

**Meeting:** International Public Sector Accounting  
Standards Board  
**Meeting Location:** Santiago, Chile  
**Meeting Date:** March 10–13, 2015

# Agenda Item 7

For:  
 Approval  
 Discussion  
 Information

## Public Sector Specific Financial Instruments

### Objective(s) of Agenda Item

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

### Material(s) Presented

Agenda Item 7.1	Draft Issues Paper, Public Sector Specific Financial Instruments
Agenda Item 7.2	Draft of the CP, Public Sector Specific Financial Instruments

## Issues Paper, Public Sector Specific Financial Instruments

### Objective of the Issues Paper

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

### Background

2. At its December 2014 meeting, the IPSASB discussed a draft of the introduction and objective chapters of the CP and a revised draft chapter on monetary gold. The IPSASB provided directions to staff regarding the further development of the CP.
3. A revised draft of the CP is included as Agenda Item 7.2. A marked-up version of the draft CP is available upon request.
4. This Issues Paper seeks the IPSASB's views on the key issues that staff has identified in revising the CP.

### Key Issues

#### Chapter 1 – Introduction and Objective

5. At its September 2014 meeting, the IPSASB requested revisions to explain to constituents why the IPSASB is addressing the issues related to central banks, where IPSAS are not commonly used. Revisions have been included in paragraphs 1.7–1.8.
6. Amendments have been included to communicate the importance of monetary authorities to the public sector and their public interest benefit and service delivery aims.

#### Matter(s) for Consideration

1. The IPSASB is asked to:
  - (a) **Confirm** that the amended paragraphs 1.7–1.8 adequately capture the key points raised during the December meeting.

#### Chapter 3 – Monetary Gold: Definitions and Descriptions

7. At the December 2014 meeting, the IPSASB directed staff to review the definition of monetary authority. The IPSASB also directed staff to develop further supporting discussion and descriptions related to certain of the other definitions.
8. Paragraphs 3.15–3.28 have been restructured to incorporate the feedback from the IPSASB.
9. The TBG decided to revise the definition “gold bullion” to “physical gold” to make it more clear and remove any confusion created by the use of the term bullion.
10. Further, the description of physical gold was updated in paragraph 3.21 to more clearly explain what saleable form means. Staff notes, as discussed previously, defining a specific saleable form of gold

assets is not possible, due to the various requirements of different exchanges for trading gold around the world. However, it was noted that a physical saleable form could indicate attributes, such as a quantifiable, standard form which is easily identified and measured to facilitate easy market transactions.

**Matter(s) for Consideration**

2. The IPSASB is asked to:
  - (a) **Indicate** whether the revised definitions of gold bullion and monetary authority are appropriate;
  - (b) **Confirm** whether the additional descriptions added are appropriate.

**Chapter 3 – Monetary Gold: Scope**

11. The IPSASB provided feedback on the scope of a monetary gold standard or component of a broader standard and noted that the discussion should be revised to consider the purity of gold assets and the purpose they are held by monetary authorities.
12. Paragraphs 3.29 to 3.35 have been revised to discuss types of gold products which should be in scope of guidance.
13. Gold assets in scope of monetary gold guidance, should be only those items which satisfy the definition and which are used by monetary authorities to achieve their objectives. The following types of gold assets meet these criteria:
  - (a) Physical gold (including gold held directly, in allocated and unallocated gold accounts);
  - (b) Commemorative gold coins and gold coins that are legal tender; and
  - (c) Some financial instruments which allow for physical settlement in gold on demand and for which monetary authorities have the intention of taking physical delivery of the gold.

**Matter(s) for Consideration**

3. The IPSASB is asked to **confirm** the proposed scope, or alternatively suggest amendments to the scope.

**Chapter 3 – Monetary Gold: Measurement**

14. In December 2014 the IPSASB directed that the CP needed to reflect the purpose for which monetary gold assets are held by monetary authorities and whether an entry value or exit value measurement basis is appropriate.
15. The IPSASB noted that monetary authorities may have different objectives for holding monetary gold assets and directed that options should be developed and linked to appropriate measurement bases.
16. The IPSASB also noted that given the nature of monetary gold assets, historical cost and market value—in open, active and orderly markets were thought to be the only appropriate bases. Staff agrees and has discussed in paragraph 3.47 why certain measurement bases are inappropriate and not considered.
17. Historical cost and market value measurement bases have been discussed and linked to the objectives of monetary authorities in paragraphs 3.53 and 3.54.

**Matter(s) for Consideration**

4. The IPSASB is asked to:
- (a) **Indicate** whether it supports the discussion of which measurement bases should be included in the development of accounting options and those which should be excluded; and
  - (b) **Indicate** if the discussion in paragraphs 3.53 and 3.54, sufficiently makes the link between monetary authorities' objectives in holding gold assets and the measurement bases.

**Chapter 3 – Option 1: Market Value in Open, Active and Orderly Market**

18. Using a current value measurement basis, issues arise over accounting for changes in value and transaction costs.
19. The CP proposes options for accounting for such changes based on considerations of the guidance in the Conceptual Framework as discussed in paragraphs 3.57–3.64.

**Matter(s) for Consideration**

5. The IPSASB is asked to:
- (a) **Indicate** if it supports the various options on accounting for recognition of changes in the value of monetary gold and transaction costs, or, alternatively, suggest amendments; and
  - (b) **Indicate** any preliminary views on the appropriate location in the financial statement to present changes in the value of monetary gold assets.

**Chapter 3 – Option 2: Historical Cost**

20. The IPSASB directed that for those monetary authorities which hold monetary gold for its service potential and do not have a history of selling gold assets, a historical cost measurement basis might be more appropriate and asked staff to consider such an option. Paragraphs 3.65–3.68, have been revised to include this discussion.
21. The TGB discussed accounting for transaction costs when using historical cost. The current analysis in the draft CP in paragraph 3.67 considers if transaction costs meet the definition of an asset in the Conceptual Framework and recommends expensing as incurred. However, this is inconsistent with how the measurement model for historical cost has been used in certain IPSAS standards (such as IPSAS 12, *Inventories* and IPSAS 28–30, *Financial Instruments*). In current IPSAS the measurement model allows for capitalization of transaction costs. Is it appropriate to test the treatment of transaction costs as an element or as part of a particular measurement model?
22. The TBG considers that this as an issue with wider implications beyond this project.

**Matter(s) for Consideration**

6. The IPSASB is asked to:
- (a) **Indicate** if it supports the discussion in relation to accounting under historical cost in paragraph 3.65–3.68, or alternatively suggest amendments; and
  - (b) **Provide** views on basing approaches on the Conceptual Framework where there are existing requirements/guidance in IPSASs that may be inconsistent with the Framework.

### Presentation Objective

23. The presentation objective included in the monetary gold chapter for the December 2014 version of the draft CP, has been reworked to form an overall objective, in paragraph 3.4, for the chapter as directed by the IPSASB.
24. It was decided to leave paragraphs 3.71–3.72 in the chapter as a placeholder. The TBG acknowledges that it may be difficult to discuss presentation and disclosure requirements in the CP, as decisions on recognition and measurement have not been made. Further, the TBG proposes to revisit presentation and disclosure at a later stage after the development of the remaining chapters in the CP.

#### Matter(s) for Consideration

7. The IPSASB is asked to:
  - (a) **Indicate** if it supports the chapter objective in paragraph 3.4; and
  - (b) **Provide** views on the TBG's proposal on presentation and disclosure.

### Next Chapters in the CP

25. Appendix A of this Issues Paper discusses some key issues and considerations for drafting the next chapters in the CP.
26. Paragraph A.2 of this Issues Paper discusses a TBG proposal for the IPSASB to consider and discuss the overall objective of the project to determine if all reserve assets described in the monetary gold chapter in paragraph 3.25 should have chapters developed in the CP.
27. Currently items considered reserve assets are monetary gold, foreign currency, highly liquid investments, and Special Drawing Rights (SDRs).
28. Monetary gold and SDRs are transactions without specific guidance in IPSAS and which the IPSASB has agreed should chapters in the CP.
29. IPSAS 4, *Effects of Changes in Foreign Exchange Rates*, and IPSAS 28–30, *Financial Instruments*, provide specific guidance for accounting for foreign currency assets and highly liquid investments. These reserve assets are not currently included in the scope of the CP.
30. The objective of holding reserve assets by the central bank, may be different than other entities and therefore it may be appropriate to consider accounting requirements for all reserve assets, regardless of whether IPSAS has current requirements or not.
31. Paragraph A.6 of this Issues Paper also requests a direction from the IPSASB as to whether a similar approach to the monetary gold chapter, is appropriate for future chapters addressing reserve assets in the CP.

#### Matter(s) for Consideration

8. The IPSASB is asked to:
  - (a) **Indicate** if all reserve assets should be in scope of the CP; and
  - (b) **Indicate** if the same approach used for the monetary gold chapter is appropriate for other chapters addressing reserve assets in the CP.

32. Appendix A of this Issues Paper, provides high level key issues for consideration in drafting the next chapters in the CP.
33. Foreign currency assets issues are discussed in paragraphs A.7–A.12 of Appendix A.
34. Currency and coin in circulation issues are discussed in paragraphs A.13–A.29 of Appendix A.

**Matter(s) for Consideration**

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

**Appendix 1: Next Chapters of CP**

- A.1 This appendix identifies the next chapters planned for development in the CP: Foreign Currency Reserve Assets and Currency and Coin in Circulation.
- A.2 During TBG discussions on the development of future chapters, TBG members discussed the approach and objective for the project overall. It was recommended that the IPSASB consider whether the objective of the project is it to develop guidance specific to all reserve assets, or to develop guidance for those reserve assets that do not have specific guidance in IPSAS.
- A.3 Reserve assets include the following items: monetary gold, foreign currency, highly liquid investments, and Special Drawing Rights (SDRs).
- A.4 Monetary gold and SDRs are transactions not addressed by specific guidance in IPSAS. Monetary gold and SDRs were both included in the public sector specific financial instruments project because they are used like financial instruments, but do not qualify for financial instruments accounting.
- A.5 Guidance for foreign currency assets accounting can be found in IPSAS 4, *Effects of Changes in Foreign Exchange Rates* and IPSAS 28–30, *Financial Instruments*. Guidance related to highly liquid investments is included in IPSAS 28–30, *Financial Instruments*. Currently these topics are not within the scope of the CP.
- A.6 For future chapters, should a similar approach to that of monetary gold be adopted? The monetary gold chapter considers GFS requirements in developing definitions and concepts. Scope, recognition and measurement decisions are guided by the conceptual framework and how monetary authorities use each type of asset to develop accounting options.

**Foreign Currency Reserve Assets**

- A.7 During the December 2014 meeting, a member raised the idea that since foreign currency reserves are used by monetary authorities as reserve assets, to achieve their objectives, it may be appropriate to include an additional chapter in the CP.
- A.8 Inclusion of Foreign Currency Reserve Assets raises the question whether all reserve assets should be included in the CP.
- A.9 Currently IPSAS requirements exist, for accounting foreign currency in IPSAS 4, *Effects of Changes in Foreign Exchange Rates* and IPSAS 28–30, *Financial Instruments*. The current guidance included in IPSAS has been developed in considering the public sector specificities. It is not thought that monetary authorities would use foreign currency in a manner unique from other entities in the private or public sector entities. Arguably, the use of foreign currency assets differs from the unique way monetary authorities use physical gold.
- A.10 IPSAS 4.32 require changes in the value of foreign currency at the reporting date to be recognized in surplus or deficit in the period in which they arise.
- A.11 Monetary gold, is used in a unique manner compared to other physical gold assets, held by other entities. Foreign exchange is held by monetary authorities for the purpose of making foreign payments, for the same purpose as in the private and public sector.

A.12 If a chapter on foreign currency reserve assets is included, the main issue is the appropriate place to recognize unrealized changes in the value of foreign exchange assets:

- (a) If the same rationale for monetary gold is applied for foreign currency assets, including unrealized gains or losses in the statement of financial performance may impair the usefulness of the surplus and deficit for the period in reporting the costs of services. Further, it may result in monetary authorities distributing accounting profits based on temporary gains/losses, which could lead to liquidity issues. Using this rationale, a chapter addressing foreign exchange, may be appropriate and might be structured as follows:
  - (i) One approach discussing the current guidance and accounting options available in IPSAS.
  - (ii) Second approach based on the Conceptual Framework, considering the appropriate place in the financial statements to recognize changes in value. For example, an approach to recognize unrealized gains or losses directly in net financial position (net assets) until realized, would potentially be one option not at odds with the Conceptual Framework.

## Currency and Coin in Circulation

A.13 The IPSASB has determined that Currency and Coin in Circulation should be a chapter of the CP.

A.14 A high level discussion of the issues related to currency and coin in circulation is presented below.

## Issues

### Issue 1: Monetary authorities recognize a liability for banknotes and coins in circulation

A.15 Monetary authorities recognize a liability at face value for banknotes and coins, because of the legal requirement to manage and maintain legal tender. Some considerations related to this issue are:

- (a) Does this liability satisfy the definition in the Conceptual Framework (*A present obligation of the entity for an outflow of resources that results from a past event.*) In the past currency was exchangeable for a fixed amount of a precious metal, therefore monetary authorities had an obligation to deliver the underlying precious metal upon demand. However, since the early 1970's, currencies have been fiat currencies; which have value because they are accepted as a medium of exchange for payments. The obligation central banks have is to maintain the currency, by printing notes and minting coins to replace damaged notes or coins, or for new series of coins and notes. The obligation is only to replace currency with new currency. It is questionable if this results in a present obligation for an outflow of resources.
- (b) All monetary authorities recognize a liability for banknotes, but not all do so for coins. Should there be a difference in accounting for coins and accounting for notes? Coins would likely be a much smaller amount, so a materiality argument might be put forward by preparers. However staff is of the view that there should not be a difference between how notes and coins are accounted for by issuers, from a conceptual point of view.
- (c) Guidance in GFS states: *notes and coins in circulation which are commonly used to make payments, are issued by the central bank or government units are a liability of the units that*

*issue them and recognized at a fixed nominal amount.* Should staff consider the GFS guidance in developing definitions?

**Issue 2: Measurement of the liability for banknotes and coins in circulation**

- A.16 Currently monetary authorities measure banknotes and coins at their face value. Consideration of the possible measurement bases available for liabilities presented below:
- (a) *Historical Cost: Consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of other consideration given, at the time of acquisition or development.* Staff believes measurement of the liability at historical cost would be the cost of production of the notes and coins, not the face value.
  - (b) *Market Value: The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.* Staff believes this may be most appropriate, as the face value of currency is exchanged for the same amount of currency at face value (damaged notes or coins, for new notes or coins).
  - (c) *Cost of Release: refers to the amount of an immediate exit from the obligation, or the amount a creditor will accept in settlement of the claim.* Staff believes this could be thought to be the face value. However, notes are only exchanged for other notes (damaged notes for new notes). Monetary authorities do not have an obligation to "settle" claims made on them by holders of currency, other than exchanging for new currency (essentially exchanging one obligation for another obligation – it is never settled).
  - (d) *Assumption Price: The amount that an entity would rationally be willing to accept in exchange for assuming an existing liability.* Not thought to be appropriate, as the obligation to maintain currency is not thought to be transferrable from the monetary authority.
- A.17 Measurement of the liability is a key issue, which may be quite complicated, when considering the Conceptual Framework guidance. Members thoughts on whether an obligation exists and if so, how to measure it from a Framework perspective would be welcomed.

**Issue 3: Accounting for costs related to producing banknotes and coins**

- A.18 Should costs be expensed as incurred or amortized over the useful life of the banknotes and coins?
- A.19 Staff views this is a less important issues than issue 1 and 2. Two possible approaches discussed below in A.20 and A.21.
- A.20 Consideration if costs of production should be considered from the point of view of an Element in the Conceptual Framework or from the point of view of a particular measurement basis? Sub issue– Timing of recognition of expense (when incurred or when notes are put into circulation).
- A.21 Capitalized and amortized over the useful life–Do the costs meet the Conceptual Framework definition of an asset: *A resource presently controlled by the entity as a result of a past event.* The CF notes a resource is *an item with service potential or the ability to generate economic benefits.* Costs related to the production of notes and coins provide service potential as they are used to pay for goods and as a medium exchange as legal tender. A sub issue is how should the useful life of banknotes be determined? Similar to capital assets requirements in IPSAS 17 (useful life). Or an alternative, such as when notes are derecognized and removed from circulation (if so actual or based on estimate).

**Issue 4: Seigniorage revenue**

- A.22 Seigniorage is the term used to describe earning revenue from the issue of money by an entity with the mandate for doing so.
- A.23 When new currency is issued, for which a liability is recognized, it is a statement of financial position transaction, where the face value of the new cash is recognized as an asset along with an offsetting liability. The central bank generally uses that new cash to purchase securities, usually securities of the national government. The securities purchased are generally fixed income securities that pay interest. Revenue (seigniorage) is generated from interest earned on the securities, which is indirectly the revenue earned from issuing new money.
- A.24 Some national governments do not recognize a liability for coins, and therefore seigniorage revenue is equal to the face value of the new coins when issued.

**Issue 5: Derecognition of the liability for banknotes and coins in circulation**

- A.25 Conceptual Frameworks notes *derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrants removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred. In evaluating uncertainty about the existence of an element the same criteria are used for derecognition as at initial recognition.*
- A.26 Many monetary authorities do not derecognize liabilities for bank notes, or do not derecognize until the series of notes has been legally stated to no longer be legal tender. Should monetary authorities be tracking the number of notes in circulation, the number they are exchanging and have a process for derecognizing currency in old series.
- A.27 When currency is derecognized, should the gain related to removing the liability be considered revenue? Should it be recognized directly in net financial position (net assets/equity).

**Issue 6: Accounting for costs to develop new series of banknotes and coins**

- A.28 Staff views this as a lesser issue. How should accounting for costs to develop new series of banknotes and coins be dealt with; capitalization in line with IPSAS 31, *Intangible Assets* where a distinction is made between research and development?
- Research costs are those that relate to research only and are expensed as incurred.
  - Development costs are those for which the development relates to a proven technically feasible, intention to complete the intangible asset and use or sell it;
  - Ability to use or sell it;
  - Availability of technical and financial resources to complete it; and
  - Ability to reliably measure the expenditure during development.
- A.29 This issue may be relevant when considering development of new types of currency (polymer notes, electronic currency). Staff view is that accounting for research and development for new series of banknotes and coins can be addressed under existing requirements and guidance in IPSAS 31.

## **1 Introduction and Objective**

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

### **History of the Project**

- 1.3 The project to develop IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*, identified several items, some of which may meet the definition of a financial instrument but have certain public sector specific characteristics. Others do not strictly meet the financial instrument definition, but are similar to financial instruments. Items identified during the initial financial instruments project as “public sector specific financial instruments” were:
  - Monetary gold;
  - Special Drawing Rights;
  - Reserve position in the IMF;
  - Currency issued by the entity;
  - Financial guarantee contracts; and
  - Concessionary loans.
- 1.4 Two public sector specific issues—concessionary loans and large-scale financial guarantee contracts—were addressed in application guidance in IPSAS 29. Both these instruments clearly meet the definitions of a financial instrument. The guidance has been applicable since January 1, 2013.
- 1.5 The IPSASB agreed to address the remaining issues through a further public sector specific financial instruments project.
- 1.6 In December 2013, the IPSASB identified additional issues to those noted in paragraph 1.3—statutory receivables, statutory payables and certain types of securitization transactions unique to the public sector. The IPSASB considers that it is in the public interest to consider these additional topics.
- 1.7 All of the topics have public interest implications given their significance to the public sector and their service delivery objectives. Considering these issues from a public sector perspective is important in meeting the information needs of users; specifically related to assessing the ability of public sector

entities to deliver services effectively, to manage the resources used and available to provide services, and to assess the liquidity and solvency of key institutions in the public sector.

- 1.8 Some topics in scope apply mainly to specific entities, such as central banks, which may apply national standards or international standards for the private sector. Because of the importance of central banks to the public sector, developing guidance for these entities is important for the IPSASB. Further, the IPSASB notes that because central banks form a part of the public sector in many jurisdictions they are likely to be controlled and consolidated into the financial accounts of the central government, even if they do apply national standards or international standards for the private sector.

### **Approach taken in this CP**

- 1.9 The Conceptual Framework was published in October 2014. This CP draws on the Framework in its analysis of each topic.
- 1.10 The CP is organized into separate chapters by topic. The output of this project has not been determined by the IPSASB at this time. The project may lead to the development of a single standard or several standards and/or additional application guidance. However, the IPSASB feels it is important to deal with all the issues in a single CP, to allow consideration of all topics by constituents. Not all topics will be relevant for all constituents.
- 1.11 The CP has the following structure:
- Chapter 1: Introduction and Objective;
  - Chapter 2: Currency and Coin Issued by the Entity;
  - Chapter 3: Monetary Gold;
  - Chapter 4: IMF Special Drawing Rights and Other IMF Transactions;
  - Chapter 5: Statutory Receivables;
  - Chapter 6: Statutory Payables; and
  - Chapter 7: Securitizations.

### **Conceptual Framework**

- 1.12 The complete Conceptual Framework was published in October 2014. This development influences the CP in the following ways:
- The objectives of financial reporting, the qualitative characteristics and the constraints on information included in general purpose financial reports, provide a framework against which the information needs of users can be weighed against accounting considerations for each chapter;
  - 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>1</sup> (GFS Policy Paper), which has been considered in developing this chapter.
- 1.18 Informed by the Conceptual Framework and the GFS Policy Paper, the IPSASB reviewed the definitions and descriptions related to each topic in scope of the project. The IPSASB considered the *System of National Accounts 2008* (SNA), *Government Finance Statistics Manual 2014* (GFSM) and *Balance of Payments and International Investment Position Manual—Sixth Edition* (BPM6). The guidance from the applicable manuals related to each topic will be considered by the IPSASB in developing accounting guidance to minimize unnecessary differences.

**2 Chapter 2: Currency and Coin Issued by the Entity**

To be developed

**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 (gold, 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>2</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.

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

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

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

### Chapter Objective

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

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

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

- 3.6 In developing options for accounting for monetary gold, it is important to identify the objectives for which monetary authorities hold monetary gold as reserve assets. Monetary authorities are complex entities and are likely to hold gold for more than one purpose. The two main objectives identified, which monetary authorities hold gold assets for are as follows:
- Objective 1: Monetary gold is held because of its financial capacity and the ability for such assets to be sold, and to transact with others using gold, if and when needed. For this objective, information on the current market prices of gold is important; and

- Objective 2: Monetary gold is held because of its service potential as it provides confidence in monetary authority's ability to carry out its key activities, such as influencing the money supply, providing liquidity and for use for international payments. For this objective information on the quantity of gold held is important, with less concern as to the current market value of gold.
- 3.7 The CP identifies two options to account for monetary gold, each option is linked to the objectives described in paragraph 3.5. 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 standard or 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 the Balance of Payments International Investment Position Manual—Sixth Edition (BPM6).
- 3.11 BPM6 notes in paragraph 6.78: *Monetary gold is gold to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and is held as reserve assets. It consists of gold bullion (including gold coins, ingots, bars with a purity of at least 995/1000, and gold bullion held in allocated gold accounts, regardless of the location of the account) and unallocated gold accounts with nonresidents that give title to claim the delivery of gold. Gold bullion is usually traded on organized markets or through bilateral arrangements between central banks. To qualify as reserve assets, gold accounts must be readily available upon demand to the monetary authorities.*
- 3.12 BPM6 explains the relationship of monetary gold to non-monetary gold in paragraph 5.78: *In contrast to monetary gold, which is a financial asset, nonmonetary physical gold is a good. (Paragraphs 10.50–10.54 deal with nonmonetary gold in the goods and services account.) Similarly, other precious metals are goods and not financial assets. Monetary gold is treated differently because of its role as a means of international payments and store of value for use in reserve assets.*
- 3.13 BPM6 notes in paragraph 6.64: *Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing).*
- 3.14 BPM6 notes in paragraph 6.66: *The functional concept of monetary authorities is essential for defining reserve assets. Monetary authorities encompass the central bank (which subsumes other institutional units included in the central bank subsector, such as the currency board) and certain operations usually attributed to the central bank but sometimes carried out by other government institutions or commercial banks, such as government-owned commercial banks. Such operations include the issuance of currency; maintenance and management of reserve assets, including those*

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

*Definitions and Descriptions*

3.15 Considering the above definitions and descriptions from BPM6, the IPSASB proposes the following definitions (detailed in paragraphs 3.16, 3.19, 3.22 and 3.25) and supporting guidance (outlined in paragraphs 3.17–3.18, 3.20–3.21, 3.23–3.24 and 3.26–3.28).

3.16 **Monetary gold** is defined as follows:

“Physical gold assets held by monetary authorities as reserve assets.”

3.17 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 gold is. Because of this central banks do not use 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.

3.18 The definition is restricted to those gold assets held by monetary authorities as reserve assets, as these are the assets available for use in achieving the objectives of monetary authorities. 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 objectives of monetary authorities and therefore have been excluded.

3.19 **Physical gold** is defined as follows:

“Physical gold that has a minimum purity of 995 parts per 1000.”

3.20 Physical 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>3</sup> for trading on markets and exchanges.

3.21 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>4</sup> of physical gold which is quantifiable<sup>5</sup>, in a standard size and form. This allows for gold to be easily identified and measured, as required to facilitate market transactions.

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

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

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

<sup>4</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.

<sup>5</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.

- 3.23 In limited circumstances a monetary authority may be (or include) an international or regional entity<sup>6</sup>.
- 3.24 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.
- 3.25 **Reserve assets** are defined as follows:  
“Assets held by monetary authorities, which are readily available for international payment needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.”
- 3.26 Reserve assets comprise monetary gold, foreign currency, highly liquid investments, and Special Drawing Rights (SDRs).
- 3.27 To be effective in contributing to the objectives of monetary authorities, reserve assets must be readily available for trading in a liquid market.
- 3.28 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 physical gold holdings held for other purposes such as use in operations, manufacturing and/or because such holdings have historical or cultural significance.<sup>7</sup>

#### Scope

- 3.29 Monetary gold must meet the definition set out in paragraph 3.15 and must be held to achieve the objectives of a monetary authority.
- 3.30 Physical gold, which is tangible in nature, can have a range of purities, from low to high gold content<sup>8</sup> and can take many forms<sup>9</sup>. Only tangible gold which satisfies the definition of monetary gold should be in scope of guidance. Monetary authorities have a number of options for holding physical gold as discussed in paragraphs 3.31–3.36.
- 3.31 Physical gold can be held directly by monetary authorities or stored with a third party in an allocated or unallocated gold account; as explained below:
- (a) Physical gold held directly by monetary authorities with a purity greater than 995/1000 which is held for use as reserve assets, satisfies the definition of monetary gold and should be in the scope of guidance;

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<sup>6</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.

<sup>7</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>8</sup> Tradable physical gold requires a purity of 995 parts per 1000 or greater gold content.

<sup>9</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.

- (b) Physical 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 physical gold held in an allocated account, which satisfies the monetary gold definition, should be included in the scope of guidance; and
- (c) Physical gold held as a deposit in an unallocated account, is gold deposited by the monetary authority with a third party (in a manner similar to how cash is deposited at a bank). Deposits of gold assets are not segregated or identified. Monetary authorities have the right to request on call delivery<sup>10</sup> of the deposited gold. Gold assets held in unallocated accounts have different risks than those held directly by monetary authorities or in allocated accounts. However, such deposits are still denominated in physical gold and allow for the delivery of a specific quantity of gold. Therefore, gold assets held in unallocated accounts, which meet the definition of monetary gold, should be included in the scope of guidance.

3.32 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>11</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 South African Kruggerrand, Canadian Maple Leaf, British Britannica, China Panda and American Gold Eagle coins. The South African Kruggerrand's legal tender value is equal to the market value of the gold content of the coin. For other 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. 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.

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

- (a) Gold loans are debt agreements for borrowings where gold is posted as collateral to secure the loan. These types of debt agreements, are not monetary gold, as they do not meet the

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<sup>10</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>11</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.

definition of monetary gold, as they are a contractual instrument and not physical 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 gold instruments allow for settlement in physical gold on demand, the gold assets satisfy the monetary gold definition and the monetary authority has the intention of taking physical delivery of such gold, such instruments may be considered monetary gold<sup>12</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 physical gold on demand, and the gold assets satisfy the monetary gold definition, such instruments may be considered monetary and should be in scope of monetary gold 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 physical in nature and the value of such gold equities is related to the combined operations of the entity, and not an underlying amount of physical gold. Therefore, gold equities are financial instruments. IPSAS 28–30 should be applied and they should not be in scope of monetary gold guidance.
- 3.34 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.

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<sup>12</sup> Staff view is that any instrument that allows for delivery of a fixed quantity of physical gold, which are held by monetary authorities as reserve assets, could meet the scope exclusion of IPSAS 29.4: which states: *...contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.*

- 3.35 Gold assets in scope of monetary gold guidance, should be only those items which satisfy the definition and which are used by monetary authorities to achieve their objectives. The following types of gold assets should be included:
- Physical 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*

- 3.36 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 is “an asset is a resource presently controlled by the entity as a result of a past event.”
- 3.37 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 physical and the existence of the global market for trading it, the risk of measurement uncertainty is minimal.
- 3.38 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 3.31.

### *Measurement*

- 3.39 Monetary authorities are inconsistent in how they measure monetary gold with some using historical cost, others using fair value/current value and a further group using a statutory rate<sup>13</sup>.
- 3.40 Chapter 7 on measurement in the Conceptual Framework, paragraph 7.2, states the *objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account and for decision-making purposes*. Paragraph 7.3 further elaborates *that selection of a measurement basis contributes to meeting the objectives of financial reporting in the public sector by providing information that enables users to assess:*
- (a) *The cost of services provided in the period in historical or current terms.*
  - (b) *Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and*
  - (c) *Financial capacity—the capacity of the entity to continue to fund its activities.*
- 3.41 The nature of monetary gold and its use by monetary authorities for reserve purposes, means that information on the contribution to operational or financial capacity is most relevant. Monetary gold is

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<sup>13</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 take at 14:30 on the reporting date.

not used directly in operations or to directly provide services, like other tangible assets and therefore information on the cost of services would not provide relevant information for users.

- 3.42 Measurement bases that provide information on operational or financial capacity are most relevant, because they enable users to assess monetary authorities' ability 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 objectives for holding monetary gold, which impacts whether information on operational or financial capacity is useful to users.
- 3.43 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 purpose or multiple objectives, as discussed in paragraph 3.6. If the main objective 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 appears most relevant.
- 3.44 Alternatively, if the main objective in holding monetary gold is because of its service potential, because it provides confidence in the monetary authorities ability to carry out its main activities. Then a measurement basis which provides information on operational capacity appears most relevant.
- 3.45 Monetary authorities currently measure monetary gold either on a historical cost basis or fair value/current value basis<sup>14</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 guidance of the Conceptual Framework.
- 3.46 The IPSASB considered the Conceptual Framework and noted that of the six potential bases available, only historical cost and market value in open, active and orderly market, were practical to consider:
- (a) Historical cost, as it is an entry value which provides information on the resources exchanged to acquire monetary gold assets, which are available to provide services in future periods. Such information allows users to assess the minimum service potential and operational capacity monetary gold assets can provide to monetary authorities.
  - (b) Market value in 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.
- 3.47 Other measurement bases were not considered appropriate by the IPSASB for the following reasons:
- Market value in inactive market is not appropriate as a global liquid, active market exists for gold;
  - Replacement cost is not appropriate, as monetary gold held for reserve purposes is not consumed in operations. Further, replacement cost would be equal to the amount to purchase gold in the market, which would be market value in open, active and orderly market;

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<sup>14</sup> Only measurement bases consistent with the conceptual frameworks guidelines are discussed, which is why a statutory rate, is not referred to here.

- Net selling price is generally more useful when an open, active and orderly market does not exist and needs to reflect constraints on a sale and is therefore not appropriate; and
- Value in use is most useful for entity-specific asset valuations, such as, assets of a specialized nature used for a specific purpose, where the service potential or ability to generate economic benefits creates more value to the entity than, the value using replacement cost. As gold is a commodity and is held for its intrinsic value and global liquid trading market. Gold assets are not used in a specialized way and therefore value in use is not an appropriate basis.

3.48 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 3.49 and 3.51.

#### *Historical Cost*

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

- **Relevance**—Historical cost information is less relevant for determining financial capacity, as it is based on the price paid to acquire an asset, not the funds available if sold. Historical cost information does provide information on the minimum resources available to provide future services, based on their acquisition cost, which is useful in assessing operational capacity;
- **Faithful Representation**—Historical cost provides a faithfully representative view of the transaction price to acquire monetary gold, providing information on the service potential but not information on the financial capacity it provides;
- **Understandability**—Historical cost information is not complex. It provides information on the cost to acquire (entry value of) monetary gold;
- **Timeliness**—Historical cost information is timely, because transaction prices are easily obtainable and the carrying amount is stable between accounting periods unless monetary gold is sold or impaired;
- **Comparability**—Historical cost does not provide comparable information over time, as the value is based on the timing of the purchase of the gold by an entity and not the current economic value; and
- **Verifiability**—Historical cost information for monetary gold is transaction based and easily verifiable.

3.50 Information provided by historical cost does meet some of the QCs and provides information which may be useful to users.

#### *Market Value*

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

- **Relevance**—Market value is a relevant measure that provides information on the contribution of monetary gold to financial and operational capacity;

- Faithful Representation—Market value provides a faithfully representative view of the financial capacity monetary gold provides as it represents the exit value and is an objective price, available in a transparent, liquid market. Market value is also an entry value, because of the open, active and orderly market for gold, and therefore provides a faithfully representative view of operational capacity as well;
  - Understandability—Market value information is understandable; the valuation of monetary gold using a spot rate is not complex;
  - Timeliness—Market value provides measurement information in a timely manner. The gold markets are transparent and prices are available in real time. Information required for financial statements can be prepared quickly using simple calculations;
  - Comparability—Market value provides measurement information which allows direct comparability of monetary gold assets with other assets, and between different monetary authorities; and
  - Verifiability—Market value provides information which is verifiable, because there is an open, active and orderly market.
- 3.52 Both historical cost and market value measurement provide information which is useful to users when considered against the QCs. Monetary authorities may hold monetary gold assets to aid in achieving different objectives as discussed in paragraph 3.6. Depending on the primary objective 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.
- 3.53 Monetary authorities with the main objective in 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-based 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.
- 3.54 Monetary authorities with the main objective in holding monetary gold, being its service potential, 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 entry value to acquire monetary gold assets. It also allows users to assess the cost of acquiring/holding monetary gold and the service potential provided, by reference to an actual transaction. Using historical cost to measure monetary gold also avoids introducing volatility into the statement of financial position, which is consistent with monetary authorities' objectives in holding gold assets. Gold prices change significantly over time and the impact of using a market value measurement basis, can impair users' ability to assess the real cost of providing services.
- 3.55 Considering the different objectives for which monetary authorities hold monetary 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.

*Measurement*

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

3.56 Measurement of monetary gold at market value gives rise to two sub issues—accounting for changes in value and transaction costs. The Conceptual Framework is considered in developing the accounting alternatives for each issue.

Accounting for Changes in Value of Monetary Gold Assets

3.57 Current 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 (temporary) gains and losses, due to revaluations.

3.58 There are different approaches for dealing with the recognition of unrealized losses. One approach is to recognize unrealized gains or losses directly in net financial position (net assets/equity), until realized. Another approach could be to recognize all gains and losses in the statement of financial performance.

3.59 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, both approaches would be appropriate and in line with guidance in the Conceptual Framework.

3.60 The global markets for trading gold can be very volatile. The volatility can cause significant changes in the value of monetary gold assets. Because of this volatility, significant unrealized gains or losses may be recognized in the statement of financial performance, which may prevent a faithfully representative view of the cost of service for the period presented. This may impair the objectives of financial reporting by presenting information to users which does not reflect the true cost of service for a 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.

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

3.62 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 financial assets are accounted for under IPSAS 29, *Financial Instruments: Recognition and Measurement*.

#### Accounting for Transaction Costs

- 3.63 Capitalization of transaction costs provide little ongoing information value to users because of the revaluation of monetary gold assets when using market value. To capitalize transaction costs, they should meet the definition of an asset in the Conceptual Framework, which is stated in paragraph 5.6 as, *a resource presently controlled by the entity as a result of a past event*. Transactions costs would only result from a past event (purchase of gold), therefore the key question to determine if transactions are assets, is if they are a resource or not. Paragraph 5.7 of the Conceptual Framework states, *a resource is an item with service potential or the ability to generate economic benefits*. Transactions costs do not embody service potential or the ability to generate economic benefits. Transaction costs are decreases in the net financial position of an entity and they are not as a result of an ownership distribution. Therefore, they meet the definition of expense and should be recognized as such. Transaction costs are a realized expense in the period, and are appropriate to recognize in the statement of financial performance. The information provided by doing so, allows users to evaluate the impact on surplus or deficit related to monetary gold transactions.
- 3.64 Market value—in open, active and orderly market provides useful information on the contribution that monetary gold makes to financial capacity.

#### Option 2: Historical Cost

- 3.65 Monetary authorities may hold monetary gold for different objectives, as noted in paragraphs 3.53–3.55. Under such circumstances, use of an entry value measurement basis such as historical cost is appropriate, when the main objective in holding gold is for its service potential.
- 3.66 From an accounting perspective accounting for monetary gold at historical cost is simple and straight forward compared to market value.
- 3.67 Historical cost would normally be recognized at the fair value at the time of acquisition plus transaction costs as these are part of the cost of acquiring the asset. However, as discussed above in paragraph 3.63, transaction costs do not meet the definition of an asset in the Conceptual Framework and appear appropriate to expense as incurred.
- 3.68 Historical cost reflects the cost to acquire the gold assets and the service potential provided by holding it (operational capacity). Monetary authorities with the main objective of holding monetary gold for 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 would directly relate to either increases or decreases of monetary gold assets, or impairments of monetary gold assets; all changes which relate to the service potential (or changes in service potential) of the assets. The historical cost approach also addresses the issue of ensuring the unrealized gains and losses are not distributed as dividends by monetary authorities.

#### *Derecognition*

- 3.69 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.*

- 3.70 In accordance with this guidance, derecognition would occur when monetary gold assets are sold or transferred to another entity. Given the physical nature of monetary gold, other than an outright transfer or sale, any sale of an interest or percentage of gold, or use as 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**

- 3.71 This section of the CP discusses at a high level the information to be presented in respect of monetary gold. It does not propose specific requirements. These requirements are linked to decisions regarding the approach to recognition and measurement, and therefore will be determined once the IPSASB has considered the responses to this chapter of the CP.
- 3.72 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.