Accounting for Financial Instruments

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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

- 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

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

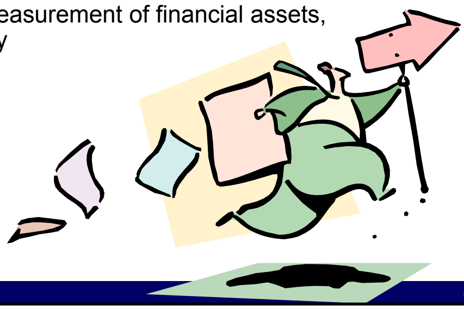
Today's Agenda

Recap

Update

Recap Agenda

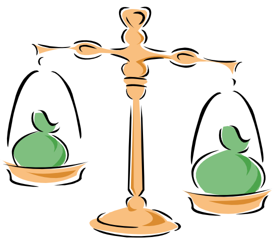
Initial Recognition	• All financial instruments, including derivatives, are recognised in the balance sheet (on balance sheet).
Classification of Fin. Assets	• Classification of financial assets
Measurement of Fin. Assets	• Subsequent measurement of financial assets, financial liability
Financial Liabilities	
Disclosure (HKFRS 7)	



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

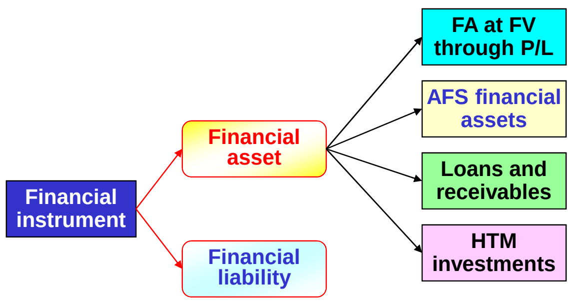
Financial instrument → Financial asset → Initial Recognition: Trade Date Accounting | Regular Way of Financial Assets

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

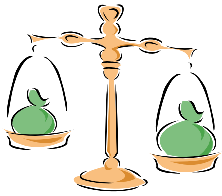


1. Financial assets at fair value through profit or loss
2. Available-for-sale financial assets
3. Loans and receivables
4. Held-to-maturity investments

- 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



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

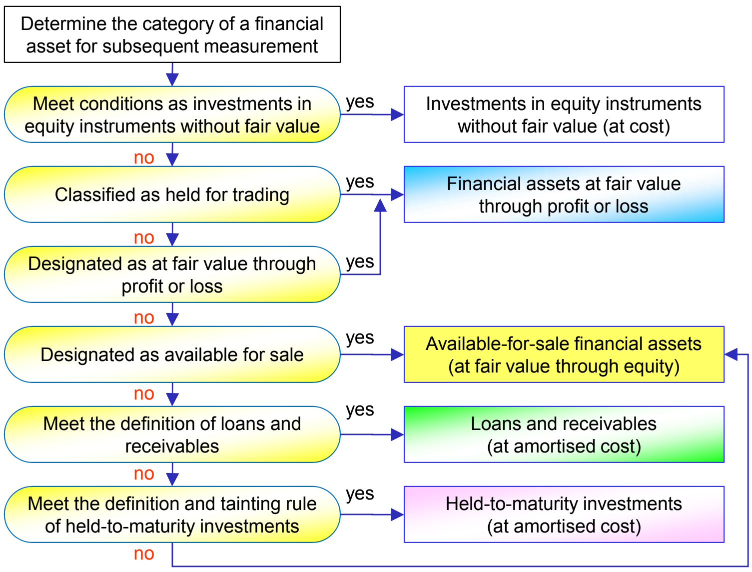
AFS financial assets

Loans and receivables

HTM investments

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

Classification under HKAS 39



FA at FV through P/L

AFS financial assets

Loans and receivables

HTM investments

 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 (for Available-for-Sale)

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.

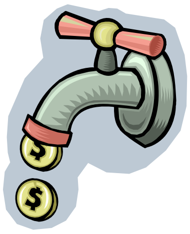
Impairment (for Available-for-Sale)

Available-for-Sale Financial Assets

- The amount of the cumulative loss that is removed from equity and recognised in profit or loss is the difference between:
  - the acquisition cost (net of any principal repayment and amortisation) and
  - the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Impairment under HKAS 39

Available-for-Sale Financial Assets

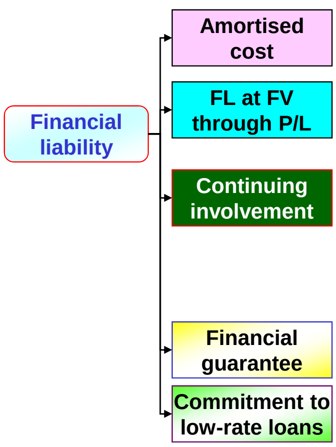


- Impairment losses on available-for-sale equity instruments
  - cannot be reversed through profit or loss (HKAS 39.69), i.e. any subsequent increase in fair value is recognised in equity.
- Reversal of the impairment loss on available-for-sale debt instrument through profit or loss is instead allowed.
  - After an impairment loss on available-for-sale debt instrument is recognised in profit or loss, if (1) the fair value of such instrument increases and (2) the increase can be objectively related to an event occurring after the recognition of impairment loss through profit or loss,
    - an entity reverses the impairment loss, with the amount of the reversal recognised in profit or loss.

Recap Agenda

Financial Liabilities

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.

Classification of Financial Liability

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
- **Financial guarantee**
- **Commitment to low-rate loans**

Financial guarantee and 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.

Subsequent Measurement of F.L.

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*.

Recap Agenda

Disclosure
(HKFRS 7)

HKFRS 7

- The objective of HKFRS 7 is to require entities to provide disclosures in their financial statements that enable users to evaluate:

  1) the significance of financial instruments for the entity's
     - financial position and
     - financial performance; and

  2) the nature and extent of risks arising from financial instruments to which the entity is exposed
     - during the period and
     - at the reporting date, and

  how the entity manages those risks.

Significance
- Balance sheet
- Income statement
- Other disclosures

Nature and Extent
- Qualitative disclosures
- Quantitative disclosures

1. Significance of Financial Instruments

- An entity shall <u>disclose information</u> that enables users of its financial statements to evaluate
  - the significance of financial instruments for its financial position and performance.

Significance

Balance Sheet

Income Statement and Equity

Other Disclosures

1. Significance of Financial Instruments

Balance Sheet

The <u>carrying amounts</u> of each of the following categories, as defined in HKAS 39, shall be disclosed either on the face of the balance sheet or in the notes:

a) financial assets at fair value through P/L, showing separately
   i) those designated as such upon initial recognition and
   ii) those classified as held for trading in accordance with HKAS 39;
b) held-to-maturity investments;
c) loans and receivables;
d) available-for-sale financial assets;
e) financial liabilities at fair value through P/L, showing separately
   i) those designated as such upon initial recognition and
   ii) those classified as held for trading in accordance with HKAS 39; and
f) financial liabilities measured at amortized cost.

1. Significance of Financial Instruments

Case

ZiJin
紫金礦業集團股份有限公司
ZIJIN MINING GROUP COMPANY LIMITED*

	Financial assets at fair value through profit or loss – held for trading RMB'000	Loans and receivables RMB'000	Available-for-sale financial assets RMB'000	Total RMB'000
Financial assets included in other assets (note 18)	–	80,000	–	80,000
Interests in associates (notes 22)	–	10,000	–	10,000
Interests in jointly-controlled entities (note 23)	–	19,128	–	19,128
Available-for-sale investments	–	–	462,178	462,178
Financial assets included in prepayments, deposits and other receivables	–	321,664	–	321,664
Trade receivables	–	293,870	–	293,870
Bills receivables	–	52,346	–	52,346
Equity investments at fair value through profit or loss	102,439	–	–	102,439
Derivative financial instruments	4,440	–	–	4,440
Pledged deposits	–	52,088	–	52,088
Cash and cash equivalents	–	2,184,510	–	2,184,510
	106,879	3,013,606	462,178	3,582,663

1. Significance of Financial Instruments

- In March 2009, HKFRS 7 was amended to require the disclosure of the fair value hierarchy, which 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. Significance of Financial Instruments

Case

HSBC

	Valuation Techniques			
At 31 December 2008 (US$m)	Quoted market price	Using observable inputs	With significant unobservable inputs	Total
Assets				
Trading assets	234,399	185,369	7,561	427,329
Financial assets designated at FV	14,590	13,483	460	28,533
Derivatives	8,495	476,498	9,883	494,876
Financial instruments: AFS	103,949	173,157	9,116	286,222
Liabilities				
Trading liabilities	105,584	135,559	6,509	247,652
Financial liabilities designated at FV	23,311	51,276	-	74,587
Derivatives	9,896	473,359	3,805	487,060

2. Nature and Extent of Risks

Significance

↓

Nature and Extent

2. Nature and Extent of Risks

- An entity shall disclose information that enables users of its financial statements to evaluate
  - the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date.
- The disclosures required focus on the risks that arise from financial instruments and how they have been managed.
- These risks typically include, but are not limited to

Market Risk

Credit Risk

Liquidity Risk

Nature and Extent

Qualitative Disclosures

Quantitative Disclosures

2. Nature and Extent of Risks

Qualitative Disclosures

- For each type of risk arising from financial instruments, an entity shall disclose:
  a) The exposures to risk and how they arise;
  b) Its objectives, policies and processes for managing the risk and the methods used to measure the risk
  c) Any changes in (a) or (b) from the previous period.

2. Nature and Extent of Risks

Quantitative Disclosures

- For each type of risk arising from financial instruments, an entity shall disclose:
  a. Summary quantitative data about its exposure to that risk at the reporting date.
     - The level of detail of such disclosure is based on the information provided internally to key management personnel of the entity (as defined in HKAS 24 *Related Party Disclosures*), for example the entity's board of directors or chief executive officer.
  b. the disclosures required in quantitative disclosures, to the extent not provided in (a), unless the risk is not material (see HKAS 1.29-31).
  c. concentrations of risk if not apparent from (a) and (b)

2. Nature and Extent – Market Risk

Quantitative Disclosures

Market risk

- HKFRS 7 requires the disclosures of sensitivity analysis.
- The disclosures of sensitivity analysis can be achieved by 2 approaches:
  1. **Simple sensitivity analysis:**
     - sensitivity analysis for each type of market risk
  2. **Interdependency sensitivity analysis:**
     - Sensitivity analysis that reflects interdependencies between risks variables

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

2. Nature and Extent – Sensitivity

Quantitative Disclosures

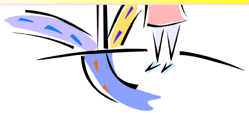
Market risk – **Simple sensitivity analysis**

- An entity shall disclose:
  a) a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date, showing:
     - how **profit or loss** and **equity** would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

  b) the methods and assumptions used in preparing the sensitivity analysis; and

  c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

Assuming that a **reasonably possible change** in the relevant risk variable had occurred at the balance sheet date and had been applied to the risk exposures in existence at that date.



2. Nature and Extent – Sensitivity

In order to disclose the simple sensitivity analysis, an entity should:

1. Decide how much detail it provides, how much emphasis it places and how it aggregates information to display
2. Identify each type of market risk to which the entity is exposed and the relevant risk variable at the reporting date
3. Judge the reasonably possible changes in the relevant risk variables at the reporting date
4. Calculate and show how profit or loss and equity would be affected at the reporting date

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

2. Nature and Extent – Sensitivity

Case

How can it be reasonably possible change?

Observed assessments by certain companies:

Entity name	Currency	Interest rate	Other price
BASF	10% (drop only)	1%	10%
BP plc	VaR	VaR	10%
CLP Holdings Ltd.	1%	0.5%	15% (2006: 5%)
DBS Group	10%	0.25%	10%
Deutsche Telecom	10%	1%	N/M
France Telecom	10%	1%	N/M
Jardine Matheson Ltd.	10%	1%	25% (AFS)
Recruit	7 – 12%	N/M	N/M
Zijin Mining	10%	1%	N/M

2. Nature and Extent – Sensitivity

Case

Royal Dutch Shell plc for 2010

- Shell uses risk management systems for recording and valuing instruments.
- There is regular review of mandated trading limits by senior management, daily monitoring of market risk exposure using value-at-risk (VAR) techniques (see below), daily monitoring of trading positions against limits and marking-to-market of trading exposures with a department independent of traders reviewing the market values applied to trading exposures.
- Although trading losses can and do occur, the nature of Shell's trading portfolio and its management are considered adequate against the risk of significant losses.
- Shell utilises VAR techniques based on variance/covariance or Monte Carlo simulation models and makes a statistical assessment of the market risk arising from possible future changes in market values over a 24-hour period and within a 95% confidence level.
- The calculation of the range of potential changes in fair value takes into account positions, the history of price movements and the correlation of these price movements.
- Each of the models is regularly back-tested against actual fair value movements to ensure model integrity is maintained.

Today's Agenda

Update

Financial Instruments

(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)*~~

7 ~~8~~ Effective Date and Transition

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 3 Recognition & Derecognition

- 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

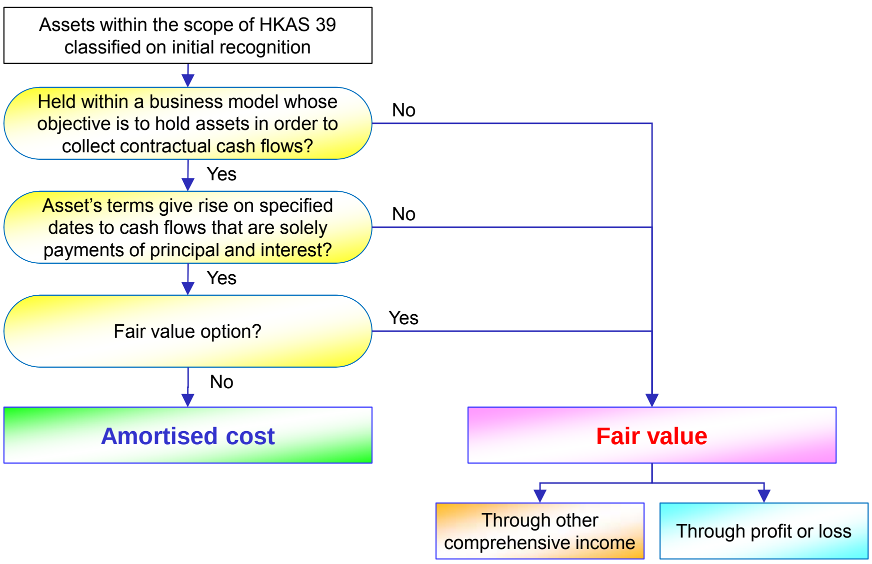
Chapter 4.1 Classification of FA

- 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

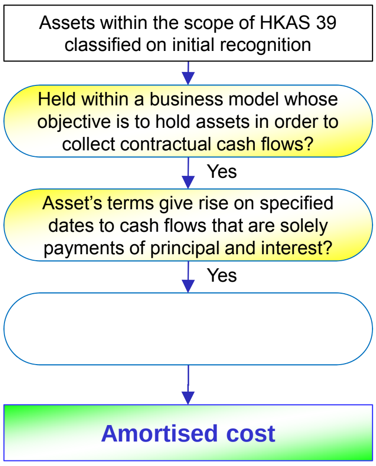
  on the basis of both:
  a) the entity's business model for managing the financial assets; and
  b) the contractual cash flow characteristics of the financial asset.
  (para. 4.1.1)

Amortised cost | **Fair value**

Chapter 4.1 Classification of FA

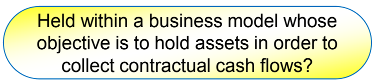


Chapter 4.1 Classification of FA



- 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



- 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)

- 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

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. 4.1.3)
- 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

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 → Fair value

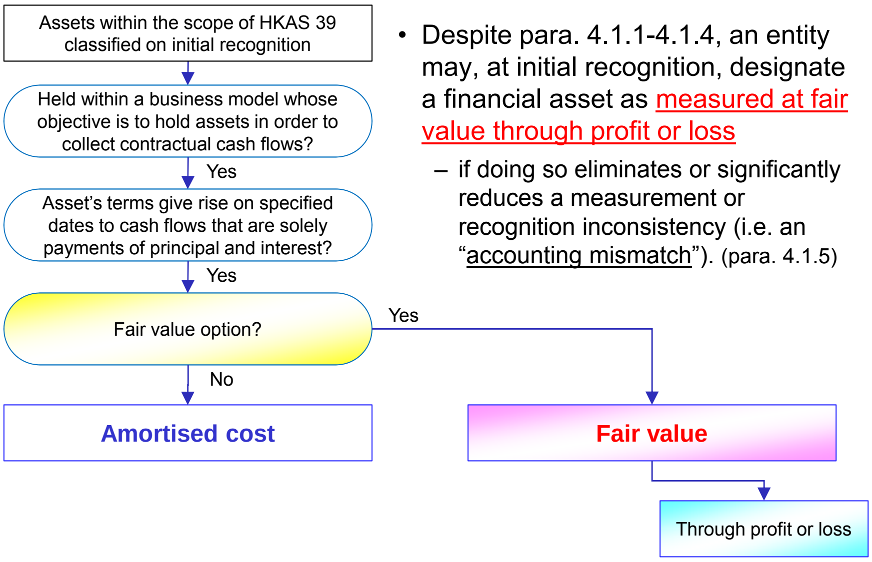
↓ Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest? — No → Fair value

- 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)

Fair value

Chapter 4.1 Classification of FA



- 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)

Chapter 4.1 Classification of FA

Case

香港交易所 HKEx

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

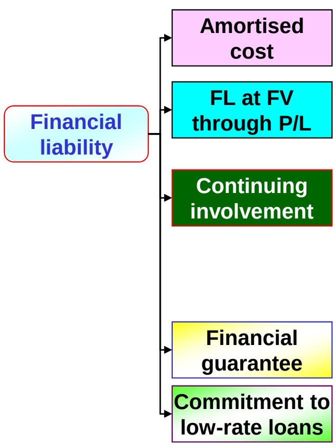
Financial statements 2009 states that:

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 Classification of FL



- 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 4.3 Embeded Derivatives

Host is an assets within HKFRS 9

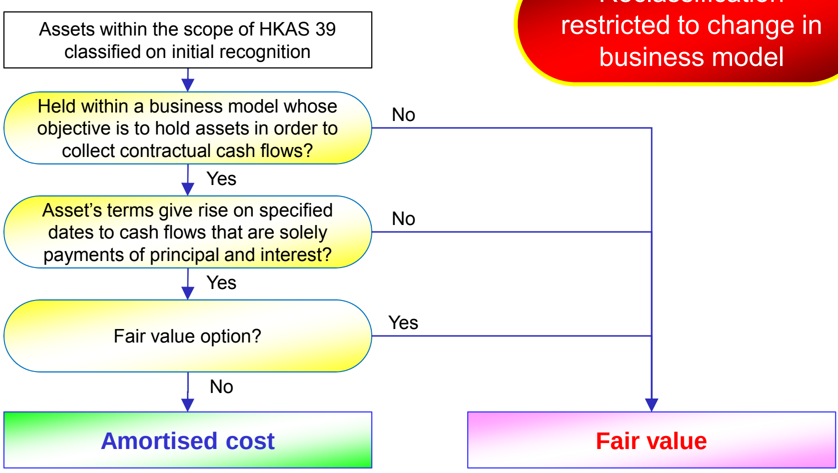
- If a hybrid contract contains a host that is an asset within the scope of HKFRS 9,
  - an entity shall apply the requirements in para. 4.1.1-4.1.5 (as discussed above) to the entire hybrid contract. (para. 4.3.2)

Other Contracts

- If a hybrid contract contains a host that is not an asset within the scope of HKFRS 9,
  - an embedded derivative shall be separated from the host and accounted for as a derivative under HKFRS 9 if, and only if:
    - All 3 conditions are met (same as those set out in HKAS 39), including:
      a. Economic characteristics & risks not closely related
      b. Embedded derivative meets the definition of derivative
      c. Hybrid contract is not measured at FV through P/L. (para. 4.3.3)

Chapter 4.4 Reclassification

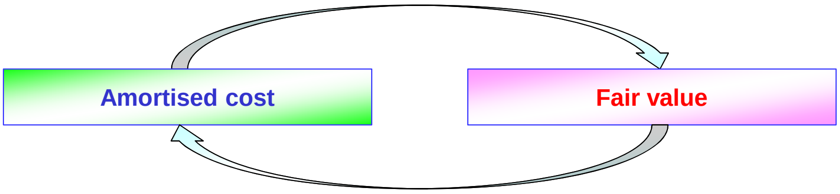
Reclassification restricted to change in business model



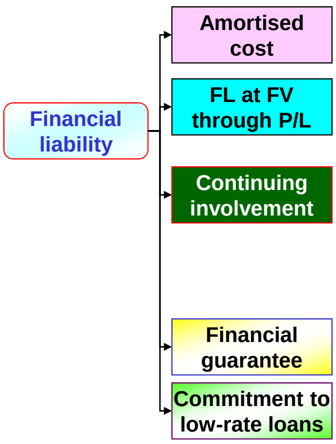
- When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets in accordance with para. 4.1.1–4.1.4. (para. 4.4.1)

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



- 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)

Chapter 5 Measurement

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 Measurement

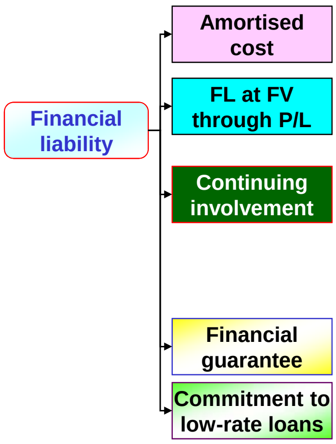
Subsequent Measurement of Financial Assets

- 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 Measurement

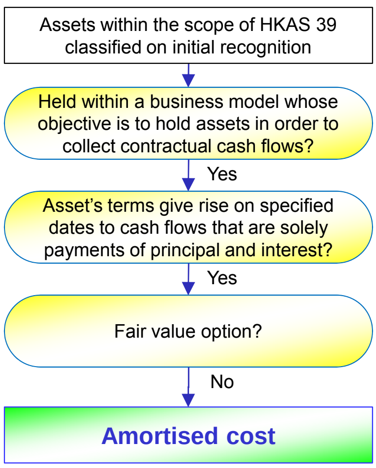
Same as HKAS 39



Subsequent Measurement of Financial Liabilities

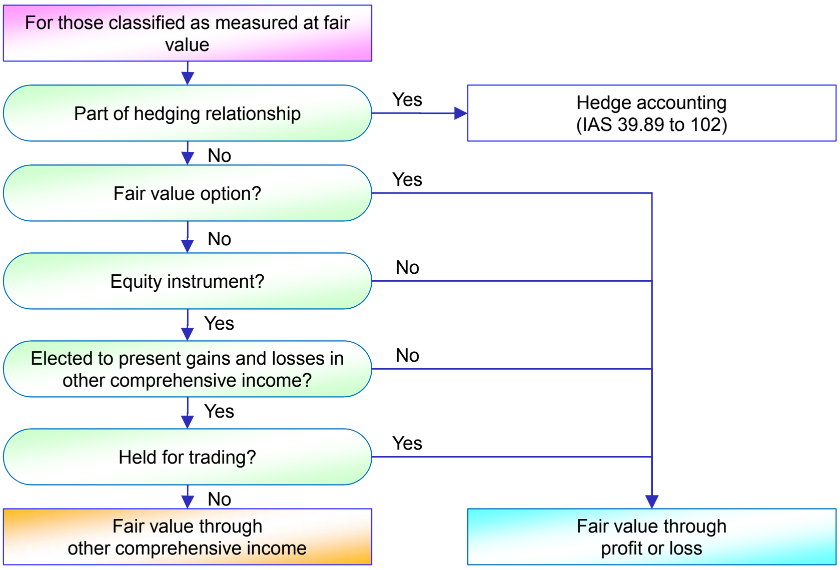
- After initial recognition, an entity shall measure a financial liability in accordance with para. 4.2.1–4.2.2.
- An entity shall apply the hedge accounting requirements of HKAS 39 to a financial liability that is designated as a hedged item. (para. 5.3.2)

Chapter 5.7 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)

Chapter 5.7 Gains and Losses



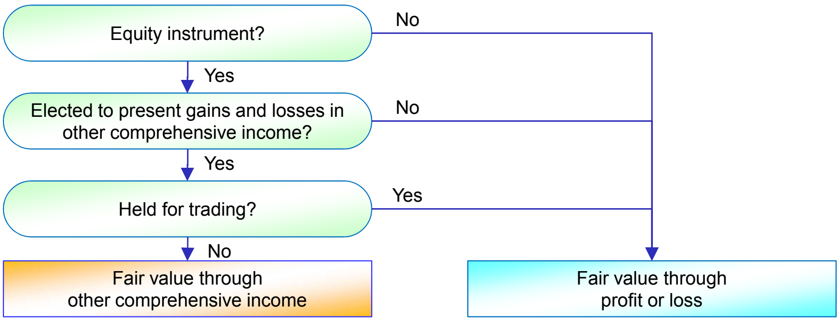
Chapter 5.7 Gains and Losses

Equity instrument?

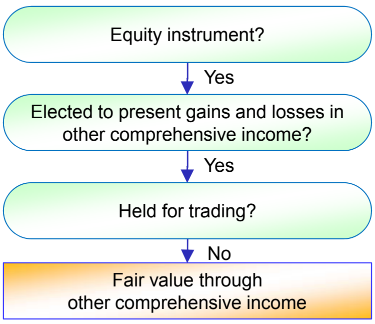
- All investments in equity instruments and contracts on those instruments must be measured at fair value.
- However, in limited circumstances, cost may be an appropriate estimate of fair value.
  - That may be the case
    - if insufficient more recent information is available to determine fair value, 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

- 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)



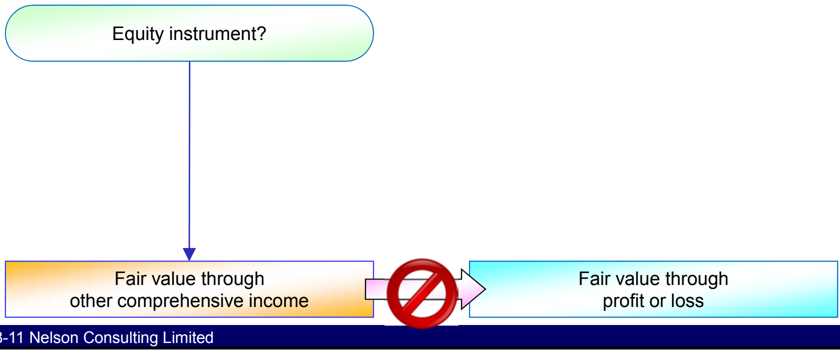
Chapter 5.7 Gains and Losses



- 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

Case

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 5.7 Gains and Losses

Case

Financial statements 2009 states that:

- For financial assets extant at 31 December 2009

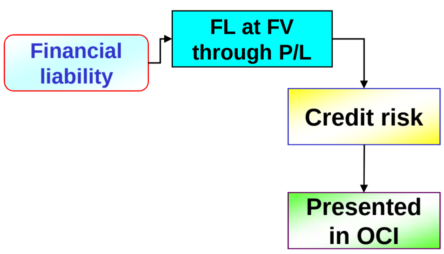
  Financial assets measured at amortised cost

  – 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 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 designated as at fair value through profit or loss

  – 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

- 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)

FL at FV through P/L → **Credit risk** → Other comprehensive income

Profit or loss

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

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).
- 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. 7.1.1)

Financial Instruments: Recap & Update

22 June 2011

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Financial Instruments: Recap & Update

22 June 2011

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