The Japanese Institute of
Certified Public Accountants
4-4-1 Kudan-Minami, Chiyoda-ku, Tokyo 102-8264, Japan
Phone: +81-3-3515-1129 Fax: +81-3-3515-1167
Email: hieirikaikei@jicpa.or.jp

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

Comments on Exposure Draft 69 "Public Sector Specific Financial Instruments: Amendments to IPSAS 41, Financial Instruments"

Dear Mr. Stanford,

The Japanese Institute of Certified Public Accountants (hereafter "JICPA") highly respects the International Public Sector Accounting Standards Board (hereafter "IPSASB") for its continuous effort to serve the public interest. We are also pleased to comment on the Exposure Draft 69 "Public Sector Specific Financial Instruments: Amendments to IPSAS 41, Financial Instruments" (hereafter "ED"). Our comments to ED are as follows.

Specific Matter for Comment 1:
Do you agree with the proposed amendments to IPSAS 41, Financial Instruments? If not, what changes would you make to the proposals?

We do not agree with the proposed amendments to IPSAS 41, *Financial Instruments*. We believe that the amendments discussed below are required.

1. Additions to the definition

The definition of each item added as a public sector specific financial instrument should be stated in the Basis for Conclusions section. In particular, the following descriptions should be added to the definitions of "monetary gold" and "currency in circulation."

(1) Monetary gold

In the context of BC18A, monetary gold should be described as "gold held by monetary authorities as reserve assets that are available to them in carrying out their mandates."

In addition, Paragraph 4.3 of the Consultation Paper "*Public Sector Specific Financial Instruments*" (hereafter "CP") defined monetary gold as "physical gold held by monetary authorities as reserve assets." The reasons underlying the decision to eliminate the term "physical gold" for monetary gold should be explained.

(2) Currency in circulation (currency issued as legal tender)

Application Guidance B1.2.1 describes whether currency issued as legal tender results a financial liability. We think the IPSASB should explain the background and process for this guidance in the basis of conclusion, including definitions and explanations of currency in circulation and the discussions at the meetings of the IPSASB.

In the definition given in Paragraph 1.6 of the CP, currency in circulation is described as "physical notes and coins with fixed and determinable values that are legal tender issued by, or on behalf of, the monetary authority; that is, legal tender either of an individual economy or, in a currency union to which an economy belongs". If this definition remains unchanged, this description should be included in the BC.

2. Hierarchy for the application of IPSAS literature to monetary gold

The description of the application of IPSAS 41 under the hierarchy set out in B1.1 should be amended as follows:

Monetary gold consists of physical gold, which is a physical instrument. <u>It would be appropriate to apply IPSAS 12 Inventories consistent with other types of physical gold</u>. However, given that monetary gold has many of the characteristics of a financial asset, it seems generally more appropriate to apply the principles set out in IPSAS 41 under the hierarchy set out in paragraphs 9–15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

In the hierarchy for the application currently described, it would be generally acceptable to first apply IPSAS 41 to monetary gold, and then to apply other IPSAS.

However, if the principle that monetary gold, like gold bullion, is not a financial instrument (B1.1), we consider monetary gold is not an asset excluded from inventories under Paragraph 2 (b) of IPSAS 12, *Inventories*. In this case, we believe that IPSAS 12 should be applied first.

Next, it should be described that the application of IPSAS 41 would be appropriate if monetary gold can be classified as a financial instrument when certain criteria are met. In deciding to apply IPSAS 41, both criteria (i) and (ii) below should be met

(i) Unlike other gold bullion, monetary gold should not be a gold held for sale or distribution in the ordinary course of operations under the definition of Paragraph 9 (c) of IPSAS 12; and

(ii) Monetary gold should have characteristics substantially similar to those other financial instruments

However, ED 69 provides no clear definition of monetary gold, which makes it difficult to separate monetary gold from gold bullion. While the definition of monetary gold (together with reserve assets, if possible) should be clarified, the description that one of characteristics of monetary gold as a reserve asset is that “it is not held for sale or distribution in the ordinary course of operations” should be included.

3. Inclusion of application guidance for currency

(1) Proposed revision

We propose to amend the requirements of B1.2.1 as follows:

> B.1.2.1 Definition of a Financial Instrument: Currency Issued as Legal Tender
>
> Does issuing currency as legal tender create a financial liability for the issuer?
>
> It depends. Currency derives its value, in part, through the statutory arrangement established between the issuer and the holder of the currency whereby currency is accepted as a medium of exchange and is recognized legally as a valid form of payment. In some jurisdictions, this statutory arrangement further obligates the issuer to exchange currency when it is presented by holders and may explicitly indicate that currency is a charge on government assets.
>
> When laws and regulations or similar requirements enforceable by law, such as a banking act, set out the requirements and responsibilities of an entity to exchange outstanding currency, a “contract” exists for the purposes of this Standard. A financial liability is created when an entity issues currency to the counterparty as, at this point, two willing parties have agreed to the terms of the arrangement. Prior to currency being issued, there is no transaction between willing parties.
>
> For the purposes of this Standard, an entity considers the substance rather than the legal form of an arrangement in determining whether there is a contractual obligation to deliver cash. Contracts are evidenced by the following:
>
> • Willing parties entering into an arrangement;
>
> • The terms of the contract create rights and obligations for the parties to the contract; and
>
> • The remedy for non-performance is enforceable by law.
>
> Unissued currency does not meet the definition of a financial instrument. An entity applies paragraph 13 of IPSAS 12, Inventories, in accounting for any unissued currency.

(2) Reordering of paragraphs 2 and 3 in B.1.2.1

In binding arrangements, laws have stronger binding power than contracts. Therefore, the explanations of requirements enforced by laws (paragraph 3 of B1.2.1) should be placed before paragraph 2 concerning substance rather than the legal form.

(3) Terms relating to “binding arrangements” and “contract

We propose that the descriptions related to B1.2.1 should be amended as follows:

Before amendment (ED)	Our proposed amendments
For the purposes of this Standard, an entity considers the substance rather than the legal form of an arrangement in determining whether there is a contractual obligation to deliver cash.	When no requirements enforced by laws and regulations exist, substance should be considered in determining whether contractual obligations exist.
When laws and regulations or similar requirements enforceable by law, such as a banking act, set out the requirements and responsibilities of an entity to exchange outstanding currency, a "contract" exists for the purposes of this Standard.	When laws and regulations or similar requirements enforceable by law, such as a banking act, set out the requirements and responsibilities of an entity to exchange outstanding currency, a "binding arrangement" exists for the purpose of this Standard. .
A financial liability is created when an entity issues currency to the counterparty as, at this point, two willing parties have agreed to the terms of the arrangement.	A financial liability is created when an entity issues currency to the counterparty based on the contract.
Prior to currency being issued, there is no transaction between willing parties.	Prior to currency being issued, there is no transaction based on the contract.

(4) Explanation of obligations incurred by monetary authorities

We request the IPSASB to additionally consider the obligations incurred by monetary authorities to stabilize and maintain the currency system, in addition to the obligations to exchange currencies.

In specifying the reason for recognizing liabilities, the ED included only the currency exchange obligations the monetary authorities have incurred. However, in practice, monetary authorities have incurred various obligations which central banks should undertake in order to maintain currency values, in addition to obligations to exchange currency.

If a liability is measured only based on the exchange obligations, the face value of a currency newly issued from a currency exchange does not represent the initial measure. Liabilities related to exchange obligations are equivalent to the fees required for exchange. In addition, it may be appropriate to estimate the expected value of exchange and recognize provisions.

The Bank of Japan, a central bank in Japan, recognizes liabilities with issued currencies. It does so because it must secure confidence in issued bank notes by appropriately performing monetary policies. It does not recognize liabilities merely on the basis that it undertakes exchange obligations.

Yours sincerely,

Hiroshi Shiina
Executive Board Member - Public Sector Accounting and Audit Practice
The Japanese Institute of Certified Public Accountants