

Financial Instruments: Presentation Narrow-scope Amendments, Section PS 1201 — Basis for Conclusions

FOREWORD

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 the Board 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 PSAB follows when developing or amending standards.

This document has been prepared by staff of PSAB. It does not form part of the CPA Canada Public Sector Accounting Handbook nor is it part of public sector generally accepted accounting principles. 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 FINANCIAL INSTRUMENTS, Section PS 3450, requires that derivatives be held at fair value. PSAB reaffirmed this position in 2018 after extensive consultation with stakeholders. The Board believes that the fair value of derivatives provides more relevant and transparent information to users and better reflects the economic substance of these arrangements.

RATIONALE FOR AMENDMENTS

- .2 Certain stakeholders raised concerns surrounding the increased volatility in net debt because of the requirement to fair value derivatives. Concerns were also raised that this volatility in net debt could be misinterpreted by key users and could reduce the overall understandability of financial reporting.
- .3 To ensure that the fair value of derivatives is clearly presented, PSAB has amended FINANCIAL STATEMENT PRESENTATION, Section PS 1201, to clarify that derivative assets and liabilities may be presented as separate line items on the statement of financial position. The Board has also introduced presentation amendments within Appendix A of the Illustrative Financial Statements in Section PS 1201. These amendments include:
- (a) presentation of the remeasurement impact of derivatives and other categories of financial instruments as separate line items on the statement of change in net debt;
 - (b) display of a new subtotal to present the change in net debt excluding the impact of remeasurement gains and losses; and
 - (c) inclusion of a footnote in the statement of financial position on the net debt indicator to refer readers to the detail provided in the statement of change in net debt.
- .4 PSAB believes that these changes will provide further transparency on net debt movements and will assist preparers in highlighting the impacts of fair value on net debt, particularly with respect to derivatives.

AMENDMENTS TO THE ILLUSTRATIVE FINANCIAL STATEMENTS

- .5 In reviewing responses to the Exposure Draft, one respondent raised uncertainty over whether the amendments made to the Appendix A Illustrative Financial Statements were optional. It was also questioned whether the Appendix B Illustrative Financial Statements for local governments would be updated to reflect a similar presentation.

- .6 The preamble to the Illustrative Financial Statements outlines that these are "prepared by CPA Canada staff to illustrate how the standards in Section PS 1201 might be implemented" and are "not intended to indicate preferred formats nor to prescribe standardized note disclosure." Accordingly, these presentation amendments are not mandatory. They are intended to highlight an optional presentation format for the statement of change in net debt that may be applied by an entity if beneficial. Despite being optional, any application of these presentation amendments would need to continue to be made in line with the general reporting principles established in Section PS 1201. This includes reporting consistent information across accounting periods to facilitate meaningful comparisons.
- .7 While these amendments were only made to the Appendix A Illustrative Financial Statements, there is nothing that would preclude local governments or other public sector entities from adopting a similar presentation. PSAB has therefore added clarification to the Appendix B Illustrative Financial Statements to indicate that this presentation may be applied by other local governments where relevant. Authoritative guidance has also been introduced within Section PS 1201 to confirm that entities may separately present the change in net debt excluding remeasurement gains and losses, as well as the remeasurement impact of derivatives and other categories of financial instruments, directly on the statement of change in net debt. The Board believes that these changes should help codify and clarify the application of these amendments.
- .8 One respondent to the Exposure Draft also encouraged PSAB to make these amendments mandatory to promote consistency between public sector entities. The Board did not pursue this approach. Required disclosures on the impacts of remeasurement gains and losses are already included in Section PS 1201. The intent of these amendments was to provide optionality to present similar information in the statement of change in net debt if this helps entities to more effectively highlight or explain the impacts of fair value measurement. Respondents did not raise further concerns on this matter.

OTHER DISCLOSURES

- .9 PSAB was encouraged in responses to the Exposure Draft to support enhanced disclosures on the nature of derivatives and reasons for their volatility. The Board notes that there are prescribed disclosures on derivatives within Section PS 3450 and supplementary disclosures in the financial statement discussion and analysis on net debt that may be made in line with the Board's Statements of Recommended Practice. The Board believes that these mechanisms for disclosure will also help ensure that fluctuations in net debt relating to the fair value of derivatives are clearly presented.

OTHER MATTERS

- .10 A couple of Exposure Draft respondents disagreed with the amendments on the basis that they did not believe separately presenting the fair value of derivatives would minimize or resolve volatility in net debt. Some respondents who agreed with the Exposure Draft proposals also raised similar concerns in their responses to PSAB. The Board's rationale for supporting the measurement of derivatives at fair value is included in the Basis for Conclusions document for Section PS 3450 published in July 2011. The intent of these narrow-scope amendments was not to remove this requirement but to illustrate how public sector entities could more clearly present these impacts while maintaining a fair value measurement model.
- .11 PSAB also received some feedback encouraging the Board to pursue a hedge accounting option to remove or mitigate volatility in net debt. This suggested option would involve not recognizing certain derivatives in the financial statements. The Board reviewed and deliberated this approach; however, it did not pursue this hedge accounting option. The Board noted that this would fundamentally differ from the hedge accounting models as seen for other publicly accountable entities, such as in IFRS® Standards and International Public Sector Accounting Standards, which would continue to require derivatives to be held at fair value. The Board believes that all derivatives should be recognized in the financial statements as this enhances transparency and accountability for users.
- .12 PSAB additionally received varying responses from respondents with respect to the presentation and calculation of net debt, including the extent to which remeasurement gains and losses should be presented and/or included within this metric. The Board will evaluate these comments more broadly as part of feedback received on the Exposure Drafts, "*The Conceptual Framework for Financial Reporting in the Public Sector*" and "*Financial Statement Presentation, Proposed Section PS 1202*." These Exposure Drafts will be out for public comment in January 2021.

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