Accounting Aspects of International Reserves and Gold

Banco de la República de Colombia

Regional Conference on Banking, Accounting, and Finance

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Yadira Duarte
1. Introduction
3. Accounting policies of the Central Bank applicable to financial instruments, particularly to:
   - The Investment Portfolio of the International Reserves.
   - Gold
1. Introduction
The purpose of this presentation is to describe the accounting practices applied by the Central Bank to financial instruments that are part of the international reserves and the treatment of gold.
Accounting Framework applied by the Central Bank
Accounting framework of *Banco de la República*

**Until 2014**
- **Sources of Accounting Regulation based on the following Standards:**
  - Issued by the National Government
  - Provided by the Office of the Financial Superintendent for entities in the financial sector and the Central Bank.
  - As per the Law and the Bylaws of the Central Bank.

**Since 2015**
- **Modernization of the Accounting Framework of the Central Bank**
  - **Act 1314 of 2009**
    - Starts the process of convergence to IFRS in Colombia.
    - Joint study between the National Accountant General for the public sector and the Office of the Financial Superintendent of Colombia (FSC).

- **Accounting model for Banco de la República**
  - IFRS with exceptions:
    - Norms that are contrary to its special regime (as per the Law and the Bylaws of the Central Bank).
    - Treatment of credit portfolio and its deterioration. (Special rules issued by the FSC are applied).

- The Central Bank does not produce any explicit statement of compliance with IFRS.
Accounting Policies of the Central Bank applicable to Financial Instruments
Treatment of Financial Instruments

Financial instruments are classified depending on their intent and capability of management, addressing the following premises:

1. The characteristics of the contractual cash flows of a financial asset (its existence).
2. How the entity manages its financial assets (Business Model).

<table>
<thead>
<tr>
<th>Management Model and Characteristics of the Instrument</th>
<th>Classification</th>
<th>Recognition of Gains and Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets held for contractual cash flows in future dates, throughout the life of the instrument more than to sell the instrument before the due date.</td>
<td>Amortized Cost (Effective Interest Rate Method)</td>
<td>Result of the period</td>
</tr>
<tr>
<td>Assets for short term sale and benefits of change in fair value (fair value gains).</td>
<td>Fair value with changes in results</td>
<td>Period Results</td>
</tr>
<tr>
<td>Assets held for obtaining (i) contractual cash flows and (ii) to be sold prior to maturity, but not in the short term.</td>
<td>Fair value with changes in OCI / Equity</td>
<td>Results of the period</td>
</tr>
<tr>
<td>Results of the period</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| - TIR yields  
- Realized Results  
- Deterioration Equity (OCI)  
- Market Variations |
International Reserves

**Concept**

**Definition and Characteristics**

The IR are assets abroad controlled by the monetary authority, which:

(i) Are under the direct and effective control of the monetary authority and,
(ii) Are available for immediate use.

**Objective**

To maintain an adequate level of assets in foreign currencies, available to intervene in the foreign exchange market and facilitate access of the public and private sector to international capital markets.

**Composition**

1) Investment Portfolio excluding Monetary Gold (94.7%)
2) Gold (1.5%)
3) Contributions to supranational entities (IMF, FLAR) and contribution to international conventions (ALADI). (3.5%)
4) Cash (0.4%)
International Reserves

Determination of Accounting Policy - Classification and Measurement

1. Cash-Flow Assessment

- Fixed-Income Instruments:
  - Securities
  - Discount Securities
  - Certificates of Deposit

- Derivatives:
  - Currency Forwards
  - Bonds and Interest Rates Futures

- Monetary Gold:
  - Gold Stocks

With Cash Flows

Without Cash Flows

Business Model Assessment
# 2. Business Model Assessment

## Assessment Criteria

<table>
<thead>
<tr>
<th>1. Objectives and Composition</th>
<th>1. Objective</th>
<th>2. Composition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintain an adequate equity level to meet the objectives of the IR efficiently</td>
<td>Investment Portfolio and Gold.</td>
<td>Contributions to entities and international organizations (IMF, FLAR, ALADI).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. Purpose of the Tranches</th>
<th>2. Composition</th>
<th>Medium-Term Tranche</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-Term Tranche</td>
<td>Maximize profitability.</td>
<td>Runs with a time limit and a profile of expected profitability of over 12 months</td>
</tr>
<tr>
<td>Cover potential liquidity needs of the reserves up to 12 months</td>
<td>Implementation of different strategies:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>o Review of benchmarks.</td>
<td>Policies addressed to the preservation of capital, showing the intent to obtain higher yields through sales as well as of through contractual cash flows.</td>
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<tr>
<th>3. Sales Volumes</th>
<th>4. Risk Parameter</th>
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<td>Significant sales volume</td>
<td>Management parameters of portfolios to meet the objectives</td>
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<th>4. Risk Parameter</th>
<th>Observations</th>
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<td>Assessment Criteria</td>
<td>Observations</td>
</tr>
<tr>
<td>---------------------</td>
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</tr>
</tbody>
</table>
| 5. Basis for Management Decision Making | - The administration of the Central Bank focuses mainly on information of reasonable value for decision-making.  
Documents constructed through this information |
| 6. Performance Evaluation | - Absolute and relative returns and their attribution based on market factors of the portfolios that make up the international reserves.  
- Market risk indicators of the aggregate portfolio of the international reserves  
- Annual assessment of the active administrators of the reserves including excess returns on the portfolios compared with their corresponding indexes.  
- Documents with proposals on strategic asset composition for trenches of the international reserves, using return and risk estimates and restrictions established related to the valuation at market prices.  

The activities carried out for the administration of the IR establish that the aim of the management model is to collect cash flows through the sale of assets, and to take decisions based on the fair values and their management to obtain profit from the fair values.  

Regarding the portion of the reserves that is delegated to external managers, both the assessment and the compensation depend on the valuation of the portfolio at market prices and their relative profitability compared to the reference index. |
The Bylaws of the Central Bank establish the following in paragraph 4 of Article 62:

"4. The international reserves should be accounted for at market rate. The exchange adjustment of the international reserves caused by fluctuations in the exchange rate of the peso vis-à-vis the currencies in which they are represented shall be recorded as a surplus (equity). The unfavorable adjustment of the exchange rate will apply to said surplus (equity). The variations in international reserves generated by changes in the prices of investments will constitute revenues and expenditures of the Bank."

As a result, should the business model applicable to the IR be otherwise, then the Bylaws of the Central Bank would need to be modified.
International Reserves

Determination of Accounting Policy - Classification and Measurement

1. Assessment of Cash Flows

- Fixed-Income Instruments
  - Securities
  - Discount Securities
  - Certificates of Deposit
  - With Cash Flows
  - Business Model
  - Fair Value with Changes to Results

- Derivatives
  - Currency Forwards
  - Bonds and Interest Rates Futures
  - Without Cash Flows
  - Fair Value with Changes to Results

- Gold
  - Gold Stocks
  - Without Cash Flows
  - Assessment of Treatment
## Treatment of Gold

### Classification

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<tr>
<th>Monetary Gold</th>
<th>Non-Monetary Gold</th>
<th>Gold Cultural Asset (Historical)</th>
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<tr>
<td>Certified Gold kept abroad.</td>
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<td>Is part of the International Reserves (IR).</td>
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### Characteristics

- **Monetary Gold**
  - Certified Gold kept abroad.
  - Is part of the International Reserves (IR).

- **Non-Monetary Gold**
  - Is not part of the IR.
  - Is used in internal purchase and sale operations or for export.

- **Gold Cultural Asset (Historical)**
  - Is not part of the IR.
  - Is used to comply with the missionary function related to cultural activity.

### Classification

- **Monetary Gold**: Financial instruments
- **Non-Monetary Gold**: Other assets
- **Gold Cultural Asset (Historical)**: Historical, artistic and cultural heritage assets

### Measurement

- **Monetary Gold**: Fair Value
- **Non-Monetary Gold**: Fair Value
- **Gold Cultural Asset (Historical)**: Historical cost
According to IFRS 9 Application Guide, Section B.1, inasmuch as monetary gold does not represent a right and does not have a liability as a counterpart, as required by the definition of a financial asset, suggests the classification as INVENTORY; being considered as a commodity.

1 Justification for the Treatment of Gold as a Financial Instrument:

✓ Being part of the assets of the international reserves (Statutory Act of the Central Bank).
✓ Gold was incorporated as an eligible asset within the estimate of the reference index of the two reserve tranches, in order to take into account the market risk incurred with the holdings of gold. I.e., it was incorporated to take into account its volatility and correlation compared to other reserve assets.
Treatment of Gold

Classification

Non-Monetary Gold

- Is not part of the IR.
- Is used in internal purchase and sale operations or for export.

Characteristics

Measurement

Other assets

Fair Value
International Price FIX
AM Stock (London).

Justification of the Classification and Measurement

☑ Does not comply with the specifications required to be monetary gold.
☑ By recognizing gold at its historical cost (or net realizable value, if less), would not be a fair presentation in the FS. (NIC 1, p. 19, and conceptual framework).
### Treatment of Gold

#### Classification

| Monetary Gold | Non-Monetary Gold | Gold Cultural Asset (historical) |

#### Characteristics

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#### Classification

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<th>Financial instruments</th>
<th>Other assets</th>
<th>Historical, artistic and cultural heritage assets</th>
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<td>In the category: At Fair Value with Changes in Results.</td>
<td></td>
<td>IPSAS 17</td>
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#### Measurement

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<th>Fair Value</th>
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<th>Historical Cost.</th>
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</table>
Recognition of Results

Financial Instruments and Non-Monetary Gold Revenue

Changes in Market Prices.
(IR portfolio including Monetary Gold)

Total Comprehensive Financial Statement

In line with IFRS 9 Financial Instruments.
Bylaws of the Central Bank.

Exchange-Rate Fluctuations
IR portfolios, including Monetary Gold

Equity (Surplus)

Exception from the Law and Bylaws of the Central Bank.

Non-Monetary Gold
Subsequent Measurement

Total Comprehensive Financial Statement

Bylaws of the Central Bank.
### Treatment of Distribution of Results

#### International Reserves Portfolio (including Monetary Gold)

<table>
<thead>
<tr>
<th>Concept</th>
<th>Distributes</th>
<th>Retains</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Price Variations</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Exchange-Rate Fluctuations¹</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

¹ Variations due to exchange-rate fluctuations are retained in equity (surplus), not transferred to results when realized.
The Central Bank is currently assessing the following mechanisms to retain non-realized profit:

- Creation of an equity reserve equivalent to non-realized results.
- Adoption\(^1\) of the Guide issued by the World Gold Council regarding:
  - Measurement: treating the difference in change and the market price variations as one valuation input.
  - Recognize unrealized earnings and losses in equity.

\(^1\) As allowed by IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors.”
Thank you for your attention.