CIPFA The Chartered Institute of Public Finance & Accountancy

Consultation Paper
Public Sector Financial Instruments

response to consultation paper

16 December 2016

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

Our ref: Responses/ SC0231 161216

International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto
Ontario M5V 3H2
CANADA
Submitted electronically

31 December 2016

Dear IPSASB secretariat

IPSASB Consultation Paper
Public Sector Financial Instruments

CIPFA is pleased to present its comments on this Consultation Paper, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

In developing this response, CIPFA consulted with UK expert stakeholders in this area, including HM Treasury and the Bank of England. While their input was very helpful, we would note that this response does not constitute a response on behalf of those UK stakeholders.

Response to Preliminary Views and Specific Matters for Comment

CIPFA comments on the preliminary views and specific matters for comment are provided in the attached annex.

I hope this is a helpful contribution to IPSASB's work in this area. If you have any questions about this response, please contact Steven Cain
(e: steven.cain@cipfa.org, t: +44(0)20 7543 5794).

Yours sincerely

Alison Scott
Head of Standards and Financial Reporting
CIPFA
77 Mansell Street, London E1 8AN
t: +44(0)1604 889451
e: alison.scott@cipfa.org

ANNEX

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?
CIPFA agrees with the substance of IPSASB's Preliminary View. However, definition a) is not as clear as it could be, and might be read as being a circular definition. Referring to 'the' central bank also seems wrong, given that there might not be a central bank. It would be clearer if the text was restructured, for example as follows: *(a)* ***Monetary authority*** *is the entity or entities which carry out operations usually attributed to a central bank. This may include a central bank, and/or one or more departments of the central (national) government.*

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?
CIPFA agrees with the IPSASB's Preliminary View.

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?

CIPFA agrees that the accounting treatment for notes should be *consistent* with the accounting treatment for coin, but based on our discussions with the monetary authorities in the UK, it is not clear to us that this requires that the treatment should be *identical*.

The way in which a liability arises depends on the nature of obligations arising from a past event, and it is this which will underlie the accounting treatment. Thus the accounting treatment for notes and coins can only be guaranteed to be identical if the obligations associated with their issuance are sufficiently similar.

In the UK context, notes are effectively promissory notes, with a contractual obligation to deliver cash to another party. Bank notes in circulation are backed by matching investments to meet the Bank of England's obligation to exchange notes. The Bank has an obligation to replace damaged notes – as the expected life of a bank note varies between 18 months and 5 years.

In line with this pattern of obligation, bank notes are treated as a liability.

By way of contrast, in the UK the value of coins derives directly from the legal position. They are legal tender by virtue of s.2 of the Coinage Act 1971. They do not represent an entitlement to receive other legal tender as is the case with bank notes.
Section 3 of the Coinage Act covers the regulation of coins by proclamation. This provides for the issuing of new coins but also provides that Her Majesty may issue a proclamation which calls in coins of any date or denomination (s. 3(1)(e)). If such a proclamation is issued then, unlike section 1(5) of the Currency and Bank Notes Act 1954, the Coinage Act does not specify that the holder must be paid the value of those coins, but the effect is that the coins called in cease to be "coins" within the meaning of the Act and therefore cease to be legal tender (see Section 2(3) of the Coinage Act).
So the factors outlined at paragraph 3.21 of the CP are not in place.

Coins, being made of durable metal, are not subject to the same wear and tear as bank notes, and the expected life of a coin can be over 40 years. Coins in circulation are not backed by equivalent securities. As there is no legal obligation to deliver cash to another party, the definition of a liability is not met.

UK Whole Of Government Accounts therefore treat coins as a contingent liability.

However, this does not mean that there are no obligations associated with coins, which in day to day transactions are exchangeable for notes. In substance, this might lead one to conclude that, despite the legal form, many monetary authorities would, in practice, replace coins in the same way that they replace notes – which might imply that there is a non-legally binding obligation.

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.

CIPFA agrees that if approach 1 is not appropriate, then approach 2 should be followed. Thus, where a liability is not recognised on issuance of currency, revenue should be recognised.

In our view it would be appropriate to recognise this in the statement of financial performance.

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?
CIPFA agrees with these definitions.

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.
CIPFA agrees it may be appropriate for entities to have the option to designate a measurement basis, based on their intentions in holding monetary gold assets. We agree that Intention 1 and Intention 2 represent the main categories of intention. However, as explained in our answer to the next question, it is not clear to us that under Intention 2 the most relevant information is necessarily historical cost.

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).

CIPFA in principle supports measurement based on intention. However, we do not agree that Intention 2 provides sufficient justification for the use of a historical cost approach.

For assets to serve as reserve assets, it seems sensible to consider valuation in the context of hypothetical or actual use of those reserves to help with financing needs and economic interventions.

As described in para 4.28, this can involve the planned active use and exchange of the assets to contribute to financial capacity. Under these circumstances the market value of monetary gold provides a direct measure of the value at which exchanges are expected to occur.

Paragraph 4.29 outlines a position where the monetary authority has an intention to hold monetary gold for an indeterminate period, and suggests that a measurement basis which provides information on cost of services may be relevant. The reason for holding is expressed as ‘because it provides confidence in the ability of [the] monetary authorit[y] to carry out their activities’.

In CIPFA’s view, the value of a reserve asset inheres in its capacity in exchanges of the last resort, having regard to the net asset/liability position of the government. It is this capacity which provides confidence in the monetary authority, and it seems to us that the relevant value for this purpose is the current market value.

Now for long term assets, there may not be a great benefit in precisely tracking the market value. So for practical purposes it would be possible to remeasure only in cases where there is a significant change in value due to impairment or appreciation.

We would note our strong view that appreciation or upward movements in the market value of reserves are very relevant to the functioning of a reserve asset – it is not just impairments that matter.

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?

CIPFA agrees with the Preliminary View, which accords with the current UK approach for these items.

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?

CIPFA agrees with the Preliminary View, which also accords with the current UK approach.