

SSAP 24
STATEMENT OF STANDARD ACCOUNTING PRACTICE 24
ACCOUNTING FOR INVESTMENTS IN SECURITIES

(Issued April 1999)

*The standards, which have been set in **bold italic type**, should be read in the context of the background material and implementation guidance and in the context of the Foreword to Statements of Standard Accounting Practice and Accounting Guidelines. Statements of Standard Accounting Practice are not intended to apply to immaterial items (see paragraph 8 of the Foreword).*

Introduction

The objective of this Statement is to prescribe principles for the accounting treatment and disclosure of investments in debt and equity securities. The major issues in accounting for investments in securities addressed by this Statement are the classification and measurement of different categories of investments, the treatment of holding gains and losses and disclosure of relevant information.

Scope

1. *This Statement should be applied in accounting and reporting for investments in debt and equity securities, except those held either solely for the purpose of recovering advances or, as investments in subsidiaries, associates or joint ventures which are dealt with in accordance with SSAP 7, SSAP 10 and SSAP 21 respectively.*
2. The requirements of this Statement do not apply to retirement schemes, authorised unit trusts and authorised mutual funds.

Definitions

3. *The following terms are used in this Statement with the meanings specified:*
 - "Amortised cost" is cost plus or minus the cumulative amortisation of the difference between the purchase price and the maturity amount.*
 - "Cost", in relation to securities held, is the amount paid or payable for the acquisition of the holding, including any charges, taxes and duties, any option premium paid or received as a precursor to the holding, but net of any selling fee received or receivable and excluding accrued interest. Where part of a holding is sold, the cost of the holding should be calculated as the average cost of acquisition.*
 - "Debt security" is a security representing a creditor relationship with an enterprise.*
 - "Equity security" is a security representing a residual interest in the assets of an enterprise after deducting all its liabilities.*
 - "Fair value" is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.*

"Holding gain or loss" is the net change in fair value of a security exclusive of dividend or other distribution or interest income recognised but not yet received and exclusive of any write-downs for other-than-temporary impairment.

"Security" is a bond or share or other negotiable instrument evidencing debt or ownership.

4. Debt security includes:
 - a. government securities, government agency securities, corporate bonds, convertible debt, commercial paper, all securitised debt instruments, such as mortgage backed securities and interest-only and principal-only strips;
 - b. any preference share that by its terms either must be redeemed by the issuing enterprise in cash, or is redeemable at the option of the investor.
5. Debt security excludes option contracts, financial futures contracts, forward contracts, and lease contracts. Trade accounts receivable arising from sales on credit by industrial or commercial enterprises and loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions are examples of receivables that do not meet the definition of security; thus, those receivables are not debt securities (unless they have been securitised, in which case they would meet the definition).
6. Equity securities represent an ownership interest in an enterprise (for example, ordinary or preference shares). However, the term does not include convertible debt or any preference share that by its terms either must be redeemed in cash by the issuing enterprise or is redeemable at the option of the investor.

Balance sheet recognition

7. ***Investments in securities should be recognised as assets or, in the case of short positions, liabilities from the date on which the enterprise is bound by the contract which gives rise to them.***
8. Some enterprises have accounted for securities transactions as of the date of the settlement of the transaction and some adopt the date on which the trade is made. This Statement requires trade date accounting since during the period between the trade date and settlement date of a purchase of a security, the enterprise has acquired all the risks and rewards of ownership of the security.
9. ***Investments in securities should continue to be recognised as such while the securities are lent, or when they are sold subject to a commitment to repurchase them at a predetermined price. However, where securities are sold subject to a repurchase agreement, the terms of which transfer substantially all the risks and rewards of ownership to the buyer, the transaction should be accounted for as an outright sale and the commitment to repurchase accounted for separately.***

Held-to-Maturity Securities

10. ***Investments in debt securities should be classified as held-to-maturity and measured at amortised cost in the balance sheet if, and only if, the reporting enterprise has the expressed intention and ability to hold those securities to maturity, subject to the requirements of paragraph 34 to write down securities to reflect any diminution in their value.***

11. A security is not classified as held-to-maturity if that security can contractually be prepaid or otherwise extinguished by the issuer in such a way that the holder of the security would not recover substantially all of its recorded investment. This prohibition does not apply to situations in which events that are not the result of contractual provisions, for example, borrower default or changes in the value of an instrument's denominated currency relative to the enterprise's functional currency, cause the holder not to recover substantially all of its recorded investment.
12. The following changes in circumstances, however, may cause the enterprise to change its intention to hold a certain security to maturity without calling into question its intention to hold other debt securities to maturity in the future. Thus, the sale or transfer of a held-to-maturity security due to one of the following changes in circumstances is not considered to be inconsistent with its original classification:
 - a. evidence of a significant deterioration in the issuer's credit-worthiness (The sale of a held-to-maturity security must be in response to an actual deterioration, not mere speculation. That deterioration should be supported by evidence about the issuer's ability to repay on maturity);
 - b. a change in tax law that eliminates or reduces the tax-exempt status of interest on the debt security (but not a change in tax law that revises the marginal tax rates applicable to interest income). Securities that may need to be sold to implement tax planning strategies would normally be classified as other investments, and not held-to-maturity or investment securities;
 - c. a major business combination or major disposition (such as sale of a segment) that necessitates the sale or transfer of held-to-maturity securities to maintain the enterprise's existing interest rate risk position or credit risk policy;
 - d. a change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of investments in certain kinds of securities, thereby causing an enterprise to dispose of a held-to-maturity security;
 - e. a significant increase by the regulator in the industry's capital requirements that causes the enterprise to downsize by selling held-to-maturity securities (however, an enterprise's ability and intention to hold securities to maturity would be called into question by the sale of held-to-maturity securities to realise gains to replenish regulatory capital that had been reduced by a provision for loan losses);
 - f. a significant increase in the risk weights of debt securities used for regulatory risk-based capital purposes; and
 - g. unanticipated or exceptional liquidity needs of financial institutions, for example, a bank run or a similar situation affecting an insurance company.

In addition to the foregoing changes in circumstances, other events that are isolated, non-recurring, and unusual for the reporting enterprise that could not have been reasonably anticipated may cause the enterprise to sell or transfer a held-to-maturity security without necessarily calling into question its intention to hold other debt securities to maturity. However, if this occurs, the classification should be re-considered in the light of the circumstances that led to the sale or transfer of the held-to-maturity security. All sales and transfers of held-to-maturity securities are disclosed pursuant to paragraph 50.

13. An enterprise should not classify a debt security as held-to-maturity if the enterprise has the intention to hold the security for only an undetermined period. Consequently, a debt security is not classified as held-to-maturity if, for example, the enterprise anticipates that the security would be available to be sold in response to:
 - a. changes in market interest rates and related changes in the security's prepayment risk;
 - b. changes in the availability of and the yield on alternative investments;
 - c. changes in funding sources and terms; or

- d. changes in foreign currency risk.
14. If a significant proportion of the held-to-maturity securities (for example, 10% of the held-to-maturity portfolio) is sold prior to maturity in any year, there is a general presumption that the whole of held-to-maturity category needs to be reclassified. Similarly, if a significant proportion of a particular type of held-to-maturity securities is sold, re-consideration of the classification of the remaining balance is then necessary.
 15. Sales of debt securities that meet either of the following two conditions may be considered as maturities for the purpose of the classification of securities under paragraph 10 and the disclosure requirements of paragraphs 49 and 50:
 - a. the sale of a security occurs near enough to its maturity date that interest rate risk is substantially eliminated as a pricing factor. That is, the date of sale is so near the maturity (for example, within three months) that changes in market interest rates would not have a significant effect on the security's fair value; and
 - b. the sale of a security occurs after the enterprise has already collected a substantial portion (at least 85 per cent) of the principal outstanding at acquisition (not the principal outstanding at issuance for securities purchased in the secondary market).
 16. *The profit or loss on disposal of a held-to-maturity security should be accounted for in the period in which the disposal occurs as the difference between the net sales proceeds and the carrying amount of the security.*

Investments other than held-to-maturity securities

17. *An enterprise should choose, as a matter of accounting policy, whether to apply the benchmark treatment of investments other than held-to-maturity securities set out in paragraphs 18 to 26 or the alternative treatment set out in paragraphs 27 to 30. Whichever policy is selected, it should be applied consistently.*

Benchmark treatment

18. *Investments in equity securities and debt securities that are not classified as held-to-maturity should be classified as either investment securities or other investments.*
19. *Investment securities are securities which are intended to be held on a continuing basis. Securities should only be treated as investment securities if:*
 - a. *they are held for an identified long term purpose and that purpose is documented at the time of acquisition or change of purpose; and*
 - b. *the securities held for the documented purpose are clearly identifiable.*
20. *Securities not classified as investment securities nor as held-to-maturity securities should be classified as other investments.*
21. The purpose of the above classification is so that the appropriate measurement requirements can be determined for securities held for different purposes. It is recognised that for disclosure purposes, some enterprises may use alternative terms (for example, "dealing securities", "long term investments", "short term investments"). This is acceptable provided that the meaning of alternative terms is made clear and the accounting treatment adopted conforms with this Statement. The requirements for financial statement presentation are dealt with more fully in paragraph 46.

22. When management intends to hold a security for the purpose of capital gain, even if it is anticipated that it may take several years for that gain to accrue, or if they invest in a liquid security in the absence of an immediate alternative use for surplus funds, an effective management will review on a regular basis whether they should continue to hold the security or sell it. Thus, in order that management's performance can be measured, it is appropriate to classify the security as "other investment" regardless of the period of holding and carry it at fair value in accordance with paragraph 24. On the other hand, when management's intention is to hold the security for an identified long term or strategic reason (for example, to maintain a good relationship with a business counterpart or to generate a regular and dependable cash flow to meet other commitments), the security would not normally be sold solely because of short term fluctuations in price. In that case, it would be justifiable to classify the security as an investment security. It would be rare for a dated debt security to be classified as an investment security.
23. *Investment securities should be carried at cost subject to the requirements of paragraph 31 to write down securities to reflect any diminution in their value which is expected to be other than temporary.*
24. *Securities classified as other investments should be measured at fair value in the balance sheet.*
25. *Unrealised holding gains and losses for other investments should be included in net profit or loss for the period.*
26. *The profit or loss on disposal of investments other than held-to-maturity securities should be accounted for in the period in which the disposal occurs as the difference between the net sales proceeds and the carrying amount of the securities.*

Alternative treatment

27. *After initial recognition, an enterprise should measure securities other than held-to-maturity securities at their fair values.*
28. *A recognised gain or loss arising from a change in the fair value of a security that is not part of a hedging relationship should be reported as follows:*
- a. *a gain or loss on a security held for trading purposes should be included in net profit or loss for the period in which it arises;*
 - b. *a gain or loss on a security that is not held for trading purposes should be recognised directly in equity, until the security is sold, collected, or otherwise disposed of, or until the security is determined to be impaired (see paragraph 37), at which time the cumulative gain or loss should be included in net profit or loss for the period.*
29. *A security is held for trading purposes if it was acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin.*
30. *Because the designation of a security as held for trading purposes is based on the objective for initially acquiring it, an enterprise should not reclassify securities that are being remeasured to fair value either into or out of the trading category while they are held.*

Impairment

31. *The carrying amounts of individual securities or holdings of the same securities, which are classified as investment securities and carried at cost in accordance with paragraph 23, should be reviewed at each reporting date in order to assess whether the fair value of such securities has declined below the carrying amount. When such a decline has occurred, the carrying amount of the securities should be reduced to the fair value unless there is evidence that the decline is temporary. The amount of the reduction should be recognised as an expense immediately.*
32. A decline in fair value of an investment to below its carrying amount that is other than temporary is obvious in some cases, such as bankruptcy or an agreement to sell an investment at an amount which will result in a loss. In less obvious situations, impairment of the carrying amount of an investment may be indicated by conditions such as:
- a. a prolonged period during which the quoted market value of the investment is less than its carrying value;
 - b. severe losses by the investee in the current year or current and prior years;
 - c. continued losses by the investee for a period of years;
 - d. suspension of trading in the securities;
 - e. liquidity or going concern problems of the investee; or
 - f. the current fair value of the investment (an appraisal) is less than its carrying value.
33. Notwithstanding provisions in paragraph 32, when a condition, indicating that an impairment in the carrying amount of an investment may have occurred, has persisted for a period of three years, there is a general presumption that there has been an impairment in value which is other than temporary. This presumption can only be rebutted by persuasive evidence to the contrary.
34. *The carrying amounts of individual securities or holdings of the same debt securities which are classified as held-to-maturity securities should be reviewed at each reporting date in order to assess the credit risk and appropriate provisions should be made when the investor is not expected to recover the carrying value of the investment in that security. The amount of the provisions should be recognised as an expense immediately.*
35. The deterioration in the credit standing of the issuer prior to maturity is obvious in some cases such as insolvency. Other possible indicators may include continued losses by the issuer for a period of years, liquidity or going concern problems of the issuer.
36. *Provisions against the carrying value of individual securities or holdings of the same equity or debt securities, which are classified as investment securities carried at cost less provisions or held-to-maturity securities, should be written back to income when the circumstances and events that led to the write-downs or write-offs cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. The amount written back should not exceed the amount of the write-downs or write-offs.*
37. *If a loss on a security carried at fair value has been recognised directly in equity in accordance with paragraph 28 and there is objective evidence that the security is impaired, the loss that had been recognised directly in equity should be removed from equity and recognised in net profit or loss for the period even though the security still meets the criteria for recognition.*
38. *The amount of the loss that should be removed from equity and reported in net profit or loss for the period is the difference between its acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that security previously recognised in net profit or loss.*

39. Objective evidence that a security is impaired includes financial difficulty, payment delinquency, a high probability of bankruptcy or other financial reorganisation of the issuer, or the disappearance of an active market for that security due to financial difficulties. The disappearance of an active market because an enterprise has 'gone private' is not evidence of impairment.

Determining Fair Value

40. It should normally be possible to estimate the fair value of a security that an enterprise has acquired from an outside party. An enterprise is unlikely to purchase a security for which it does not expect to be able to obtain a reliable measure of fair value after acquisition. Generally quoted market prices, if available, give the most reliable measure of fair value provided that the securities are actively traded in a liquid market. Although quoted market prices are not available for all securities, a reasonable estimate of fair value can usually be made or obtained for other securities required to be valued at fair value by this standard. For debt securities that do not trade regularly or that trade only in principal-to-principal markets, a reasonable estimate of fair value can be made using a variety of pricing techniques, including, discounted cash flow analysis. Similarly for unquoted equity securities, fair value may be estimated by a variety of techniques, including comparison of price/earnings ratios and dividend yields with those of quoted securities and estimates based on the price at which the last reported sale or purchase took place.
41. Where a holding of a quoted security is so large that it could be disposed of only at an unfavourable price or over an extended period, it should be valued at an appropriate discount to the market price. The discount should be sufficient to reflect the reduction in price resulting from the size of the holding or all future costs likely to be incurred in disposing of the interest over time in the ordinary course of business.

Hedging

42. *Where securities positions are maintained as designated and effective hedges, the accounting treatment adopted should mirror that of the underlying assets, liabilities or off-balance sheet items for which the hedge is maintained.*

Transfers between categories of investments

43. *The transfer of a security between categories of investments should be accounted for at fair value. At the date of the transfer, the security's unrealised holding gain or loss should be accounted for as follows:*
- a. *for a security transferred from the other investments category, the unrealised holding gain or loss at the date of the transfer will have already been recognised in net profit or loss and should not be reversed;*
 - b. *for a security transferred into the other investments category, the unrealised holding gain or loss at the date of the transfer should be recognised in net profit or loss immediately.*
44. The intention of the above paragraph is that the profit or loss arising from transfers between categories of investments is accounted for as if the investment were sold and repurchased at the date of transfer.

45. Having regard to the provisions set out in paragraphs 10 to 15, transfers from the held-to-maturity category should be rare, i.e. generally restricted to transfers due to the changes in circumstances identified in subparagraphs 12a to 12g. Given the nature of investment securities, transfers into or from the investment securities category should be infrequent.

Financial statement presentation

46. *An enterprise that presents a classified balance sheet (one that distinguishes between current and non-current assets and liabilities) should report all held-to maturity securities, debt securities classified as investment securities and other investments (including those for which the alternative treatment in paragraphs 27 to 30 has been adopted) as either current or non-current, as appropriate, under the provisions of SSAP 1, Presentation of Financial Statements. Equity securities which are classified as investment securities, by their nature, should be reported as non-current assets. Presentation of individual amounts for the three categories of investments on the face of the balance sheet is not required, provided the information is presented in the notes.*
47. Cash flows from purchases, sales, and maturities of held-to-maturity securities, investment securities and other investments will usually be classified as cash flows from investing activities unless they meet the definition of cash equivalents. Cash flows from purchases, sales, and maturities of other investments may also be classified as cash flows from operating activities if trading in other investments forms part of the principal activities of the enterprise.

Disclosure

48. *An enterprise should disclose:*
- a. *the accounting policies adopted for:*
 - i. *the determination of carrying amount of investments;*
 - ii. *the treatment of changes in fair value of securities carried at fair value; and*
 - iii. *the treatment of a revaluation surplus on the sale of a revalued investment;*
 - b. *the significant amounts included in income for:*
 - i. *dividends and interest from investment in securities;*
 - ii. *the net realised gain or loss on disposal of investment securities, showing separately any amounts previously recognised in equity;*
 - iii. *the net realised and unrealised holding gain or loss on other investments; and*
 - iv. *the net gain or loss from transfers of securities into the other investments category; and*
 - v. *impairment losses;*
 - c. *the market value of listed investments if they are not carried at market value;*
 - d. *significant restrictions on the realisability of investments or the remittance of income and proceeds of disposal;*
 - e. *the movements in investment revaluation reserve for the period and the nature of such movements; and*

- f. for enterprises whose main business is the holding of investments, an analysis of the portfolio of investments.*
49. *Investments in securities should be distinguished between equities and debt securities. They should be analysed between those which are listed and those which are unlisted. This analysis should be provided separately for trading securities, other investments, investment securities and held-to-maturity securities as appropriate for the measurement treatment adopted.*
50. *For any sales of or transfers from debt securities classified as held-to-maturity, the amortised cost amount of the sold or transferred security, the related realised or unrealised gain or loss, and the circumstances leading to the decision to sell or transfer the security should be disclosed in the notes to the accounts.*
51. The following disclosures may be provided to assist a reader's understanding of the financial statements:
- a. the directors' assessment of the fair value of investments that are not marketable;
 - b. where investments are not marketable, the method of assessing value used for comparison with cost, where applicable;
 - c. details of any single investment which represents a significant proportion of the reporting enterprise's assets.

Effective date

52. *The accounting practices set out in this Statement should be regarded as standard in respect of financial statements relating to periods beginning on or after 1 January 1999. Earlier adoption is encouraged but not required.*

Notes on legal requirements in Hong Kong

53. The references to "the Schedule" below are to the Tenth Schedule to the Companies Ordinance.

Balance sheet

54. Section 129 of the Companies Ordinance requires that if at the balance sheet date, a company holds more than 20% of any class of issued shares of another company, or the shareholding in another company exceeds 10% of the total assets of the investing company, the following should be disclosed:
- a. the name of that other company;
 - b. its country of incorporation; and
 - c. the description and proportion of the classes of shares held.
55. Paragraph 4(2) of the Schedule requires fixed assets, current assets and assets that are neither fixed nor current to be separately identified.
56. Paragraph 5 of the Schedule requires that where the directors' valuation of unlisted investments is not given and such investments are classified as fixed assets, the following should be stated:
- a. cost or valuation as shown in the company's books; and
 - b. any amount provided or written off for diminution in value.

57. Paragraph 9(1) of the Schedule requires separate disclosure of the aggregate amounts respectively of listed investments and unlisted investments.
58. Paragraph 9(3) of the Schedule requires that the carrying amounts of listed investments in the balance sheet should be analysed into those listed in Hong Kong and those listed outside Hong Kong.
59. Paragraph 12(10) of the Schedule requires that, if in the opinion of the directors, the realisable value of any current assets is less than the balance sheet value, a statement of that fact should be included in the accounts.
60. Paragraph 12(11) of the Schedule requires disclosure of the aggregate market value of listed investments where it differs from the carrying amounts in the balance sheet. If the aggregate market value is higher than the Stock Exchange value, the Stock Exchange value should also be disclosed.

Profit and loss account

61. Paragraph 13(1)(a) of the Schedule requires disclosure of the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets.
62. Paragraph 13(1)(g) of the Schedule requires disclosure of the amounts respectively of income from listed investments and income from unlisted investments.

Compliance with International Accounting Standards

63. The requirements of International Accounting Standard (IAS) No. 32 "Financial Instruments: Disclosure and Presentation" which relate to investments in securities provide for extensive disclosure of, among other things: the extent and nature of financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; exposure to interest rate risk; exposure to credit risk; and details of hedges of risks associated with anticipated future transactions. Attention is drawn to the fact that IAS 32 requires more extensive disclosures than those specified in this Statement and therefore compliance with this Statement does not ensure full compliance with the requirements of IAS 32 which relate to presentation and disclosure of investments in securities.
64. Similarly, International Accounting Standard (IAS) No. 39, "Financial Instruments: Recognition and Measurement" is more extensive in scope than this standard and therefore compliance with this Statement does not ensure full compliance with the requirements of IAS 39 which relate to recognition and measurement of investments in securities. However adoption of the alternative treatment set out in paragraphs 27 to 30 of this standard may enable entities which also wish to comply with IAS 39 to do so.