



Foreign Currency Translation

October 2009

**COMMENTS MUST BE RECEIVED BY
JANUARY 15, 2010**

This Exposure Draft is issued by the Public Sector Accounting Board. The members of the Board are drawn from government, public accounting, business and academe. All members serve as individuals and not as representatives of their governments, employers or organizations.

Individuals, governments and organizations are invited to send written comments to the Board on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

All comments received will be available on the website at www.psab-ccsp.ca ten days after the comment deadline, unless confidentiality is requested.

To be considered, comments must be received by January 15, 2010, addressed to:

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A PDF [response form](#) has been posted with this document to assist you in submitting your comments. Alternatively, you may send comments by e-mail (in Word format), to: ed.psector@cica.ca

Public Sector Accounting Standards, Guidelines and Recommended Practices need not be applied to immaterial items. Materiality is a matter of professional judgment in the particular circumstances. Materiality may be judged in relation to the reasonable prospect of its significance in the making of assessments and judgments by the users of financial statements. A material item would be expected to affect assessments of and judgments on government financial operations and management.

Highlights

The Public Sector Accounting Board (PSAB) proposes, subject to comments received on this Exposure Draft (ED), to revise FOREIGN CURRENCY TRANSLATION, Section PS 2600. The revisions apply to all levels of government. Responses are requested by December 11, 2009.

Background

Why are these amendments being proposed at this time?

To ensure that the reporting of economic effects of currency risk is consistent with the Financial Instruments ED and related amendments to FINANCIAL STATEMENT PRESENTATION, Section PS 1200.

How will reporting on currency risk be improved?

The measures of net debt and accumulated surplus/deficit will reflect the economic effects of translating all monetary items based on the exchange rates at the financial statement date. As such, there is enhanced representational faithfulness. Under the deferral approach, items with currency risk can be measured inconsistently in relation to one another and in relation to how it is proposed that derivatives will be reported.

The statement of operations will reflect the economic effects of changes in exchange rates that occur during the reporting period. Amendments to presentation requirements will distinguish gains and losses that are realized from changes associated with currency exposures that are yet to be settled. This should enhance budget-to-actual comparisons. At present, those comparisons include the amortization of translation gains and losses on long-term monetary items that are yet to be settled.

How will this affect indicators within the statement of operations?

Readers of financial statements will be able to clearly distinguish between realized and unrealized gains and losses arising on foreign currency translation. Budget-to-actual comparisons will be expected only in the case of the first component of the statement of operations. Only those gains and losses associated with foreign currency exposures that have been realized will be presented in the first component.

When gains and losses arise on the translation of items yet to be settled, they will be presented in the statement of operations as remeasurement gains and losses. Remeasurement gains and losses will be reported in the second component of the statement of operations. Taken together, the two components will account for a period's surplus/deficit. By ending the practice of deferring a portion of unrealized gains and losses, the change in the surplus/deficit will report the full effect of changes in exchange rates that have occurred.

Summary of key technical features

Foreign currency translation provides users with financial statements expressed in Canadian dollars irrespective of the underlying currency of the items reported. This allows users to focus on the messages provided by key financial statement indicators, confident that the underlying balances and transactions are measured in a uniform manner.

The amendments are being introduced at this time in an effort to conform the accounting for currency risk and the presentation of gains and losses arising from foreign currency translation with the methodology proposed for financial instruments.

Scope

PSAB is proposing that the amended requirements will apply to all transactions originating in a foreign currency for all levels of government. The Section will also now apply to transactions intended to sustain foreign exchange reserves.

Definitions

The definition of currency risk is being amended to conform to the definition proposed in the Financial Instruments ED. When items that have yet to be settled, translation gains and losses associated with those items will be presented as remeasurement gains and losses. Consistent with the conclusion that hedge accounting is no longer required, specific supporting definitions have been removed.

Accounting

The standard will be amended to remove an exception that applies when an item is initially recognized. The Financial Instruments ED limits offsetting of a financial asset and a financial liability to situations where a legal right of offset is in place and is expected to be exercised, making this exception redundant. A consistent basis of measurement will apply from the date a government initially recognizes items denominated in a foreign currency.

When subsequently measured, all monetary items, together with those non-monetary items included in the fair value category, will be translated at the exchange rate for the financial reporting date. An example of a non-monetary item included in the fair value category is an equity instrument quoted in an active market.

PSAB believes these amendments will enhance representational faithfulness by measuring both short and long-term monetary items uniformly at their Canadian dollar equivalent.

Presentation of gains and losses arising from translation

PSAB is proposing to amend FINANCIAL STATEMENT PRESENTATION, Section PS 1200, to distinguish the economic effects of transactions arising from remeasurements. These amendments are set out on page 40 in the Financial Instruments ED.

To reflect the inherent uncertainty associated with items denominated in a foreign currency that have yet to be settled, such gains and losses will be presented as remeasurement gains and losses. This approach is consistent with the presentation of gains and losses arising on items subject to fair value measurement.

Governments will report on the outcomes associated with currency risks in two stages. When items have yet to be settled, the gains and losses will be presented as remeasurement gains and losses. The Financial Instruments ED requires changes in the value of derivatives to be reported in the same manner. It is the contractual right to receive (or obligation to pay) future cash flows that give rise to a derivative's value and changes in the specified index or rate that give rise to gains or losses. As such, these proposals will report value changes that have yet to be realized in the same component within the statement of operations.

The economic effects of realized transactions (including amounts realized on derivatives used to manage exchange risk) will be reflected in the measure of surplus/deficit excluding remeasurement gains and losses. Budget-to-actual comparisons will apply to this component. Together, these two components will report all gains and losses arising from currency translation within the statement of operations.

Distinguishing gains and losses

Realized gains and losses on:

- financial instruments
- currency exposures



Revenue/expense before remeasurement gains and losses (budget-to-actual comparisons apply)

Unrealized gains and losses due to:

- fair value remeasurements
- currency exposures yet to be settled



Remeasurement gains and losses

Statement of Operations

Withdrawal of hedge accounting

By distinguishing gains and losses in this manner, hedge accounting is viewed to be unnecessary and the proposals remove the hedge accounting provisions. The complexity of hedge accounting and uncertainty associated with measures of its efficiency are avoided. Users will be better informed of the effects of currency risk on financial position and operating results by distinguishing transactions settled from those that are unsettled.

Illustration

A government issues a three-year foreign denominated debt obligation. The date of issue is March 31, 20X1. Interest is omitted.

<i>Exchange rates:</i>		Obligation per \$100 FX at <u>reporting date</u>
March 31, 20X1 (at issue)	\$1 CDN = \$0.909 FX	\$110 CDN
March 31, 20X2	\$1 CDN = \$0.833 FX	\$120 CDN
March 31, 20X3	\$1 CDN = \$0.869 FX	\$114 CDN
March 31, 20X4 (due date)	\$1 CDN = \$0.855 FX	\$117 CDN

The table below illustrates the effect on specific measures:

	Statement of Financial Position		Statement of Operations		
	Net Debt	Accum. Surplus (Deficit)	Surplus/deficit before Remeasurement	Remeasurement	Annual Surplus (Deficit)
March 31, 20X1 (at issue)	110				
Change in exchange rate	10				
March 31, 20X2	120	(10)	—	(10)	(10)
Change in exchange rate	(6)				
March 31, 20X3	114	(4)	—	6	6
Change in exchange rate	3				
March 31, 20X4 (when due)	117	(7)	(7)	4	(3)

At each financial statement date, the debt obligation is remeasured based on its Canadian dollar equivalent. Until the due date of the debt instrument, the translation gain or loss is presented in the statement of operations as a remeasurement gain or loss. In the period of settlement, the actual gain or loss is reported in the component of the statement of operations to which budget comparisons apply. The amount reported in the remeasurement component reflects the reversal of the net remeasurement changes reported in the preceding periods. These proposals will not impact presentation within the statement of change in net debt.

Implications for fiscal planning

The currency risk associated with maturing debt obligations will merit additional consideration during the budget process. As is presently the case, derivatives may mitigate currency risk and the volatility that may arise in budget-to-actual comparisons. However, this is dependent on the actual performance of the derivative and the reporting period cash flow settlements are attributable to. Alternatively, when risk management strategies have not been employed, the amounts reported will faithfully reflect the economic gain or loss realized due to currency risk. At present, changes in exchange rates are artificially “smoothed” through the process of amortization. This approach will no longer be applied as it does not faithfully report the economic effect of changes in exchange rates.

Comments requested

PSAB welcomes comments on all aspects of the Exposure Draft. Comments are most helpful if they relate to a specific paragraph or group of paragraphs, and, when expressing disagreement, they clearly explain the problem and indicate a suggestion, supported by specific reasoning for alternative wording.

For your convenience, a PDF [response form](#) has been posted with this document that can be downloaded here. You can save the form both during and after its completion for future reference. Alternatively, written comments may be submitted by e-mail (Word format preferred) to: ed.psector@cica.ca

Please respond to the following questions:

1. Do you agree with the amendments that affect the translation of balances at dates subsequent to their initial recognition? If not, why not?

2. Do you agree with the proposal that an exchange gain or loss arising prior to the period of its settlement be presented in the statement of operations among remeasurement gains and losses? If not, why not?
3. Do you agree with the decision to withdraw hedge accounting? If not, please explain why an exception to the conceptual framework for hedge accounting is warranted.
4. Do you agree with the proposed date for transition? If you do not agree, please indicate reasons the proposed date may not be practical and suggest when the new requirements should apply.
5. Do you agree with the transitional provisions that require retroactive restatement with no restatement of prior periods with an adjustment to opening accumulated surplus/deficit for:
 - a) items measured based on the present hedge accounting provisions; and
 - b) unamortized deferred amounts that originate from the translation of long-term monetary items?

Foreign Currency Translation

PROPOSAL

FOREIGN CURRENCY TRANSLATION, Section PS 2600, would be amended by adding the text denoted by underlining and deleting text denoted by strikethrough, as indicated below.

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.~~
- .025 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

- .036 The following definitions have been adopted for the purposes of this Section:
- (a) **Currency risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in the value of an asset or liability due to changes in foreign exchange rates.
 - (b) **Exchange gain or loss** is the difference that arises when a monetary item denominated in a foreign currency ~~denominated monetary item or a non-monetary item denominated in a foreign currency that is included in the fair value category in accordance with FINANCIAL INSTRUMENTS, Section PS 3xxx~~ 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.
- (h) **Remeasurement gains and losses** encompass revenues and expenses arising:
 - (i) when prior to the period of an item's settlement an **exchange gain or loss** is recognized in accordance with the provisions of this Section; and
 - (ii) when financial instruments in the fair value category are remeasured in accordance with FINANCIAL INSTRUMENTS, Section PS 3xxx.
- (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

- .047 The financial statements reflect a government's exposure to foreign currency risk.
- .05 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.

- ~~.068~~ 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.
- ~~.07~~ Monetary items are those assets and liabilities which represent the right to receive or the obligation to pay a fixed amount of currency. Translation of a transaction denominated in a foreign currency conforms its reported value to the Canadian dollar equivalent.
- ~~.08~~ The exchange rate in effect at the date of the transaction is used when recording revenues, expenses and non-monetary items except those measured at fair value, as no further exposure to currency risk is measured and reported on.
- ~~.09~~ When translating monetary items that have yet to be settled, the exchange rate in effect on the financial statement date is used. The exchange rate in effect on the financial statement date is also applied to items measured at fair value in accordance with FINANCIAL INSTRUMENTS, Section PS 3xxx. It would be illogical to apply the exchange rate in effect at the transaction date (i.e., a historical exchange rate) to items measured at fair value.
- ~~.109~~ 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 and items measured at fair value 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 and items measured at fair value at settlement.

Initial recognition

- ~~.110~~ ➤ *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.*
- ~~.121~~ 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

- ~~.132~~ 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.~~

- .143 ➤ *At each financial statement date,:*
(a) monetary assets and monetary liabilities denominated in a foreign currency; and
(b) non-monetary items denominated in a foreign currency that are included in the fair value category in accordance with FINANCIAL INSTRUMENTS, Section PS 3xxx;
should be adjusted to reflect the exchange rate in effect at that date and be recognized in the statement of financial position.

Exchange gains or losses

- .154 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.
- .165 During the life of a foreign currency denominated ~~monetary~~ item, there is uncertainty as to the actual gain or loss that will arise on its 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.*
- ~~.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.*
- ~~.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

- .1723 The unamortized Presentation of exchange gains or and losses in the statement of operations reflects the inherent uncertainty associated with foreign exchange. Some of 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.
- .18 ➤ An exchange gain or loss that arises prior to the period of settlement is presented in the statement of operations as remeasurement gains and losses.
- .19 ➤ In the period of settlement:
- (a) the cumulative amount of remeasurement gains and losses previously reported is reversed; and
 - (b) an exchange gain or loss measured in relation to the exchange rate at the date of the item's initial recognition is recognized as revenues (other than remeasurement gains) or expenses (other than remeasurement losses).
- .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
- .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).

- .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.*
- .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).*

- .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

- .2046 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.
- .21 Currency risk is a specific market risk a government may face when holding and transacting financial instruments. A government applies FINANCIAL INSTRUMENTS, paragraphs PS 3xxx.92-.93, to determine the information it discloses.
- .22 ➤ A government should disclose the exchange gains and losses recognized in the statement of operations, distinguishing between amounts included in:
(a) revenues and expenses (other than remeasurement gains and losses); and
(b) remeasurement gains and losses.
- .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.
- .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.
- .23 This Section applies to fiscal years beginning on or after April 1, 2012. Earlier adoption is encouraged. In the fiscal year a government adopts this Section, it also adopts FINANCIAL INSTRUMENTS, Section PS 3xxx.
- .24 The following provisions are applied at the beginning of the fiscal year (the transition date) in which this Section is initially adopted.
- (a) Hedge accounting policies followed in financial statements for periods prior to the fiscal year a government adopts this Section are not reversed and, therefore, those financial statements are not restated. Any gain or loss arising prior to the transition date on a derivative hedging instrument, and any foreign exchange gain or loss arising prior to the transition date on a non-derivative hedging instrument is accounted for as an adjustment in the balance of the accumulated surplus/deficit at the transition date. The carrying value of the hedged item is adjusted based on the foreign exchange rate on the transition date and is accounted for as an adjustment in the balance of accumulated surplus/deficit at the transition date.
- (b) Any unamortized foreign exchange gain or loss relating to a long-term foreign currency denominated monetary item deferred on the statement of financial position is accounted for as an adjustment in the balance of the accumulated surplus/deficit at the transition date.