

## Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII

16th January, 2020

The IPSAS Board has requested comments and answers to specific questions regarding its Proposed Amendments to IPSAS 41 covering Public Sector Specific Financial Instruments. The comments and responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented below.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 17 researchers from these networks. The views expressed in this document are widely shared by the members of the Task Force, but neither do they represent the views of the whole research community represented by the networks, nor of the Institutions/Universities with which they are affiliated.

### **Comments and suggestions considering the IPSAS Board document for ED 69 'Public Sector Specific Financial Instruments: Amendments to IPSAS 41, Financial Instruments'**

We welcome the opportunity to comment on the proposed amendments to IPSAS 41 contained in ED 69. We see the development of standards and guidance on matters that are specific to the public sector as being a particularly important part of the continuing programme of work of the IPSAS Board.

#### **Core assumptions**

We are of the opinion that Public Financial Management (PFM), in its broadest sense, is the system by which public financial resources are planned, managed and controlled. Furthermore, the PFM system is the foundation on which the *accountability* of public sector entities, both external and internal, is built to enable and influence the efficient and effective delivery of public service outcomes and to discharge accountability *towards citizens*. In our view, PFM is paramount for accountability and should support the stewardship function, as well as decision-making, which are both subordinated. We recognise the pivotal role of the Board in developing high quality international public sector accounting standards to support financial reporting and to enhance non-financial disclosure by public sector entities to increase citizens' trust.

We are of the opinion that, in general, public sector entities require public sector specific principles and standards that properly address and accommodate public sector specificities. As such, when public sector transactions resemble those taking place in the private sector, principles and standards may be kept as aligned as possible. However, for public-sector-specific transactions, we are in favour of standards that are not adapted artificially from private sector accounting and we think there is a need to seek options that best fit the public sector. This core thesis underpins our proposals and recommendations herein.

**With respect to ED 69**, we understand that the IPSAS Board is sorting out several critical issues, which have been dealt with under IPSAS 41, in order to provide non-authoritative guidance over them. Since non-authoritative guidance from an authority such as the IPSAS Board tends to become authoritative in fact, if not in principle, this move may be hazardous. We encourage the IPSAS Board, therefore, to be more precise and to prevent from diversity in practice, by giving more guidance and by running two separate projects for monetary gold and currency in circulation, especially when answering questions raised in the definition section for the sake of transparency and comparability as prerequisites of the paramount accountability objective.

**Our two main concerns are about 'monetary gold' and 'currency in circulation'. These two items need to be addressed by separate projects. Non-authoritative indications are not sufficient. These projects could be informed by the guidance provided in ESA 2010.**

**Monetary gold** is currently held by central banks as a reserve asset. If gold may be accounted for as a

financial asset, as suggested, it should be valued at current values. In commodity markets, gold current prices have been highly speculative involving material fluctuations. This may undermine a true and fair view of government finances by accounting for unrealised capital gains and losses over gold reserves, while encouraging governments to pursue dysfunctional reactions to those fluctuations. Therefore, **an individual “gold project”** is needed.

**Issued currency** is another critical matter. We differentiate two cases: (a) issuance against debt securities; and (b) without such a purchase.

Ad (a): When a central bank issues currency, it generally buys government debt securities against the issue. These two mutual positions may be offset by consolidation. Accounting for both “issued currency” and the related “government debt” position would result in double counting.

Ad (b): If currency is held by third parties, it seems not faithfully representative to evaluate it as a real right on government assets, since it does generally consist of paper money issued by fiat<sup>1</sup>. Contrary to a financial liability, this is an in-kind conversion that does not involve any “real” financial promise or “real” financial obligation. Issued currency should not, therefore, be accounted for as a liability on the central bank’s balance sheet.<sup>2</sup>

Against the backdrop of those two cases, the IPSAS Board should consider to address the open questions by a **separate “issued currency project”**.

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<sup>1</sup> See Biondi, Y. and Sierra, M. (2018), Financial Sustainability and Public Debt Management in Central Government. in: M. P. R. Bolívar ed. “Financial Sustainability in Public Administrations,” Basingstoke (UK): Palgrave Macmillan Pub. DOI: [http://dx.doi.org/10.1007/978-3-319-57962-7\\_7](http://dx.doi.org/10.1007/978-3-319-57962-7_7), providing further references.

<sup>2</sup> A special non-distributable reserve may be set in the equity section, if the usual threefold classification among asset/liability/equity has to be maintained.

### Specific Matter for Comment 1

**Do you agree with the proposed amendments to IPSAS 41, Financial Instruments?  
If not, what changes would you make to the proposals?**

#### **Scope of ED 69 (amendments to the Basis for Conclusions):**

The IPSAS Board identified seven types of public sector specific financial instruments: 1. Monetary gold; 2. Special Drawing Rights; 3. IMF quota subscriptions; 4. Currency in circulation; 5. Statutory receivables/payables; 6. Concessionary loans; 7. Financial guarantee contracts. (ED 69.BC.3A).

The IPSAS Board agreed to address these instruments, if possible, in the current financial instruments standard (ED 69.BC3D).

##### Rationale/IPSAS Board (scope) conclusions:

1. *Monetary gold*: additional implementation guidance should be developed (ED 69.BC3E);
2. *Currency in circulation*: additional implementation guidance should be developed (ED 69.BC3E);
3. *Special Drawing Rights*: additional implementation guidance should be developed (ED 69.BC3E);
4. *IMF quota subscriptions*: no need for additional guidance, as the features are those of Illustrative Example 32 (ED 69.BC3E), what is to be expressed by a clarifying amendment of Illustrative Example 32;
5. *Statutory payables and receivables*: both do not meet the definition of a financial instrument because they are not contractual. They should be addressed in a separate project (ED 69.BC3B);
6. *Concessionary loans*; and
7. *Financial guarantee contracts*: both are financial instruments and were addressed in the application guidance in IPSAS 41 (ED 69.BC3B).

#### **Response:**

We agree with the decision that there is no further guidance needed for concessionary loans and financial guarantee contracts and to the limited modification of the Illustrative Example 32 (by adding “or similar international organisation”; ED 69 IE211) in order to link this example to IMF quota subscriptions. But **monetary gold and currency in circulation may require more sophisticated guidance than that provided by ED 69**. Therefore, the IPSAS Board should consider initiating two separate projects one for gold and another one for issued currency. Also, each project could be informed by the guidance and the case distinctions in ESA 2010.

<b>Monetary Gold</b> (amendments to the Basis for Conclusions):	<b>Monetary Gold</b> (amendments to the Implementation Guidance: Section B: Definitions):
<p>“As part of the Public Sector Financial Instruments project, the IPSAS Board considered accounting for gold held by monetary authorities as reserve assets that are available to monetary authorities in carrying out their mandates, i.e., monetary gold. Some constituents indicated the scope of IPSAS 41 should be expanded to include monetary gold as it shares several characteristics with a financial asset. For example, monetary gold is:</p>	<p><b>“Is monetary gold a financial instrument (like cash)?</b></p>
<p>a. Readily convertible into cash;</p>	<p>No. Similar to gold bullion, monetary gold is not a financial instrument as there is no contractual right to receive cash or another financial asset inherent in the item. However, given that monetary gold has many of the characteristics of a financial asset, applying the principles set out in IPSAS 41 is generally appropriate under the hierarchy set out in paragraphs 9–15 of IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors. It may however be appropriate for an entity to consider other IPSAS depending on the facts and circumstances related to its holding of monetary gold.” (ED 69 IG.B1.1.1.)</p>
<p>b. Quoted globally in US dollars;</p>	
<p>c. Easily traded with willing counterparties (durable, divisible and portable);</p>	
<p>d. Accepted as a form of payment by some central banks; and</p>	
<p>e. A store of wealth.</p>	
<p>Furthermore, monetary gold can be held:</p>	
<p>a. For its contribution to financial capacity because of its ability to be sold in the global liquid gold trading markets; and</p>	
<p>b. For an indeterminate period of time, because it provides confidence in the monetary authority’s financial strength and ability to carry out its activities.” (ED 69.BC18A)</p>	
<p>Nevertheless, “monetary gold is not a financial instrument. ... there is no contractual right to receive cash or another financial asset.” (ED 69.BC18B)</p>	
<p>As the IPSAS Board does not expand the scope of IPSAS 41, the reporting entity could conclude, that the principles of IPSAS 41 could be appropriate for monetary gold when closing the respective accounting gap for monetary gold in applying “the hierarchy set out in paragraphs 9–15 of IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors.” (ED 69.BC18C)</p>	
<p>“... the hierarchy set out in IPSAS 3 requires an entity to assess all facts specific to the circumstances related to the holding of monetary gold. Should an entity account for monetary gold using principles consistent with those applied to financial assets, the IPSASB expects all classification and measurement requirements set out in IPSAS 41 to be applied.” (ED 69.BC18D)</p>	

## Response:

We agree with the decision not to expand the scope of IPSAS 41. However, current rules allow for a broad range of measurement opportunities, resulting in a foreseeable diversity in practice.<sup>3</sup> In addition, the analogous application of IPSAS 41 results in solutions that seem to be neither convincing nor appropriate. Therefore, the IPSAS Board should consider running **an individual project on monetary gold**. The reasoning behind our conclusion is indicated above (in the section “Core assumptions”) and in the following.

Accounting practice requires compliance with the IPSAS 3.9-15 hierarchy. We agree that this could result in an accounting policy to be derived from IPSAS 41. Nevertheless, we encourage the IPSAS Board to be more precise on alternative measurement possibilities (perhaps according to IPSAS 16 or 17 - see below), because it has been argued that, an IPSAS 41 analogy is one possibility (“could”), and because the measurement consequences of an analogous IPSAS 41 application do not seem to be appropriate.

What are the consequences of an IPSAS 41 application? Monetary gold held (a) as a contribution to financial capacity; and (b) to strengthen confidence, which has to be classified by two criteria:

- management model: here “hold (and sell)”,
- contractual cash flows (i.e. payments for the principal and interests on the principal outstanding): here no contractual cash flows.

According to this, monetary gold should be measured “at fair value through surplus or deficit”<sup>4</sup>. To our mind, however, monetary gold serving as reserve asset should **rather be measured at amortized cost** for the sake of accountability, as its fair value changes do not reflect any kind of “performance”. This is why the fair value measurement does not seem to be appropriate.

With respect to the status quo, how can more appropriate measurement alternatives be identified? In applying the IPSAS 3 hierarchy, a reporting unit could find an analogy between land (held as a reserve asset) and monetary gold (held as a reserve asset) because both are non-monetary and non-depreciable assets that support the “business model” – perhaps for more than one period – by (indirectly) fostering its operational capacity. Following these basic similarities, IPSAS 17 (rather than IPSAS 16) could be considered for analogous application. Consequently, monetary gold could be measured “at cost” according to IPSAS 17 (or IPSAS 16 alternative treatment) or “at fair value through net assets/equity” (revaluation option included in IPSAS 17) or “at fair value through surplus or deficit” (preferred treatment according to IPSAS 16, but, in our opinion, inappropriate for monetary gold).<sup>5</sup>

**Summarizing**, we agree that the hierarchy set out in paragraphs 9-15 of IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors, has to be applied. However, considering all facts and circumstances related to the holding of monetary gold, this consideration could lead to a broad range of accounting policies (e.g. derived from IPSAS 16, 17, or 41). Therefore, we encourage the Board to **run an own project for the monetary gold item**, instead of the proposed amendments to IPSAS 41. Otherwise, more guidance is needed as to which IPSAS (besides IPSAS 41) is considered to be appropriate for measuring monetary gold (and why); and at least one example should be given.

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<sup>3</sup> <https://www.cemla.org/actividades/2019-final/2019-04-banca-contabilidad-finanzas/2019-04-banca-contabilidad-finanzas7.pdf>; <https://www.centralbanking.com/central-banks/governance/financial-reporting/4500011/a-spotlight-on-ipsas-draft-69>.

<sup>4</sup> The irrevocable option to measure “at fair value through net assets/equity” is limited to equity instruments (IPSAS 41.43) and therefore not available.

<sup>5</sup> The subsequent measurement alternative “at fair value through net assets/equity” means, that fair value changes should be disaggregated in “gold price” and “foreign currency (i.e. US-\$) effects”, because US-\$ are considered as transaction currency for gold and currency effects must be recorded in surplus and deficit according to IPSAS 4 (The Effects of Changes in Foreign Exchange Rates). As explained above, these effects may provide potentially harmful information for decision-making and accountability purposes.

### Currency Issued as Legal Tender (amendments to the Implementation Guidance: Section B: Definitions):

#### “Does issuing currency as legal tender create a financial liability for the issuer?”

It depends. Currency derives its value, in part, through the statutory arrangement established between the issuer and the holder of the currency whereby currency is accepted as a medium of exchange and is recognized legally as a valid form of payment. In some jurisdictions, this statutory arrangement further obligates the issuer to exchange currency when it is presented by holders and may explicitly indicate that currency is a charge on government assets.

For the purposes of this Standard, an entity considers the substance rather than the legal form of an arrangement in determining whether there is a contractual obligation to deliver cash. Contracts are evidenced by the following:

- Willing parties entering into an arrangement;
- The terms of the contract create rights and obligations for the parties to the contract; and
- The remedy for non-performance is enforceable by law.

When laws and regulations or similar requirements enforceable by law, such as a banking act, set out the requirements and responsibilities of an entity to exchange outstanding currency, a “contract” exists for the purposes of this Standard. A financial liability is created when an entity issues currency to the counterparty as, at this point, two willing parties have agreed to the terms of the arrangement. Prior to currency being issued, there is no transaction between willing parties. Unissued currency does not meet the definition of a financial instrument. An entity applies paragraph 13 of IPSAS 12, Inventories, in accounting for any unissued currency.” (ED 69 IG.B1.2.1.)

#### Response:

The IPSAS Board should reconsider to run a **separate project on issued currency**, as the proposed amendment to IPSAS 41 raises concerns and requires differentiations:

- by transactions (e.g. – besides unissued currency – (a) currency issued against government debt securities; and (b) other issuance of currency); and
- by systems (e.g. fiat money regimes).

The reasoning behind our conclusion is indicated above (please refer to the section “Core assumptions”) and in the following.

We agree with the conclusions:

- to measure unissued currency according to IPSAS 12.13 (Inventories), but encourage the IPSAS Board to clarify the point in time, when printed, coined (or digital e-) currency turns from inventory to issued currency.
- to the existence of a contract, if a banking act for example, requires the exchange of outstanding currency.

However, for the assessment of whether the existence of a contract leads to a financial liability, when an entity issues currency to the counterparty, substance over form considerations are needed, especially in fiat money regimes. The crucial point for the treatment of the case (b) here is against what the outstanding currency has to be exchanged by its issuer. Under fiat money regimes, the central bank only promises to convert old currency (i.e. old bills) to new currency (i.e. new bills) at par. This implies an in-kind conversion at nominal value, which, in substance, does not involve any financial promise or financial obligation concerning the economic value of the currency or its conversion in another asset (such as gold). **Unless the laws and regulations require the issuer to convert currency into another financial asset, no financial liability is created.**

Moreover, pro-cyclical effects and feedbacks may be generated between the valuation of currency as a financial liability (for the central bank, and a financial instrument when held by the government) at its current exchange rates, and the public debt value dynamics (and its underlying credit worthiness). For instance, when the exchange rate goes up, the issued currency becomes more valuable in terms of foreign currencies, while the corresponding central bank liability increases in value, generating holding capital losses for the central bank that issued it.

Special Drawing Rights Holdings (SDR) (amendments to the Implementation Guidance: Section B: Definitions):

“Do Special Drawing Rights Holdings (SDR) meet the definition of a financial asset?”	“Do Special Drawing Rights Allocations meet the definition of a financial liability?”
Yes. SDR holdings represent a claim on the currencies of members of the International Monetary Fund (IMF). SDR’s can be used in transactions with the IMF or can be exchanged between participants of the IMF’s SDR Department. Liquidity is guaranteed by a mechanism requiring participants to deliver cash in exchange for SDRs. Accordingly, SDR holdings are regarded as a financial asset.” (ED 69 IG.B1.2.2.)	Yes. SDR allocations represent the obligation assumed when SDR holdings are distributed to members. IMF members must stand ready to provide currency holdings up to the amount of their SDR allocation. This represents a contractual obligation to deliver cash. Accordingly, SDR allocations are regarded as a financial liability. ...” (ED 69 IG.B1.2.3.)

**Response:**

We agree with these interpretations.

Furthermore, we agree in the differentiation of SDR holdings and allocations leading to separate assets and liabilities with separate disclosures and no offsetting option.<sup>6</sup>

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<sup>6</sup> Centralbanking: A spotlight on ED 69 (<https://www.centralbanking.com/central-banks/governance/financial-reporting/4500011/a-spotlight-on-ipsas-draft-69>).

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Signed on behalf of the persons listed below:

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