GUIDELINE ON RECLASSIFICATION OF FINANCIAL ASSETS FROM AVAILABLE-FOR-SALE TO HELD-TO-MATURITY

The issue has arisen as to the requirements of IFRS should an entity that prepares its financial statements in accordance with full IFRS and has not early adopted IFRS 9 – Financial Instruments wish to reclassify financial assets (particularly long term bonds) from the available-for-sale category to the held-to-maturity category.

Held-to-maturity assets are defined (IAS 39.9) as non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity other than:

a) Those that the entity upon initial recognition designates as at fair value through profit or loss;
b) Those that the entity classifies as available-for-sale;
c) Those that meet the definition of loans and receivables.

Held-to-maturity assets are measured at amortised cost using the effective interest method (IAS 39.46).

An entity is not allowed to classify any financial assets as held-to-maturity if it has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (with certain exceptions) (IAS 39.9). In this situation, the held-to-maturity portfolio is referred to as being 'tainted'.

Provided the held-to-maturity portfolio is not tainted, an entity may reclassify assets such as bonds from the available-for-sale category to the held-to-maturity category if there has been a change in intention or ability (IAS 39.54): i.e. the entity now has the positive intention and ability to hold such assets to maturity. This 'positive intention and ability' may be difficult to demonstrate for bonds that have a life of, say, more than 10 years. Entities need to be aware that if they subsequently sell or reclassify more than an insignificant amount of the whole portfolio of held-to-maturity investments before maturity, then the whole of the remaining held-to-maturity portfolio would have to be reclassified as available-for-sale and measured at fair value.

If an entity has changed its intentions and chooses to reclassify bonds from available-for-sale to held-to-maturity, then the fair value of the each bond at the date of such reclassification becomes the new amortised cost of the respective bond. This 'cost' must then be amortised over the remaining life of the bond using the effective interest method. Any gain or loss in fair value previously recognised through 'other comprehensive income' has to be amortised and reclassified to profit or loss over the remaining life of the bond, again using the effective interest method (IAS 39.54).

IFRS 7.12 requires that an entity that has reclassified assets from available-for-sale to held-to-maturity discloses in its financial statements the amount reclassified, and the reason for such reclassification.

Financial assets measurement under IFRS 9 Financial Instruments

For entities that have early adopted IFRS 9 *Financial Instruments* they are required to subsequently measure financial assets at either amortised cost or fair value on the basis of:

a. The business model adopted by the entity in managing its financial assets.
b. The contractual cash flow characteristics of the financial assets.

IFRS 9 further elaborates the following conditions must be met for financial assets to be measured at amortised cost. These are:

a. The asset is held within a business model whose objective is to hold assets so as to collect the contractual cash flows that arise.
b. The contractual terms of the financial assets are such that on specific dates cash flows arise that are solely payments of principal and interest on the principal amounts outstanding.

Under fair value, an entity can irrevocably designate a financial asset as measured at fair value through profit and loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency.

Reclassification of financial assets under IFRS 9

Under IFRS 9, an entity can reclassify as and only when the entity changes its business model for managing its financial assets. However, transfers of financial assets between parts of an entity with different business models are deemed not to be changes in business model (B4.4.3), and the assets cannot, therefore, be reclassified. On reclassification, if permitted, an entity shall apply the reclassification prospectively from the 'reclassification date', which is the first day of the first reporting period following the change in business model (Appendix A of IFRS 9). This being the case, the entity shall not restate any previously recognised gains, losses or interest. Under IFRS 9, if an entity reclassifies a financial asset so that it is now measured at fair value, its fair value shall be determined at the reclassification date. Any gains or losses arising from the reclassification of the financial asset, that is the previous carrying amount and the now fair value, should be recognised in profit or loss. Alternatively, when an entity reclassifies a financial asset that was previously measured at fair value, its fair value at the date of the reclassification shall become its new carrying amount.