



## **HKFRS 9 *Financial Instruments***

### **HKICPA Standard Setting Department Staff Summary (March 2010)**

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to [commentletters@hkicpa.org.hk](mailto:commentletters@hkicpa.org.hk).

### **Introduction**

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1. HKFRS 9 *Financial Instruments* addresses classification and measurement of financial assets.
2. An entity shall apply the Standard for annual periods beginning on or after 1 January 2013. Earlier application is permitted. At the date of initial application, an entity shall perform the business model assessment on the basis of the facts and circumstances that exist at the date of initial application.
3. Entities that adopt the Standard for reporting periods beginning before 1 January 2012 need not restate prior periods.

### **Reasons for issuing HKFRS 9**

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4. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing HKFRS 9 is to maintain international convergence arising from the issue of IFRS 9 *Financial Instruments* by the International Accounting Standards Board (IASB).
5. Many users of financial statements and other interested parties have told the IASB that the requirements in IAS 39 *Financial Instruments: Recognition and Measurement* are difficult to understand, apply and interpret. They have urged the IASB to develop a new standard for financial reporting for financial instruments that is principle-based and less complex.
6. In April 2009, 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 such as the Financial Stability Board, the IASB announced an accelerated timetable for replacing IAS 39.



7. IFRS 9 is the first part of Phase 1 of the IASB's project to replace IAS 39. The main phases are:
  - a. Phase 1: Classification and measurement (issued in November 2009, which addresses only requirements for financial assets and requirements for financial liabilities will be finalised in due course)
  - b. Phase 2: Impairment methodology (Exposure Draft issued in November 2009)
  - c. Phase 3: Hedge accounting (Exposure Draft expected to be issued in the first quarter of 2010).

### **Main features of HKFRS 9**

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#### **Classification**

8. Unless 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 (that is, business model test). The entity's business model does not depend on the management's intentions for an individual instrument and should be determined on a higher level of aggregation. An entity could have more than one business model for managing its financial instruments.
  - b. The contractual cash flow characteristics of the financial asset (that is, contractual cash flow characteristics test).
9. 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; and
  - b. The contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other financial assets are measured at fair value.

#### **Fair value option**

10. 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 an accounting mismatch.

#### **Embedded derivatives**

11. If a hybrid contract contains a financial asset host, an entity shall apply the classification requirements contained above (that is, either at amortised cost or fair value) to the entire hybrid contract. HKAS 39 continues to apply for a hybrid contract with a host that is not within the scope of HKFRS 9 (that is, an entity shall apply the requirements in paragraphs 11 – 13 and AG27 – AG33B of HKAS 39 to determine whether it must separate the embedded derivative from the host).



### **Contractually linked instruments**

12. The Standard also contains guidance for contractually linked instruments that create concentrations of credit risk (that is, tranches). In particular, an entity holding such financial asset must look through until it can identify the underlying pool of instruments that are creating the cash flows. If the holder cannot perform the 'look through' test at initial recognition, the tranche must be measured at fair value.

### **Reclassification**

13. When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets. Such changes in business model would be very infrequent, significant and demonstrable and determined by the entity's senior management as a result of external or internal change.

### **Investment in equity instruments**

14. Classification principles stated above indicate that all equity investments should be measured at fair value. However, the Standard allows an entity, at initial recognition only, to elect to present changes in the fair value of an investment in an equity instrument that is not held for trading in other comprehensive income. This election is irrevocable and can be made on an instrument-by-instrument basis.
15. The amounts recognised in other comprehensive income are not recycled to profit or loss on disposal of the investment or in any other circumstances, although they may be reclassified within equity. Dividend income on such investments is recognised in profit or loss in accordance with HKAS 18 *Revenue*.

### **Other references on IFRS 9**

1. BDO Hong Kong Update on HKFRS 9  
[http://www.bdo.com.hk/file\\_publication.php/25/HKFRS\\_9\\_Financial\\_Instruments](http://www.bdo.com.hk/file_publication.php/25/HKFRS_9_Financial_Instruments)
2. Deloitte IAS Plus on IFRS 9  
<http://www.iasplus.com/iasplus/0911ifrs9.pdf>
3. Ernst & Young Supplement to IFRS outlook on IFRS 9 – Phase 1 of new standard to replace IAS 39  
[http://www.ey.com/Publication/vwLUAssets/Supplement\\_60/\\$File/Supplement\\_60\\_GL\\_IFRS.pdf](http://www.ey.com/Publication/vwLUAssets/Supplement_60/$File/Supplement_60_GL_IFRS.pdf)
4. KPMG IFRS Briefing Sheet on IFRS 9  
[http://www.kpmg.com.hk/en/virtual\\_library/Audit/IFRS\\_briefingsheet/IFRSBS09160.pdf](http://www.kpmg.com.hk/en/virtual_library/Audit/IFRS_briefingsheet/IFRSBS09160.pdf)
5. PricewaterhouseCoopers HKFRS News on HKFRS 9  
[http://www.pwchk.com/webmedia/doc/633952556437760662\\_hkfrs\\_news\\_dec2009.pdf](http://www.pwchk.com/webmedia/doc/633952556437760662_hkfrs_news_dec2009.pdf)

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