

31 March 2016

AC-4-5-5

Mr John Stanford
The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017 United States of America

Dear John

Consultation Paper: Public Sector Specific Financial Instruments

The New Zealand Treasury welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board's Consultation Paper *Public Sector Specific Financial Instruments*

We are pleased that the IPSASB is looking at these specific public sector issues to complement the IPSASB's project to converge IPSASs 28 – 30, *Financial Instruments*.

We have attached our responses to the specified matters for comment. We apologise for the delay in sending our response.

Yours sincerely



Nicola Haslam
Manager, Fiscal Reporting

ATTACHMENT

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.

(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?

We agree with the definitions in Chapter 2. We support the definition of *Monetary Authority* including entities that are not labelled central banks but perform the same functions of a central bank.

We note the definition of a *Monetary Authority* relies on an understanding of a central bank and its usual operations. On that basis, we suggest the IPSASB consider developing in the definition a description of what central banks usually do, which we understand is to control a jurisdictions' money supply through a variety of activities.

Preliminary View – Chapter 3-1

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?

We agree with the definitions of currency in circulation.

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, 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?

We agree that where the purpose and function of notes and coins are the same, the accounting treatment of notes and coins should be consistent. We also agree that the different physical characteristics of notes and coins should not in themselves lead to different accounting treatments, although we are aware that the legal obligation to replace currency differs between

notes and coins in some jurisdictions and therefore, may result in different assessments about whether a present obligation arises.

We agree that a liability should be recognised when both notes and coins are issued by the monetary authority and the monetary authority assesses that a present obligation exists.

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.

We note that in the IPSASB's Conceptual Framework leaves open the possibility that that revenue could be directly recognised in the statement of net assets/equity at a standards level.

In our view, if the issuance of currency results in the recognition of revenue because it does not meet the definition of a liability, the revenue should be recognised in the statement of financial performance. This is because such a transaction would reflect the operations and activities of the monetary authority in the reporting period in which the transaction took place.

We also note that if a liability was initially recognised when currency is issued, but is later extinguished through demonetisation, any windfall gain at that time should also be booked as revenue in the statement of financial performance, augmented with proper disclosure.

Under our jurisdiction's legislation, the liability for issued currency is never extinguished, even in the event of demonetisation. As the liability for any issued currency is payable on demand, we currently do not book the liability at less than face value, even if we are convinced that old notes and coins will never be returned (e.g. New Zealand's pre decimal currency before 1967). This approach is consistent with the treatment of a financial instrument repayable on demand.

However, if we were to follow the approach in IPSAS 19 *Provisions, Contingent Liabilities, and Contingent Assets*, it is possible that a liability would not be recognised (e.g. it may be considered improbable that there would be any outflow or resources) or, if recognised the measurement of the liability would reflect the likelihood of demonetised notes expected to be returned.

While this is not a material issue in our jurisdiction, and we would expect this to be a small proportion of the notes (and coins) on issue measured by value in most jurisdictions, we suggest that the IPSASB contemplates the measurement principles for demonetised currency, particularly where a legal on-demand obligation exists even though there is a remote chance of any demand in relation to those demonetised notes and coins being made on the monetary authority.

Preliminary View – Chapter 4

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

(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).

The New Zealand monetary authority (the Reserve Bank of New Zealand) does not hold monetary gold.

In our view, if monetary gold is held as reserve assets, the most relevant information is financial capacity, whether the entity intends to hold the gold for an indeterminate period of time or not. This leads us to the view that monetary gold should be measured at market value in all circumstances.

Preliminary View – Chapter 5-1

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?

We suggest the Board reconsider the definition of SDR Holdings. The current definition implies that SDR holdings can only allocated by the IMF.

We understand that SDR Holdings reflects both SDRs that IMF has allocated to the member country in proportion to their IMF quota, and movements as a result of trading SDRs with other members. If that is the case, we suggest the following amendment to the definition:

SDR Holdings are International reserve assets created by the IMF and allocated to members to supplement a member's reserves.

We agree with the other definitions in Chapter 5.

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?

We think the IPSASB should reconsider the nature and value of the IMF quota subscription asset proposed to be recognised.

We understand the first 25 percent of the quota payment, the reserve asset portion, must be paid in SDR holdings or a highly liquid currency (e.g. US dollars, Japanese yen, euro, pound sterling). The remaining 75 percent portion 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 member's designated depository (typically its central bank). In our jurisdiction the 75 per cent portion is supported by the issuance of promissory notes.

The IPSASB's current proposal is to recognise the IMF quota subscription as a financial asset for the full 100 percent with a corresponding financial liability for 75 percent (the promissory note) and a reduction in cash for the 25 percent actually paid.

We do not believe that the member country has an asset for the 75 per cent portion when it is supported by the issuance of a promissory note. There are two sets of benefits that arise from IMF quota subscriptions; the indirect benefits arising from IMF membership, and the direct benefits arising from contractual cash flows associated with the reserve asset portion.

With respect to the membership benefits, it appears to us that the entire IMF membership benefits can be secured with payments of the reserve asset portion only, and a promise to pay the 75% portion, even if the IMF never calls on it to be paid. We note that the benefits of membership include the voting rights equal to the size of a member's quota relative to total membership and a right to borrow from the IMF based on the amount of the quota subscription for balance of payment needs. It appears to us the ability to vote and borrow with reference to

the whole quota does not require the IMF to call on the promissory note supporting the 75 per cent portion.

With respect to the direct benefits from the financial asset itself, we note that direct ownership benefits of interest received in relation to the quota subscription only arises on the reserve asset portion and not the 75 percent. Likewise, if member withdraws from the arrangement the direct ownership benefit would be the repayment of the reserve asset portion only, and there would be no additional inflow of resources above the reserve asset portion. We acknowledge there would also be an extinguishment of the capital commitment to transfer funds in the future.

The logical consequence therefore is there are no economic benefits arising from the unpaid quota; it would therefore be misleading to report this as an asset. We do not consider a promise to pay the 75 per cent portion where the IMF may or may not call on it, leads to an asset of the member that should be recognised on its balance sheet. We feel there is a difference in substance between recognising an asset because you have paid (or must pay unconditionally) compared to having a capital commitment to pay conditional on the IMF's call in the future. In the latter case, the economic substance appears more akin to either a line of credit for the IMF to call on in specific circumstances or "uncalled capital"

It is our understanding that even though promissory notes are "at call" there are significant restrictions on the IMF's actual ability to call them. Also, from a member's perspective there is no realistic estimate of either the amount or the timeframe of any call. If they are called, then the amount invested in IMF should increase. If they are not called, there is no economic sacrifice, so there should be no liability reported for the promissory note.

We understand that the IMF to meet the financing needs of members particularly through the global financial crisis, did not make a call on promissory notes in relation to the quota subscription, but secured large bilateral borrowing agreements from individual member countries, expanded the New Arrangements to Borrow (NAB) and increased quota subscriptions of member countries. The increase in quota subscription is paid for in the customary proportions i.e. 25 percent of the increase was required to be paid in a highly liquid currency and a promissory note issued for the increase in the 75 per cent portion.

We also understand under the separate NAB, members commit to the IMF to lend (to other members) up to a maximum amount agreed with the IMF. The IMF then instructs the lending member to issue loans at some time in the future. The lending member recognises a loan asset when the loan is drawn down. From the lending member's perspective, there is very little difference between committing to the IMF to lend up to a maximum amount under NAB and committing to IMF via a promissory note to make a future payment to facilitate lending and global liquidity. Both arrangements are contingent on being called by the IMF in specific circumstances. We are not convinced these two commitments should be treated differently on the member's balance sheet.

We believe the IMF quota asset to be recognised on balance sheet should be limited to the reserve asset portion, with disclosure of the capital commitment in relation to the promissory note for the 75 per cent portion. This commitment could either be disclosed as a capital commitment or uncalled capital. Likewise, the maximum commitment amount agreed under the NAB should also be disclosed.

We agree with the IPSASB's preliminary views in relation to SDR holdings and SDR allocations.

