ICGFM The International Consortium on Governmental Financial Management

PO Box 1077
St Michaels, MD 21663
USA
T. 410-745-8570
F. 410-745-8569

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The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2
CANADA

Dear Sir

1. The International Consortium on Governmental Financial Management (ICGFM) welcomes the opportunity to respond to Exposure Draft 62 "Financial Instruments" issued August 24, 2017.

2. Whilst we accept the need to bring IPSAS into line with IFRS 9 on the same issues, we are concerned about the resulting complexity of the requirements. Most governments will not issue or acquire complex financial instruments; therefore, we would favour a structured standard first defining basic principles and rules for simple financial instruments before moving on to the rules for complex financial instruments.

3. We appreciate the opportunity to comment on this Exposure Draft and would be pleased to discuss this letter with you at your convenience. If you have questions concerning this letter, please contact Michael Parry at Michael.parry@michaelparry.com or on +44 7525 763381.

Yours faithfully,

Michael Parry

Michael Parry
Chair, ICGFM Accounting Standards Committee

Members

Michael Parry, Chair
Andrew Wynne
Anne Owuor
Hassan Ouda
Jesse Hughes
Mark Silins
Nino Tchelishvili
Paul Waiswa
Tony Bennett

Cc: Jim Wright, President, ICGFM

International Consortium on Government Financial Management (ICGFM)

Response to Exposure Draft 62 "Financial Instruments"

Issued August 2017

Overview

It is not as yet clear how ED62 will be reflected in accounting standards. The documentation includes both a standalone ED62 and also proposed amendments to ED29. This needs to be clarified.

This is a very complex set of proposals. ED62 alone is 410 pages, with additional documentation amounting a further 330 pages. The documents themselves are also very complex, with the use of terminology unfamiliar to most government accountants, and multiple cross references to other standards. Only a limited number of specialists in some governments will need to understand the full complexity of the proposed standards and the implications for financial reporting. But all governments will need to be able to apply the basic principles of reporting on lending to or by governments, and equity investments held by governments.

Therefore, our first **recommendation** is for a structure to any resulting standard, or standards, that is accessible to government financial managers who neither have, nor require, specialist knowledge of the more arcane financial products and situations. **This is very important if the standard is to be properly implemented by many smaller or poorer countries without access to specialist expertise**. In particular the excellent summary and diagrams in the "At a Glance" publication should be incorporated within the Standard.

Specific matters for comment

There are just three specific matters for comment as summarised in the table below, together with our response.

Comment request	**ICGFM Response**
Specific Matter for Comment 1: Consistent with the relief provided in IFRS 9, the IPSASB has agreed in [draft] IPSAS [X] (ED 62) to allow an option for entities to continue to apply the IPSAS 29 hedging requirements. Do you agree with the IPSASB's proposal?	Agreed. This seems sensible There should be provisions for additional disclosure in the notes to the financial reports on conditions relating to risk hedging, peculiarities of repayment on financial liabilities, the acquisition and maintenance of financial assets.

Comment request	ICGFM Response
Specific Matter for Comment 2: The IPSASB recognizes that transition to the new standard [draft] IPSAS [X] (ED 62) may present implementation challenges as a result of the number of significant changes proposed. Therefore, the IPSASB intends to provide a 3 year implementation period until [draft] IPSAS [X] (ED 62) is effective (early adoption will be permitted). Do you agree with the proposed 3-year implementation period before [draft] IPSAS [X] (ED 62) becomes mandatory? Please explain.	Agreed As above, a sensible provision in view of the changes
Specific Matter for Comment 3: Do you agree with the proposed transition requirements in paragraphs, consistent with those provided in IFRS 9? If not, what specific changes do you recommend and why?	Agreed The illustrative examples provided are useful for interpreting ED62. We would suggest these examples should be expanded to include some of the situations and issues faced by members of the ICGFM, as indicated below.

Comments on the proposals

As indicated, most governments do not invest in, or issue, financial derivatives, and there is limited hedging of currency transactions. However, where such situations do occur they can be of national significance. We therefore **support** an approach based on IFRS9 to ensure consistency with commercial practice.

Definition of cash

ED 62 contains no definition of cash and cash equivalents, yet these are the most pervasive of all financial instruments. Cash and cash equivalents are defined in IPSAS 2, para 8. We **recommend** the definition of cash and cash equivalents be repeated in any Standard that results from ED62.

Classification of financial instruments

We support the broad classification of financial instruments between financial assets, financial liabilities and equity.

The classification structure in Paragraphs 39-56 is on the valuation basis. This is not necessarily the most informative presentation for financial reporting. The IMF Government Finance Statistics (GFS) Manual requires classification based on the maturity and source of the financial instrument. We **recommend** that for General Purpose Financial Reports the GFS classification structure is adopted.

Practical problems identified by ICGFM members

The practical problems identified by ICGFM members primarily relate to loans between public sector institutions, e.g.

- Loans by multilateral or bilateral donor organisations, either directly to governments and then on lent to public sector entities, or directly to public sector entities, with various covenants attached. Problems relate to valuing the on lent loan asset when some of the covenants are breached but the loan is not called in. Also, where the loan is directly to the public sector body, impact of the above events on the valuation of other loans to that entity.
- Lending to or by state-owned banks by public corporations on preferential terms (e.g. below market interest rates, repayment at the end of the contract period, informal but regular loan extension, very large lending). The fair value of such lending may be below the nominal value of the loan, but there is often resistance to provisioning against loans to other public sector entities.
- The risk of default by public sector borrowers is real, yet is difficult to assess and quantify. Often political considerations make it very difficult to write off or provide against loans by other public sector entities.

In all of the above situations clear guidance and examples in the IPSAS would support appropriate valuations.

Valuation of financial instruments

As a matter of principle, the value of any financial instruments is the discounted expected future cash flows to be generated or incurred from such financial instrument. Any other measure is a surrogate for the present value of such future cash flows.

Where available, market values provide the best indicator of the above present value of future cash flows, since such values are generated by multiple investor estimates. This will normally be what is referred to as "fair value" and hence the approach is **supported**. For governments, the distinction between fair value through surplus/deficit or through net assets/equity is of limited significance, but we accept it is necessary to keep the distinction for consistency with IFRS 9. We also **support** the amortised cost basis in the limited circumstances described.

However, we **recommend**:

1. The section on valuation should start with a statement of basic principles
2. The clarity of this section be improved by concluding with a simple set of rules (without cross references).

Impairment

We **support** the revised impairment rules which address a criticism of the existing rules particularly for commercial entities.