



HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

12 Apr 2005

Review on Impact of the New Hong Kong Accounting Standards on Authorized Institutions' Capital Base and Regulatory Reporting

Our Ref: G10/1/7C

12 April 2005

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Review on Impact of the New Hong Kong Accounting Standards on Authorized Institutions' Capital Base and Regulatory Reporting

As you may already be aware, the HKMA has conducted an internal review to consider the implications of the new Hong Kong Accounting Standards (HKAS) on Als' capital base and regulatory reporting. In line with the Basel Committee's recommendations and to avoid a significant increase in Als' reporting burden, the HKMA has adopted a pragmatic approach that aims to minimise the impact of the new HKAS on its capital adequacy framework and hence to keep the required changes to a minimum. As such, the HKMA's review has focused on a few major accounting issues where the new HKAS have regulatory compliance/reporting implications.

We summarised our policy conclusions and the resultant changes required on regulatory reporting in a consultation paper which was issued to the industry Associations in early February. We also met with representatives of the HKICPA to discuss the impact of accounting changes on prudential reporting and the proposed treatment by the HKMA as contained in the consultation paper. The purpose of this letter is to draw your attention to the guidance that we have formulated as a result of this process. The associated changes to regulatory reporting should be made to returns submitted to HKMA from June 2005.

On provisioning, it is now accepted that it is not inconsistent with HKAS 30 for an AI to set aside amounts for general banking risks, including future losses or other unforeseeable risks, in addition to impairment losses recognised under HKAS 39 on loans and advances. With the intention of ensuring that the accounting changes are generally neutral with respect to Als' regulatory capital and recognising that collective assessment allowance is broadly akin to general provision, the HKMA will permit both the collective impairment allowance and the regulatory reserve to be included in tier 2 capital for capital adequacy purpose. The sum of these inclusions will continue to be limited to 1.25% of all risk-weighted exposures. Als should consult their auditors for appropriate disclosure in the published accounts.

Regarding the other policy issues arising from the accounting changes, the HKMA has concluded as follows:

- Consistent with HKAS 39, which eliminates the concept of interest in suspense, interest income for impaired loans should continue to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.
- On the treatment of gains and losses arising from available-for-sale (AFS) financial assets, Als should exclude any unrealised gains and losses arising from loans designated as AFS instruments in capital base and include revaluation gains of equity securities and debt securities not held for trading purposes in Tier 2 capital, subject to a haircut of 30%.
- Regarding capital treatment of fair value changes of securities designated at fair value through profit or loss, Als should exclude such fair value changes in Tier 1 capital and include it in Tier 2 capital, subject to a haircut of 30%.
- As for cash flow hedges, Als should exclude any fair value gains and losses from both the hedging instrument and the hedged item (i.e. the effective portion) from reserves of Tier 1 capital. The ineffective portion should be included in the profit and loss account.
- Concerning fair value changes of investment properties, the HKMA considers it appropriate for Als to include revaluation gains of investment property in Tier 2 capital, subject to 30% haircut on the revaluation surplus from lands and interest in land in Tier 2 capital.
- For designation of any other assets not referenced above at fair value through profit or loss, Als should seek the prior agreement of the HKMA.

In the light of the above policy decisions, it is our conclusion that a number of changes to the completion instructions of the regulatory returns are necessary to provide Als with appropriate guidance in regulatory reporting under the new accounting framework. In addition, the HKMA considers that a one-off survey will be useful for assessing the materiality of the accounting changes from a regulatory reporting and capital perspective. Depending on the results of this survey the HKMA may request additional regular reports in future.

Following the consultation with the industry Associations and discussions with the accounting profession, the proposals have been finalised and Guidance to Als, including the background paper and the one-off Survey Form, has been drawn up and is enclosed for your action. We also enclose with this letter a list of commonly-asked questions as an additional reference for Als.

It should be noted that the changes highlighted in this letter only affect locally incorporated Als and overseas-incorporated Als whose head offices have chosen to adopt comparable standards from 2005. These proposals will not apply to Als which are yet to adopt such new standards and they should continue to report on the original accounting basis until the relevant implementation date of the new accounting standards.

I should also emphasise that the policy conclusions and the changes to regulatory reporting are interim measure intended to guide Als through the immediate impact of the accounting changes. In the medium term, these conclusions will need to be re-examined as part of the

review of capital adequacy requirements and regulatory reporting in the context of the Basel II implementation and in the light of further guidance from the Basel Committee.

Should you have any questions, please feel free to contact Ms Theresa Kwan at 2878-1093 or Mr Eric Wong at 2878-8279.

Yours faithfully,

Simon Topping
Executive Director (Banking Policy)

Encl. [Guidance to Als](#) (MS Word, 61KB)
 [Background Paper](#) (MS Word, 75KB)
 [Survey Form](#) (MS Word, 28KB)
 [Q&A](#) (MS Word, 35KB)

c.c. The Hong Kong Association of Banks
 The Deposit-taking Companies Associations
 The Hong Kong Institute of Certified Public Accountants

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