

Responses to IPSASB Consultation Paper: Public Sector Specific Financial Instruments (July, 2016; Comments due: December 31, 2016)

## CONSULTATION PAPER (CP), PUBLIC SECTOR SPECIFIC FINANCIAL INSTRUMENTS

*The Technical Director*

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Brasília-Brazil

December 30, 2016

Dear Mr. John Stanford,

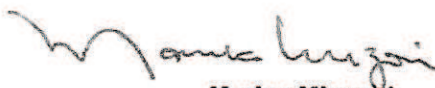
The Brazilian Task Force on this consultation paper composed by Banco Central do Brasil (BCB), Secretaria do Tesouro Nacional (STN) and Conselho Federal de Contabilidade (CFC) welcomes the opportunity to collaborate with the consultation on *Public Sector Specific Financial Instruments*.

Our points of view and comments can be found on the appendix of this document that was prepared by the Task Force, which was chaired by the Brazilian Monetary Authority, the Banco Central do Brasil (BCB).

If you have any questions or require clarification of any matters in this submission, please contact:

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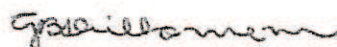
Regards,



**Marisa Minzoni**

*Deputy Head of Department*

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**Gildenora Batista Dantas  
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## APPENDIX

### 1. Context and General Comments

In Brazil, the National Monetary Council (CMN, acronym for "*Conselho Monetário Nacional*") is responsible to decide on the accounting system and the financial statements of the Central Bank of Brazil (BCB, "*Banco Central do Brasil*"). In this context, the CMN approves the basic guidelines to be applied and, internally, the BCB's Accounting and Financial Department (Deafi, "*Departamento de Contabilidade e Execução Financeira*") regulate these guidelines through the Financial Management Services Manual (FMSF) and the General Chart of Accounts (PGC, "*Plano Geral de Contas*").

The approval of the accounting guidelines by the CNM mainly derives from the fact that the BCB has unique activities and operations that are not observed in private or public entities, even in financial institutions. Therefore, the BCB does not follow any regulation issued by accounting regulatory bodies in Brazil and abroad.

Since 1999, there were initial discussions in order to develop the BCB's accounting standards. These resulted in a series of improvements, including the mark-to-market of the securities portfolio and the creation of a specific committee to monitor the assets to be provisioned, the search for greater transparency in the explanatory notes of the financial statements and the hiring of an independent audit firm. At the root of these discussions were highlighted aspects such as: a) using accounting as the main communication language for the evaluation of investments or the risk of their transactions; b) the use of different accounting practices may lead to difficulties in understanding and to a lack of comparability of economic and financial information on the international level.

In addition, it was also considered the diversity of users of financial statements, in which the following stand out: the Board of Directors of the BCB and the CMN, which approve them; the Ministry of Finance (MF, "*Ministério da Fazenda*") and the National Treasury Secretariat (STN, "*Secretaria do Tesouro Nacional*"); the Federal Court of Auditors (TCU, "*Tribunal de Contas da União*") and the National Congress; the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD); universities and consulting firms related to the economic and financial areas. Thus, in June 2002, the CMN approved a guideline, determining that BCB accounting needed to adopt and implement the standards issued by the International Accounting Standards Board (IASB), noting, however, the peculiarities of its activities and the orientations of the Bank for International Settlements (BIS), as well as practices developed in other central banks worldwide.

The need to supplement the IASB's rules is justified by the fact that central banks are sole bodies and not all of their operations are covered by the pronouncements of the IASB or any other standard-setting board.

In general, with the adoption of international accounting standards, it is expected that more accurate and understandable information will improve the analysis of the financial statements and, consequently, increase its reliability.



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## 2. Responses to the Specific Matters for Comment and Preliminary Views

### 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?

Response to Preliminary View – Chapter 2 (following paragraph 2.9):

Disagree with the IPSASB's Preliminary View on the definition of Monetary authority.

Regarding the definition of monetary authority, our understanding is that the operations usually attributable to a central bank may vary from country to country. In the case of the BCB, these attributions are provided by the legislation in a comprehensive way.

The proposed definition by IPSASB's Preliminary View seems a little vague and does not lead the preparers to know what, in fact, would be the role of the monetary authority. Perhaps it would be appropriate to change the definition and add some examples drawn from experiences around the world.

Suggestion:

- (a) *Monetary authority is the entity or entities, including the central bank or a department(s) of the central (national) government which, given the authority by the government or the legislation on the various jurisdictions, carry out typical operations usually attributed to the central bank, such as follows:*

*[provide some illustrative examples in this point of text]*

In the Brazilian jurisdiction, it is possible to use, as examples, some (or all) of the items defined by Chapter III of Law number 4595, of 1964, as follows:

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*"It is the exclusive responsibility of the Banco Central da República do Brasil", among others:*

- a) *To issue notes and coins (currency);*
- b) *To provide the services related to currencies;*
- c) *To receive the compulsory deposits referred and also the voluntary deposits of financial institutions;*
- d) *To carry out rediscount operations and loans to banking financial institutions;*
- e) *To exercise the control of credit in all of its forms;*
- f) *To exercise the control of foreign capital, under the terms of the current legislation;*
- g) *To be the depositary of the official reserves of gold and foreign currency and Special Drawing Rights (SDRs) and to perform any operations provided for on the Agreement of the International Monetary Fund;*
- h) *To exercise supervision of financial institutions and apply penalties;*
- i) *To grant specific authorizations to the financial institutions regarding their operations.*

Partially agree with the IPSASB's Preliminary View on the definition of reserve assets.

The definition of reserve assets on the preliminary view is related to the definition presented by the IMF in its 6th edition of the Balance of Payments and International Investment Position Manual (BPM6):

*A country's international reserves refer to "... 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)" (BPM6, paragraph 6.64).*

As defined by BPM6, the concept of international reserves is based on the balance-sheet framework, with "reserve assets" being a gross concept. It does not include external liabilities of the monetary authorities. However, for further analysis, BPM6 defines reserve-related liabilities and provides an additional analytical framework for analyzing foreign currency liquidity of the authorities.

Thus, we believe that the concept presented provides a good basis to account for public sector specific financial instruments. However, it is necessary taking into account on the definitions the reserve-related liabilities.

**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?

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

Partially Agree with the IPSASB's Preliminary View on the definition of currency in circulation.

The Monetary and Financial Statistics Manual and Compilation Guide (IMF, 2008) defines currency in circulation as *"the amount of currency issued by the central bank and held by resident sectors and nonresidents. Currency in circulation consists of all currency issued by the central bank less currency held as vault cash in the central bank"*.

In this definition, it is necessary to emphasize that, in addition to the issuance aspect by the central bank, the possession of the issued currency belongs to the general public (resident and non-resident). Thus, it does not consider the currency issued, but held in cash by the central bank. The new version of the Monetary and Financial Statistics Manual and Compilation Guide, which is still in the discussion phase, currency in circulation is defined as *"the amount of currency outside the central bank (and any other issuing unit) held by all other resident sectors and nonresidents"*. Although it simplifies the previous definition, this concept maintains the premise that only the currency issued and held by the general public would fall under the definition of currency in circulation.

Another point to consider is the possibility of issuing digital coins, an issue that has been widely studied by central banks.

Thus, we believe that the definition proposed in the IPSASB's Preliminary View should exclude the concept of physical currency and incorporate the premise that only the currency issued and held by the general public makes up the circulating medium.

**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?

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

We agree with the consistent treatment to both notes and coins, but we disagree with their accounting treatment, according IPSASB's Preliminary View.

Initially, it is worth discussing the definition of liabilities. Liability, according to the International Financial Reporting Standards (IFRS), which were adopted by the BCB, "is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits". According to IPSASB's The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, liability is "a present obligation of the entity for an outflow of resources that results from a past event". On both definitions, liability, essentially, is an obligation, a duty or responsibility to act or perform in a certain way.

Thus, notes and coins (currency) does not fully meet the definition of liabilities, according to the IASB's and IPSASB's Conceptual Framework. This is because, although it represents an obligation for the central bank, its "settlement" does not result in an outflow of economic resources from the entity, since it occurs through an exchange of currency by the currency itself.

Since it is not possible to define it as a liability, would the currency, by exclusion, be an equity item? We believe that this approach also generates misunderstanding, since the net equity is ultimately the residual book value pertaining to the shareholders, quota holders or partners of the entity, which, in our view, would not be the case of the currency.

Our understanding, following the practice most commonly adopted by central banks, is the treatment of currency as a separate item in the financial statements - that is, segregated from liabilities and equity.

In addition, IPSASB's Conceptual Framework presents the following definitions of other resources and other obligations:

*5.27 As explained in paragraph 5.4, in some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element defined in the Conceptual Framework needs to be recognized in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as other resources or other obligations, which are items additional to the six elements defined in this Framework.*

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Thus, considering the approach of the IPSASB's Conceptual Framework our suggestion is to consider currency as other obligations.

Although it is not the main focus of the questions presented by this Consultation Paper, it also draws attention to the fact that currency does not fit as a financial instrument. A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Currency gives the general public the right to a financial asset, represented by the cash or the right to receive cash, but does not give rise to a financial liability or equity instrument for the central bank, because, as discussed above, it does not fully meet the definitions of liabilities and equity. Thus, we understand that issues related to currency should be dealt with on another document (not related to financial instruments, even public sector specific financial instruments).


**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.


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

As discussed in the previous question, following the practice most commonly adopted by central banks, it is proposed to account for currency as a separate element in the financial statements (other obligations), that is segregated from liabilities and equity. Thus, we understand that no revenue should be recognized.




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**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?

**Response to Preliminary View – Chapter 4 (following paragraph 4.14)**

Disagree with the IPSASB's Preliminary View on the definition of monetary gold.

According to IMF's BMF6, monetary gold corresponds to "gold (including gold deposits and, if appropriate, gold swapped)". In turn,

*Gold includes gold bullion (including allocated gold accounts) and unallocated gold accounts with nonresidents that give title to claim the delivery of gold. Gold bullion takes the form of coins, ingots, or bars with a purity of at least 995 parts per 1,000, including such gold held in allocated gold accounts (BPM6 paragraph 5.74-5.76).*

To be coherent with the practices in use by the central banks, the IPSASB should observe IMF's definitions for monetary gold.

**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.

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

Studies on the accounting treatment of gold investments by central banks are not common in the literature, given the specificities of the asset and the type of organization involved. An exception is the study by Chris Sermon (*Accountancy's Golden Puzzle, Central Banking Journal, Vol. XVI, No. 1, August 2005*), whose purpose was to discuss what would be the best accounting treatment to be applied in such cases.

Regarding the measurement basis, Sermon's study concluded that the use of fair value as a benchmark for the measurement of gold, among other reasons, due to the fact that this type of investment by central banks tends to be maintained for the long term. Consequently, the adoption of historical cost would cause material misstatements in accounting information.

In studies conducted by the BCB, it was found that the use of fair value as a benchmark for the measurement of gold is consistent with the practice adopted by other central banks, and it is not common to use different measurement bases depending on the intentions of the entity. Also in a recent World Gold Council debate on the subject, Kenneth Sullivan presented a Discussion Paper (*Working Towards a Common Accounting Framework for Gold*, available for download at [www.gold.org/research/working-towards-common-accounting-framework-gold](http://www.gold.org/research/working-towards-common-accounting-framework-gold)) in which, among 69 surveyed central banks, 60 use the fair value as a benchmark for gold measurement. According to this work:

*Strong reasons exist for central banks to account for gold at fair value, as it is consistent with their foreign reserves accounting and provides a closer approximation of the level of liquidity accessible as compared to cost.*

The BCB recognizes investments in monetary gold at fair value upon their contracting, that is, on the date the entity undertakes to make the purchase or sale. After the initial recording, the gains and losses arising from the changes in fair value are recognized in the statement of financial performance on an accrual basis.

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**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).

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

As discussed in the previous question, the measurement basis most commonly adopted by central banks is fair value.

**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?

**Response to Preliminary Views – Chapter 5-1 (following paragraph 5.12) and Chapter 5-2 (following paragraph 5.33)**

Agree with the IPSASB's Preliminary View on the definitions of IMF Quota Subscription, SDR Holdings and SDR allocations and disagree with the accounting treatment.

The IMF Quota Subscription, as a share of the capital of the organization, should be measured at fair value.

Regarding to SDR holdings and SDR allocations, they are financial instruments characterized by fixed and / or determinable amortizations that are not quoted in a market. For this reason, we believe that its measurement should be at amortized cost, defined as the value of the recognition date, plus contractual interest, using the effective interest rate.