

HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation

8

Presentation of financial statements - current assets: classification of restricted and appropriated cash balances

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

References: *Framework for the preparation and presentation of financial statements*
 SSAP 1 Presentation of financial statements

ISSUE

1. Entities sometimes pledge cash, short-term deposits or other cash equivalents as security for an overdraft, other short term borrowings or facilities. Such a situation may arise, for example, as a condition of the borrowing facility, or pursuant to a hedging strategy to protect against currency devaluations.
2. SSAP 1 paragraph 60 states:
"An asset should be classified as a current asset when it:
 - a. is expected to be realised in, or is held for sale or consumption in, the normal course of the enterprise's operating cycle; or*
 - b. is held primarily for trading purposes or for the short-term and expected to be realised within twelve months of the balance sheet date; or*
 - c. is cash or a cash equivalent asset which is not restricted in its use.**All other assets should be classified as non-current assets."*
3. The issue is whether cash, short-term deposits or cash equivalents so pledged may be classified as current assets in accordance with SSAP 1 paragraph 60(c).

CONCLUSION

4. Cash, short-term deposits or cash equivalents pledged as security for a current liability or an undrawn facility are not considered to be restricted in use for the purposes of classification under SSAP 1 paragraph 60(c).

DISCLOSURES

5. The amount of pledged cash, short-term deposits or cash equivalents classified as current assets by virtue of not being considered restricted in use should be shown as a separate line item on the face of the balance sheet with an appropriate description (e.g. "pledged deposits") in accordance with SSAP 1 paragraph 70.
6. Additional information about the security and financing arrangements relating to such pledged cash, short-term deposits or cash equivalents should be provided in the notes to the financial statements to provide a true and fair view in accordance with the requirements of SSAP 1 paragraph 101(c). The additional information should also take into consideration any subsequent events where appropriate.

BASIS FOR CONCLUSION

7. The essence of the current/non-current distinction elaborated on in SSAP 1 paragraphs 55 et seq. is that to justify "current asset" classification an asset should be held for or expected to be realised in the normal course of an entity's operating cycle. The substance of pledging arrangements as described in paragraph 1 above is that the pledged security is available to settle a current liability usually at either party's option.
8. Such treatment is considered to be reliable in that it:
 - a. represents faithfully the financial position of the enterprise (SSAP 1 paragraph 21(b)(i); Framework paragraphs 31 et seq.); and
 - b. reflects the economic substance of events and transactions and not merely their legal form (SSAP 1 paragraph 21(b)(ii); Framework paragraph 33).
9. In considering this issue the Hong Kong Society of Accountants (HKSA) also considered the issue of offsetting and concluded that pledged cash, short-term deposits or cash equivalents should not be offset against the related short-term borrowings unless all the requirements of SSAP 1 paragraph 34 are met.
10. SSAP 1 paragraph 34 states (emphasis added):

"Assets and liabilities should not be offset except when offsetting is permitted or required by another Statement of Standard Accounting Practice or when and only when all the following conditions are met:....."
11. Fundamental to the provisions of the conditions set out in SSAP 1 paragraph 34 are the requirements that the reporting enterprise has the ability to insist on a net settlement and that the reporting entity has the ability to insist on such beyond doubt. In particular it is essential that the ability to insist on a net settlement would survive the insolvency of any or all of the parties involved. Accordingly in determining whether offsetting is permitted in accordance with SSAP 1 paragraph 34 due regard must be had to the strict legal rights of all parties involved on a case by case basis.
12. Where advantage is taken of any offsetting rights, consideration should be given to presenting further details as to the gross borrowings and amount deducted therefrom either on the face of the balance sheet, or in the notes thereto in order to comply with SSAP 1 paragraphs 70 and 75.

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