Guidance for Monetary Authorities on the recommended practice in accounting for monetary gold

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, the Far East, Europe and the US, the World Gold Council is an association whose members include the world's leading and most forward-thinking gold mining companies.

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Introduction

Monetary authorities, including central banks and finance ministries, currently hold more than 33,000 tonnes of gold, worth approximately US$1.4 trillion, at today's prices – making these official institutions among the world's largest holders of gold. Monetary authorities hold this gold in the performance of their official functions, typically as part of the county's official foreign exchange reserves.[1] As such, the functional purpose of this "monetary gold," which is viewed as a financial instrument by monetary authorities, differs significantly from corporate entities, such as jewelers or manufacturers.

General purpose financial reporting frameworks, such as the International Financial Reporting Standards (IFRS), offer some guidance for the accounting of physical gold held by corporate entities. Namely, IFRS states that gold is a commodity, not a financial instrument, and thus should be accounted for at the lower of cost and net realisable value.[2] While this treatment may be appropriate for jewellers and manufacturers, monetary authorities deploy their gold to raise foreign exchange liquidity, inter alia, during times of national crisis, at which point they need a fair value assessment of the resources at their disposal. Thus, monetary authorities require an accounting framework for monetary gold[3] that matches these functional objectives.

The European System of Central Banks (ESCB) Accounting Guidelines provide such guidance for those monetary authorities within the Eurosystem. Monetary authorities outside the ESCB, however, typically rely on IFRS or other national accounting frameworks – all of which lack appropriate guidance on monetary gold.

Because of this lack of guidance, numerous accounting treatments for monetary gold have emerged. In a recent report, *"Working towards a common accounting framework for gold"* published in June 2016,[4] we identify seven ways of accounting for monetary gold.

Method	Number of Central Banks
1. Cost	9
2. Fair Value through Profit and Loss (FVTPL)	4
3. Fair Value to Reserves via Profit	11
4. Fair Value to Reserves through Other Comprehensive Income (FVOCI)	13
5. Fair Value Direct to Reserves	7
6. Fair Value Direct to Non-Equity Revaluation Account	25
7. Fixed Asset	1

As indicated by the variety of treatments, the lack of guidance has also caused confusion among monetary authorities about the accounting practice that best suits their needs. Additionally, it limits the transparency and comparability of financial statements, risking a reduction in their credibility – a key element in monetary authorities' independence and accountability. The lack of guidance has been especially problematic with respect to the treatment of unrealised revaluations, the distribution of which most central banks try to avoid for policy and capital maintenance considerations.

1 Typically, a country's official foreign exchange reserves are held in support of a range of objectives, as noted by the IMF, including: to support and maintain confidence in a country's ability to meet its external obligations, limit external vulnerabilities to exogenous shocks, and act as an emergency reserve in times of financial stress.

2 An exception exists for commodity broker-traders who measure their inventories at fair value less costs to sell. (IAS 2 p3(b))

3 Monetary authorities may hold gold in other forms (e.g. non-monetary and antique gold) – a brief discussion of which is covered for completeness – but the main focus of this Guidance is on monetary gold.

4 The discussion paper can be found on the World Gold Council's website at: www.gold.org/research/working-towards-common-accounting-framework-gold

Several central banks approached the World Gold Council for assistance on this issue and, as a result, we commissioned this Guidance. The Guidance provides a standard accounting practice for monetary authorities to recognise and account for monetary gold in an appropriate and consistent manner. The Guidance was prepared with reference to the conceptual framework of current financial reporting standards, and uses similar terminology as far as possible. The Guidance considers both the presentation in the statement of financial position and in the income statement (or comprehensive income statement where presented), and the treatment of unrealised revaluations. For those monetary authorities where issues of distribution to the central government arise, guidance is included as to what should be regarded as distributable, although this will be subordinate to local laws.

The Guidance is intended solely for those monetary authorities that hold monetary gold. The adoption of this Guidance is at the discretion of the monetary authority. However, it is helpful to note that for those monetary authorities adopting IFRS, the adoption of a common treatment for an issue not well covered by IFRS, as allowed under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* provides stronger grounds for auditor acceptance of the treatment for this specific item.

While the focus of the Guidance is on monetary gold, it also includes guidance on other forms of gold that a monetary authority may hold. This is to provide consistency across monetary authorities in the accounting for all forms of their gold holdings.

Definitions

The Guidance uses the following terms with the meanings specified:

Allocated vs unallocated gold

Allocated gold denotes ownership of a discrete gold asset. Unallocated gold is a claim to a pool of gold assets with no claim to a specific element of that pool.

Antique gold

Antique gold comprises historic gold objects, which a monetary authority chooses to hold for cultural or historic reasons, and not as a foreign reserve asset. Antique gold may meet the criteria of monetary gold, but the monetary authority makes the explicit decision to hold this gold as part of a cultural function, rather than as part of foreign reserves.

Gold commodity swaps

A commodity swap is a contract where both sides of the transaction agree to exchange cash flows, which are dependent on the price of an underlying commodity.

Gold deposits (loans, lending, leasing)

Gold deposits occur when the depositor lends gold to an entity for a set period after which the entity returns an identical amount of gold to the depositor in return for a fee. Collateral is not compulsory, but if given is usually in financial instruments.

Gold swaps (gold repos)

A gold swap is a form of a repurchase agreement, in which gold is exchanged for foreign currency at a specified price, with a commitment to repurchase the gold at a fixed price on a specified future date.

Location swaps

A location swap involves an exchange of physical gold between entities in different locations for a specified period. On maturity, the gold reverts to its original location within each entity. The function of a location swap is to provide physical gold to entities in different locations without the need to transport the physical gold between the two locations.

Monetary authorities

Monetary authorities are central banks, central government departments and international financial institutions, whose functional obligations cause them to maintain holdings of monetary gold.

Monetary gold

Monetary gold is gold held by a monetary authority principally as an element of its foreign exchange reserves. To qualify as monetary gold, the gold must meet the International Monetary Fund's (IMF's) definition of monetary gold and the monetary authority must designate the gold as part of its foreign reserve portfolio. Monetary gold includes allocated gold bullion and unallocated gold accounts with nonresidents, that give title to claim the delivery of gold. Gold bullion can take the form of coins, ingots, or bars with a purity of at least 995 parts per 1000, including such gold held in allocated gold accounts. London Good Delivery (LGD) gold qualifies as monetary gold if so designated by the monetary authority.

Non-monetary gold

Non-monetary gold is gold that a monetary authority holds that does not meet the criteria of monetary gold or which the monetary authority has chosen not to classify as monetary gold. Examples may include: scrap jewellery, unrefined gold, alluvial gold dust and nuggets, and antique gold.

Profit available for distribution

This consists of the profit reported in the statement of profit and loss, adjusted for allocations to reserves mandated in the law prior to any distributions to dividends or realised reserves.

Recommended practice in accounting for monetary gold

Objective

1 To provide a common framework for monetary authorities to recognise and account for monetary gold in an appropriate and consistent manner in their financial statements. The approach is to regard monetary gold as equivalent to a financial instrument denominated in the national currency. Other forms of gold are to be accounted for in accordance with the monetary authority's adopted reporting framework.

Scope

2 This Guidance is designed to be applicable to all monetary authorities that hold monetary gold for meeting policy objectives specified in their relevant legislation. This includes, but is not limited to, monetary authorities responsible for managing their nation's foreign exchange reserves. Importantly, this Guidance represents recommended best practices in accounting for monetary gold, rather than a pronouncement on such practices. As such, there is no specific mandate, legal or otherwise, associated with this Guidance.

Recognition and derecognition

Initial recognition and classification

3 A monetary authority shall recognise the gold when it acquires the contractual rights to the economic risks and rewards of the gold ownership. On acquisition, it shall classify the gold as monetary gold, non-monetary gold or antique gold.

Derecognition

4 A monetary authority shall derecognise the gold when it surrenders the contractual rights to the economic risks and rewards of the gold ownership. A transaction that involves a transfer or encumbrance of gold does not constitute derecognition if the monetary authority will receive equal gold back at the end of the transaction or retains the economic risks and rewards of the gold ownership.

Measurement

Initial measurement

5 On initial acquisition, or recognition as monetary gold, a monetary authority shall recognise monetary gold at fair value, plus transaction costs that are directly attributable to the acquisition of the gold.

Subsequent measurement

6 For the purposes of measuring gold after initial recognition, this Guidance adopts three (3) classifications:

A monetary gold

B non-monetary gold

C antique gold.

7 Monetary gold – A monetary authority shall measure monetary gold after initial recognition at fair value without any deductions for additional costs, except in the situation described in paragraph 9 or the following situations:

A the gold requires further refining to bring it to a form required in open markets

B the gold requires transportation from its current location to a recognised gold market to enable its trading and delivery.

In these situations, the entity will reflect these costs in fair value.

8 No entity shall apply any discount to fair value to cover any perceived market risks.

9 In the situation where the entity's overall accounting framework adopts amortised cost accounting, and the adoption of fair value would represent a material distortion of the financial position and performance of the entity, the entity may apply cost as defined in its accounting framework for subsequent measurement.

10 Non-monetary gold – A monetary authority shall account for non-monetary gold as a commodity as the entity does not hold such gold for policy purposes. Valuation may be the lower of cost and net realisable value.

11 Antique gold – If a monetary authority holds gold objects as part of art or museum collections, the accounting for these objects should follow the accounting policy for this function.

Reclassification

12 In the event of a change in classification of a gold holding, the monetary authority shall treat any previously unrealised revaluations related to that gold as per paragraph 16, and disclose the change in classification in the notes to the accounts.

Treatment of gains and losses

Unrealised gains

13 On recognition of unrealised revaluation gains, a monetary authority shall report the valuation gains as other comprehensive income in the statement of other comprehensive income (or equivalent statement). The revaluation shall combine the price and foreign exchange movements as a single valuation entry. The monetary authority shall allocate the gold revaluations to a dedicated gold unrealised revaluation reserve within equity.

Unrealised losses

14 On recognition of unrealised revaluation losses, a monetary authority shall report these as other comprehensive expense in the statement of other comprehensive income (or equivalent statement). The revaluation shall combine the price and foreign exchange movements as a single valuation entry. The monetary authority shall allocate the gold revaluations to a dedicated gold unrealised revaluation reserve within equity.

15 In the event that unrealised losses exceed the balance in the revaluation reserve, the entity shall charge the excess against the period's profit available for distribution. A central bank shall account for any subsequent reversals of unrealised losses according to paragraph 13.

Realised gains and losses

16 On the sale or reclassification of gold, the entity will recycle existing unrealised gains and losses relating to the sold or reclassified gold through profit and loss, or in compliance with its policy on the definition of realised revaluations.

Other transactions

Gold swaps

17 Two approaches exist for accounting for gold swaps:

A The monetary authority shall account for the gold swap as a currency swap in accordance with its general financial reporting framework. Quoted gold swap prices provide data for pricing, revaluation and income recognition.

B The monetary authority shall account for the gold swap as a repurchase agreement in accordance with its general financial reporting framework. The entity retains the gold on its financial statements as an encumbered asset.

Location swaps

18 As the net holdings of gold of the two entities involved in the location swap remain the same, the accounting is to disclose the swapped gold as encumbered in the financial statements. Accounting for fees related to the location swap shall be in accordance with the monetary authority's accounting framework accrual principles.

Gold deposits (loans, lending, leasing)

19 A monetary authority depositing the gold in a gold deposit transaction shall treat the transaction as a deposit. The financial statements will retain the gold holdings, but will disclose them as an encumbered asset. The entity will report revenue as interest on a deposit.

20 The accounting for any collateral received by the depositor under the gold deposit agreement shall be in accordance with the relevant accounting standard covering the conditions relating to the collateral as specified in the gold deposit agreement.

Gold commodity swaps

21 Where a monetary authority undertakes a gold commodity swap, it shall account for it as a commodity swap as prescribed under its general financial reporting framework.

Gold forwards, futures, and options

22 These are financial instrument transactions and should be accounted for under the relevant accounting standard.

Disclosures

23 The objective of this Guidance is to enable entities to provide disclosures in their financial statements to enable users to evaluate:

A the functional reasons for holding monetary gold and its significance

B the functional reasons for holding non-monetary and antique gold

C the accounting policies adopted when accounting for all classes of gold holdings.

24 The monetary authority should harmonise the disclosures recommended in this Guidance with those required in its general financial reporting framework for accounting policies, and those covering the nature and extent of risks arising from holding financial instruments, and how the entity manages these risks.

25 Within the notes to the financial statements, the monetary authority shall disclose information identifying the:

A purpose and intention of holding gold

B amount of gold holdings for separate functions

C basis of recognition of gold holdings

D approach to gold revaluations (frequency, source of prices, adjustments)

E classification of unrealised gold revaluation gains through Other Comprehensive Income (OCI)

F allocation of unrealised gold revaluations gains to a dedicated gold revaluation reserve, within equity

G treatment of gold revaluation losses, including when they exceed any previously accumulated gains

H basis for determining the cost of sales for any gold sold

I treatment of realised gains arising from gold sales

J reasons for, and effects of, changes in gold classifications

K swaps and gold lending transactions, disclosing encumbered assets

Reconciliation with IMF reporting

26 In situations where the monetary authority is responsible for the reporting of the country's foreign exchange reserves arising from its IMF membership, the monetary authority shall provide sufficient information to allow reconciliation between the total monetary gold holding reported in the respective statements.

Initial adoption

27 On initial adoption of this Guidance, the monetary authority will apply the rules for changes in accounting policy as specified in its general accounting framework. Any reclassification arising from initial adoption will not qualify as reclassification under paragraph 12.

Basis of conclusions

This Guidance seeks to provide those monetary authorities that hold monetary gold with a common accounting framework for their holdings. The recommended approach is consistent with the functional rationale for holding the asset as an element in their foreign exchange reserves.

At the same time, the Guidance seeks to comply, where possible, with the principles found in the most widely adopted central bank financial reporting frameworks. These are IFRS and the ESCB accounting guidelines. IFRS does not provide specific direction for the accounting of monetary gold and so the Guidance seeks to provide a consistent approach in accordance with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.[5] A consistent adoption of a departure from IFRS across monetary authorities will provide greater comparability and a stronger defence for central banks from audit qualifications.

The third point of reference is the requirements for reporting monetary gold specified in the IMF's *Balance of Payments and International Investment Position Manual* – Sixth Edition (BPM6).[6]

Detailing a specific set of disclosures covering monetary gold enhances transparency within financial statements and comparability between monetary authorities.

In conjunction with observing principles of recognised accounting frameworks, the Guidance also takes account of the most widely adopted practices covered in the World Gold Council's previous discussion paper on this topic.[7] Of the 70 monetary authorities studied, 61 accounted for their monetary gold at fair value – 57 of which held all or part of the revaluations in an unrealised revaluation reserve or provision. Thirteen (13) authorities adopted a "Fair Value to Reserves through Other Comprehensive Income (FVOCI)" approach, the treatment that most closely approximates the framework adopted by the Guidance. While the "Fair Value Direct to Non-Equity Revaluation Account," the ESCB approach, was the most widely adopted (25), the Guidance prefers a more comprehensive disclosure of revaluations in statements of financial performance (or equivalent statement) and the holding of revaluations in an equity revaluation account. The Guidance considers this more consistent with the principles of other accounting frameworks that classify such accounts as an element of equity.

5 IAS 8, paragraph 10. In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users and

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form

(iii) are neutral, ie free from bias

(iv) are prudent and

(v) are complete in all material respects.

IAS 8, paragraph 11. In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in IFRS dealing with similar and related issues and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

6 This *Balance of Payments and International Investment Position Manual* – Sixth Edition (BPM6) covers IMF members reporting of their foreign exchange reserves holdings (see www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf)

7 The discussion paper can be found on the World Gold Council's website at: www.gold.org/research/working-towards-common-accounting-framework-gold

Definitions

Monetary gold – the definition reflects the functional criteria for classifying gold as monetary gold. It reflects the definition of monetary gold found in the IMF's *Balance of Payments and International Investment Position Manual* – Sixth Edition (BPM6) as this is the definition widely adopted by monetary authorities in their financial statements.

Paragraphs in Guidance

Paragraph

2 The Guidance is limited to entities that carry monetary gold to meet delegated functional objectives, usually as a component of their foreign exchange reserves portfolio.

3 The recognition criteria align with the moment the monetary authority assumes beneficial ownership of the monetary gold. It is consistent with the initial recognition criteria adopted by internationally recognised accounting frameworks.

4 Derecognition issues arise at times of any transaction involving gold. The Guidance believes that if the monetary authority retains the economic risks and rewards associated through the duration of the transaction, it should not have cause to derecognise the gold. This applies to gold deposits, swaps, and lending.

5 The Guidance adopts fair value for initial recognition, as it is consistent with other international standards, and with the manner of valuation for foreign exchange reserves portfolios. The IMF's BPM6 mandates the adoption of fair value for reporting monetary gold holdings.

6 The definitions of the three classifications reflect the three purposes for which a monetary authority may hold gold. Functional considerations determine the classification. Each classification represents a different class of assets with their own accounting criteria, rather than sub-groups of the same class of assets. Financial statement presentations should reflect these different asset classes.

7 Presenting monetary gold at its fair value conforms with the presentation of other assets in a foreign reserves asset portfolio. The fair value, which should reflect the costs of getting gold to market in a saleable form, represents the best measure of the value that the monetary authority may obtain from this asset.

8 While monetary authorities may sell monetary gold in volumes that can impact market prices, the scale of such movements, if they occur, is unknown. Also, a monetary authority may use the gold as collateral in a swap transaction that will produce no discounts. The Guidance believes that fair value, free of any arbitrary conservatism, presents the best presentation for transparency and comparability purposes.

9 In the situation where a monetary authority adopts an amortised cost basis for its financial reporting, the adoption of fair value just for monetary gold proposed in this Guidance may produce outcomes inconsistent with the broader accounting framework. In such a situation, the monetary authority should comply with its overarching reporting framework when accounting for monetary gold.

10 The Guidance seeks to align the accounting for non-monetary gold with IFRS.

11 Monetary authorities may maintain collections of antique gold artifacts within museums or art collections as part of a public good function. As gold is not necessarily the only exhibit in these displays, the Guidance aligns the accounting for antique gold with the broader accounting framework adopted for that function.

12 A central bank may reclassify gold holdings by removing existing holdings from the pool of assets qualifying as foreign exchange reserves into non-monetary gold or antiques. Conversely, it may add previously non-monetary gold to its foreign reserve portfolio if it complies with monetary gold definitions. This may follow the processing of holdings of non-monetary gold, such as alluvial gold, to LGD form and recognising it as monetary gold.

A change in classification is a transfer of the asset between a financial instrument, a commodity, or an antique, each a different asset class. The Guidance considers this a sale and purchase within the monetary authority that requires the realisation of all related accumulated unrealised revaluations.

13 The Guidance adopts the combination of the price and foreign currency effects of the revaluation as a single total, as this represents how monetary authorities manage monetary gold. This reflects the default practice by those monetary authorities that hold monetary gold, and thus reflects the manner in which the holders manage this asset.

The requirement to disclose revaluations through OCI is consistent with the requirement for transparent reporting, and the function of OCI or equivalent statement to disclose the non-equity sources of changes in the balance sheet. The Guidance believes the requirement to disclose revaluations through OCI is important for transparency in understanding balance sheet movements.

Allocating the gold revaluations to a dedicated revaluation account is consistent with both IFRS and ESCB prohibitions of netting different asset valuation balances.

14 This approach seeks to maintain symmetry with the recognition of the revaluation gains process for as long as a positive (credit) balance exists in the relevant revaluation reserves.

15 Issues of capital maintenance justify this asymmetrical treatment of unrealised revaluation losses for the purposes of distribution. These adjustments occur after the determination of operating profit for the period. The net impact is on the relative balances of realised and unrealised reserves within equity.

Alternatives to the treatment specified allow the accumulation of debit balances in the revaluation account. The Guidance adopts the approach of offsetting excess unrealised revaluation losses against realised earnings for the following reasons:

A The accumulation of unrealised revaluations is a capital maintenance strategy. The accumulation of debit balances, rather than netting them against distributable realised earnings, risks the distribution of realised gains, while accumulating negative equity balances in the revaluation reserve. This defeats the capital maintenance logic of accumulating unrealised revaluations.

B Internationally recognised accounting frameworks do not support the accumulation of debit balances in equity reserves for anything other than temporary occurrences.

C The asymmetric treatment of recovered revaluation losses does not impact recognised earnings from operations. Rather, its impact is on the timing of distributions to stakeholders and the accumulation of realised and unrealised capital reserves.

16 The sale or reclassification of gold represents the transformation of gold from one asset class to another. Reclassification also changes the functional rationale for a monetary authority retaining the asset. Neither the sale nor reclassification provides a rationale for a monetary authority's retention of accumulated unrealised revaluations attaching to the asset, unless the sale occurs as part of a foreign reserves portfolio rebalancing.

A monetary authority may maintain an accounting policy on the treatment of realised revaluation gains and losses. This may contain specific provisions covering the treatment of realised evaluation gains arising from a restructuring of the foreign reserve portfolio. This Guidance allows alignment of the treatment of realised revaluation gains from the sale of monetary gold with any policy on the treatment of realised revaluation gains.

About the author

Kenneth Sullivan is a former Senior Financial Sector Expert with the International Monetary Fund (IMF). Previously, he spent seven years at the Reserve Bank of New Zealand as Chief Manager of both Accounting and Corporate Services, where the bank won accounting prizes for the transparency of its published financial statements. Prior to that, he provided a financial management information system consultancy, held senior accounting roles in insurance and wholesaling, and worked in education.

Starting in 1993, he served as a central banking expert on IMF missions, providing technical assistance in accounting, risk management and recapitalisation to central banks around the world. He presented at central bank accounting workshops and participated in Financial Sector Assessment Program and Safeguard Assessment missions. He has written on issues of central bank financial reporting, capital adequacy, organisation and accountability. He is a qualified Chartered Accountant of New Zealand.

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