

Consultation Paper
July 2016
Comments due: December 31, 2016

Public Sector Specific Financial Instruments

IPSASB

International Public
Sector Accounting
Standards Board®

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

Copyright © July 2016 by the International Federation of Accountants (IFAC). For copyright, trademark, and permissions information, please see [page 75](#).

REQUEST FOR COMMENTS

This Consultation Paper, *Public Sector Specific Financial Instruments*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by December 31, 2016.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Guide for Respondents

The IPSASB welcomes comments on all of the matters discussed in this Consultation Paper, including all Preliminary Views and Specific Matters for Comment. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate and contain a clear rationale.

The Preliminary Views and Specific Matters for Comment in this Consultation Paper are provided below. Paragraph numbers identify the location of the Preliminary View or Specific Matter for Comment in the text.

Preliminary View – Chapter 2 (following paragraph 2.9)

Definitions are as follows:

- (a) **Monetary authority** is the entity or entities, including the central bank or a department(s) of the central (national) government, which carry out operations usually attributed to the central bank.
- (b) **Reserve assets** are those external assets held by monetary authorities that are readily available for balance of payments financing needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.

Do you agree with the IPSASB's Preliminary View – Chapter 2?

Preliminary View – Chapter 3-1 (following paragraph 3.10)

Definition is as follows:

- (a) **Currency in Circulation** is physical notes and coins with fixed and determinable values that are legal tender issued by, or on behalf of the monetary authority, that is, either that of an individual economy or, in a currency union to which the economy belongs.

Do you agree with the IPSASB's Preliminary View – Chapter 3-1?

Preliminary View – Chapter 3-2 (following paragraph 3.30)

- (a) Notes and coins (currency) derive value because they are legal tender and accepted as a medium of exchange and therefore serve the same purpose and function in the economy. As the purpose and function of notes and coins is the same, the IPSASB's view is the accounting treatment should be consistent for both (as noted in paragraph 3.12), with the recognition of a liability when issued.

Do you agree with the IPSASB's Preliminary View – Chapter 3-2?

Specific Matters for Comment – Chapter 3-1 (following paragraph 3.43)

- (a) When the monetary authority assesses that a present obligation does not exist as a result of the issuance of currency, because of the absence of a legal or non-legally binding obligation (approach 1), it results in the recognition of revenue (approach 2), please explain your view and your thoughts on what is the appropriate financial statement in which to recognize revenue:
- (i) Statement of financial performance; or
 - (ii) Statement of net assets/equity?

Please provide the reasons for your support of your preferred option, including the conceptual merits and weaknesses; the extent it addresses the objectives of financial reporting and how it provides useful information to users.

Preliminary View – Chapter 4 (following paragraph 4.14)

Definitions are as follows:

- (a) **Monetary gold** is tangible gold held by monetary authorities as reserve assets.
- (b) **Tangible gold** is physical gold that has a minimum purity of 995 parts per 1000.

Do you agree with the IPSASB's Preliminary View – Chapter 4?

Specific Matters for Comment – Chapter 4-1 (following paragraph 4.50)

- (a) Should entities have the option to designate a measurement basis, based on their intentions in holding monetary gold assets (as noted in paragraphs 4.5-4.6)?

Please provide the reasons for your support for or against allowing an option to designate a measurement basis based on intentions.

Specific Matters for Comment – Chapter 4-2 (following paragraph 4.50)

- (a) Please describe under what circumstances it would be appropriate to measure monetary gold assets at either:
- i. Market value; or
 - ii. Historical cost?

Please provide reasons for your views, including the conceptual merits and weaknesses of each measurement basis; the extent to which each addresses the objectives of financial reporting; and how each provides useful information.

If you support measurement based on intentions as discussed in SMC 4-1, please indicate your views about an appropriate measurement basis for each intention for which monetary authorities may hold monetary gold, as discussed in paragraph 4.5 (i.e., intended to be held for its contribution to financial capacity because of its ability to be sold in the global liquid gold trading markets, or intended to be held for an indeterminate period of time).

Preliminary View – Chapter 5-1 (following paragraph 5.12)

Definitions are as follows:

- (a) The **IMF Quota Subscription** is the amount equal to the assigned quota, payable by the member on joining the IMF, and as adjusted subsequently.

- (b) **SDR Holdings** are International reserve assets created by the IMF and allocated to members to supplement reserves.
- (c) **SDR Allocations** are obligations which arise through IMF member's participation in the SDR Department and that are related to the allocation of SDR holdings.

Do you agree with the IPSASB's Preliminary View – Chapter 5-1?

Preliminary View – Chapter 5-2 (following paragraph 5.33)

The IPSASBs view is 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.
- (b) SDR holdings satisfy the Conceptual Framework definition of an asset and should be recognized, with measurement at market value.
- (c) SDR allocations satisfy the Conceptual Framework definition of a liability and should be recognized, with measurement at market value.

Do you agree with the IPSASB's Preliminary View – Chapter 5-2?

PUBLIC SECTOR FINANCIAL INSTRUMENTS

CONTENTS

	Page
Chapter 1: Introduction and Objective	8
History of the Project.....	8
Approach taken in this CP.....	9
Conceptual Framework.....	9
Consideration of Government Finance Statistics (GFS).....	10
Chapter 2: General Definitions	11
Chapter 3: Currency in Circulation	13
Chapter Objective	13
Definition	13
Approach 1: Liability.....	16
Is there a liability—Factors to be Considered	16
Measurement of the liability	18
Approach 2: Revenue	19
Consistency with Current IPSASs.....	21
Chapter 4: Monetary Gold	23
Chapter Objective	23
Definitions.....	24
Accounting Considerations	28
Factors to be Considered—Recognition	28
Factors to be Considered—Measurement	29
Consistency with Current IPSASs.....	33
Chapter 5: International Monetary Fund Quota Subscription and Special Drawing Rights	36
Chapter Objective	36
Definitions.....	36
Nature and Function.....	37
Accounting Considerations	38
Factors to be Considered—Recognition	39
Factors to be Considered—Measurement	43
Consistency with current IPSASs	49

Appendix A: Government Finance Statistics Guidance

Appendix B: Currency in Circulation: Notes

Appendix C: Currency in Circulation: Coins

Appendix D: Decision Tree – Currency in Circulation

Appendix E: IMF Information

Appendix F: IMF Quota Subscription, SDR Holdings and SDR Allocations: Illustrative Examples

1. Introduction and Objective

- 1.1 IPSASs do not provide requirements or guidance on how to account for a number of monetary items that the IPSASB has termed “public sector specific financial instruments”. The lack of guidance for these transactions¹ 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 in scope of the CP; and
 - Approaches to recognition and measurement.

History of the Project

- 1.3 The project² to develop IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*, identified several items which have public sector specific characteristics. Some items identified may meet the definition of a financial instrument, while others may not. The items identified during the initial financial instruments project as “public sector specific financial instruments” were:
- Monetary gold;
 - Special Drawing Rights;
 - International Monetary Fund (IMF) Quota Subscription;
 - Currency in circulation;
 - Concessionary loans; and
 - Financial guarantee contracts.
- 1.4 Two public sector specific issues—concessionary loans³ and financial guarantee contracts issued through non-exchange transactions⁴—were addressed in the application guidance in IPSAS 29. Both instruments meet the definition 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 In addition to the meaning of transactions from an accounting context, the use in the CP is also meant to include economic flows and stock positions from a government finance statistics perspective.

² The IPSASB has a separate project on its agenda to update the suite of IPSAS financial instruments standards (IPSAS 28–30).

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

⁴ IPSAS 29.AG92–AG97 contains application guidance related to accounting for financial guarantees issued through a Non-Exchange Transaction.

- 1.6 In December 2013, the IPSASB identified additional issues to those noted in paragraph 1.3—statutory receivables, statutory payables and certain types of securitization transactions unique to the public sector. The IPSASB believes dealing with these topics is important to the public interest.
- 1.7 The items included in this project have public interest implications because of their significance to the public sector and the service delivery objectives of public sector entities. These issues are important because they allow users to assess public sector entities' ability to:
- Deliver services effectively;
 - Manage the resources used and available to provide services; and
 - Manage liquidity and solvency.
- 1.8 Some topics in scope of the CP apply to specific entities such as central banks, which may apply national or international financial reporting standards for the private sector. Central banks are important to the public sector, and it is therefore important for the IPSASB to consider developing guidance for these entities. Central banks often form part of the public sector as they are controlled and consolidated into the financial accounts of the central government, regardless of whether they apply national or international financial reporting standards for the private sector.
- 1.9 The IPSASB decided to manage the project in phases. This CP deals with the topics which apply to central banks and central governments (or their equivalents). Securitization transactions unique to the public sector will be addressed in the project to update IPSAS 28–30: *Financial Instruments*. Statutory receivables and payables will be addressed in the IPSASB projects on revenue and non-exchanges expenses.

Approach taken in this CP

- 1.10 The final output of this project has not been determined by the IPSASB. The project may lead to the development of a single standard or several standards and/or additional application guidance to existing standards.
- 1.11 The CP for this phase of the project has the following structure:
- Chapter 1: Introduction and Objective;
 - Chapter 2: General Definitions;
 - Chapter 3: Currency in Circulation;
 - Chapter 4: Monetary Gold; and
 - Chapter 5: IMF Quota Subscription and Special Drawing Rights.

Conceptual Framework

- 1.12 The Conceptual Framework was published in October 2014 and influences the CP in the following ways:
- The objectives of financial reporting, the qualitative characteristics and the constraints on information included in general purpose financial reports (GPFRs), provide guidance necessary for assessing the needs of users and the attributes of such information in developing accounting considerations for each chapter;

- The definitions of elements and the recognition criteria provide guidance for evaluating transactions and determining whether they should be recognized in financial statements;
- The measurement objective provides a framework for assessing the information needs of users and which measurement basis appropriately meet such needs; and
- The concepts for presentation 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.

Presentation

1.16 The CP generally does not propose specific requirements for presentation. 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 CP.

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 2014⁵ (GFS Policy Paper), which has been considered in developing this CP. Appendix A: Government Finance Statistics, includes information on the main guidance considered from the applicable macroeconomic statistical manuals in developing the chapters in the CP.

⁵ <http://www.ifac.org/sites/default/files/publications/files/IPSASB-GFS-Policy-Paper.pdf>

2. Chapter 2: General Definitions

- 2.1 The proposed definitions⁶ in this chapter apply to more than one topic or transaction considered in the CP, and therefore have been included as a separate chapter. As noted in paragraph 1.8, this CP deals with topics and transactions which apply to central banks and central governments. Such entities are referred to as monetary authorities in this CP.
- 2.2 The definitions in this chapter have been developed with consideration of the requirements of Government Finance Statistics. Appendix A: Government Finance Statistics, includes information on the main guidance considered from the applicable manuals. Based on that guidance, the proposed definitions below have been developed by the IPSASB.
- 2.3 The proposed definition of **monetary authority** is as follows:
 “The entity or entities, including the central bank or a department(s) of the central (national) government, which carry out operations usually attributed to the central bank.”
- 2.4 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. In limited circumstances a monetary authority may be (or include) a regional entity, e.g. the European Central Bank.
- 2.5 The proposed definition of **reserve assets** is as follows:
 “Are those external assets held by monetary authorities that are readily available for balance of payments financing needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.”
- 2.6 External assets are those that have a foreign (nonresident) counterparty, when they have one. Because tangible gold is a physical asset, it does not have a counterparty.
- 2.7 Reserve assets comprise monetary gold, foreign currency, highly liquid investments, and Special Drawing Rights (SDRs).
- 2.8 To be effective, reserve assets must be readily available for trading.
- 2.9 The reserve asset definition is a common and well understood concept for monetary authorities from a GFS reporting perspective. Therefore it is important to align the accounting definition with GFS to avoid unintended departures.

Preliminary View – Chapter 2

Definitions are as follows:

- (a) **Monetary authority** is the entity or entities, including the central bank or a department(s) of the central (national) government, which carry out operations usually attributed to the central bank.

⁶ The definitions in the CP have been developed to reflect conventions included in IPSASs and discussions by the IPSASB related to the transactions in an accounting context. The IPSASB intends for these definition to have the same substance as guidance included in the various GFS manuals referenced.

(b) **Reserve assets** are those external assets held by monetary authorities that are readily available for balance of payments financing needs, intervention in the currency markets to affect exchange rates and maintaining confidence in the currency and the economy.

Do you agree with the IPSASB's Preliminary View – Chapter 2?

3. Chapter 3: Currency in Circulation

Chapter Objective

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

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

- The impact of currency in circulation on the entity's financial performance and financial position;
- The nature and extent of risks arising from issuing currency in circulation, and how the entity manages those risks; and
- The types of currency in circulation issued by the entity.

Introduction

3.2 Currency in circulation⁷ comprises notes and coins. Although laws vary between jurisdictions, monetary authorities generally are responsible for maintaining currency in circulation⁸.

3.3 This chapter of the CP considers the approaches to, and issues arising in, accounting for currency in circulation. The approaches identified relate to the type of currency, the stage in the production and issuance process, as well as any obligations arising from issuing currency in circulation. The objective is to initiate a debate about matters such as:

- (a) The different types of currency in circulation;
- (b) The accounting approaches for recognition and measurement of liabilities related to currency in circulation in order to provide the best information to users; and
- (c) The recognition of revenue for currency issued into circulation.

Definition

3.4 This section of the CP proposes a definition and guidance on the types of currency that may be included in any future guidance on accounting for currency in circulation. Appendix A: Government Finance Statistics, includes information on the main guidance considered from the applicable manuals in developing this chapter. Based on that guidance, the IPSASB proposes the following definition of currency in circulation.

3.5 The proposed definition of ***Currency in Circulation*** is as follows:

"Physical notes and coins with fixed and determinable values that are legal tender issued by, or on behalf of the monetary authority, that is, either that of an individual economy or, in a currency union to which the economy belongs."

3.6 Physical notes and coins issued as legal tender are a medium of payment, recognized by a legal system as a valid form of payment.

⁷ The concept of currency in circulation is linked to money supply, but this paper is not meant to cover the concepts of money supply or monetary policy, which have broader implications than accounting.

⁸ In some jurisdictions the responsibility for currency is delegated to commercial banks.

- 3.7 Currency in circulation is issued by the monetary authority for the economy to which it belongs; such currency is referred to as domestic currency. Domestic currency is distinguished from foreign currency. Domestic currency is that which is legal tender in the economy and issued by the monetary authority (or third party) for that economy (the domestic monetary authority). Adoption of a foreign currency—that is, currency issued by a monetary authority outside of the domestic economy (a foreign monetary authority)—for use as legal tender in the domestic economy does not give rise to currency liabilities for the domestic monetary authority. In some cases, the domestic monetary authority issues domestic currency alongside the adopted foreign currency. Only the domestic currency gives rise to a liability for the domestic monetary authority.
- 3.8 For example, some countries other than the United States of America (US), use the US dollar as legal tender. The adoption of the US dollar by a country other than the US is called dollarization. Dollarization is when a country officially or unofficially uses a foreign country’s currency as legal tender for conducting transactions. Usually a country will do so because of the greater stability in the value of the foreign currency over the domestic currency. Use of a foreign currency in this manner does not give rise to a liability for the domestic monetary authority.
- 3.9 Currency unions consist of more than one economy and have a regional central decision-making body with the authority to conduct a single monetary policy and issue the legal tender of the area, which is considered domestic currency for all the countries of the union. Such arrangements meet the definition of currency in circulation.
- 3.10 A monetary authority may directly produce and issue currency, or it may use a third party to produce and/or issue currency.

Preliminary View – Chapter 3-1

- (a) **Currency in Circulation** is physical notes and coins with fixed and determinable values that are legal tender issued by, or on behalf of the monetary authority, that is, either that of an individual economy or, in a currency union to which the economy belongs.

Do you agree with the IPSASB’s Preliminary View – Chapter 3-1?

Accounting for Currency

Nature of Currency

- 3.11 Physical currency issued by the monetary authority comprises notes and coins. It is important to consider whether notes and coins have a different function or purpose, which may justify different accounting treatments. All physical currencies are now fiat currencies⁹ and derive their value based on their acceptance as a medium of exchange.
- 3.12 Notes and coins have different physical characteristics which may affect how long they last and their residual value if damaged. Because they are made of metals, coins often last longer and have some residual value compared to notes made from paper or plastic. However, notes and coins are used in the same manner for payments, as both are accepted as consideration equal to their face value in exchange for purchases. Thus the purpose and function are the same for notes and coins.

⁹ Currencies which have no intrinsic value.

Currency Inventory

- 3.13 Currency inventory comprises the cost of purchase of raw materials and related production costs including labor and overhead costs or the cost of purchasing notes and coins produced by a third party¹⁰. This CP takes the view that transactions related to the purchase and production of currency should be treated in accordance with IPSAS 12, *Inventories*¹¹, and recognized accordingly. Under GFS, notes and coins in circulation are treated as liabilities at full face value of the issuer. The cost of producing the physical notes and coins is recorded as government expenditure and not netted against the receipts from issuing the currency.
- 3.14 Where production costs exceed the face value¹², the inventory value of currency recognized should be equal to the face value of the currency¹³. (See Appendix B & C, for examples of the transaction and journal entries related to the purchase of materials, production and distribution of currency, as well as adjustments for net realizable value of coins when cost exceeds face value).

Issuance of Currency

- 3.15 This section of the CP considers the different approaches for accounting for the issuance of currency. The approaches consider the guidance of the Conceptual Framework and are described below, with Approach 1: Liability starting from paragraph 3.18 and Approach 2: Revenue starting from paragraph 3.34. Appendix D summarizes the decision points in determining the appropriate accounting treatment when currency is issued.
- 3.16 The amount of currency in circulation is driven by consumer demand for physical currency, and fluctuates during the year. For example, the demand may be higher during holidays and lower at other times. Typically, banks or other depository institutions maintain reserve accounts at the monetary authority. Currency in circulation increases when a bank or other depository institution requests and receives currency from the monetary authority in exchange for a reduction to its reserve account. Similarly, currency in circulation decreases when the bank or other depository institution returns currency to the monetary authority as a deposit to their reserve account. Exchanges of currency between the monetary authority and a bank or other depository institution, such as to replace damaged currency or exchange currency for different denominations, have no net effect on currency in circulation.
- 3.17 The monetary base of an economy's currency is the sum of the amount of physical currency in circulation and the reserve deposit balances banks and depository institutions hold with the monetary authority. The size of the monetary base is managed through monetary policy operations of the monetary authority and has a direct effect on interest and exchange rates denominated in that currency.

¹⁰ Some monetary authorities may outsource the production of notes and coins, in such cases purchases of finished notes and coins would be accounted for by applying IPSAS 12, *Inventories*.

¹¹ IPSAS 12.11 notes that inventories encompass goods purchased and held for resale... Inventories also encompass finished goods produced, or work-in-progress being produced, by the entity. Inventories also include (a) material and supplies waiting use in the production process, and (b) good purchased or produced by an entity...

¹² The issue of production costs exceeding face value is generally limited to smaller denominations of coins, which have low face values.

¹³ IPSAS 12.15 states that inventories shall be measured at the lower of cost and net realizable value.

Approach 1: Liability

3.18 This approach considers the Conceptual Framework guidance related to the recognition of a liability. Chapter Five of the Conceptual Framework includes the following:

Definition

5.14 A liability is:

A present obligation of the entity for an outflow of resources that results from a past event.

A Present Obligation

5.15 Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

Is there a liability—Factors to be Considered

3.19 The key factors which determine recognition of a liability by an entity when currency is issued are discussed below.

Has a past event occurred?

3.20 The past event occurs when currency is issued into circulation by the entity. This is the most straight forward factor when examining if a liability should be recognized.

Does issuance of currency give rise to a present obligation?

3.21 For legal obligations, a present obligation arises when legislation exists that sets out legal or similar requirements and responsibilities for monetary authorities in relation to currency in circulation. Such legislation can vary. However, such laws may include one or more of the following requirements or responsibilities of monetary authorities:

- (a) Exchange damaged currency for new currency;
- (b) Hold collateral for the amount of currency in circulation; and
- (c) Establish explicit claims against the assets of the monetary authority for the currency in circulation.

Such laws may also include requirements and responsibilities to manage the amount of currency in an economy and carry out monetary policy with the objective of stable inflation and exchange rates.

3.22 The key consideration is that the obligation must be legally enforceable¹⁴. The Conceptual Framework notes that enforceable obligations may arise from a variety of legal constructs and that exchange transactions are usually contractual in nature and therefore enforceable by law or an equivalent authority or arrangement. Issuance of currency is an exchange transaction because consideration is received equal to the cumulative face value of the currency issued.

3.23 When laws and regulations exist and set out the requirements and responsibilities of monetary authorities, a legal obligation is present and therefore it is appropriate to consider if a legal liability should be recognized.

¹⁴ Conceptual Framework, paragraph 5.20.

- 3.24 The absence of currency laws and regulations that establish responsibilities and requirements for monetary authorities indicates that an entity does not have a present legal obligation. The entity therefore considers if a non-legally binding obligation may be present. In order for a non-legally binding obligation to give rise to a liability there must be:
- An indication to others that the entity will accept certain responsibilities;
 - The creation of a valid expectation; as well as
 - Little or no realistic alternative to avoid an outflow of resources.
- 3.25 The three factors should not be considered in isolation. They are inter-related. An entity must give a sufficiently precise indication to others that the entity will accept the responsibilities in relation to currency. This indication creates a valid expectation that the entity will discharge those responsibilities. The result of creating that valid expectation is that the entity has little or no realistic alternative to avoid an outflow of resources.

Indication to others that the entity will accept certain responsibilities

- 3.26 The Conceptual Framework¹⁵ considers what actions might indicate to others that an entity will accept certain responsibilities. It gives the examples of past practice, published policies and sufficiently specific current statements, whilst noting that announcements made in the early stages of implementing a policy are unlikely to give rise to non-legally binding obligations. In the case of currency in circulation, it is likely to be past practice (for example, redeeming damaged currency) that indicates a willingness to accept certain responsibilities.

Creation of a valid expectation

- 3.27 For a valid expectation to be created, announcements that an entity will accept certain responsibilities need to be sufficiently precise and certain. Policies included in legislation are more likely to create a valid expectation.

Does the entity have little or no realistic alternative to avoid an outflow of resources?

- 3.28 For a legal obligation, there is likely to be an outflow of resources required to discharge those obligations¹⁶ when a past event (issuance of currency) gives rise to a present obligation. Therefore, in the case of a legal obligation, the Conceptual Framework definition of a liability appears to be satisfied.
- 3.29 Interpreting this requirement in the context of non-legally binding obligations is difficult. However, the IPSASB is of the view that, when the entity has a past practice of redeeming currency when presented by holders in the absence of a legal obligation to do so, this establishes that the entity has little or no realistic alternative to avoid an outflow of resources.

Conclusion on Recognition

- 3.30 The IPSASB's view is that the issuance of currency satisfies the definition of a liability in the Conceptual Framework and recognition criteria, when a present obligation exists as described in either paragraphs 3.23 or 3.24. If the monetary authority assess that a present obligation does not

¹⁵ Conceptual Framework, paragraph 5.23.

¹⁶ Regardless of the specific terms of currency laws, monetary authorities will incur costs to meet the legal requirements.

exist, because of the absence of a legal or a non-legally binding obligation, it should then assess whether it is appropriate to recognize revenue in accordance with approach 2 described starting from paragraph 3.34.

Preliminary View – Chapter 3-2

- (a) Notes and coins (currency), derive value because they are legal tender and accepted as a medium of exchange and therefore serve the same purpose and function in the economy. As the purpose and function of notes and coins is the same (as noted in paragraph 3.12), the IPSASB's view is the accounting treatment should be consistent for both, with the recognition of a liability when issued.

Do you agree with the IPSASB's Preliminary View – Chapter 3-2?

Measurement of the liability

- 3.31 This section considers the measurement of any liability recognized using Approach 1. Chapter 7 of the Conceptual Framework discusses a number of measurement bases for liabilities and provides guidance for selecting an appropriate measurement basis by considering the nature of the liability and settlement options available.
- 3.32 The IPSASB believes that the following measurement bases from the Conceptual Framework may be appropriate: Historical Cost, Cost of Fulfillment, and Market Value¹⁷ as explained below:
- (a) Historical Cost is defined as: *The consideration received to assume an obligation, which is the cash or cash equivalents or the value of other consideration received, at the time the liability is incurred.* The liability is incurred when currency is issued. The monetary authority receives consideration equal to the face value of the currency issued. Therefore, if historical cost is the basis used, measurement is appropriate at the cumulative face value of the currency issued.
- (b) Cost of Fulfillment is defined as: *The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming it does so in the least costly manner.* When measurement on this basis is dependent on uncertain future events, which might be the case in the context of currency in circulation, then all possible outcomes should be taken into account. However, the least costly manner to fulfill the obligation would likely be based on the cost of producing the expected amount of future currency needed, and not the cumulative face value of all currency issued. This indicates that measurement using cost of fulfillment is limited to the expected cost of producing currency.
- (c) Market Value is defined as: *The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.* This may also be appropriate, as the cumulative face value of currency issued, is redeemed for an equal amount of currency, or other consideration.
- 3.33 The nature of the obligation which gives rise to the liability (legal vs. non-legally binding), may impact which measurement bases are appropriate.
- (a) A present legal obligation, arising from a contract or similar arrangement appears appropriate to be measured at historical cost or market value. The legal nature of the liability indicates that

¹⁷ The IPSASB does not believe that Cost of Release and Assumption Price measurement bases are appropriate in the context of measuring currency in circulation since the monetary authority cannot be released from, nor transfer, its obligations.

settlement is expected at the amount legally enforceable by law. Regardless of whether historical cost or market value are more appropriate, the actual amount of the liability is equal. Measurement at either historical cost or market value gives rise to liabilities equal to the cumulative face value of currency issued by the monetary authority.

- (b) Non-legally binding obligations arising because of past practices and an expectation of an outflow of resources may be more appropriately measured using the cost of fulfillment. This is because the future settlement of currency in circulation is uncertain in both time (when it will be redeemed) and amount (how much currency will be redeemed). Considering the nature of this type of non-legally binding obligation, cost of fulfillment would seem appropriate. It could be argued that a legal obligation related to currency in circulation, also has the same uncertainty in terms of timing and amount of currency to be redeemed. However, the key difference is the contractual nature of currency in this case means that the obligations are enforceable by law.

Approach 2: Revenue

3.34 If the monetary authority assess that a present obligation does not exist, because of the absence of a legal or a non-legally binding obligation, it should then assess whether it is appropriate to recognize revenue in accordance with approach 2.

3.35 This approach considers the Conceptual Framework guidance related to the recognition of revenue.

Definitions relating to Revenue and Ownership Contributions

3.36 Chapter Five of the Conceptual Framework includes the following:

Definition

5.29 Revenue is:
Increases in the net financial position of the entity, other than increases arising from ownership contributions.

5.31 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and ability to generate economic benefits through impairments. Revenue and expense may arise from individual transactions or groups of transactions.

5.33 Ownership contributions are:
Inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

3.37 Issuance of currency by monetary authorities is an exchange transaction that results in inflows from external parties to the monetary authorities and an increase in net financial position. Therefore, according to the guidance of the Conceptual Framework, issuance of currency would qualify as revenue, as long as that issuance is not considered an ownership contribution. However, it is unlikely that those external parties are acting in an ownership capacity or establishing an interest in the net financial position of the entity. When an external party acquires currency, it obtains a fixed amount of currency for a fixed amount of consideration. The external party does not acquire an interest in the net financial position of the monetary authority.

- 3.38 Therefore, if Approach 1 does not result in the recognition of a liability, then the issuance of currency should be recognized in the financial statements as revenue because the definition of revenue is satisfied.
- 3.39 Requirements for presentation are generally not considered in this CP as noted in paragraph 1.16. However, under the revenue approach a possibility exists to recognize revenue in the statement of financial performance or directly in the statement of net assets/equity. The Conceptual Framework leaves open the possibility that revenue could be directly recognized in the statement of net assets/equity at the standards level. This might be the case, for example, if it was determined that the revenue is not attributable to the period covered by the financial statements. In some instances unrealized gains or losses resulting from revaluations of financial instruments are recognized in the statement of net assets/equity, but when such items are realized (or when they are considered impaired) they are recognized in the statement of financial performance. Although the IPSASB acknowledges the possibility that revenue may be recognized in the statement of net assets/equity, current IPSAS standards do not include examples where the full amount of revenue is presented in the statement of net assets/equity. Therefore, the IPSASB has included SMC 3-1 to obtain constituents views.
- 3.40 The IPSASB's discussion is based on the Conceptual Framework guidance and its views on the transactions related to the currency in circulation. However, some respondents may have alternative views as described in paragraphs 3.41 and 3.42.
- 3.41 Those who do not support recognition of a liability when currency is issued into circulation argue that:
- (a) There is not a present obligation. When the monetary authority provides or receives currency, it is offset by an equal reduction or increase in the depository institution's reserve account and the liability for deposits at the monetary authority, respectively. Such treatment is similar to an individual withdrawing or depositing cash in a bank, whereby the individual's account in the bank and the bank's deposit liability is reduced or increased, respectively, and there is no obligation beyond the liability for deposits. The monetary authority provides or receives currency when a depository institution initiates the transaction. Consequently, the monetary authority does not have a present obligation until the depository institution initiates a transaction.
 - (b) The monetary authority provides currency in exchange for an equal amount of currency; however, such a transaction does not result in a net outflow from the monetary authority.
 - (c) The increase in the value of the currency from cost of production to face value when currency is put into circulation does not represent a new obligation. Once currency is issued, the cost of any replacement, such as for worn currency, is the cost of production.
 - (d) The increase in the value of the currency from the cost of production should be recognized as revenue and possibly presented directly in net assets/equity, as described in paragraphs 3.37 and 3.39.
- 3.42 Those who support recognition of revenue directly in the statement of net assets/equity argue that the issuance of currency in circulation does not represent a liability and should not affect the operating results of the entity, and instead should be presented directly in net assets/equity.

Conclusion on Recognition

- 3.43 The IPSASB's view is that when the issuance of currency does not satisfy the definition of a liability in the Conceptual Framework and recognition criteria, it should be recognized as revenue.

Specific Matters for Comment – Chapter 3-1

- (a) When the monetary authority assesses that a present obligation does not exist as a result of the issuance of currency, because of the absence of a legal or non-legally binding obligation (approach 1), it results in the recognition of revenue (approach 2), please explain your view and your thoughts on what is the appropriate financial statement in which to recognize revenue:

- (i) Statement of financial performance; or
(ii) Statement of net assets/equity?

Please provide the reasons for your support of your preferred option, including the conceptual merits and weaknesses; the extent it addresses the objectives of financial reporting and how it provides useful information to users.

Measurement

- 3.44 The IPSASB's view is that it is appropriate to measure revenue at the cumulative face value of currency issued, which is equal to the amount of consideration received.

Consistency with Current IPSASs

- 3.45 Based on preliminary view 3-2, Approach 1 (Liability) is consistent with current IPSASs. Recognizing a liability based on the requirements of legislation (legal obligation) for currency in circulation or a past practice of redeeming currency by the monetary authority (constructive obligation) is consistent with IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets*, which requires that *a provision shall be recognized when: (a) An entity has a present obligation (legal or constructive) as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognized.*¹⁸
- 3.46 Approach 1 is also consistent with IPSAS 28 *Financial Instruments: Presentation*, which defines a financial liability as *a liability that is a contractual obligation to deliver cash or another financial asset to another entity*. Because of laws and regulations which compel monetary authorities to redeem currency when presented by holders, such an obligation in the view of the IPSASB, has the characteristics of a financial liability. IPSAS 28.AG10 explicitly states that IPSAS 28 does not address currency issued as legal tender from the perspective of the issuer. However, currency does appear to qualify as a financial liability. IPSAS 29 *Financial Instruments: Recognition and Measurement* sets out requirements for recognition and subsequent measurement for financial liabilities as follows:
- (a) Financial liabilities at amortized cost, are initially recognized and measured at fair value plus transaction costs, and subsequently measured at amortized cost; and

¹⁸ However, for the case when an obligation is not recognized, IPSAS 19 provides guidance on contingent liabilities (defined in IPSAS 19.18). IPSAS 19 states contingent liabilities shall not be recognized and should instead be disclosed unless the possibility of an outflow or resources embodying economic benefits or service potential is remote.

- (b) Financial liabilities classified as fair value through surplus or deficit are initially recognized at fair value with transaction costs expensed as incurred in the statement of financial performance with subsequent measurement at fair value.
- 3.47 Accounting for currency at amortized cost, is inappropriate, as currency does not have maturity dates or interest payments. Therefore, accounting for currency liabilities at fair value through surplus or deficit is appropriate. This would result in measurement at face value.
- 3.48 The IPSASB considered if currency liabilities are an equity instrument, rather than a financial liability. IPSAS 28 defines an equity instrument as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Currency only gives the holder a claim to the face value of the currency held. It does not give any rights to any additional residual or variable interest in the monetary authority. Therefore, accounting for currency in circulation as an equity instrument is inappropriate. This is consistent with the analysis in approach 2, where it was determined that issuance of currency does not give rise to ownership contributions (equity contribution).

4. Chapter 4: Monetary Gold

Chapter Objective

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

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

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

Introduction

4.2 Physical gold has a long history as a reserve asset. Historically, currency was produced from precious metals (typically gold and silver). As economies advanced, paper money became more prevalent; however, it would typically be exchangeable for a precious metal. Gold played a more direct role in the monetary system until the early 1970s, when the US dollar¹⁹ 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.

4.3 Monetary authorities hold gold as a reserve asset. The unique characteristics of gold make it an important reserve asset for such entities, for the following reasons:

- Economic security—Gold does not deteriorate or decay. It has a high density, so small amounts have high value. It is physical and therefore is not a liability of another party (no counterparty risk);
- Risk diversification—Gold is transacted in a large global market, but a unique market to those of other reserve assets (gold markets often move inversely to key global currency markets, such as the US dollar);
- Confidence—Currency is no longer backed or exchangeable for gold. However, confidence in currency and monetary authorities 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.

4.4 Accounting for monetary gold is inconsistent by monetary authorities, with a range of measurement bases used. 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.

¹⁹ The US dollar was the last currency which was exchangeable for a fixed amount of gold.

- 4.5 To achieve this objective, it is important to identify the intentions for which monetary authorities hold monetary gold as reserve assets. The two main intentions identified are as follows:
- (a) Intention 1: Monetary gold intended to be held for its contribution to financial capacity because of its ability to be sold, in the global liquid gold trading markets. Therefore, information on the current market value of gold is important; and
 - (b) Intention 2: Monetary gold intended to be held for an indeterminate period of time, because it provides confidence in the monetary authority's financial strength and ability to carry out its activities. There may be prohibitions or restrictions placed on these monetary authorities which limit the ability to sell monetary gold assets. Therefore, when monetary gold is held with this intention, the quantity and the price paid to acquire it is important.
- 4.6 The CP identifies two approaches to accounting for monetary gold, both linked to the above intentions. In assessing these approaches, the IPSASB will consider how well they satisfy the qualitative characteristics (QCs) set out in the Conceptual Framework, the objectives of financial reporting and meeting users' information needs.

Definitions

- 4.7 This section of the CP proposes a definition of monetary gold and whether certain transactions meet the definition of monetary gold. Appendix A: Government Finance Statistics, includes information on the main guidance considered from the applicable manuals in developing this chapter. Based on that guidance, the IPSASB proposes the definitions set out below. However, certain terms used in the statistical guidance, such as the reference to monetary gold being a financial asset²⁰ have not been included in the proposed definitions, because monetary gold does not meet the IPSAS definition of a financial asset because of its physical nature.
- 4.8 The proposed definition of **monetary gold** is as follows:
- “Tangible gold held by monetary authorities as reserve assets.”
- 4.9 The definition is restricted to those gold assets held by monetary authorities as reserve assets, as these are the assets available to monetary authorities in carrying out their mandates. Gold assets not held by monetary authorities or those held by monetary authorities but not as reserve assets, would not be considered to be held to assist in achieving the core mandate of monetary authorities and therefore are not within the definition.
- 4.10 The proposed definition of **tangible gold** is as follows:
- “Physical gold that has a minimum purity of 995 parts per 1000.”
- 4.11 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 rules²¹ for trading on markets and exchanges. In addition to meeting the minimum purity requirement of 995/1000, assets should also

²⁰ IPSAS 29.9 states a financial asset is any asset that is: (a) Cash; (b) An equity instrument of another entity; (c) A contractual right: (i) To receive cash or another financial asset from another entity; or (ii) To exchange financial assets or liabilities with another entity under conditions that are potentially favorable to the entity; or (d) A contract that will or may be settled in the entity's own equity instruments; or (i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed number of the entity's own equity instruments...

²¹ The rules of the London Bullion Exchange set the international standard for transacting in physical gold.

be in a form which facilitates a timely transaction, meaning a form²² of tangible gold which is quantifiable²³, in a standard size and form.

- 4.12 Contracts which permit settlement in physical gold may meet the definition of monetary gold, as discussed in paragraph 4.18 because, in some instances, monetary authorities hold these types of financial instruments with the intention of taking physical delivery of gold.
- 4.13 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. Therefore, monetary gold has an economic substance that differs from gold holdings held for other purposes such as use in operations, manufacturing or because such holdings have historical or cultural significance.²⁴
- 4.14 The definition excludes other precious metals (silver or platinum). Unlike gold, non-gold precious metals are not considered a store of value, or as a medium for international payments, in the manner that gold is. Therefore, monetary authorities do not hold non-gold precious metals as reserve assets. The IPSASB noted that none of the monetary authority financial statements examined accounted for or disclosed any holdings of precious metals, other than gold.

Preliminary View – Chapter 4

The key definitions are as follows:

- (a) **Monetary gold** is tangible gold held by monetary authorities as reserve assets.
- (b) **Tangible gold** is physical gold that has a minimum purity of 995 parts per 1000.

Do you agree with the IPSASB's Preliminary View – Chapter 4?

Analysis of transactions which satisfy the definition of monetary gold

- 4.15 Monetary gold guidance should only cover those items which satisfy the definitions set out above. The following types of gold assets should be included:
- Gold held directly by monetary authorities or 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.
- These are discussed in the following paragraphs.
- 4.16 Gold can be held directly by monetary authorities or with a third party in an allocated or unallocated gold account; as explained below:
- (a) Gold held directly by monetary authorities, that satisfies the tangible gold definition and is held for use as a reserve asset; satisfies the definition of monetary gold;

²² 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.

²³ 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.

²⁴ Some monetary authorities may hold physical gold for the purpose of facilitating trading with banks or commodity brokers. Monetary authorities may also hold physical gold to manufacture products to sell.

- (b) Gold held in an allocated account is gold—is that which is held for safekeeping with a third party. Gold assets in allocated accounts are specifically identified and segregated in the third party’s storage facilities. Monetary authorities have the right to demand delivery of their specific gold assets, or to instruct the third party to undertake transactions on their behalf. The rights and obligations of owning the gold assets have not been transferred, as the third party is an agent providing safekeeping services. Therefore gold held in an allocated account, satisfies the definition of monetary gold; and
- (c) Gold held in an unallocated account is gold which is deposited by the monetary authority with a third party (in a manner similar to how cash is deposited at a bank). Deposits of gold assets are not segregated or identified. Monetary authorities have the right to request delivery²⁵ of their deposits. Such gold deposits have different risks than those held directly by monetary authorities or in allocated accounts. However, such deposits are still denominated in gold and allow for the delivery of a specific quantity. Therefore gold held in an unallocated account, satisfies the definition of monetary gold.

4.17 Gold can be held as, 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 their numismatic²⁶ value. Commemorative gold coins are not legal tender and are not considered to be currency in circulation. The value of commemorative gold coins may be greater than the intrinsic value of the gold. Therefore, monetary authorities may be less likely to hold these as reserve assets, because higher values could be achieved by selling these through the non-commodity markets. However, when monetary authorities hold commemorative gold coins as reserve assets, they meet the definition of monetary gold²⁷. Alternatively, when they are held because of their numismatic value or used for purposes other than as reserve assets, they do not satisfy the definition of monetary gold; and
- (b) Gold coins may be legal tender in a particular jurisdiction – examples include the Canadian Maple Leaf and Chinese Panda gold coins. The legal tender face value is less than the value of the gold content in the coins. Such coins are legal tender and therefore currency in circulation. Some legal tender gold coins do not contain a high enough gold content to satisfy the requirements of the definition of monetary gold²⁸. However, those legal tender gold coins which satisfy the purity requirements and are held as reserve assets, meet the definition of monetary gold.

²⁵ 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.

²⁶ 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.

²⁷ Assuming they also satisfy the purity requirement of a minimum of 995/1000 gold content.

²⁸ The South African Kruggerand, American Gold Eagle and British Britannia are all legal tender gold coins. However, their gold content is lower than the definition requirements of 995/1000.

- 4.18 A range of investment products and securities linked and/or backed with gold exist. The main categories are discussed below:
- (a) Gold loans are debt instruments where gold is used as collateral. These types of instruments are not monetary gold as they do not meet the monetary gold definition, because these are liabilities. Further, the fact that the loan is secured by gold, does not mean that it is available to use as reserve assets by monetary authorities and therefore does not satisfy the definition of monetary gold;
 - (b) Gold exchange traded funds (ETFs) are securities (investment instruments) 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 that 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. However, instruments which allow settlement in gold on demand, held by the monetary authority as reserve assets with the intention of taking delivery of gold, would satisfy the definition of monetary gold²⁹;
 - (c) Gold forward/futures are contracts for the exchange of a quantity of gold at a future date at a specified price. These 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. In some instances, monetary authorities may hold such instruments with the intention of taking physical delivery of gold. When these instruments allow for settlement on demand and the monetary authority has the intention of taking delivery of gold, these would satisfy the monetary gold definition; and
 - (d) Gold equities are common and preferred shares of companies which generate revenue through the exploration, development and mining of gold. These 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 value of such gold equities is related to the market price of the shares, influenced by the performance of the combined operations of the entity, and are not an investment in an underlying amount of gold (or that may permit settlement in gold). Therefore, gold equities do not satisfy the definition of monetary gold and are financial instruments within the scope of IPSAS 28–30.
- 4.19 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 requirements³⁰.

²⁹ The IPSASB view is that any instrument that allows for delivery of a fixed quantity of physical gold, which are held by monetary authorities as reserve assets, could meet the scope exclusion of IPSAS 29.4: which states: *...contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.*

³⁰ In 2015 the IPSASB has initiated a project to consider accounting for Heritage Items.

Accounting Considerations

Key Guidance from the Conceptual Framework

4.20 This CP considers the guidance of the Conceptual Framework as applied to monetary gold transactions:

<p>6.2 The recognition criteria are that:</p> <ul style="list-style-type: none"> • An item satisfies the definition of an element; and • Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFs.
<p>Definitions</p> <p>5.6 An asset is:</p> <p><i>A resource presently controlled by the entity as a result of a past event.</i></p> <p>...</p> <p>Presently Controlled by the Entity</p> <p>5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.</p> <p>5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:</p> <ul style="list-style-type: none"> • Legal ownership; • Access to the resource, or the ability to deny or restrict access to the resource; • The means to ensure that the resource is used to achieve its objectives; and • The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource. <p>While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.</p>

Factors to be Considered—Recognition

4.21 The Conceptual Framework notes that items are recognized as assets when they satisfy the definition of an element and can be measured and requires consideration of the following:

- Has a past event occurred?
- Does the transaction give rise to a resource (noting that a resource is an item with service potential or the ability to generate economic benefits)?
- Does the entity presently control that resource (indicating that control of the resource entails the ability of the entity to use the resource to derive benefits from the service potential or economic benefits)?

4.22 For monetary gold, the past event occurs when it is acquired. Monetary gold is a resource, because it can be sold to generate economic benefits or held for its service potential. As a result of the physical nature of monetary gold, a monetary authority either physically controls the asset by taking possession, stores the gold with an agent for safekeeping or is a party to a financial instrument that

allows for settlement in physical gold. Control can be exercised whether the gold is held directly by the entity or not.

Conclusion on Recognition

- 4.23 Monetary gold satisfies the definition of an asset and the recognition criteria because it is a resource that provides economic benefits and service potential, and it is presently controlled.

Factors to be Considered—Measurement

- 4.24 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.*
- 4.25 The nature of monetary gold and its use by monetary authorities for reserve purposes means that information on the contribution to financial capacity is relevant. Monetary gold is not used directly in operations or to directly provide services, like other tangible assets. However, the acquisition cost and information on cost of services, provides relevant information for users, when monetary gold assets are intended to be held for an indeterminate period of time.
- 4.26 Measurement bases that provide information on financial capacity are relevant, because they enable users to assess the ability of monetary authorities to provide stability and liquidity in the monetary system or to fund its activities. Monetary authorities may have different intentions for holding monetary gold, which impacts whether information on financial capacity is useful to users.
- 4.27 Measurement bases that provide information on cost of service may also be relevant, when monetary authorities have the intention of holding gold assets for an indeterminate period of time, because they enable users to assess the cost of acquiring monetary gold assets and holding them. Only when monetary gold assets are sold or impaired will their impact on costs of services be recognized in the statement of financial performance which may provide users with useful information.
- 4.28 Monetary authorities have a variety of different reserve assets available for use to achieve their objectives. Depending on management of such reserves by monetary authorities, monetary gold may be held for a specific intention, as discussed in paragraph 4.5. If monetary gold is held for trading purposes, such as use for international payments, to influence the money supply and/or to provide liquidity and stability to the economy, then a measurement basis which provides information on financial capacity may be relevant.
- 4.29 Alternatively, if the intention is to hold monetary gold for an indeterminate period, because it provides confidence in the ability of monetary authorities to carry out their activities, then a measurement basis which provides information on cost of services may be relevant.

- 4.30 Monetary authorities currently measure monetary gold either on a historical cost basis, or fair value/market value basis. A smaller group of monetary authorities also use a statutory rate³¹. While statutory rates and their application vary between jurisdictions, monetary authorities using this method have a common aim of reducing the volatility caused by changes in gold prices. Use of a statutory rate is not a basis discussed in the Conceptual Framework.
- 4.31 The IPSASB considered the Conceptual Framework and noted that of the six potential bases available, only market value in an open, active and orderly market and historical cost are practical to consider³²:
- (a) Market value in an open, active and orderly market, as it is a current value measurement basis which provides users with the information required to assess the ability of monetary gold to contribute to the financial capacity of monetary authorities; and
 - (b) 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 monetary gold assets can provide to monetary authorities.
- 4.32 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. These are considered further in the following paragraphs.

Approach 1: Market value in an open, active and orderly market

- 4.33 An assessment of the information provided by measuring monetary gold at market value for each of the QCs is summarized as follows:
- (a) Relevance—Market value is a relevant measure that provides information on the contribution of monetary gold to financial capacity;
 - (b) Faithful Representation—Market value provides a faithfully representative view of the financial capacity monetary gold provides as it represents the exit value and is an objective price, available in a transparent, liquid market. Market value is also an entry value, because of the open, active and orderly market for gold, and therefore provides a faithfully representative view of operational capacity as well;
 - (c) Understandability—Market value information is understandable; the valuation of monetary gold using a spot rate is not complex;

³¹ Two examples of monetary authorities using statutory rates to measure monetary gold are the US Federal Reserve Bank and the South African Reserve bank. The US Federal Reserve measures monetary gold at the statutory rate set by law at \$42.22 per fine troy ounce. The South African Reserve Bank measures monetary gold at the market price taken at 14:30 on the reporting date.

³² The IPSASB does not believe that Market Value in an inactive market, replacement cost, net selling price and value in use measurement bases are appropriate in the context of measuring monetary gold since there is an active gold market, the gold is not consumed in operations and is not used in a specialized way.

- (d) Timeliness—Market value provides measurement information in a timely manner. The gold markets are transparent and prices are available in real time. Information required for financial statements can be prepared quickly using simple calculations;
 - (e) Comparability—Market value provides measurement information which allows direct comparability of monetary gold assets with other assets, and between different monetary authorities; and
 - (f) Verifiability—Market value provides information which is verifiable, because there is an open, active and orderly market.
- 4.34 Measurement of monetary gold at market value gives rise to two further issues—accounting for changes in value and transaction costs. The IPSASB considered the Conceptual Framework in developing the accounting alternatives for each issue. Additionally, relevant IPSAS standards are also considered.
- 4.35 Market value measurement requires monetary gold assets recognized in the statement of financial position to be revalued based on the spot rate. This provides users information to assess the financial capacity of monetary authorities. However, it does give rise to the issue of the appropriate place to recognize unrealized (and therefore possibly temporary) gains and losses, attributable to revaluations. There are different approaches for dealing with the recognition of unrealized gains or losses. One approach is to recognize all gains and losses in the statement of financial performance. Another approach is to recognize unrealized gains or losses directly in net financial position (net assets/equity), until realized.
- 4.36 Some may view recognition of all gains and losses due to changes in value in the statement of financial performance to be appropriate because IPSAS 1 requires this, unless a specific IPSAS states otherwise. Further, Chapter 7 of the Conceptual Framework notes the following: *revenue from providing services reported in the financial statements is measured on the basis of prices current in the reporting period. Thus the surplus or deficit for the period includes prices movements that take place over the period during which assets and liabilities are held, and no profit or loss is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, the existence of the market provides assurance that the entity would be able to realize the market value (and no more) at the reporting date: it is therefore unnecessary to postpone recognition of changes in value until a surplus is realized on a sale.*
- 4.37 However, some view the approach to recognize unrealized gains or losses directly in net financial position (net assets/equity), as appropriate because it is consistent with IPSAS 29, which requires unrealized gains and losses for financial assets designated as available-for-sale (AFS) to be recognized directly in net financial position, until realized. Further, Chapter 5 of the Conceptual Framework notes that *revenue and (expenses), are increases (decreases) in the net financial position of the entity other than increases (decreases) arising from ownership contributions (distributions).* Changes in fair value of monetary gold assets, both unrealized (temporary) and realized will give rise to revenue or expense as they result in changes in the net financial position (net assets/equity) of the entity which are not ownership contributions or distributions. Therefore, recognition of unrealized losses directly in net financial position (net assets/equity) or in the statement of financial performance may be appropriate when considering the guidance on recognition of elements in the Conceptual Framework.
- 4.38 The global markets for trading gold can be very volatile. The volatility can cause significant changes in the value of monetary gold assets. Some argue that recognizing unrealized gains or losses in the

statement of financial performance may not provide a faithfully representative view of the cost of services for the period presented. Further, some consider that this impairs the objectives of financial reporting by presenting information to users which does not reflect the true cost of services for the period, or the change in financial capacity provided by holding monetary gold assets. Therefore, it may be more appropriate to recognize unrealized gains or losses directly in net financial position (net assets/equity) until they are realized.

- 4.39 Another consideration in determining the appropriate approach to recognition of unrealized gains or losses relates to the relationship of a monetary authority with the central government. Many monetary authorities are required to pay dividends to the central (national) government based on accounting profits. Dividends paid based on unrealized gains or losses may lead to an erosion of capital to insufficient levels. As monetary authorities have an important role in the economy, it is important that they have adequate capital available. When monetary authorities are not properly capitalized, they may not be able to perform their role effectively.
- 4.40 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 derecognition³³ of monetary gold assets, and is consistent with the purpose monetary authorities hold gold assets for trading purposes. This approach is also consistent with how available-for-sale (AFS)³⁴ financial assets are accounted for in IPSAS 29, *Financial Instruments: Recognition and Measurement*.

Approach 2: Historical Cost

- 4.41 An assessment of the information provided by measuring monetary gold using historical cost for each of the QCs is summarized as follows:
- (a) Relevance—Historical cost information provides information on the minimum resources available to provide future services, based on their acquisition cost of monetary gold;
 - (b) Faithful Representation—Historical cost provides a faithfully representative view of the transaction price to acquire monetary gold, providing information on the minimum service potential but not information on the contribution to financial capacity that it provides;
 - (c) Understandability—Historical cost information is not complex. It provides information on the cost to acquire (entry value of) monetary gold;
 - (d) Timeliness—Historical cost information is timely, because transaction prices are easily obtainable and the carrying amount is stable between accounting periods unless monetary gold is acquired, sold or impaired;
 - (e) Comparability—Historical cost does not provide comparable information from one entity to another, as the value is based on the timing of the purchase of the gold by each entity and not the current economic value. However, it does provide comparable information from period to

³³ 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.

³⁴ The project to update IPSAS 28–30 for IFRS 9, *Financial Instruments* may introduce changes to classification terminology.

period for an individual entity, as changes in carrying amounts are stable, unless gold is acquired, sold or impaired; and

- (f) Verifiability—Historical cost information for monetary gold is transaction based and easily verifiable.
- 4.42 Historical cost is normally the fair value at the time of acquisition plus transaction costs (as these are part of the cost of acquiring the asset). Changes to the historical cost of monetary gold assets only result from impairments, when the market price of gold decreases below the acquisition price. Losses due to impairment are recognized in the statement of financial performance, with a corresponding decrease in the carrying amount of the monetary gold assets on the statement of financial position.
- 4.43 Historical cost reflects the cost to acquire the gold assets and the minimum service potential provided by holding it. Monetary authorities with the intention of holding monetary gold because of its service potential, are often more concerned with the quantity of gold held. Therefore, changes in the historical cost values on the statement of financial position directly relate to either increases or decreases in the quantity of monetary gold assets, or impairments of monetary gold assets. The historical cost approach also addresses the issue of ensuring the unrealized gains and losses are not distributed as dividends by monetary authorities.

Consistency with Current IPSASs

Approach 1: Market value in an open, active and orderly market

- 4.44 Guidance on accounting for financial assets in IPSAS 29 is based on the classification of the financial instrument, with different requirements for initial recognition, treatment of transaction costs and subsequent changes in value.
- 4.45 Monetary gold held with the intention of trading is similar to the IPSAS 29 requirements for financial assets classified at fair value through surplus or deficit (FV) or available-for-sale (AFS).
- 4.46 Fair value in IPSASs is defined as the amount for which assets could be exchanged between knowledgeable, willing parties in an arm's length transaction. In the case of monetary gold this is the spot rate of gold. Fair value for monetary gold assets is the same regardless of whether it is classified as FV or AFS.
- 4.47 IPSAS 29 requires initial transaction costs to be expensed as incurred in the statement of financial performance when classified as FV. Transaction costs directly attributable to the acquisition of AFS assets are included as part of the initial cost of the assets (fair value plus directly attributable transaction costs).
- 4.48 The classification of FV and AFS for financial assets also impacts how subsequent changes in value are accounted for. For those assets classified as FV, all changes in value, both realized and unrealized, are recognized in the statement of financial performance. For those assets classified as AFS, unrealized changes in value are recognized directly in net financial position. For changes in value which are realized (due to derecognition of the assets), or when the financial assets are impaired, the cumulative gain or loss is recognized in the statement of financial performance.

Approach 2: Historical cost

- 4.49 There are many current IPSASs which use a historical cost measurement model. The appropriate measurement model to consider depends on whether monetary gold is viewed as a tangible asset or

as a financial asset. The most appropriate applications of the historical cost measurement model in IPSAS are as follows:

- (a) IPSAS 12, *Inventories*, requires initial measurement at cost, which includes all costs of purchase and other costs in bringing inventories to present location and condition. Subsequent measurement is at the lower of cost and net realizable value, except where inventories are acquired in a non-exchange transaction or where inventories are likely to be distributed at no or nominal charge (unlikely for monetary gold). For monetary gold, initial measurement would be the purchase price, plus initial transaction costs. At subsequent reporting periods, the cost of inventory is compared to the recoverable amount to determine if the inventories require a write down to net realizable value. Since IPSAS 12 is intended for goods purchased and held for resale, it is not appropriate for monetary gold assets held for an indeterminate period of time.
- (b) IPSAS 17, *Property, Plant and Equipment*, requires that an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost. Cost includes purchase price, plus non-refundable duties and taxes, net of rebates, plus any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, plus any estimate of the costs of dismantling and removing the item and restoring the site is located, for which the obligation related to such costs has been recognized. For monetary gold, this would be fair value plus initial transaction costs. Using IPSAS 17 by analogy to measure monetary gold assets, is similar to how the standard treats land. Land is measured at its initial fair value plus transaction costs and is not amortized.
- (c) IPSAS 29 requires that financial assets classified as AFS for which there is not a quoted market price in an active market and which cannot be reliably measured, are required to be measured at cost³⁵. Although, an active market for gold does exist, this does demonstrate the use of the historical cost model in the IPSASB's financial instrument standards. Monetary gold assets held for an indeterminate period of time by monetary authorities, without a history of selling such assets, may be considered similar transactions to thinly traded or illiquid equity securities, which lack a market price.

Summary

4.50 Both historical cost and market value provide information which is useful to users. Monetary authorities may hold monetary gold assets to aid in achieving different intentions as discussed in paragraph 4.5. Depending on the monetary authority's primary intention for holding monetary gold, there may be benefits for using historical cost over market value as a measurement basis, or vice versa:

- (a) Monetary authorities with the primary intention of holding monetary gold for use similar to foreign currency may prefer an exit value measurement basis. In this case, market value is a more appropriate measurement basis, because it provides information to assess the financial capacity of the entity. The best exit value measure is market value because there is an open, active and orderly market for gold, which is non-entity specific. By using market value to

³⁵ IPSAS 29.48(c) notes that Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to an must be settled by delivery of such unquoted equity instruments, shall be measured as cost.

measure the value of monetary gold, it allows for the faithful representation of the contribution of monetary gold to an entity's financial capacity.

- (b) Monetary authorities with the primary intention of holding monetary gold for an indeterminate period of time may prefer an entry value measurement basis. Some monetary authorities hold large quantities of monetary gold and do not have a history of sales. Additionally monetary authorities in some circumstances are restricted from selling monetary gold assets. Therefore, a historical cost measurement basis may be more appropriate, as it reflects the value to acquire monetary gold assets. It also allows users to assess the cost of acquiring/holding monetary gold and the service potential provided by reference to an actual transaction. Using historical cost to measure monetary gold also avoids introducing volatility into the statement of financial position and the statement of financial performance, which is consistent with some monetary authorities' intention in holding gold assets. Gold prices change significantly over time and the impact of using a market value measurement basis, can impair users' ability to assess the real cost of providing services, such as ensuring monetary stability.

Specific Matters for Comment – Chapter 4-1

- (a) Should entities have the option to designate a measurement basis, based on their intentions in holding monetary gold assets (as noted in paragraphs 4.5-4.6)?

Please provide the reasons for your support for or against allowing an option to designate a measurement basis based on intentions.

Specific Matters for Comment – Chapter 4-2

- (a) Please describe under what circumstances it would be appropriate to measure monetary gold assets at either:
- i. Market value; or
 - ii. Historical cost?

Please provide reasons for your views, including the conceptual merits and weaknesses of each measurement basis; the extent to which each addresses the objectives of financial reporting; and how each provides useful information.

If you support measurement based on intentions as discussed in SMC 4-1, please indicate your views about an appropriate measurement basis for each intention for which monetary authorities may hold monetary gold, as discussed in paragraph 4.5 (i.e., intended to be held for its contribution to financial capacity because of its ability to be sold in the global liquid gold trading markets, or intended to be held for an indeterminate period of time).

5. Chapter 5: International Monetary Fund (IMF) Quota Subscription and Special Drawing Rights (SDR)

Chapter Objective

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

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

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

Introduction

5.2 The IMF is an international cooperative monetary organization of member countries, established to carry out key activities³⁶ in three areas: lending, international monetary system surveillance, and capacity building.

5.3 On joining the IMF, member countries are assigned a quota based on their relative position in the world economy and pay a subscription equal to the value of the quota. The quota is also the key determinant of the voting power, amount of financial assistance available to the member from the IMF, and the member country's allocations of Special Drawing Rights (SDRs).

5.4 The value of a unit of SDRs is based on a basket of four currencies (Euro, Japanese Yen, Pound Sterling and US Dollar, with the Chinese Renminbi being added as a fifth currency from October 2016). The US dollar-equivalent value of the SDR is posted daily on the IMF's website and is calculated as the sum of the specific amounts of the four basket currencies, on the basis of the middle rate between the buying and selling exchange rates quoted at noon each day in the London market³⁷.

5.5 Transactions and asset/liability positions with the IMF are allocated between different institutions (usually the central bank or government) dependent on institutional and legal arrangements specific to each member country. Typically these transactions are recognized by the central bank. However, in some countries, transactions occur through government directly, or by the government (usually the department of finance or treasury) with the monetary authority as an intermediary.

5.6 For more information on the background and operation of the IMF, please see Appendix E.

Definitions

5.7 This section of the CP addresses the scope and definitions for any future guidance related to IMF quota subscriptions, SDR holdings and SDR allocations. Appendix A provides extracts from the Balance of Payments International Investment Position Manual—Sixth Edition, which forms the basis for statistical accounting under GFS for transactions of monetary authorities. Based on that guidance, the IPSASB proposes the following definitions for the IMF-related transactions in scope of this CP:

³⁶ For more information on the IMF activities see the following website: <http://www.imf.org/external/about/whatwedo.htm#key>.

³⁷ If the exchange rate for any currency cannot be obtained from the London Market, the rate shall be the middle rate between the buying and selling exchange rates at noon in the New York market or, if not available there, the rate shall be determined on the basis of euro reference rates communicated by the European Central Bank.

- 5.8 The proposed definition of **IMF Quota Subscriptions** is as follows:
 “The amount equal to the assigned quota, payable by the member on joining the IMF, and as adjusted subsequently.”
- 5.9 The IMF periodically reviews and adjusts member quotas. Additional contributions or redemptions may be required at this time.
- 5.10 Exchange rate fluctuations in a member’s domestic currency may give rise to adjusting contributions to, or redemptions from the IMF. When the domestic currency of a member devalues, an adjusting contribution for the quota subscription is required to the IMF. Conversely, when the domestic currency of a member appreciates, an adjusting redemption is received from the IMF.
- 5.11 The proposed definition of **SDR Holdings** is as follows:
 “International reserve assets created by the IMF and allocated to members to supplement reserves.”
- 5.12 The proposed definition of **SDR Allocations** is as follows:
 “Obligations which arise through IMF member’s participation in the SDR Department and that are related to the allocation of SDR holdings.”

Preliminary View – Chapter 5-1

The definitions are as follows:

- (a) The **IMF Quota Subscription** is the amount equal to the assigned quota, payable by the member on joining the IMF, and as adjusted subsequently.
- (b) **SDR Holdings** are International reserve assets created by the IMF and allocated to members to supplement reserves.
- (c) **SDR Allocations** are obligations which arise through IMF member’s participation in the SDR Department and that are related to the allocation of SDR holdings.

Do you agree with the IPSASB’s Preliminary View – Chapter 5-1?

Nature and Function

IMF Quota Subscription

- 5.13 The quota subscription provides members with membership in the IMF; that membership brings rights, benefits and obligations. Twenty-five percent of a member’s quota is paid in reserve assets (SDRs or foreign currency acceptable to the IMF), with the remaining seventy-five percent paid with domestic currency or a promissory note. The quota subscription gives:
- (a) Voting rights equal to the size of a member’s quota relative to total membership;
 - (b) Payments of interest from the IMF based upon a calculation of a member’s ‘reserve tranche position’; and
 - (c) A right to borrow from the IMF based on the amount of the quota subscription for balance of payment needs³⁸.

³⁸ For example, under the IMF Stand-by Arrangements and Extended Fund Facility, a member can borrow up to 200 percent of its quota annually and 600 percent cumulatively. However, access may be higher in exceptional circumstances.

- 5.14 The quota subscription has attributes of financial instruments, with similarities to:
- (a) Common shares in that the size of a member's quota determines voting rights and an ability to influence the activities of the IMF; and
 - (b) Debt instruments like bonds, loans, and preference shares because of the payment of interest on the reserve tranche position, as opposed to a return on profit or a return on the investment.
- 5.15 The right to borrow from the IMF based on the amount of the quota subscription for balance of payments needs is a unique attribute that could be viewed as similar to a collateral borrowing arrangement, where borrowing is permitted on demand up to a certain collateral level.
- 5.16 The Quota Subscription differs from common shares in that, being the equivalent of a membership fee, it cannot be sold. The only way to exit the investment is to withdraw from the IMF voluntarily or for the IMF to remove the member³⁹. Appendix F, includes a number of illustrative examples related to the IMF quota subscription.

SDR Holdings and Allocations

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

Accounting Considerations

Key Guidance from the Conceptual Framework

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

- 6.2 The recognition criteria are that:
- An item satisfies the definition of an element; and
 - Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

³⁹ The IMF Articles of Agreement set out provisions for withdrawal of membership, as well termination of partition in the fund.

Definitions

5.6 An asset is:

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

...

Presently Controlled by the Entity

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

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

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

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

Definition

5.14 A liability is:

A present obligation of the entity for an outflow of resources that results from a past event.

A Present Obligation

5.15 Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

Factors to be Considered—Recognition

5.21 The Conceptual Framework notes that items are recognized as assets or liabilities when they satisfy the definition of an element and can be measured and requires consideration of the following:

- Has a past event occurred?
- Does the transaction give rise to a resource (noting that a resource is an item with service potential or the ability to generate economic benefits) or a present obligation?
- Does the entity presently control that resource (indicating that control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) to derive benefits from the service potential or economic benefits)?

5.22 Table 5-1 below considers each of these requirements for IMF quota subscriptions, SDR holdings and SDR allocations.

Table 5-1: Recognition

	Past event	Giving rise to a resource or a present obligation	Control of the resource or ability to avoid an outflow of resources
IMF Quota Subscription	When the payment is made.	A resource. The quota may give rise to both service potential and the ability to generate economic benefits. Service potential may be provided indirectly because of the overall benefits to a member's economy from the IMF's contributions to the international financial structure. The quota also provides economic benefits because it may decrease costs of borrowing for foreign currency (reserve assets) because of the SDR market.	<p>(a) The IMF quota provides voting rights relative to the size of the members' quota compared to the total outstanding member quotas. This allows members the ability to impact decisions of the IMF. Further, the Articles of Agreement set out procedures for members to withdraw from the IMF and include rights and obligations to settle outstanding accounts, including the quota subscription. These two factors are indicators of present control of the resource.</p> <p>(b) The IMF requires a minimum of 25% of the quota to be payable in reserve assets and the remaining balance to be payable in domestic currency or by issuance of a promissory note. The IMF pays members interest based on the member's reserve tranche position. Member's which have a larger reserve tranche position receive higher interest payments. Does the split in payment method or difference in potential benefits impact the assessment of control over the resource? It is thought that it would not because the subscription is payable in full. Therefore, the different payment methods do not impact the ability to presently control the resource.</p>

PUBLIC SECTOR FINANCIAL INSTRUMENTS

	Past event	Giving rise to a resource or a present obligation	Control of the resource or ability to avoid an outflow of resources
SDR Holdings	Receipt of SDR holdings after a country becomes a member of the IMF, and a participant of the SDR Department, or after acquisition of SDR holdings.	<p>A resource.</p> <p>(a) SDR holdings can be used as consideration to transact with other IMF members for foreign currency; and</p> <p>(b) The holdings accrue interest from the SDR department.</p>	<p>(a) Members are free to transact the SDRs through the IMF or other voluntary arrangements at the member's discretion; and</p> <p>(b) The IMF Articles of Agreement set out the obligations and rules for the use of SDRs and which members agree to when participating in the SDR department; which facilitate the functioning of the SDR market.</p>

PUBLIC SECTOR FINANCIAL INSTRUMENTS

	Past event	Giving rise to a resource or a present obligation	Control of the resource or ability to avoid an outflow of resources
SDR Allocations	Membership in the IMF, participation in the SDR program and allocation of SDRs.	<p>A present obligation.</p> <p>(a) The IMF Articles of Agreement set out the rights and obligations of the IMF and IMF members. These articles include dispute resolution mechanisms to be overseen by the International Court of Justice, which therefore appear to be backed by the force of law. Therefore, SDR allocations appear to be legally enforceable they appear to give rise to a legally binding obligation.</p> <p>(b) In the event that one questions if the IMF Articles of Agreement give rise to a legally enforceable obligation, there would appear to be a high likelihood that a non-legally binding obligation may also exist because, by joining the IMF participating in the SDR department, a member indicates to the IMF as well as other members of the fund, that it accepts the responsibilities set out in the Articles of Agreement and creates a valid expectation that it will discharge those responsibilities. Failure to discharge those responsibilities is not viewed as realistic, because it would likely lead to withdrawal from the IMF.</p>	As the allocations are legally enforceable, there is little or no realistic alternative to avoid an outflow of resources.

Conclusions on Recognition

- 5.23 The IMF quota subscription satisfies the definition of an asset because it is a resource that provides service potential and economic benefits which is presently controlled. Some may argue that, because of the unique nature of the quota subscription, it could be considered a grant or a fee to the IMF. If so, an alternative approach may be to recognize the contribution as an expense because it would satisfy the definition of an expense if it decreased the net financial position of the entity⁴⁰. However, because the quota satisfies the definition of an asset, it would not decrease the net financial position of the entity and it does not appear appropriate, therefore, to consider it as an expense and the CP does not propose this alternative.
- 5.24 SDR holdings satisfy the asset element definition and recognition criteria in the Conceptual Framework. There does not appear to be a viable alternative treatment to consider.
- 5.25 SDR allocations satisfy the definition of a liability because a present obligation exists to other members of the IMF and there is no realistic ability to avoid settlement of that liability (because it is legally enforceable). There does not appear to be a viable alternative treatment to consider.

Factors to be Considered—Measurement

- 5.26 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.*
- 5.27 The IMF quota subscription is a requirement for membership in the IMF and provides its main source of funding. IMF membership provides benefits to members through its lending facilities, oversight of the international monetary system and capacity building services for developing countries. All of these IMF activities provide benefits that impact the global economy by helping to promote economic growth and stability. IMF membership helps ensure monetary authorities have the capacity to support the provision of services in future periods through physical and other resources and therefore information on operational capacity is most relevant.
- 5.28 SDRs were created by the IMF to supplement other reserve assets and help ensure growth in international trade through increased global liquidity. Use of SDRs (SDR holdings and allocations) for reserve purposes, indicates that information on their contribution to financial capacity is most relevant. This is because reserve assets need to be readily available for balance of payments financing needs, intervention in the currency markets and to maintain confidence in the currency and

⁴⁰ The Conceptual Framework defines an expense in 5.30 as “Decreases in net financial position of the entity, other than decreases arising from ownerships distributions.”

local economy. As such, their measurement basis needs to reflect the value available to the entity to fund such activities.

- 5.29 The IPSASB considered the Conceptual Framework guidance related to measurement for each of the IMF Quota Subscription, SDR holdings and SDR allocations. The IPSASB has analyzed the applicable measurement bases in table 5-2.

Table 5-2: Measurement

Measurement Basis	IMF Quota Subscription	SDR Holdings	SDR Allocations
<p>Historical Cost</p> <p>Defined in the Conceptual Framework as: <i>The consideration given (received) to acquire or develop an asset (assume an obligation), which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development (received at the time the liability is incurred).</i></p>	<p>Appropriate for initial measurement because it is an entry value which provides information on the resources exchanged to acquire the IMF quota subscription (and the related IMF membership benefits). Further, when additional adjusting contributions to, or redemptions from the IMF, are required as a result of exchange rates fluctuations of a member's domestic currency, historical cost may be appropriate when it reflects the cumulative resources contributed for the IMF quota subscription.</p> <p>However, the IMF quota subscription is denominated in SDRs and may require translation at each reporting date as it is analogous with a monetary item as defined in IPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i>. When the translated value of the quota subscription is equal to the cumulative resources contributed to the IMF, historical cost is appropriate. When there is a difference between the cumulative resources contributed and the translated value of the quota subscription, historical cost is not appropriate.</p>	<p>Appropriate for initial measurement as it provides users with the financial capacity provided to monetary authorities from SDR holdings as the amount of consideration given to acquire SDR holdings.</p> <p>However, historical cost would not be appropriate for subsequent measurement because SDR holdings are considered a monetary item in accordance with IPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i> and therefore require translation at each reporting date.</p>	<p>Appropriate for initial recognition and measurement as it provides users with information on the impact on monetary authorities financial capacity from SDR allocations, as the amount of consideration received to assume SDR allocations.</p> <p>However, historical cost would not be appropriate for subsequent measurement because SDR allocations are considered a monetary item in accordance with IPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i> and therefore require translation at each reporting date.</p>

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Measurement Basis	IMF Quota Subscription	SDR Holdings	SDR Allocations
<p>Market Value</p> <p>Defined in the Conceptual Framework as: <i>The amount for which an asset (liability) could be exchanged (settled) between knowledgeable, willing parties in an arm's length transaction.</i></p>	<p>The IMF quota subscription cannot be exchanged – that is, IMF members cannot sell their quota to another member or any other entity. Therefore, an open, active and orderly market does not exist. IMF members can redeem their quota subscription with the IMF and such a redemption could be considered a sale in an inactive market. However, the IPSASB view is that net selling price would be the more appropriate measurement basis to consider if a redemption is considered equivalent to a sale. Further, the IPSASB's view is measurement at market value in an inactive market would not be materially different than net selling price, as transaction costs do not appear significant.</p>	<p>Appropriate, because an open, active and orderly market exists, facilitated by the IMF, where transactions occur through the SDR department at the prevailing market rate. Therefore, use of a market rate provides users the best information on the financial capacity SDR holdings can provide the monetary authority.</p>	<p>Appropriate, because an open, active and orderly market exists, facilitated by the IMF, where transactions occur through the SDR department at the prevailing market rate. Therefore, use of a market rate, would provide users the best information to assess the impact of SDR allocations on financial capacity of the monetary authority.</p>
<p>Replacement cost</p> <p>Defined in the Conceptual Framework as: <i>The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.</i></p>	<p>Not appropriate⁴¹</p>	<p>The IPSASB's view is this is not materially different from market value, because to replace the service potential of SDR holdings would require purchasing SDR holdings at market value.</p>	<p>Not applicable for liabilities</p>

⁴¹ The IPSASB does not believe that replacement cost or value in use are appropriate because these are measurement bases more appropriate for tangible assets.

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Measurement Basis	IMF Quota Subscription	SDR Holdings	SDR Allocations
<p>Net Selling Price</p> <p>Defined in the Conceptual Framework as <i>The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.</i></p>	<p>Due to the unique nature of the IMF investment, it is not thought that it could be sold. However, it can be redeemed by withdrawing from the IMF, which may be considered similar to a sale, with the amount recovered equivalent to a redemption at the net selling price.</p>	<p>The IPSASB's view is this is not materially different from market value, as the IMF SDR department does not appear to include significant transaction costs.</p>	<p>Not applicable for liabilities</p>
<p>Value in use</p> <p>Defined in the Conceptual Framework as <i>The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.</i></p>	<p>Not appropriate</p>	<p>Not appropriate</p>	<p>Not applicable for liabilities</p>
<p>Cost of fulfillment</p> <p>Defined in the Conceptual Framework as: <i>The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming it does so in the least costly manner.</i></p>	<p>Not applicable for assets</p>	<p>Not applicable for assets</p>	<p>When the cost of fulfillment is dependent on uncertain future events, all possible outcomes are taken into account. The timing of settlement of SDR allocations is uncertain because settlement is at the discretion of other IMF members. The SDR allocation is a legally enforceable obligation, therefore settlement would be at the market value of the liability.</p>

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Measurement Basis	IMF Quota Subscription	SDR Holdings	SDR Allocations
<p>Cost of Release</p> <p>Defined in the Conceptual Framework as <i>The amount of an immediate exit from the obligation, or the amount a creditor will accept in settlement of the claim.</i></p>	<p>Not applicable for assets</p>	<p>Not applicable for assets</p>	<p>Not appropriate, as IMF members have little to no ability to seek immediate exit from the SDR allocation, as the timing of settlement is controlled by other IMF members.</p>
<p>Assumption Price</p> <p>Defined in the Conceptual Framework as <i>The amount that an entity would rationally be willing to accept in exchange for assuming an existing liability.</i></p>	<p>Not applicable for assets</p>	<p>Not applicable for assets</p>	<p>Not appropriate, as the SDR allocation obligation is not likely to be transferrable from the IMF member.</p>

Conclusions on Measurement

5.30 Based on the analysis in table 5-2, the IPSASB concludes that:

- (a) A mix of measurement bases should be used for the IMF quota subscription. Historical cost is appropriate for measurement on initial recognition and may be appropriate subsequently when adjusting contributions to, or redemptions from the IMF reflect the cumulative resources contributed for the quota subscription. Historical cost is not appropriate for subsequent measurement when the translated value of the quota subscription does not equal the cumulative resources contributed, as this value no longer reflects the historical cost. Under such circumstances, net selling price would be most appropriate. The mixed measurement approach is appropriate because it provides users with the best information on the operational capacity provided by the IMF quota subscription; and
- (b) The SDR holdings and allocations should be measured at market value, because it provides users with the best information on the impact on financial capacity.

Consistency with current IPSASs*IMF Quota Subscription*

5.31 The conceptual discussion for the IMF quota subscription is consistent with requirements in IPSAS 29⁴² to treat it as a financial asset. Further, it is consistent with how some IMF members account for the quota when applying IFRS.

IMF SDR Holdings

5.32 The conceptual discussion for SDR holdings is consistent with accounting for the SDR holdings as a financial asset measured at fair value through surplus or deficit and the requirements in IPSAS 29. Further, the treatment is consistent with how some IMF members account for SDR holdings when applying IFRS. Additionally the conceptual discussion is consistent with the treatment of a foreign currency in IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, with recognition at the exchange rate between the functional currency and foreign currency (market rate) at the transaction date and at the closing rate (market rate) at subsequent reporting periods⁴³. The proposed treatment is also consistent with the applicable requirements under Government Finance Statistics.

IMF SDR Allocations

5.33 The conceptual discussion related to accounting for SDR allocations is consistent with accounting for the SDR allocations as a financial liability measured at amortized cost and the requirements in IPSAS 29. Further, the treatment is consistent with how some IMF members account for SDR allocations when applying IFRS. The proposed treatment is also consistent with the applicable requirements under Government Finance Statistics.

⁴² IPSAS 29.45 – requires initial recognition at fair value which is equal to the historical cost paid for the instruments (fair value plus transactions costs directly attributable to acquisition) for instruments not designated at fair value through surplus or deficit. IPSAS 29.48 notes that investments in equity instruments that do not have a quoted market shall be subsequently measured at cost because of the lack of a market, these equity instruments can be measured at cost.

⁴³ IPSAS 4.24 and IPSAS 4.27.

Preliminary View – Chapter 5-2

The IPSASBs view is 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.
- (b) SDR holdings satisfy the Conceptual Framework definition of an asset and should be recognized, with measurement at market value.
- (c) SDR allocations satisfy the Conceptual Framework definition of a liability and should be recognized, with measurement at market value.

Do you agree with the IPSASB's Preliminary View – Chapter 5-2?

Appendix A: Government Finance Statistics Guidance

A.1 Informed by the Conceptual Framework and the GFS Policy Paper, the IPSASB reviewed the appropriate definitions and descriptions related to each topic included in the System of National Accounts 2008 (SNA), Government Finance Statistics Manual 2014 (GFSM) and Balance of Payments and International Investment Position Manual—Sixth Edition (BPM6). The IPSASB considered the applicable manuals related to each chapter when developing accounting guidance to minimize unnecessary differences. Excerpts from the manuals with the main guidance considered in development of the CP is included below.

Chapter 3: Currency in Circulation

The applicable guidance considered in developing the chapter follows:

- A.2 The most comprehensive guidance on statistical accounting for transactions of monetary authorities, is found in BPM6.
- A.3 BPM6 notes in paragraph 3.95: For an economy, a domestic currency is distinguished from foreign currency. Domestic currency is that which is legal tender in the economy and issued by the monetary authority for that economy; that is, either that of an individual economy or, in a currency union, that of the common currency area to which the economy belongs. All other currencies are foreign currencies.
- A.4 BPM6 notes in paragraph 5.36: Currency consists of notes and coins that are of fixed nominal values and are issued or authorized by central banks or governments.
- A.5 BPM6 notes in paragraph 11.53: Notes and coins are treated as liabilities at full face value. The cost of producing the physical notes and coins is recorded as government expenditure and not netted against the receipts from issuing the currency.

Chapter 2: General Definitions and Chapter 4: Monetary Gold

The applicable guidance considered in developing the chapter follows:

- A.6 The most comprehensive guidance on statistical accounting for monetary gold, can be found in BPM6.
- A.7 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.
- A.8 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 gold⁴⁴ is treated differently because of its role as a means of international payments and store of value for use in reserve assets.

- A.9 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).
- A.10 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.

Chapter 5: International Monetary Fund (IMF) Quota Subscription and Special Drawing Rights (SDR)

The applicable guidance considered in developing the chapter follows:

- A.11 The most comprehensive statistical guidance related to accounting for the IMF quota subscription and SDRs, can be found in BPM6.
- A.12 BPM6 notes in paragraph 3.97: SDRs are considered to be foreign currency in all cases, including for the economies that issue the currencies in the SDR basket.
- A.13 BPM6 notes in paragraph 5.34: SDRs are international reserve assets created by the IMF and allocated to members to supplement existing official reserves. SDRs are held only by the monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders. SDR holdings represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members.
- A.14 BPM6 notes in paragraph 5.35: Holdings of SDRs by an IMF member are recorded as an asset, while the allocation of SDRs is recorded as the incurrence of a liability of the member receiving them (because of a requirement to repay the allocation in certain circumstances, and also because interest accrues). The holdings and allocations should be shown gross, rather than netted.
- A.15 BPM6 notes in paragraph 7.82: The IMF pays its members “remuneration” quarterly on the basis of their reserve tranche position, except for a small portion related to prior quota payments in gold that are interest-free resources to the IMF. This remuneration is classified on an accrual basis as investment income–reserve assets–interest (credit), which is offset by an increase in reserve assets (debit).
- A.16 BPM6 notes in paragraph 6.85: Reserve position in the IMF is the sum of:

⁴⁴ Regardless whether gold assets are considered monetary gold or nonmonetary gold, under GFS guidance they are accounted for at market value. The difference in treatment under GFS relates to the classification and presentation of gold assets and not the recognition and measurement requirements.

- (a) The “reserve tranche,” that is, the foreign currency (including SDRs) amounts that a member country may draw from the IMF at short notice; and
 - (b) Any indebtedness of the IMF (under a loan agreement) in the General Resources Account that is readily available to the member country, including the reporting country’s lending to the IMF under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). While a member country must present a declaration of balance of payments-related need to make a purchase in the reserve tranche (reduction in reserve position), the IMF does not challenge a member’s request for reserve tranche purchases. Convertible currencies from a reserve tranche purchase may be made available within days.
- A.17 BPM6 notes in paragraph 7.75: IMF member countries are assigned a quota on joining the IMF. The subscription of the quota consists of two components:
- (a) Foreign exchange component. A member is required to pay 25 percent of its quota in SDRs or in foreign currencies acceptable to the IMF. This 25 percent portion is a component of the member’s reserve assets. In the balance of payments, subscribing this portion is shown as a transaction involving a reduction in other reserve assets (credit) offset by an increase in the reserve tranche position in the IMF (debit).
 - (b) Domestic currency component. The other 75 percent of the quota is payable in the member’s own currency at a designated depository, normally the member’s central bank. The payment is made either in domestic currency (IMF No. 1 and No. 2 Accounts) or by issuance of a promissory note (IMF Securities Account). The No. 1 Account is used for the IMF’s operational transactions (e.g., purchases and repurchases), whereas the No. 2 Account is used for the payment of local administrative expenses incurred by the IMF in the member’s currency. The promissory notes are encashable by the IMF on demand. The domestic portion of the quota payment is not recorded in the member’s balance of payments or in the IIP (see paragraph 6.85), except for the No. 2 account (see below). No interest is payable on either the deposit account or the note.

Appendix B: Currency in Circulation: Notes

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

Purchase Materials - Notes			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Purchase Materials - Journal Entry	<i>Purchase Material (Ink & Paper) for 1000, 100CU notes – cost 100CU</i>	<i>Purchase Material (Ink & Paper) for 1000, 100CU notes – cost 100CU</i>	<i>No new notes needed for this transaction.</i>
	DR Inventory - 100	DR Inventory - 100	
	CR Cash - 100	CR Cash - 100	
Production of Notes			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Production of Notes Journal Entry	<i>Production of 1000, 100CU notes. Production costs (Overhead & Labor) - cost 100CU</i>	<i>Production of 1000, 1000, 100CU notes. Production costs (Overhead & Labor) - cost 100CU</i>	<i>No new notes needed for this transaction.</i>
	DR Inventory - 100	DR Inventory - 100	
	CR Cash - 100	CR Cash - 100	

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Distribution of Notes			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Journal Entry to Recognize Financial Asset Received for Notes Distribution	<i>Issuance of 1000, 100CU notes, total cumulative face value 100,000CU. Transaction to Increase the amount of notes.</i>	<i>Transaction to exchange old notes for new notes. Issuance of 1000, 100CU notes, total cumulative face value 100,000CU. Net impact of currency in circulation is Nil - Redeeming old notes for new notes.</i>	No new notes issued for this transaction.
	DR Financial Asset (Other than domestic notes) - 100,000	DR Cash (old notes) - 100,000	
	CR Liability for Currency Issued - 100,000	CR Liability for Currency Issued - 100,000 ⁴⁵	
Journal Entry to Recognize Cost of Notes Issued	DR Cost of Notes Issued - 200	DR Cost of Notes Issued - 200	
	CR Inventory - 200	CR Inventory - 200	

⁴⁵ After old damaged notes are removed from circulation, they would usually be destroyed. At that point, the amount of cash is reduced accordingly and the liability is reduced. For example, the journal entry would be DR Liability for Currency Issued (old notes) – 100,000, CR – Cash (old Notes) – 100,000. Regardless of whether the cash is destroyed and permanently removed, any domestic notes held by the monetary authority are offset against the liability for currency in circulation, because such notes are not in circulation.

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Removal of Notes From Circulation			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Derecognition of liability due to removal of notes from circulation	<i>No notes being removed from circulation. No transaction to record.</i>	<i>Net change is nil, as old notes redeemed for new notes. Therefore, no impact on liability recognized.</i>	<i>Notes being removed from circulation; must exchange a financial asset other than domestic notes. Assume 1000, 100CU face value notes removed from circulation.</i>
			DR Liability, Currency in Circulation - 100,000
			CR Financial Asset (other than cash) - 100,000

Appendix C: Currency in Circulation: Coins

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

Purchase Materials			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Purchase Materials - Journal Entry	<i>Purchase Material (metal) for 1000, 0.25CU coins. Cost of 100CU.</i>	<i>Purchase Material (metal) for 1000, 0.25CU coins. Cost of 100CU.</i>	<i>No new coins needed for this transaction.</i>
	DR Inventory - 100	DR Inventory - 100	
	CR Cash - 100	CR Cash - 100	

Production of Coins			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Production of Coins Journal Entry	<i>Production of 1000, 0.25CU coins. Production costs (Overhead & Labor) - cost 100CU</i>	<i>Production of 1000, 0.25CU coins. Production costs (Overhead & Labor) - cost 100CU</i>	<i>No new coins needed for this transaction.</i>
	DR Inventory - 100	DR Inventory - 100	
	CR Cash - 100	CR Cash - 100	

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Distribution of Coins – Liability Recognized			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Journal Entry to Recognize Financial Asset Received for Coins Issued	<i>Issuance of 1000, 0.25CU coins, total cumulative face value 250CU. Transaction to Increase amount of coins.</i>	<i>Transaction to exchange old coins for new coins. Issuance of 1000, 0.25CU coins, total cumulative face value 250CU. Net impact of transaction Nil - Redeeming old coins for new coins.</i>	<i>No new coins issued for this transaction.</i>
	DR Financial Asset (Other than cash) - 250	DR Cash (old Coins) - 250	
	CR Liability for Currency Issued - 250	CR Liability for Currency Issued ⁴⁶ - 250.	
Journal Entry to Recognize Cost of Coins Issued	DR Cost of Coins Issued - 200	DR Cost of Coins Issued - 200	
	CR Inventory - 200	CR Inventory - 200	

⁴⁶ After old damaged coins are removed from circulation, they would usually be destroyed. At that point, the cash balance is reduced accordingly and the liability is reduced. For example, the journal entry would be DR Liability for Currency Issued (old coins) – 250, CR – Cash (old coins) – 250. Regardless of whether the cash is destroyed and permanently removed, any domestic coins held by the monetary authority are offset against the liability for currency in circulation, because such coins are not in circulation.

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Removal of Coins From Circulation – Liability Recognized			
Transaction	Increase Currency in Circulation	No Change Currency in Circulation	Decrease Currency in Circulation
Derecognition of liability due to removal of coins from circulation	<i>No Coins being removed from circulation. No transaction to record.</i>	<i>Net change is nil, as old coins redeemed for new coins. Therefore, no impact on liability recognized⁴⁷.</i>	<i>Coins being removed from circulation, must exchange for a financial asset other than domestic currency. Assume 1000, 0.25 face value coins removed from circulation.</i>
			DR Liability, Currency in Circulation - 250
			CR Financial Asset (other than cash) - 250

Distribution of Coins – No Liability Recognized⁴⁸	
Transaction	Increase Currency in Circulation
Journal Entry to Recognize Financial Asset Received for Coins Distribution	<i>Issuance of 1000, 0.25CU coins, total cumulative face value 250CU. Transaction to Increase amount of coins.</i>
	DR Financial Asset - 250
	CR Revenue - Issuance of Coins - 250
Journal Entry to Recognize Cost of Coins Issued	DR Cost of Coins Issued - 200
	CR Inventory - 200

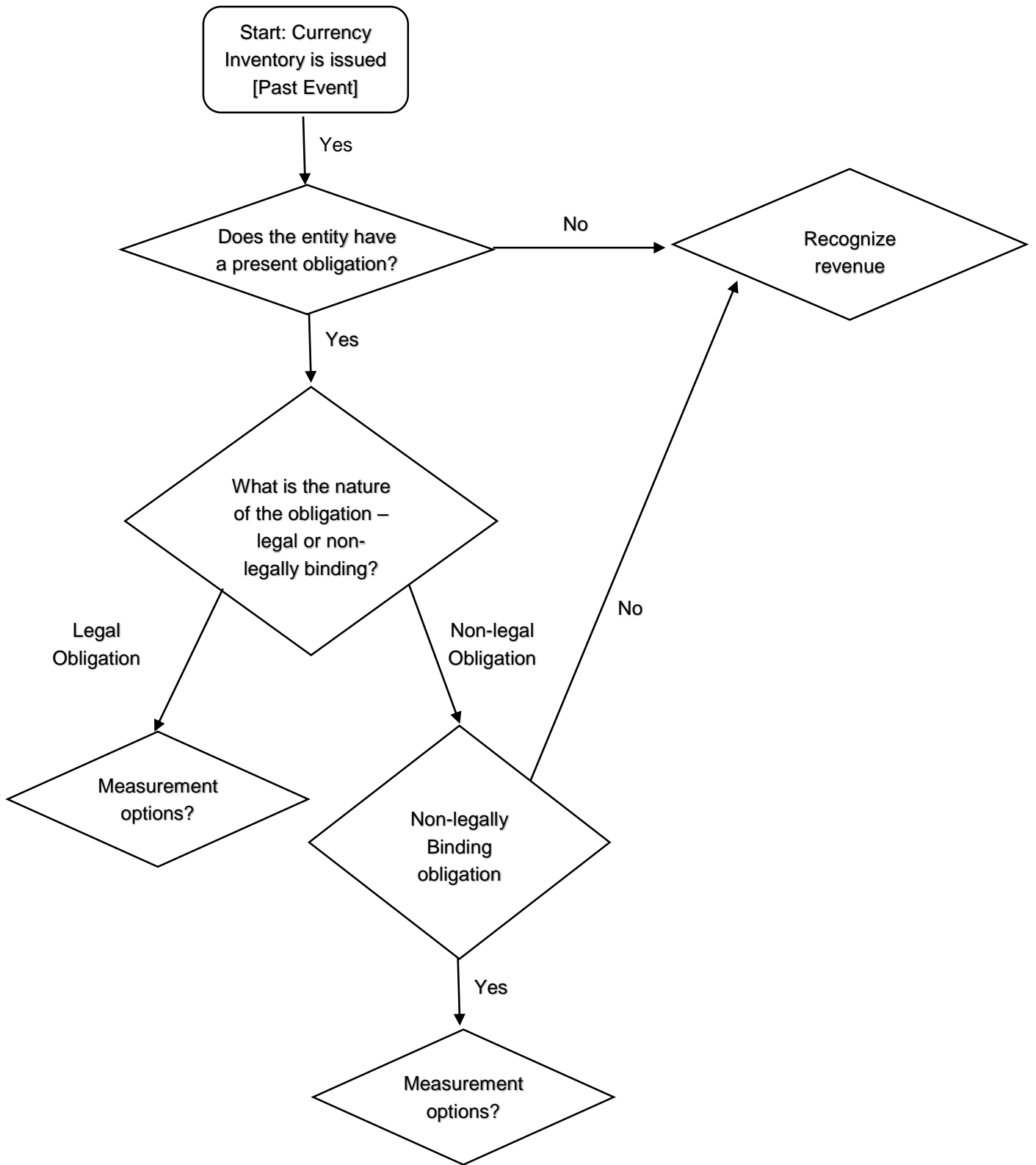
⁴⁷ When old coins are received, there may be a journal entry to recognize the residual value of the metal received as inventory which has not been included.

⁴⁸ No liability is recognized because there is a lack of a present obligation. Therefore only the transaction to put coins into circulation has been included.

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Cost of Materials and Production Exceed Face Value of Coins	
Transaction	Inventory
Journal Entry to record cost of production.	<i>Purchase Material (metal) for 1000, 0.25CU coins for cost of 100CU. As well as production costs for 1000, 0.25CU coins – cost of 200CU. Total cost of production equal to 300CU</i>
	DR inventory – 300
	CR Cash - 300
Journal Entry to write inventory down to the lower of cost and net realizable value.	Because the 300CU inventory cost is higher than the face value of the coins (the net realizable value of the coins) an adjustment needs to be recorded to write down the inventory value to the 250CU realizable face value of the coins (1000, 0.25CU coins = 250 CU face value)
	DR Inventory Impairment loss (lower of cost and net realizable value) - 50
	CR Inventory - 50

Appendix D: Decision Tree – Currency in Circulation



Appendix E: IMF Information

E1. This appendix provides an overview of background information on the IMF and the IMF quota subscription and SDR holdings and SDR allocations for information purposes only. This information is drawn from the IMF Financial Operations 2015 manual: <http://www.imf.org/external/pubs/ft/finop/2015/pdf/finop2015.pdf>.

IMF Overview

- E2. The IMF was founded over 70 years ago close to the end of World War II. The founding aim was to build a framework for economic cooperation. The world has changed significantly since the IMF was founded, and with it the IMF has changed. However, the main purpose of the IMF—to support the global public good of financial stability and prosperity—is the same today as when the organization was founded.
- E3. The IMF has near global membership of 188 countries. This places the IMF in a unique position to help members' governments take advantage of the opportunities and manage the challenges posed by globalization and economic development.
- E4. The IMF is a cooperative international monetary organization that was established together with the International Bank for Reconstruction and Development (known as the World Bank), by agreement of 44 countries that convened at the Bretton Woods of July 1944.
- E5. The IMF carries out its key activities⁴⁹ classified under three areas as follows:
- (a) Lending functions—tailored to address specific circumstances of its diverse membership. Most notably it is the financial institution that provides resources to member countries experiencing temporary balance of payment problems (actual or potential).
 - (b) Surveillance functions—responsibility for overseeing the international monetary system and the policies of its members.
 - (c) Capacity building—services to members from the IMF, including technical assistance and training, creation and distribution of international statistical information and methodologies and establishment and monitoring of standards and codes for international best practices (economic and financial statistics, financial sector soundness and good governance).
- E6. The IMF's remit is broader than that of a lending institution. The IMF is not only concerned with the economic challenges of member countries, but also with the functioning of the international monetary system as a whole. Therefore, its activities are aimed at promoting policies by which members work together to ensure stability in the financial system and sustainable economic growth.

IMF Quota Subscriptions

E7. The IMF is a quota-based institution, and quotas play a number of key roles; they not only determine a country's voting power and maximum financial commitment but are also relevant for access to IMF resources. The IMF normally reviews quotas every 5 years. These reviews are an opportunity to assess the appropriate size of the Fund and the distribution of quotas among its members.

⁴⁹ For more information on the key IMF activities see the following website: <http://www.imf.org/external/about/whatwedo.htm#key>.

- E8. Quotas provide the primary source of the IMF's financial base and play several key roles in the relationship with members, as follows:
- (a) Subscriptions: A member's quota subscription determines the maximum amount of financial resources it must provide the IMF. The IMF's regular lending is financed from the fully paid-in capital subscribed by member countries;
 - (b) Voting Power: Quotas largely determine the distribution of voting power to IMF members and thereby their decision-making and representation on the Executive Board;
 - (c) Access to Financing: Quotas play a role in determining a member countries' access to IMF resources; and
 - (d) SDR Holdings: Quotas determine a member's share when SDRs are allocated.
- E9. The IMF conducts general reviews of all members' quotas at least every five years. This allows the IMF to assess the adequacy of quotas in terms of members' needs for conditional liquidity and the IMF's ability to finance those needs. A general review allows for adjustments of members' quotas to reflect changes in their relative positions in the world economy.
- E10. A member may request an ad hoc quota adjustment outside of a general review.
- E11. Quota subscriptions from member countries are the primary source of financing for the IMF. However the IMF can supplement its quota resources through borrowing if it believes that resources may fall short of members' needs. The IMF maintains two standing borrowing arrangements:
- General Arrangements to Borrow (GAB)—Been in place since 1962 and was conceived as a means by which the main industrialized countries could stand ready to lend to the IMF up to a specified amount of their currencies. These loans would be made when supplementary resources were needed by the IMF to help finance drawings by GAB participants when such financing would forestall or cope with an impairment of the international monetary system.
 - New Arrangements to Borrow (NAB)—The first and primary resource in the event of a need for supplementary resources. NAB is a set of credit arrangements between 38 member countries. The aim of the NAB is similar to that of the GAB.

IMF Special Drawing Rights

- E12. Special Drawing Rights (SDRs) were created in 1969 as an international reserve asset to supplement other reserve assets whose growth was inadequate to finance the expansion of international trade and finances under the Bretton woods system.
- E13. The Bretton Woods fixed exchange rate system came under pressure during the 1960's because it did not have a mechanism for regulating the growth of reserves to finance the expansion of global trade and financial development. Gold production was inadequate and unreliable source of reserve supplies, and the continuing growth in global U.S. dollar reserves required a persistent deficit in the U.S. balance of payments, with itself posed a threat to the value of the U.S. dollar. Therefore Special Drawing Rights (SDRs) were created in 1969 as an international reserve asset to supplement other reserve assets whose growth was inadequate to finance the expansion of international trade and finances under the Bretton Woods system.
- E14. The SDR was created with the intention to make regulation of international liquidity subject for the first time to international consultation and deliberation.

- E15. The SDR is not a currency nor a claim on the IMF. Instead, it is a potential claim on the freely usable currencies of IMF members. The IMF may allocate SDRs unconditionally to members (participants) who may use them to obtain freely usable currencies in order to meet a balance of payments need without under-taking economic policy measures or repayment obligations.
- E16. The SDRs value as a reserve asset derives from the commitments of members to exchange SDRs for freely usable currencies and to honor various obligations connect with the proper operation of the SDR department. The IMF helps ensure the SDRs claim on freely usable currencies by acting as an intermediary between holders of SDRs in a voluntary but managed market.
- E17. To be allocated SDRs or to participate in borrowing arrangements of the IMF, a country needs to be an IMF member. To become an IMF member a country needs to fund its quota subscription in full by paying 25% of its value in SDRs or widely accepted currencies (such as the Euro, US Dollar, Pound Sterling or Japanese Yen). The remaining balance is generally funded by a non-interest bearing demand note payable to the IMF in the member country's own currency.
- E18. Holders of SDRs can obtain foreign currencies in two ways, either through the arrangement of voluntary exchanges between members, or by the IMF designating members with strong external positions to purchase SDRs from members with weak positions.
- E19. The SDR is an interest-bearing international reserve asset created by the IMF to supplement existing reserve assets and can be held and used only by participants in the IMF, and certain designed official entities – referred to as prescribed holders.
- E20. Since 1987 – SDR market has functioned primarily through voluntary trading arrangements—a number of members and one prescribed holder have volunteered to buy and sell SDRs as defined by their respective arrangements. In the event of insufficient capital under the voluntary arrangements, the IMF can activate the designated mechanism, which is IMF members with strong balance of payments and reserves position may be designated by the IMF to purchase SDRs from members with weak external positions. This designation mechanism serves as a back-stop to guarantee the liquidity and reserve asset character of the SDR. Thus, the functioning of the SDR Department, like that of the General Department, is based on the principle of mutuality and intergovernmental cooperation.
- E21. The SDR is valued based on a basket of currencies (USD, Euro, Pound and Yen) currently. The value is calculated daily as the sum of specific amounts of the basket currencies valued in US dollars on the basis of the exchange rates quoted at noon each day in the London Market—the value of which is posted on the IMF website each day in USD. The IMF recently decided that in 2016 it will add a fifth currency—the Chinese Renminbi, to the SDR currency basket used for valuation purposes.
- E22. The SDR interest rate was initially fixed and set at below market levels. However, it is now market based and calculated weekly. It is based on a weighted average of representative interest rates on short-term debt in money markets of the SDR basket of currencies, except if the weighted average falls below the floor for the SDR interest rate of .0050 percent (5 basis points). The value and yield of the SDR are linked to the prevailing market for the SDR itself in which excess supply or demand pressure can be eliminated by adjustments in the price, or value, of the SDR. Rather, the IMF itself manages the flows of SDRs to ensure liquidity in the system.
- E23. Members earn interest on SDR holdings and pay interest on its cumulative allocations, but the two interest rates are identical and the payments therefore net out as long as member's cumulative

allocations are equal to its holdings of SDRs. Countries holding SDRs can use these assets by exchanging them for freely usable currencies at a value determined by the value of the SDR basket.

- E24. The IMF's Executive Board reviews the SDR valuation every 5 years. These reviews cover currencies to be included in the SDR valuation basket, determine the relative weights of those currencies, and assess the financial instruments that are used to calculate the SDR interest rate.
- E25. The weighting of currencies included in the basket is based on a combination of the value of exports and official reserve assets held by monetary authorities outside of the country or the monetary union issuing the respective currency.
- E26. The SDR interest rate provides the basis for calculating the interest charged to members on non-concessional IMF loans and from the IMF's general resources, the interest paid to IMF members on their remunerated creditor positions in the IMF (reserve tranche positions and claimed under borrowing agreements), and the interest paid to members on their SDR holdings and charged on their SDR allocation.
- E27. The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term financial debt instruments in the money markets of the SDR basket currencies except if the weighted average falls below the floor for the SDR interest rate of .050 percent (5 basis points). The review of the financial instruments to determine the SDR interest rate consider two broad criteria:
- The FIs' in the interest rate basket should be broadly representative of the range of FI's that are actually available to investors in a particular currency, and the interest rate on the instruments should be responsive to changes in underlying credit conditions in the corresponding money market.
 - The FIs in the interest rate basket should have characteristics similar to the official standing of the SDR itself—that is, they should have a credit risk profile of the highest quality and be fully comparable to that of government paper available in the market or, in the absence of appropriate official paper, comparable credit risk on prime financial instruments. Instruments should also reflect the actual reserve asset choice of reserve managers—for example, regarding the form of the financial instruments, its liquidity and its maturity.
- E28. The current benchmark rates for the four currencies are as follows:
- (a) U.S. dollar: 3 month U.S. Treasury bills
 - (b) Euro: 3-month rate for euro area central government bonds with a rating of AA and above published by the European Central Bank
 - (c) Japanese yen: 3-month Japanese Treasury discount bill
 - (d) Pound sterling: 3-month U.K. Treasury bill.

The yields on these instruments are used to calculate the SDR interest rate for each week.

- E29. Under the Articles of Agreement, the IMF Executive Board may create unconditional liquidity through general allocations of SDRs to member countries that participate in the SDR Department in proportion to their IMF Quotas. Such an allocation provides each member with an unconditional international reserve asset. The IMF cannot allocate SDRs to itself or prescribed holders.

- E30. SDR allocations are a form of unconditional liquidity. Participants in the SDR Department do not have to meet any specific requirements to receive their proportional share in a general allocation. And, following such an allocation, they have the right to use the newly allocated SDRs when they have a balance of payments need or in order to adjust the composition of their reserves to obtain currency from other participants in transactions by agreement or in necessary through the designation plan. There is no obligation under the current Executive Board decisions to maintain any particular level of SDR holdings. The SDR system therefore provides members with access on demand to freely usable currencies on an unconditional basis with no fixed maturity.
- E31. SDRs are allocated only to IMF members that elect to be participants in the SDR Department and agree to observe the obligations of participants. Since April 7, 1980, all members of the IMF have been participants in the SDR Department.
- E32. SDRs may be used by IMF members and the IMF itself in accordance with the Articles of Agreements and decisions adopted by the IMF Executive Board and the Board of Governors. SDRs cannot be held by private entities or individuals. Other holders of SDRs include the IMF, through the GRA within the General Department, and international organizations and monetary institutions prescribed by the IMF.
- E33. The IMF has the authority to prescribe, as other holders of SDRs, nonmembers, member countries that are not SDR Department Participants, institutions that perform the functions of a central bank for more than one member, and other official entities. As of April 30, 2015 therefore 15 organizations⁵⁰ approved as ‘prescribed holders’. These entities may acquire and use SDRs in transactions by agreement and in operations with other holders, but they may not receive allocations of SDRs.

⁵⁰ The 2015 IMF Financial Operation Manual notes that the 15 prescribed holders are four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and eight development institutions (African Development Bank; African Development Fund; Asian Development Bank; International Bank for Reconstruction and Development, and International Development Association—respectively, the “hard” and “soft” loan entities of the World Bank Group; Islamic Development Bank; Nordic Investment Bank; and International Fund for Agricultural Development).

Appendix F: IMF Quota Subscription, SDR Holdings and SDR Allocations: Illustrative Examples

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

IMF Quota Subscription

- IE1. The following scenarios illustrate key transactions in the IMF quota subscriptions process. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying the draft chapter. The examples are for information and understanding purposes, to help understand the economic substance of transactions related to IMF quota subscription transactions.
- IE2. Each scenario illustrates process steps related to the IMF quota subscription, including a member country joining the IMF, and other important related subsequent transactions.

Scenario 1: Becoming an IMF member country

- IE3. In this example, a country becomes a member of the IMF and pays its quota subscription.
- IE4. The amount of the initial quota subscription is based on a formula used by the IMF to determine the calculated quota share. The main factor in the calculation relates to the country's GDP.
- IE5. After the amount of the quota subscription is determined the country pays the quota. The first twenty-five percent of the quota payment is called the reserve asset portion and must be paid in SDR holdings or a highly liquid currency of other IMF members (usually U.S. dollars, euros, Japanese Yen or pound sterling). The remaining seventy-five percent is called the local currency portion (domestic currency) and is payable in a member's own currency or through the issuance of a promissory note to be held in the IMF's Securities Account with the member's designated depository, typically its central bank.
- IE6. Example: The IMF determines the amount of the quota subscription to be 100,000 SDRs for country A. 1 SDR = CU2 in Country A. Country A, pays the reserve asset portion of the quota subscription—25,000 SDRs in USD, equal to CU50,000 and issues a promissory note for the 75,000 SDRs equal to CU150,000. The total amount paid by Country A for the 100,000 SDRs quota subscription is equal to CU200,000.

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

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

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

Scenario 2: IMF Quota Increases under General Reviews

- IE7. In this example, the IMF under a general review increases Country A's quota.
- IE8. At least every five years, the IMF completes a quota review, which can lead to an adjustment of members quota as a result in changes in their relative positions in the world economy or a general increase in the total quota amount for all IMF members.
- IE9. Example: The IMF increases the total quota amount after a general review. Country A's new quota subscription has increased from 100,000 SDRs by 20,000 SDRs to the new quota amount equal to 120,000 SDRs. Before the general review, Country A's quota is equal to CU200,000 and paid in full. 1 SDR = CU2 in Country A. Country A, pays the reserve asset portion of the additional quota subscription—5,000 SDR holdings, valued at CU10,000 and issues a promissory note for the local currency portion (i.e. domestic currency portion)—15,000 SDR holdings equal to CU30,000. The total paid by Country A for the additional quota equals 20,000 SDRs (CU40,000). The foreign currency portion of the IMF quota increase can be paid with SDRs, or another global liquid currency such as USD, Yen, Pounds or Euros.

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

The quota subscription for the Country A has increased from 100,000 SDRs to the revised amount of 120,000 SDRs which is equal to CU240,000 in Country A's functional currency (domestic currency). The member pays the additional reserve asset portion of 5,000 SDRs, equal to CU10,000. The member pays the remaining additional local currency portion of 15,000 SDRs by issuing a promissory note equal to CU30,000.

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

After the increase in the quota due to the general review and the payment by Country A, the total amount of the IMF quota subscription (financial asset) is 120,000 SDRs, equal to CU240,000. The total balance of the promissory note (financial liability) is equal to CU180,000.

Scenario 3: Member Country Currency Devalues Compared to the SDR

- IE10. In this example, Country A's domestic currency devalues (relative to SDRs). Therefore there is an increase in the value of the quota subscription because it denominated in SDRs which is not the functional currency of Country A.
- IE11. Country A's quota subscription equals 120,000 SDRs. The domestic currency has devalued relative to the SDR, so that 1 SDR now equals CU2.5 (subsequent to the devaluation of the domestic currency 1 SDR was equal to CU2). Therefore the value of the quota subscription increased from CU240,000 to CU300,000.

1. The journal entry to recognize the increase in the value of the IMF Quota would be as follows:

Dr	IMF quota subscription (Financial Asset)	60,000	
	Cr	Foreign Exchange Gain	60,000

The 120,000 SDRs quota has not changed. However, Country A's domestic currency has devalued relative to the SDR, with the exchange rate decreasing from 1 SDR = CU2 to the new rate of 1 SDR

= CU2.5. Therefore the value of the quota for the Country A has increased from CU240,000 to the CU300,000, resulting in a CU60,000 foreign exchange gain.

Scenario 4: Member Makes Additional Payment Because of Currency Devaluation

IE12. In this example, Country A must make an additional payment to the IMF for its quota subscription, because of the devaluation of its domestic currency.

IE13. The IMF requires countries to make additional payments, related to the domestic currency portion of their quota subscriptions when their currency devalues relative to the SDR. Country A's quota subscription remains 120,000 SDRs, however the domestic currency has devalued so that 1 SDR now equals CU2.5. In domestic currency the quota subscription is now equal to CU300,000. The IMF requires an additional payment to the domestic currency portion of the quota subscription because of the devaluation. Therefore, an additional payment is required.

1. The journal entry to recognize the additional top up payment would be as follows:

Dr	IMF quota subscription (Financial Asset)	45,000	
	Cr	Promissory Note (Financial Liability)	45,000

The 120,000 SDRs quota has not changed. However, because of the devaluation of Country A's domestic currency an additional payment is required. The domestic currency has decreased from 1 SDR = CU2 to the new rate of 1 SDR = CU2.5. Therefore the value of the quota for the Country A has increased from CU240,000, by CU60,000 to the new value of CU300,000. A payment is required for the local currency portion (domestic currency) of the quota subscription which is 75% of the increase in the quota subscription value of CU60,000, which is equal to CU45,000.

IE14. Because the IMF quota has increased as a result of the additional payment to the IMF, the cost of the investment is now higher than the value in domestic currency. The IMF quota subscription after the additional payment is equal to CU345,000. However, because the exchange rate is equal to 1 SDR = CU2.5. The IMF quota is equal to 120,000 SDRs, which is equal to CU300,000. Therefore, an additional foreign currency adjustment must be recognized as follows:

1. The journal entry to recognize the foreign exchange adjustment subsequent to the additional payment to the IMF is as follows:

Dr	Loss on foreign exchange	45,000	
	Cr	IMF quota subscription	45,000

The 120,000 SDRs quota has not changed. However, in domestic currency the investment in the IMF quota subscription is equal to CU345,000 after the additional required payment to the IMF for the domestic currency portion of the quota increase. The exchange rate is now 1 SDR = CU2.5, therefore the value in domestic currency of the 120,000 SDRs quota subscription is still CU300,000. Therefore as adjustment must be recognized, as the quota is equal to CU345,000 and requires an adjustment.

Scenario 5: IMF Pays Remuneration on Country A's Reserve Tranche Position

IE15. In this example, the IMF pays remuneration (interest) on country A's reserve tranche position.

IE16. The reserve tranche position is equal to the member's quota less the IMF's holdings of the members own currency⁵¹.

IE17. For this scenario we assume that Country A's reserve tranche position equals 30,000 SDR holdings. The IMF pays interest based on the SDR interest rate. The reserve tranche position interest rate for this scenario is equal to 1% per year and is paid quarterly in SDR holdings. 1 SDR = CU2.5 in Country A.

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

On a quarterly basis, interest is paid at the IMF SDR interest rate⁵² on the reserve tranche position. Country A earns 1% interest per annum on the reserve tranche position, which is paid on a quarterly basis. Country A's reserve tranche position is equal to 30,000 SDRs. The interest paid for the quarter in SDRs is $1\% \times 30,000 = 300$ year. Therefore, $300 / 4$ quarters = 75 SDRs interest each quarter, which equals CU187.5.

Dr	SDR holdings (Financial Asset)	187.5	
	Cr	Interest Revenue – quota subscription	187.5

Special Drawing Rights (SDRs)

IE18. The following scenarios illustrate different steps in the process for accounting IMF SDR holdings and allocations transactions. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying the draft chapter. The examples are for information and understanding purposes, to help demonstrate the substance of certain transactions.

IE19. Each scenario illustrates a different transaction involving SDRs.

Scenario 6: Member Country Receives Allocation of SDRs

IE20. In this example, an IMF member country agrees to participate in the SDR department and receives an initial allocation of SDRs.

IE21. When a member country agrees to participate in the SDR department of the IMF, SDR holdings and allocations are distributed based on the size of the countries IMF quota subscription.

IE22. The IMF determines that Country A's quota subscription of 120,000 SDRs equals a grant of SDR holdings and allocations of 50,000 SDRs. 1 SDR = CU2.5 in Country A.

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

The IMF distributes Country A 50,000 SDR holdings (asset), for which Country A recognizes 50,000 SDR allocations (liability), both equal to CU125,000.

⁵¹ A small portion of the reserve tranche position related to an IMF members holdings as of April 1, 1978 in unremunerated. For simplicity of the example, the unremunerated portion of the reserve tranche position has not been considered.

⁵² The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term financial debt instruments in the money markets of the SDR basket currencies except if the weighted average falls below the floor for the SDR interest rate of 0.05 percent (5 basis points). The SDR interest rate is expressed as an annual rate with interest paid on a quarterly basis.

PUBLIC SECTOR FINANCIAL INSTRUMENTS

Dr	SDR Holdings	125,000	
	Cr	SDR Allocations	125,000

Scenario 7: Interest on SDRs: Member Country Allocation and Holdings Equal

- IE23. In this example, interest expense/revenue are calculated on SDR holdings and allocations.
- IE24. The IMF pays interest on members SDR holdings and members are charged interest by the IMF on SDR allocations. The interest rate is the same for both holdings and allocations and is paid SDRs.
- IE25. Country A has an equal amount of SDR holdings and allocations 50,000 SDRs equal to CU125,000. The SDR interest rate is 0.8% per annum and is paid quarterly. 1 SDR = CU2.5 in Country A.

1. The journal entries to recognize quarterly interest on the SDR holdings and allocations, both equal to 50,000 SDRs or CU125,000 at the rate 0.8% per annum would be as follows:

*The IMF interest rate 0.8% per annum which is 0.2% per quarter * 50,000 SDRs for holdings and allocations equals 100 SDRs, or CU250.*

This entry is for the Interest revenue on SDR holdings

Dr	SDR Holdings	250	
	Cr	Interest Revenue on SDR Holdings	250

This entry is for the Interest expense on SDR allocations

Dr	Interest Expense on SDR Allocations	250	
	Cr	SDR Holdings	250

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

Scenario 8: Member country transacts SDR holdings for foreign currency

- IE26. In this example, Country A trades SDR holdings for foreign currency.
- IE27. When member countries require foreign currency or other reserve assets, they may transact through the IMF with other members using SDR holdings to obtain it.
- IE28. Country A requires foreign currency and contacts the IMF to initiate a transaction using its SDR holdings. Country A requires Japanese Yen, for an international loan payment. The Yen currently trades at CU5 to 1 SDRs, 1 SDR equals CU2.5. Country A requires 20,000 yen for its loan payment. The calculation of the transaction is as follows:

Country A requires 20,000 yen for a loan payment. Therefore, it contacts the IMF and initiates a transaction using its SDR holdings to obtain the yen needed. The Yen exchange rate to SDRs is CU5 to 1 SDR and 1 SDR equals CU2.5. The calculation is as follows: 20,000 yen equals 4,000 SDR holdings, 4,000 SDR holdings equals CU10,000.

The entry to recognize the transaction is as follows:

Dr	Foreign Currency – Yen (20,000 yen = CU10,000)	10,000	
	Cr	SDR holdings (4,000 SDR holdings = CU10,000 = 20,000 yen)	10,000

Scenario 9: Member Country allocation of SDRs in excess of SDR Holdings

IE29. In this example, interest expenses/revenue are calculated on SDR holdings and allocations.

IE30. The IMF pays interest on the SDR holdings and member countries are charged interest by the IMF on SDR allocations. The interest rate is the same for both holdings and allocations and paid in SDRs.

IE31. Country A has SDR holdings equal to 46,000 SDRs and allocations of 50,000 SDRs. The SDR interest rate is 0.8% per annum and is paid quarterly. 1 SDR = CU2.5 in Country A.

1. The journal entries recognize quarterly interest on the SDR holdings of 46,000 SDRs or CU115,000 and SDR allocations of 50,000 SDRs or CU125,000. The interest rate on both SDR allocations and holdings is 0.8% per annum. The calculations are as follows:

*The IMF interest rate 0.8% per annum which is 0.2% per quarter * 46,000 SDR holdings and 50,000 SDR allocations. The quarterly interest for the SDR holdings is 92 SDRs, or CU230. The quarterly interest for the SDR allocations is 100 SDRs, or CU250.*

This entry is for the Interest earned on SDR holdings

Dr	SDR Holdings	230	
	Cr	Interest Earned on SDR Holdings	230

This entry is for the Interest expense on SDR allocations

Dr	Interest Expense on SDR Allocations	250	
	Cr	SDR Holdings	250

In this scenario because the SDR allocations exceed the SDR holdings, the net impact is an interest expense of CU20 and a net decrease in SDR holdings of CU20.

Scenario 10: Member Country holdings in excess of allocation SDRs

IE32. In this example, interest expenses/revenue are calculated on SDR holdings and allocations.

IE33. The IMF pays interest on the SDR holdings and member countries are charged interest by the IMF on SDR allocations. The interest rate is the same for both holdings and allocations and paid in SDRs.

IE34. Assume Country A has SDR holdings equal to 60,000 SDRs and allocations of 50,000 SDRs. The SDR interest rate is 0.8% per annum and is paid quarterly. 1 SDR = CU2.5 in Country A.

1. The journal entries recognize quarterly interest on the SDR holdings of 60,000 SDRs equal to CU150,000 and SDR allocations of 50,000 SDRs equal to CU125,000. The interest rate on both SDR allocations and holdings is 0.8% per annum, paid quarterly. The calculations are as follows:

*The IMF interest rate 0.8% per annum which is 0.2% per quarter * 60,000 SDR holdings and 50,000 SDR allocations. The quarterly interest for the SDR holdings is 120 SDRs, equal to CU300. The quarterly interest for the SDR allocations is 100 SDRs, equal to CU250.*

This entry is for the Interest earned on SDR holdings

Dr	SDR Holdings	300	
	Cr	Interest Earned on SDR Holdings	300

This entry is for the Interest expense on SDR allocations

Dr	Interest Expense on SDR Allocations	250	
----	-------------------------------------	-----	--

International Public Sector Accounting Standards, Exposure Drafts, Consultation Papers, Recommended Practice Guidelines, and other IPSASB publications are published by, and copyright of, IFAC.

The IPSASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

The 'International Public Sector Accounting Standards Board', 'International Public Sector Accounting Standards', 'Recommended Practice Guidelines', 'International Federation of Accountants', 'IPSASB', 'IPSAS', 'RPG', 'IFAC', the IPSASB logo, and IFAC logo are trademarks of IFAC, or registered trademarks and service marks of IFAC in the US and other countries.

Copyright © July 2016 by the International Federation of Accountants (IFAC). All rights reserved. Permission is granted to make copies of this work to achieve maximum exposure and feedback provided that each copy bears the following credit line: *“Copyright © July 2016 by the International Federation of Accountants (IFAC). All rights reserved. Used with permission of IFAC. Permission is granted to make copies of this work to achieve maximum exposure and feedback.”*

Published by:



IPSASB

**International Public
Sector Accounting
Standards Board®**

529 Fifth Avenue, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ipsasb.org