Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Summary of meeting with Financial Instruments Advisory Panel
Extract of minutes

Date: 29 April 2020, Wednesday
Time: 9:30 a.m. – 12:00 noon
Venue: Boardroom, 37/F., Wu Chung House, 213 Queen's Road East, Wanchai, Hong Kong (and via videoconference)

Present:	Panel members	HKICPA staff
	Joe Ng, Ernst & Young	Michelle Fisher, Deputy Director
	Isabel Lin, KPMG	Carmen Ho, Associate Director
	Martin Friedhoff, KPMG	Eky Liu, Associate Director
	Lisa Zhang, PwC	Joni Kan, Associate Director
	Mateusz Lasik, Deloitte	Katherine Leung, Associate Director
	Eros Lau, Deloitte	
	Fran Hung, Deloitte	

1. ED/2019/7 General Presentation and Disclosures

Operating category: Application to financial entities

- Most of the panel members generally agreed with the proposal in paragraph 51 of the ED to give banks an accounting policy choice on the classification of income and expenses from financing activities and from cash and cash equivalents. Also, they commented that the illustrative example of a statement of financial performance for an investment and retail bank is generally consistent with the current practice of banks. One panel member shared her observation that there may be a potential change in current practice for the classification of impairment losses in banks as there is currently diversity in practice in where this is presented.
- However, two panel members considered that it may not be appropriate for investment fund companies or conglomerates to have this accounting policy choice because if these companies choose to classify all the income and expenses from financing activities and from cash and cash equivalents in the operating category, it will distort their operating results. One panel member questioned how much of an entity's total business would need to be providing financing to customers to be able to use the option in paragraph 51(b) of the ED. Another Panel member suggested that, instead of an accounting policy choice, for companies other than banks the allocation of income and expenses to financing activities should be based on the entity's business model.
- Panel members expressed mixed views on the staff suggestion that instead of having an accounting policy choice, a viable alternative might be to have an impracticable exemption−ie require an entity that provides financing to customers as a main business activity to classify the income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers in the operating category unless impracticable to do so. If it is impracticable to do this allocation, then all income and expenses from financing activities and all income and expenses from cash and cash equivalents would be required to be classified in the operating category.
- A panel member explained that it is not easy to operationalise the impracticable criterion. Another Panel member noted that an undue cost and effort exemption would also be difficult to operationalise. These Panel members noted although the accounting policy choice will reduce the comparability of the financial results, it may be the best alternative

and noted that it is difficult for some companies to distinguish whether their business activities are financing or operating.

- Some panel members considered that for companies that both provide financing to customers and invest in the course of their main business activities it may be subjective and arbitrary to allocate expenses from financing activities, eg interest expense, between these two activities. They observed that the IASB has noted this difficulty in paragraph BC66 but recommended the IASB should provide more guidance and examples to help these companies perform the above allocation in order to apply the option in paragraph 51(a) of the ED.
- A panel member questioned that if there is a change in a company's main business activity so that providing financing to customers is no longer a company's main business activity, how the company should present[1] this change in the financial statements.

Classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments

- The Panel generally agreed with the proposals in paragraphs 56-59 of the ED. One panel member considered the proposal is conceptually sensible, though it may not be very clear to the practice in certain areas. Some panel members shared similar views that further guidance on classification for fair value gains and losses on derivatives and hedging instruments would be appreciated.
- One panel member shared his observation that the classification of fair value gains and losses on embedded derivatives (eg a conversion option separately accounted for and not classified as equity in a convertible bond) should be clarified under the IASB's proposals. He suggested the IASB to provide guidance on whether the classification follows the general proposal for derivatives or depends on where the embedded derivatives are originated (eg because it is from a convertible bond it should go to financing). Similarly, one panel member suggested the IASB should also clarify how to classify the fair value gains and losses of a hybrid financial instrument designated as a fair value through profit or loss financial instrument under the proposals.
- One panel member questioned in the case of an interest rate swap with the 2 legs being separated for different purposes, should the corresponding changes in fair value gains or losses classify according to the risks being managed by the entity or wholly recognised under the investing category, ie can part of the change in fair value of the swap go in one income statement line item and the other part go through a different line item (split accounting). The Panel member suggested that the IASB should clarify this.
- One panel member observed there is diversity in practice for the presentation of the effective and ineffective portion of the fair value changes of a qualified hedging instrument. The proposals are unclear whether the ineffective portion should be classified in a different line item in the same category as the effective portion or in the investing category by default. Another panel member shared similar view and suggested the IASB to provide an illustration for clarification purposes.
- One panel member raised concerns about how to operationalise the "undue cost of effort" exemption in paragraph 58 of the ED, in particular from an audit perspective. He shared his view that an entity should understand the objectives of holding each derivatives and it should not incur undue cost or effort to consider the classification of the corresponding fair value gains and losses provided the requirements are clear enough. He recommended the IASB to provide more clarity in the application of the proposals.

[1] The IASB states in paragraph 33 of the ED that if there is significant change in the nature of the entity's operation, that another presentation, disclosure or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in IAS 8 *Basis of Preparation, Accounting Policies, Changes in Accounting Estimates and Errors*.

Statement of cash flows

- The Panel generally supported the IASB's proposal to remove the accounting policy choice and require entities with particular business activities, including banks, to classify cash flows from interest received/paid and dividends received depending on the classification of the related income and expenses in the statement of profit or loss and classify cash flows from dividends paid as cash flows from financing activities.
- Two panel members shared the observations that the IASB's proposal may change the classification of cash flows related to Tier-2 financing not classified as equity for banks from financing activities to operating activities.
- Some panel members also recommended that the IASB should review IAS 7 *Statement of Cash Flows* more broadly to align its categorisation with the statement of profit or loss for consistency purposes.
- One panel member considered the definition of cash and cash equivalents is unclear. With the presence of different type of money market funds, he suggested the IASB to further clarify the definition of cash and cash equivalents.