EXPOSURE DRAFT

Hong Kong Accounting Standard 30

Disclosures in the Financial Statements of Banks and Similar Financial Institutions

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Hong Kong Accounting Standard 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* (HKAS 30) is set out in paragraphs 1-59. All the paragraphs have equal authority. HKAS 30 should be read in the context of the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Scope

1. This Standard shall be applied in the financial statements of banks and similar financial institutions (subsequently referred to as banks).

2. For the purposes of this Standard, the term "bank" includes all financial institutions, one of whose principal activities is to take deposits and borrow with the objective of lending and investing and which are within the scope of banking or similar legislation. The Standard is relevant to such enterprises whether or not they have the word "bank" in their name.

3. Banks represent a significant and influential sector of business worldwide. Most individuals and organisations make use of banks, either as depositors or borrowers. Banks play a major role in maintaining confidence in the monetary system through their close relationship with regulatory authorities and governments and the regulations imposed on them by those governments. Hence there is considerable and widespread interest in the well-being of banks, and in particular their solvency and liquidity and the relative degree of risk that attaches to the different types of their business. The operations, and thus the accounting and reporting requirements, of banks are different from those of other commercial enterprises. This Standard recognises their special needs. It also encourages the presentation of a commentary on the financial statements which deals with such matters as the management and control of liquidity and risk.

4. This Standard supplements other Hong Kong Accounting Standards which also apply to banks unless they are specifically exempted in a Standard.

5. This Standard applies to the separate financial statements and the consolidated financial statements of a bank. Where a group undertakes banking operations, this Standard is applicable in respect of those operations on a consolidated basis.

Background

6. The users of the financial statements of a bank need relevant, reliable and comparable information which assists them in evaluating the financial position and performance of the bank and which is useful to them in making economic decisions. They also need information which gives them a better understanding of the special characteristics of the operations of a bank. Users need such information even though

a bank is subject to supervision and provides the regulatory authorities with information that is not always available to the public. Therefore disclosures in the financial statements of a bank need to be sufficiently comprehensive to meet the needs of users, within the constraint of what it is reasonable to require of management.

7. The users of the financial statements of a bank are interested in its liquidity and solvency and the risks related to the assets and liabilities recognised on its balance sheet and to its off balance sheet items. Liquidity refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments as they fall due. Solvency refers to the excess of assets over liabilities and, hence, to the adequacy of the bank's capital. A bank is exposed to liquidity risk and to risks arising from currency fluctuations, interest rate movements, changes in market prices and from counterparty failure. These risks may be reflected in the financial statements, but users obtain a better understanding if management provides a commentary on the financial statements which describes the way it manages and controls the risks associated with the operations of the bank.

Accounting Policies

8. Banks use differing methods for the recognition and measurement of items in their financial statements. While harmonisation of these methods is desirable, it is beyond the scope of this Standard. In order to comply with HKAS 1 *Presentation of Financial Statements* and thereby enable users to understand the basis on which the financial statements of a bank are prepared, accounting policies dealing with the following items may need to be disclosed:

   (a) the recognition of the principal types of income (see paragraphs 10 and 11);

   (b) the valuation of investment and dealing securities (see paragraphs 24 and 25);

   (c) the distinction between those transactions and other events that result in the recognition of assets and liabilities on the balance sheet and those transactions and other events that only give rise to contingencies and commitments (see paragraphs 26 to 29);

   (d) the basis for the determination of impairment losses on loans and advances and for writing off uncollectable loans and advances (see paragraphs 43- 49); and

   (e) the basis for the determination of charges for general banking risks and the accounting treatment of such charges (see paragraphs 50 to 52).

   Some of these topics are the subject of existing Hong Kong Accounting Standards while others may be dealt with at a later date.

Income Statement

9. A bank should present an income statement which groups income and expenses by nature and discloses the amounts of the principal types of income and expenses.

10. ***In addition to the requirements of other Standards, the disclosures in the income statement or the notes to the financial statements should include, but are not limited to, the following items of income and expenses:***

Interest and similar income;

Interest expense and similar charges;

Dividend income;

Fee and commission income;

Fee and commission expense;

Gains less losses arising from dealing securities;

Gains less losses arising from investment securities;

Gains less losses arising from dealing in foreign currencies;

Other operating income;

Impairment losses on loans and advances;

General administrative expenses; and

Other operating expenses.

11. The principal types of income arising from the operations of a bank include interest, fees for services, commissions and dealing results. Each type of income is separately disclosed in order that users can assess the performance of a bank. Such disclosures are in addition to those of the source of income required by HKAS 14 *Segment Reporting*.

12. The principal types of expenses arising from the operations of a bank include interest, commissions, losses on loans and advances, charges relating to the reduction in the carrying amount of investments and general administrative expenses. Each type of expense is separately disclosed in order that users can assess the performance of a bank.

13. ***Income and expense items should not be offset except for those relating to hedges and to assets and liabilities which have been offset in accordance with HKAS 32.***

14. Offsetting in cases other than those relating to hedges and to assets and liabilities which have been offset as described in HKAS 32 prevents users from assessing the performance of the separate activities of a bank and the return that it obtains on particular classes of assets.

15. Gains and losses arising from each of the following are normally reported on a net basis:

(a) disposals and changes in the carrying amount of dealing securities;

(b) disposals of investment securities; and

(c) dealings in foreign currencies.

16. Interest income and interest expense are disclosed separately in order to give a better understanding of the composition of, and reasons for changes in, net interest.

17. Net interest is a product of both interest rates and the amounts of borrowing and lending. It is desirable for management to provide a commentary about average interest rates, average interest earning assets and average interest-bearing liabilities for the period. In some countries, governments provide assistance to banks by making deposits and other credit facilities available at interest rates which are substantially below market rates. In these cases, management's commentary often discloses the extent of these deposits and facilities and their effect on net income.

Balance Sheet

18. A bank should present a balance sheet that groups assets and liabilities by nature and lists them in an order that reflects their relative liquidity.

19. In addition to the requirements of other Hong Kong Accounting Standards, the disclosures in the balance sheet or the notes to the financial statements should include, but are not limited to, the following assets and liabilities.

Assets

Cash and balances with the central bank;

Treasury bills and other bills eligible for rediscounting with the central bank;

Government and other securities held for dealing purposes;

Placements with, and loans and advances to, other banks;

Other money market placements;

Loans and advances to customers; and

Investment securities.

Liabilities

Deposits from other banks;

Other money market deposits;

Amounts owed to other depositors;

Certificates of deposits;

Promissory notes and other liabilities evidenced by paper; and

Other borrowed funds.

20. The most useful approach to the classification of the assets and liabilities of a bank is to group them by their nature and list them in the approximate order of their liquidity; this may equate broadly to their maturities. Current and non-current items are not presented separately because most assets and liabilities of a bank can be realised or settled in the near future.

21. The distinction between balances with other banks and those with other parts of the money market and from other depositors is relevant information because it gives an understanding of a bank's relations with, and dependence on, other banks and the money market. Hence, a bank discloses separately:

(a) balances with the central bank;

(b) placements with other banks;

(c) other money market placements;

(d) deposits from other banks;

(e) other money market deposits; and

(f) other deposits.

22. A bank generally does not know the holders of its certificates of deposit because they are usually traded on an open market. Hence, a bank discloses separately deposits that have been obtained through the issue of its own certificates of deposit or other negotiable paper.

23. [Not used]

24. A bank should disclose the fair values of each class of its financial assets and liabilities as required by HKAS 32 **Financial Instruments: Disclosure and Presentation.**

25. HKAS 39 provides for four classifications of financial assets: loans and receivables, held-to-maturity investments, financial assets at fair value through profit or loss, and available-for-sale financial assets. A bank will disclose the fair values of its financial assets for these four classifications, as a minimum.

Contingencies and Commitments Including Off Balance Sheet Items

26. A bank should disclose the following contingent liabilities and commitments:

(a) the nature and amount of commitments to extend credit that are irrevocable because they cannot be withdrawn at the discretion of the bank without the risk of incurring significant penalty or expense; and

(b) the nature and amount of contingent liabilities and commitments arising from off balance sheet items including those relating to:

(i) direct credit substitutes including general guarantees of indebtedness, bank acceptance guarantees and standby letters of credit serving as financial guarantees for loans and securities;

(ii) certain transaction-related contingent liabilities including performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions;

(iii) ***short-term self-liquidating trade-related contingent liabilities arising from the movement of goods, such as documentary credits where the underlying shipment is used as security; and***

(vi) ***other commitments, note issuance facilities and revolving underwriting facilities.***

27. HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* deals generally with accounting for, and disclosure of, contingent liabilities. The Standard is of particular relevance to banks because banks often become engaged in many types of contingent liabilities and commitments, some revocable and others irrevocable, which are frequently significant in amount and substantially larger than those of other commercial enterprises.

28. Many banks also enter into transactions that are presently not recognised as assets or liabilities in the balance sheet but which give rise to contingencies and commitments. Such off balance sheet items often represent an important part of the business of a bank and may have a significant bearing on the level of risk to which the bank is exposed. These items may add to, or reduce, other risks, for example by hedging assets or liabilities on the balance sheet.

29. The users of the financial statements need to know about the contingencies and irrevocable commitments of a bank because of the demands they may put on its liquidity and solvency and the inherent possibility of potential losses. Users also require adequate information about the nature and amount of off balance sheet transactions undertaken by a bank.

Maturities of Assets and Liabilities

30. ***A bank should disclose an analysis of assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.***

31. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of a bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability but can also increase the risk of losses.

32. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of a bank and its exposure to changes in interest rates and exchange rates. In order to provide information that is relevant for the assessment of its liquidity, a bank discloses, as a minimum, an analysis of assets and liabilities into relevant maturity groupings.

33. The maturity groupings applied to individual assets and liabilities differ between banks and in their appropriateness to particular assets and liabilities. Examples of periods used include the following:

(a) up to 1 month;

(b) from 1 month to 3 months;

(c) from 3 months to 1 year;

(d) from 1 year to 5 years; and

(e) from 5 years and over.

Frequently the periods are combined, for example, in the case of loans and advances, by grouping those under one year and those over one year. When repayment is spread over a period of time, each instalment is allocated to the period in which it is contractually agreed or expected to be paid or received.

34. It is essential that the maturity periods adopted by a bank are the same for assets and liabilities. This makes clear the extent to which the maturities are matched and the consequent dependence of the bank on other sources of liquidity.

35. Maturities could be expressed in terms of:

(a) the remaining period to the repayment date;

(b) the original period to the repayment date; or

(c) the remaining period to the next date at which interest rates may be changed.

The analysis of assets and liabilities by their remaining periods to the repayment dates provides the best basis to evaluate the liquidity of a bank. A bank may also disclose repayment maturities based on the original period to the repayment date in order to provide information about its funding and business strategy. In addition, a bank may disclose maturity groupings based on the remaining period to the next date at which interest rates may be changed in order to demonstrate its exposure to interest rate risks. Management may also provide, in its commentary on the financial statements, information about interest rate exposure and about the way it manages and controls such exposures.

36. In many countries, deposits made with a bank may be withdrawn on demand and advances given by a bank may be repayable on demand. However, in practice, these deposits and advances are often maintained for long periods without withdrawal or repayment; hence, the effective date of repayment is later than the contractual date. Nevertheless, a bank discloses an analysis expressed in terms of contractual maturities even though the contractual repayment period is often not the effective period because contractual dates reflect the liquidity risks attaching to the bank's assets and liabilities.

37. Some assets of a bank do not have a contractual maturity date. The period in which these assets are assumed to mature is usually taken as the expected date on which the assets will be realised.

38. The users' evaluation of the liquidity of a bank from its disclosure of maturity groupings is made in the context of local banking practices, including the availability of funds to banks. In some countries, short-term funds are available, in the normal course of business, from the money market or, in an emergency, from the central bank. In other countries, this is not the case.

39. In order to provide users with a full understanding of the maturity groupings, the disclosures in the financial statements may need to be supplemented by information as to the likelihood of repayment within the remaining period. Hence, management may provide, in its commentary on the financial statements, information about the effective periods and about the way it manages and controls the risks and exposures associated with different maturity and interest rate profiles.

Concentrations of Assets, Liabilities and Off Balance Sheet Items

40. A bank should disclose any significant concentrations of its assets, liabilities and off balance sheet items. Such disclosures should be made in terms of geographical areas, customer or industry groups or other concentrations of risk. A bank should also disclose the amount of significant net foreign currency exposures.

41. A bank discloses significant concentrations in the distribution of its assets and in the source of its liabilities because it is a useful indication of the potential risks inherent in the realisation of the assets and the funds available to the bank. Such disclosures are made in terms of geographical areas, customer or industry groups or other concentrations of risk which are appropriate in the circumstances of the bank. A similar analysis and explanation of off balance sheet items is also important. Geographical areas may comprise individual countries, groups of countries or regions within a country; customer disclosures may deal with sectors such as governments, public authorities, and commercial and business enterprises. Such disclosures are made in addition to any segment information required by HKAS 14 *Segment Reporting*.

42. The disclosure of significant net foreign currency exposures is also a useful indication of the risk of losses arising from changes in exchange rates.

Losses on Loans and Advances

43. A bank should disclose the following:

(a) the accounting policy which describes the basis on which uncollectable loans and advances are recognised as an expense and written off;

(b) details of the movements in any allowance account for impairment losses on loans and advances during the period. It shall disclose separately the amount recognised as an expense in the period for impairment losses on uncollectible loans and advances, the amount charged in the period for loans and advances written off and the amount credited in the period for loans and advances previously written off that have been recovered;

(c) the aggregate amount of any allowance account for impairment losses on loans and advances at the balance sheet date.

44. Any amounts set aside in respect of losses on loans and advances in addition to impairment losses recognised under HKAS 39 on loans and advances shall be accounted for as appropriations of retained earnings. Any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of net profit or loss for the period.

45. [Not used].

46. Local circumstances or legislation may require or allow a bank to set aside amounts for impairment losses on loans and advances in addition to those losses which have been recognised under HKAS 39. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining profit or loss. Similarly, any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of profit or loss.

47. Users of the financial statements of a bank need to know the impact that impairment losses on loans and advances have had on the financial position and performance of the bank; this helps them judge the effectiveness with which the bank has employed its resources. Therefore a bank discloses the aggregate amount of any allowance account for impairment losses on loans and advances at the balance sheet date and the movements in the allowance account during the period. The movements in the allowance account, including the amounts previously written off that have been recovered during the reporting period, are shown separately.

48. [Not used].

49. When loans and advances cannot be recovered, they are written off and charged against any allowance account for impairment losses. In some cases, they are not written off until all the necessary legal procedures have been completed and the amount of the impairment loss is finally determined. In other cases, they are written off earlier, for example when the borrower has not paid any interest or repaid any principal that was due in a specified period. As the time at which uncollectible loans and advances are written off differs, the gross amount of loans and advances and of the allowance account for impairment losses may vary considerably in similar circumstances. As a result, a bank discloses its policy for writing off uncollectible loans and advances.

General Banking Risks

50. Any amounts set aside for general banking risks, including future losses and other unforeseeable risks or contingencies should be separately disclosed as appropriations of retained earnings. Any credits resulting from the reduction of such amounts result in an increase in retained earnings and should not be included in the determination of net profit or loss for the period.

51. Local circumstances or legislation may require or allow a bank to set aside amounts for general banking risks, including future losses or other unforeseeable risks, in addition to the charges for losses on loans and advances determined in accordance with paragraph 45. A bank may also be required or allowed to set aside amounts for contingencies. Such amounts for general banking risks and contingencies do not qualify for recognition as provisions under HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Therefore, a bank recognises such amounts as appropriations of retained earnings. This is necessary to avoid the overstatement of liabilities, understatement of assets, undisclosed accruals and provisions and the opportunity to distort net income and equity.

52. The income statement cannot present relevant and reliable information about the performance of a bank if net profit or loss for the period includes the effects of undisclosed amounts set aside for general banking risks or additional contingencies, or undisclosed credits resulting from the reversal of such amounts. Similarly, the balance sheet cannot provide relevant and reliable information about the financial position of a bank if the balance sheet includes overstated liabilities, understated assets or undisclosed accruals and provisions.

Assets Pledged as Security

53. A bank should disclose the aggregate amount of secured liabilities and the nature and carrying amount of the assets pledged as security.

54. In some countries, banks are required, either by law or national custom, to pledge assets as security to support certain deposits and other liabilities. The amounts involved are often substantial and so may have a significant impact on the assessment of the financial position of a bank.

Trust Activities

55. Banks commonly act as trustees and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. Provided the trustee or similar relationship is legally supported, these assets are not assets of the bank and, therefore, are not included in its balance sheet. If the bank is engaged in significant trust activities, disclosure of that fact and an indication of the extent of those activities is made in its financial statements because of the potential liability if it fails in its fiduciary duties. For this purpose, trust activities do not encompass safe custody functions.

Related Party Transactions

56. HKAS 24 *Related Party Disclosures* deals generally with the disclosures of related party relationships and transactions between a reporting enterprise and its related parties. In some countries, the law or regulatory authorities prevent or restrict banks entering into transactions with related parties whereas in others such transactions are permitted. HKAS 24 is of particular relevance in the presentation of the financial statements of a bank in a country that permits such transactions.

57. Certain transactions between related parties may be effected on different terms from those with unrelated parties. For example, a bank may advance a larger sum or charge lower interest rates to a related party than it would in otherwise identical circumstances to an unrelated party; advances or deposits may be moved between related parties more quickly and with less formality than is possible when unrelated parties are involved. Even when related party transactions arise in the ordinary course of a bank's business, information about such transactions is relevant to the needs of users and its disclosure is required by HKAS 24.

58. When a bank has entered into transactions with related parties, it is appropriate to disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effects of the relationships on the financial statements of the bank. The disclosures are made in accordance with HKAS 24 and include disclosures relating to a bank's policy for lending to related parties and, in respect of related party transactions, the amount

included in:

(a) each of loans and advances, deposits and acceptances and promissory notes; disclosures may include the aggregate amounts outstanding at the beginning and end of the period, as well as advances, deposits, repayments and other changes during the period;

(b) each of the principal types of income, interest expense and commissions paid;

(c) the amount of the expense recognised in the period for impairment losses on loans and advances and the amount of any allowance account at the balance sheet date; and

(d) irrevocable commitments and contingencies and commitments arising from off balance sheet items.

Effective Date

59. This Hong Kong Accounting Standard becomes operative for the financial statements of banks covering periods beginning on or after 1 January 2005.

Appendix

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at 9 March 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 30.

The International Accounting Standard comparable with HKAS 30 is IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.

There are no major textual differences between HKAS 30 and IAS 30.