

Gold Reserves and How to Account for Them

Ezechiel Copic & Kenneth Sullivan

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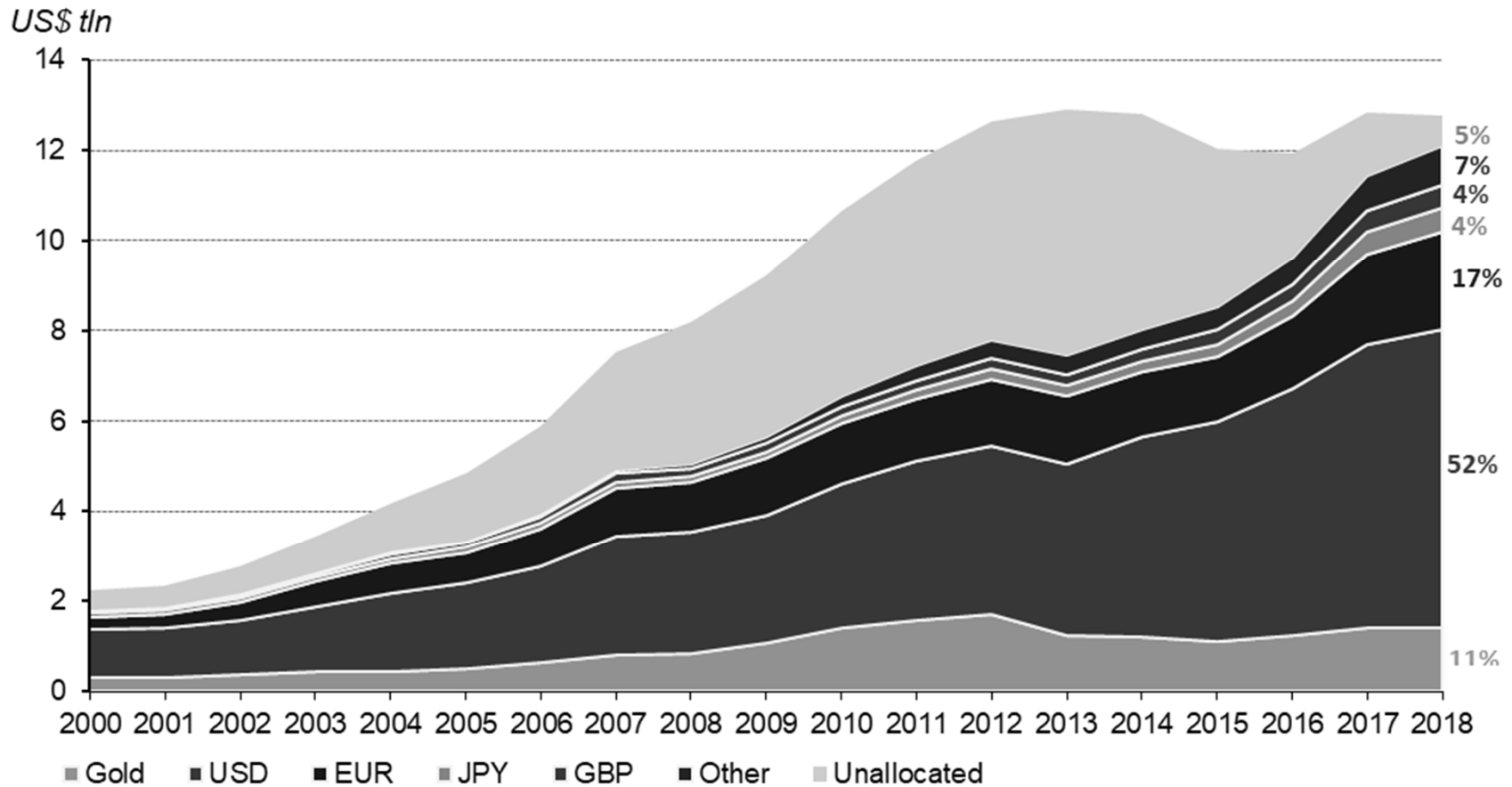
Agenda

- Gold as a Foreign Reserve Asset
- Issues Related to the Accounting for Monetary Gold
- Guidance on the Recommended Practice in Accounting for Monetary Gold

Gold as a Foreign Reserve Asset



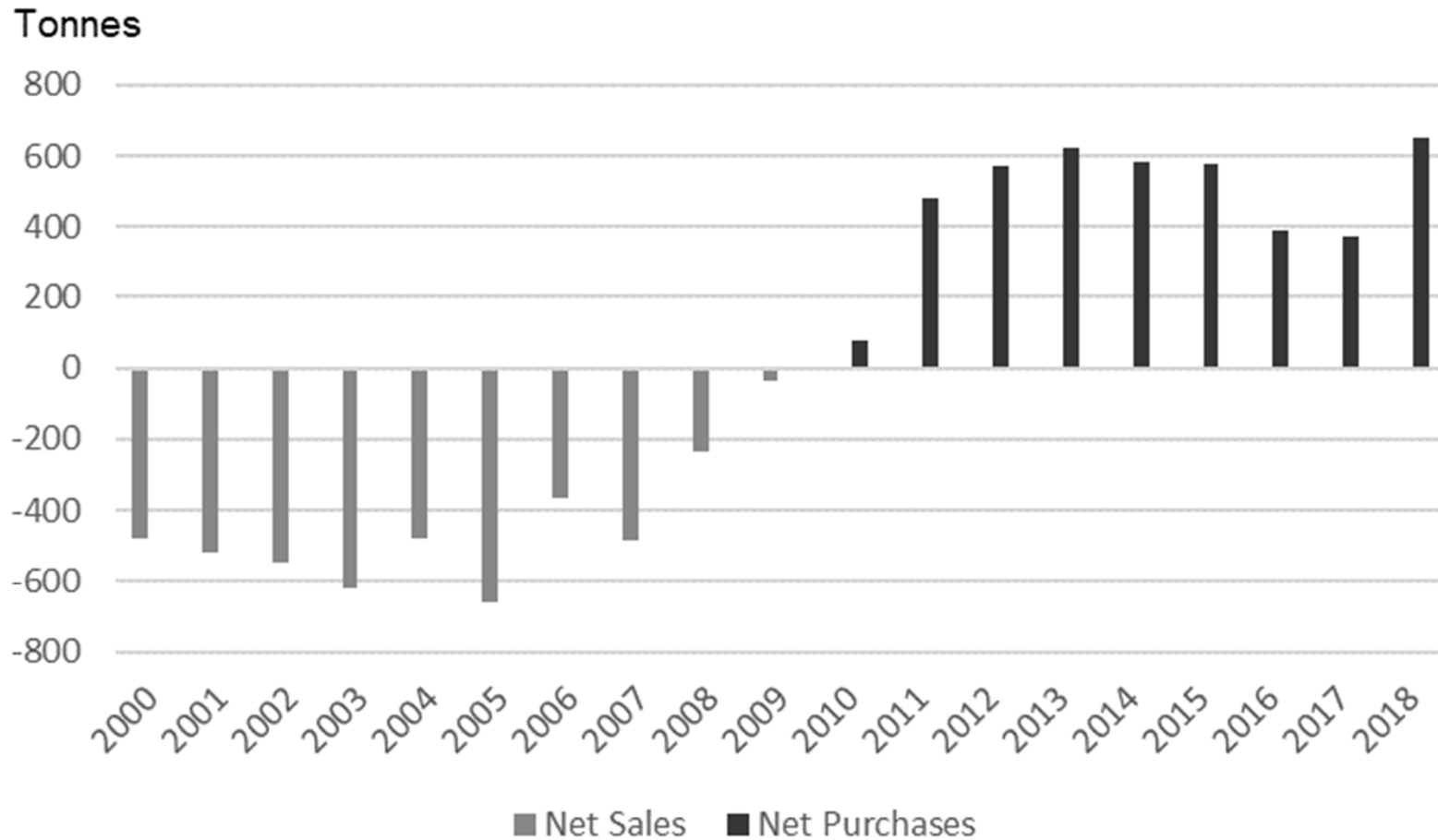
Gold is the third largest reserve asset globally



Source: Bloomberg, IMF

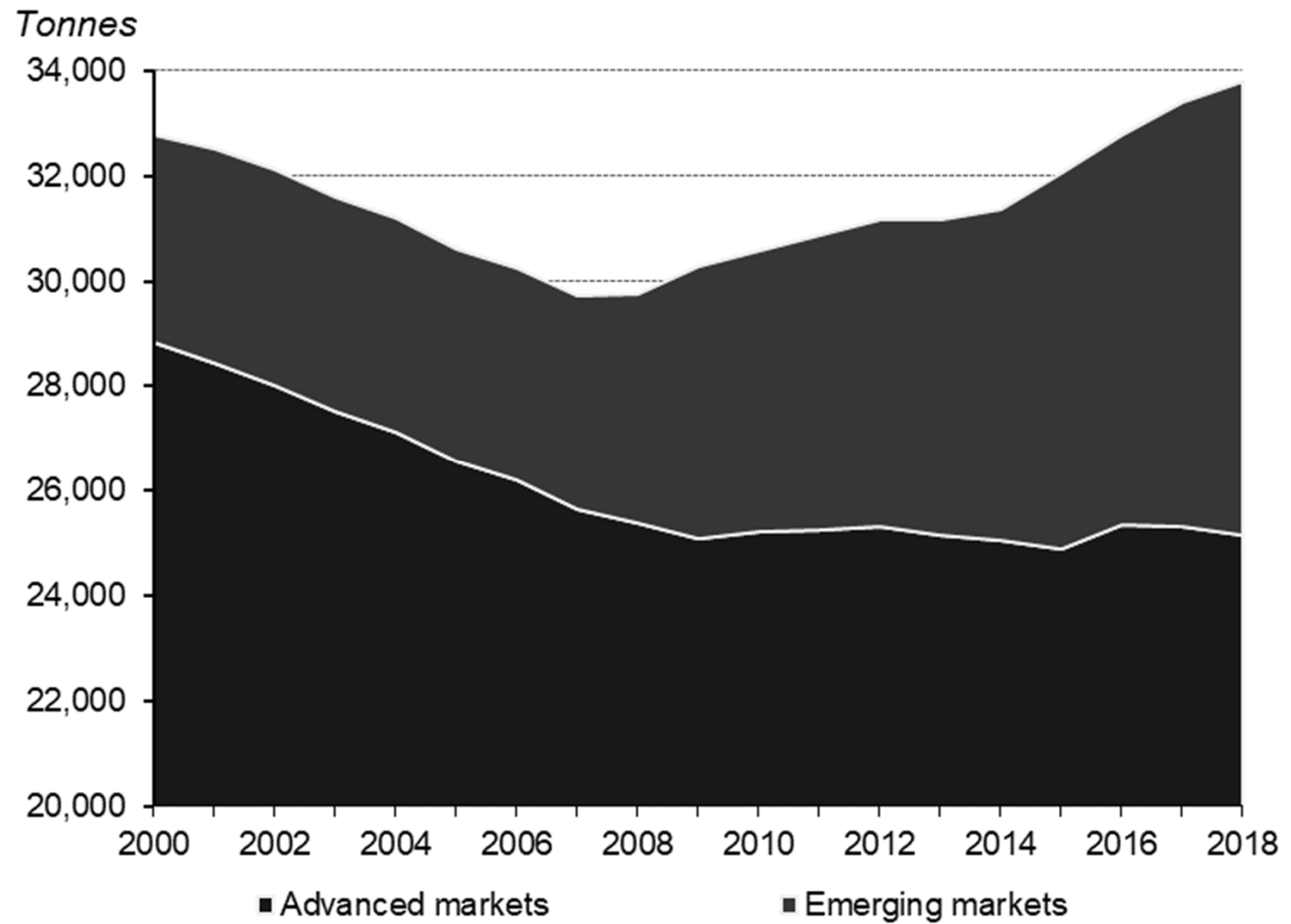
Central bank demand highest since 1971

Annual net sales and purchases of gold by central banks



Source: Metals Focus, Refinitiv GFMS, World Gold Council

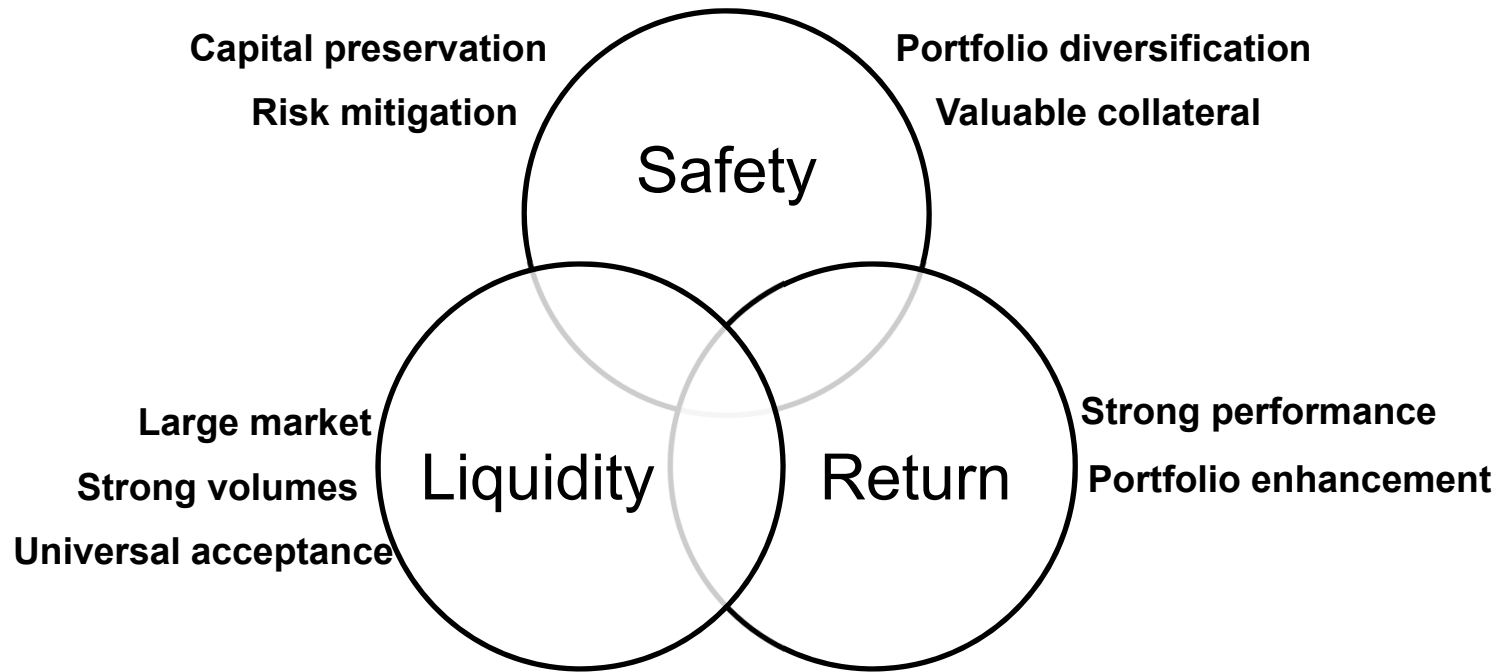
Gold reserves on the rise in emerging markets...



*Note: Developed and emerging market country classifications were taken from the IMF's categorisation. Developed market data also includes gold held by the IMF and BIS.

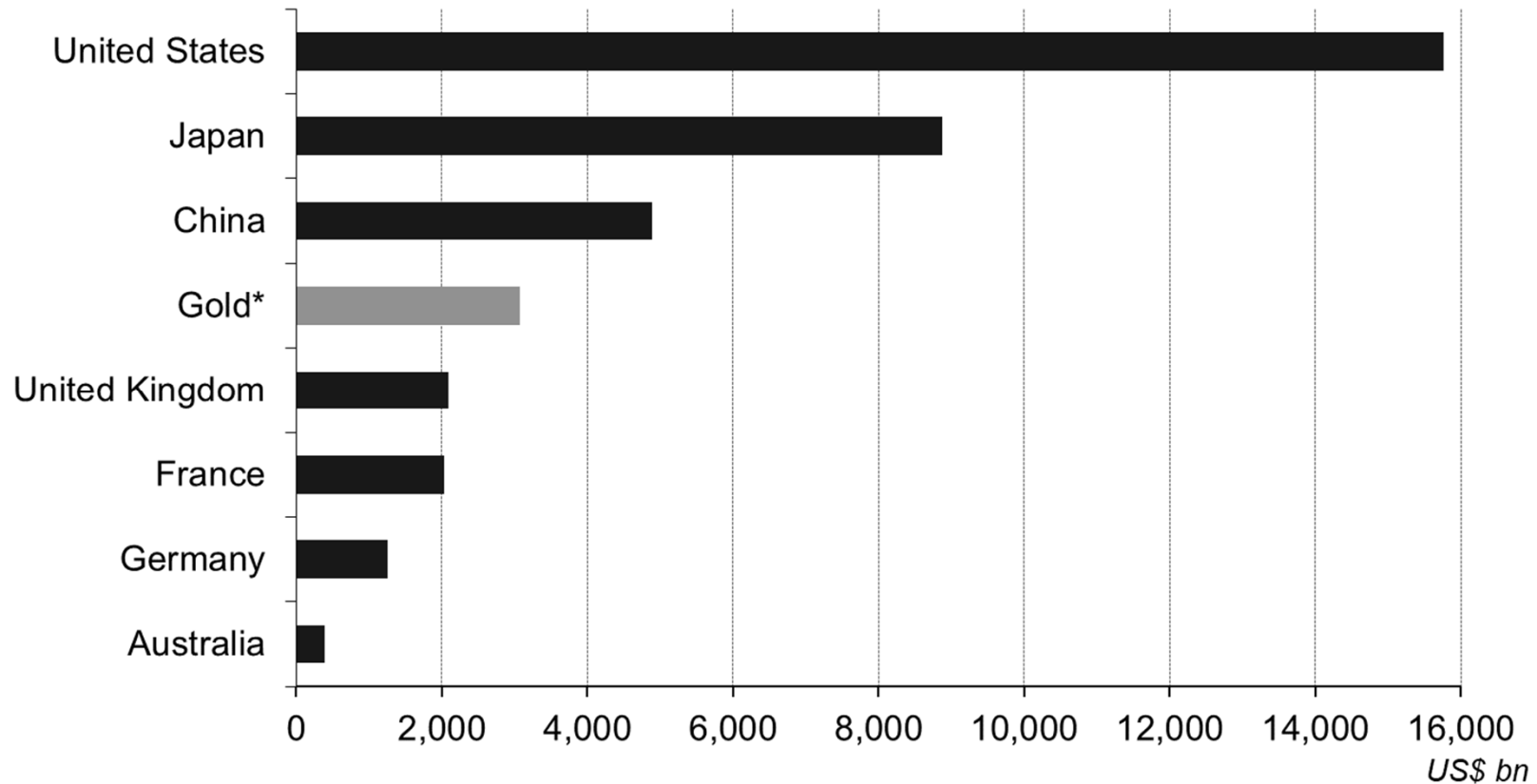
Source: World Gold Council

Foreign reserves management



Financial gold market rivals major sovereign debt

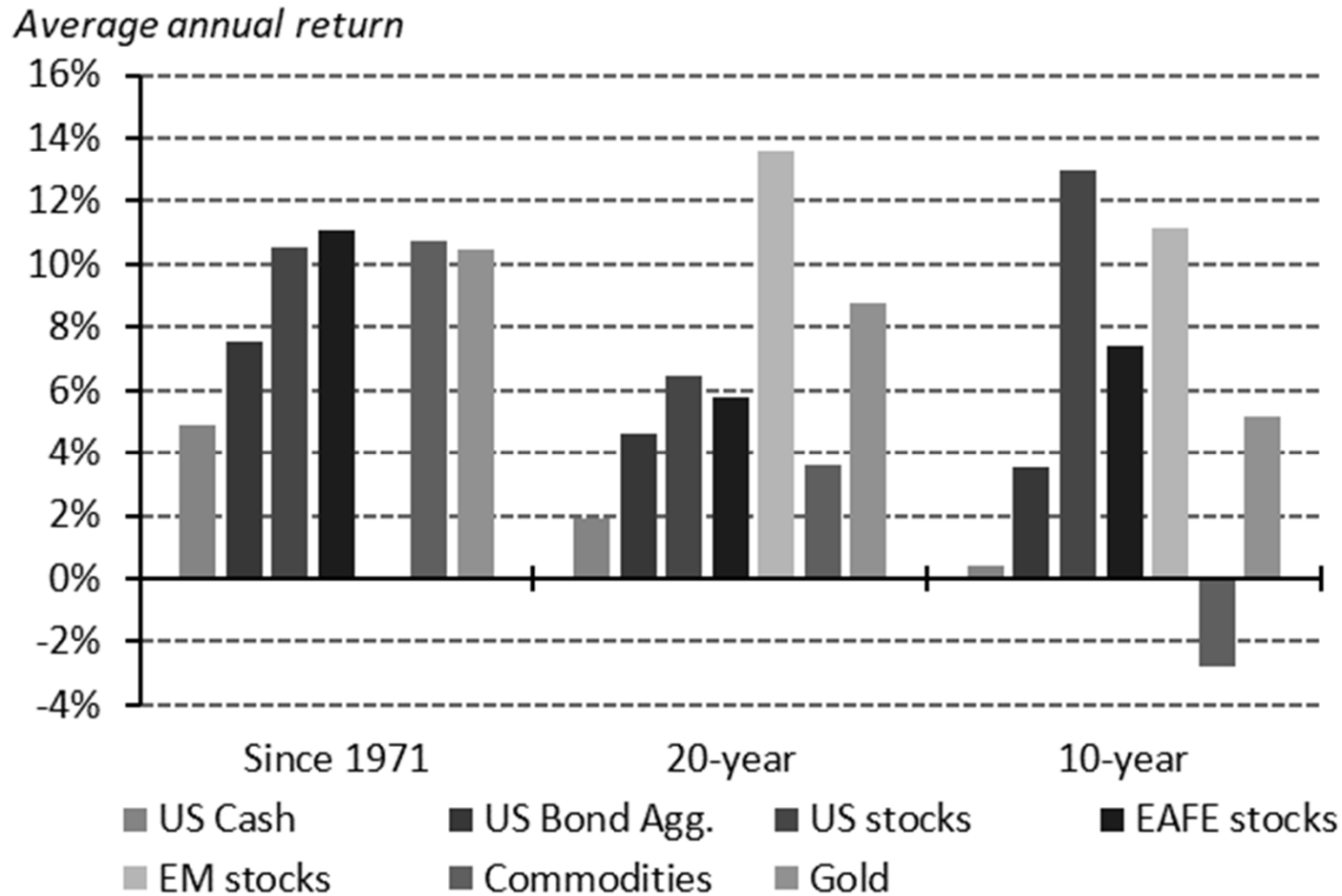
Market size of major government securities



*Gold is the sum of the above-ground stock of bars and coins, ETPs and official sector (or “Financial Gold”).

Source (date updated): BIS (Sep-18), Sifma (Feb-19), Japan Ministry of Finance (Dec-18), UK Debt Mgmt Office (Mar-19), German Finance Agency (Mar-19), Agence France Tresor (Jan-19), Australia Office of Financial Mgmt (Feb-19), World Gold Council (Dec-18)

Gold returns comparable to stocks, higher than bonds



*As of 31 December 2018. Computations in US dollars of total return indices for ICE 3-month Treasury, Bloomberg Barclays US Bond Aggregate, MSCI US, EAFE and EM indices, Bloomberg Commodity Index and spot for LBMA Gold Price PM.

Source: Bloomberg; ICE Benchmark Administration; World Gold Council

Issues Related to the Accounting for Monetary Gold



How did we get here?

Like many central banks, CBS's law requires it to adopt IFRS as its framework.

But IFRS does not provide appropriate guidance for the accounting of **monetary gold**.

So, many central banks turn to the IMF's Balance of Payments and International Investment Position Manual (BPM6) for assistance.

GOLD



vs.



Definition:

Defines monetary and nonmonetary gold

Unequivocally defines gold as a commodity

Financial instrument:

Includes monetary gold in list of financial assets

States that gold is not a financial instrument

Accounting:

Monetary gold should be valued at prevailing market price.

Accounted for at lower of cost and net realizable value

What has been the Result?

- Multiple practices in accounting for monetary gold
- WGC commissioned report on practices
- Identified 7 broad approaches
- 1 used cost other 7 used market value
- Difference in 7 fair value was treatment of unrealized revaluations; eg
 - FVTPL
 - FVOCI
 - Direct to reserves
- Prompted WGC to produce guidance

WGC Guidance for the accounting of monetary gold

This *Guidance* represents **recommended best practices in accounting for monetary gold**, rather than a pronouncement on such practices.

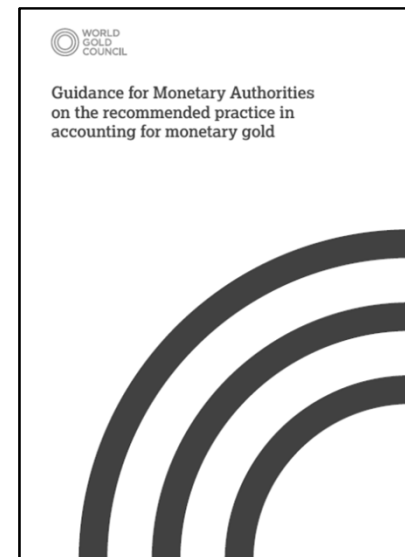
There is **no specific legal mandate** associated with this *Guidance*.

This *Guidance* was **prepared with reference to the IASB's conceptual framework** and uses similar terminology as far as possible.

The recommended approach is **consistent with functional rationale** for holding gold as an element in FX reserves.

Consistent with **IMF BoP reporting** requirements

- All FX reserves are fair valued



Classification and application

Three classifications for gold:

- *Monetary gold* – meets IMF definition of monetary gold (not necessarily LGD)
- *Antique gold* – historic gold artifacts
- *Non-monetary gold* – residual gold holdings

Guidance applies only to **monetary gold**

- Antique and non monetary gold linked to general accounting framework

Treat monetary gold as financial instrument denominated in national currency

Guidance **does not apply** where a central bank has a **fully historic cost framework**

Measurement

Monetary Gold – initial measurement at **fair value**

- Subsequent measurements at fair value, but **based on cost of getting gold to market**
 - Cost-based adjustments could be applicable in the following cases:
 - **Refining** costs – gold may not be in LGD form
 - **Transport** costs – gold may not be held at recognized market location

Non-monetary gold – as a **commodity**

Antique gold – in accordance to bank's **accounting policy for art**

Treatment of revaluations

Unrealised gains

- Treat price and FX movements as a single item
- Disclose through OCI or equivalent statement – e.g. statement of changes in equity
- Allocate to dedicated gold unrealized revaluation reserve in equity.

Unrealised losses

- Report in OCI
- Allocate to gold revaluation reserve until zero balance
- Report losses in excess of reserve balance through P&L

Realised gains and losses

- Report realized gains and losses through P&L
- Reverse realized gains and losses from revaluation reserve

Other Monetary Gold Transactions

Gold swaps

Location swaps

Gold deposits (loans, lending, leasing)

Gold commodity swaps

Gold forwards, futures, and options

Treatment of these are consistent with similar financial instrument transactions IFRS

Disclosures

Research showed **uneven level of disclosures** for gold holdings

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

- functional reasons for holding monetary gold and its significance
- functional reasons for holding non-monetary and antique gold
- accounting policies adopted when accounting for all classes of gold holdings.

The monetary authority should **harmonize 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.

Summary

Benefits of this approach:

- Reports fair value on balance sheet (hedge effect) – **consistent with IMF** requirements
- Discloses unrealized revaluations in OCI as **single revaluation**
- Allocates revaluations to dedicated revaluation equity account
 - No split between FX and price
 - No offset to other revaluations
- Excludes revaluations from considerations for dividends
- Allows reporting of **realized gains and losses through profit and loss**
- **Enhanced disclosures**
 - Valuation movements through SOCI

Consistent with treating gold as a non-monetary FX asset (IAS 16)

Summary of Findings

Method	Number of Central Banks
1. Cost	9
2. Fair Value through Profit and Loss (FVTPL)	3
3. Fair Value to Reserves via Profit	11
4. Fair Value to Reserves through Other Comprehensive Income (FVOCI)	14
5. Fair Value Direct to Reserves	7
6. Fair Value Direct to Non-Equity Revaluation Account	25
7. “Financial” Fixed Asset	1

Why the *Guidance* prevailed

According to the Central Bank of Somewhere, they ultimately decided to adopt the World Gold Council's *Guidance* for the following reasons:

- **Clarity and precision of the language** used in the *Guidance*
- **Integration with other central bank reporting requirements** (IMF BOP requirements gained strong support from CBS's statistics department)
- **Consistency** with the manner in which CBS manages its FX reserve assets (business model).

Other central banks are currently in the process of reviewing the *Guidance* with a view towards adopting it as well.

Please don't hesitate to contact us if you want to discuss the *Guidance* in further detail.