

# Financial Instruments: Transitional Provisions

## — Basis for Conclusions

### Sections PS 2601 and PS 3450

#### FOREWORD

CICA Public Sector Accounting Handbook Revisions Release No. 36, issued in May 2012, contained amendments to the transitional provisions contained in FOREIGN CURRENCY TRANSLATION, Section PS 2601, and FINANCIAL INSTRUMENTS, Section PS 3450.

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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TABLE OF CONTENTS	Paragraph
Background	1-6
Items formerly classified for measurement at fair value	7-10
Investments — Externally restricted assets	11
Cash flow hedges of risk other than currency risk	12-13

#### BACKGROUND

- 1 In June 2011, PSAB issued new standards, FOREIGN CURRENCY TRANSLATION, Section PS 2601, and FINANCIAL INSTRUMENTS, Section PS 3450. Amendments to the transitional provisions in these standards were proposed in an Exposure Draft, "Financial Instruments: Transitional Provisions," issued in January 2012.
- 2 In March 2012, PSAB deliberated matters arising from responses to the Exposure Draft and approved amendments to Sections PS 2601, and PS 3450.
- 3 The amendments were proposed to address issues specific to government organizations transitioning to the CICA Public Sector Accounting (PSA) Handbook from pre-changeover accounting standards in the CICA Handbook – Accounting.
- 4 The amendments to paragraph PS 2601.25 address the accounting at the date of transition, in opening accumulated remeasurement gains and losses, of:
  - (a) accumulated gains and losses yet to be recognized in net income or operations associated with hedging items, such as those designated to a cash flow hedge or to hedge a net investment in a self-sustaining foreign operation; and
  - (b) accumulated other comprehensive income or, in the case of a not-for-profit organization, the equivalent accumulated gain or loss recognized in the statement of changes in net assets, attributable to the translation of the financial statements of a self-sustaining foreign operation.
- 5 Paragraph PS 3450.099(c) was added to clarify that government organizations transitioning from the standards in the CICA Handbook – Accounting recognize an amount in accumulated remeasurement gains and losses at the beginning of the year the Section is initially applied equal to the closing accumulated other comprehensive income attributable to items classified as available for sale.
- 6 Respondents to the Exposure Draft indicated broad support for adoption of the amendments. As well, respondents identified other issues not addressed in the Exposure Draft.

#### **ITEMS FORMERLY CLASSIFIED FOR MEASUREMENT AT FAIR VALUE**

- 7 Some respondents advocated amending the proposal to allow first-time adopters of Public Sector Accounting Standards to retroactively restate items formerly classified as held for trading to historical cost. Under this approach, the difference between fair value and historical cost would be accounted for in opening accumulated remeasurement gains and losses for all items previously measured at fair value. Some respondents advocated this approach on the grounds that it would avoid the need to track the values at the date of adoption associated with items in the former held-for-trading category. As well, it was asserted that restoring historical cost values would mean that the gains and losses reported on the eventual disposal of assets would be measured in relation to historic cost, irrespective of whether the asset was acquired before or after adoption of Public Sector Accounting Standards.
- 8 Another respondent commented on the need to guide government organizations transitioning to the PSA Handbook that hold interest-bearing financial instruments, formerly classified as held for trading, that no longer qualify for fair value measurement under Section PS 3450. This respondent asked that gains or losses recognized to date on interest-bearing held-for-trading items not be reversed. PSAB agreed, as it respects the Board's intention that the measurement provisions be applied prospectively.
- 9 PSAB rejected the alternative of including gains and losses (as yet unrealized) associated with held-for-trading items in opening accumulated remeasurement gains and losses as these gains and losses have already been reported in the operating results of prior periods. Allowing these gains and losses to be reported for a second time, when the item is eventually disposed of, seems illogical. In the case of interest-bearing financial instruments, prospective application of the effective interest method in reporting periods following adoption of Section PS 3450 will adjust the yield over the remaining term to the value at maturity.
- 10 To clarify that it is PSAB's intention that the measurement provisions in the financial instruments standard are applied prospectively, a change was also made to paragraph PS 3450.099(b)(iii). PSAB did not consider it necessary to re-expose this change as it clarifies the Board's intention that prospective application should apply and is not a significant change.

#### **INVESTMENTS — EXTERNALLY RESTRICTED ASSETS**

- 11 Several respondents asked PSAB to clarify the accounting on transition when externally restricted assets are invested in financial instruments and the presentation of gains and losses associated with such items in the reporting period resources are used for the purpose or purposes specified. In August 2012, PSAB issued an Exposure Draft, "Financial Instruments: Income on Externally Restricted Assets," setting out proposals to respond to these concerns.

#### **CASH FLOW HEDGES OF RISKS OTHER THAN CURRENCY RISK**

- 12 Government organizations may have recognized gains and losses on cash flow hedges in accumulated other comprehensive income arising from changes in the fair value of an item not related to foreign exchange translation, such as interest rate changes. It was suggested that the transitional provisions in Section PS 3450 address the accounting treatment on transition for accumulated gains and losses related to the hedging instruments.
- 13 The transitional requirement specific to hedging instruments is included in Section PS 2601 as hedge accounting was among the reporting issues addressed in Section PS 2600, upon which Section PS 2601 was based. Consequently, PSAB did not feel it was necessary to duplicate the requirements stated in paragraph PS 2601.25(a) in Section PS 3450.