

Technical Note 06/2008 (Revised) – Amendments to HKAS 39 and HKFRS 7 Reclassification of Financial Assets

On 29 October 2008, the Hong Kong Institute of Certified Public Accountants (HKICPA) issued Amendments to HKAS 39 “Financial Instruments: Recognition and Measurement” and HKFRS 7 “Financial Instruments: Disclosures” – “Reclassification of Financial Assets” (the “Amendments”). **A further amendment was issued in 11 December 2008 to clarify the effective date of the Amendments. [Writer: The further amendment in effect voids the original Amendments. Few entities would reclassify financial assets if retrospective reclassification is not permitted after 1 November 2008.]**

Paragraphs 50 and AG8 of HKAS 39 and paragraph 12 of HKFRS 7 have been amended. Paragraphs 50B to 50E and 103G are added to HKAS 39 and paragraphs 12A and 44E are added to HKFRS 7.

The major changes are as follows:

- (i) Before the issuance of the Amendments, HKAS 39 prohibits reclassification of a financial instrument into or out of the fair value through profit or loss category while it is held or issued.

The Amendments do not affect derivatives and financial instruments that have been designated as financial instruments at fair value through profit or loss (“designated instruments”). [HKAS 39.50(a) & (b)]

That is, an entity should continue to follow the previous requirements that an entity should not reclassify derivatives or designated instruments out of or into the fair value through profit or loss category after initial recognition.

- (ii) An entity may have been required to classify a financial asset that meet the definition of loans and receivables as held for trading (and hence carried at fair value through profit or loss) in according to the requirements of HKAS 39, for example, when the financial asset was acquired principally for the purpose of selling it in the near term, (“loans originally held-for-trading”).

Before the issuance of the Amendments, HKAS 39 prohibits reclassification of these “loans originally held-for-trading” out of the fair value through profit or loss category while it is held.

The Amendments now permit the entity to reclassify these “loans originally held for trading” out of the fair value through profit or loss category when the entity has the intention and ability to hold these financial assets for the foreseeable future or until maturity. [HKAS 39.50(c) & HKAS 39.50D]

- (iii) For all financial assets at fair value through profit or loss other than those covered in (i) or (ii) above, an entity may reclassify them out of the fair value through profit or loss category when they are no longer held for the purpose of selling or repurchasing it in the near term. [HKAS 39.50(c)]

But the Amendments make it clear that this applies only in rare circumstances. [HKAS 39.50B]

The financial market crisis at the global level happened in the second quarter of 2008 is an example of such “rare circumstances”.

HKAS 39 BC 104D 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” [as a justification for reclassification under HKAS 39.50B].

The following table illustrates the reclassifications of financial assets that have been explicitly prohibited or permitted/required by HKAS 39 as amended by the Amendments:

To	From	FVTPL			AFS		HTM	L&R
		dv	dg	ht	fv	ac		
FVTPL	dv		n/a	n/a	X ^[39.50]	X ^[39.50]	X ^[39.50]	X ^[39.50]
	dg	n/a		n/a	X ^[39.50]	X ^[39.50]	X ^[39.50]	X ^[39.50]
	ht	n/a	n/a		X ^[39.50]	X ^[39.50]	X ^[39.50]	X ^[39.50]
AFS	fv	X ^[39.50(a)]	X ^[39.50(b)]	✓ ^[39.50(c)]		✓ ^[39.53]	✓ ^[39.51&52]	?
	ac	X ^[39.50(a)]	X ^[39.50(b)]	✓ ^[39.50(c)]	✓ ^[39.54]		n/a	n/a
HTM		X ^[39.50(a)]	X ^[39.50(b)]	✓ ^[39.50(e)]	✓ ^[39.54]	n/a		✓ ^[39.54]
L&R		X ^[39.50(a)]	X ^[39.50(b)]	✓ ^[39.50(c)]	✓ ^[39.50E]	n/a	X ^[39.51&52]	

FVTPL – dv: Fair value through profit or loss - derivatives

FVTPL – dg: Fair value through profit or loss - designated

FVTPL – ht: Fair value through profit or loss – held for trading

AFS – fv: Available for sale – at fair value

AFS – ac: Available for sale – at cost

HTM Held to maturity

L&R Loans and receivables

X Reclassification prohibited

✓ Reclassification already permitted/required by HKAS 39

✓ Reclassification newly permitted by the Amendments

(iv) Effective date and transition:

An entity should apply the Amendments on or after 1 July 2008.

An entity should not reclassify a financial asset in accordance with the Amendments before 1 July 2008.

Any reclassification of a financial asset made on or after 1 November 2008*** shall take effect only from the date when the reclassification is made.

Any reclassification of a financial asset in accordance with the Amendment shall not be applied retrospectively before 1 July 2008.

[*** Writer: In the original version of the Amendments, it refers to the reclassification of a financial asset made “in periods beginning” on or after 1 November 2008. The wordings “in periods beginning” were removed by a further amendment issued in 11 December 2008. That is, any “retrospective reclassification” is prohibited for reclassification made on or after 1 November 2008. That would effectively make the effective date 1 July 2008 meaningless in practice since only a few, if any at all, would be able to react to the original amendment so promptly within two days when the original Amendments was issued on 29 October 2008 . The further amendment in effect voids the original Amendments. Few entities would reclassify financial assets if retrospective reclassification is not permitted after 1 November 2008.]

(v) Disclosure

If the entity has reclassified a financial asset out of the fair value through profit or loss category, or out of the available-for-sale category, in accordance with the Amendments, it shall disclose:

- (a) for the reporting period when the financial asset was reclassified
 - (i) the amount reclassified into and out of each category;
 - (ii) the fair value gain or loss on the financial asset recognised in profit or loss or other comprehensive income in that reporting period and in the previous reporting period;
 - (iii) the effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.
 - (iv) the rare situation, and the facts and circumstances indicating that the situation was rare (if a financial asset was reclassified in accordance with paragraph 50B);
- (b) for each reporting period until derecognition (including the reporting period in which the financial asset was reclassified):
 - (i) the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods; and
 - (ii) the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income if the financial asset had not been reclassified, and the gain, loss, income and expense recognised in profit or loss.

An example disclosure for a reclassification made in financial statements for the year ended 31 December 2008 is as follows:

HKAS 39.12A(a), (b)	During the year, the Company initially applied the Amendments to HKAS 39 and HKFRS 7 – Reclassification of Financial Assets. The Company reclassified quoted equity investments held for trading with an aggregate carrying amount, and aggregate fair value, of HK\$100,000,000 as available for sale financial assets because of the unusual financial market fluctuations at the global level happened in the last quarter of 2008, which was considered a rare circumstance. The Company expected to recover the carrying amount at the date of reclassification in the future periods.												
HKAS 39.12A(c)													
HKAS 39.12A(f)													
	Changes in fair value during the year of the reclassified investments are recognised as follows:												
	<table border="0"> <thead> <tr> <th></th> <th style="text-align: right;">2008</th> <th style="text-align: right;">2007</th> </tr> <tr> <th></th> <th style="text-align: right;">HK\$'000</th> <th style="text-align: right;">HK\$'000</th> </tr> </thead> <tbody> <tr> <td>Through profit or loss</td> <td style="text-align: right;">20,000</td> <td style="text-align: right;">5,000</td> </tr> <tr> <td>**Directly in equity**</td> <td style="text-align: right;">(70,000)</td> <td style="text-align: right;">-</td> </tr> </tbody> </table>		2008	2007		HK\$'000	HK\$'000	Through profit or loss	20,000	5,000	**Directly in equity**	(70,000)	-
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	HK\$'000	HK\$'000											
Through profit or loss	20,000	5,000											
Directly in equity	(70,000)	-											
HKAS 39.12A(d)													
	[**Other comprehensive income** if HKAS 1 (Revised) in early adopted.]												
	If the investments had not been reclassified, the changes in fair values would have been recognised as follows:												
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