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14 December 2016

Dear Sir/Madam

COMMENT ON CONSULTATION PAPER: PUBLIC SECTOR SPECIFIC FINANCIAL INSTRUMENTS

The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario M5V 3H2 Canada

We welcome the opportunity to comment on Consultation Paper: *Public Sector Specific Financial Instruments.*

The Consultation Paper, *Public Sector Specific Financial Instruments* aims to establish approaches for recognizing and measuring public sector specific financial instruments.

Overall, we are supportive of the IPSASB's Consultation Paper: *Public Sector Specific Financial Instruments*. Our responses to the preliminary views and specific matters for comment are listed below.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

KPMG Services Proprietary Limited

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KPMG Services Proprietary Limited is not a Registered Auditor in terms of the Auditing Profession Act, 26 of 2005 and does not provide audit services as defined in Section 1 of this Act.

Registration number 1999/012876/07

Policy Board:
Chief Executive: TH Hoole

Executive Directors: N Dlomu, M Letsitsi, SL Louw, NKS Malaba, M Oddy, M Saloojee, CAT Smit

Other Directors: ZA Beseti, ZH De Beer, LP Fourie, N Fubu, AH Jaffer (Chairman of the Board), FA Karreem, ME Magondo, F Mall, GM Pickering, JN Pierce, T Rossouw, GCC Smith

The company's principal place of business is at KPMG Crescent, 85 Empire Road, Parktown, where a list of the directors' names is available for inspection.

PRELIMINARY VIEWS & SPECIFIC MATTERS FOR COMMENT

Preliminary View – Chapter 2:

Do you agree with the proposed definitions of Monetary authority and Reserve assets?

With regard to the proposed definition of "Monetary authority" in paragraph 2.3 of the CP, we suggest that the IPSASB considers the following:

"Monetary authority is defined as an entity or entities with the mandate to oversee the issuance and maintenance of a certain currency, management of reserve assets, and operation and administration of exchange rate stabilization funds. Generally a monetary authority is a central bank. In limited circumstances a monetary authority may be (or include) a regional entity, e.g. the European Central Bank."

With regards to the proposed definition of "Reserve assets", we recommend that the IPSASB considers the following:

"Reserve assets comprise valuable commodities such as gold bullion, foreign currencies and other external assets and financial capital held by monetary authorities, such as central banks, to finance trade imbalances, check the impact of foreign exchange fluctuation and address other issues under the purview of the central bank. Reserve assets should be highly liquid and under the monetary authority's control."[1]

Following the above, we would suggest that the CP include an explanation of "highly liquid" in paragraph 2.7 and clarify if it is the same concept as in other IPSASs. For example IPSAS 2: *Cash Flow Statements* standard defines cash equivalents as highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Preliminary View – Chapter 3-1:

Do you agree with the proposed definition of Currency in Circulation?

We support the proposed definition of Currency in Circulation.

We suggest that the IPSASB defines the term "legal tender" and provides guidance to clarify, for example, in a country such as Zimbabwe that trades in US dollar, that US dollar would not be considered Currency in Circulation as it was not issued by, or on behalf of the monetary authority of Zimbabwe, or a monetary authority in a currency union to which Zimbabwe belongs (i.e. Zimbabwe is not in a currency union with the United States).

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[1] Adapted from http://www.investopedia.com/terms/r/reserve-assets.asp

We also suggest that the IPSASB clarifies whether items such as the proposed Zimbabwean bond notes, pegged to parity with the US dollar and considered to be legal tender only in Zimbabwe, would be considered physical notes and coins and meet the definition of Currency in Circulation.

Preliminary View – Chapter 3-2:

Do you agree that the accounting treatment should be consistent for notes and coins, with the recognition of a liability when issued?

We are of the opinion that the accounting treatment should be consistent for notes and coins, with the recognition of a liability when issued, if a present obligation exists as per paragraph 3.23 or 3.24. It should be noted that the legislation for notes and coins could differ in some countries, which would result in different accounting treatments being applied. For example, the Eurosystem only issues notes, and coins are issued by national governments. Consequently, the value of the coins do not appear as a liability in the balance sheets of the Eurosystem central banks.

We believe that the most appropriate measurement basis of the liability is market value as it will result in a liability equal to the cumulative face value of the currency issued by the monetary authority. This will result in consistent measurement with the GFS, which measures the liability at the full face value.

Specific Matter for Comment – Chapter 3-1:

Do you agree that the absence of a present obligation upon issuance of the currency, results in the recognition of revenue, and what is the appropriate statement in which to recognise revenue?

Given the definition of currency in circulation in paragraph 3.5 of the CP, which includes the concept of 'legal tender', we suggest it is important to explain the context of how there could be situations where a present obligation does not exist upon issuance of a currency.

We recommend that IPSASB consider explaining how 'the absence of a present obligation could arise and clarifying that it is not envisaging a situation whereby a monetary authority would issue currency notes and coins without intending to honour them as legal tender.

A situation where the question of whether present obligation associated with the issuance of currency notes/coins exist could be when a central bank replaces an old series of currency notes/coins with a new series rendering the old series obsolete and not legal tender after a certain timeline. We understand that after the expiration of the timeline, there could be a certain amount of currency notes/coins in the old series remaining outside the central bank, giving rise to two accounting questions; how to estimate the amount of such old currency notes/coins and how to account for them in the financial statements. The CP is lacking in guidance on how to estimate, for example, whether there is basis for using statistical models based on the number of years the currency notes/coins had been in issue and the number of years past the timeline for exchange.

There could be other similar and limited circumstances when an entity assesses that a present obligation does not exist and our view is that the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (Conceptual Framework) supports the amount being recognised in revenue [Conceptual Framework, paragraph 5.2].

Preliminary View – Chapter 4:

Do you agree with the proposed definitions of Monetary gold and Tangible gold?

It is unclear why the CP restricts the definition of 'Monetary gold' to include only tangible gold held as reserve assets. Gold instruments with foreign counterparties could potentially be held as reserve assets, but the proposed definition would exclude them as monetary gold. If this is intentional, it would be very helpful if the CP explained the rationale for such a narrow definition.

We agree with the proposed definition of Tangible gold. We recommend that the IPSASB specifies whether Tangible gold includes refined gold, unrefined gold or both and it would be helpful to include comments on how the definition relates to gold bullion, a commonly used and understood term.

Specific Matter for Comment – Chapter 4-1:

Should entities have the option to designate a measurement basis, based on their intentions in holding monetary gold assets?

We are of the opinion that entities should have the option to designate a measurement basis based on their intentions in holding monetary gold assets.

We agree with the analysis provided in paragraphs 4.25 to 4.29 of the CP relating an entity's intention for holding monetary gold to the different measurement basis. We believe that allowing entities to designate a measurement basis based on their intention would result in consistency of accounting treatment on monetary gold that is held with similar intentions if there are sufficient safeguards in the proposed standard. For example, there should be clear guidance on:
- How to designate and quarantine each type of designation;
- Critical points when intention changes;
- What to do when an entity changes its intention with regard to the monetary gold reserve assets;
- Consistency of application year-on-year; and
- Appropriate disclosures.

Specific Matter for Comment – Chapter 4-2:

Under what circumstances would it be appropriate to measure monetary gold assets at either market value or historical cost?

In our view, monetary gold assets held for their contribution to financial capacity because of their ability to be sold in the global liquid gold market should be measured at market value as this will reflect the entity's financial capacity and provide comparability with other monetary authorities [Conceptual Framework paragraph 7.34]. If monetary gold is held to provide services in future, the resources available to provide those services would be equal to the market value of the monetary gold at that point in time. However, if the market value is lower than the historical acquisition cost of the monetary gold, then the market value is likely to be less relevant than the historical cost [Conceptual Framework paragraph 7.33].

If the market value is used to remeasure monetary gold assets, changes in the value of the monetary gold assets should be recognised in the statement of financial performance as indicated in the Conceptual Framework, paragraph 5.31.

Under International Financial Reporting Standards (IFRS), there is potential for recognising increases in the value of the monetary gold assets in 'other comprehensive income' (OCI) if a central bank considers monetary gold assets held for their contribution to financial capacity as fixed assets or property, plant and equipment, the terminology used in IFRS. Under IAS 16 *Property, Plant and Equipment,* revaluation gains, other than a reversal of a revaluation loss previously recognised in profit or loss, are recognised in OCI and accumulated in equity under the heading of revaluation surplus. Conversely, revaluation decreases are taken to profit or loss, except to the extent of any credit balance existing in the revaluation surplus in respect of that asset, in which case the loss is recognised in OCI.

In our view, when monetary gold assets are intended to be held for an indeterminate period of time, because it provides confidence in the monetary authority's financial strength and ability to carry out is activities, it may be appropriate to measure such monetary gold assets at historical cost if there are prohibitions or restrictions placed on the central bank to limit the ability to sell these monetary gold assets. Otherwise the entity may measure them at market value. If measured at cost, the entity would have to develop a concept of impairment to reflect reductions in realisable value or recoverable amount of gold under certain circumstances.

We recommend that the IPSASB require the quantity of gold held to be disclosed, regardless of the measurement basis, as this provides useful information to the users of the financial statements.

Preliminary View – Chapter 5-1:

Do you agree with the proposed definitions of IMF Quota Subscription, SDR Holdings and SDR Allocations?

We agree with the proposed definitions of IMF Quota Subscription, SDR Holdings and SDR Allocations.

Preliminary View – Chapter 5-2:

Do you agree with the IPSASBs view that:

a) *The IMF Quota Subscription satisfies the Conceptual Framework definition of an asset and should be recognized, with initial measurement at historical cost. Subsequent measurement may be at historical cost when the translated value of the quota subscription equals the cumulative resources contributed to the IMF, when it does not it should be measured at net selling price.*

   We agree that the IMF Quota Subscription satisfies the Conceptual Framework definition of an asset and should be recognized, with initial measurement at historical cost. Subsequent measurement at historical cost could result in a significant gain or loss in the statement of financial performance when the entity redeems the Quota Subscription by withdrawing from the IMF, but information for measurement at historical cost is readily available. Subsequent measurement at net selling price will result in gains or losses being recognised year-on-year, but will eliminate the possibility of a significant gain or loss being recognised when the Quota Subscription is redeemed. We are of the opinion that entities should be allowed to make an accounting policy choice, to subsequently measure the IMF Quota Subscription at either historical cost or net selling price.

b) *SDR holdings satisfy the Conceptual Framework definition of an asset and should be recognized, with measurement at market value.*

   We agree that SDR holdings satisfy the Conceptual Framework definition of an asset and should be recognized, with measurement at market value. In addition, it would be helpful if the CP clarifies that the gains and losses on re-measurement, consistent with the Conceptual Framework, should be taken to the statement of financial performance [Conceptual Framework paragraph 5.31].

c) *SDR allocations satisfy the Conceptual Framework definition of a liability and should be recognized, with measurement at market value.*

   We agree that SDR allocations satisfy the Conceptual Framework definition of a liability and should be recognized, with measurement at market value.

OTHER COMMENTS

Currency inventory

Paragraph 3.14 states that where production costs exceed the face value, the inventory value of currency recognized should be equal to the face value of the currency. We recommend that the IPSASB provides guidance for the accounting treatment of the production costs incurred in excess of the face value, i.e. if it costs CU12 to produce a note with a face value of CU10, how should the CU2 be accounted for.

IMF quota subscription

It would be helpful if the CP provides guidance on the question of offsetting in the situation when a member has issued a promissory note as part of its settlement of the quota subscription. Whilst currency holdings (including the promissory note) are current and liquid claims by the IMF that they can call upon at any time and any right of offset of the quota against currency holdings would not be exercisable until a member terminates its membership with the IMF, our view is that it would be difficult to justify offsetting in the statement of financial position.