

# Portfolio Investments — Basis for Conclusions

## Section PS 3041

### FOREWORD

CICA Public Sector Accounting Handbook Revisions Release No. 35, issued in March 2012, included PORTFOLIO INVESTMENTS, Section PS 3041, which revises and replaces PORTFOLIO INVESTMENTS, Section PS 3040.

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 In June 2011, PSAB issued a new standard, FINANCIAL INSTRUMENTS, Section PS 3450. Amendments to conform requirements in PORTFOLIO INVESTMENTS, Section PS 3040, were proposed in an Exposure Draft, "Amendments Resulting from Section PS 3450," issued in July 2011.
- 2 The new standard, PORTFOLIO INVESTMENTS, Section PS 3041, is generally equivalent to Section PS 3040.

### PURPOSE AND SCOPE

- 3 There are two changes in the scope of items accounted for under the new Section PS 3041. PSAB has removed the distinction between temporary and portfolio investments. The implication is when temporary investments are not cash equivalents, as described in FINANCIAL STATEMENT PRESENTATION, paragraph PS 1201.105, they are accounted for as portfolio investments. When Section PS 3450 is adopted, TEMPORARY INVESTMENTS, Section PS 3030, no longer applies.
- 4 A second change is that Section PS 3041 no longer excludes pooled investment funds from its scope. When a public sector entity adopts FINANCIAL INSTRUMENTS, Section PS 3450, it will need to account for any interests in pooled investment funds in accordance with the requirements of Sections PS 3041 and PS 3450. In accounting for units in a pooled investment fund, a public sector entity examines the rights associated with those units rather than the fund's underlying investments. For example, although a pooled investment fund may invest only in bonds, unit holders are only entitled to an interest in any distributable income and a residual interest in the fund's net assets. These units have the characteristics of an equity instrument.
- 5 Some respondents favoured integration of the accounting requirements applying to portfolio investments into an amended Section PS 3450. PSAB considered assertions that such an approach would clarify the requirements; however, it chose to maintain a separate standard to address the accounting for portfolio investments, judging this approach to be less disruptive.

### ACCOUNTING AND PRESENTATION

- 6 The definition and requirement to use the effective interest method is now consistent with FINANCIAL INSTRUMENTS, Section PS 3450. The reason PSAB requires the effective interest method is explained in a separate Basis for Conclusions for Section PS 3450.

- 7 One respondent suggested the definition of the cost method should be retained. However, that definition is no longer needed because the cost method is not used in the new Section. The definition of amortized cost was added because many portfolio investments will be measured using that method.
- 8 Section PS 3041 clarifies that the presentation and disclosure requirements do not apply to externally restricted sinking funds. When a sinking fund is externally restricted, the presentation and disclosure requirements in LONG-TERM DEBT, Section PS 3230, apply.
- 9 Some respondents requested clarification regarding whether previously recorded but unrealized losses are reclassified from the statement of remeasurement gains and losses to the statement of operations when there is decline in the value of a portfolio investment in the fair value category that is determined to be other than temporary. They felt the requirements do not address the assessment and accounting treatment for items in the fair value category that may be impaired.
- 10 FINANCIAL INSTRUMENTS, Section PS 3450, is clear on the need to assess financial assets for impairment. When a financial asset shows evidence of impairment, paragraph PS 3450.034 requires an assessment be made and in the case of portfolio investments, directs that the criteria in Section PS 3041 be applied. Paragraph PS 3450.035 states that non-derivative financial assets in the fair value category are assessed for impairment when there is a loss in value that reflects the expectation that the underlying economic resource has diminished in a manner that is other than temporary.
- 11 When assessing impairment, no special provisions or methods apply to items in the fair value category. The purpose of the impairment assessment is to determine whether a write-down (i.e., expense through operations) is recorded. To ensure the final standard clearly communicates these requirements, paragraph PS 3041.09 clarifies that the loss in value is measured in relation to its cost or amortized cost, adjusted for any write-downs recorded in previous reporting periods.
- 12 To address the concern that the proposed presentation requirements were not sufficiently explicit, paragraph PS 3041.07 clarifies the need to reverse net remeasurements.
- 13 Respondents to the Exposure Draft requested other amendments to the accounting requirements in this standard. However, as the purpose of the project was limited to conforming the requirements within its scope to those adopted when FINANCIAL INSTRUMENTS, Section PS 3450, was approved, PSAB decided that other changes to the accounting for portfolio investments should not be introduced at this time.

#### **TRANSITIONAL PROVISIONS**

- 14 Section PS 3041 applies in the same reporting period FINANCIAL STATEMENT PRESENTATION, Section PS 1201, FOREIGN CURRENCY TRANSLATION, Section PS 2601, and FINANCIAL INSTRUMENTS, Section PS 3450, are adopted.
- 15 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.
- 16 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.