

# IFRS Briefing Sheet

Reclassification of Financial Assets – Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*

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This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB or Board) amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* that were published on 13 October 2008.

The amendments, which address the desire to reduce differences between IFRSs and U.S. GAAP, were developed and finalised, with no exposure draft, in approximately one week. This unusual action followed the recent decision made by the Trustees of the International Accounting Standards Committee Foundation to allow suspension of the IASB's normal due process requirements to facilitate a rapid response to the calls from EU leaders.

The amendments deal separately with reclassifications of loans and receivables and with reclassifications of other financial assets. The amendments permit loans and receivables to be reclassified from the held for trading or available for sale categories if the entity has the intent and ability to hold the financial asset for the foreseeable future. The amendments also allow non-derivative financial assets classified as held for trading to be reclassified in *rare circumstances*. Assets designated as fair value through profit and loss upon initial recognition may not be reclassified. The option of reclassifications as introduced by the amendments already was permitted under US GAAP in rare circumstances.

The amended standards do not define *rare circumstances* but the IASB notes in the accompanying Basis for

## Background and Executive Summary

In response to concerns expressed by European Union (EU) leaders that European financial institutions were being disadvantaged in comparison to their competitors reporting under U.S. GAAP, the IASB has issued amendments to IAS 39 that permit reclassifications of certain financial assets that previously were not allowed.

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Conclusions that “rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term.” An accompanying IASB press release stated 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 and therefore justifies its immediate publication.”

All items that are reclassified are measured at their fair value at the date of transfer. Reclassifications made in financial periods beginning prior to 1 November 2008 are permitted to be deemed to have occurred as of 1 July 2008.

### **Amendments to IAS 39** **Reclassification out of Fair Value Through Profit or Loss**

The amendments to IAS 39 establish different criteria for transfers of loans and receivables and for other qualifying financial assets:

- If a non-derivative financial asset would have met the definition of loans and receivables absent having been required to be classified as held for trading on initial recognition, and the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity, then it may be reclassified out of the fair value through profit or loss category if the entity elects to do so.
- Non-derivative financial assets other than those described immediately above may be reclassified out of the held for trading category only in *rare circumstances*.

If an entity reclassifies a financial asset out of the fair value through profit or loss 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.

### **Reclassification out of Available for Sale**

If a financial asset would have met the definition of loans and receivables absent having been designated as available for sale, and the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity, then that asset may be reclassified out of the available for sale category if the entity chooses to do so.

If an entity reclassifies a financial asset from the available for sale category, then the financial asset is reclassified at its fair value on the date of reclassification and this fair value becomes its new cost or amortised cost, as applicable. Any gain or loss previously recognised in other comprehensive income is accounted for in accordance with IAS 39 paragraph 54. That guidance states that if the financial asset has a fixed maturity, then any gain or loss is amortised to profit or loss over the remaining life of the held-to-maturity investment using the effective interest method.

### **Effective Interest Rate Calculation**

The amendment also addresses how to deal with increases in estimates of future cash receipts as a result of expected increased recoverability of those cash receipts subsequent to a financial asset being reclassified from either of the fair value through profit or loss or available for sale categories. The effect of such an increase is 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 change in estimate. As a result, the change in estimate is recognised in profit or loss as part of interest income over

the remaining holding period of the asset, rather than being recognised immediately in profit or loss.

### **Effective Date and Transition**

The transition requirements offer limited relief to treat a reclassification as if it had occurred at an earlier date. The effective date for the amendments is 1 July 2008. An entity can elect to make a reclassification and treat it as if it occurred on 1 July 2008. This relief is available only for reclassifications made in financial periods beginning prior to 1 November 2008; any reclassification of a financial asset made in periods beginning on or after that date takes effect from the date the reclassification is made. Reclassifications of a financial asset cannot be applied retrospectively prior to 1 July 2008.

### **Amendments to IFRS 7**

If an entity reclassifies a financial asset out of the fair value through profit or loss or available for sale categories, then the amended IFRS 7 requires the following to be disclosed:

- In the period in which a reclassification occurs, the amount reclassified into and out of each category.
- For each reporting period until derecognition of the reclassified financial asset, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods.
- If the financial asset was reclassified due to *rare circumstances*, then the facts and circumstances indicating the situation was rare.
- For the reporting period in which 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.

- For the reporting period in which the financial asset was reclassified and each reporting period until the financial asset is derecognised, 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.
- 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.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

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