Financial Instruments Standards

(Part 1)

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Background

- In response to the input received on its work responding to the financial crisis, and following the conclusions of the G20 leaders and the recommendations of international bodies,
  - the IASB announced an accelerated timetable for replacing IAS 39 in April 2009, and
  - finally, IFRS 9 *Financial Instruments* in Nov. 2009
- HKFRS 9 was issued to maintain international convergence with the issuance of IFRS 9.

Background

- It is intended that HKFRS 9 will ultimately replace HKAS 39 in its entirety.
  - However, in response to requests from interested parties that the accounting for financial instruments should be improved quickly, the project to replace HKAS 39 is divided into three main phases.
- As each phase is completed, as well as its separate project on the derecognition of financial instruments,
  - the relevant portions of HKAS 39 will be deleted and
  - chapters in HKFRS 9 will be created to replace the requirements in HKAS 39.

Background

- The three main phases of the project to replace HKAS 39 are:
  a) Phase 1: Classification and measurement of financial assets and financial liabilities.
  b) Phase 2: Impairment methodology.
  c) Phase 3: Hedge accounting.
- HKFRS 9 issued so far includes only the chapters relating to Phase 1 (classification and measurement of financial assets and financial liabilities).

Additions of Financial Liabilities issued on 25 Nov. 2010 in HK

Structure of HKFRS 9

Chapters

1 Objective
2 Scope
3 Recognition and Derecognition
4 Classification
5 Measurement
6 Hedge Accounting *(not used yet)*
7 Effective Date and Transition

Definitions in HKFRS 9

- The definitions in HKFRS 9 same as those used in HKAS 32 or HKAS 39, including:
  a) amortised cost of a financial asset or financial liability
  b) derivative
  c) effective interest method
  d) equity instrument
  e) fair value
  f) financial asset
  g) financial instrument
  h) financial liability
  i) hedged item
  j) hedging instrument
  k) held for trading
  l) regular way purchase or sale
  m) transaction costs

Background

HKAS 32

- Presentation
  - Liabilities and Equity
  - Compound Financial Instruments
  - Offsetting

HKFRS 7

- Disclosure requirements

HKFRS 9

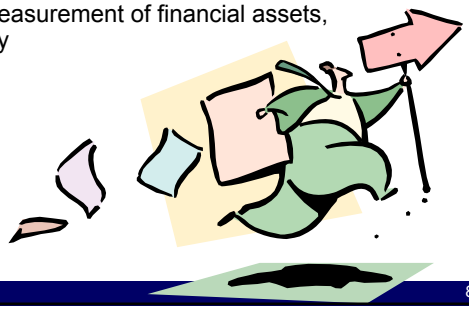
- Classification and measurement

HKAS 39

- Classification of financial instruments
- Recognition and derecognition of financial instruments
- Measurement of financial instruments
- Derivatives and embedded derivatives
- Hedging and hedge accounting

Today's Agenda

Scope	• Extended the scope to all contract to buy and sell of non-financial items that meet the scope.
Initial Recognition	• All financial instruments, including derivatives, are recognised in the balance sheet (on balance sheet).
Classification of Fin. Assets	• Classification of financial assets
Measurement of Fin. Assets	• Subsequent measurement of financial assets, financial liability



Chapter 1 and 2

Objective

- The objective of HKFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows. (para. 1.1)

Scope

- An entity shall apply HKFRS 9 to all assets within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*. (para. 2.1)

Chapter 2 Scope

Example

1. Tony buys a 6-month future contract in oil with a bank over the counter and Tony uses it to hedge with the oil that it would buy in 6 months for his factory.

2. Tony also signs a contract to buy oil from a US oil company and the oil company promises to deliver the oil in 3 months.

Are these two contracts within the scope of HKAS 39?

Chapter 2 Scope

Same as HKAS 39

Contracts to buy or sell a non-financial item can be divided into 2 types:

1. that can be settled
   - net in cash or another financial instrument, or
   - by exchanging financial instruments

Forward contracts
- as if financial instruments
- within scope

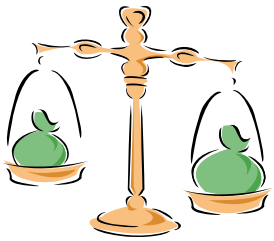
2. that were entered into and continue to be held
   - for the purpose of the receipt or delivery of a non-financial item
   - in accordance with the entity's expected purchase, sale or usage requirements

Usual executory contracts
- **NOT** within scope

Chapter 2 Scope

Same as HKAS 39

A **financial instrument** is any contract that gives rise to
1. a **financial asset** of one entity, and
2. a **financial liability** or **equity instrument** of another equity



Financial instrument → **Financial asset** → **of one entity**

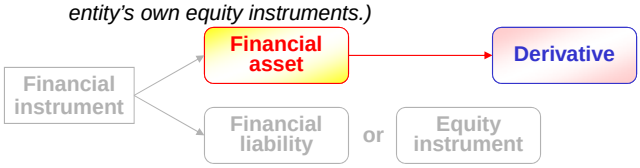
Financial instrument → **Financial liability** or **Equity instrument** → **of another entity**

Chapter 2 Scope

Same as HKAS 39

Financial asset is any asset that is:

- Cash
- An equity instrument of another entity
- A contractual right
  - i) to receive cash or another financial asset from another entity
  - ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity
- A contract that will or may settled in the entity's own equity instruments and is
  - i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. *(For this purpose, the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.)*

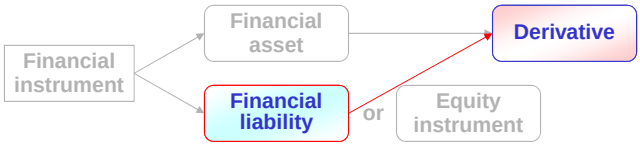


Chapter 2 Scope

Same as HKAS 39

Financial liability is any liability that is

- A contractual right
  - i) to deliver cash or another financial asset from another entity
  - ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity
- A contract that will or may settled in the entity's own equity instruments and is
  - i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. *(For this purpose, the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.)*



Chapter 2 Scope

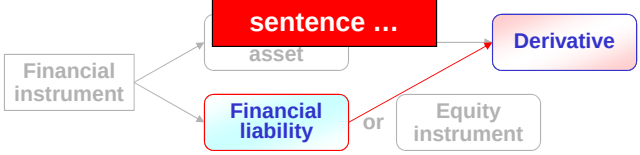
Same as HKAS 39

Financial liability is any liability that is

- A contract that will or may be settled in the entity's own equity instruments and is:
  i. a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also for these purposes the entity's own equity instruments .....

include instruments that themselves contracts for the future receipt or delivery of the entity's own equity

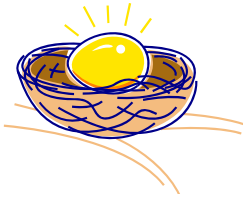
Add a new sentence …

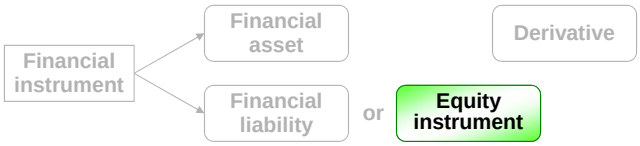


Chapter 2 Scope

Same as HKAS 39

Equity instruments ⇒ is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities





Chapter 2 Scope

Example

Gold Bullion

- Is gold bullion a financial instrument (like cash) or is it a commodity?

It is a commodity.

- Bullion is highly liquid
- But there is no contractual right to receive cash or another financial asset inherent in bullion.

Financial instrument → Financial asset / Financial liability

Derivative

Financial liability or Equity instrument

Today's Agenda

Initial Recognition

- All financial instruments, including derivatives, are recognised in the balance sheet (on balance sheet).

Chapter 3.1 Initial Recognition

- An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when,
  - the entity becomes party to the contractual provisions of the instrument.

Same as before

- When an entity first recognises a financial asset, it shall
  - **classify** it in accordance with paragraphs 4.1.1-4.1.5 and
  - **measure** it in accordance with paragraph 5.1.1 and 5.1.2.

Amended (Ch. 4 of HKFRS 9)

Amended (Ch. 5 of HKFRS 9)

- When an entity first recognises a financial liability, it shall
  - **classify** it in accordance with paragraphs 4.2.1 and 4.2.2 and
  - **measure** it in accordance with paragraph 5.1.1. (para. 3.1.1)

Similar to HKAS 39

Same para. as financial assets

Chapter 3.1 Initial Recognition

Same as HKAS 39

- A regular way purchase or sale of a financial asset
  - shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting (see para. B3.1.3–B3.1.6). (para. 3.1.2)

Same as before

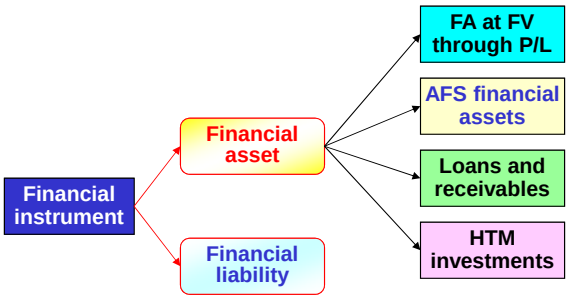
Today's Agenda

Classification

- Classification of financial assets, financial liability and equity

Classification under HK

Based on original HKAS 39



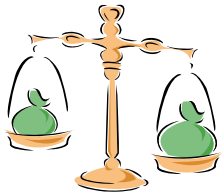
1. Financial assets at fair value through profit or loss
2. Available-for-sale financial assets
3. Loans and receivables
4. Held-to-maturity investments

- Initial recognition and measurement principle for financial assets and financial liabilities are the same
- But, HKAS 39 further defines financial asset into 4 categories for subsequent measurement (financial liability to be discussed later)

The 4-category classification will <u>affect the subsequent measurement</u> of financial assets, but <u>not the initial measurement</u>.

Classification under HK

Based on original HKAS 39



The categories named in HKAS 39

- For the purpose of our discussion, five categories are used and explained for subsequent measurement of financial assets
  - Financial assets at fair value through profit or loss
  - Available-for-sale financial assets
  - Investments in equity instruments without fair value
  - Loans and receivables
  - Held-to-maturity investments

FA at FV through P/L

AFS financial assets

Loans and receivables

HTM investments

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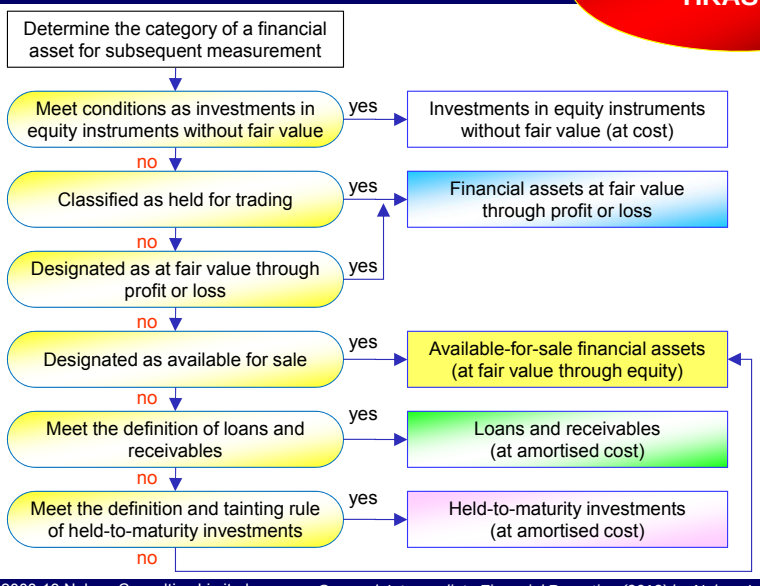
Classification under HK

Based on original HKAS 39



FA at FV through P/L

AFS financial assets

Loans and receivables

HTM investments

Sourced: Intermediate Financial Reporting (2012) by Nelson Lam and Peter Lau 24

Chapter 4.1 Classification of FA

- Unless para. 4.1.5 of HKFRS 9 (so-called "fair value option") applies, an entity shall classify financial assets as subsequently measured at either
  - **amortised cost** or
  - **fair value**

  on the basis of both:

  a) the entity's **business model** for managing the financial assets; and

  b) the **contractual cash flow characteristics** of the financial asset. (para. 4.1.1)

Amortised cost | **Fair value**

Chapter 4.1 Classification of FA

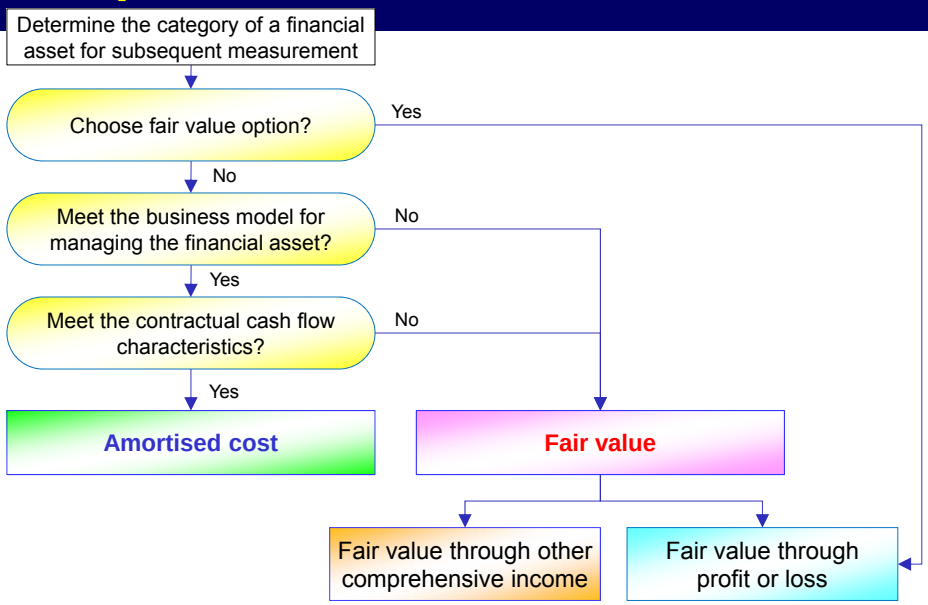
- Even the common understanding views that there are two categories in HKFRS 9 for the classification and subsequent measurement of a financial asset, a financial asset can be classified into the following four categories or sub-categories:
  1. Designated as at fair value through profit or loss; and
  2. Classified as at:
     a. Amortised cost;
     b. Fair value through profit or loss; and
     c. Fair value through other comprehensive income.

Amortised cost

Fair value
- Fair value through other comprehensive income
- Fair value through profit or loss

Sourced: Intermediate Financial Reporting (2012) by Nelson Lam and Peter Lau

Chapter 4.1 Classification of FA



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Chapter 4.1 Classification of FA

Case

香港交易所 HKEx

Financial statements 2009 states that:

- In the fourth quarter of 2009, the Group early adopted all new/revised HKFRSs issued up to 31 December 2009 which were pertinent to its operations where early adoption is permitted.
- The applicable HKFRSs are set out below:
  - HKFRS 9: Financial Instruments ……
- HKFRS 9 is the first part of a project to replace HKAS 39: *Financial Instruments: Recognition and Measurement*, and it replaces the classification and measurement requirements in HKAS 39 for financial assets.

Amortised cost | **Fair value**

Chapter 4.1 Classification of FA

Case

Financial statements 2009 states that:

- Previously, financial assets of the Group were classified as financial assets at
  - fair value through profit or loss,
  - available-for-sale financial assets or
  - loans and receivables (which included bank deposits) ……
- The early adoption of HKFRS 9 has resulted in a change in accounting policy, and financial assets are classified into
  - financial assets measured at fair value through profit or loss or
  - financial assets measured at amortised cost.

Amortised cost

Fair value → Fair value through profit or loss

Chapter 4.1 Classification of FA

Determine the category of a financial asset for subsequent measurement

Choose fair value option?

To eliminate or significantly reduce an accounting mismatch

Yes

- Despite para. 4.1.1-4.1.4, an entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss
  - if doing so eliminates or significantly reduces a measurement or recognition inconsistency (i.e. an "accounting mismatch"). (para. 4.1.5)

Fair value → Fair value through profit or loss

- This option
  - is termed as "fair value option" and
  - is an accounting policy choice.

Sourced: Intermediate Financial Reporting (2012) by Nelson Lam and Peter Lau

Chapter 4.1 Classification of FA

Determine the category of a financial asset for subsequent measurement

Choose fair value option?

No

Meet the business model for managing the financial asset?

Yes

Meet the contractual cash flow characteristics?

Yes

Amortised cost

- A financial asset shall be measured at **amortised cost** if both of the following conditions are met:
  a. the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.
  b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. (para. 4.1.2)

Chapter 4.1 Classification of FA

Determine the category of a financial asset for subsequent measurement

Choose fair value option?

No

Meet the business model for managing the financial asset?

Yes

Meet the contractual cash flow characteristics?

Yes

Amortised cost

- Determined by key management personnel
- Not instrument-by-instrument basis
- No held for trading

- An asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows

- Contractual terms of an asset give rise on specified dates to cash flows that are solely payments of principal and interest

- Interest for the time value of money and the credit risk
- Unleveraged

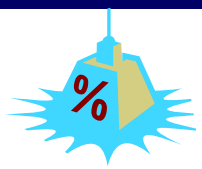
Chapter 4.1 Classification of FA

- Assesses the basis of the objective of the business model as determined by the entity's key management personnel (as defined in HKAS 24 *Related Party Disclosures*). (para. B4.1.1)

Meet the business model for managing the financial asset?

- The entity's business model does not depend on management's intentions for an individual instrument.
  - Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation.
  - However, a single entity may have more than one business model for managing its financial instruments.
  - Therefore, classification need not be determined at the reporting entity level. (para. B4.1.2)

Chapter 4.1 Classification of FA



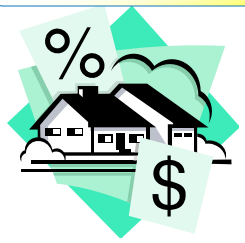
Meet the business model for managing the financial asset?

- Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows,
  - the entity need not hold all of those instruments until maturity.
    - Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur.
- However, if more than an infrequent number of sales are made out of a portfolio,
  - the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. (para. B4.1.3)

Chapter 4.1 Classification of FA

Meet the business model for managing the financial asset?

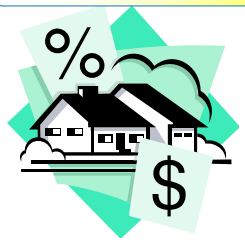
Meet the contractual cash flow characteristics?



- Interest is consideration
  - for the time value of money and
  - for the credit risk associated with the principal amount outstanding during a particular period of time. (para. 4.1.3)
- Contractual cash flows are assessed on the currency in which the financial asset is denominated. (para. B4.1.8)

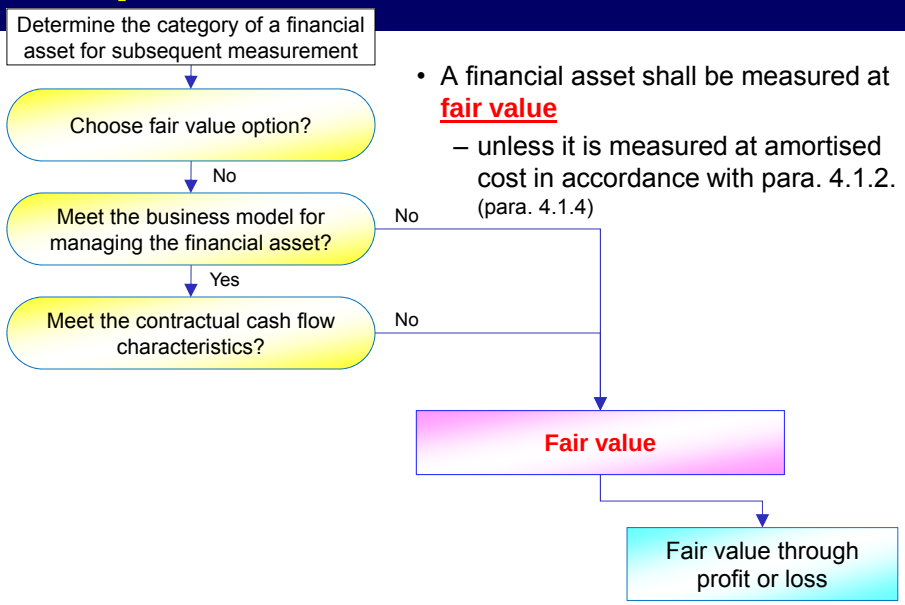
Chapter 4.1 Classification of FA

Meet the contractual cash flow characteristics?



- Financial assets including leverage do not meet this condition and cannot be subsequently measured at amortised cost.
  - Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest.
  - Stand-alone option, forward and swap contracts are examples of financial assets that include leverage. (para. B4.1.9)

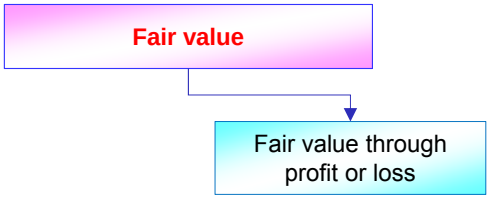
Chapter 4.1 Classification of FA



- A financial asset shall be measured at **fair value**
  - unless it is measured at amortised cost in accordance with para. 4.1.2. (para. 4.1.4)

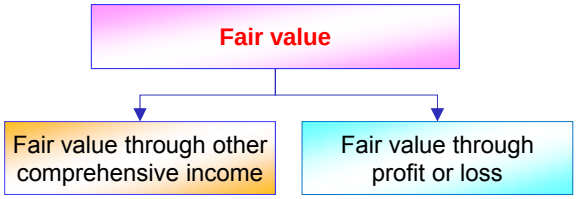
Chapter 4.1 Classification of FA

- The category of financial assets at fair value through profit or loss is composed of at least three groups of financial assets and they are:
  1. Financial assets designated at fair value through profit or loss by an entity;
  2. Financial assets measured at fair value but unable to be measured through other comprehensive income; and
  3. Financial assets held for trading, including derivatives.



Chapter 4.1 Classification of FA

- An entity is required to measure all financial assets at fair value through profit or loss
  - unless a financial asset meets the following conditions:
    1. The financial asset is an investment in an equity instrument; and
    2. The entity has made an irrevocable election to present gains and losses on that investment in other comprehensive income. (para. 5.7.1)
       - At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of HKFRS 9 that is not held for trading (to be discussed more later).



Chapter 4.1 Classification of FA

Case

Financial statements 2009 states that:

- Following the adoption of HKFRS 9, investments and other financial assets of the Group extant at 31 December 2009 are classified under the following categories:

  Financial assets measured at amortised cost

  Investments are classified under this category if they satisfy both of the following conditions:

  - the assets are held within a business model whose objective is to hold assets in order to collect contractual cash flows for managing liquidity and generating income on its investment, but not for the purpose of realising fair value gains; and
  - the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, with interest being the consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and are unleveraged.

  Bank deposits, trade and accounts receivable and other deposits are also classified under this category.

Chapter 4.1 Classification of FA

Case

Financial statements 2009 states that:

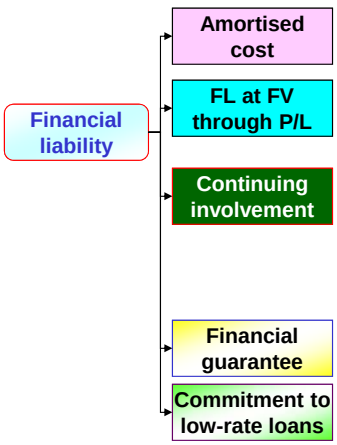
Financial assets measured at fair value through profit or loss

Investments and other financial assets are classified under this category if they do not meet the conditions to be measured at amortised cost.

Securities or bank deposits with embedded derivatives are classified in their entirety as measured at fair value through profit or loss, where the economic characteristics and risks of the embedded derivatives are dissimilar to those of the host contracts and modify the contractual cash flows, such that they are not solely payments of principal and interest on the principal amount outstanding or the interest rate does not reflect only consideration for the time value of money and credit risk.

Chapter 4.2 Classificati

Same as HKAS 39



- An entity shall classify all financial liabilities as subsequently measured at amortised cost using the effective interest method, except for:
  a. financial liabilities at fair value through profit or loss.
  b. financial liabilities that arise
     - when a transfer of a financial asset does not qualify for derecognition or
     - when the continuing involvement approach applies.
  c. financial guarantee contracts.
  d. commitments to provide a loan at a below-market interest rate.
  (para. 4.2.1)

Chapter 4.2 Classification of FI

Same as HKAS 39

- An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through P/L
  - when permitted by para 4.3.5 (i.e. embedded derivative), or
  - when doing so results in more relevant information, because either
    a. it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
    b. a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in HKAS 24), e.g. directors and CEO. (para. 4.2.2)

Embedded Derivative Condition

Eliminates Inconsistency

Managed on Fair Value Basis

Chapter 4.3 Embeded Derivatives

Same as HKAS 39

- A hybrid instrument includes
  - a non-derivative host contract and
  - an embedded derivative with the effect that some of the cash flows of the hybrid instrument vary in a way similar to a stand-alone derivative.
- However, a derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument. (para 4.3.1)

Hybrid (Combined) Contract

Host Contract

Embedded Derivative

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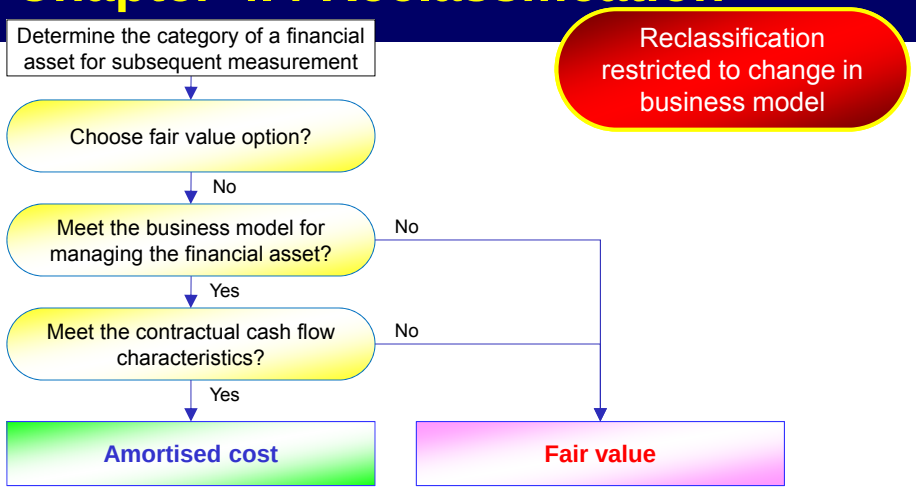
Chapter 4.4 Reclassification



- When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets in accordance with para. 4.1.1–4.1.4. (para. 4.4.1)

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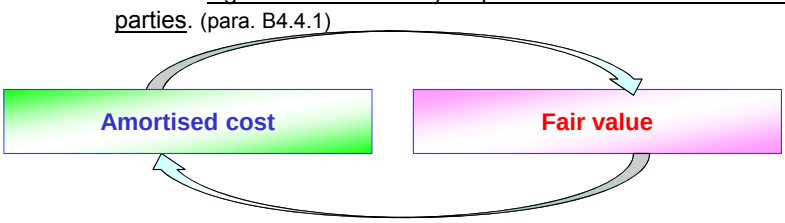
Chapter 4.4 Reclassification

- HKFRS 9 requires an entity to reclassify financial assets if the objective of the entity's business model for managing those financial assets changes.
  - Such changes are expected to be very infrequent.
  - Such changes
    - must be determined by the entity's senior management as a result of external or internal changes and
    - must be significant to the entity's operations and demonstrable to external parties. (para. B4.4.1)



Chapter 4.4 Reclassification

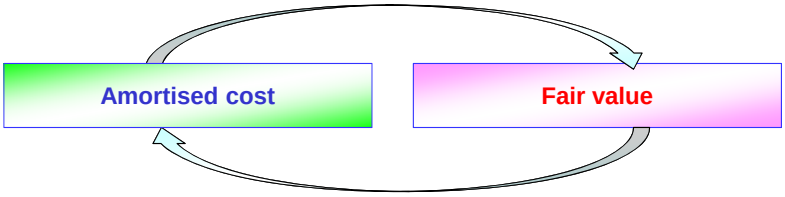
Example

- Examples of a change in business model include the following:
  a. An entity has a portfolio of commercial loans that it holds to sell in the short term.
     - The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows.
     - The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.
  b. A financial services firm decides to shut down its retail mortgage business.
     - That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale. (para. B4.4.1)

Chapter 4.4 Reclassification

Example

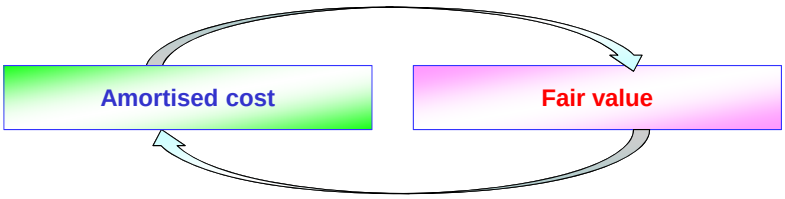
- The following are <u>not changes in business model</u>:
  a. <u>a change in intention</u> related to particular financial assets (even in circumstances of significant changes in market conditions).
  b. a <u>temporary disappearance of a particular market</u> for financial assets.
  c. a <u>transfer of financial assets between parts of the entity with different business models</u>. (para. B4.4.3)



Chapter 4.4 Reclassification

Reclassification of Financial Assets

- A change in the objective of the entity's business model must be effected before the reclassification date. (para. B4.4.2)
  - Reclassification date is defined as:
    - The first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets.



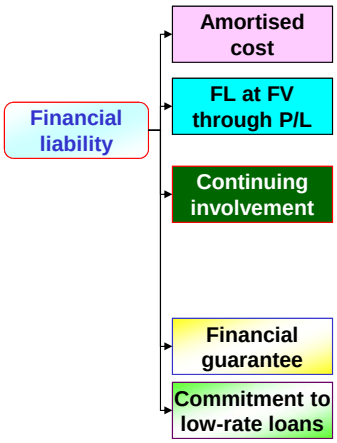
Chapter 4.4 Reclassification

Example

- If a financial services firm decides on 15 February to shut down its retail mortgage business and it has a reporting period ended on 31 March, what is the reclassification date?

- If a financial services firm decides on 15 February to shut down its retail mortgage business
  - The must reclassify all affected financial assets on 1 April (i.e. the first day of the entity's next reporting period),
  - The entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former business model after 15 February. (para. B4.4.2)

Chapter 4.4 Reclassification



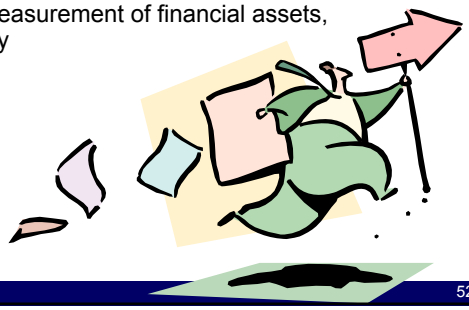
- An entity shall not reclassify any financial liability. (para. 4.4.2)
- The following changes in circumstances are not reclassifications for the purposes of para. 4.4.1 and 4.4.2:
  a) A derivative that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such.
  b) A derivative becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge. (para. 4.4.3)

Sourced: Intermediate Financial Reporting (2012) by Nelson Lam and Peter Lau

Today's Agenda

Measurement

- Subsequent measurement of financial assets, financial liability



Chapter 5.1 Initial Measurement

Same as HKAS 39

Initial measurement (same as HKAS 39)

- At initial recognition, an entity shall measure a financial asset or financial liabilities at
  - its fair value plus or minus,
  - in the case of a financial asset or financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. (para. 5.1.1)

Initial Measurement

Fair Value

+

Transaction Cost

- When an entity uses settlement date accounting for an asset that is subsequently measured at amortised cost,
  - the asset is recognised initially at its fair value on the trade date (see para. B3.1.3–B3.1.6). (para. 5.1.2)

Chapter 5.1 Initial Measurement

Same as HKAS 39

- The fair value of a financial asset at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received, see also B5.4.8).
- However, if part of the consideration given or received is for something other than the financial instrument,
  - the fair value of the financial instrument is estimated using a valuation technique (see B5.4.6-5.4.12). (para. B5.1.1)

Chapter 5.1 Initial Measurement

Example

- How can the fair value of a long-term loan or receivable that carries no interest be estimated?

- The fair value of a long-term loan or receivable that carries no interest
  - can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.
  - Any additional amount lent is an expense or a reduction of income
    - unless it qualifies for recognition as some other type of asset. (para. B5.1.1)

Chapter 5.1 Initial Measurement

Example

- If an entity originates a loan that bears an off-market interest rate (e.g. 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation,
  - ➢ the entity recognises the loan at its fair value, i.e. net of the fee it receives. (para. B5.1.2)

Chapter 5.1 Initial Measurement

Same as HKAS 39

- In the case of a financial asset or financial liability that will be classified as financial asset or financial liability at fair value through profit or loss,
  - an entity is only required to measure it at its fair value only
  - its transaction costs should not be recognised. (para. 5.1.1)

Chapter 5.1 Initial Measurement

Same as HKAS 39

- Fair value
  - is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- Transaction costs
  - are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.
  - An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Chapter 5.1 Initial Measurement

Example

Fair value at Initial Recognition – Low Interest Loan

- Entity A grants a 3-year loan of $50,000 to a related party, B, on 1 Jan. 2005 as one kind of financial assistance to support B's operation.
  - A charges B at a interest rate of 2% as A expects the return on B's future operation would be higher.
  - A charges another related party at a current market lending rate of 6%
- Discuss the implication of the loan.

Fair value at Initial Recognition – No Interest Deposit

- Entity X is required to deposit $50,000 to a customer in order to guarantee that it would complete the service contract in 5 years' time.
- When the contract completes (say after 5 years), the deposit would be refunded in full without any interest.

Chapter 5.1 Initial Measurement

Same as HKAS 39

HKFRS 9 para. B5.1.1

- The fair value of a financial instrument on initial recognition is normally the **transaction price** (i.e. the fair value of the consideration given or received).
- However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique.
  - For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as
    - the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.
  - Any additional amount lent is an expense or a reduction of income
    - unless it qualifies for recognition as some other type of asset.

Chapter 5.1 Initial Measurement

Example

- Advance Finance Inc. grants a 3-year loan of $50,000 to a new customer on 1 January 2008.
- Advance Finance Inc. charges the interest at 4% per annum as it expects to generate more new business from this new customer.
- The current market lending rate of a similar loan is 6% per annum.
- Discuss the implication of the loan.

Chapter 5.1 Initial Measurement

Example

- On initial recognition, Advance Finance Inc. should recognise the loan receivable at the fair value.
- Even the best evidence of the fair value of the loan at initial recognition is the transaction price but part of the consideration given is for something other than the loan, the fair value of the loan should be estimated using a valuation technique.
- The fair value of the loan receivable can be estimated as the present value of all future cash receipts discounted using the prevailing market interest rate for a similar instrument.
- By using the market interest rate of 6% for a similar loan, Advance Finance Inc. derives the present value of the interests and principal repayments as follows:

	Cash inflow	Discount factor	Present value
2008	$ 2,000	$1 \div (1+6\%)^1$	$ 1,887
2009	2,000	$1 \div (1+6\%)^2$	1,780
2010	2,000	$1 \div (1+6\%)^3$	1,679
2010	50,000	$1 \div (1+6\%)^3$	41,981
Present value of all future cash receipts			47,327

Chapter 5.1 Initial Measurement

Example

- Discounting the interest and principal repayments using the market rate of 6%, Advance Finance Inc. will recognise an originated loan of $47,327. The difference of $2,673 between $50,000 and $47,327 may represent the value of future business with the customer. However, it does not qualify for recognition as an asset and should be expensed immediately. Advance Finance Inc. recognises the loan receivable as follows:

Dr	Financial asset	$47,327	
	Profit or loss	2,673	
Cr	Cash		$50,000

Subsequent Measurem

Based on original HKAS 39

- At initial recognition,
  - Financial asset is normally using trade date accounting at fair value plus transaction cost, except for financial asset at fair value through profit or loss.
  - Financial asset at fair value through profit or loss is initially recognised at fair value only.
- After initial recognition, an entity is required to measure financial assets, including derivatives that are assets, at their fair values, except for the following financial assets:
  - Investments in equity instruments without fair value
  - Loans and receivables
  - Held-to-maturity investments

at fair value

at cost

at amortised cost

at amortised cost

Chapter 5.2 Subsequent Measurement

Subsequent Measurement of Financial Assets

- After initial recognition, an entity shall measure financial assets in accordance with para. 4.1.1 -4.1.5 (as discussed above) at
  - **fair value** or
  - **amortised cost**. (para. 5.2.1)
- An entity shall apply the impairment requirements of HKAS 39 to all financial assets measured at amortised cost. (para. 5.2.2)
  - ➢ No impairment requirements on financial assets measured at fair value
- An entity shall apply the hedge accounting requirements of HKAS 39 to a financial asset that is designated as a hedged item. (para. 5.2.3)

Amortised cost | **Fair value**

Chapter 5.2 Subsequent Measurement

Same as HKAS 39

- **Amortised cost** of a financial instrument is:
  - the amount at which the financial instrument is measured at initial recognition
  - minus principal repayments,
  - plus or minus the cumulative amortisation using **the effective interest method** of any difference between that initial amount and the maturity amount, and
  - minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Chapter 5.2 Subsequent Measurement

Same as HKAS 39

- An entity is required to use the effective interest method and effective interest rate to subsequently measure loans and receivables and held-to-maturity investments at amortised cost.
  - The effective interest method is a method:
    - of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and
    - of allocating the interest income or interest expense over the relevant period.
  - The effective interest rate is the rate that exactly discounts
    - estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period
    - to the net carrying amount of the financial asset or financial liability.

Loans and receivables

HTM investments

Chapter 5.2 Subsequent Measurement

Example

- On 2 January 2007, Knut Investments Limited purchased a new 5-year debt instrument at its fair value plus transaction costs at $8,000.
- The principal amount of the instrument was $10,000 and the instrument carried fixed interest of 4.75% that would be paid annually.
- The issuer of the instrument had an option to prepay the instrument and that no penalty would be charged for prepayment.
- At inception, Knut expected the issuer not to exercise this option and there is no incurred credit loss.
- Explain and calculate the effective interest rate of the 5-year debt instrument for Knut.

Sourced: Intermediate Financial Reporting (2012) by Nelson Lam and Peter Lau

Chapter 5.2 Subsequent Measurement

Example

- The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the instrument to the net carrying amount of the instrument.
- In Knut's case, the estimated future cash receipts are the annual interest receipts ($10,000 × 4.75% = $475 per year) and the final principal receipts ($10,000) and the expected life of the instrument is 5 years, the effective interest rate can be found by using the following equation:

$$\$8{,}000 = \frac{\$475}{(1+r)^1} + \frac{\$475}{(1+r)^2} + \frac{\$475}{(1+r)^3} + \frac{\$475}{(1+r)^4} + \frac{\$475 + \$10{,}000}{(1+r)^5}$$

- The effective interest rate, *r*, should be 10.03%. In other words, in order to allocate interest receipts ($475) and the initial discount ($10,000 – $8,000 = $2,000) over the term of the debt instrument at a constant rate on the carrying amount, the effective interest must be accrued at the rate of 10.03% annually.

Chapter 5.2 Subsequent Measurement

Example

- Based on the previous example, Knut Investments Limited purchases a new 5-year debt instrument at its fair value plus transaction costs at $8,000 on 2 January 2007.
- The principal amount of the instrument is $10,000 and the instrument carried fixed interest of 4.75% that is paid annually.
- The effective interest rate as estimated is 10.03%.
- Explain and calculate the amortised cost and interest income of the 5-year debt instrument for Knut in each reporting period.

Chapter 5.2 Subsequent Measurement

Example

- While the initial amount of the 5-year debt instrument is $8,000 and its principal (or maturity amount) is $10,000, Knut has purchased the instrument at a discount.
- Since the effective interest is accrued at 10.03% annually, the interest income for 2007 will be $802 ($8,000 × 10.03%) and the amortisation of the discount will be $327 ($802 – $ 475).
- In consequence, the amortised cost of the 5-year debt instrument at the end of 2007 will be:

The amount at which financial asset is measured at initial recognition	$8,000
– Minus principal repayments	0
– Plus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount	327
– Minus any reduction for impairment or uncollectibility	0
Amortised cost at the end of 2007	*$8,327*

Chapter 5.2 Subsequent Measurement

Example

- The amortised cost, interest income and cash flows of the debt instrument in each reporting period can be summarised as follows:

Year	Amortised cost at the beginning of the year	Interest income	Cash inflows	Amortised cost at the end of the year
2007	$ 8,000	$ 802	$ 475	$ 8,327
2008	8,327	836	475	8,688
2009	8,688	871	475	9,084
2010	9,084	911	475	9,520
2011	9,520	955	10,475	0

- For example, in 2007, the following journal entries should be recognised by Knut:

Dr	Loans and receivables	$8,000	
Cr	Cash		$8,000

Being the initial recognition of the 5-year debt instrument.

Chapter 5.2 Subsequent Measurement

Example

Dr	Loans and receivables	$802	
Cr	Profit or loss		$802

To recognise the interest income using the effective interest rate.

Dr	Cash	$475	
Cr	Loans and receivables		$475

Being the cash received from the 5-year debt instrument at the end of 2007.

- The last two journal entries above may be combined and recognised as follows:

Dr	Loans and receivables	$327	
	Cash	$475	
Cr	Profit or loss		$802

To recognise the interest income using the effective interest rate and the cash received from the 5-year debt instrument at the end of 2007.

Sourced: Intermediate Financial Reporting (2012) by Nelson Lam and Peter Lau

Chapter 5.2 Impairment

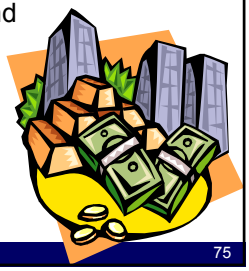
Same as HKAS 39

- Before HKAS 39 (and now HKFRS 9),
  - there was no HKAS or HKFRS to mandate an assessment of the impairment or the collectability of financial assets.
- Even nearly all entities would assess the recoverability of financial assets, in particular trade or other receivables, and make different amounts of bad debt, provision for bad debt or provision for doubtful debt,
  - there were no consistent practices.

Chapter 5.2 Impairment

Same as HKAS 39

- HKAS 39 (and now HKFRS 9) introduces the compulsory and consistent requirements in assessing the impairment and collectability of financial assets and requires that all financial assets, except for those financial assets measured at fair value through profit or loss, are subject to review for impairment.
- In accordance with the HKAS 39 (and now HKFRS 9), an entity is required to adopt the following two-step approach in recognising the impairment loss:
  - Assessment of objective evidence of impairment, and
  - Measurement and recognition of impairment loss.



Chapter 5.2 Impairment

Same as HKAS 39

- HKAS 39 provides specific guidance in assessing the objective evidence of their impairment and in measuring and recognising the impairment loss.
  - The process for estimating impairment considers all credit exposures, not only those of low credit quality;
  - The process in assessing the objective evidence and the process in measuring the impairment loss are illustrated separately below, they can be performed simultaneously.

Chapter 5.2 Impairment

Same as HKAS 39

- **Two-Stage Assessment of Objective Evidence**
  - Before an impairment loss is measured and recognised, an entity is required to assess whether objective evidence of impairment exists for those financial assets measured at amortised cost using a two-stage assessment approach as follows:
    1. **First stage (individual assessment)** – an entity is required to firstly assesses whether objective evidence of impairment exists
       - individually for the financial assets that are individually significant, and
       - individually or collectively for the financial assets that are not individually significant.
    2. **Second stage (collective assessment)** – If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Chapter 5.2 Impairment

Case

Ping An Insurance (Group) Co. of China, Ltd.

- Accounting report 2006

  Impairment of financial assets
  - The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired ……
  - The Group first assesses whether objective evidence of impairment exists
    - individually for financial assets that are individually significant, and
    - individually or collectively for financial assets that are not individually significant.

    Individual Assessment
  - If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not,
    - the asset is included in a group of financial assets with similar credit risk characteristics and
    - that group of financial assets is collectively assessed for impairment.

    Collective Assessment
  - Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized
    - are not included in a collective assessment of impairment.
  - The impairment assessment is performed at each balance sheet date.

Chapter 5.2 Impairment

Same as HKAS 39

- If there is objective evidence that financial assets measured at amortised cost has been incurred, the amount of the impairment loss is measured as the difference between
  - the asset's carrying amount and
  - the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition).

Chapter 5.2 Impairment

Same as HKAS 39

- The amount of the impairment loss is recognised in profit or loss while the carrying amount of the impaired asset is reduced either:
  - directly in the asset or
  - through use of an allowance account.

Chapter 5.2 Impairment

Example

Amortised Cost on Low Interest Loan

- Entity A grants a 3-year loan of $50,000 to an important new customer in 1 Jan. 2005
  - The interest rate on the loan is 4%
  - The current market lending rates for similar loans is 6%
- On initial recognition, Entity A recognised $47,327 and at 31 Dec. 2005, the amortised cost was $ 48,167. The repayment schedule is:

	Balance b/f	Effective interest (6%)	Interest received (4%)	Balance c/f
31.12.2005	$ 47,327	$ 2,840	($ 2,000)	$ 48,167
31.12.2006	$ 48,167	$ 2,890	($ 2,000)	$ 49,057
31.12.2007	$ 49,057	$ 2,943	($ 2,000)	$ 50,000

- At 2 Jan. 2006, Entity A agreed a loan restructure with the customer and waived all the interest payments in 2006 and 2007.

Chapter 5.2 Impairment

Example

	Cash to be received as estimated at 2.1.2006	Discount factor	Present value
31.12.2006	$ 0	$1 / (1 + 6\%)^1$	$ 0
31.12.2007	$ 50,000	$1 / (1 + 6\%)^2$	$ 44,500

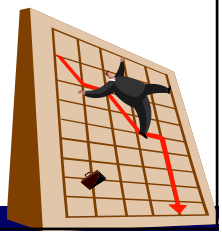
Carrying amount (per the balance as at 31.12.2006)	$ 48,167
Present Value of estimated future cash flows discounted at original effective interest rate as at 2.1.2006	44,500
Impairment loss	$ 3,667

Dr	Impairment loss (in income statement)	$3,667	
Cr	Allowance on impairment loss (alternatively, Loans and receivables)		$3,667

Chapter 5.2 Impairment

Same as HKAS 39

- An entity is required to reverse the previously recognised impairment loss either directly or by adjusting an allowance account if, in a subsequent period, the following two conditions are met:
  - the amount of the impairment loss decreases and
  - the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating).
- The amount of the reversal is recognised in profit or loss but it must not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed.



Chapter 5.2 Impairment

Example

Impairment at Initial Recognition

- Entity A lends $2,000 to Customer B
- Based on past experience, Entity A expects that 1% of the principal amount of loans given will not be collectable.
- Can Entity A recognise an immediate impairment loss of $20?

No.

- HKAS 39 requires financial asset to be initially measured at fair value.
- For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or privileges).
- In addition, HKAS 39 further requires that an impairment loss is recognised only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition.
- Thus, it is inconsistent with HKAS 39 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.

Chapter 5.2 Impairment

Example

Impairment Based on Ageing Analysis

- Entity A calculates impairment in the unsecured portion of loans and receivables on the basis of a provision matrix
  - that specifies fixed provision rates for the number of days a loan has been classified as non-performing as follows:
    - 0% if less than 90 days
    - 20% if 90-180 days
    - 50% if 181-365 days, and
    - 100% if more than 365 days
- Can the results be considered to be appropriate for the purpose of calculating the impairment loss on loans and receivables?

Not necessarily.

- HKAS 39 requires impairment or bad debt losses to be calculated as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial instrument's original effective interest rate.

Chapter 5.2 Impairment (for FV)

For Financial Assets Measured at Fair Value

- No impairment requirements under HKFRS 9

Chapter 5.3 Subsequent Measurement

Same as HKAS 39

Financial liability
- Amortised cost
- FL at FV through P/L
- Continuing involvement
- Financial guarantee
- Commitment to low-rate loans

Subsequent Measurement of Financial Liabilities

- After initial recognition, an entity shall measure a financial liability in accordance with para. 4.2.1–4.2.2.
- An entity shall apply the hedge accounting requirements of HKAS 39 to a financial liability that is designated as a hedged item. (para. 5.3.2)

Chapter 5.3 Subsequent Measurement

Same as HKAS 39

Financial liability
- Amortised cost: Subsequently measured at amortised cost using the effective interest method
- FL at FV through P/L: Incl. derivatives that are liabilities, shall be subsequently measured at fair value.
- Continuing involvement: Derecognition approach (para. 3.2.15 and 3.2.17)
- Financial guarantee / Commitment to low-rate loans: Subsequently measured at the higher of:
  i) the amount determined in accordance with HKAS 37 and
  ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18.

Chapter 5.3 Subsequent Measurement

Same as HKAS 39

Amortised cost

- Amortised cost
  - As those discussed in financial assets

FL at FV through P/L

- Financial liabilities at fair value through profit or loss
- Similar to financial asset at fair value through profit or loss
  - Those held for trading — Entity has NO choice
    - Acquired principally for selling in the near term
    - Recent actual short-term profit taking
    - Derivatives that are liabilities (except for hedging instruments)
  - Those designated (if allowed) — Entity has a choice
- Excluded those unquoted and fair value cannot be reliably measured
- If a financial instrument that was previously recognised as a financial asset is measured at fair value and its fair value falls below zero, it is a financial liability

Continuing involvement

- Financial liabilities that arise when
  - a transfer of a financial asset **does not qualify for derecognition**, or
  - when the **Continuing Involvement Approach** applies

Chapter 5.3 Subsequent Measurement

Same as HKAS 39

FL at FV through P/L

- Financial liabilities held for trading include:
  a) derivative liabilities that are not accounted for as hedging instruments;
  b) obligations to deliver financial assets borrowed by a short seller (i.e. an entity that sells financial assets it has borrowed and does not yet own);
  c) financial liabilities that are incurred with an intention to repurchase them in the near term (e.g. a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and
  d) financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.
- The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Chapter 5.3 Subsequent Measurement

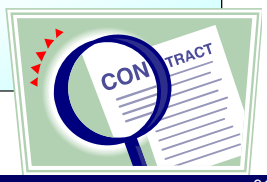
Same as HKAS 39

Financial guarantee

Commitment to low-rate loans

- Financial guarantee contract is a contract that:
  - requires the issuer to make specified payments to reimburse the holder for a loss it incurs
  - because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

- Financial guarantee contracts may have various legal forms, such as
  - a guarantee
  - some types of letter of credit
  - a credit default contract or
  - an insurance contract



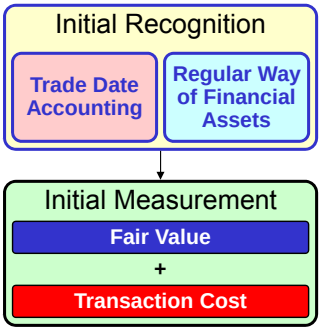
Chapter 5.3 Subsequent Measurement

Same as HKAS 39

Financial guarantee

Commitment to low-rate loans

- Financial guarantee contracts and commitment to provide a loan at a below-market interest rate
  - are within the scope of HKFRS 9.
- In consequence, the issuer shall initially recognise and measure it as other financial assets and liabilities and at
  - its fair value
  - plus transaction costs (unless classified as fair value through profit or loss)



- If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction,
  - its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary.

Chapter 5.3 Subsequent Measurement

Same as HKAS 39

Financial guarantee

Commitment to low-rate loans

After initial recognition,

- An issuer of such contract and such guarantee shall measure it at the higher of:
  - i) the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
  - ii) the amount initially recognised *less*, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

Chapter 5.3 Subsequent Measurement

Same as HKAS 39

Financial guarantee

Asserted Explicitly

Used Insurance Accounting

- However, for financial guarantee contracts alone, such contracts may be excluded from the scope of HKAS 39
- HKAS 39.2e states that:

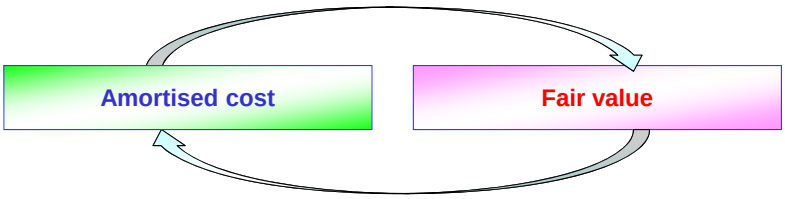
  "if an issuer of financial guarantee contracts
  - has previously asserted explicitly that it regards such contracts as insurance contracts and
  - has used accounting applicable to insurance contracts,
    - the issuer may elect to apply either
      - HKAS 39 or
      - HKFRS 4

      to such financial guarantee contracts (see paragraphs AG4 and AG4A).

  The issuer may make that election contract by contract, but the election for each contract is irrevocable.

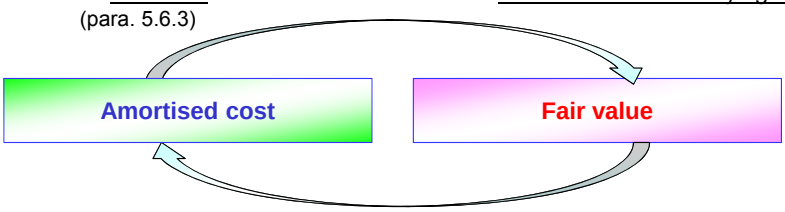
Chapter 5.6 Reclassification of FA

- If an entity reclassifies financial assets in accordance with para. 4.4.1 (as discussed),
  - it shall apply the reclassification *prospectively from the reclassification date*
  - the entity shall not restate any previously recognised gains, losses or interest. (para. 5.6.1)

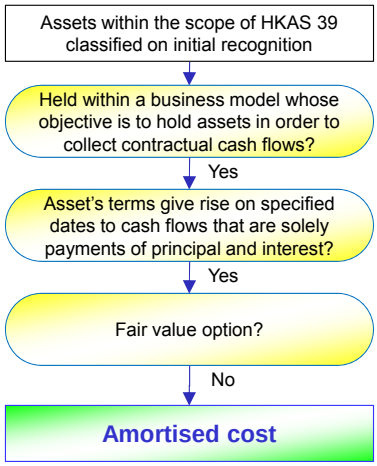


Chapter 5.6 Reclassification of FA

- If, in accordance with para. 4.4.1, an entity reclassifies a financial asset so that it is measured at fair value,
  - its fair value is determined at the reclassification date
  - any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss. (para. 5.6.2)
- If, in accordance with para. 4.4.1, an entity reclassifies a financial asset so that it is measured at amortised cost,
  - its fair value at the reclassification date becomes its new carrying amount. (para. 5.6.3)



Chapter 5.7 Gains and Losses



- A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship
  - shall be recognised in profit or loss
    - when the financial asset is derecognised, impaired or reclassified, and through the amortisation process. (para. 5.7.2)

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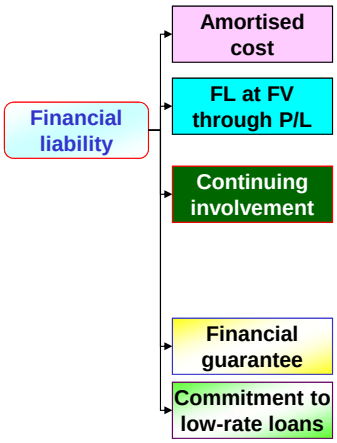
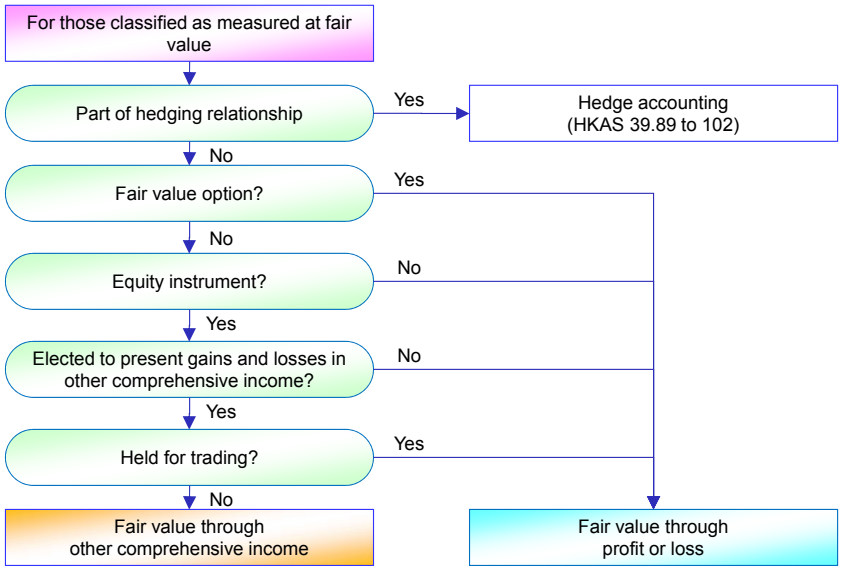
Chapter 5.7 Gains and Losses



- A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship
  - shall be recognised in profit or loss
    - when the financial liability is derecognised and through the amortisation process. (para. 5.7.2)

Chapter 5.7 Gains and Losses



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Chapter 5.7 Gains and Losses

Equity instrument?

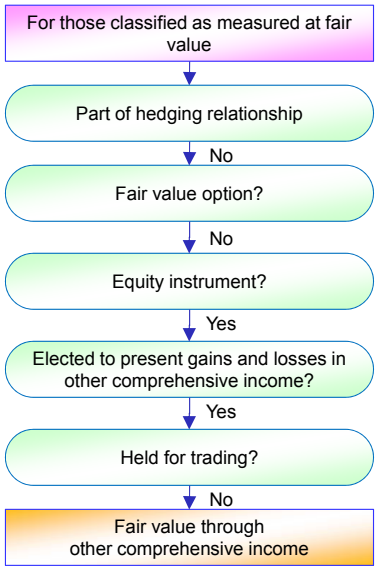
- All investments in equity instruments and contracts on those instruments must be measured at fair value.
- However, in limited circumstances, cost may be an appropriate estimate of fair value.
  - That may be the case
    - if insufficient more recent information is available to determine fair value, or
    - if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range. (para. B5.4.14)

Chapter 5.7 Gains and Losses

Example

- Indicators that cost might not be representative of fair value include:
  a. a significant change in the performance of the investee compared with budgets, plans or milestones.
  b. changes in expectation that the investee's technical product milestones will be achieved.
  c. a significant change in the market for the investee's equity or its products or potential products.
  d. a significant change in the global economy or the economic environment in which the investee operates.
  e. a significant change in the performance of comparable entities, or in the valuations implied by the overall market.
  f. internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.
  g. evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties. (para. B5.4.15)

Chapter 5.7 Gains and Losses



- A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in **profit or loss** unless
  a. It is part of a hedging relationship
  b. the financial asset is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income …… (para. 5.7.1)

Fair value through profit or loss

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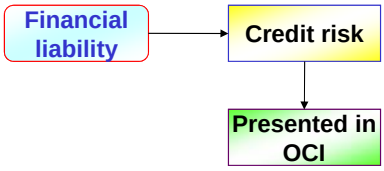
Chapter 5.7 Gains and Losses



- A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in **profit or loss** unless
  a. It is part of a hedging relationship
  b. the financial asset is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income ……

- If it is financial liability,
  – a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's **credit risk** in other comprehensive income in accordance with para. 5.7.7. (para. 5.7.1)

Chapter 5.7 Gains and Losses

- A gain or loss on financial assets or financial liabilities that are hedged items
  – shall be recognised in accordance with para. 89-102 of HKAS 39. (para. 5.7.3)

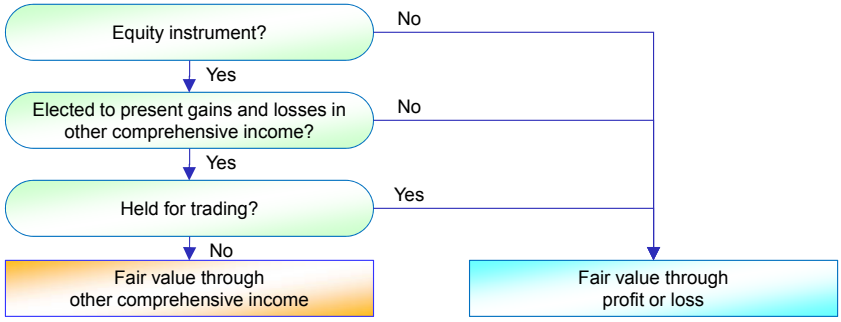
Same as before

Chapter 5.7 Gains and Losses

- If an entity recognises financial assets using settlement date accounting,
  - For assets measured at amortised cost (other than impairment losses),
    - any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised
  - For assets measured at fair value, however,
    - the change in fair value shall be recognised in profit or loss or in other comprehensive income, as appropriate under para. 5.7.1. (para. 5.7.4)

Chapter 5.7 Gains and Losses

- At initial recognition, an entity may make an irrevocable election to
  - present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of HKFRS 9 that are not held for trading. (para. 5.7.5)
- If an entity makes such election, it shall recognise in profit or loss dividends from that investment when the entity's right to receive payment of the dividend is established in accordance with HKAS 18 *Revenue*. (para. 5.7.6)



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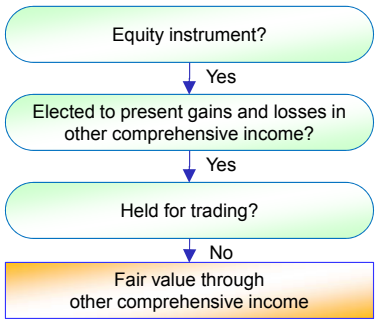
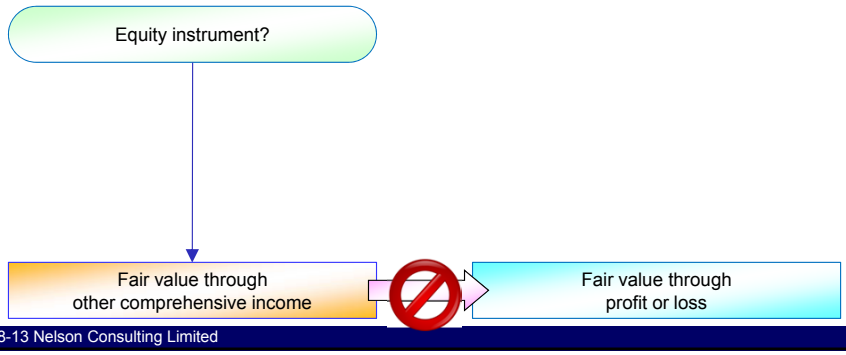
Chapter 5.7 Gains and Losses



- Such irrevocable election (presenting fair value changes in other comprehensive income)
  - is made on an instrument-by-instrument (ie share-by-share) basis.
- Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss.
  - However, the entity may transfer the cumulative gain or loss within equity (e.g.. transfer between reserves).
- Dividends on such investments are recognised in profit or loss in accordance with HKAS 18 Revenue
  - unless the dividend clearly represents a recovery of part of the cost of the investment. (para. B5.7.1)

Chapter 5.7 Gains and Losses

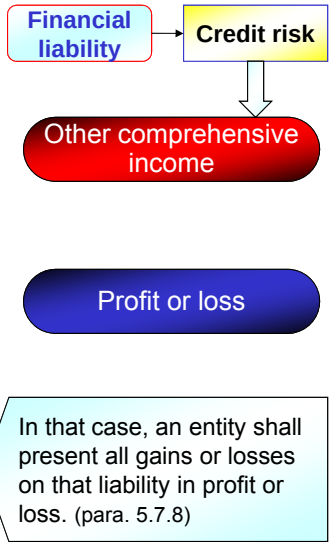
- Under HKFRS 9, amount presented in other comprehensive income shall not be subsequently transferred to profit or loss
  - Implies that
    - no recycling of any fair value change on those financial assets measured at fair value through other comprehensive income to profit or loss (or income statement)
    - no gain or loss will be recognised in profit or loss (or income statement) on derecognition of such investments in equity instruments



Chapter 5.7 Gains and Losses

- An entity shall present a gain or loss on a financial liability designated as at fair value through profit or loss as follows:
  a. The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive income (see para. B5.7.13–B5.7.20), and
  b. the remaining amount of change in the fair value of the liability shall be presented in profit or loss

  unless
  – the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in profit or loss (in which case paragraph 5.7.8 applies). (para. 5.7.7)



In that case, an entity shall present all gains or losses on that liability in profit or loss. (para. 5.7.8)

Chapter 6

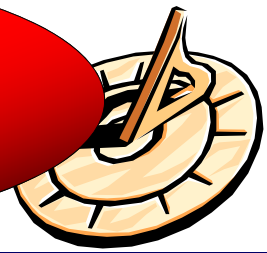
- Chapter 6 not yet used
  – As hedge accounting not yet introduced

Chapter 7 Effective Date & Transition

Effective date

- An entity shall apply HKFRS 9 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- However, if an entity elects to apply HKFRS 9 early and has not already applied HKFRS 9 issued in 2009, it must apply all of the requirements in HKFRS 9 at the same time (but see also para. 7.3.2).

Amendments to HKFRS 9 Financial Instruments defer its mandatory effective date from 1 January 2013 to 1 January 2015. The deferral will make it possible for all phases of the project to have the same mandatory effective date.



Financial Instruments Standards

(Part 1)

15 January 2013

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Financial Instruments Standards

(Part 1)

15 January 2013

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