Exploration of the Impact of International Financial Reporting Standards on Financial Assets in Chinese Banks

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Abstract: With the further improvement and development of China's financial market, financial products have become more diverse. The expression and presentation of correlation information related to financial assets in financial statements have always been a hot topic in relevant industries. Since introducing the new accounting standards, the previous four major categories have been reduced to three, and the scope of fair value measurement has been expanded. Numerous improvements have been made to the original accounting standards, providing a more transparent and standardised theoretical framework for the accounting of financial assets. This is conducive to the standardised classification of financial assets, ensuring the accuracy and understandability in the measurement and accounting process. It also provides users with more objective and fair information on financial statements. This article mainly analyses the changes in the international accounting standards for financial assets and explores the impact of these changes on the development of banks. The aim is to provide reference opinions to ensure the accuracy of measuring bank financial assets.

Keywords: Financial assets; New accounting standards; Bank development

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1. Introduction

Since the global financial crisis, G20 member countries have aimed to establish more standardised and unified new accounting standards to cope with the volatility caused by the financial crisis, completely replacing the original accounting standards. The new standards have significant changes in the accounting process. Firstly, the new standards ensure the fairness of accounting subjects. Secondly, the new standards' fair value measurement scope is expanded, and the accounting subject classification measured at amortised cost has changed from two categories in the past to only one. Finally, the new standards provide relatively more freedom in the guidance process, abandoning the overly stringent regulatory rules and classification methods of the past. In the context of the continuous deepening of economic globalisation and the integration of the domestic market with the international market, there is a demand for national accounting standards to maintain convergence with the global development trend. This is to weaken the imbalance or asymmetry in financial reporting information in different regions. As an essential participant in the financial market, banks have relatively strong correlations between their primary business and other financial activities. The financial assets they hold are also much more significant than other small and micro

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enterprises. Therefore, the transformation of the new accounting standards for financial assets will inevitably impact the development of banks.

2. New Changes in International Accounting Standards for Financial Assets

Under the new standards, financial assets are primarily classified into three types: amortised cost measurement, fair value measurement with changes recognised in the current period of profit or loss, and fair value measurement with changes recognised in other comprehensive income [2]. The new standards specify that reclassification can only occur when there is a change in the financial asset management model, and reclassification is only applicable to the affected new management model.

(1) Improvements to Held-to-maturity investments

The new standards pay more attention to the bank's management model and the cash flow characteristics in contractual transactions. Unlike the previous standards, the definition of held-to-maturity investments is less stringent under the new standards. It now requires multiple rounds of screening and assessment. The amortised cost measurement comprehensively evaluates the updated normative management assessment model and contract cash flow testing. Only the part outside the exercise of the fair value option can be classified as such. Secondly, the new standards avoid the past strict orientation in the classification process. Under the new standards, Held-to-maturity investments need to have a fixed recoverable amount during the holding period, implying a clear indication of the reported amount and maturity date in the contract. However, equity securities, such as stock options and warrants, cannot be classified as held-to-maturity investments due to the uncertainty in the recoverable amount after the holding period [3]. The new standards provide more flexibility in defining and identifying amortised costs than the rigid rules of the past. Thirdly, the new criterion emphasises the objective evidence and information resources presented during the transaction process. In the original criterion, convertible bonds were not classified as held-to-maturity investments, mainly because holders expected to benefit from the embedded option value in the bonds. However, in normal circumstances, most holders would forgo the opportunity to benefit from the conversion rights after holding them until maturity. If the conversion rights can only be exercised on the maturity date, most entities would still prefer to hold until maturity. Considering the inherent connection between contractual cash flows and the issuer's equity, there is often an inseparable intrinsic relationship, which needs to be more consistent with the amounts specified in the underlying loan agreement. However, during the conversion process by the issuer, this portion of financial assets needs to be converted at a fixed value or an unfixed equity, at which point the issuer will equate its equity to the monetary value, and the amount obtained will be equal to the sum of the unredeemed principal and interest. Therefore, during the conversion, this sum of principal and interest should be considered as prepayment of the debt instrument, and the holding should be terminated. It is evident from this that, in the original criterion, more attention was given to the holder's intent in holding shares, while the new criterion avoids this concept and classifies financial instruments more objectively and impartially.

(2) Improvements based on loan and receivable items

In the original criteria, loans and accounts receivable were considered non-derivative financial instruments with relatively specific return rates. They were to be classified as financial assets without active market quotations. When loans and accounts receivable are generated, there is typically no transaction between the parties, as it arises from the direct provision of money or other services by the enterprise to the debtor, forming a debt obligation. The ability to publicly quote and price bonds in an active market economy depends on the amount and frequency of bond transactions. If bonds have no actual market transactions and the holder has a positive intent to hold them until maturity, this portion of financial assets can be classified as loans and receivables. Unlike held-to-maturity, loans and receivables do not necessarily have to meet the criteria of having both a positive intent and the ability to hold them until maturity. Still, they must meet other requirements for non-short-term transaction purposes [4]. The classification of loans and receivables in the original criteria must meet the prerequisite of no active market quotations, a provision lacking logical consistency in accounting, exhibiting an overly absolute boundary in the recognition process, and overall lacking objectivity and fairness. In the new criteria, as long as financial assets meet the condition of holding only for the collection of contractual cash flows and pass the market SPPI test, they can be classified as amortised costs. The new criteria expand the scope for reclassifying financial assets, with certain limitations but a more flexible approach to classification.

3. Impact of the New International Accounting Standards for Financial Assets on Banks

This article takes a domestic banking group as an example, which was officially established in the late 1980s and has listed shares in mainland China as well as the Hong Kong and Macau regions. It is classified as a commercial bank ranking among the top 500 in the world. In 2015, the bank's total operating income exceeded 200 billion, making it a significant player among domestic joint-stock banks. With total assets reaching 5,474.978 billion, earnings per share are approximately 1.4 yuan, and the net asset yield surpasses 9.54%. Its future development prospects are immeasurable.

Under the new accounting standards, the bank records the portion of financial assets whose fair value changes are recognised in the current period's profit or loss. The total amount of trading financial assets reached 50.809 billion. These categories mainly include the bank's bond investments, equity investments, fund investments, etc. The total amount of financial assets measured at fair value with changes recognised in profit or loss is approximately 8.272 billion yuan, all in the form of debt investments. According to the classification method of the new accounting standards, these new financial assets are not solely for receiving contractual cash flows. Their fair value is used as the initial recognition basis, and other relevant changes are recognised in the current profit or loss. Considering that all assets originally designated in this bank's specified category are debt investments and do not meet the classification criteria for this type of financial asset, they are uniformly classified as financial assets measured at fair value with changes recognised in profit or loss.

Regarding the classification of held-to-maturity investments, whether under the new or old standards, financial assets must meet strict criteria to be classified as amortised costs. The new standards introduce more flexible classification principles, incorporating two new testing models. Based on objective facts, if other specified conditions are not met, only then will they be classified under the amortised cost model. Considering that the held-to-maturity investments of this commercial bank are strategic holdings for long-term development, with a positive intention for long-term retention, and the investment portfolio mainly consists of bonds with relatively stable returns. Over the years, the bank has yet to engage in large-scale or frequent sales of these investments. The overall development prospects are promising, with a generally high yield. The bank has even moderately increased the allocation of fixed-rate bonds. Apart from the reduction in the holding amount due to bond maturity, this portion of financial assets is showing an upward trend year by year.

In addition, the new standards also impact the risk and return of banks. Implementing the new standards makes the specification classification into cost measurement more stringent. Financial assets that did not meet specific management models or did not pass contract cash flow tests under the previous standards are now classified into the two fair value measurement models. This affects the asset operation of banks [5].

Therefore, management should judiciously choose the asset management method based on a cost-benefit analysis and make judgments based on the objective situation of asset transactions or fund operations. For example, the new standards will impact banks' operational risks. With the change in the criteria for classification, more financial assets are measured based on fair value, which means the scope of fair value measurement is expanding. This measurement model effectively integrates the financial status objectively presented in the overall operation of the bank with the overall trend of the financial market. The cyclical patterns of changes become more significant. When the overall financial market sentiment declines, financial assets measured at fair value will significantly shrink, causing panic among related stakeholders. This may lead to a large-scale sell-off of financial assets, further causing a decline in market value and potentially initiating a vicious cycle.

4. Strategies for Banks under the New International Accounting Standards for Financial Assets

(1) In-Depth understanding and exploration of the new standards

Implementing and further promoting the new standards pose significant crises and challenges for bank management. The criteria and logic for determining and classifying financial assets in the new standards are more rigorous. While management and classification are flexible, the specific classification processes and methods have changed. This demands a more stringent requirement for the professional competence of bank managers [6]. It is essential for bank management to deepen their understanding of the intrinsic value of the new standards, grasp the relevant evidence and asset testing methods for the classification of financial assets, and make judgments on the new concepts introduced. This ensures the smooth implementation of the new standards and helps banks navigate the crises and challenges they bring.

(2) Enhancing the valuation capability of fair value to ensure accuracy of fair value information

Under the new accounting standards, there has been a significant change in the recognition of bank financial assets, particularly in the measurement and classification of fair value. Many financial products or special financial instruments previously measured at cost under the old standards are now classified under fair value measurement. The delineation of accounting boundaries between the two has placed stricter demands on the assessment capabilities of bank management for fair value. Bank staff must assess fair value with a more impartial and objective attitude. Currently, fair value assessment technology and systems in Chinese banks still need improvement, with an overall lag in assessment levels. The fair value assessment of many financial projects needs more objectivity, and the classification needs to be more rigorous during the assessment process. In this situation, banks need to intensify efforts to standardise and categorise fair value valuation techniques clearly. They should distinctly classify financial projects or instruments that meet fair value boundaries and, for uncertain items, have flexible classification criteria and principles to ensure the operability and accuracy of the fair value estimation of financial assets. This will facilitate the further implementation and enforcement of the new standards in banks.

(3) Emphasizing the establishment of a positive communication relationship with accounting standards committees

After the implementation of the new standards, there have been significant changes in the content and criteria for classification. Many bank managers, needing an understanding of the criteria and principles for classification, may inadvertently make classification errors when not adapting to the new standards. In addition, some banks may need help adjusting to the new criteria. Banks should actively provide feedback while implementing and enforcing the new standards to address this. By establishing a constructive communication relationship with the accounting standards committee, they can report various issues arising from the new standards, participate in discussions, and contribute to the subsequent revision process.

The formulation of accounting standards is closely related to the reality of banks and financial markets. It requires the development of more reasonable accounting standards based on the current state of the financial market. Therefore, as essential participants in the financial market, banks should actively contribute to the discussion and revision process of standards, expressing their practical demands positively. While the international accounting standards have been substantially revised, China's financial assets and measurement revisions are still immature. In this context, commercial banks should proactively identify issues related to the new standards during the trial period when implementing new policies. Through discussions or negotiations, they can propose suggestions for addressing deficiencies in the new standards, contributing to developing new accounting standards more adaptable to China's specific context.

5. Conclusion

In summary, introducing the new accounting standards further streamlines the classification of financial assets, providing a more precise and clear scope for their classification. The criteria for classification are also more flexible. Therefore, banks should employ a multifaceted approach, including a deep understanding of the policy implications of the new standards, establishing close communication with committees, and further enhancing the accuracy of fair value valuation. This will better enable them to navigate the impacts and fluctuations of the new standards in the financial market.

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