Directive on Accounting Standards: GC 3450 Financial Instruments

Note to reader

This document is part of the Appendix A of the Directive on Accounting Standards.

A. Primary PSAS reference

PS 3450 Financial Instruments

B. Effective date

April 1, 2022

C. Government of Canada Consolidated Financial Statements

1. As stated in PS 3450.004, not all financial assets meet the definition of a financial instrument. Only those financial assets that arise from contracts and give rise to financial liabilities or equity of the counterparty are financial instruments.

2. In accordance with PS 3450.003(p), contracts to buy or sell non-financial items when quantities are in accordance with a government’s expected purchase, sale or usage requirements are excluded from the scope of PS 3450. Such “own use” contracts provide for settlement only through the receipt or delivery of goods or services and, therefore, are not financial instruments.
3. However, as stated in PS 3450.005 and PS 3450.A13, contracts in quantities in excess of a government’s expected purchase, sale or usage requirements that can be settled net in cash or another financial instrument in lieu of the receipt or delivery of the goods or services, or in which the non-financial item is readily convertible to cash (for example, a traded commodity), are in the scope of PS 3450.
4. PS 3450.007 requires that loan guarantees accounted for under PS 3310 Loan Guarantees are also within the scope of PS 3450 when the payments under the guarantee fluctuate in response to changes in a financial variable (for example, interest rate, financial instrument price, commodity price, foreign exchange rate, index or prices or rates, credit rating or credit index) or a non-financial variable that is not specific to a party to the contract. In such instances, the loan guarantee is a derivative in its entirety and must be measured at fair value in accordance with PS 3450.017. PS 3450 does not apply to guarantees other than loan guarantees accounted for under PS 3310.

D. Recognition

5. PS 3450.14 requires that derivatives embedded in host contracts be identified and assessed to determine whether their economic characteristics are closely related to the host contract. Only those host contracts in the scope of PS 3450 must be reviewed for embedded derivatives. When an embedded derivative is not closely

related to the host contract, it is accounted for separately as a stand-alone derivative.

6. PS 3450A.25-.26 provides further examples of financial and non-financial contracts with embedded derivatives that are closely related and those that are not closely related. Additional guidance is provided in GC 3450 Guideline: Embedded Directives.
7. The government may hold securities in deposit or trust accounts or as collateral support. To determine whether these securities are recognized as financial assets of the government, departments must assess whether the government has control of the resource and the associated benefits by reviewing the relevant legal, contractual and regulatory requirements. In general, securities held in trust would not be recognized as financial assets unless title to the security passes to the government.
8. Also refer to GC 4100 Specified Purpose Accounts, section C, subsection 4.b.

E. Measurement

9. There are two measurement categories under PS 3450:
    a. Fair value:
        i. Derivatives;
        ii. Portfolio investments quoted in an active market; and
        iii. Financial instruments designated to the fair value category [1] (optional);
    b. Cost or amortized cost:
        i. All other financial instruments of the Government of Canada.

10. The effective interest method, defined in the glossary to PS 3450, is applied to determine the carrying value of financial instruments measured at amortized cost according to PS 3450.033. Guidance on applying the effective interest method is provided in PS 3450.A41-.A45.
11. All cash flows arising from the contractual terms of the financial instrument are included in the effective interest rate calculation. These cash flows include interest payments, any fees, points paid or received, transaction costs and other premiums or discounts (PS 3450.A41).
12. When applying the effective interest method to a variable rate loan, the amortization period reflects the next date at which the interest rate is reset. For example, the terms of the loan may state that the loan rate is reset annually to the prime rate plus a fixed percentage (PS 3450.A42).
13. When it is not possible to reliably estimate either the cash flows or the expected life of a variable rate loan, the contractual cash flows over the full contractual term of the financial instrument would be used (PS 3450.A41).
14. When applying the effective interest method to variable rate concessionary loans that are not reset on specific dates (for example, the interest rate changes on the date the prime rate changes), the interest payments and loan discount would be considered separately as follows:
    a. The loan discount would be calculated in accordance with GC 3050 at inception of the loan and amortized based on the effective interest method over the contractual term. The loan discount is not affected by future changes in the interest rate; and

  b. The floating interest revenue would be accrued annually based on the current interest rate according to the contractual terms of the loan.

15. The original effective interest rate continues to be applied to the gross carrying amount of the financial asset for which a valuation allowance has been recognized unless collection of the principal or interest is not reasonably assured (PS 3450.A41).
16. When an impairment loss has been recognized, the effective interest rate is adjusted to the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (PS 3450.A45).
17. The effective interest method is not required for financial assets and liabilities where balances are not material or where they have a short period to maturity, such as:
    a. Accounts payable and accrued liabilities; or
    b. Accounts receivable.

F. Foreign reserves (Department of Finance Canada)

18. The assets and related non-derivative liabilities of the Exchange Fund Account are managed on a fair value basis. These financial instruments are measured at cost or amortized cost, and not designated to the fair value category as permitted by PS 3450.23.
19. Balances with the International Monetary Fund (IMF), whether in the form of subscriptions, notes, or special drawing rights, are excluded from the scope of PS 3450 (PS 3450.003(i)).
20. The accounting policies that apply to balances with the IMF are set out in the following table.

IMF balance type	Applicable accounting policy
Recognition	
All IMF balances	PS 3450.009-.014
Measurement	
Subscriptions to the IMF (quota)	Asset measured at cost
Special drawing rights (SDR) allocations	Asset measured at cost
SDR holdings	Liability measured at cost
Loans receivable	Asset measured at cost with valuation allowance
Notes payable	Liability measured at cost no less than the amount payable on demand
Interest on loans receivable	Effective interest method
Presentation	
Unrealized and realized foreign exchange gains and losses	Statement of Operations
IMF assets and liabilities	Statement of Financial Position

G. Departmental Financial Statements

13. Applies without additional policy choices or interpretation for Departmental Financial Statements.

Footnotes

1 Designation of financial instruments to the fair value category, as permitted by PS 3450.23, requires the approval of the Comptroller General of Canada.

Date modified: 2023-11-02