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

# MEMBERS' HANDBOOK

## Update No. 54

*(Issued October 2008)*

This Update relates to the issuance of Amendments to HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 7 *Financial Instruments: Disclosures – Reclassification of Financial Assets*.

| ***Document Reference and Title*** | ***Instructions*** | ***Explanations*** |
|---|---|---|
| **VOLUME II** | | |
| Contents of Volume II | Discard the existing pages i and ii and replace with the new pages i and ii. | Revised contents pages |
| **HONG KONG ACCOUNTING STANDARDS (HKAS)** | | |
| HKAS 39 *Financial Instruments: Recognition and Measurement* (Standard) | Replace pages 4 and 6A with revised pages 4 and 6A. Insert pages 87G and 87H after page 87F. | Amendments to HKAS 39 and HKFRS 7 – Note |
| HKAS 39 *Financial Instruments: Recognition and Measurement* (Basis for Conclusions) | Replace page 147B with revised page 147B. Insert pages 147D-147F after page 147C. | Amendments to HKAS 39 and HKFRS 7 – Note |
| **HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)** | | |
| HKFRS 7 *Financial Instruments: Disclosures* (Standard) | Replace page 3 with revised page 3. Insert pages 37-38 after page 36. | Amendments to HKAS 39 and HKFRS 7– Note |
| HKFRS 7 *Financial Instruments: Disclosures* (Basis for Conclusions) | Replace pages 3, 20, 21 and 22 with revised pages 3, 20, 21 and 22. Discard the existing page 23. | Amendments to HKAS 39 and HKFRS 7– Note |

**Note:**

**BACKGROUND ABOUT AMENDMENTS TO HKAS 39 AND HKFRS 7**

The amendments to HKAS 39 *Financial Instruments: Recognition and Measurement* introduce the possibility of reclassifications for companies applying Hong Kong Financial Reporting Standards, which were already permitted under US generally accepted accounting principles (GAAP) in rare circumstances. The amendments reduce differences between HKFRSs and US GAAP and create a more level playing field for those companies applying HKFRSs and those using US GAAP regarding the ability to reclassify financial assets.

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 (a single event that is unusual and highly unlikely to recur in the near future) cited in these HKFRS amendments.

The amendments to 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 if the entity has the intention and ability to hold the asset for the foreseeable future or until maturity.

The following table illustrates how reclassification will be dealt with following the amendment when compared with US GAAP.

| | **US GAAP** | **HKAS 39 Amendments** |
|---|---|---|
| Reclassification of securities (non-derivative) out of the trading category in rare circumstances (other than those designated in fair value through project 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 option previously elected | Not permitted | Not permitted |

The amendments also amend HKFRS 7 *Financial Instruments: Disclosures* to require extensive disclosures for any financial asset reclassified in the situation described.

An entity shall apply the amendments to HKAS 39 and 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.

For further information, click the following emails sent by the Institute to members:

(1) Email of 14 October 2008 – Reclassification of Financial Assets.
(2) Email of 22 October 2008 – Reclassification and not suspension of fair value.

For general guidance only, Questions and Answers have been developed for your reference.

**SUMMARY**

In summary, the amendments permit an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendments also permit an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future.

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

# MEMBERS' HANDBOOK
# CONTENTS OF VOLUME II

(Updated to October 2008)

## Implementation Guidance

## Illustrative Example

Hong Kong Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (HKAS 39) is set out in paragraphs 1-109 and Appendices A-D~~, B and C~~. All the paragraphs have equal authority. HKAS 39 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

# Appendix D

## Amendments to HKAS 39 and HKFRS 7 *Reclassification of Financial Assets* (issued in October 2008) - effective from 1 July 2008

*In October 2008, the Institute issued Amendments to HKAS 39 Financial Instruments: Recognition and Measurement and HKFRS 7 Financial Instruments: Disclosures – Reclassification of Financial Assets that are effective from 1 July 2008. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

Paragraph 50 is amended (new text is underlined and deleted text is struck through) and paragraphs 50B–50F and 103G are added.

## Measurement

### Reclassifications

**50 An entity<u>:</u>**

**<u>(a)</u> shall not reclassify a <u>derivative</u> ~~financial instrument into or~~ out of the fair value through profit or loss category while it is held or issued~~.~~<u>;</u>**

**<u>(b)</u> <u>shall not reclassify any financial instrument out of the fair value through profit or loss category if upon initial recognition it was designated by the entity as at fair value through profit or loss; and</u>**

**<u>(c)</u> <u>may, if a financial asset is no longer held for the purpose of selling or repurchasing it in the near term (notwithstanding that the financial asset may have been acquired or incurred principally for the purpose of selling or repurchasing it in the near term), reclassify that financial asset out of the fair value through profit or loss category if the requirements in paragraph 50B or 50D are met.</u>**

**<u>An entity shall not reclassify any financial instrument into the fair value through profit or loss category after initial recognition.</u>**

50B A financial asset to which paragraph 50(c) applies (except a financial asset of the type described in paragraph 50D) may be reclassified out of the fair value through profit or loss category only in rare circumstances.

50C If an entity reclassifies a financial asset out of the fair value through profit or loss category in accordance with paragraph 50B, the financial asset shall be reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in profit or loss shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

50D A financial asset to which paragraph 50(c) applies that would have met the definition of loans and receivables (if the financial asset had not been required to be classified as held for trading at initial recognition) may be reclassified out of the fair value through profit or loss category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

50E A financial asset classified as available for sale that would have met the definition of loans and receivables (if it had not been designated as available for sale) may be reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

50F If an entity reclassifies a financial asset out of the fair value through profit or loss category in accordance with paragraph 50D or out of the available-for-sale category in accordance with paragraph 50E, it shall reclassify the financial asset at its fair value on the date of reclassification. For a financial asset reclassified in accordance with paragraph 50D, any gain or loss already recognised in profit or loss shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable. For a financial asset reclassified out of the available-for-sale category in accordance with paragraph 50E, any previous gain or loss on that asset that has been recognised in other comprehensive income in accordance with paragraph 55(b) shall be accounted for in accordance with paragraph 54.

## Effective date and transition

103G *Reclassification of Financial Assets* (Amendments to HKAS 39 and FRS 7), issued in October 2008, amended paragraphs 50 and AG8, and added paragraphs 50B–50F. An entity shall apply those amendments from 1 July 2008. An entity shall not reclassify a financial asset in accordance with paragraph 50B, 50D or 50E 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. Any reclassification of a financial asset in accordance with paragraph 50B, 50D or 50E shall not be applied retrospectively to reporting periods ended before the effective date set out in this paragraph.

In Appendix A *Application guidance*, paragraph AG8 is amended (new text is underlined).

### Effective interest rate

AG8 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognised as income or expense in profit or loss. <u>If a financial asset is reclassified in accordance with paragraph 50B, 50D or 50E, and the entity subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase shall be recognised as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the asset at the date of the change in estimate.</u>

# Appendix A

## Amendments resulting from other Basis for Conclusions

*The following sets out amendments required for this Basis for Conclusions resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

### HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions is amended as follows:

> *This Basis for Conclusions accompanies, but is not part of, IAS 39.*
>
> *In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1* Presentation of Financial Statements *(as revised in 2007).*

Paragraphs BC75, BC125, BC155, BC167, BC221(c) and BC222(p) and (s)(iii) are footnoted as follows:

BC75 IAS 39 … It requires some gains and losses to be recognised in profit or loss, and others to be recognised initially as a component of equity.* This combination of measurement and recognition requirements can result in inconsistencies, which some refer to as 'accounting mismatches', between the accounting for an asset (or group of assets) and a liability (or group of liabilities). The notion …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 these other gains and losses are recognized in other comprehensive income.

BC125 In the Exposure Draft … The Board noted that this was consistent with the recognition of changes in the fair value of available-for-sale financial assets directly in equity* (see paragraph 55(b)).

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such changes are recognised in other comprehensive income.

BC155 The question … The entity enters into a derivative to hedge against possible future changes in the US dollar/euro exchange rate. Such a hedge is classified as a cash flow hedge under IAS 39, with the effect that gains and losses on the hedging instrument (to the extent that the hedge is effective) are initially recognised in equity.* The question …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such gains and losses are recognised in other comprehensive income.

# Appendix B

## Amendments to Basis for Conclusions on HKAS 39 and HKFRS 7 *Reclassification of Financial Assets* (issued in October 2008) – effective from 1 July 2008

*In October 2008, the Institute issued Amendments to HKAS 39 Financial Instruments: Recognition and Measurement and HKFRS 7 Financial Instruments: Disclosures – Reclassification of Financial Assets that are effective from 1 July 2008.*

In the Basis for Conclusions, paragraph BC11E is added and a heading and paragraphs BC104A–BC104E are added.

## Background

BC11E In October 2008 the Board received requests to address differences between the reclassification requirements of IAS 39 and US GAAP (Statements of Financial Accounting Standards No. 115 *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115) and No. 65 *Accounting for Certain Mortgage Banking Activities* (SFAS 65) issued by the US Financial Accounting Standards Board). In response the Board issued *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7) in October 2008. The amendments to IAS 39 permit non-derivative financial assets held for trading and available-for-sale financial assets to be reclassified in particular situations. The rationale for the amendments is set out in paragraphs BC104A–BC104E.

## Measurement

### Reclassification of financial instruments (paragraphs 50–54)

BC104A As described in paragraph BC11E, in October 2008 the Board received requests to address differences between the reclassification requirements of IAS 39 and US GAAP. SFAS 115 permits a security to be reclassified out of the trading category in rare situations. SFAS 65 permits a loan to be reclassified out of the Held for Sale category if the entity has the intention and ability to hold the loan for the foreseeable future or until maturity. IAS 39 permitted no reclassifications for financial assets classified as held for trading. The Board was asked to consider allowing entities applying IFRSs the same ability to reclassify a financial asset out of the held-for-trading category as is permitted by SFAS 115 and SFAS 65.

BC104B The Board noted that allowing reclassification, even in limited circumstances, could allow an entity to manage its reported profit or loss by avoiding future fair value gains or losses on the reclassified assets.

BC104C The Board was also informed that, in practice under US GAAP, reclassification out of the trading category of SFAS 115 is extremely rare. However, the Board noted that the possibility of reclassification of securities and loans under US GAAP is available and that entities applying IFRSs do not have that possibility.

BC104D The Board therefore decided to permit non-derivative financial assets to be reclassified out of the held-for-trading category in the same circumstances as are permitted in SFAS 115 and SFAS 65. The Board also noted that rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Board decided that a financial asset that would have met the definition of loans and receivables (if it had not been designated as available for sale) should be permitted to be transferred from the available-for-sale category to loans and receivables, if the entity intends to hold the loan or receivable for the foreseeable future or until maturity. The Board decided that this substantially aligns the accounting for reclassifications of loans and receivables with that permitted under US GAAP.

BC104E The Board normally publishes an exposure draft of any proposed amendments to standards to invite comments from interested parties. However, given the requests to address this issue urgently in the light of market conditions, and after consultation with the Trustees of the IASC Foundation, the Board decided to proceed directly to issuing the amendments. In taking this exceptional step the Board noted that the amendments to IAS 39 relaxed the existing requirements to provide short-term relief for some entities. The Board also noted that the amendments were a short-term response to the requests and therefore the Board decided to restrict the scope of the amendments.

# Appendix C

## Dissenting opinions (October 2008 Amendment)

## Dissent of James J Leisenring and John T Smith from the issue in October 2008 of amendments to IAS 39 and IFRS 7 on the reclassification of financial assets

DO1 Messrs Leisenring and Smith dissent from *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7). The amendments to IAS 39 are asserted to level the playing field with US GAAP. It accomplishes that with respect to the reclassification of financial instruments to the held-to-maturity category of loans and receivables from other classifications. However, once reclassified, the measurement of impairment and when that measurement is required are quite different and a level playing field in accounting for these instruments is not achieved. Messrs Leisenring and Smith would have been willing to support the alternative approach considered by the Board that would have closely aligned the impairment requirements of US GAAP with IFRSs.

DO2 As described in paragraph BC11E, in October 2008 the Board received requests to address differences between the reclassification requirements of IAS 39 and US GAAP. SFAS 115 permits a security to be reclassified out of the trading category in rare situations. SFAS 65 permits a loan to be reclassified out of the Held for Sale category if the entity has the intention to hold the loan for the foreseeable future or until maturity. IAS 39 permitted no reclassifications for financial assets classified as held for trading. The Board was asked to consider allowing entities applying IFRSs the same ability to reclassify a financial asset out of the held-for-trading category as is permitted by SFAS 115 and SFAS 65.

DO3 Messrs Leisenring and Smith both believe that the current requirements in IFRSs for reclassification are superior to US GAAP and that the accounting for impairments in US GAAP is superior to the requirements of IAS 39.

DO4 Furthermore, Messrs Leisenring and Smith do not believe that amendments to standards should be made without any due process.

## APPENDICES



## BASIS FOR CONCLUSIONS

## IMPLEMENTATION GUIDANCE

Hong Kong Financial Reporting Standard 7 *Financial Instruments: Disclosures* (HKFRS 7) is set out in paragraphs 1-45 and Appendices A-D and F. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. HKFRS 7 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

# Appendix F

## Amendments to HKAS 39 and HKFRS 7 *Reclassification of Financial Assets* (issued in October 2008) - effective on 1 July 2008

*In October 2008, the Institute issued Amendments to HKAS 39 Financial Instruments: Recognition and Measurement and HKFRS 7 Financial Instruments: Disclosures – Reclassification of Financial Assets that are effective from 1 July 2008.*

Paragraph 12 is amended (new text is underlined and deleted text is struck through) and paragraphs 12A and 44E are added.

## Significance of financial instruments for financial position and performance

### Statement of financial position

#### Reclassification

12 If the entity has reclassified a financial asset <u>(in accordance with paragraphs 51─54 of HKAS 39)</u> as one measured:

(a) at cost or amortised cost, rather than fair value; or

(b) at fair value, rather than at cost or amortised cost,

it shall disclose the amount reclassified into and out of each category and the reason for that reclassification ~~(see paragraphs 51–54 of HKAS 39)~~.

12A If the entity has reclassified a financial asset out of the fair value through profit or loss category in accordance with paragraph 50B or 50D of HKAS 39 or out of the available-for-sale category in accordance with paragraph 50E of HKAS 39, it shall disclose:

(a) the amount reclassified into and out of each category;

(b) for each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;

(c) if a financial asset was reclassified in accordance with paragraph 50B, the rare situation, and the facts and circumstances indicating that the situation was rare;

(d) for the reporting period when the financial asset was reclassified, 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;

(e) for each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, 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; and

(f) 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.

## Effective date and transition

44E *Reclassification of Financial Assets* (Amendments to HKAS 39 and HKFRS 7), issued in October 2008, amended paragraph 12 and added paragraph 12A. An entity shall apply those amendments from 1 July 2008.

# APPENDIX A
# Amendments to Basis for Conclusions on other IFRSs (included in the Basis for Conclusions on the corresponding HKFRSs)

*This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 7. In the amended paragraphs, new text is underlined and deleted text is struck through.*

* * *

*The amendments contained in this appendix when this Basis for Conclusions was issued have been incorporated into the relevant Basis for Conclusions.*

# Appendix B
# Amendments resulting from other Basis for Conclusions

*The following sets out amendments required for this Basis for Conclusions resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

## HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC47 is footnoted as follows:

> In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.

## HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions on IFRS 7 is amended as follows:

> *This Basis for Conclusions accompanies, but is not part of, IFRS 7.*
>
> *In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1* Presentation of Financial Statements *(as revised in 2007)*

## Appendix C

## Amendments to Basis for Conclusions on HKAS 39 and HKFRS 7 *Reclassification of Financial Assets* (issued in October 2008) - effective from 1 July 2008

*In October 2008, the Institute issued Amendments to HKAS 39 Financial Instruments: Recognition and Measurement and HKFRS 7 Financial Instruments: Disclosures – Reclassification of Financial Assets that are effective from 1 July 2008.*

In the Basis for Conclusions, the heading above paragraph BC23 is amended (new text is underlined) and paragraph BC23A is added.

## Disclosures about the significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)

### Balance sheet disclosures (paragraphs 8–19 and B4)

#### Reclassification (paragraph<u>s</u> 12 <u>and 12A</u>)

BC23A In October 2008 the Board amended IAS 39 to permit reclassification of particular financial assets in some circumstances. The Board decided to require additional disclosures about the situations in which any such reclassification is made, and the effects on the financial statements. The Board regards such information as useful because the reclassification of a financial asset can have a significant effect on the financial statements.