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PSAB Public Sector Accounting Board
CCSP Conseil sur la comptabilité dans le secteur public

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Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
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Re: Comments on Financial Instruments Exposure Drafts 37, 38 and 39

Thank you for providing us with the opportunity to comment on these proposals. PSAB staff supports the issue of measurement and recognition requirements for financial instruments and IPSASB's efforts to update existing disclosure requirements.

Financial Instruments exposure draft approved by PSAB

At its June meeting, PSAB approved an exposure draft that similarly addresses the recognition, measurement, presentation and disclosure issues associated with financial instruments. Two measurement categories are proposed: fair value and cost or amortized cost. The requirement to measure financial instruments at fair value subsequent to initial recognition would be limited to derivatives and equity instruments that are portfolio investments quoted in an active market. Unless the fair value option is exercised, all other items within the scope of the standard would be measured at cost or amortized cost.

Gains and losses that arise on the remeasurement of items in the fair value category would be distinguished from all other revenues and expenses by dividing the statement of operations into two components. As such, users would be provided with a financial statement measure of surplus/deficit excluding remeasurement gains and losses. Budget-to-actual comparisons would apply only to the component that excludes the fair value remeasurements required by the standard. PSAB also proposes to retire the use of hedge accounting and require all fair value remeasurements be reported within the statement of operations (in its second component).

Reporting on changes in assets and liabilities

The IAS Framework defines income to encompass both revenue and gains. On the other hand, the definitions of revenue and expense given in IPSAS 1 do not mention 'gains' or 'losses', nor are these terms defined.

Paragraph 106(a) in ED 38 requires "…the portion of the gain or loss on the hedging instrument… …shall be recognized directly in net assets/equity.

We believe the wording of the ED should explicitly state that such gains are revenues (and such losses are expenses). Accordingly, we would recommend amending paragraph 106 to state:

If a cash flow hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:
(a) The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) is a revenue or expense that shall be recognized directly in net assets/equity through the statement of changes in net assets/equity…

Other paragraphs that require gains or losses be recognized directly in net assets/equity should be amended in a similar manner.

In the attached Appendix you will find our responses to the specific matters for comment.

Please note that these comments are the views of PSAB staff and not those of the Public Sector Accounting Board (PSAB).

We appreciate the opportunity to comment on this Exposure Draft.

Yours truly,

Tim Beauchamp

Tim Beauchamp
Director
Public Sector Accounting

Appendix: Responses to Specific Matters for Comment

ED 37 – Financial Instruments: Presentation

1. *ED 37 allows entities to treat financial guarantee contracts issued through an exchange transaction as insurance contracts if the issuer elects to recognize and measure them in accordance with the international or national accounting standard dealing with insurance contracts. However, all financial guarantee contracts issued at no or nominal consideration are required to be treated as financial instruments. Do you agree with this approach? Please state your reasons for either agreeing or disagreeing with this approach*.

We agree. Until a comprehensive review of accounting for insurance contracts is completed, IPSASB should not restrict the application of national standards that apply to the reporting of insurance contracts. To maintain the integrity of the standard, it is important that contracts with the features of a derivative be accounted for as derivatives.

2. The transitional provisions to ED 37 do not provide any relief for entities initially adopting accrual accounting from preparing and presenting comparative information. Do you support this proposal? If additional transitional provisions are necessary, please indicate what these should be and state your reasons.

As the public sector in Canada applies accrual accounting, we hold no strong views on this point. However, while comparative information is generally valuable, it may be onerous and of less relevance to prepare such information where an effort to retrospectively present hedging outcomes is required. As such IPSASB may wish to consider specific targeted exemptions that would apply to specific situations such as hedge accounting.

ED 38 – Financial Instruments: Recognition and Measurement

1. Do you agree with the Application Guidance relating to the issuer of concessionary loans (paragraphs AG83 to AG89), in particular:

a) The requirement that any difference between the transaction price of the loan and fair value of the loan at initial recognition should be expensed;

b) The distinction between concessionary loans and the waiver of debt?

Yes, we agree that any difference between the face amount of loan and its fair value (measured based on a discounted cash flow basis) should be expensed. There is a distinction between concessionary loans and a waiver of debt, and we agree with the explanation given in paragraph AG85.

2. *Do you agree with the Application Guidance relating to financial guarantees provided for nil or nominal consideration (paragraphs AG91 to AG96), in particular that entities should apply a mathematical valuation technique to obtain a fair value where this produces a reliable measure of fair value? Alternatively, where a fair value cannot be obtained through observation of an active market, do you think that initial recognition should be in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets." Please state your reasons.*

We agree with provisions in the Application Guidance applying to financial guarantees and find particularly useful the reference in paragraph AG96 requiring entities to apply the principles of IPSAS 19 to the measurement of a financial guarantee at initial recognition (when no Level One or Level Two value is available).

3. *Do you agree with the transitional provisions in paragraphs 114 to 123? If you do not agree with these transitional provisions please indicate further transitional provisions that are necessary, or those transitional provisions that are unnecessary. Please state your reasons.*

We agree with the transitional provisions as proposed.

ED 39 – Financial Instruments: Disclosures

1. *The IPSASB considered all of the required disclosures in IFRS 7 to assess whether any disclosures should be deleted for public sector specific reasons. Examples of disclosures specifically considered include sensitivity analyses and collateral. The IPSAS concluded that there is no public sector specific reason to depart from the requirements of IFRS 7 by deleting any disclosures. Do you agree?*

We agree. In the exposure draft it recently approved, PSAB generally adopted the required disclosures set out in IFRS 7. In certain areas, IFRS 7 requirements were streamlined where they served to provide readers with information to support designations to specific financial instrument categories, as PSAB proposes to limit the available financial instrument measurement categories to fair value and, cost or amortized cost.