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To: The Members of the International Public Sector Accounting Standards Board (IPSASB)

IMF Comments on The Consultation Paper on Public Sector Specific Instruments[1] [2]

Thank you for the opportunity to review the Consultation Paper on Public Sector Specific Financial Instruments.

Our comments cover some general remarks on the context within which these pronouncements are being developed, as well as some detailed responses, including our thoughts on the IPSASB's preliminary views on the topics covered in the Consultation Paper.

I. GENERAL COMMENTS

1. **We have some reservations on the broad context within which the IPSASB will potentially be issuing pronouncements on these topics**. The IPSASB develops and issues standards to be used for the preparation of general purpose financial statements by governments and other public sector entities. The IPSASB defines the public sector entities to include "…national and sub-national (regional, state/provincial, and local) governments and related governmental entities" as well as international public sector organizations. Government business enterprises are excluded from the scope.

Broadly speaking, the Consultation Paper considers two categories of transactions, and the associated financial statement elements:

- Transactions entered into principally by monetary authorities and certain international organizations – specifically, currency in circulation and monetary gold;
- Transactions between the IMF and its members, as well as other transactions denominated in Special Drawing Rights;

[1] The following departments contributed to these comments: Fiscal Affairs, Finance, Statistics, Monetary and Capital Markets.

With regard to the first category, we note that monetary authorities do not as a general rule adopt International Public Sector Accounting Standards (IPSAS) as their financial reporting framework. The monetary authority function are usually captures in the activities of the central bank—these entities are part of the public financial corporation sector. Therefore, they would be excluded from the scope of the IPSASs. It seems therefore that the paper does not really recognize the applicability of the guidance on the distinct entities that deals with these topics and may therefore become irrelevant.

Moreover, as far as we are aware, the Reserve Bank of New Zealand is the only central bank that reports in accordance with IPSAS. Our research suggests that the majority of central banks apply either International Financial Reporting Standards (IFRS) or the European Central Bank guidelines. Accordingly, there may be questions as to the status and authority of any pronouncements that may emanate from this project – especially as the accounting issues around monetary gold and currency in circulation are already the subject of ongoing discussion and debate in other fora. It is therefore unclear that IPSASB pronouncements on these topics would be authoritative.

With regard to the second category of transactions, which are covered in detail in Chapter 5 and Appendices E and F, we note that the material draws heavily on the *IMF Financial Operations 2015* publication (per the acknowledgment in Appendix E). The IMF updates this publication annually, hence it is likely to be more up to date than any pronouncement that the IPSASB may issue on this topic. More fundamentally, we are not convinced that additional IPSAS guidance in this area is necessary. Accounting for IMF transactions should reflect member-specific legal and institutional frameworks, and accounting treatments follow from these arrangements. Accordingly, we do not believe that a universal standard for these transactions is feasible. The IMF provides its members, on an ongoing basis, with general guidance on the nature of the transactions and accounting considerations.

2. **We have reservations about the specifically proposed definitions**. We question the need to create separate "accounting definitions" (of terms such as monetary authority, reserve assets, monetary gold, IMF related assets and liabilities) for concepts that are already well understood and established in the existing guidelines on the international monetary/economical architecture. These definitions were carefully crafted after extensive negotiations with the international community and are also contained in guidelines such as the System of National Accounts Manual and the Balance of Payments Manual, Government Finance Statistics Manual, etc.). While we recognize and appreciate attempts to align with these existing definitions, we are concerned that the remaining departures may lead to unintended differences in accounting and statistical/economical recording.

3. **We have concerns about the extent to which the development of this standard serve the public interest**. The issues raised in the Paper concern a very limited population of preparers of financial statements (in the case of monetary authorities, fewer than 200, of which very few are part of government as defined in IPSASs). Many of these entities, as noted above, already apply recognized accounting frameworks for general purpose financial reporting, such as International Financial Reporting Standards. Whilst we agree that the

transactions covered by this project are of legitimate public interest, we do not believe that a compelling case is made as to why or how IPSASB pronouncements would address a public interest need that is not being adequately met by existing financial reporting in the financial sector. We are of the view that there are likely to be more pressing public interest imperatives in other areas of the IPSASB's purview.

II. DETAILED COMMENTS

Chapter 2: General Definitions

4. **We don't agree with the proposed definitions *of* Monetary Authority and Reserve Assets**. The stated objective is to ensure consistency with Government Financial Statistics (GFS) (paragraph 2.9 of the CP) – This reference should rather be to the statistical basis of reporting since the details of some of the definitions were derived from Balance of Payments Manual 6 (BPM6)/2008 System of National Accounts (2008 SNA), etc. rather than GFS. But, in spite of this stated objective the definitions depart significantly from that used in the statistical basis of reporting.

While the proposed definitions are derived from the BPM6 and other statistical guidelines, they are simplified and at times word exchanges made them imprecise. We caution against simplification of the existing established concepts as it opens them up to misinterpretation. The discussion in the chapter and in the accompanying Appendix A repeats the selected parts of BPM6 but does not offer any new analysis to justify the departure from the established definitions. Examples of departures from BPM6 include:

- The CP's definition of reserve assets refers to assets *held by* monetary authorities, whereas BPM6 refers to assets that are *controlled* by monetary authorities. Further it includes a closed catalogue of objectives, while the BPM6 refers to "other related purposes". Assets could potentially be held by a monetary authority on behalf of a depositor, without the monetary authority having sufficient control over the asset to be able to use it as a reserve asset. Therefore, the exchange of the word in the definition may have significant implications in the calculation of the amount of reserve assets.

- The monetary authority definition in the CP is based on an entity concept, whereas the BPM6 definition uses a functional concept. As it stands, the CP definition would imply that the entire entity carrying an operation attributable to a central bank (e.g., a Sovereign Wealth Fund managing a portion of official reserves) could be considered a monetary authority. Furthermore, the list of functions of the monetary authority seems to omit other responsibilities such as transacting with the IMF, financial stability, supervision of the financial sector, etc.

- Paragraph 2.7 could be further enhanced by: indicating that "foreign currency" should be "convertible foreign currency"; adding "the Reserve Position in the IMF" as a component; and making the distinction that it is the "holdings of Special Drawing Rights (SDRs)" that are included (the allocations of SDRs are not included).

Chapter 3: Currency in Circulation.

5. **We broadly agree with the preliminary views on the definition of currency in circulation and the liability recognition of notes and coins upon issuance**. However, the CP discussion skirts around two issues in this area that are of relevance to financial reporting by central banks—namely, the de-recognition of liabilities and the pattern of expensing/amortizing the production costs. For completeness of the discussion, it would be beneficial to address these specific issues and analyze them with reference to the Conceptual Framework principles. The linkages with the income statement of the reporting entities could usefully also be addressed.

It is our understanding that many central banks, including those reporting under International Financial Reporting Standards (IFRS), have concluded that currency in circulation meets the definition of a liability under the financial instruments standards. However, the timing of de-recognition has been subject to debate when central banks contemplate extinguishment of liabilities for currency that is estimated to have been destroyed outside of central bank control. This is less of an issue in demonetization when a legal obligation is clearly cancelled.

The CP touches on currency production costs and concludes that they should be treated in accordance with IPSAS 12, *Inventories*. While this appears reasonable based on the observed practices, it would also be beneficial to extend the discussion to the methods for expensing or amortizing such costs. [Will reference to Inventory concepts help the users justify a common practice of amortizing currency production costs over the life of the notes?]

Lastly, we have some difficulty understanding the logic of the arguments presented in *Approach 2: Revenue*. We assume the discussion centers around initial recognition upon issuance, not de-recognition when a legal obligation is extinguished (e.g., when currency is cancelled and replaced). We struggle to understand the objectives of issuing currency without an underlying legal obligation.

6. **Footnote 8 requires further clarification**. The reference to delegation of responsibility may be misleading. Usually, these commercial banks are authorized to issue currency fully backed by deposits with the central bank. The sentence should therefore read "In some jurisdictions commercial banks are authorized to issue currency fully backed by deposits with the central bank.

7. **Paragraph 3.12 could usefully clarify** that commemorative coins are held for their numismatic value and should be excluded from currency in circulation.

8. **The description of the monetary base in paragraph 3.17 is incomplete and should be further enhanced.** The sentence should read The monetary base is the amount of

physical currency in circulation, deposit balances banks and depository institutions hold with the monetary authority, securities held by banks that can be used to constitute reserve requirements, and those deposits of other sectors of the economy at the central bank that are included in the national definition of broad money."

9. Paragraph 3.43 and Specific Matters for Comment Chapter 3-1 should be reconsidered. From the perspective of monetary statistics, issuance of currency by the central bank does always result in the creation of a liability (currency in circulation). Similarly, GFS recognizes the issuance of currency as a liability. Approach 1, recognizing these as liabilities is therefore the preferred option because it will eliminate differences in recording between accounts and statistics. Therefore, in our opinion the discussion on where to allocate the "revenue" is not appropriate. Furthermore, some consideration should be given to the identical treatment of bank notes and coins from a liability perspective. Notes and coins in circulation are managed differently during their life cycle. Notes are generally expected to be returned for replacement, while coins are never expected to be returned, but could be destroyed over time. Careful consideration of recording of respectively notes and coins under these circumstances should be added.

Chapter 4: Monetary Gold.

10. **We don't agree with the proposed definition for monetary gold**. Similar to Chapter 2, the definition of monetary gold is not entirely consistent with the established definitions under BPM6 and the statistical basis of reporting. These differences may be open to misinterpretation. The BPM6 definition refers to both "title" and holding, whereas the proposed definition in the CP refers only to holding. Since the monetary authority could also hold gold on behalf of another entity (i.e., gold that they don't have title to), the difference in the definition could result in significant differences in recording.

More importantly, the CP definition refers to tangible gold that is defined as physical gold that has a minimum purity of 995 parts per 1000. In terms of the well-established international financial architecture, the gold referred to in the BPM definition includes gold bullion and unallocated gold accounts with nonresidents that give title to claim the delivery of gold. This aspect of the monetary gold definition is totally absent from the CP and may lead to large discrepancies between accounts and statistical reporting.

11. **We agree with the CP's conclusion that monetary gold meets the definition of an asset** and recognize the importance of the factors considered in the discussion on the measurement basis. We note, however, that the measurement discussion is largely based on accounting criteria for existing classes of assets under the Conceptual Framework (i.e., financial instruments, inventories, or property, plant, and equipment). For consistency with IFRS, it would be important to bear in mind that the IASB has concluded that gold bullion does not meet the IFRS definition of a financial instrument. It would be beneficial to consider a rationale for treating gold as a class on its own and further analyze its recognition, presentation and measurement independently under the Conceptual Framework principles.

12. **Paragraph 4.5 seems to draw an analog with debt securities held to maturity.** It is our opinion that these arguments are irrelevant for the valuation of gold, which should be valued at market prices. Debt securities have a definitive maturity profile determined by the date when those securities held to maturity will be converted to cash, and therefore the exception is to not use market values for these instruments. This is not the case for gold, which does not have a redemption date, and therefore the value of the instrument will not be influenced by such a maturing date.

13. **With regards to the valuation of monetary gold, we strongly argue that market values rather than historical cost should be considered as the basis for valuation.** As is the case for any other asset for which a market exist, gold should be valued at market prices. The service potential of monetary gold is its international price multiplied by volume. Considering a different valuation bases depending on the intention of use of the gold will complicate the measurement basis without providing more reliable and faithful information. Even in the case where a monetary authority holds the gold for an indeterminate period, market value should be use. The gold as component give the certainty to counterparts in international transactions that if all else fails, a country can sell the gold at market value and pay its debts.

While we agree that both historical cost and market value provide information which could be useful to users, historical cost becomes irrelevant, in particular in cases where these assets were acquired a very long time ago. Historical cost could lead to over or in most cases undervaluation, depending on the economic conditions when the gold was acquired. For example, the monetary gold held by the Bank of England, would probably be worth very little according to historical cost, yet the economic value as part of the reserve assets will be significantly different. In some cases, historical cost for such gold might not be available for gold acquired many years ago.

Chapter 5: IMF Quota Subscription and Special Drawing Rights.

14. **We don't agree with the preliminary views in Chapter 5-1 (following paragraph 5.12) on the definitions of IMF Quota Subscription, SDR Holdings and SDR Allocations.** The definitions included in Chapter 5-1 tend to rephrase what the IMF has already disseminated to the general public in many of its publications. To provide a full and accurate description of the terms, our preference would be to quote directly from IMF official publications (e.g. Government Finance Statistics Manual, Financial Operations Manual, Balance of Payments Manual, IMF website factsheets) and also make references to such publications. These small differences in the definitions may have unintended consequences.

15. **We support the Preliminary Views in Chapter 5-2 (following paragraph 5.33) concluding that the IMF Quota Subscription and SDR Holdings are assets and that SDR Allocation is a liability.** However, we suggest that some of the underlying arguments be further strengthened. In this regard, IMF members are entitled to encash their reserve

tranche positions (a portion of their quota subscriptions) at any time upon a representation of a balance of payments need. Moreover, quota subscriptions are fully refundable upon withdrawal from the IMF. With respect to SDR holdings, they represent the potential claim on the freely usable currencies of other participants in the SDR Department. Participants have full ownership of and unconditional rights to use their SDR holdings without undertaking the economic policy measures required of normal IMF financing or repayment obligations.

16. **We are not in favor of the recommendation for the subsequent measurement of the IMF Quota Subscription**. Notwithstanding the fact that IMF quota subscriptions are not marketable financial instruments, they are denominated in SDRs which are measured at market value (see further explanations below). Since members account for the IMF Quota Subscriptions in their own currencies, the measurement basis should be the market value and any fluctuations in the carrying value would give rise to foreign exchange gains and losses. In our view, the reference to events (e.g. redemption) that are considered to be equivalent to a sale is irrelevant in this context.

17. **We agree with the conclusion that SDR holdings should be measured at market value**, even though the value of the SDR is set in accordance with the methodology stipulated by the IMF. In practice, the value is calculated as the sum of the specific amounts of the basket currencies valued in U.S. dollars on the basis of market exchange rates.

On the other hand, the Consultation Paper could further elaborate on the rationale for the measurement of SDR allocations. Our view is that the SDR Department is a closed system and the values of SDR holdings and SDR allocations must be identical. Furthermore, upon cancelation of the SDR allocation or liquidation of the SDR Department, each participant must pay the IMF an amount equal to the SDR canceled or the net cumulative allocations as the case may be. Since such obligations are denominated in SDR terms, the measurement basis of SDR allocations should also follow that for SDR holdings, i.e., market value.

Additional Detailed Comments on Chapter 5

Reference	Description	Comments
5.1	Chapter objective	The accounting for the IMF's holdings of member countries' currencies, an integral part of members' financial positions with the IMF, is omitted.
5.4	Introduction - Value of the SDR	The Chinese Renminbi is now officially a component of the SDR currency basket—the basket therefore now comprises five currencies.
5.10	Currency valuation adjustments	IMF members are required to maintain the value of the IMF's holdings of their currencies in terms of the SDR. The IMF revalues periodically its holdings of members' currencies, but not their quota subscriptions, and members are obligated to settle the resulting valuation adjustments promptly. As the currency holdings could be above or below the members' quotas, the adjustment is not limited to members' quota subscriptions.
5.13	Reserve tranche position	Members' voting rights are determined on the basis of basic votes and quota-based votes. 5.13(a) could be rephrased to note that voting rights are largely determined by a member's relative quota size. 5.13(b) should be revised to read "*payments of interest from the IMF based upon a member's reserve tranche position, if any*."
F/N 38	Limits on access to IMF financing	The new limits for IMF Standby Arrangements and Extended Fund Facility are 145 percent of quota per annum and 435 percent cumulatively.
5.18	Uses of SDRs	The right to use SDRs is not limited to obtaining freely usable currencies. Holders of SDRs may also use them in settlement of financial obligations, loans, swaps, forward operations and grants.
5.19	Obligations of participants in the SDR Department	The obligation for designated participants to provide freely usable currencies does not render SDR allocations a liability since SDR allocations would remain the same. Moreover, only participants whose balance of payments and reserves positions are deemed sufficiently strong could be designated to provide freely usable currencies in exchange for SDRs (up to a limit of 300 percent of their net cumulative SDR allocations). SDR allocations are a liability because of the obligation to repay the IMF upon a cancellation of SDR allocations or termination of participation in the SDR Department.
Table 5.1, p. 40	IMF quota subscription	The assertion that IMF members' cost of borrowing for foreign currency by virtue of their quota subscriptions is lower because of the SDR market is unsupported by empirical evidence. The nature of the SDR market should also be clarified.
Table 5.1, p. 40	IMF quota subscription	The modalities for quota payments are irrelevant in the determining whether control of the resources exists and their inclusion could be misleading. Suggest deletion (see also comment on the definition of IMF quota subscription below). In addition, the reserve asset portion of quota payment is 25 percent (not a minimum of 25 percent) for quota increases.

Table 5.1, p. 41	SDR holdings	Participants in the SDR Department can conduct SDR transactions with other participants and prescribed holders (primarily international financial organizations).
Table 5.1, p. 42	SDR allocations	Replace "*the SDR program*" with "*the SDR Department*".
5.23	Definition of the IMF quota subscription	An alternative view is that quota payments are essentially an exchange of assets (reserve asset payment) and the incurrence of a liability (domestic currency payment).
5.25	SDR allocations	SDR allocations are not an obligation to other IMF members. They represent obligations to repay the IMF upon the cancellation of SDR allocations or a participant's termination of participation in the SDR Department.
5.27	IMF quota subscription	It is unclear how the benefits related to enhanced operational capacity accorded by IMF membership can be measured. This assertion also appears to contradict the conclusion that value in use is not an appropriate factor for consideration (Table 5.2, p. 47).
Table 5.2, p. 45	Measurement basis (historical cost) for IMF quota subscriptions	The distinction between "*additional adjusting contributions to or redemptions from the IMF required as a result of exchange rates fluctuations of a member's domestic currency*" and "*the change in "translated value of the quota subscription*" is unclear. The former appears to refer to the adjustment arising from the revaluation of the IMF's holdings of a member's currency (a member's liability), while the latter is the revaluation of the IMF Quota Subscription (an asset).
Table 5.2, p. 46	Measurement basis (market value) for IMF quota subscriptions	The net selling price upon redemption is not defined and transaction costs are not a relevant consideration. Regardless, IMF quota subscriptions are denominated in SDRs and 'the redemption price" does not fluctuate.
Table 5.2, p. 46	Measurement basis (market value) for SDR allocations	The arguments supporting the conclusion that SDR holdings should be measured at market value do not apply to SDR allocations, which do not have "an open, active and orderly market". Nevertheless, the value of SDR holdings could be a proxy for the value of SDR allocations since the two values are identical by design.
Table 5.2, p. 47	Measurement basis (net settling price) for SDR holdings	The SDR Department does not levy fees on SDR transactions.
Table 5.2, p. 47 and 48	Measurement basis (cost of fulfillment and cost of release) for SDR allocations	Settlement of SDR allocations is not at the discretion of other IMF members.
5.31-5.33	IMF quota subscription, SDR holdings and allocations	The assertion that some IMF members account for these items as stated should be backed up with benchmarking or survey results.
5.33	SDR allocations	The analysis underlying the measurement of SDR allocations at amortized cost is missing in Table 5.2. As noted above, the measurement bases for SDR holdings and allocations should be the same.

Appendix E	IMF Information	The SDR Section duplicates portions of the IMF's Financial Operations Manual (Chapter 4, Special Drawing Rights). Consider replacing this section with a reference to the Manual via IMF's website (http://www.imf.org/external/pubs/ft/finop/2015).
Appendix F	Illustrative Examples	The examples provided are more extensive than the guidance IMF provides to its members to assist in accounting for and reporting the financial operations between the IMF and its members. Several operations for which scenarios are given are not applicable to the concepts discussed in Chapter 5. The scope of this Appendix should be substantially narrowed to cover only financial operations relating to IMF Quota Subscriptions and the allocation of SDRs.

Sincerely yours,

Rainer Koehler
Division Chief
Government Finance Division
Statistics Department