Deloitte.

October 2008 – Special edition

Audit

IAS Plus.

Published for our clients and staff throughout the world

Deloitte global IFRS leadership team

IFRS global office

Global IFRS leader
Ken Wild
kwild@deloitte.co.uk

IFRS centres of excellence

Americas

New York
Robert Uhl
iasplusamericas@deloitte.com

Montreal
Robert Lefrancois
iasplus@deloitte.ca

Asia-Pacific

Hong Kong
Stephen Taylor
iasplus@deloitte.com.hk

Melbourne
Bruce Porter
iasplus@deloitte.com.au

Europe-Africa

Johannesburg
Graeme Berry
iasplus@deloitte.co.za

Copenhagen
Jan Peter Larsen
dk_iasplus@deloitte.dk

London
Veronica Poole
iasplus@deloitte.co.uk

Paris
Laurence Rivat
iasplus@deloitte.fr

Amendments to IAS 39 & IFRS 7 – reclassification of financial assets (updated)

On 13 October 2008, the International Accounting Standards Board (IASB) published amendments to IAS 39 **Financial Instruments: Recognition and Measurement** and IFRS 7 **Financial Instruments: Disclosures**.

The amendments are a response to calls from constituents, particularly within the European Union, to create a 'level playing field' with US GAAP regarding the ability to reclassify financial assets. The changes to IAS 39 permit an entity to reclassify non-derivative financial assets **out** of the 'fair value through profit or loss' (FVTPL) and 'available-for-sale' (AFS) categories in limited circumstances. Such reclassifications will trigger additional disclosure requirements.

On 24 October 2008, in response to queries raised by practitioners, the IASB issued clarifying guidance in its October Update regarding the effective date of the amendments and transitional provisions. This newsletter has been updated to reflect that supplementary guidance (see page 3).

Scope of the amendments

The amendments will only permit reclassification of certain non-derivative financial assets recognised in accordance with IAS 39. Financial liabilities, derivatives and financial assets that are designated as at FVTPL on initial recognition under the 'fair value option' cannot be reclassified. The amendments therefore only permit reclassification of debt and equity financial assets subject to meeting specified criteria.

The amendments do not permit reclassification **into** FVTPL.

Reclassification out of FVTPL and AFS

A financial asset within the scope of these amendments can only be reclassified out of FVTPL or AFS if specified criteria are met. The criteria vary depending on whether the asset would have met the definition of 'loans and receivables' (L&R) had it not been classified as at FVTPL or AFS at initial recognition.

A debt instrument that would have met the definition of L&R (if it had not been required to be classified as held for trading at initial recognition) may be reclassified out of FVTPL if the entity has the intention and ability to hold the asset for the foreseeable future or until maturity.

A debt instrument classified as AFS that would have met the definition of L&R (if it had not been designated as AFS) may be reclassified to the L&R category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

Any other debt instrument, or any equity instrument, may be reclassified from FVTPL to AFS, or from FVTPL to HTM (in the case of debt instruments only), if the financial asset is no longer held for the purpose of selling in the near term – but only in 'rare' circumstances. In its press release the IASB acknowledged that market conditions in the third quarter of 2008 are a possible example of a 'rare' circumstance.

It should be noted that the amendments do not refer to the reclassification of AFS debt instruments to HTM because IAS 39 already permitted such reclassifications (see IAS 39.54). These reclassifications are not within the scope of the current amendments, and therefore they do not trigger the additional disclosures required by IFRS 7.12A referred to below.

Measurement at the reclassification date

All reclassifications must be made at the fair value of the financial asset at the date of reclassification. Any previously recognised gains or losses cannot be reversed. The fair value at the date of reclassification becomes the new cost or amortised cost of the financial asset, as applicable.

Measurement after the reclassification date

The existing requirements in IAS 39 for measuring financial assets at cost or amortised cost apply after the reclassification date (with one exception – see below). Therefore, for financial assets measured at amortised cost, a new effective interest rate will be determined at the date of reclassification. In the case of reclassifications of a fixed rate debt instrument to L&R and HTM, this effective interest rate will be used as the discount rate for future impairment calculations.

For reclassifications out of AFS, IAS 39.54 requires the amounts previously recognised in other comprehensive income (OCI) to be reclassified to profit or loss either through the effective interest rate (if the instrument has a maturity) or at disposal (if the instrument has no maturity – i.e. it is perpetual). Amounts deferred in equity may also need to be reclassified to profit or loss if there is an impairment.

The one exception to the existing measurement requirements is for reclassified debt instruments. If, after reclassification, an entity increases its estimate of recoverability of future cash flows, the carrying amount is not adjusted upwards as is currently required by IAS 39.AG8 for changes in estimates of cash flows. Instead, a new effective interest rate is determined and is applied from that date forward. Hence, the increase in the recoverability of cash flows is recognised over the expected life of the financial asset.

Disclosures

To make transparent to users any reclassifications under the new requirements, IFRS 7 is also amended. Although the requirements for reclassifications in accordance with IAS 39.51-54 remain unchanged (IFRS 7.12), the following additional disclosures are required for reclassifications within the scope of the current amendments (new paragraph IFRS 7.12A):

- the amount reclassified into and out of each category;
- for each reporting period until derecognition, the carrying amounts and fair values of all financial assets reclassified in the current or previous reporting periods;
- if the financial asset has been reclassified based on the 'rare circumstances' exception, details of those circumstances – including the factors that indicated that the situation was rare;
- the fair value gain or loss recognised in profit or loss or OCI for the reporting period in which reclassification occurs and in the previous period;
- in the period of reclassification and in subsequent periods until the financial asset is derecognised, the gain or loss that would have been recognised in profit or loss or OCI had the financial asset not been reclassified, and the actual gain, loss, income and expense recognised in profit or loss; and
- the effective interest rate and estimated cash flows the entity expects to recover as at the date of reclassification of the financial asset.

Effective date and transition

These amendments are effective from 1 July 2008. Entities are not permitted to reclassify financial assets in accordance with the amendments before 1 July 2008. The amendments state that any reclassification of a financial asset made in periods beginning on or after 1 November 2008 will take effect only from the date when the reclassification is made. Any reclassification of a financial asset in accordance with the amendments should not be applied retrospectively to reporting periods ended before the effective date.

The IASB has clarified the following points.

- For reclassifications made before 1 November 2008, an entity can reclassify a financial asset with effect from 1 July 2008 (but not before), or any date thereafter until 31 October 2008. Such assets must be identified and documented before 1 November 2008.

  For example, an entity with an October year end may wish to choose 1 August as the date of reclassification, rather than 1 July, in order for the reclassifications to take effect at the start of Q4, rather than part way through Q3.

  Equally, an entity's intent to hold for trading purposes may have changed part-way through a period for different loans, say 5 September, 25 September etc, as a result of specific events on those dates. An entity could reclassify at various dates if the criteria are met and evidence is available regarding the change of intent.

- Any reclassification made on or after 1 November 2008 (irrespective of when the accounting period started) is effective from the date of reclassification i.e. reclassifications are made on a real-time basis.

  For example, an entity with a Q4 ending 31 December can make reclassifications on or after 1 November and they will take effect from the dates the assets are reclassified.

Designed and produced by The Creative Studio at Deloitte, London. 27041

Deloitte
Touche
Tohmatsu