Financial Instruments: Recap & Update

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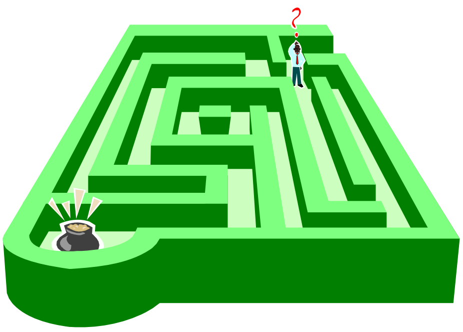
Nelson Lam 林智遠
MBA MSc BBA ACA ACIS CFA CPA(Aust.)
CPA(US) FCCA FCPA FHKIoD MSCA

HKAS 32, HKAS 39 and HKFRS 7 ……

Anyone who says they understand IAS 39 has not read it ……

Professor Sir David Tweedie
Chairman of IASB



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.
- The replacement of HKAS 39 in its entirety is aimed to be completed by the end of 2010.

Background

- HKFRS 9 issued so far includes only the chapters relating to the classification and measurement of financial assets.
  - HKFRS 9 addressed those matters first because they form the foundation of a standard on reporting financial instruments.
  - Moreover, many of the concerns expressed during the financial crisis arose from the classification and measurement requirements for financial assets in HKAS 39.

Financial Assets Only

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

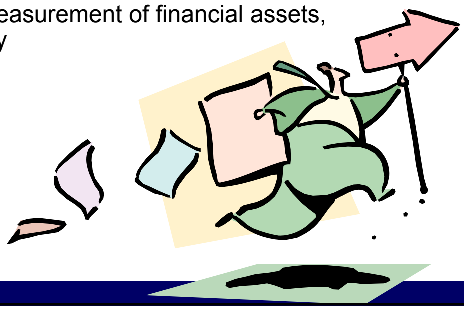
Today's Agenda

Recap

Update

Recap Agenda

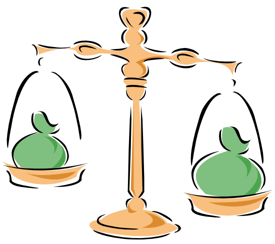
Initial Recognition	• All financial instruments, including derivatives, are recognised in the balance sheet (on balance sheet).
Classification of Fin. Assets	• Classification of financial assets
Measurement of Fin. Assets	• Subsequent measurement of financial assets, financial liability
Financial Liabilities	



Scope – What is Financial Instrument?

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

Initial Recognition & Measurement

- Initial recognition requirements for financial assets and financial liabilities in HKAS 39 are the same.
- An entity is required to recognise a financial asset or a financial liability on its balance sheet when, and only when, the entity becomes a party to the contractual provisions of the instrument.
- In other accounting standards, the recognition criteria are
  1) it is probable that future economic benefits associated with the item will flow to (or flow out from) the entity; and
  2) the cost of the item can be measured reliably.

Imply trade date accounting

Imply settlement date accounting

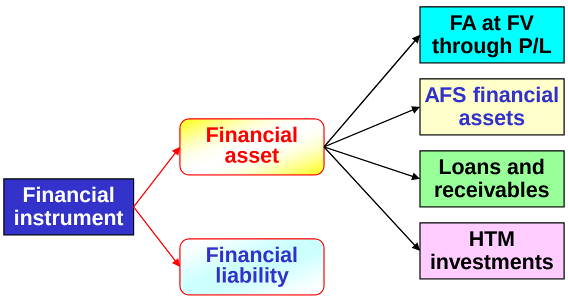
Financial instrument → Financial asset

Financial instrument → Financial liability

Initial Recognition & Measurement

- For both financial assets and financial liabilities, HKAS 39 has
  - the same initial recognition requirements
  - the same initial measurement basis
- When a financial asset or financial liability (except for it at fair value through profit or loss) is recognised initially, an entity is required to measure it at:
  1. its **fair value** plus
  2. its **transactions costs** that are directly attributable to the acquisition or issue of the financial asset or financial liability

Classification under HKAS 39

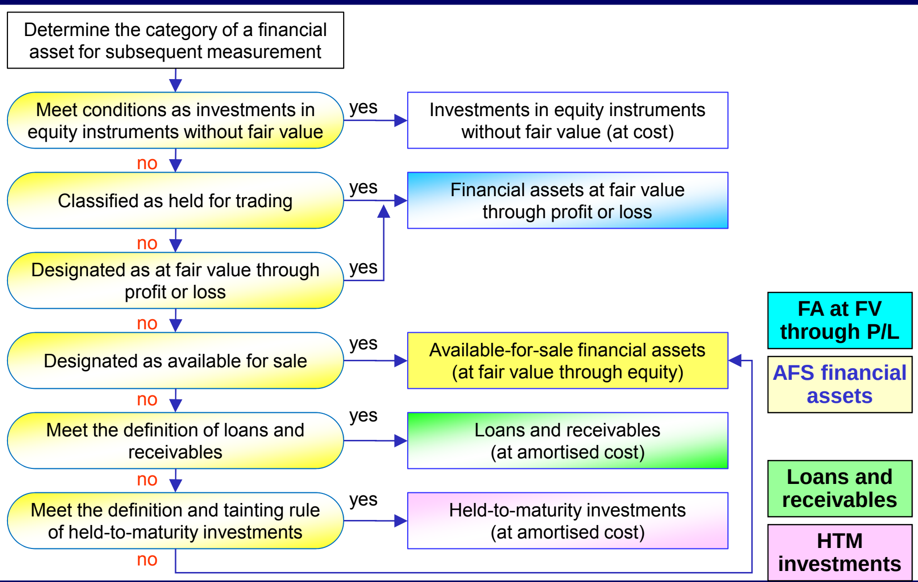


1. Financial assets at fair value through profit or loss
2. Available-for-sale financial assets
3. Loans and receivables
4. Held-to-maturity investments

- 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 affect the subsequent measurement of financial assets, but not the initial measurement.

Classification under HKAS 39



 Sourced from Intermediate Financial Reporting (2008) by Nelson Lam and Peter Lau

Subsequent Measurement of F.A.

- 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: — at fair value
  - Investments in equity instruments without fair value — at cost
  - Loans and receivables — at amortised cost
  - Held-to-maturity investments — at amortised cost

Impairment (for Amortised Cost)

- **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.

Impairment (for Amortised Cost)

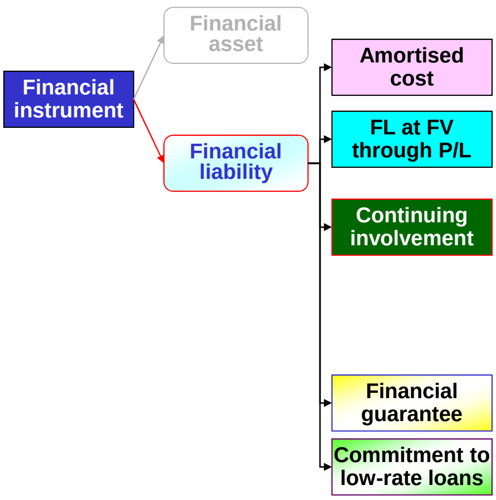
- If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the impairment loss is measured as the difference between
  – the asset's carrying amount and
  – the present value of estimated 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).

Impairment under HKAS 39

Available-for-Sale Financial Assets

- For available-for-sale financial asset carried at fair value, an entity recognises the impairment loss on it only when:
  - a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and
  - there is objective evidence that the asset is impaired.
- In recognising the impairment loss on an available-for-sale financial asset, the entity
  - removes the cumulative loss that had been recognised directly in equity from equity and
  - recognises the loss in profit or loss even though t financial asset has not been derecognised.

Classification of Financial Liability



After initial recognition, an entity shall measure all financial liabilities 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.

Today's Agenda

Update

Effective for 2009-12 Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• Amendments to HKFRS 2 *Vesting Conditions and Cancellations*	➢ 1 Jan. 2009
• HKFRS 8 *Operating Segments*	➢ 1 Jan. 2009
• HKAS 1 (Revised) *Presentation of Financial Statements*	➢ 1 Jan. 2009
• HKAS 23 (Revised) *Borrowing Costs*	➢ 1 Jan. 2009
• Amendments to HKFRS 1 and HKAS 27 *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*	➢ 1 Jan. 2009
• Amendments to HKAS 32 and HKAS 1 *Puttable Financial Instruments and Obligations Arising on Liquidation*	➢ 1 Jan. 2009
• HK(IFRIC) 13 *Customer Loyalty Programmes*	➢ 1 Jul. 2008
• HK(IFRIC) 15 *Agreements for the Construction of Real Estate*	➢ 1 Jan. 2009
• HK(IFRIC) 16 *Hedges of a Net Investment in a Foreign Operation*	➢ 1 Oct. 2008
• Annual improvements to HKFRSs 2008	➢ 1 Jan. 2009
• HK(IFRIC) 18 *Transfers of Assets from Customers*	➢ 1 Jul. 2009 (trans. date)
• Amendments to HKFRS 7 *Improving Disclosure about Financial Instruments*	➢ 1 Jan. 2009
• Amendments to HK(IFRIC) 9 and HKAS 39 *Embedded Derivatives*	➢ Ended on/after 30 Jun. 2009

 Updated from HKICPA, "HKFRS Update", 6 Nov. 2009

Effective for 2010-12 Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• HKFRS 1 (Revised) *First-time Adoption of HKFRS*	➢ 1 Jul. 2009
• Amendments to HKFRS 1 *Additional Exemptions for First-time Adopters*	➢ 1 Jan. 2010
• Amendments to HKFRS 2 *Share-based Payment – Group Cash-settled Share-based Payment Transactions*	➢ 1 Jan. 2010
• HKAS 27 (Revised) *Consolidated and Separate Financial Statements*	➢ 1 Jul. 2009
• HKFRS 3 (Revised) *Business Combination*	➢ 1 Jul. 2009
• Amendments to HKAS 39 *Eligible Hedged Items*	➢ 1 Jul. 2009
• HK(IFRIC) 17 *Distributions of Non-cash Assets to Owners*	➢ 1 Jul. 2009
• Annual Improvements to HKFRSs 2009	➢ 1 Jan. 2010 (unless specified)
• HK(IFRIC) 19 *Extinguishing Financial Liabilities with Equity Instruments*	➢ 1 Jan. 2010
• *HKFRS for Private Entities (or IFRS for SME)*	➢ Effective upon issue
• Amendments to HK Interpretation 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*	➢ Not specified

Effective after 2010-12 Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• Amendments to HKAS 32 *Classification of Rights Issues*	➢ 1 Feb.2010
• HKAS 24(Revised) *Related Party Disclosures*	➢ 1 Jan. 2011
• HKFRS 9 *Financial Instruments*	➢ 1 Jan. 2013
• Amendments to HK(IFRIC) 14 *HKAS 19 —The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*	➢ 1 Jan. 2011
• Amendment to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards – Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters*	➢ 1 Jul. 2010
• Annual Improvements to HKFRSs 2010	➢ 1 Jan. 2011 (unless specified)

Improving Disclosures about Financial Instruments (Amendments to HKFRS 7)

Amendments to HKFRS 7 in 03/2009

- The aim of the amendments was to enhance disclosures about
  - fair value and
  - liquidity risk
- SFAS 157 of US FASB requires disclosures that are based on a <u>three-level fair value hierarchy</u> for the inputs used in valuation techniques to measure fair value.
- IASB concluded
  - that such a hierarchy would improve comparability between entities about the effects of fair value measurements as well as increase the convergence of IFRSs and US GAAP.
  - to require disclosures for financial instruments on the basis of a fair value hierarchy.

1. Fair Value Disclosure

- If there has been a change in valuation technique,
  - the entity shall disclose that change and the reasons for making it.
- A fair value hierarchy for disclosure is also required:
  - classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

1. Fair Value Disclosure

- The fair value hierarchy shall have the following levels:
  a. quoted prices (unadjusted) in active markets for identical assets or liabilities (**Level 1**);
  b. inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (**Level 2**); and
  c. inputs for the asset or liability that are not based on observable market data (unobservable inputs) (**Level 3**).

1. Fair Value Disclosure

- The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.
  - For this purpose, the significance of an input is assessed against the fair value measurement in its entirety.
  - If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs,
    - that measurement is a Level 3 measurement.
  - Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

1. Fair Value Disclosure

- For fair value measurements recognised in the statement of financial position an entity shall disclose for each class of financial instruments:
  1. the level in the fair value hierarchy
  2. any significant transfers between Level 1 and Level 2 of the fair value hierarchy (with other details)
  3. Further details for Level 3.
- An entity shall present the quantitative disclosures as required above in tabular format unless another format is more appropriate.

1. Fair Value Disclosure

- Further details for Level 3:
  1. total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented)
  2. total gains or losses recognised in other comprehensive income
  3. purchases, sales, issues and settlements (each type of movement disclosed separately)
  4. transfers into or out of Level 3
     (e.g. transfers attributable to changes in the observability of market data) and the reasons for those transfers. (If significant, separate transfers into and out of Level 3)
  5. the fact and the effect of changes (for the inputs to assumptions if their changes affect fair value significantly)

1. Fair Value Disclosure

Case

CATHAY PACIFIC

Annual report 2009

	Group				Company			
	2009 Level 1 HK$M	2009 Level 2 HK$M	2009 Level 3 HK$M	2009 Total HK$M	2009 Level 1 HK$M	2009 Level 2 HK$M	2009 Level 3 HK$M	2009 Total HK$M
Assets								
Investments at fair value								
– Listed	175	–	–	175	–	–	–	–
– Unlisted	–	–	1,373	1,373	–	–	1,328	1,328
Liquid funds								
– Funds with investment managers	–	2,370	–	2,370	–	–	–	–
– Other liquid investments	–	1,388	–	1,388	–	1,146	–	1,146
Derivative financial assets	–	2,637	–	2,637	–	2,624	–	2,624
	175	6,395	1,373	7,943	–	3,770	1,328	5,098

1. Fair Value Disclosure

Case

CATHAY PACIFIC

Annual report 2009

The movement during the year in the balance of level 3 fair value measurements is as follows:

	Group HK$M	Company HK$M
Investments at fair value – unlisted		
At 1st January 2009	**992**	**916**
Net unrealised gains or losses recognised in other comprehensive income during the year	**381**	**412**
At 31st December 2009	**1,373**	**1,328**

Financial Instruments

(HKFRS 9)

Structure of HKFRS 9

Chapters

1 Objective
2 Scope
3 Recognition and Derecognition
4 Classification
5 Measurement
6 Hedge Accounting *(not used yet)*
7 Disclosures *(not used yet)*
8 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

Chapter 1 and 2

Objective

- The objective of HKFRS 9 is to establish principles for the financial reporting of financial assets 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 3 Recognition & Derecognition

Recognition and Derecognition

- An entity shall recognise a financial asset 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 4.1-4.5 and
  - **measure** it in accordance with paragraph 5.1.1.

Amended (Ch. 4 of HKFRS 9)

Amended (Ch. 5 of HKFRS 9)

- A regular way purchase or sale of a financial asset
  - shall be recognised and derecognised in accordance with paragraphs 38 and AG53–AG56 of HKAS 39. (para. 3.1.1 to 3.1.2)

Same as before

Chapter 4 Classification

- Unless para. 4.5 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:

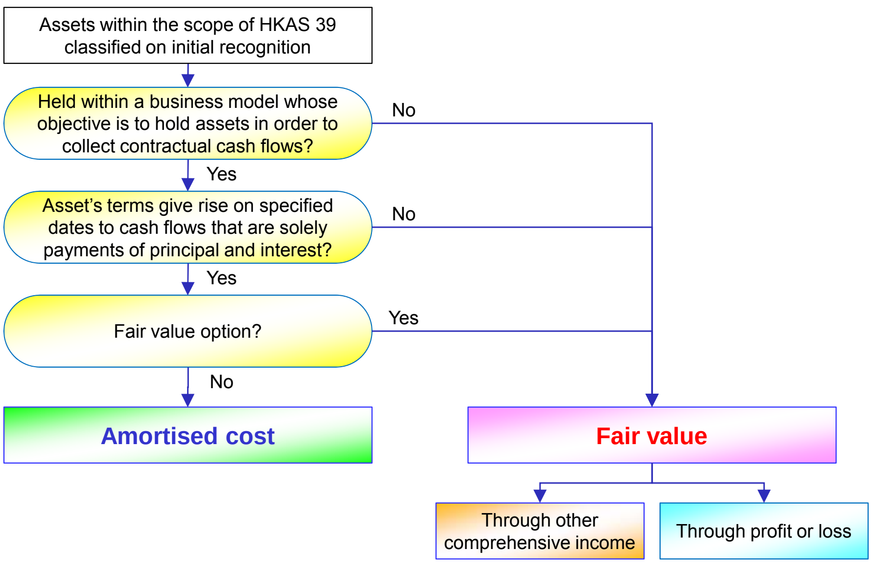
  a) the entity’s **business model** for managing the financial assets; and

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

  (para. 4.1)

Amortised cost	Fair value

Chapter 4 Classification



Chapter 4 Classification

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 Classification

Case

香港交易所 HKEx

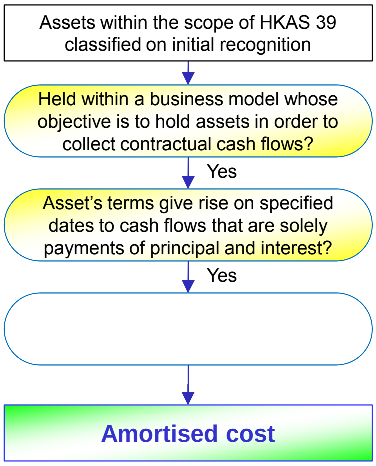
Financial statements 2009 states that:

- 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**

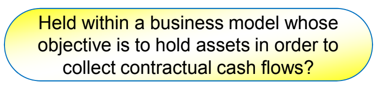
Fair value → Through profit or loss

Chapter 4 Classification



- 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. 4.2)

Chapter 4 Classification



- 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)

- 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.B4.2)

Chapter 4 Classification

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

↓ Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

- 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. 4.3)
- Contractual cash flows are assessed on the currency in which the financial asset is denominated. (para. B4.8)

Chapter 4 Classification

- 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. B4.9)

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

Chapter 4 Classification

Assets within the scope of HKAS 39 classified on initial recognition

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

No

Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

No

- A financial asset shall be measured at **fair value**
  - unless it is measured at amortised cost in accordance with para. 4.2. (para. 4.4)

Fair value

Chapter 4 Classification

Assets within the scope of HKAS 39 classified on initial recognition

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

Yes

Fair value option?

Yes

No

Amortised cost

Fair value

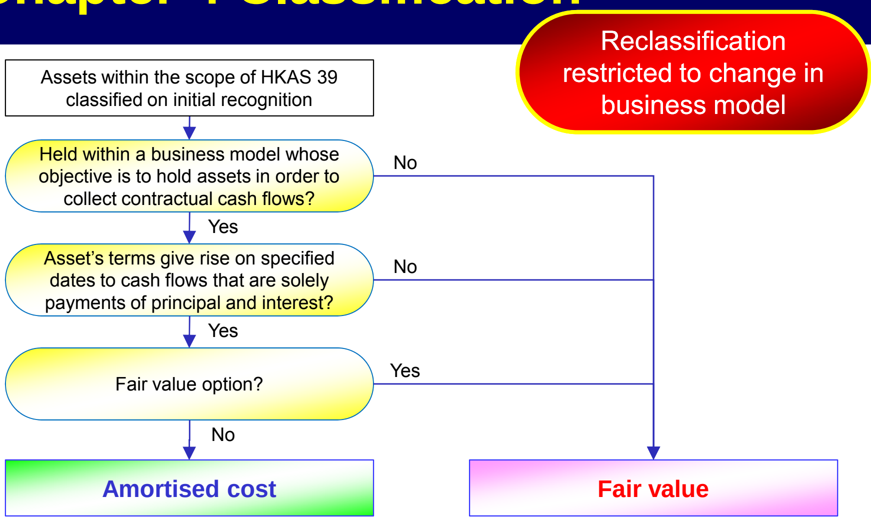
Through profit or loss

- Notwithstanding para. 4.1-4.4, 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. 4.5)

Chapter 4 Classification

- If a hybrid contract contains a host that <u>is within</u> the scope of HKFRS 9,
  – an entity shall apply the requirements in para. 4.1-4.5 (as discussed above) to <u>the entire hybrid contract</u>. (para. 4.7)
- If a hybrid contract contains a host that is <u>not within</u> the scope of HKFRS 9,
  – an entity shall apply the requirements in para. 11–13 and AG27–AG33B of HKAS 39 (as before) <u>to determine whether it must separate the embedded derivative from the host</u>.
- If the embedded derivative must be separated from the host, the entity shall:
  a. classify the derivative in accordance with either
     - para. 4.1-4.4 for derivative assets or
     - para. 9 of HKAS 39 for all other derivatives; and
  b. account for the host in accordance with other HKFRSs. (para.4.8)

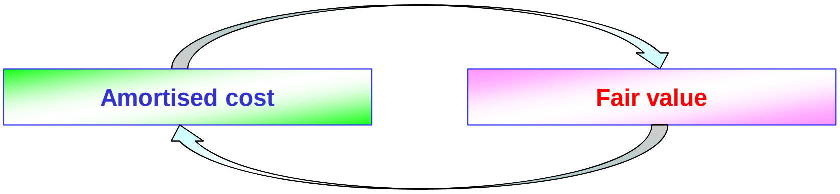
Chapter 4 Classification



- <u>When, and only when</u>, an entity <u>changes its business model</u> for managing financial assets it shall reclassify all affected financial assets in accordance with para. 4.1–4.4. (para. 4.9)

Chapter 4 Classification

- 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. B5.9)



Chapter 4 Classification

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 Classification

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 5 Measurement

Initial measurement (same as HKAS 39)

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

Initial Measurement

Fair Value

+

Transaction Cost

Chapter 5 Measurement

Subsequent Measurement

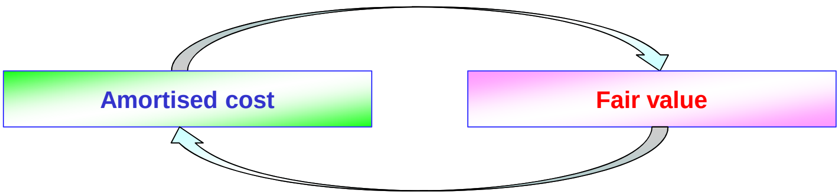
- After initial recognition, an entity shall measure financial assets in accordance with para. 4.1 -4.5 (as discussed above) at
  - **fair value** or
  - **amortised cost**. (para. 5.2.1)
- An entity shall apply the impairment requirements of HKAS 39 to all financial assets measured at amortised cost. (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 financial assets that are designated as hedged items. (para. 5.2.3)

Amortised cost | **Fair value**

Chapter 5 Measurement

Reclassification

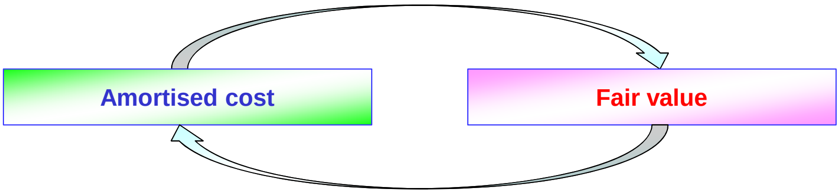
- If an entity reclassifies financial assets in accordance with para. 4.9 (as discussed),
  - it shall apply the reclassification *prospectively from the reclassification date*
  - the entity shall not restate any previously recognised gains, losses or interest. (para. 5.3.1)



Chapter 5 Measurement

Reclassification

- A change in the objective of the entity's business model must be effected before the reclassification date. (para. B5.10)
  - 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 5 Measurement

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. B5.10)

Chapter 5 Measurement

Reclassification

- If, in accordance with para. 4.9, 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. 5.3.2)
- If, in accordance with para. 4.9, 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. 5.3.3)

Amortised cost ⇄ **Fair value**

Chapter 5 Measurement

Assets within the scope of HKAS 39 classified on initial recognition

↓

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

↓ Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

↓ Yes

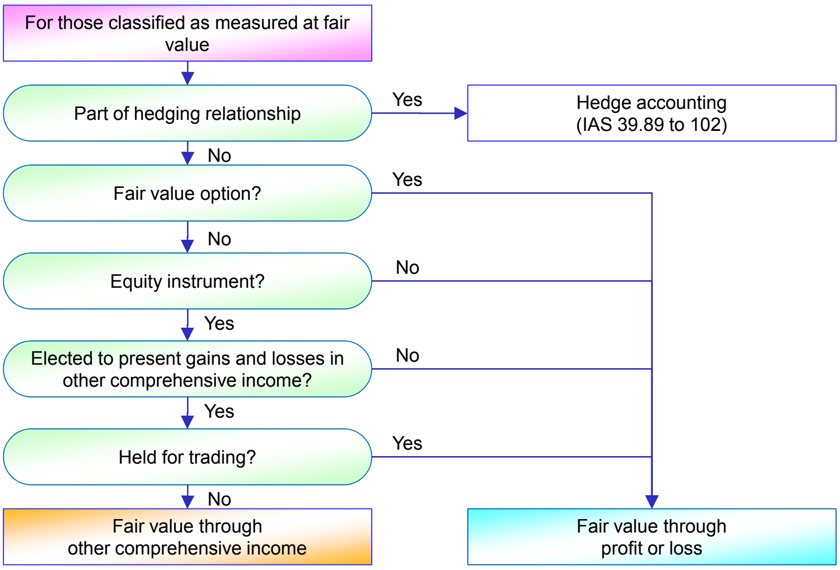
Fair value option?

↓ No

Amortised cost

- 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. 5.4.2)

Chapter 5 Measurement



Chapter 5 Measurement

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. B5.5)

Chapter 5 Measurement

For those classified as measured at fair value
↓
Part of hedging relationship
↓ No
Fair value option?
↓ No
Equity instrument?
↓ Yes
Elected to present gains and losses in other comprehensive income?
↓ Yes
Held for trading?
↓ No
Fair value through other comprehensive income

Fair value through profit or loss

- A gain or loss on a financial asset that is measured at fair value and is not part of a hedging relationship
  - shall be recognised in **profit or loss**
  - unless :
    - 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. 5.4.1)

Chapter 5 Measurement

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

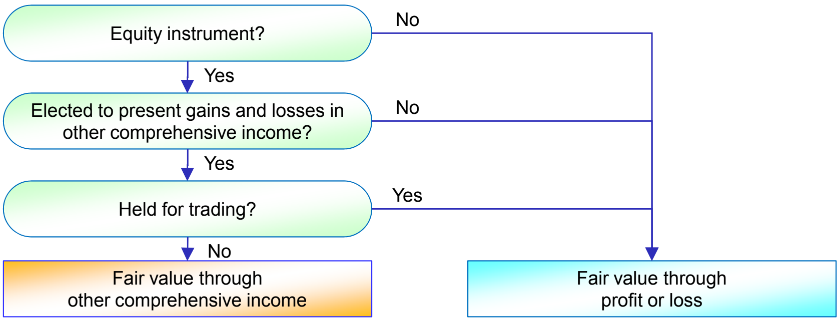
  Same as before

  b. accounted for using settlement date accounting
    - shall be recognised in accordance with para. 57 of HKAS 39. (para.5.4.3)

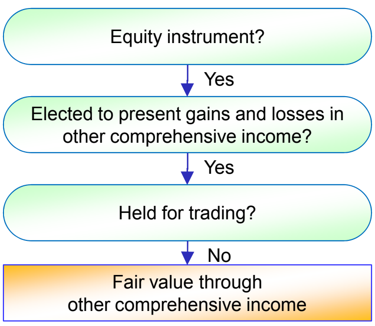
  Same as before

Chapter 5 Measurement

- 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. 5.4.4)
- 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. 5.4.5)



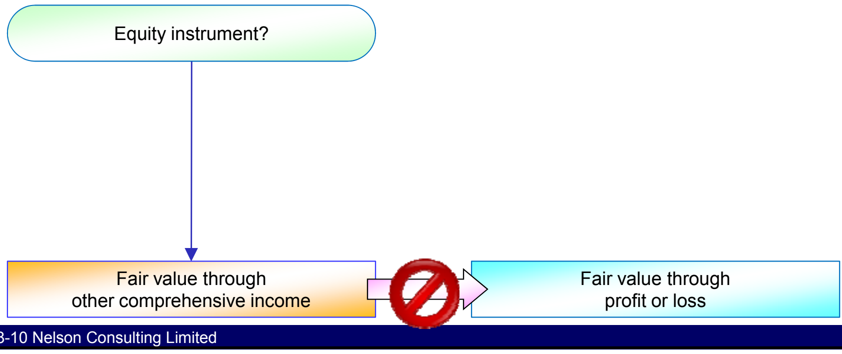
Chapter 5 Measurement



- 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. B5.12)

Chapter 5 Measurement

- 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 Measurement

Case

香港交易所 HKEx

Financial statements 2009 states that:

- For financial assets extant at 31 December 2009

  Financial assets measured at fair value through profit or loss
  - Financial assets under this category are investments carried at fair value.
    - Unrealised gains and losses arising from changes in the fair value are included in profit or loss in the period in which they arise.
    - Upon disposal, the differences between the net sale proceeds and the carrying values are included in profit or loss.
  - Interest income is recognised using the effective interest method and included in net realised and unrealised gains/(losses) and interest income from these financial assets.
  - Dividend income is recognised when the right to receive a dividend is established and is disclosed separately as dividend income.

Chapter 5 Measurement

Case

Financial statements 2009 states that:

- For financial assets extant at 31 December 2009

  Financial assets measured at amortised cost

  – Financial assets under this category are carried at amortised cost using the effective interest method less provision for impairment.

    - Gains and losses arising from disposal, being the differences between the net sale proceeds and the carrying values, are recognised in profit or loss.

  – Interest income is recognised using the effective interest method and disclosed as interest income.

Chapter 6 and 7

- Chapter 6 and 7 not yet used
  – As hedge accounting and disclosure not yet introduced

Chapter 8 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.
- If an entity applies HKFRS 9 in its financial statements for a period beginning before 1 January 2013,
  - it shall disclose that fact and at the same time apply the amendments in Appendix C (i.e. Amendments to other HKFRSs). (para. 8.1.1)

Chapter 8 Effective Date & Transition

Transition

- An entity shall apply HKFRS 9 retrospectively, in accordance with HKAS 8, except as specified in paragraphs 8.2.4–8.2.13.
- HKFRS 9 shall not be applied to financial assets that have already been derecognised at the date of initial application. (para. 8.2.1)

Chapter 8 Effective Date & Transition

Transition

- The date of initial application is the date when an entity first applies the requirements of HKFRS 9.
- The date of initial application may be:
  a. For entities initially applying HKFRS 9 before 1 January 2011
     ➢ any date between the issue of HKFRS 9 and 31 December 2010,; or
  b. For entities initially applying HKFRS 9 on or after 1 January 2011
     ➢ the beginning of the first reporting period in which the entity adopts HKFRS 9. (para. 8.2.2)
- If the date of initial application is not at the beginning of a reporting period,
  – the entity shall disclose
    - that fact and
    - the reasons for using that date of initial application.

Chapter 8 Effective Date & Transition

Case

香港交易所 HKEx

Financial statements 2009 states that:

- As HKFRS 9 was only issued in November 2009, the Group first applied the requirements of HKFRS 9 on 31 December 2009, which was not at the beginning of the reporting period ……
- Under the transitional provisions, HKFRS 9 was applied to financial assets extant at the date of initial application (i.e., 31 December 2009) and comparative figures were not restated.
- No adjustments to retained earnings or revaluation reserves were required as at 1 January 2009 because the available-for-sale financial assets as at 31 December 2009 solely comprised those assets purchased during 2009 and
  – there was no reclassification from financial assets at fair value through profit or loss to financial assets measured at amortised cost or from loans and receivables to financial assets measured at fair value through profit or loss at that date.
- There are consequential amendments to certain provisions of HKFRS 7, which the Group has also early adopted in the accounts.

Chapter 8 Effective Date & Transition

Case

Adoption of HKFRS 9 – Re-designation of financial assets on 31 December 2009

香港交易所
HKEx

Group

Original measurement category and carrying amount in accordance with HKAS 39		New measurement category and carrying amount in accordance with HKFRS 9	
Original measurement category	Original carrying amount $'000	Financial assets measured at amortised cost $'000	Financial assets mandatorily measured at fair value through profit or loss $'000
Financial assets at fair value through profit or loss, on designation	2,946,253	–	2,946,253
Financial assets at fair value through profit or loss, held for trading	3,182,641	–	3,182,641
Available-for-sale financial assets	9,188,368	1,295,912	7,895,984
Loans and receivables:			
Financial assets at amortised cost	3,629,268	3,629,268	–
Accounts receivable and deposits*	11,319,690	11,319,690	–
Cash and cash equivalents *	14,738,083	14,738,083	–

Next Step for IFRS 9 ......

- IFRS 9 (or equivalent HKFRS 9) is the first part of Phase 1 of the project to replace IAS 39. The main phases are:
  - ***Phase 1: Classification and measurement***. (Requirements for financial liabilities will be included in HKFRS 9 in due course.
  - ***Phase 2: Impairment methodology***. The request for Information on the feasibility of an expected loss model for the impairment of financial assets was published on 25 Jun. 2009. This formed the basis of an exposure draft, Financial Instruments: Amortised Cost and Impairment, published in Nov. 2009 with a comment deadline of 30 Jun. 2010.
  - ***Phase 3: Hedge accounting***. The project for considering how to improve and simplify the hedge accounting requirements of HKAS 39 has started and the proposals are expected to be published shortly.

Financial Instruments: Recap & Update

5 August 2010

Nelson Lam 林智遠
nelson@nelsoncpa.com.hk
www.NelsonCPA.com.hk
www.Facebook.com/NelsonCPA

Financial Instruments: Recap & Update

5 August 2010

Nelson Lam 林智遠
nelson@nelsoncpa.com.hk
www.NelsonCPA.com.hk
www.Facebook.com/NelsonCPA

