appendix C: GFS Information	8.1.9
	10. Appendix D: Definitions-Supporting Descriptions	8.1.10
	11. Directions from December 2015 meeting actioned	8.1.11
<b>Other supporting items</b>	Directions up to December 2015 Meeting	8.2
	Decisions up to December 2015	8.3
	Draft CP chapter 4: IMF Quota Subscription and SDRs	8.4
	Draft CP chapters 1-3: Introduction, Currency in Circulation & Monetary Gold	8.5

*Note to IPSASB members, this agenda item trials a different structure for agenda papers and their organization. The approach aims to focus attention on the decisions required at the meeting. There will be a discussion of how well this structure works in the closed session (Agenda Item 15) at the March Meeting.*

**Objective of the IMF Chapter****Questions**

1. Should the chapter objective be the first section of the IMF Chapter or should it go after the introduction in the same manner as the monetary gold and currency in circulation chapters?
2. The IPSASB is asked to review and agree the proposed chapter objective included in the CP, as follows:

The objective of this chapter is to discuss the IPSASB's proposal that:

An entity shall account for the IMF quota subscriptions and SDR holdings and allocations in a manner that helps users of its financial statements assess:

- Their impact on the entity's financial performance and financial position; and
- Their nature and extent of risks arising from them, and how the entity manages those risks.

**Detail**

3. The current structure of the IMF chapter in the CP includes the chapter objective preceding the introduction.
4. Because the scope is straightforward for the IMF chapter compared to the monetary gold and currency in circulation chapter, the TBG and staff favour including the objective as the first section of the chapter.

**Decision required**

Does the IPSASB agree with the proposed approach for the IMF Chapter objective?

**IMF Chapter Scope and Definitions****Question**

Does the Board agree with the proposed definitions included in the IMF Chapter, as follows:

1.1 **IMF Quota Subscription** is defined as:

“The amount equal to the quota assigned to the member on joining the IMF that must be paid in full to become an IMF member”.

1.2 **SDR Holdings** are defined as:

“International reserve assets created by the IMF and allocated to members to supplement reserves.”

1.3 **SDR Allocations** are defined as:

“Obligations which arise through IMF member’s participation in the SDR Department and that are related to the allocation of SDR holdings.”

**Detail**

1. The definitions have been developed with reference to the guidance included in the appropriate statistical guidance (Balance of Payments International Investment Position-6<sup>th</sup> Edition (BPM6)).
2. The definitions included in the draft chapter included in agenda item 8.4 paragraphs 4.8-4.10.

**Decision required**

The Board is asked to confirm it agrees with the proposed definitions.

### Nature and Function: IMF Transactions

#### Question

Is the nature and function appropriately identified and explained in the CP, for the following transactions:

- IMF quota subscription—paragraphs 4.11-4.14
- SDR holdings and allocations—paragraphs 4.15-4.17

#### Detail

1. The IPSASB directed staff to consider how the attributes of the IMF items are similar and/or different to more common financial instruments, to help with understanding the economic substance of each transaction.
2. The IMF quota subscription has attributes of financial instruments with similarities and differences as follows:

Similarities	Differences
<ul style="list-style-type: none"> <li>- Common Shares – provide voting rights in proportion to quota amount to total quota; and</li> <li>- Debt Instruments, such as bonds, loans and preference shares because interest earned is a fixed amount, not dependent on profit or return on investment.</li> <li>- Collateral borrowing – borrow up to a specific collateral level (quota amount similar to collateral)</li> </ul>	<ul style="list-style-type: none"> <li>- Unique to common shares because being equivalent to a membership fee, it cannot be sold. To exit investment must withdraw from the IMF.</li> </ul>

3. The IMF SDR holdings and allocations have attributes that are similar and different from other financial instruments as follows:

Similarities	Differences
<ul style="list-style-type: none"> <li>- SDR holdings: value based on four underlying foreign currencies, therefore, are much like a foreign currency instrument.</li> <li>- SDR allocations: attributes of a demand loan or credit line.</li> </ul>	<ul style="list-style-type: none"> <li>- SDR holdings: cannot be used to purchase goods and services like other foreign currencies.</li> <li>- SDR allocations: no requirements to repay principal and do not have a maturity date.</li> </ul>

#### Decision required

The Board is asked to confirm that it agrees with the discussion on the nature and function of the IMF quota subscription and SDR holdings and allocations included in the draft chapter.

### IMF quota subscription – Recognition & Measurement

#### Questions

Does the Board agree with the analysis of:

- (a) The factors that may give rise to recognition of an asset in relation to the payment of the quota subscription; and
- (b) The discussion of the measurement bases for the IMF quota subscription.

#### Detail

1. The question of whether the payment of the IMF quota subscription gives rise to recognition of an asset in the context of the Conceptual Framework considers the following:
  - (a) Has a past event occurred?
  - (b) Does paying the quota give rise to a resource? and
  - (c) Does the entity presently control that resource?
2. Staff concludes that payment of the quota gives rise to the occurrence of a past event. Is the quota subscription a resource and does the member control that resource? This is discussed in CP paragraphs 4.21 to 4.25, where staff conclude that:
  - (a) To be a resource the quota should provide service potential or the ability to generate economic benefits. The quota may give rise to both service potential and the ability to generate economic benefits because of the overall benefits to a member's economy from the IMF's contributions to the international financial structure. The quota also provides economic benefits because it may decrease costs of borrowing for foreign currency (reserve assets) because of the SDR market.
  - (b) Control of the resource is the ability to use the resource (or direct other parties on its use) to derive economic benefits or service potential for the entity. The member controls the benefits of the quota because:
    - It has voting rights and an ability to influence the activities of the IMF; and
    - The IMF Articles of Agreement set out procedures to withdraw from the IMF and includes rights and obligations to settle the quota subscription.
3. Consideration of the factors indicates that an asset may exist, that asset needs to be measured. CP paragraphs 4.26 to 4.28 consider the measurement bases set out in the Conceptual Framework and conclude that IMF quota subscription should be measured at historical cost.

#### Decisions required

Does the IPSASB agree that:

- Consistent with the analysis in the CP, the IMF quota subscription is appropriate to be recognized as an asset?
- The IMF quota subscription asset should be measured at historical cost?

### SDR Holdings – Recognition & Measurement

#### Question

Does the Board agree with the analysis of:

- (a) The factors that may give rise to recognition of an asset in relation to the allocation of SDR holdings; and
- (b) The discussion of the measurement bases for the IMF SDR holdings.

#### Detail

1. The question of whether the allocation of SDR holdings gives rise to recognition of an asset in the context of the Conceptual Framework considers the following:
  - Has a past event occurred?
  - Do SDR holdings give rise to a resource? and
  - Does the entity presently control that resource?
2. Staff concludes that the past event aspect of the definition is satisfied when the SDR holdings are granted. Because a grant cannot happen until an entity becomes an IMF member (and pays its quota subscription) and chooses to participate in the SDR program. Only after those events occur, will SDRs be granted, which means the grant of SDRs confirms the past event has occurred.
3. Are SDR holdings a resource and does the member control that resource? This is discussed in CP paragraphs 4.31 to 4.34, where staff conclude that:
  - (a) SDR holdings appear to be a resource because:
    - (i) They can be used as consideration to transact with other IMF members for foreign currency; and
    - (ii) The accrue interest payments from the SDR department.
  - (b) SDR holdings also appear to be presently controlled for the following reasons:
    - (i) Members are free to transact the SDRs through the IMF or other voluntary arrangements at the member's discretion; and
    - (ii) The IMF Articles of Agreement set out the obligations and rules for the use of SDRs and which members agree to when participating in the SDR department; which facilitate the functioning of the SDR market.
4. Consideration of the factors indicates that an asset may exist, that asset needs to be measured. CP paragraphs 4.36 to 4.37 consider the measurement bases set out in the Conceptual Framework note that SDR holdings may be appropriate to be measured at market value, historical cost or net selling price.

#### Decisions required

Does the IPSASB agree that:

- Consistent with the analysis in the CP, SDR holdings are appropriate to be recognized as an asset?
- SDR holdings may be appropriate to be measured at market value, historical cost and net selling price?

**SDR Allocations – Recognition & Measurement****Question**

Does the Board agree with the analysis of:

- (a) The factors that may give rise to recognition of a liability in relation to the SDR allocations;  
and
- (b) The discussion of the measurement bases for SDR allocations.

**Detail**

1. The question of whether the allocation of SDR allocations give rise to recognition of a liability in the context of the Conceptual Framework considers the following:
  - 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. Staff concludes that the past event occurs when the member joins the IMF, agrees to participate in the SDR department and receives an allocation of SDRs.
3. Does a present obligation exist for SDR allocations and if so what is the nature of the obligation? This is discussed in CP paragraphs 4.40 to 4.42, where staff conclude that:
  - SDR allocations give rise to a legal obligation because of the IMF Articles of Agreement that set out the rights and obligations of the IMF and IMF members, including dispute resolution mechanisms enforced through the International Court of Justice.
  - Because the SDR appear to be legally enforceable – there appears to be little or no realistic alternative to avoid an outflow or resources.
4. Consideration of the factors indicates that liability may exist, that liability needs to be measured. CP paragraphs 4.44 to 4.45 consider the measurement bases set out in the Conceptual Framework note that SDR allocations may be appropriate to be measured at market value or cost of fulfillment.

**Decisions required**

Does the IPSASB agree that:

- Consistent with the analysis in the CP, SDR allocations are appropriate to be recognized as a liability?
- SDR allocations may be appropriate to be measured at market value or cost of fulfillment?

**IMF Chapter: Appendix A-Illustrative Examples**

**Question**

Is the Board content with the coverage of the Illustrative Examples?

**Detail**

1. Appendix A of the IMF Chapter in agenda item 8.4 sets out a number of scenarios and examples for understanding of transactions related to the IMF Chapter.

**Decisions required**

Does the IPSASB agree that:

- The examples for each scenario are clear, understandable and helpful?
- The examples and scenarios are complete; or are there additional examples that should be added?



**IMF Chapter: Appendix B-IMF Information**

**Question**

Whether background information on the IMF should be included in the CP

**Detail**

1. Appendix B of the IMF Chapter in agenda item 8.4 provides detailed background information on the IMF.
2. The IPSASB noted that because of the unique nature of the IMF transactions a more detailed background on the IMF and the transactions being considered should be included in the CP. Staff and the TBG recommend that this additional background information be included in the appendix of the CP rather than the main text. This is so that those who have a detailed understanding of the IMF transactions covered in the CP do not have to read the text, which will signpost the Appendix for those who need it.

**Decisions required**

Does the IPSASB agree that the appendix is helpful and should be retained in the CP?

**IMF Chapter: Appendix C-GFS Guidance****Question**

Should the GFS guidance be included in an Appendix to the CP or in the main text.

**Detail**

1. Appendix C of the IMF Chapter in agenda item 8.4 outlines the guidance from the Balance of Payments and International Investment Position Manual-6<sup>th</sup> Edition (BPM6) (applicable GFS guidance) considered in developing the chapter.
2. Staff and the TBG note that the GFS guidance considered is built into the scope and definitions and is better located in an appendix for reference.
3. Further, staff and TBG propose that the GFS guidance in each chapter be included in Appendices.

**Decisions required**

Does the IPSASB agree that: the GFS guidance should be included in an appendix for all CP chapters?

**IMF Chapter: Appendix D-Definitions-Supporting Descriptions**

**Question**

1. Whether the supporting descriptions for the definitions of IMF transactions should be included in an Appendix rather than in the text of the CP.

**Detail**

2. Because IMF transactions are well defined and understood between the IMF and member countries, only definitions have been included in the CP. Further supporting descriptions to the definitions are provided in Appendix D.

**Decisions required**

Does the IPSASB agree that:

- The supporting descriptions to the IMF transaction definitions should be included in an appendix as per the staff proposal or should they be relocated to the Scope and Definition section of the CP?

### Directions from December 2015 meeting actioned

#### Question

- Whether the Board approves the actions taken to address the directions given at the December 2015 meeting.

#### Detail

- The definition of “reserve asset”: The IPSASB agreed with modifications to the “reserve asset” definition to align more closely with Government Finance Statistics (GFS) terminology. The IPSASB also directed that further explanation should be added to highlight the importance the GFS terminology has in setting out the reserve asset definition. Staff has included additional explanatory information on the importance of GFS terminology and included it in paragraphs 3.26 and 3.28 respectively in agenda item 8.5.
- Monetary Gold SMCs. The Board directed that two SMCs be included in chapter 3: one on whether there should be an option to select a measurement basis (current value or historical cost) based on their intention in holding monetary gold assets; and a second on which measurement basis is most appropriate for monetary gold – current value or historical cost. Staff proposes the following SMCs:

#### Specific Matter for Comment–Chapter 3–1

- Should entities have the option to select a measurement basis (current value or historical cost) based on their intentions in holding monetary gold assets?

#### Specific Matter for Comment–Chapter 3–2

- Which measurement basis is most appropriate for monetary gold, current value or historical cost?

- Preliminary View on currency in circulation. IPSASB formed a view that both 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 and directed that a draft preliminary view should be developed for consideration at the March 2016 meeting. Staff proposes the following Preliminary View:

#### Preliminary View – Chapter 2

- 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. As the purpose and function of notes and coins is the same, the IPSASBs view is the accounting treatment should be consistent for both.

#### Decisions required

Does the IPSASB agree:

- The revisions and additions in paragraphs 3.26-3.28 in respect of the reserve asset definition;
- The SMCs for Monetary Gold; and
- The Preliminary View for currency in circulation.

### DIRECTIONS ISSUED UP TO DECEMBER 2015

Meeting	Direction	Actioned
December 2015	Modify “reserve asset” definition to align more closely with Government Finance Statistics (GFS) terminology and provide further explanation	Monetary Gold chapter (Agenda Item 8.5) paras 3.26 and 3.28 are amended.
December 2015	Revert to two SMCs for the monetary gold chapter: - One SMC will ask if there should be an option to select a measurement basis (current value or historical cost) based on their intention in holding monetary gold assets. - A second SMC will ask which measurement basis is most appropriate for monetary gold – current value or historical cost.	Monetary Gold Chapter (Agenda Item 8.5) following para. 3.78.
December 2015	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.	Currency chapter (Agenda Item 8.5) following para 2.23.
December 2015	Accounting for currency in circulation should be driven by the economic substance of the transactions; therefore the discussion of accounting ‘options’ is more appropriately termed accounting ‘approaches’ and should be revised.	Currency chapter (Agenda Item 8.5) – several changes included in mark-up.
September 2015	The term “domestic” should be removed from the definition of currency because it may create confusion in those jurisdictions using a foreign currency, such as the US dollar.	
September 2015	Each of the different types of currency arrangements be identified and explained: (a) Currency issued by a monetary authority for its economy; (b) Currency issued by a monetary authority for a currency union; and (c) Currency issued by a monetary authority for a foreign economy which has been adopted without formal agreement.	
September 2015	A revised chapter on currency in circulation should include examples for each option developed as this would be helpful for constituents to understand the differences of each.	
June 2015	Definition of currency should be revised to discuss ‘domestic currency’ and include not only ‘issued’ but also ‘authorized’ for those jurisdictions that rely on another entity to produce and distribute currency	
June 2015	To consider the implications of accounting for currency that is more costly to purchase/produce than its face value.	
June 2015	To consider if it is a common approach for entities to recognize a liability because of the obligation to maintain currency or whether the liability is a financial liability.	
March 2015	To revise the discussion of the historical cost of monetary gold and the relationship to information on the cost of services.	

## Agenda Item 8.2

	Further, Staff should consider the restrictions on selling monetary gold that apply to many monetary authorities in further developing the CP.	
December 2014	The CP should include measurement options to get feedback from constituents.	
	Inclusion of only one measurement options (market value—in open active market because of monetary golds financial capacity) may not reflect other reasons monetary gold is held. Other options to be developed for the next version of the CP.	
September 2014	Introduction chapter should include a more complete explanation as to how this project has evolved to communicate to constituents why the CP covers the topics included and their importance to the public sector.	
September 2014	Further consideration of perspectives other than an exit value measurement basis is required.	
March 2014	Staff to liaise with the IASB to understand if any future research or project work undertaken by their organization would cover monetary gold, currency in circulation or IMF quota subscriptions or special drawing rights	

### DECISIONS UP TO DECEMBER 2015

Date of Decision	Decision
December 2015	Modifications to the “reserve asset” definition to align more closely with Government Finance Statistics (GFS) terminology and further explanation to be added to highlight the importance the GFS terminology has in setting out the reserve asset definition.
December 2015	Revert to two SMCs for the monetary gold chapter: <ul style="list-style-type: none"> <li>- One SMC will ask if there should be an option to select a measurement basis (current value or historical cost) based on their intention in holding monetary gold assets.</li> <li>- A second SMC will ask which measurement basis is most appropriate for monetary gold – current value or historical cost.</li> </ul>
December 2015	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.
December 2015	Historical cost, market value, and on limited occasions, cost of fulfillment may be viable measurement bases for currency in circulation.
September 2015	Agreed the revised tangible gold definition and the additional description added noting that financial instruments which can result in the delivery of gold are considered in the scope of guidance in the CP.
September 2015	Preliminary views should be developed for all definitions in each chapter.
September 2015	Include a single SMC on Monetary Gold, asking constituents if the IPSASB should prescribe an accounting requirement for measurement at current value or historical cost and to include a further sub-option asking if preparers should be allowed to select a measurement basis (current value or historical cost) based on their intention in holding the gold assets.
September 2015	More consideration of options for accounting for currency which reflect users' perspectives is necessary.
September 2015	The options for accounting for currency need to consider guidance in the conceptual framework more fully, specifically if a legal or non-legally binding obligation exists for currency issued by the entity.
June 2015	Scope of CP to be limited to monetary gold, currency in circulation and IMF-related transactions.
June 2015	The monetary gold definition should depart from the GFS definition, because that definition refers to it as a financial asset, which is a defined term in IPSAS.
June 2015	A description should be included to explain that contracts that result in the physical delivery of gold are in scope of the chapter in some circumstances.
June 2015	The chapter on monetary gold should develop broad and open options to receive feedback from constituents.
June 2015	Proposed modification of the definition of “physical gold” to “tangible gold” was agreed.
June 2015	Currency in circulation chapter objective and structure agreed.
June 2015	Accounting for the purchase and production for notes and coins as inventory is appropriate.

June 2015	'Amount of currency in circulation' should be used rather than 'money supply', which has broader meaning from an economic context.
June 2015	Market value, historical cost and cost of fulfilment may be appropriate measurement bases for currency in circulation.
June 2015	Measurement should be consistent for both notes and coins in the currency chapter.
June 2015	It is useful to include a discussion on currency in relation to current IPSAS requirements in the CP.
March 2015	Revised introduction of the CP to emphasize the importance of public interest and why the topics being addressed have been included.
March 2015	Revised definitions of monetary gold, physical gold and monetary authority, as well as the supporting descriptions included in the revised CP, agreed.
March 2015	Revisions in the CP agreed. The following gold assets should be in scope: <ul style="list-style-type: none"> <li>(a) Physical gold (including gold held directly, in allocated and unallocated gold accounts);</li> <li>(b) Commemorative gold coins and gold coins that are legal tender; and</li> <li>(c) Some financial instruments which allow for physical settlement in gold on demand without restriction and for which monetary authorities have the intention of taking physical delivery of the gold.</li> </ul>
March 2015	Arguments for both monetary gold measurement options should consider the monetary authority's reason for holding such assets. Linking the measurement model to the intention of holding assets is more appropriate than a direct reliance on the Conceptual Framework.
March 2015	Consideration of presentation and disclosure should be revisited after all the chapters have been developed in the CP.
March 2015	The historical cost option in the CP should consider accounting for changes in value due to impairments.
March 2015	The scope of the CP should not be expanded to include all reserve assets as defined in GFS.
March 2015	A key question for both notes and coins is the nature of the liability for the entity that issues the currency and the appropriate measurement basis for measuring such a liability. Each should be considered separately on a step-by-step basis.
December 2014	Chapter 1 to include more information on the reasons why the topics have been included and emphasize the importance of the topics included from a public interest perspective (in particular those topics related to central banks).
September 2014	GFS definitions should be followed to the extent possible.
September 2014	Scope of monetary gold chapter should consider the economic substance of the transactions and include those gold holdings which are either tangible gold, or result in delivery of tangible gold.
September 2014	Measurement objective should be developed considering the different perspectives of users.
September 2014	Options for the measurement objective need to be developed to link into the reasons monetary authorities hold monetary gold.
September 2014	Information on disclosures should be based on a consideration of users' needs as communicated through a disclosure objective.



## Agenda Item 8.3

March 2014	Monetary gold, currency in circulation and IMF quota subscriptions and SDRs relate mainly to central banks. However, the CP should take a transactional approach, rather than an entity-specific approach.
March 2014	Illustrative examples noting the debits and credits for initial recognition, revaluations (if any) and derecognition for the various types of transactions would be helpful for understanding.
December 2013	<p>The scope of the project was agreed to include the following:</p> <ul style="list-style-type: none"> <li>- Monetary gold (including gold reserves and instruments linked to gold);</li> <li>- Currency in circulation;</li> <li>- IMF SDRs and quota subscription;</li> <li>- Statutory Receivables;</li> <li>- Statutory Payables; and</li> <li>- Public Sector Securitizations (being those where because of powers of the government an item not recognized in the statement of financial position is securitized).</li> </ul>
December 2013	The requirements and guidance included in IPSAS 29 on concessionary loans and financial guarantees issues in non-exchange transactions should not be in scope of the public sector specific financial instruments projects.
December 2013	The Public Sector Specific Financial Instruments Project should be independent and separate from the project to update IPSAS 28-20 for IFRS 9, <i>Financial Instruments</i> .

### 1 Introduction and Objective

See Agenda Item 8.5

### 2 Chapter 2: Currency in Circulation

See Agenda Item 8.5

### 3 Chapter 3: Monetary Gold

See Agenda Item 8.5

### 4 Chapter 4: International Monetary Fund (IMF) Quota Subscription and Special Drawing Rights (SDR)

#### Chapter Objective

The objective of this chapter is to discuss the IPSASB's proposal that:

An entity shall account for the IMF quota subscriptions and SDR holdings and allocations in a manner that helps users of its financial statements assess:

- Their impact on the entity's financial performance and financial position; and
- Their nature and extent of risks arising from them, and how the entity manages those risks.

#### Introduction

- 4.1 The International Monetary Fund (IMF) is an international cooperative monetary organization of member countries, established to carry out key activities<sup>1</sup> in three areas: lending, international monetary system surveillance, and capacity building.
- 4.2 On joining the IMF, member countries are assigned a quota based on their relative position in the world economy and pay a subscription equal to the value of the quota. The quota is also the key determinant of the voting power, amount of financial assistance available to the member from the IMF, and the member country's allocations of Special Drawing Rights (SDRs).
- 4.3 The value of a unit of SDRs is based on a basket of four currencies (Euro, Japanese Yen, Pound Sterling and US Dollar, with the Chinese Renminbi being added as a fifth currency from October 2016). 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 the middle rate between the buying and selling exchange rates quoted at noon each day in the London market<sup>2</sup>.
- 4.4 Transactions and asset/liability positions with the IMF are allocated between different institutions (usually the central bank or government) dependent on institutional and legal arrangements specific

<sup>1</sup> For more information on the IMF activities see the following website: <http://www.imf.org/external/about/whatwedo.htm#key>.

<sup>2</sup> If the exchange rate for any currency cannot be obtained from the London Market, the rate shall be the middle rate between the buying and selling exchange rates at noon in the New York market or, if not available there, the rate shall be determined on the basis of euro reference rates communicated by the European Central Bank.

to each member's country. Typically these transactions are recognized by the central bank. However, in some countries, transactions occur through government directly, or by the government (usually the department of finance or treasury) with the monetary authority as an intermediary.

4.5 For more information on the background and operation of the IMF, please see Appendix B.

### Scope and Definitions

4.6 This section of the CP addresses the scope and definitions for any future guidance related to IMF quota subscriptions, SDR holdings and SDR allocations.

#### *Scope and Definitions*

4.7 The scope of the proposed guidance covers IMF quota subscriptions, SDR holdings and SDR allocations. Because these transactions are well defined, and understood by the IMF and member countries, the IPSASB considered guidance from the Balance of Payments and International Investment Position Manual-6<sup>th</sup> Edition (BPM6), included in Appendix C in developing the definitions below. Further supporting descriptions are provided in Appendix D.

4.8 **IMF Quota Subscription** is defined as:

"The amount equal to the quota assigned to the member on joining the IMF that must be paid in full to become an IMF member".

4.9 **SDR Holdings** are defined as:

"International reserve assets created by the IMF and allocated to members to supplement reserves."

4.10 **SDR Allocations** are defined as:

"Obligations which arise through IMF member's participation in the SDR Department and that are related to the allocation of SDR holdings."

### Nature and Function

#### *IMF Quota Subscription*

4.11 Payment of the quota provides members with membership in the IMF; that membership brings rights, benefits and obligations. Twenty-five percent of a member's quota is paid in reserve assets (SDRs or foreign currency acceptable to the IMF), with the remaining seventy-five percent paid with domestic currency or a promissory note. The quota subscription gives:

- (a) Voting rights equal to the size of a member's quota relative to total membership;
- (b) Payments of interest from the IMF based upon a calculation of a member's 'reserve tranche position' (the foreign currency (including SDRs) amounts that a member country may draw from the IMF at short notice); and

- (c) A right to borrow from the IMF based on the amount of the quota subscription for balance of payment needs<sup>3</sup>.
- 4.12 The quota subscription appears to have attributes of financial instruments, with similarities to:
- (a) Common shares in that the size of a member's quota determines voting rights and an ability to influence control over the activities of the IMF; and
  - (b) Debt instruments like bonds, loans, and preference shares because the payment of interest on the reserve tranche position is a fixed amount, not dependent on profit or return on investment.
- 4.13 The right to borrow from the IMF up to the amount of the quota subscription for balance of payments needs is a unique attribute that could be viewed as similar to a collateral borrowing arrangement, where borrowing is permitted on demand up to a certain collateral level.
- 4.14 The Quota Subscription differs from common shares in that, being the equivalent of a membership fee, it cannot be sold. The only way to exit the investment is to withdraw from the IMF voluntarily or for the IMF remove the member<sup>4</sup>.

#### *SDR Holdings and Allocations*

- 4.15 IMF members receive SDR holdings and allocations based on the relative size of their IMF quota subscription. The holdings and allocations at the time they are granted are equal in size. They accrue interest at the same IMF rate.
- 4.16 SDR holdings provide members with a reserve asset, which can only be used to obtain foreign currency from other members through the IMF. SDR holdings are valued based upon the daily exchange rates of four underlying currencies (Euro, Japanese Yen, Pound Sterling and US Dollar) and therefore are similar to foreign currency. However, unlike a foreign currency, SDRs cannot be used to purchase goods or services.
- 4.17 SDR allocations represent the obligation assumed when SDR holdings are distributed to members. IMF members must stand ready to provide foreign currency holdings up to the amount of their SDR allocation. The IMF charges interest at a set SDR rate on the accumulated allocation amount. The SDR allocation has the attributes of a demand loan or credit line, without requirements to repay principal or a maturity date.

### **Accounting Considerations**

#### *Key Guidance from the Conceptual Framework*

- 4.18 This CP considers the different accounting approaches for IMF quota subscriptions, SDR holdings and SDR allocations. The approaches consider the guidance of the Conceptual Framework:

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<sup>3</sup> For example, under the IMF Stand-by and Extended Arrangements, a member can borrow up to 200 percent of its quota annually and 600 percent cumulatively. However, access may be higher in exceptional circumstances.

<sup>4</sup> The IMF Articles of Agreement set out provisions for withdrawal of membership, as well termination of partition in the fund.

6.2 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 account of constraints on information in GPFRs.

### Definitions

5.6 An asset is:

*A resource presently controlled by the entity as a result of a past event.*

...

### Presently Controlled by the Entity

5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

### 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.

## Factors to be Considered—IMF Quota Subscription

### Recognition

4.19 The Conceptual Framework notes that items are recognized when they satisfy the definition of an element and can be measured.

4.20 Therefore to determine if the IMF quota subscription should be recognized, it must satisfy the element definition for an asset. The Conceptual Framework requires the following be met:

- Has a past event occurred?
- Does paying the IMF quota subscription give rise to a resource?
- Does the entity presently control that resource?

4.21 The past event occurs when the IMF quota subscription is paid by the entity.

4.22 The Conceptual Framework (CF) notes a resource is an item with service potential or the ability to generate economic benefits. An analysis of whether the quota subscription is a resource and assessment of the benefits it may provide is as follows:

- (a) The quota may give rise to both service potential and the ability to generate economic benefits. Service potential may be provided indirectly because of the overall benefits to a member's economy from the IMF's contributions to the international financial structure. The quota also provides economic benefits because it may decrease costs of borrowing for foreign currency (reserve assets) because of the SDR market.

4.23 The Conceptual Framework indicates that control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) to derive benefits from the service potential or economic benefits. An analysis of whether members control the IMF quota resource follows:

- (a) The IMF quota provides voting rights relative to the size of the members' quota compared to the total outstanding member quotas. This allows members the ability to impact decisions of the IMF. Further, the Articles of Agreement set out procedures for members to withdraw from the IMF and include rights and obligations to settle outstanding accounts, including the quota subscription. These two factors are indicators of present control of the resource.
- (b) The IMF requires a minimum of 25% of the quota to be paid in reserve assets and the remaining balance to be paid in local currency or by issuance of a promissory note. The IMF pays members interest based on the reserve asset portion of the quota and members that pay a greater amount than required minimum, will receive higher interest payments. Does the split in payment method or difference in potential benefits impact the assessment of control over the resource? It is thought that it would not because the subscription is paid in full<sup>5</sup>. Therefore, the different payment methods does not impact the ability to presently control the resource.

4.24 It appears that the IMF quota subscription satisfies the definition of an asset because it is a resource that provides service potential and economic benefits which is presently controlled.

4.25 Some may argue that because of the unique nature of the quota subscription it could be considered a grant or a fee to the IMF. If so, an alternative approach may be to recognize the payment as an expense because it would satisfy the definition of an expense if it decreased the net financial position of the entity<sup>6</sup>. However, because the quota appears to satisfy the definition of an asset, it would not decrease the net financial position of the entity. Therefore it does not appear appropriate to consider it as an expense and the CP does not propose this alternative.

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<sup>5</sup> The IMF Articles of Agreement state in article III-section 1: Quotas and Subscriptions: ...The subscription of each member shall be equal to its quota and shall be paid in full to the Fund at the appropriate depository.

<sup>6</sup> The Conceptual Framework defines an expense in 5.30 as "*Decreases in net financial position of the entity, other than decreases arising from ownerships distributions.*"

### Measurement

4.26 Chapter 7 of the Conceptual Framework provides guidance for selecting an appropriate measurement basis.

4.27 The following measurement basis from the Conceptual Framework may be appropriate:

- (a) Historical Cost is defined in the Conceptual Framework as: *The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.* This would be the cumulative cash amount paid for the quota subscription, which is the entity specific value paid for membership in the IMF.

4.28 The IPSASB believes that for IMF quota subscription not all measurement bases are appropriate. The following measurement bases are not considered appropriate:

- (a) Market Value is defined in the Conceptual Framework as: *The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.* This does not seem appropriate as the IMF quota subscription cannot be exchanged. Meaning, IMF members cannot sell their quota to another member or any other entity. Therefore, a market does not exist (active or inactive).
- (b) Replacement cost is: *The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.* Similar to the discussion on market value, membership in the IMF is not as asset that could be replaced. Further, the IMF quota is not an asset with a useful life or for which a disposal value could be estimated.
- (c) Net Selling Price: *The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.* Similar to other market based measures, due to the unique nature of the IMF investment, it is not thought that it could be sold and therefore, this measurement basis may not appear appropriate. The investment can however, be exited from by withdrawing from the IMF, which some may consider to be similar to sale and the amount recovered may be considered a redemption at the net selling price.
- (d) Value in Use: *The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.* Value in use is generally not an appropriate measurement basis for a financial investment, such as the IMF quota subscription. Value in use is generally used to estimate the value of a tangible asset(s) based on the cash flows it generates.

### Factors to be Considered—SDR Holdings

#### Recognition

4.29 The key factors which determines recognition of an asset when an entity receives its SDR holdings is as follows:

- Has a past event occurred?
- Do SDR holdings give rise to a resource?

- Does the entity presently control that resource?
- 4.30 The past event aspect of the definition is satisfied when the SDR holdings are allocated. Because the allocation cannot happen until an entity becomes an IMF member (and pays its quota subscription) and chooses to participate in the SDR program. Only after those events occur, will SDRs be allocated, which means the allocation of SDRs confirms the past event has occurred.
- 4.31 Therefore to satisfy the definition of an asset the SDR holdings must be a resource, presently controlled by the entity.
- 4.32 SDR holdings appear to be a resource because:
- (a) They can be used as consideration to transact with other IMF members for foreign currency; and
  - (b) The holdings accrue interest from the SDR department.
- The above factors demonstrate that the SDR holdings are a resource with service potential and ability to generate economic benefits.
- 4.33 SDR holdings also appear to be presently controlled for the following reasons:
- (a) Members are free to transact the SDRs through the IMF or other voluntary arrangements at the member's discretion; and
  - (b) The IMF Articles of Agreement set out the obligations and rules for the use of SDRs and which members agree to when participating in the SDR department; which facilitate the functioning of the SDR market.
- Therefore, even though there are restrictions on the use of SDRs, these restrictions do not seem to impact if a member presently controls them.
- 4.34 As SDR holdings appear to satisfy the asset element definition and recognition criteria in the conceptual framework. There does not appear to be a viable alternative treatment to consider, and therefore, the CP does not propose an alternative accounting treatment.

#### *Measurement*

- 4.35 Chapter 7 of the Conceptual Framework provides guidance for selecting an appropriate measurement basis.
- 4.36 The following measurement bases from the Conceptual Framework may be appropriate:
- (a) Market Value is defined in the Conceptual Framework as: *The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.* Similar to how foreign currencies (foreign currency monetary items) are accounted for under IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* using a market rate appears appropriate for the measurement of SDR holdings. This is because SDRs are valued using the IMF basket of 4 underlying foreign currencies and SDRs are transacted through the IMF SDR department at a market rate. SDRs because of their close relationship to foreign currencies have characteristics and similarities to foreign currency.
  - (b) Historical Cost is defined in the Conceptual Framework as: *The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.* For SDR holdings, this



would be the amount of the consideration given in SDR allocations, as members are granted holdings and allocations simultaneously by the IMF. At acquisition market value would be equal to historical cost, as the value is based upon the market value of the underlying currency basket. However, at subsequent reporting periods historical cost would differ from the market value and would no longer reflect the financial capacity SDR holdings provide as reserve assets, which arguable provides less useful information. Further, use of a historical cost would appear to be in contradiction to the guidance in IPSAS 4 as noted in the preceding paragraph.

- (c) **Net Selling Price:** *The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.* This is not thought to be materially different than market value, as the IMF SDR department does not appear to include significant transaction costs.

4.37 The IPSASB believes that for SDR holdings not all measurement bases in the Conceptual Framework are appropriate. The following measurement bases are not considered appropriate, because these are more appropriate for tangible assets, which generally would be used to provide services and less useful;

- (a) **Replacement cost is:** *The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.* This is not thought to be an appropriate basis, however, even if it was used for SDR holdings, it would likely result in measurement similar to market value.
- (b) **Value in Use:** *The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.* Value in use is more suited for tangible assets and reflects the benefits an entity gains through its operations and disposal. As SDR holdings are financial assets, this does not appear to be an appropriate basis.

### **Factors to be Considered—SDR Allocations**

#### *Recognition*

4.38 The key factors which determine recognition of a liability for SDR allocations 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?

4.39 The past event occurs when the member joins the IMF, agrees to participate in the SDR program and receives an allocation of SDRs.

4.40 To determine if there is a liability, an assessment of whether a present obligation exists needs to be undertaken. In determining if a present obligation exists, an understanding of the nature of the obligation should be considered:

- (a) The IMF Articles of Agreement set out the rights and obligations of the IMF and IMF members. These articles include dispute resolution mechanisms to be overseen by the International Court of Justice, which therefore appear to be backed by the force of law.

Because SDR allocations appear to be legally enforceable they appear to give rise to a legally binding obligation.

- (b) In the event that one questions if the IMF Articles of Agreement give rise to a legally enforceable obligation. There would appear to be a high likelihood that a non-legally binding obligation may also exist for the following reasons:
  - (i) By joining the IMF and entering into the SDR department, a member indicates to the IMF as well as other members of the fund that it accepts the responsibilities set out in the Articles of Agreement and creates a valid expectation that it will discharge those responsibilities. Failure to discharge those responsibilities is not seen as realistic as it would likely lead to withdrawal from the IMF.

4.41 In regards to the ability to avoid the obligation, because it appears legally enforceable, there is little or no realistic alternative to avoid an outflow of resources. Some may argue that because the SDR allocations do not include settlement dates and are obligations of other IMF members which are not specifically identifiable, that a liability should not be recognized. However, the Conceptual Framework states that it is not essential to know the identity of the external party or for the arrangement to contain settlement dates to recognize the liability<sup>7</sup>.

4.42 Based on the above analysis, it appears that SDR allocations satisfy the definition of a liability because a present obligation exists to other members of the IMF and there is no realistic ability to avoid settlement of that liability (because it is legally enforceable). There does not appear to be a viable alternative treatment to consider and therefore, the CP does not propose one.

#### *Measurement*

4.43 Chapter 7 of the Conceptual Framework provides guidance for selecting an appropriate measurement basis.

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

- (a) 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.* Similar to how monetary items denominated in a foreign currency are accounted for under IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* using a market rate appears appropriate to measure SDR allocations. This is because SDRs are valued using the IMF basket of 4 underlying foreign currencies and SDRs are transacted through the IMF SDR department at a market rate.
- (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 the timing of settlement is uncertain and at the discretion of other IMF members. As the SDR allocation obligation appears legally enforceable that settlement would be at the market value of the liability.

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<sup>7</sup> Paragraphs 5.18 and 5.19 of the Conceptual Framework.

4.45 The IPSASB believes that for SDR allocations not all measurement bases in the Conceptual Framework are appropriate. The following measurement bases are not considered 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 SDR allocation liability for is incurred when SDR holdings are distributed and members accept the obligation to provide foreign currency to other IMF members in future when called to do so. Historical cost would equal to market value at initial recognition. However, it is questionable if it would be appropriate for subsequent measurement, given SDRs attributes being similar to a foreign currency and the fact SDRs are valued based on a basket of underlying foreign currencies. Additionally, similar to the discussion for SDR holdings, for a monetary item, historical cost measurement would be inconsistent with the guidance in IPSAS 4.
- (b) 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 IMF members have little to no ability to seek immediate exit from the SDR allocation, as the timing of settlement is controlled by other IMF members.
- (c) 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 SDR allocation obligation is not likely to be transferrable from the IMF member.

## Proposed and Current Practice

4.46 The following discussion considers how IMF transactions would be treated if applying the conclusions from the above conceptual discussion compared to current IPSASB literature.

### *IMF Quota Subscription*

4.47 The conceptual discussion for the IMF quota subscriptions is consistent with requirements in IPSAS 29<sup>8</sup> to treat it as a financial asset. Further, it is consistent with how some IMF members account the quota when applying IFRS.

### *IMF SDR Holdings*

4.48 The conceptual discussion for SDR holdings is consistent with accounting for the SDR holdings as a financial asset measured at fair value through surplus or deficit and the requirements in IPSAS 29. Further, the treatment is consistent with how some IMF members account for SDR holdings when applying IFRS. Additionally the conceptual discussion appears consistent with the treatment of a foreign currency in IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, with recognition at the exchange rate between the functional currency and foreign currency (market rate)

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<sup>8</sup> IPSAS 29.45 – requires initial recognition at fair value which is equal to the historical cost paid for the instruments (fair value plus transactions costs directly attributable to acquisition) for instruments not designated at fair value through surplus or deficit. IPSAS 29.48 notes that investments in equity instruments that do not have a quoted market shall be subsequently measured at cost because of the lack of a market, these equity instruments can be measured at cost.

at the transaction date and at the closing rate (market rate) at subsequent reporting periods<sup>9</sup>. The proposed treatment is also consistent with the applicable requirements under Government Finance Statistics.

*IMF SDR Allocations*

- 4.49 The conceptual discussion related to accounting for SDR allocations is consistent with accounting for the SDR allocations as a financial liability measured at fair value through surplus or deficit and the requirements in IPSAS 29. Further, the treatment is consistent with how some IMF members account for SDR allocations when applying IFRS. The proposed treatment is also consistent with the applicable requirements under Government Finance Statistics.

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<sup>9</sup> IPSAS 4.24 and IPSAS 4.27.

## Appendix A: Illustrative Examples

*These examples accompany, but are not part of, the draft chapter.*

### IMF Quota Subscription

IE1. The following scenarios illustrate the process for IMF quota subscriptions. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying the draft chapter. The examples are for information and understanding purposes, to help understand the economic substance of IMF transactions.

IE2. Each scenario illustrates a step in the process of becoming an IMF member country.

#### *Scenario 1: Becoming an IMF member country*

IE3. In this example, a country becomes a member of the IMF and pays its quota subscription.

IE4. The amount of the initial quota subscription is based on a formula used by the IMF to determine the calculated quota share. The main factor in the calculation relates to the country's GDP.

IE5. After the amount of the quota subscription is determined the country must pay the quota. The first Twenty-five percent of the quota payment is called the reserve asset portion and must be paid in SDR holdings or a highly liquid currency of other IMF members (usually U.S. dollars, euros, Japanese Yen or pound sterling). The remaining seventy-five percent is called the local currency portion and is payable in a member's own physical currency or through the issuance of a promissory note to be held in the IMF's Securities Account with the member's designated depository, typically its central bank.

IE6. Example: The IMF determines the amount of the quota subscription to be 100,000 SDRs for country A. 1 SDR = CU2 in Country A. Country A, pays the reserve asset portion of the quota subscription—25,000 SDRs in USD, valued at CU50,000 and issues a promissory note for the 75,000 SDR holdings amount in local currency portion equal to CU150,000. The total amount paid by Country A equals 100,000 SDRs (CU200,000).

1. The journal entry on initial recognition of the quota subscription for the member would be as follows:

*The quota subscription for the member country is 100,000 SDR holdings, which is equal to CU200,000 Country A's functional currency (local currency). The member pays the reserve asset portion in USD equal to CU50,000. The member pays the remaining local currency amount by issuing a promissory note equal to CU150,000.*

Dr	IMF quota subscription (Financial Asset)	200,000	
	Cr US Foreign Currency (equal to 25,000 SDRs = CU50,000)	50,000	
	Cr Promissory Note (Financial Liability)		150,000

#### *Scenario 2: IMF Quota Increases under General Reviews*

IE7. In this example, the IMF under a general review increases a Country A's quota.

IE8. At least every five years, the IMF completes a quota review, which can lead to an adjustment of members quota as a result in changes in their relative positions in the world economy or a general increase in the total quota amount for all IMF members.

IE9. Example: The IMF increases the total quota amount after a general review. Country A's new quota subscription has increased from 100,000 SDR holdings by 20,000 SDR holdings to the new amount of 120,000 SDRs. Country A's current quota is equal to CU200,000 and paid in full. 1 SDR = CU2 in Country A. Country A, pays the reserve asset portion of the quota subscription—5,000 SDR holdings, valued at CU10,000 and issues a promissory note for the 15,000 SDR holdings local currency portion equal to CU30,000. The total paid by Country A for the additional quota equals 20,000 SDRs (CU40,000).

1. The journal entry for the increase in the quota subscription for the member would be as follows:

*The quota subscription for the Country A has increased from 100,000 SDR holdings to the revised amount of 120,000 SDR holdings which is equal to CU240,000 Country A's functional currency (local currency). The member pays the additional reserve asset portion of 10,000 SDRs, equal to CU10,000. The member pays the remaining additional portion of 15,000 SDRs in local currency by issuing a promissory note equal to CU30,000.*

Dr	IMF quota subscription (Financial Asset)	40,000	
	Cr SDRs (5,000 SDR holdings = CU10,000)		10,000
	Cr Promissory Note (Financial Liability)		30,000

After the increase in the quota the total amount of the IMF quota subscription (financial asset) is equal to CU240,000 and the total balance of the promissory note (financial liability) is equal to 180,000.

### *Scenario 3: IMF Pays Remuneration on Country A's Reserve Tranche Position*

IE10. In this example, the IMF pays remuneration (interest) on the reserve asset portion of Country A's quota subscription.

IE11. The reserve asset portion of a member's quota payment is called the reserve tranche position and is equal to the member's quota less the IMF's holdings of the members own currency<sup>10</sup>.

IE12. Country A's quota subscription is equal to 120,000 SDR holdings. The reserve asset portion is equal to 25% of the quota, which equals 30,000 SDR holdings. The reserve tranche position interest rate is equal to 1% per year and is paid quarterly in SDR holdings. 1 SDR = CU2 in Country A.

1. The journal entry to recognize the quarterly payment of interest on the reserve tranche position would be as follows:

*The IMF pays Country A 1% interest per annum on the reserve asset position of its quota, called the reserve tranche position. Country A's reserve tranche position is equal to 30,000 SDRs. The*

<sup>10</sup> A small portion of the reserve tranche position related to an IMF members holdings as of April 1, 1978 in unremunerated. For simplicity of the example, the unremunerated portion of the reserve tranche position has not been considered.

*interest paid for the quarter in SDRs is  $1\% * 30,000 = 300$  year.  $300 / 4$  quarters = 75 SDRs interest each quarter, which equals CU150.*

Dr	SDR holdings (Financial Asset)	150	
	Cr Interest Revenue – quota subscription		150

### Special Drawing Rights (SDRs)

IE13. The following scenarios illustrate different steps in the process for accounting IMF SDR holdings and allocations transactions. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying the draft chapter. The examples are for information and understanding purposes, to help demonstrate the substance of certain transactions.

IE14. Each scenario illustrates a different transaction involving SDRs.

#### *Scenario 4: Member Country Receives Allocation of SDRs*

IE15. In this example, an IMF member country agrees to participate in the SDR program and receives and initial allocation of SDRs.

IE16. When a member country agrees to participate in the SDR department of the IMF, SDR holdings and allocations are granted based on the size of the countries IMF quota subscription.

IE17. The IMF determines that Country A's quota subscription of 120,000 SDRs equals a grant of SDR holdings and allocations of 50,000 SDRs. 1 SDR = CU2 in Country A.

1. The journal entry to recognize the SDR holdings and allocations granted by the IMF would be as follows:

*The IMF pays grants Country 50,000 SDR holdings and 50,000 SDR allocations, both equal to CU100,000.*

Dr	SDR Holdings	100,000	
	Cr SDR Allocations		100,000

#### *Scenario 5: Interest on SDRs: Member Country Allocation and Holdings Equal*

IE18. In this example, interest expenses/revenue are calculated on SDR holdings and allocations.

IE19. The IMF charges interest on the SDR holdings and member countries and pay interest on SDR holdings. The interest rate is the same for both holdings and allocations and paid in SDRs.

IE20. Country A has an equal amount of SDR holdings and allocations 50,000 SDRs equal to CU100,000 each. The SDR interest rate is .75% per annum and is paid quarterly. 1 SDR = CU2 in Country A.

1. The journal entries recognize quarterly interest on the SDR holdings and allocations both equal to 50,000 SDRs or CU100,000 at the rate .75% per annum would be as follows:

*The IMF interest rate .75% per annum which is .1875% per quarter \* 50,000 SDRs for holdings and allocations equals 93.75 SDRs, or CU187.5.*

This entry is for the Interest earned on SDR holdings

Dr	SDR Holdings	187.5	
	Cr	Interest Revenue on SDR Holdings	187.5

This entry is for the Interest expense on SDR allocations

Dr	Interest Expense on SDR Allocations	187.5	
	Cr	SDR Holdings	187.5

In this scenario because the SDR holdings and allocations are equal, the net impact of the above two entries is nil.

*Scenario 6: Member Country allocation of SDRs in excess of Holdings*

- IE21. In this example, interest expenses/revenue are calculated on SDR holdings and allocations.
- IE22. The IMF charges interest on the SDR holdings and member countries and pay interest on SDR holdings. The interest rate is the same for both holdings and allocations and paid in SDRs.
- IE23. Country A has SDR holdings equal to 40,000 SDRs and allocations of 50,000 SDRs. The SDR interest rate is .75% per annum and is paid quarterly. 1 SDR = CU2 in Country A.
1. The journal entries recognize quarterly interest on the SDR holdings of 40,000 SDRs or CU 80,000 and SDR allocations of 50,000 SDRs or CU100,000. The interest rate on both SDR allocations and holdings is .75% per annum. The calculations are as follows:

*The IMF interest rate .75% per annum which is .1875% per quarter \* 40,000 SDR holdings and 50,000 SDR allocations. The quarterly interest for the SDR holdings is 75 SDRs, or CU150. The quarterly interest for the SDR allocations is 93.75 SDRs, or CU187.5.*

This entry is for the Interest earned on SDR holdings

Dr	SDR Holdings	150	
	Cr	Interest Earned on SDR Holdings	150

This entry is for the Interest expense on SDR allocations

Dr	Interest Expense on SDR Allocations	187.5	
	Cr	SDR Holdings	187.5

In this scenario because the SDR allocations exceed the SDR holdings, the net impact is an interest expense of CU37.5.

*Scenario 7: Member Country holdings in excess of allocation SDRs*

- IE24. In this example, interest expenses/revenue are calculated on SDR holdings and allocations.
- IE25. The IMF charges interest on the SDR holdings and member countries and pay interest on SDR holdings. The interest rate is the same for both holdings and allocations and paid in SDRs.



IE26. Country A has SDR holdings equal to 60,000 SDRs and allocations of 50,000 SDRs. The SDR interest rate is .75% per annum and is paid quarterly. 1 SDR = CU2 in Country A.

1. The journal entries recognize quarterly interest on the SDR holdings of 60,000 SDRs or CU 120,000 and SDR allocations of 50,000 SDRs or CU100,000. The interest rate on both SDR allocations and holdings is .75% per annum. The calculations are as follows:

*The IMF interest rate .75% per annum which is .1875% per quarter \* 60,000 SDR holdings and 50,000 SDR allocations. The quarterly interest for the SDR holdings is 112.5 SDRs, or CU225. The quarterly interest for the SDR allocations is 93.75 SDRs, or CU187.5.*

This entry is for the Interest earned on SDR holdings

Dr	SDR Holdings	225	
	Cr Interest Earned on SDR Holdings		225

This entry is for the Interest expense on SDR allocations

Dr	Interest Expense on SDR Allocations	187.5	
	Cr SDR Holdings		187.5

In this scenario because the SDR allocations exceed the SDR holdings, the net impact is interest revenue of CU37.5.

*Scenario 8: Member country transacts SDR holdings for foreign currency*

IE27. In this example, a member country trades SDR holdings for foreign currency.

IE28. When member countries require foreign currency or other reserve assets, they may transact through the IMF with other members using SDR holdings to obtain it.

IE29. Country A requires foreign currency and contacts the IMF to initiate a transaction using its SDR holdings. Country A requires Japanese Yen, for an international loan payment. The Yen currently trades at CU5 to 1 SDRs, 1 SDR equals CU2. Country A requires 20,000 yen for its loan payment. The calculation of the transaction is as follows:

*Country A requires 20,000 yen for a loan payment. Therefore, it contacts the IMF and initiates a transaction using its SDR holdings to obtain the yen needed. The Yen exchange rate to SDRs is CU5 to 1 SDR and 1 SDR equals CU2. The calculation is as follows: 20,000 yen equals 4,000 SDR holdings, 4,000 SDR holdings equals CU8,000.*

The entry to recognize the transaction is as follows:

Dr	Foreign Currency (20,000 yen = 4,000 SDR holdings =CU8,000)	8,000	
	Cr SDR holdings (4,000 SDR holdings = CU8,000 = 20,000 yen)		8,000

## Appendix B: IMF Information

### *IMF Overview*

- B.1 The IMF was founded over 70 years ago close to the end of World War II. The founding aim was to build a framework for economic cooperation. The world has changed significantly since the IMF was founded, and with it the IMF has changed. However, the main purpose of the IMF—to support the global public good of financial stability and prosperity—is the same today as when the organization was founded.
- B.1 The IMF has near global membership of 188 countries. This places the IMF in a unique position to help member governments take advantage of the opportunities and manage the challenges posed by globalization and economic development.
- B.2 The IMF is a cooperative international monetary organization that was established together with the International Bank for Reconstruction and Development (known as the World Bank), by agreement of 44 countries that convened at the Bretton Woods of July 1944.
- B.3 The IMF carries out its key activities<sup>11</sup> classified under three areas as follows:
- (a) Lending functions—tailored to address specific circumstances of its diverse membership. Most notably it is the financial institution that provides resources to member countries experiencing temporary balance of payment problems (actual or potential).
  - (b) Surveillance functions—responsibility for overseeing the international monetary system and the policies of its members.
  - (c) Capacity building—services to members from the IMF, including technical assistance and training, creation and distribution of international statistical information and methodologies and establishment and monitoring of standards and codes for international best practices (economic and financial statistics, financial sector soundness and good governance).
- B.4 The IMF's remit is broader than that of a lending institution. The IMF is not only concerned with the economic challenges of member countries, but also with the functioning of the international monetary system as a whole. Therefore, its activities are aimed at promoting policies by which members work together to ensure stability in the financial system and sustainable economic growth.

### *IMF Quota Subscriptions*

- B.5 The IMF is a quota-based institution, and quotas play a number of key roles; they not only determine a country's voting power and maximum financial commitment but are also relevant for access to IMF resources. The IMF normally reviews quotas every 5 years. These reviews are an opportunity to assess the appropriate size of the Fund and the distribution of quotas among its members.
- B.6 Quotas provide the primary source of the IMF's financial base and play several key roles in the relationship with members, as follows:

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<sup>11</sup> For more information on the key IMF activities see the following website: <http://www.imf.org/external/about/whatwedo.htm#key>.

- (a) Subscriptions: A member's quota subscription determines the maximum amount of financial resources it must provide the IMF. The IMF's regular lending is financed from the fully paid-in capital subscribed by member countries;
  - (b) Voting Power: Quota's largely determine the distribution of voting power to IMF members and thereby their decision-making and representation on the Executive Board;
  - (c) Access to Financing: Quota's play a role in determining a member countries' access to IMF resources; and
  - (d) SDR Holdings: Quotas determine a member's share when SDRs are allocated.
- B.7 The IMF conducts general reviews of all members' quotas at least every five years. This allows the IMF to assess the adequacy of quotas in terms of members' needs for conditional liquidity and the IMF's ability to finance those needs. A general review allows for adjustments of members' quotas to reflect changes in their relative positions in the world economy.
- B.8 A member may request an ad hoc quota adjustment outside of a general review.
- B.9 Quota subscriptions from member countries are the primary source of financing for the IMF. However the IMF can supplement its quota resources through borrowing if it believes that resources may fall short of members' needs. The IMF maintains two standing borrowing arrangements:
- (a) General Arrangements to Borrow (GAB)—Been in place since 1962 and was conceived as a means by which the main industrialized countries could stand ready to lend to the IMF up to a specified amount of their currencies. These loans would be made when supplementary resources were needed by the IMF to help finance drawings by GAB participants when such financing would forestall or cope with an impairment of the international monetary system.
  - (b) New Arrangements to Borrow (NAB)—The first and primary resource in the event of a need for supplementary resources. NAB is a set of credit arrangements between 38 member countries. The aim of the NAB is similar to that of the GAB.

#### *IMF Special Drawing Rights*

- B.10 Special Drawing Rights (SDRs) were created in 1969 as an international reserve asset to supplement other reserve assets whose growth was inadequate to finance the expansion of international trade and finances under the Bretton woods system.
- B.11 The Bretton Woods fixed exchange rate system came under pressure during the 1960's because it did not have a mechanism for regulating the growth of reserves to finance the expansion of global trade and financial development. Gold production was inadequate and unreliable source of reserve supplies, and the continuing growth in global U.S. dollar reserves required a persistent deficit in the U.S. balance of payments, with itself posed a threat to the value of the U.S. dollar. Therefore Special Drawing Rights (SDRs) were created in 1969 as an international reserve asset to supplement other reserve assets whose growth was inadequate to finance the expansion of international trade and finances under the Bretton Woods system.
- B.12 The SDR was created with the intention to make regulation of international liquidity subject for the first time to international consultation and deliberation.

- B.13 The SDR is not a currency nor a claim on the IMF. Instead, it is a potential claim on the freely usable currencies of IMF members. The IMF may allocate SDRs unconditionally to members (participants) who may use them to obtain freely usable currencies in order to meet a balance of payments need without under-taking economic policy measures or repayment obligations.
- B.14 The SDRs value as a reserve asset derives from the commitments of members to exchange SDRs for freely usable currencies and to honor various obligations connect with the proper operation of the SDR department. The IMF helps ensure the SDRs claim on freely usable currencies by acting as an intermediary between holders of SDRs in a voluntary but managed market.
- B.15 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.
- B.16 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.
- B.17 The SDR is an interest-bearing international reserve asset created by the IMF to supplement existing reserve assets and can be held and used only by participants in the IMF, and certain designed official entities – referred to as prescribed holders.
- B.18 Since 1987 – SDR market has functioned primarily through voluntary trading arrangements—a number of members and one prescribed holder have volunteered to buy and sell SDRs as defined by their respective arrangements. In the event of insufficient capital under the voluntary arrangements, the IMF can activate the designated mechanism, which is IMF members with strong balance of payments and reserves position may be designated by the IMF to purchase SDRs from members with weak external positions. This designation mechanism serves as a back-stop to guarantee the liquidity and reserve asset character of the SDR. Thus, the functioning of the SDR Department, like that of the General Department, is based on the principle of mutuality and intergovernmental cooperation.
- B.19 The SDR is valued based on a basket of currencies (USD, Euro, Pound and Yen) currently. The value is calculated daily as the sum of specific amounts of the basket currencies valued in US dollars on the basis of the exchange rates quoted at noon each day in the London Market—the value of which is posted on the IMF website each day in USD. The IMF recently decided that in 2016 it will add a fifth currency—the Chinese Renminbi, to the SDR currency basket used for valuation purposes.
- B.20 The SDR interest rate was initially fixed and set at below market levels. However, it is now market based and calculated weekly. It is based on a weighted average of representative interest rates on short-term debt in money markets of the SDR basket of currencies, except if the weighted average falls below the floor for the SDR interest rate of .0050 percent (5 basis points). The value and yield of the SDR are linked to the prevailing market for the SDR itself in which excess supply or demand pressure can be eliminated by adjustments in the price, or value, of the SDR. Rather, the IMF itself manages the flows of SDRs to ensure liquidity in the system.

- B.21 Members earn interest on SDR holdings and pay interest on its cumulative allocations, but the two interest rates are identical and the payments therefore net out as long as member's cumulative allocations are equal to its holdings of SDRs. Countries holding SDRs can use these assets by exchanging them for freely usable currencies at a value determined by the value of the SDR basket.
- B.22 The IMF's Executive Board reviews the SDR valuation every 5 years. These reviews cover currencies to be included in the SDR valuation basket, determine the relative weights of those currencies, and assess the financial instruments that are used to calculate the SDR interest rate.
- B.23 The weighting of currencies included in the basket is based on a combination of the value of exports and official reserve assets held by monetary authorities outside of the country or the monetary union issuing the respective currency.
- B.24 The SDR interest rate provides the basis for calculating the interest charged to members on non-concessional IMF loans and from the IMF's general resources, the interest paid to IMF members on their remunerated creditor positions in the IMF (reserve tranche positions and claimed under borrowing agreements), and the interest paid to members on their SDR holdings and charged on their SDR allocation.
- B.25 The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term financial debt instruments in the money markets of the SDR basket currencies except if the weighted average falls below the floor for the SDR interest rate of .050 percent (5 basis points). The review of the financial instruments to determine the SDR interest rate consider two broad criteria:
- (a) The FIs' in the interest rate basket should be broadly representative of the range of FI's that are actually available to investors in a particular currency, and the interest rate on the instruments should be responsive to changes in underlying credit conditions in the corresponding money market.
  - (b) The FIs in the interest rate basket should have characteristics similar to the official standing of the SDR itself—that is, they should have a credit risk profile of the highest quality and be fully comparable to that of government paper available in the market or, in the absence of appropriate official paper, comparable credit risk on prime financial instruments. Instruments should also reflect the actual reserve asset choice of reserve managers—for example, regarding the form of the financial instruments, its liquidity and its maturity.
- B.26 The current benchmark rates for the four currencies are as follows:
- (a) U.S. dollar: 3 month U.S. Treasury bills
  - (b) Euro: 3-month rate for euro area central government bonds with a rating of AA and above published by the European Central Bank
  - (c) Japanese yen: 3-month Japanese Treasury discount bill
  - (d) Pound sterling: 3-month U.K. Treasury bill.
- The yields on these instruments are used to calculate the SDR interest rate for each week.
- B.27 Under the Articles of Agreement, the IMF Executive Board may create unconditional liquidity through general allocations of SDRs to member countries that participate in the SDR Department in

proportion to their IMF Quotas. Such an allocation provides each member with an unconditional international reserve asset. The IMF cannot allocate SDRs to itself or prescribed holders.

- B.28 SDR allocations are a form of unconditional liquidity. Participants in the SDR Department do not have to meet any specific requirements to receive their proportional share in a general allocation. And, following such an allocation, they have the right to use the newly allocated SDRs when they have a balance of payments need or in order to adjust the composition of their reserves to obtain currency from other participants in transactions by agreement or in necessary through the designation plan. There is no obligation under the current Executive Board decisions to maintain any particular level of SDR holdings. The SDR system therefore provides members with access on demand to freely usable currencies on an unconditional basis with no fixed maturity.
- B.29 SDRs are allocated only to IMF members that elect to be participants in the SDR Department and agree to observe the obligations of participants. Since April 7, 1980, all members of the IMF have been participants in the SDR Department.
- B.30 SDRs may be used by IMF members and the IMF itself in accordance with the Articles of Agreements and decisions adopted by the IMF Executive Board and the Board of Governors. SDRs cannot be held by private entities or individuals. Other holders of SDRs include the IMF, through the GRA within the General Department, and international organizations and monetary institutions prescribed by the IMF.
- B.31 The IMF has the authority to prescribe, as other holders of SDRs, nonmembers, member countries that are not SDR Department Participants, institutions that perform the functions of a central bank for more than one member, and other official entities. As of April 30, 2015 therefore 15 organizations<sup>12</sup> approved as 'prescribed holders'. These entities may acquire and use SDRs in transactions by agreement and in operations with other holders, but they may not receive allocations of SDRs.

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<sup>12</sup> The 2015 IMF Financial Operation Manual notes that the 15 prescribed holders are four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and eight development institutions (African Development Bank; African Development Fund; Asian Development Bank; International Bank for Reconstruction and Development, and International Development Association—respectively, the “hard” and “soft” loan entities of the World Bank Group; Islamic Development Bank; Nordic Investment Bank; and International Fund for Agricultural Development).

## Appendix C: GFS Guidance

### *GFS Guidance Considered*

- C.1 Balance of Payments and International Investment Position Manual-6<sup>th</sup> Edition (BPM6) notes in paragraph 3.97: *SDRs are considered to be foreign currency in all cases, including for the economies that issue the currencies in the SDR basket.*
- C.2 BPM6 notes in paragraph 5.34: *SDRs are international reserve assets created by the IMF and allocated to members to supplement existing official reserves. SDRs are held only by the monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders. SDR holdings represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members.*
- C.3 BPM6 notes in paragraph 5.35: *Holdings of SDRs by an IMF member are recorded as an asset, while the allocation of SDRs is recorded as the incurrence of a liability of the member receiving them (because of a requirement to repay the allocation in certain circumstances, and also because interest accrues). The holdings and allocations should be shown gross, rather than netted.*
- C.4 BPM6 notes in paragraph 7.82: *The IMF pays its members “remuneration” quarterly on the basis of their reserve tranche position, except for a small portion related to prior quota payments in gold that are interest-free resources to the IMF. This remuneration is classified on an accrual basis as investment income—reserve assets—interest (credit), which is offset by an increase in reserve assets (debit).*
- C.5 BPM6 notes in paragraph 6.85: *Reserve position in the IMF is the sum of:*
- (a) *The “reserve tranche,” that is, the foreign currency (including SDRs) amounts that a member country may draw from the IMF at short notice; and*
  - (b) *Any indebtedness of the IMF (under a loan agreement) in the General Resources Account that is readily available to the member country, including the reporting country’s lending to the IMF under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). While a member country must present a declaration of balance of payments-related need to make a purchase in the reserve tranche (reduction in reserve position), the IMF does not challenge a member’s request for reserve tranche purchases. Convertible currencies from a reserve tranche purchase may be made available within days.*
- C.6 BPM6 notes in paragraph 7.75: *IMF member countries are assigned a quota on joining the IMF. The subscription of the quota consists of two components:*
- (a) *Foreign exchange component. A member is required to pay 25 percent of its quota in SDRs or in foreign currencies acceptable to the IMF. This 25 percent portion is a component of the member’s reserve assets. In the balance of payments, subscribing this portion is shown as a transaction involving a reduction in other reserve assets (credit) offset by an increase in the reserve tranche position in the IMF (debit).*
  - (b) *Domestic currency component. The other 75 percent of the quota is payable in the member’s own currency at a designated depository, normally the member’s central bank. The payment is made either in domestic currency (IMF No. 1 and No. 2 Accounts) or by*

*issuance of a promissory note (IMF Securities Account). The No. 1 Account is used for the IMF's operational transactions (e.g., purchases and repurchases), whereas the No. 2 Account is used for the payment of local administrative expenses incurred by the IMF in the member's currency. The promissory notes are encashable by the IMF on demand. The domestic portion of the quota payment is not recorded in the member's balance of payments or in the IIP (see paragraph 6.85), except for the No. 2 account (see below). No interest is payable on either the deposit account or the note.*



## Appendix D: Definitions—Supporting Descriptions

*The information in this appendix is provided for information purposes to support the definitions included in paragraphs 4.9-4.11 of the CP.*

- D.1 The IMF quota subscription determines the maximum amount of financial resources a member must provide to the IMF.
- D.2 Twenty-five percent of a member's quota is paid in reserve assets (SDRs or foreign currency acceptable to the IMF), with the remaining seventy-five percent payable in domestic currency or a promissory note.
- D.3 SDR holdings are held only by the monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders. SDR holdings represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members.
- D.4 SDR holdings are considered reserve assets from a statistical purpose because of the unconditional rights to obtain foreign currency or other reserve assets from other IMF members.
- D.5 For statistical purposes, SDR holdings and allocations are recognized on a gross basis as assets and liabilities respectively.
- D.6 SDR allocations are liabilities for statistical purposes because of the following:
  - (a) A repayment requirement exists; and
  - (b) Interest charges accrue based the amounts allocated to members.
- D.7 SDR holdings must be transacted through the SDR Department of the IMF with other IMF members or a small group of international entities permitted to do so by the IMF.<sup>13</sup> SDR holdings are only allowed for use as consideration for reserve assets (not permitted as consideration for tangible goods or services).

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<sup>13</sup> The 2015 IMF Financial Operation Manual notes that the 15 prescribed holders are four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and eight development institutions (African Development Bank; African Development Fund; Asian Development Bank; International Bank for Reconstruction and Development, and International Development Association—respectively, the “hard” and “soft” loan entities of the World Bank Group; Islamic Development Bank; Nordic Investment Bank; and International Fund for Agricultural Development).

### 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 project<sup>1</sup> to develop IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*, identified several items<sup>2</sup> 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) [Quota Subscription](#);
  - Currency in Circulation;
  - Financial guarantee contracts; and
  - Concessionary loans.
- 1.4 Two public sector specific issues—concessionary loans<sup>3</sup> and financial guarantee contracts issued through non-exchange transactions<sup>4</sup>—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.

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

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

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

<sup>4</sup> 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 [Quota Subscription and 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 2014<sup>5</sup> (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.

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<sup>5</sup> <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 circulation<sup>6</sup>. 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-approaches](#) 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-approaches](#) for accounting for currency in circulation.
- 2.5 The [approachoptions](#) 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-approach](#) 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).

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<sup>6</sup> 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 dollarization<sup>7</sup>. 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 CP<sup>8</sup>.
- 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.

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<sup>7</sup> 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.

<sup>8</sup> 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.

**Preliminary View – Chapter 2**

(a) 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. As the purpose and function of notes and coins is the same, the IPSASBs view is the accounting treatment should be consistent for both.

## Currency Inventory

[2.232.24](#) 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 party<sup>9</sup>. This CP takes the views that transactions related to the purchase and production of currency should be treated in accordance with IPSAS 12, *Inventories*<sup>10</sup>.

[2.242.25](#) 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.*

[2.252.26](#) According to the guidance in BPM6, the statistical accounting approach is to recognize the cost of producing currency as an expense.

[2.262.27](#) 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.

[2.272.28](#) A further issue is how to account for production costs that exceed the face value<sup>11</sup>. 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 value<sup>12</sup>. 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

[2.282.29](#) The main accounting issue relates to ~~the appropriate accounting~~<sup>where to account for the resulting credit in the financial statements</sup>, when currency is distributed into circulation.

[2.292.30](#) This CP considers the different ~~options~~<sup>approaches</sup> for accounting for ~~the issuance the credit related to issuing of~~ currency in the financial statements. The ~~options~~<sup>approaches</sup> consider the guidance of the Conceptual Framework and are described below.

## Option Approach 1: Liability

### Introduction

[2.302.31](#) Appendix C, summarizes the decision points in determining the appropriate ~~accounting treatment~~<sup>place in the financial statements to recognize the credit when</sup> ~~when~~ currency is issued. This ~~option~~<sup>approach</sup> considers the Conceptual Framework guidance related to the recognition of a liability.

[2.312.32](#) Chapter Five of the Conceptual Framework includes the following:

<sup>9</sup> 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*.

<sup>10</sup> 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...

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

<sup>12</sup> 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.

[2.322.33](#) 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?

[2.332.34](#) 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.

[2.342.35](#) 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**

[2.352.36](#) For legal obligations, the present obligation arises when legislation exists setting out requirements and responsibilities for monetary authorities in relation to currency in circulation.

[2.362.37](#) 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.

[2.372.38](#) The key consideration is if that obligation is legally enforceable in law<sup>13</sup>. 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.

[2.382.39](#) 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.

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13 Conceptual Framework, paragraph 5.20.

[2.392.40](#) 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 obligations<sup>14</sup>.

[2.402.41](#) 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.

[2.412.42](#) 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*

[2.422.43](#) The definition of a non-legally binding obligation requires that an entity indicate acceptance of certain responsibilities to others. The Conceptual Framework<sup>15</sup> 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).

[2.432.44](#) 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.

[2.442.45](#) 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.

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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*

[2.452.46](#) 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.

[2.462.47](#) 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.

[2.472.48](#) 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*

[2.482.49](#) 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.

[2.492.50](#) 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 reporting<sup>16</sup>. 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.

[2.502.51](#) 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*

[2.512.52](#) 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*

[2.522.53](#) 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.

[2.532.54](#) 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.

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

2.542.55 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.

2.552.56 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.

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

2.572.58 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.

[2-582.59](#) 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

[2-592.60](#) 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 approach](#) must be considered to determine the appropriate accounting for the credit related to the issuance of currency.

## Option Approach 2: Revenue

### Introduction

[2-602.61](#) 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 approach](#) considers the Conceptual Framework guidance related to the recognition of revenue.

### Definitions relating to Revenue and Ownership Contributions

[2-612.62](#) 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.*

[2-622.63](#) 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.

[2-632.64](#) 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.

[2.642.65](#) Therefore, if [option approach 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*

[2.652.66](#) 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**

[2.662.67](#) 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.

[2.672.68](#) All the monetary authorities [universally](#) considered recognize a liability for notes in circulation<sup>17</sup>. Seigniorage<sup>18</sup> is not recognized because a liability is recognized equal to the face value of the notes in circulation.

[2.682.69](#) The practice of accounting for notes by monetary authorities is consistent with [option approach 1](#) for legal obligations. In practice, monetary authorities account for the cumulative face value of notes in circulation, which is consistent with [option approach 1](#) for legal obligations.

[2.692.70](#) 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.

[2.702.71](#) 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.

[2.712.72](#) The accounting for coins when a liability is recognized appears consistent with [option approach 1](#) for legal obligations.

[2.722.73](#) 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.

[2.732.74](#) 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.

[2.742.75](#) 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

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<sup>17</sup> 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.

<sup>18</sup> 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).

[option approach](#) 1. All monetary authorities which recognize an obligation account for them at the cumulative face value of the currency issued.

[2.752.76](#) Monetary authorities which do not recognize a liability for coins in circulation, appear to account for coins consistent with [option approach](#) 2 and recognize the credit as revenue equal to the cumulative face value of the amount issued.

### Consistency with Current IPSASs

[2.762.77](#) 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 approach](#) 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 liabilities<sup>19</sup> 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.

[2.772.78](#) 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 approach-1](#).

[2.782.79](#) 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.

[2.792.80](#) 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.

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<sup>19</sup> 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.



[2.802.81](#) 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 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 approach 2](#), where it was determined that issuance of currency does not give rise to ownership contributions (equity contribution).

#### Presentation and Disclosure

[2.812.82](#) 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.

[2.822.83](#) 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 dollar<sup>20</sup>, 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:

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<sup>20</sup> 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<sup>21</sup> 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 rules<sup>22</sup> 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 form<sup>23</sup> of

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<sup>21</sup> Regardless whether gold assets are considered monetary gold or nonmonetary gold, under GFS guidance they are accounted for at market value. The difference in treatment under GFS relates to the classification and presentation of gold assets and not the recognition and measurement requirements.

<sup>22</sup> The international standard for transacting in physical gold, are the rules of the London Bullion Exchange.

<sup>23</sup> 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 quantifiable<sup>24</sup>, 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 asset<sup>25</sup> 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 entity<sup>26</sup>.

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:

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

3.27 The reserve asset definition is a common and well understood concept for monetary authorities from a GFS reporting perspective. Therefore it is important to align the accounting definition with GFS to avoid unintended departures.

3.28 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.

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

<sup>24</sup> 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.

<sup>25</sup> 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...

<sup>26</sup> 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.

[3.283.30](#) To be effective, reserve assets must be readily available for trading.

[3.293.31](#) 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.<sup>27</sup>

[3.303.32](#) 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*

[3.313.33](#) Monetary gold must meet the definition set out in paragraph 3.16 and must be held to achieve the intentions of a monetary authority.

[3.323.34](#) Gold, can have a range of purities, from low to high gold content<sup>28</sup> and can take many forms<sup>29</sup>. However, only gold which satisfies the definition of monetary gold, as defined in paragraph 3.16, should be in scope of guidance. Monetary authorities have a number of options for holding gold as discussed in the following paragraphs.

[3.333.35](#) Gold can be held directly by monetary authorities or stored with a third party in an allocated or unallocated gold account; as explained below:

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<sup>27</sup> 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.

<sup>28</sup> Tradable physical gold requires a purity of 995 parts per 1000 or greater gold content.

<sup>29</sup> 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.

- (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 delivery<sup>30</sup> 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.

3.343.36 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 numismatic<sup>31</sup> 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 definition<sup>32</sup>. However, those legal tender gold coins which meet the monetary gold definition and which are held for use as reserve assets should be included in the scope of guidance.

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

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<sup>30</sup> 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.

<sup>31</sup> 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.

<sup>32</sup> 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.

- (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 gold<sup>33</sup>;
- (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.

3.363.38 Gold antiques are cultural and historical items which contain gold. These items have value arising from their gold content, as well as their historical and/or cultural value. Gold antiques are likely to be held by government entities because of their cultural and/or historical significance and are unlikely to be held as reserve assets. Even if such items are held by monetary authorities and the gold items meet the purity requirements, it is unlikely they would be in saleable form and therefore would not satisfy the definition requirements. Gold antiques are not considered to be in scope of monetary gold guidance<sup>34</sup>.

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<sup>33</sup> 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.*

<sup>34</sup> In 2015 the IPSASB has initiated a project to consider accounting for Heritage Assets.

[3.373.39](#) 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

[3.383.40](#) 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 criteria<sup>35</sup>.

[3.393.41](#) 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.

[3.403.42](#) 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

[3.413.43](#) 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 rates<sup>36</sup>.

[3.423.44](#) Chapter 7 on measurement in the Conceptual Framework, paragraph 7.2, states the *objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account and for decision-making purposes*. Paragraph 7.3 further elaborates *that selection of a measurement basis contributes to meeting the objectives of financial reporting in the public sector by providing information that enables users to assess:*

- (a) *The cost of services provided in the period in historical or current terms.*

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<sup>35</sup> 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.*

<sup>36</sup> 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.



- (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.*

[3.433.45](#) 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.

[3.443.46](#) 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.

[3.453.47](#) 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.

[3.463.48](#) 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.

[3.473.49](#) Alternatively, if the intention in holding monetary gold is to hold it for an indeterminate period, because it provides confidence in the ability of monetary authorities to carry out their activities, then a measurement basis which provides information on cost of services may be relevant.

[3.483.50](#) Monetary authorities currently measure monetary gold either on a historical cost basis, or fair value/market value basis<sup>37</sup>. 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.

[3.493.51](#) The IPSASB considered the Conceptual Framework and noted that of the six potential bases available, only historical cost and market value in an open, active and orderly market, are practical to consider:

- (a) Historical cost, as it is an entry value which provides information on the resources exchanged to acquire monetary gold assets, which are available to provide services in future periods. Such

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<sup>37</sup> Only measurement bases consistent with the Conceptual Frameworks' guidelines are discussed, which is why a statutory rate, is not referred to here.

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.

3.503.52 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.

3.513.53 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*

3.523.54 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*

[3.533.55](#) 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.

[3.543.56](#) 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.

[3.553.57](#) 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.

[3.563.58](#) 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.

[3.573.59](#) 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

[3.583.60](#) 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.

[3.593.61](#) 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.

[3.603.62](#) 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.

[3.613.63](#) 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.*

[3.623.64](#) 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.

[3.633.65](#) 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.

[3.643.66](#) 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.

[3.653.67](#) 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.

[3.663.68](#) 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)<sup>38</sup> financial assets are accounted for in IPSAS 29, *Financial Instruments: Recognition and Measurement*.

#### Consistency with Current IPSAS Guidance

[3.673.69](#) 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.

[3.683.70](#) 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).

[3.693.71](#) 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.

[3.703.72](#) 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

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<sup>38</sup> The project to update IPSAS 28–30 for IFRS 9, *Financial Instruments* may introduce changes to classification terminology.

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

[3.743.73](#) 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.

[3.723.74](#) 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

[3.733.75](#) 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.

[3.743.76](#) Accounting for monetary gold at historical cost is less complex compared to using market value.

[3.753.77](#) 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.

[3.78](#) 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.

## [2. Specific Matter for Comment—Chapter 3–1](#)

[\(a\) Should entities have the option to select a measurement basis \(current value or historical cost\) based on their intentions in holding monetary gold assets?](#)

## [3. Specific Matter for Comment—Chapter 3–2](#)

[\(a\) Which measurement basis is most appropriate for monetary gold, current value or historical cost?](#)

## [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

3.763.79 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)~~(a) 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)~~(b) 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)~~(c) 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 cost<sup>39</sup>. 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.

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<sup>39</sup> 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.*

[3.773.80](#) 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*

[3.783.81](#) 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.*

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

#### **Presentation and Disclosure**

[3.803.83](#) 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.

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



## Appendix A: Currency in Circulation: Notes

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

Purchase Materials			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Purchase Materials - Journal Entry	<i>Purchase Material (Ink &amp; Paper) for 1000, 100CU notes – cost 100CU</i>	<i>Purchase Material (Ink &amp; 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 &amp; Labour) - cost 100CU</i>	<i>Production of 1000, 1000, 100CU notes. Production costs (Overhead &amp; 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 <sup>40</sup>	
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

<sup>40</sup> 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 &amp; Labor) - cost 100CU</i>	<i>Production of 1000, .25CU coins. Production costs (Overhead &amp; 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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<b>Distribution of Coins – Liability Recognized</b>			
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 <sup>41</sup> 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	

<sup>41</sup> 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 recognized<sup>42</sup>.</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 <sup>43</sup>	
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

<sup>42</sup> 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.

<sup>43</sup> 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

