Hong Kong Institute of
Certified Public Accountants
香港會計師公會

22 October 2008

Dear members,

Last week we sent you an email apprising you of the fact that Council had approved adopting, for HKFRS, the IASB's amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures.

Since then, we have seen a great deal of confusion as our members, the public and the news media have talked about these amendments.

I write to clarify this confusion. I have also given interviews with HDTVB and Metro Radio in Cantonese explaining these changes, should you wish to hear these.

Reclassification and not suspension of fair value

On the most important issue, the amendments to IAS 39/HKAS 39 made no changes to fair value accounting. What they have done are to permit an entity, if it no longer intends to hold a non-derivative financial asset for the purpose of selling or repurchasing in the near term (notwithstanding that the financial asset may have been acquired or incurred principally for these purposes), to reclassify that non-derivative financial asset out of the "held for trading" category (measured at fair value through the income statement) to "available for sale" (measured at fair value through equity) or "held to maturity" (measured at cost or amortized cost) or "loans and receivables" (measured at cost or amortized cost). Such reclassifications were not previously allowed under IAS 39/HKAS 39 but permitted under US GAAP. The amendments reduce differences between IFRSs and US GAAP and create a level playing field.

Additional disclosures maintain transparency

This move does in no way compromise the principle of transparency as when an entity reclassifies a financial asset out of "fair value through profit or loss" or "available for sale" categories, the amendments to IFRS 7/HKFRS 7 requires additional disclosures about the situations in which any such reclassification is made, and the effects on the financial statements; including the amounts reclassified into and out of each category and the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods.

Illustration of the Amendments

The following illustrates the different classification categories that are possible for different financial assets under IAS 39/HKAS 39 together with their measurement requirements and how changes in value are recorded:

Classification	Investment in a debt security	Investment in an equity security for which fair value can be reliably measured	Derivatives and embedded derivatives	Measurement	Recording of changes
Financial assets at fair value through profit or loss (FVTPL)					
(a) held for trading	✓	✓	✓	Fair value	Income statement

(b) designated at FVTPL	✓	✓			
Loans and receivables	✓			Amortised cost	Income statement
Held-to-maturity investments	✓			Amortised cost	Income statement
Available for sale financial assets	✓	✓		Fair value	Directly to equity except for impairment losses

Before the amendments, IAS 39 prohibited reclassifications for financial assets once they are recognized as held for trading. The amendments now allow certain reclassification but with very specific requirements.

In general terms,

(1) The amendments allow *equity securities* classified as held for trading to be reclassified into "available for sale" category but only in rare circumstances. Equity securities cannot be reclassified to "loan and receivables" or "held to maturity" as they do not meet the definition of either category.

(2) For *debt securities that meet the definition of loans and receivables*, the amendments allow them to be reclassified from "held for trading" or "available for sale" to "loans and receivables" if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

(3) For *other debt securities* classified as held for trading, the amendments allow them to be reclassified into "available for sale" or "held to maturity" if the financial asset is no longer held for the purpose of selling in the near term and in rare circumstances. Reclassification from "available for sale" to "held to maturity" is already allowed under paragraph 54 of IAS 39/HKAS39.

(4) The amendments *exclude derivative* financial instruments from reclassification, including linked securities, options and futures, which will continue to be categorized as "held for trading" and measured at fair value through the income statement. Other exclusions are those financial assets that have already been designated at FVTPL upon initial recognition.

Effective date 1 July 2008 for new cost on reclassification

All items that are reclassified into "held to maturity" or "loans and receivables" from "held for trading" or "available for sale" are measured at their fair value at the date of transfer, which will become their new cost or amortized cost, as applicable. Any gains or loss already recognized in profit or loss up to that date shall not be reversed.

The reclassification can be made, retrospective to 1 July 2008 if the election is made before 1 November 2008.

Reclassification made on or after 1 November 2008 shall take effect only from the date of reclassification.

Further guidance to follow

We will be issuing fuller technical guidance in the form of Q&As to assist members' understanding of these important amendments as soon as possible.

You may also be interested in this press release from IOSCO supporting the actions of the IASB.

Sincere regards,

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