

Financial Statement Presentation — Basis for Conclusions

Section PS 1201

FOREWORD

CICA Public Sector Accounting Handbook Revisions Release No. 34, issued in June 2011, included FINANCIAL STATEMENT PRESENTATION, Section PS 1201, which revises and replaces FINANCIAL STATEMENT PRESENTATION, Section PS 1200.

The primary objective of a Basis for Conclusions document is to set out how the Public Sector Accounting Board (PSAB) reached its conclusions. As well, it sets out significant matters arising from comments received in response to the proposals exposed and indicates how PSAB has dealt with the issues raised.

These documents are intended to assist financial statement users, preparers, auditors and other parties interested in public sector financial reporting in understanding the rationale followed by PSAB when developing the standards.

This document has been prepared by the staff of PSAB. This document does not form part of the CICA Public Sector Accounting (PSA) Handbook nor is it a part of public sector generally accepted accounting principles (GAAP). Basis for Conclusions documents also do not include any guidance on the application of the relevant Section or Guideline.

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BACKGROUND

- 1 The new standard replaces FINANCIAL STATEMENT PRESENTATION, Section PS 1200. It introduces a statement of remeasurement gains and losses. Requirements in FOREIGN CURRENCY TRANSLATION, Section PS 2601, and FINANCIAL INSTRUMENTS, Section PS 3450, can give rise to the presentation of gains and losses as remeasurement gains and losses. This is explained below.
- 2 The text of Section PS 1201 is generally equivalent to Section PS 1200 other than the changes made to set out the requirements related to the new statement as well as related referencing and editorial changes.
- 3 The new standard applies to all public sector entities issuing general purpose financial statements prepared in accordance with the CICA Public Sector Accounting (PSA) Handbook. Its text applies a drafting convention that refers to entities applying the PSA Handbook as "governments". Within this document, the term public sector entity applies to all public sector entities using the PSA Handbook.

PRESENTATION OF REMEASUREMENT GAINS AND LOSSES

- 4 At an early stage in the financial instruments project, PSAB concluded that derivatives have the characteristics of assets and liabilities. PSAB reached this conclusion for the following reasons:
 - (a) The ability to settle a derivative in a gain position by receiving cash, another financial asset or a non-financial asset is evidence of a future economic benefit and is compelling evidence that the instrument is an asset.
 - (b) Similarly, the requirement to pay cash, transfer a financial asset, or a non-financial asset in settlement of a derivative in a loss position is evidence of a duty to sacrifice assets in the future and indicates that the instrument is a liability.
 - (c) The transaction or event giving rise to the public sector entity's control of the benefit, or conversely obligating the public sector entity, occurs upon execution of the contract to acquire the derivative financial instrument.
- 5 Comments received supported the conclusion that derivatives have the characteristics of assets and liabilities as defined in the CICA Public Sector Accounting (PSA) Handbook. The Public Sector Accounting Board (PSAB) considered how derivatives and non-derivative financial instruments should be measured in financial reporting periods subsequent to their initial recognition. It determined that fair value measurement should apply to derivatives and portfolio investments that are equity instruments quoted in an active market. In the case of derivatives, it reached this conclusion for the following reasons:

- (a) Amortized historical cost is not a relevant measure of a derivative because the historical cost of a derivative is often zero.
 - (b) Fair values depict the market's assessment of the present value of the net future cash flows directly or indirectly embodied in all financial instruments, discounted to reflect both current interest rates and the market's assessment of the risk that the cash flows will not occur.
 - (c) Fair value reflects the current cash equivalent rather than the price of a past transaction.
- 6 Alternatives to fair value measurement or reasons that cost is a superior measurement approach were not among the arguments advanced in responses to an Exposure Draft, "Financial Instruments and Foreign Currency Translation: Financial Statement Presentation," issued in November 2010. However, it was asserted that introduction of fair value measurement will affect comparability of results in relation to budget and introduce volatility as changes in fair value caused by "point in time" measurement cannot be reliably anticipated.
 - 7 Responding to these concerns, PSAB sought to ensure that results reported on and the comparison with budget would provide user with information that is relevant, useful and complete. PSAB did not want to diminish the value of the budget to actual comparison or leave out information because some were concerned it might be misinterpreted.
 - 8 To accomplish this objective, revenues and expenses that have yet to be realized but arise due to fair value remeasurement or changes in exchange rates are presented as remeasurement gains and losses.
 - 9 Remeasurement gains and losses are revenues and expenses arising:
 - (a) when, prior to an item's settlement, an exchange gain or loss is recognized in accordance with the provisions of Section PS 2601; and
 - (b) when financial instruments in the fair value category are remeasured in accordance with FINANCIAL INSTRUMENTS, section PS 3450.
 - 10 The reporting of gains and losses arising from currency risk and fair value measurement was the most controversial aspect of the project. In a September 2009 Exposure Draft, "Financial Instruments", PSAB proposed to simply present any remeasurement gains and losses as the second component within the statement of operations.
 - 11 While a two-component approach would comply with the objective set out in FINANCIAL STATEMENT CONCEPTS, paragraph PS 1000.34, that states: "revenues and expenses and, therefore, operating results for an accounting period, result only from changes in assets and liabilities" respondents felt that two components would confuse readers or lead to conflicting assertions as to financial performance.
 - 12 An alternative that would also maintain articulation within a single statement of operations would be to define new elements that are deferrals. PSAB rejected this alternative as it would take losses and present them as assets, and take gains and present them as liabilities.
 - 13 The concept of other comprehensive income is not being introduced into public sector accounting. PSAB believes reporting changes attributable to the effects of fair value measurement and unsettled currency risk in a separate statement is more meaningful to users and an easier concept to grasp than other comprehensive income. PSAB's underlying classification of financial instruments is straightforward, alternatives are limited and the complexity associated with hedge accounting is avoided. Remeasurement gains and losses differ in principle and scope from those gains and losses that are defined to be other comprehensive income.
 - 14 PSAB revisited whether disclosure alone might address the needs of the users of financial statements. It concluded it would not as the measures of financial position and performance would be incomplete as derivatives are assets and liabilities. When an item satisfies the recognition criteria, FINANCIAL STATEMENT CONCEPTS, Section PS 1000, requires its inclusion within one or more individual statements. Disclosure is not a suitable substitute for recognition.
 - 15 Hedge accounting was evaluated on numerous occasions. The Basis for Conclusions issued for FOREIGN CURRENCY TRANSLATION, Section PS 2601, explains why PSAB ultimately decided to withdraw hedge accounting.
 - 16 In the end, PSAB determined that it would adopt the presentation provisions in this new standard. These provisions were exposed for comment in the November 2010 Exposure Draft. PSAB concluded the presentation of remeasurement gains and losses in a separate financial statement was preferable to the other alternatives. In reaching this conclusion, it balanced concerns about volatility against the need to ensure public sector financial reporting is transparent and creditable.
 - 17 Remeasurement gains and losses are not new financial statement elements. The framework does not set out characteristics that distinguish gains from revenues or losses from expenses. Consequently, the approach taken is consistent with the position that remeasurement gains and losses are not elements unto themselves.
 - 18 Section PS 1201 was issued to set out the presentation of remeasurement gains and losses in public sector financial statements. When a government has no remeasurement gains or losses to report and does not have any accumulated remeasurement gains and losses, it is not intended that it would present a statement of remeasurement gains and losses. Some respondents asked that the standard explicitly state this; however, it was determined that this was not necessary as the Introduction to Public Sector Accounting Standards states that standards are not intended to apply to immaterial or insignificant items or matters.

- 19 When a public sector entity includes the results of government business enterprises and government business partnerships in the entity's summary financial statements, it may need to account for the other comprehensive income of those entities. PSAB determined that any other comprehensive income arising from the application of modified equity accounting is reported in the statement of remeasurement gains and losses. Prior to adoption of Section PS 1201, INCLUDING RESULTS OF ORGANIZATIONS AND PARTNERSHIPS APPLYING FAIR VALUE MEASUREMENT, PSG-6, required a public sector entity to report other comprehensive income in the statement of accumulated surplus or deficit. This requirement is reflected in Section PS 1201 and through amendments made to INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070.

TRANSITIONAL PROVISIONS

- 20 Public Sector entities adopt Section PS 1201 in the same reporting period Sections PS 2601 and PS 3450 are adopted.
- 21 Government organizations apply the new standard for fiscal periods beginning on or after April 1, 2012. Beginning in 2011, many government organizations will adopt the PSA Handbook as their primary source of GAAP. In nearly all cases, these organizations will transition from the CICA Handbook – Accounting. Consequently, these organizations are already applying standards that require the recognition of derivatives and the use of fair value measurement.
- 22 In the case of governments, the new standard applies to fiscal years beginning on or after April 1, 2015. Governments are being provided with additional time to transition as the changes required of them are of greater consequence. In noting that a review will be undertaken by December 31, 2013, PSAB recognizes the international standards development activities on this topic and its own Concepts Underlying Financial Performance project may reveal concepts that the Board had not considered previously.

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