Amendments to HKAS 39 and HKFRS 7 – Reclassification of Financial Assets

The Questions and Answers (Q&As) below should be read in conjunction with the Amendments to IAS 39/HKAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7/HKFRS 7 *Financial Instruments: Disclosures* – Reclassification of Financial Assets. This set of Q&As addresses some of the common issues on the application of the Amendments.

The Q&As are intended for general guidance only and represents the current understanding of the Amendments and may be subject to change if the IASB issues further amendments or clarifications. The Institute DOES NOT accept any responsibility or liability, and DISCLAIMS all responsibility and liability, in respect of the Q&As and any consequences that may arise from any person acting or refraining from action as a result of any materials in the Q&As. The Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk, for the attention of Steve Ong, Deputy Director, of the Institute.

Q1. Why did the International Accounting Standards Board (IASB) issue amendments to IAS 39/HKAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7/HKFRS 7 *Financial Instruments: Disclosures – Reclassification of Financial Assets*?

A1. The amendments to IAS 39/HKAS 39 introduce the possibility of reclassifications for entities applying IFRSs/HKFRSs, which were already permitted under US GAAP in rare circumstances. The amendments reduce differences between IFRSs/HKFRSs and US GAAP and create a more level playing field for those entities applying IFRSs/HKFRSs and those using US GAAP regarding the ability to reclassify financial assets.

The IASB included the following table in their press release accompanying the release of the amendments. It illustrates how the reclassification will be dealt with following the amendments when compared with US GAAP.

	US GAAP	IAS 39/HKAS 39 Amendments
Reclassification of securities (non-derivative) out of the trading category in rare circumstances (other than those designated in fair value through profit or loss upon initial recognition)	Permitted	Permitted
Reclassification to loan category (cost basis) if intention and ability to hold for the foreseeable future (loans) or until maturity (debt securities)	Permitted	Permitted
Reclassification if fair value options previously elected	Not permitted	Not permitted

Q2. What is a possible example of rare circumstances?

A2. The IASB press release states that the deterioration of the world's financial markets that has occurred during the third quarter of this year is a possible example of rare circumstances cited in these IFRS amendments.

IAS 39 BC104D/HKAS 39 BC 104D also notes that "rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term", which would restrict repeated use of what are "rare circumstances".

Q3. What is the scope of the amendments?

A3. In response to the credit crisis, some of the entities no longer have the intention to hold the financial assets such as equity and debt securities and loans and receivables for trading purpose (i.e. no longer held for the purpose of selling it in the near term) and therefore have concerns on their mark-to-market implications.

The amendments to IAS 39/HKAS 39 permit an entity to reclassify non-derivative financial assets that are classified as held for trading in particular circumstances. They also permit an entity to reclassify certain financial assets from the available-for-sale (AFS) category to the loans and receivables category, according to the reclassification rule set out in A4.

Those financial instruments that are excluded from the reclassification amendments include derivatives, including options and futures, and all those that were designated at Fair Value Through Profit or Loss (FVTPL) upon initial recognition (i.e. where the entity opted to categorise them as FVTPL even though not held for trading).

Equity securities cannot be reclassified into the loans and receivables category or the held to maturity (HTM) category as they cannot meet the definition of either category. They can therefore only be reclassified into the AFS category.

Q4. How to apply the reclassification rule in the amendment to IAS 39/HKAS 39?

A4. The amendments to IAS 39/HKAS 39 address the reclassification of non-derivative financial assets out of the fair value through profit or loss (FVTPL) category or out of the AFS category.

Reclassification out of the FVTPL category

The amended IAS 39/HKAS 39 allows non-derivative financial assets classified as held for trading to be reclassified in rare circumstances (i.e. a single event that is unusual and highly unlikely to recur in the near term). This applies to reclassification of debt securities (other than those that would have met the definition of loans and receivables — see next paragraph below) and equity securities out of the FVTPL category to the AFS or HTM category, as appropriate.

For financial assets that would have met the definition of loans and receivables (if they had not been required to be classified as held for trading at initial recognition), the amendments allow these assets to be reclassified out of the FVTPL category if the entity has the intent and ability to hold the financial asset for the foreseeable future or until maturity, in which case, the financial assets would be reclassified into the loans and receivables category. The “rare circumstances” rule does not apply.

Reclassification out of the AFS category

For financial assets that would have met the definition of loans and receivables (if they had not been designated as AFS), the amendments allow these assets to be reclassified out of the AFS category if the entity has the intent and ability to hold the financial asset for the foreseeable future or until maturity, in which case, the financial assets would be reclassified into the loans and receivables category. The “rare circumstances” rule does not apply.

It should be noted that the amendments do not refer to the reclassification of AFS assets into the HTM category because IAS 39.54/HKAS 39.54 already permits such reclassification.

Furthermore, it should be noted that IAS 39.50/HKAS 39.50 prohibits reclassification into the FVTPL category after initial recognition, so no financial assets classified as AFS can be reclassified into the FVTPL category.

Q5. How should the financial assets be measured at the reclassification date?

A5. (a) *Reclassification out of the FVTPL category*

If an entity reclassifies a financial asset out of the FVTPL category, then the financial asset is reclassified at its fair value on the date of reclassification and this fair value becomes the new cost or amortised cost, as applicable.

Any gain or loss previously recognised in profit or loss is not reversed upon reclassification.

(b) Reclassification out of the AFS category

If an entity reclassifies a financial asset out of the AFS category, then the financial asset is reclassified at its fair value on the date of reclassification and this fair value becomes the new cost or amortised cost, as applicable.

Any gain or loss previously recognised directly in equity (or recognised in other comprehensive income) is amortised to profit or loss over the remaining life of the HTM investment or loans and receivables using the effective interest method in the case of financial asset with a fixed maturity (IAS 39.54/HKAS 39.54).

Q6. When is the effective date and what are the transitional arrangements?

A6. An entity shall apply the amendments to IAS 39/HKAS 39 and IFRS 7/HKFRS 7 from 1 July 2008.

An entity shall not reclassify a financial asset before 1 July 2008. Any reclassification of a financial asset made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made. However, any reclassification before 1 November 2008 can take effect from

1 July 2008 or a subsequent date. Any reclassification cannot be applied retrospectively before 1 July 2008.

A reclassification cannot be applied retrospectively before 1 July 2008.

Q7. What are the specific disclosure amendments to IFRS 7/HKFRS 7?

A7. The IFRS 7/HKFRS 7 disclosure amendments require continuing fair value information to be provided for reclassified financial assets until their disposal or derecognition. Details of the specific disclosure requirements are set out in the amendments to IFRS 7/HKFRS 7.

(October 2008)

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