SECTION PS 2600
foreign currency translation

FOR FUTURE UPDATES TO THIS SECTION, see new Section PS 2601.

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PURPOSE AND SCOPE

.01 This Section establishes standards on how to account for and report transactions that are denominated in a foreign currency in government financial statements. It also addresses **hedge accounting** for foreign exchange transactions.

.02 Governments issue or hold **monetary items** denominated in **foreign currency**. When transactions are denominated in a foreign currency, a government assumes **foreign exchange** risk. The financial effects of changes in foreign exchange rates would be recognized in government financial statements. Accordingly, a government needs to decide which exchange rate to use and how to recognize the financial effects of changes in exchange rates in the financial statements.

.03 In order to include foreign currency transactions in the financial statements of a government, the transaction would be expressed in the government's reporting currency. It is assumed that the government's financial statements are prepared in Canadian dollars.

.04 This Section does not apply to the translation of balances derived from foreign exchange transactions intended to sustain foreign exchange reserves and orderly conditions in the foreign exchange market for the Canadian dollar or to provide assistance to foreign countries.

.05 This Section also does not apply to the translation of the financial statements of foreign operations. A foreign operation of a government is typically financially or operationally interdependent with the government such that the exposure to exchange rate changes is similar to the exposure that would exist had the transactions and activities of the foreign operation been undertaken by the government itself.

DEFINITIONS

.06 The following definitions have been adopted for the purposes of this Section:

(a) **Currency risk** is the risk of changes in the value of an asset or liability due to changes in exchange rates.

(b) **Exchange gain or loss** is the difference that arises when a foreign currency denominated monetary item is settled or translated at an exchange rate different from that at which it was previously recorded or carried.

(c) **Exchange rate** is the ratio for exchange of two currencies.

(d) **Fair value** is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

(e) **Foreign currency** is a currency other than the reporting currency of a government.

(f) **Foreign currency transactions** are transactions of the government whose terms are denominated in a currency other than its reporting currency.

(g) **Hedge accounting** is a method for recognizing the gains, losses, revenues and expenses associated with the items in a hedging relationship, such that those gains, losses, revenues and expenses are recognized in operations in the same period when they would otherwise be recognized in different periods.

(h) **Hedge effectiveness** is the extent to which changes in fair value or cash flows of a hedged item relating to the foreign exchange risk being hedged and arising during the term of a hedging relationship are offset by changes in the fair value or cash flows of the corresponding hedging item relating to the foreign exchange risk and arising during the same period.

(i) A **hedged item** is all or a specified portion of an asset, a liability or a group of similar assets or liabilities having an identified foreign exchange risk exposure that a government has taken steps to modify.

(j) A **hedging item** is all or a specified portion of an asset, a liability, or a group of similar assets or liabilities modifying the foreign exchange risk exposure identified in the hedged item.

(k) A **hedging relationship** is a relationship established by a government between a hedged item and a hedging item, including a synthetic instrument relationship.

(l) **Monetary items** are cash and claims to cash the value of which, in terms of the monetary unit, whether foreign or domestic, is fixed by contract or otherwise.

(m) **Synthetic instruments** are monetary items that are artificially created through the use of other monetary or derivative items in combination to emulate the characteristics and behaviour of a specific monetary item.

(n) **Synthetic instrument accounting** is a method of accounting for the assets and liabilities in a synthetic instrument relationship as though they were the item being emulated.

ACCOUNTING

.07 The financial statements reflect a government's exposure to foreign **currency risk**.

.08 A foreign currency transaction is a transaction that is denominated in or requires settlement in a foreign currency, including transactions arising when a government either:

(a) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(b) becomes a party to a contract involving foreign currencies.

.09 Recognizing and measuring foreign currency transactions will involve one or more of the following stages:

(a) translation to record the transaction as at the transaction date;

(b) translation of monetary items outstanding at the financial statement date to reflect the effect of movements in exchange rates subsequent to the transaction date or previous financial statement date; and

(c) translation of monetary items at settlement.

Initial recognition

.10 ♦ *At the transaction date, each asset, liability, revenue or expense arising from a foreign currency transaction of the government should be translated into Canadian dollars by applying the exchange rate in effect at that date, except as noted in paragraph* PS 2600.40*.* [JAN. 2003]

.11 For practical reasons, a rate that approximates the actual rate at the date of transaction is often used. For example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Subsequent financial statement dates

.12 If a transaction denominated in a foreign currency is not settled by the financial statement date, the exchange rate has likely changed from the transaction date or previous financial statement date. The effect of the change in exchange rate would be recognized in the government's financial statements. The Canadian dollar equivalent of the foreign currency denominated monetary item is affected and would be remeasured.

.13 ♦ *At each financial statement date, monetary assets and liabilities denominated in a foreign currency should be adjusted to reflect the exchange rate in effect at that date and be recognized in the statement of financial position.* [JAN. 2003]

Exchange gains or losses

.14 Changes in the foreign exchange rate between the transaction date and subsequent financial statement dates give rise to an **exchange gain or loss**. This resulting exchange gain or loss would be accounted for in the financial statements.

.15 During the life of a foreign currency denominated monetary item, there is uncertainty as to the actual gain or loss that will arise on settlement of that monetary item. Substantial unrealized gains or losses may result from translating an asset or liability into Canadian dollar equivalents for financial statement purposes.

.16 ♦ *The foreign exchange gain or loss relating to a long-term foreign currency denominated monetary item should be recognized in the financial statements and deferred and amortized to revenue / expense over the remaining life of the monetary item.* [JAN. 2003]

.17 Amortizing the foreign exchange gains or losses over the remaining life of the monetary item provides a systematic and rational basis for allocating the currency rate fluctuation of the associated foreign currency denominated monetary item to revenue / expense.

Settlement

.18 The exchange gain or loss resulting from settling the foreign currency denominated monetary item is realized and thus would be recognized in the statement of operations.

.19 ♦ *An exchange gain or loss of the government that arises on settlement of a foreign currency denominated monetary item should be recognized in the statement of operations for the current period.* [JAN. 2003]

.20 When a long-term foreign currency denominated monetary item is settled prior to the maturity date, the actual cost of the foreign currency risk will be known. Accordingly, any unamortized exchange gain or loss will be recognized in the statement of operations at the date of settlement.

.21 There may be situations when changes in the terms and conditions of a long-term foreign currency denominated monetary item may not constitute a settlement, as contemplated in paragraph PS 2600.20. Such circumstances may include a modification or exchange of debt instruments when the terms of the new or modified debt are not substantially changed from the terms of the original debt instrument.

.22 In such circumstances, any unamortized balance of exchange gains and losses at the date of modification would be amortized over the shorter of:

(a) the remaining life of the original monetary item; or

(b) the life of the modified monetary item.

Any gains or losses arising from changes in exchange rates occurring subsequent to the date of modification relate to the modified monetary item and would be amortized over the life of the modified monetary item.

PRESENTATION

.23 The unamortized exchange gain or loss reflects the inherent uncertainty associated with foreign exchange. These amounts are tentative in nature and are subject to fluctuation. This measurement uncertainty associated with long-term unhedged foreign currency denominated monetary items is recognized through the use of a contra account on the statement of financial position.

.24 ♦ *The unamortized foreign exchange gain or loss should be separately reported on the statement of financial position as an offset or addition to the related monetary item.* [JAN. 2003]

.25 Reporting the unamortized foreign exchange gain or loss on the statement of financial position highlights the measurement uncertainty associated with foreign currency translation and reflects the economic effects that have occurred.

HEDGING OF FOREIGN CURRENCY ITEMS

.26 Hedging is an activity designed to manage a government's exposure to one or more risks. The objective of hedging foreign currency items is to protect the government from adverse fluctuations in the foreign exchange markets.

.27 When a government enters into a hedge (e.g., forward exchange contract, foreign currency futures contract, foreign currency option contract), this would be reflected in the financial statements.

.28 The purpose of **hedge accounting** is to ensure that counterbalancing gains and losses that result from the translation of the components of a foreign currency **hedging relationship** are recognized in the statement of operations in the same period(s).

.29 ♦ *When hedge accounting is used, counterbalancing gains and losses that result from the translation of the components of a foreign currency hedging relationship should be recognized in the statement of operations in the same period(s).* [JAN. 2003]

.30 There may also be situations where the government is protected from exchange rate fluctuations because of certain transactions. Such transactions may, by their nature, produce effective hedges even though that was not their primary purpose. For example, an existing asset or liability or future revenue stream denominated in a foreign currency may act as an effective hedge.

.31 Hedge accounting modifies the normal basis for recognizing the gains, losses, revenues and expenses associated with a **hedged item** or a **hedging item** in a government's financial statements. Accordingly, hedge accounting is only permitted under conditions that justify its use.

.32 ♦ *A foreign currency hedging relationship qualifies for hedge accounting only when all of the following conditions are satisfied:*

(a) At the inception of the hedging relationship, the government:

(i) identifies the nature of the specific risk exposure(s) being hedged in accordance with its risk management objective and strategy; and

(ii) designates that hedge accounting will be applied to the hedging relationship.

(b) At the inception of the hedging relationship, the government has formal documentation of:

(i) its risk management objective and strategy for establishing the relationship;

(ii) the hedging relationships, identifying the hedged items, the related hedging items and the intended term of the hedging relationships;

(iii) the method for assessing the effectiveness of the hedging relationship; and

(iv) the method for recognizing in operations the gains, losses, revenues and expenses associated with the items in the hedging relationship.

(c) Both at inception of the hedging relationship and throughout its term, the government expects it to be effective and consistent with the originally documented risk management objective and strategy. Accordingly:

(i) the effectiveness of the hedging relationship should be reliably measurable, which requires that the effects of the risk exposure being modified be reliably measurable for each hedged item and each hedging item; and

(ii) the hedging relationship should be assessed on a regular periodic basis over its term to determine that it has remained, and is expected to continue to be, effective. [JAN. 2003]

.33 Foreign currency hedge accounting is optional and the government can decide not to designate hedging relationships that otherwise qualify for hedge accounting. Accordingly, one of the hedge accounting conditions is that the government designate a hedging relationship as such for purposes of applying hedge accounting, identifying the items included in the hedging relationship and the period over which the hedging relationship is intended to be effective. The designation of the hedging relationship is documented formally in the government's records when designation occurs.

.34 Reasonable assurance that the hedge is and will continue to be effective is needed. For a government to have reasonable assurance of the effectiveness of a hedging relationship, both at its inception and on an ongoing basis, the government must expect the relationship to be effective in achieving offsetting changes in the fair value or cash flows of the hedged item and the hedging item that are attributable to the hedged foreign exchange risk exposure and occur during the term of the relationship. Effectiveness requires a high correlation of changes in fair values or cash flows.

.35 Effectiveness is assessed for the current fiscal period to determine whether hedge accounting remains appropriate. Effectiveness is assessed for the remaining term of the hedging relationship to justify the assessment that the relationship will be effective. Effectiveness is assessed, at a minimum, at the time a government prepares its financial statements.

.36 A government assesses the effectiveness of its hedging relationship in light of its risk management objective and strategy. The method a government adopts for assessing hedge effectiveness will depend on its risk management strategy. A government's documentation of its risk management objective and strategy will include its procedures for assessing effectiveness.

.37 Sometimes a government may be unable to obtain a hedge to cover the entire period for which it is desired. Successive hedges may be used to meet this requirement, providing the government can demonstrate, at the time of entering into the first hedge, a reasonable assurance of continuing the policy for the remainder of the period and a reasonable likelihood that it will be able to renew the hedge as required.

.38 Normally liabilities would be grouped with other liabilities as a single hedged item or hedging item and, similarly, assets would be grouped with other assets. Items may be grouped together as a hedged item or as a hedging item only when they all share a foreign exchange risk exposure. Each individual asset / liability in a hedge group would be expected to correspond in a generally proportionate manner to changes in the foreign exchange rates attributed to the hedged risk exposure for the group as a whole.

.39 Hedging relationships include synthetic instruments, which involve relationships between two or more distinct assets or liabilities for the purpose of emulating the net cash flows or other characteristics of a single asset or liability. The objective of **synthetic instrument accounting** is to account for the assets and liabilities in a synthetic instrument relationship as though they were the item being emulated. Synthetic instrument accounting may include some modification to the normal basis for recognizing the gains, losses, revenues and expenses associated with the separate assets and liabilities comprising a synthetic instrument. Accordingly, synthetic instrument accounting is subject to the conditions outlined in paragraph PS 2600.32 for applying hedge accounting, with the result that only those synthetic instruments satisfying the conditions in paragraph PS 2600.32 qualify for the application of synthetic instrument accounting.

.40 ♦ *When synthetic instrument accounting is used for foreign currency denominated items, the Canadian dollar equivalent of the synthetic instrument at initial recognition and at subsequent financial statement dates is established by the rate implied by the terms of the hedge(s).* [JAN. 2003]

.41 Hedge accounting is not appropriate for non-monetary assets or liabilities in many circumstances because of an inability to demonstrate effectiveness. However, the conditions for hedge accounting may be satisfied in some circumstances involving non-monetary items, including:

(a) existing or expected future contracts to purchase or sell non-monetary items, when the transactions will give rise to monetary assets or liabilities as consideration; and

(b) derivative or other contracts to deliver a commodity that hedge expected future production of that commodity.

Hedge at date subsequent to inception

.42 Designation of a hedging relationship subsequent to the initial recognition of one of the components of the hedging relationship by a government is possible, but does not result in any recognition of the hedging relationship for hedge accounting purposes prior to the date of designation.

.43 When the item is hedged, the Canadian dollar amount due upon settlement would be established and the government would not be susceptible to any further exchange rate changes. In such circumstances, any unamortized balance of exchange gains and losses at the date of inception of the hedge would continue to be amortized over the remaining life of the monetary item.

Discontinuing hedge accounting

.44 There may be situations where a hedging relationship ceases to exist. For example, the government may decide, at its discretion, to discontinue hedge accounting for a specific hedging relationship by terminating the designation of that relationship. Alternatively, the effectiveness of the hedge may be impaired. When such circumstances arise, the hedge no longer meets the conditions for hedge accounting

.45 The accounting consequences of ceasing to satisfy the conditions for hedge accounting depend on the circumstances.

(a) When a hedging item ceases to exist as a result of its maturity, expiry, sale, termination, cancellation or exercise and is not replaced as part of the government's documented hedging strategy, any gains, losses, revenues or expenses associated with the hedging item that had been deferred previously as a result of applying hedge accounting are carried forward to be recognized in the statement of operations in the same period as the corresponding gains, losses, revenues or expenses associated with the hedged item.

(b) When a hedged item ceases to exist as a result of its maturity, expiry, sale, termination, cancellation or exercise, any gains, losses, revenues or expenses associated with the hedging item that had been deferred previously as a result of applying hedge accounting are recognized in the current period's statement of operations along with the corresponding gains, losses, revenues or expenses recognized on the hedged item.

(c) When a government terminates its designation of a hedging relationship, or a hedging relationship ceases to be effective, hedge accounting is not applied to gains, losses, revenues, or expenses arising subsequently. However, the hedge accounting applied to the hedging relationship in prior periods is not reversed. Any gains, losses, revenues or expenses deferred previously as a result of applying hedge accounting continue to be carried forward for subsequent recognition in the statement of operations in the same period as the corresponding gains, losses, revenues or expenses associated with the hedged item.

DISCLOSURE

.46 LONG-TERM DEBT, Section PS 3230, contains specific disclosures for long-term debt that would be applied for long-term foreign currency denominated monetary items as well.

.47 In addition, foreign currency translation disclosures are required to provide information that will enhance understanding of the significance of the government's currency exposure as well as the extent to which financial instruments are used to manage the currency risk.

.48 ♦ *The government should disclose the following:*

(a) the government's policy for managing foreign currency risk, including a general description of the nature of the hedges undertaken to mitigate the government's currency exposure, the government's method for assessing hedge effectiveness, and information about the magnitude of hedging activities;

(b) the Canadian dollar equivalent of the unhedged foreign denominated monetary items at the financial statement date by major currency;

(c) the Canadian dollar equivalent of the aggregate amount, by major currency, estimated to be required in each of the next five years and thereafter to meet sinking fund or retirement provisions for the foreign denominated debt;

(d) the exchange gains or losses that have been recognized in the statement of operations; and

(e) a sensitivity analysis illustrating the impact on the unhedged foreign currency denominated monetary item of foreign exchange rate changes. [JAN. 2003]

.49 A government provides useful information about its exposure to foreign currency fluctuations by indicating the effect of a hypothetical change in the foreign exchange rate on the balance of long-term foreign currency denominated monetary items. Such currency rate sensitivity information may, for example, be based on an assumed one-cent change in the foreign exchange rate occurring at the financial statement date. When disclosing currency rate sensitivity information, the government indicates the basis on which it has prepared the information, including any significant assumptions.

.50 A government may also choose to disclose additional information considered useful to the reader in assessing the government's exposure to foreign currency risk. Such disclosures may include an analysis of the impact of foreign exchange rate changes on the government's debt service costs.

TRANSITIONAL PROVISIONS

.51 This Section applies to fiscal years beginning on or after January 1, 2003. Earlier adoption is encouraged.

.52 This Section applies to all long-term foreign currency denominated monetary items held by a government. If application of the Section results in a change in accounting policy, ACCOUNTING CHANGES, Section PS 2120, applies.

.53 At the beginning of the fiscal year in which this Section is first applied, a government assesses its existing hedging relationships to determine whether they satisfy all of the conditions for hedge accounting. A government may take steps at the beginning of the fiscal year in which this Section is first applied to satisfy any of the conditions in this Section that a hedging relationship did not previously satisfy, so that it may continue to apply hedge accounting to that relationship. For example, at the beginning of the fiscal year in which this Section is first applied, a government may formally document its risk management objective and strategy for undertaking hedging activities, or document or designate an existing hedging relationship that had not previously been documented or designated in accordance with this Section. Hedge accounting is discontinued in the manner described in paragraph PS 2600.45 for hedging relationships that do not meet the conditions in this Section as at the date on which it is first applied.

APPENDIX A

ILLUSTRATIVE EXAMPLE

The following example has been prepared by CICA staff to illustrate how the standards in Section PS 2600 might be implemented.

The example is illustrative only and matters of principle relating to particular situations should be decided in the context of the Section. It is not intended to indicate preferred formats nor to prescribe standardized note disclosure, as variations in format will be necessary to meet the requirements of differing circumstances.

For ease of presentation, selections are made from accounting alternatives permitted by the Section.

Example — Statement of financial position presentation

The government holds both domestic long-term debt and foreign currency denominated long-term debt at the financial statement date. In some instances, foreign currency denominated debt issues were swapped into Canadian dollars. The "unmatured debt" amount presented on the statement of financial position represents the Canadian dollar equivalent of total borrowings. Disclosing the unamortized foreign exchange gains or losses on the face of the statement of financial position as an offset to unmatured debt provides more transparency regarding the economic effects that have occurred and the uncertainty associated with participating in foreign markets. Information about the unhedged foreign currency denominated debt, which represents the amount of foreign currency denominated debt remaining exposed to foreign currency variations translated at the exchange rate at the financial statement date, would be provided in the notes to the financial statements.

Statement of Financial Position (excerpts)

As at March 31 ($ thousands)		20X3			20X2	
Liabilities						
Accounts payable and accrued liabilities			x			x
Unmatured debt (a)		105,793			106,137	
Unamortized foreign exchange (gains) / losses	(3,378)		102,415	(4,592)		101,545
Debt of municipal financing corporation			x			x
Pension obligations			x			x
Other accrued liabilities			x			x
Deferred revenue			x			x
Total liabilities			x			x
			=======			=======

(a) Unmatured debt includes amounts that have been hedged into Canadian dollars at the financial statement date as well as unhedged foreign currency denominated debt. Further information about this debt would be disclosed in the notes. This does not preclude a government from providing more detailed information on the face of the statement of financial position if desired.