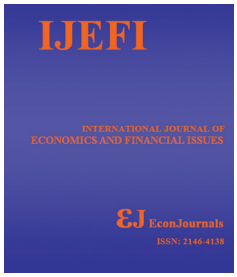

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The Preparation of Banking Industry in Implementing IFRS 9 Financial Instruments (A Case Study of HSBC Holdings Plc Listed on London Stock Exchange of Year 2015–2017)

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ABSTRACT

Global financial crisis 2008 was a very close call of total systemic collapse in financial markets. This had urged the leaders of G20 to involve the key global accounting standards bodies for creating a single high-quality global standard. IFRS 9 "financial instruments" released in 2014 is a project of IASB to achieve that goal and its effective date is 1 January 2018. However, a poll found that 46% of 91 banks in the world (excluding some U.S. banks) believe not having adequate resources to implement the standard by 2018. That is why this research wants to figure out the preparation of banking industry especially HSBC Holdings Plc to implement the standard. Using an exploratory research method, the researcher has found out that HSBC has been well-prepared to implement the standard. The findings of this research also realize a certain extent of agreement to MacNeal's theory and positive theory introduced by Watts and Zimmerman.

Keywords: IAS 39, IFRS 9, Financial Instruments, Recognition and Measurement, Financial Reporting
JEL Classifications: G11, G21, G32

1. INTRODUCTION

Deemed as the most severe crisis since the Great Depression of the 1930s, a financial crisis hit the global economy in 2008. A decisive downward and quick spreading of home prices in the United States (U.S.) began from the entire U.S. financial sector, extended to financial markets abroad. All investment banks, the largest insurance company, Fannie Mae and Freddie Mac (both are government chartered companies to provide mortgage lending) and two of the biggest commercial banks had become the casualties. Although the massacre was on financial sector, most companies also underwent terrible condition as they rely on credit. What had worsened the condition back then is banks simply stopped providing credit, while most businesses have to fix their cash flows. As a result, stock prices fell steeply - the Dow Jones Industrial Average in the U.S.' value decreased by 33.8% in 2008 - and by the end the year, a global economy recession took place (Viswanathan and Dickson, 2007).

Fannie Mae and Freddie Mac were chartered by U.S. Congress as Government-Sponsored Enterprise in 1968 and 1970. Both of them provide leverage to the thousands of banks, savings and loans, and mortgage companies that supply home loans by creating a liquid secondary market. This meant that financial institutions no longer had to hold onto the mortgages they originated, but could sell them into the secondary market shortly after origination. As a result, it loosened their funds so they could then make additional mortgages (Courchane et al., 2008).

Implicit government backing of Fannie Mae and Freddie Mac brought a lot of advantages. First, they can borrow money in the bond market at lower rates (yields) than other financial

institutions. Second, investors would be more than happy to buy their Mortgage-Backed Securities (MBS) because of its higher return than U.S. Treasury and implicit guarantee. Furthermore, rating agencies such as Moody's, S&P and Fitch placed AAA for these securities (Cordell et al., 2009).

Rising demand of higher-yielding paper (such as MBS) led to increasing demand for mortgages. This made financial institutions engaged in subprime lending with low credit quality. Later on, Fannie Mae and Freddie Mac began purchasing these subprime loans because its rivals on Wall Street were more competitive. Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers and Bear Stearns were among those purchase and sell subprime mortgages. At the end of the day, the "hype" ended tragically as a lot of subprime credits defaulted, leading to asset bubble burst which put an end to "lend-to-sell-to-securitizes" model (Chen and Phou, 2013).

Since the Federal Reserve (the Fed) lowered its funds rate to 1.75% in December 2001 and following by another cut down to 1.24% in November 2002, many homeowners would be pleased for the lower interest loans. As a result, the subprime mortgage increased two folds, from 10% to 20%, of all mortgages between 2001 and 2006. Although banks' incomes from loans were lower, they did not hesitate to lend more subprime mortgage, as they can earn a lot from selling derivatives. Following the increased demand of mortgage, housing demand advanced to a high which created an asset bubble in real estate in 2005. The asset bubble burst in 2007, leading to banking crisis in the same year and unfolded 2008 financial crisis (André et al., 2009).

Started with the bankruptcy of Lehman Brothers on 15 September 2008, it caused a global financial panic. This event had agitated global markets and accelerated the huge decline in value of almost all investment instruments – common stocks, corporate bonds, real estate, commodities like oil, copper and gold, private equity and hedge funds alike. A day before the chaos, Merrill Lynch agreed to be purchased in an all-stock deal at $50 billion by Bank of America. Earlier before that, it was revealed that American International Group (AIG), the largest global insurance company needed a huge amount of capital injection. On 16 September 2008, the Fed bailed out AIG with $85 billion funds in the exchange of 79.9% AIG's equity. The decision was made by the Fed to avoid a systemic risk in the entire commercial paper market because AIG's insurance subsidiaries were ones of the largest in the U.S (Mattera et al., 2012).

Ireland had become one of the first to react after Lehman Brothers collapse by insuring €440bn of liabilities at six government-owned institutions and a foreign-owned bank, not long after it became the first Eurozone country slid into recession. Despite all the efforts made by Irish government and bailout by the European Union (EU), Ireland still needed an additional €24bn capital injection by 31 March 2011, to boost their reserves and cover the cost of more loan write-offs. Before the start of recession, Greek debt was downgraded to junk at 27 April 2010. The starting of Eurozone crisis then was indicated by an agreement of Eurozone finance ministers to bailout Greece for a loan of €110bn. Hundreds of thousands of protesters came down to the streets upon that decision. After the first failed attempt of its austerity program, Greece was bailed-out for the second time in July 2011. A year after that, the situation got worse as unemployment level of Europeans reached its highest level and Spanish's debt hit a record high (Carvalho et al., 2011).

For this very close call on a total systemic collapse, nobody knows who owe what to whom. However, there are several critical reasons why the financial crisis occurred. The first reason is deregulation, in which Glass-Steagall Act of 1993 was repealed. The repeal permitted banks to invest in derivatives by using deposits. By promising to only invest in low risk securities for protecting their customers, bank lobbyists argued that it was necessary to compete with foreign firms. A year after that, a new act called Commodity Futures Modernization Act overruled the state laws which formerly prohibited credit default swaps and other derivatives as gambling.

The second reason behind 2008 financial crisis was securitization. Thanks to the subprime mortgage, hedge funds and others alike made a fortune from MBS. An MBS is a financial product whose price is based on the value of the mortgages that are used for collateral. The investors who bought MBS assumed for all default risks, but they were not worried because AIG sold credit default swaps. In case those securities were default and they did, AIG would bear all the consequences. Because these derivatives were considered safe (backed by collateral and AIG insurance), the demand grew and so did the banks' demand for more and more mortgages to back the securities. Bear Stearns, Citibank and Lehman Brothers were among the ones owning a lot of these derivatives (Mcleay, 2006).

The third reason is the fact that Sarbanes-Oxley did not prevent such crisis. It is really questionable about why the reforms failed to deliver the promised improvements to the independence and quality of public company audits. Lehman Brothers, AIG, Citigroup, Fannie Mae, Freddie Mac and Bear Stearns all received "Unqualified" audit opinions within months of the failure. Therefore, even auditors cannot declare as being "irresponsible" for the financial crisis.

Systemic risk is the possibility that an event at the company level could trigger severe instability or collapse an entire industry or economy (Investopedia). The global financial crisis 2008 was really a close call of entire financial market collapse, hence national authorities carried out necessary measures to re-establish confidence in the firmness of markets and financial institutions. Monetary and fiscal stimulus, operations of central bank liquidity, policies to encourage asset market liquidity and activities to resolve problems at particular institutions were included. On the other side, financial institutions struggled to rebuild capital and liquidity support. Recommendations and resources both were developed by both national and international organizations, to reduce the occurrence likelihood of another similar event.

HSBC is one of the biggest global banks operating around the world, with its assets valued at $2.37 trillion. Ranging from commercial banking, global private banking, global banking and markets, retail

banking and wealth management, the global businesses of HSBC serve around 38 million customers worldwide through a network of around 3900 offices in 67 countries and territories. As the former executives put corporate client relationships before profitability, HSBC had failed to foresee weaker loan book quality when growth in Brazil began to wane around 2012. Facing the pressure of banking regulation and standard setters as well as shareholders, the giant bank chose to end its operation in that country. On 3 August 2015, HSBC disclosed its decision for selling its entire business in Brazil, as a measure to optimize its global network and reduce complexity. Although the sale initiative is viewed as the right step to maintain HSBC profitability via restructuring and streamlining measures, the transaction resulted in a loss on sale of $1.7 billion after accounting for foreign exchange losses. Additional charges of $1bn to cover restructuring costs and $439m provision to compensate customers for payment protection insurance are also required, not to mention the huge decline of pound exchange rate against the U.S. dollar worsened the financial liabilities from the deal. While the transaction seemed unfavorable for HSBC, the management claims that the transaction is expected to decrease Group risk weighted assets by around US$37bn and increase the Group's common equity tier 1 ratio by c.65bps. Apparently HSBC is serious on increasing its financial assets' quality, but it could not avoid facing the sanction of $470 m (£325 m) for "abusive mortgage practices" related to 2007-2009 housing crisis. Therefore, it is very interesting for the researcher to find out the extent of HSBC compliance for its financial reporting, as IFRS 9 implementation date is around the corner (IFRS Foundation, 2014).

2. LITERATURE REVIEW

2.1. Concept Definition and Theoretical Approach

Watts and Zimmerman (1990) likely implied that there is only one scientific method for accounting theory, which what they label as positive accounting theory (Watts and Zimmerman, 1978). Positive accounting theory is a statement that accounting theory attempts to explain and predict accounting practice. As one of the most considered works in accounting, positive accounting theory has contributed considerable findings on empirical regularities and explanations behind those regularities despite there were lots of criticisms upon this theory. Among of those criticisms are concerned about methodology, results interpretation, and replication.

Unlike the positivists, chambers provides a summarized view that accounting is more of an improvised practice rather than systematical structured theory, "Accounting has frequently been described as a body of practices which have been developed in response to practical needs rather than by deliberate and systematic thinking" (Shokri et al., 2011). To explain this, it is simpler to say that many accounting practices were prescribed to resolve issues as they arose. Examples include various methods of depreciation and inventory expensing even within the same industry, as well as fair value and historical costs measurement (Anagnostopoulos and Buckland, 2005).

A simple conclusion that can be drawn is no single theory available which can explain, resolve and predict every accounting issue. All theories have contributed to some extent, whether they are practical or not. Accounting theory is complex and even though conceptual (theoretical) framework has been developed, it is unlikely that the issue of inconsistency in accounting practices will be solved in the near future.

2.2. Normative Accounting Theories

Normative theories focus on what "should be" rather than what "it is". This leads to normative accounting researchers are more concerned with policy recommendations rather than analyzing and explaining the currently accepted and implemented practice. There are two concentrations of normative accounting theories (Ingenbleek and van der Lans, 2013):

a. True income: True income theorists concentrated on deriving a single measure for assets and a unique (correct) profit figure. Because there was no established measure of a correct or true measure of value and profit, the debate has been going on to determine how to best measure a firm's profits.

b. Decision-usefulness: The decision-usefulness approach assumes that the basic objective of accounting to aid the decision-making process of certain "users" of accounting reports by providing useful, or relevant, accounting data; for example, to Whelp investors (current and potential) decide whether to buy, hold or sell shares. Substantially, this view is normative in nature due to the following assumptions must be made:

- Accounting should be a measurement system
- Profit and value can be measured precisely
- Financial accounting is useful for making economic decisions
- Markets are inefficient or can be fooled by "creative accountants"
- Conventional accounting is inefficient (in an information sense)
- There is no unique profit measure.

Normative theories have contributed a lot of insightful views on how to formulate accounting standards that are beneficial for the users of financial statements. In employing a normative accounting research, there are three models to be followed: (a) Deductive model; (b) inductive model and (c) decision-usefulness approach. Since IFRS 9 is intended to replace IAS 39 on its entirety, there are five important works with emphasis on recognition and measurement issues namely (Macneal, 2013).

As a revolutionary thinker in accounting, (Macneal, 1982) reasons that the function of accounting is to report economic truth (Friedler and Hadari, 2006). He argues that financial statements are misleading to the stakeholders such as investors and creditors. Specifically, he points that the historical cost and conservatism principles forestall financial statements to present true financial position and operating results of the firm.

Three justifications proposed in favor of the cost principles are evaluated by (Macneal, 1971) in his work. First, cost represents the value of a fixed asset to a going concern, called "the going value" theory. Second, it is impractical and expensive to revalue assets every year. Third, even if revaluations of fixed assets were done every year that would not provide significant information to the users.

Paton and Littleton develop their theory based on six basic assumptions. Using a deductive methodology, Graham et al. (2005) aim to develop a statement of accounting standards for serving as "guideposts to the best in accounting practice" (Lopes and Rodrigues, 2008). Most of their proposals are in line with existing accounting practice.

Paton and Littleton's proposals emphasize on reliability and it is different from (Macneal, 1982) whom put greater emphasis on relevance. Paton and Littleton are mainly concerned for providing reliable information to the absentee owners and other stakeholders. While Macneal's proposals are backed up by the argument that present accounting practice does not meet the information needs of the investors and creditors, Paton and Littleton lay their concept on verifiable and objective evidence. To explain their concept, (Ijiri, 2018), (Paton, 1980) say:

In particular cases there may be a strong urge to increase immediate profits in any possible manner, or at least to report increased profits if any way to do so can be found. Similarly the group in control may under some circumstances desire to minimize, in the statements, the reported earning power of the enterprise (Kabir, 2005).

All assumptions above derive from the central purpose of accounting, which is to Littleton, the determination of periodic income by matching costs and revenues. In his proposition, the central purpose is the organizing theme (Ijiri, 2018) reveals, "The central purpose of accounting is to make possible the periodic matching of costs (efforts) and revenue (accomplishments). This concept is the nucleus of accounting, and a benchmark that affords a fixed point of reference for accounting discussion" (Kabir, 2005). It implies that income statement is primary accounting report and balance sheet is secondary. This is because efforts and accomplishments are both reflected in costs and revenues respectively in the income statement.

As long as the business entity exists to provide economic service and the entity itself is a going concern, stakeholders would be interested in the progress of achievement rather than the solvency of the entity. In other words, income statement is the financial statement close enough to fulfill the information needs relating to enterprise efforts and accomplishments. As secondary importance, balance sheet is not intended to represent values and in Littleton's proposal (Markarian, 2014), assets are unexpired costs waiting for settlement to income statement. Reporting property values in balance sheet would be irrelevant in most of the time, according to Littleton. It would be relevant only at the time of liquidation. Because the entity itself is a going concern, earning power, not solvency is the greatest assurance for creditors.

The foundation of Littleton's study is the central purpose (Andrea et al., 2013). There are six sub-areas of accounting surrounding that purpose consisting of: (a) Accounts: Categories of classification, (b) transactions: raw data to be analyzed into categories, (c) booking: use of mechanisms for handling data and classifications, (d) apportionment: methodology for reclassification of initially classified data among comparable time segments, (e) financial statements: means of communicating information about the reporting enterprise to interested parties, and (f) auditing: A critical professional examination of the classification system and the resulting financial statements. Interrelation exists among these sub-areas and Littleton thinks that the interrelation between real and nominal accounts (consequently balance sheet and income statement) is the most notable one.

As Littleton adheres to historical cost, he would reject the lower of costs or market rule for inventory. This also applies to the practice of determining depreciation based on the appraised value of depreciable assets. However, he does not deny the usefulness of price level data in decision making and therefore, recommends improving interpretative skills of the analyst to solve the issues emerging from the underlying limitations of accounting (Zeff, 2010).

Chambers' concept is established by the idea of adaptation. It premises that an entity engages in exchanges to adapt to the prevailing market condition. Because the realizable amount of assets influences and limits the entity's scope of action in the market, the entity needs to know its amount of exchangeable means (marketable assets). Accounting's objective is to provide contemporary financial information acting as a guide for future action. (Kabir, 2005) states, "---accounting information shall be relevant to *adaptive behavior* under uncertainty and environmental variability". Furthermore, (Kabir, 2005) also asserts, "But at any *present* time all past prices are simply a matter of history. Only present prices have any bearing on the choice of an action" (Kabir, 2005).

The concept proposed by Chambers is not without disagreement. It is questionable why firms only adapt by reselling their assets, while they also can do it by replacing assets. Moreover, firms can also rely on the money market and the capital market for acquiring funds (Fiechter, 2011) also argues that financial statements become allocation-free (Kabir, 2005), due to Chambers' scheme of treating depreciation expense as the decline in an asset's market value.

Inconsistency also exists between stated purpose and the detailed rules of Chambers. He criticizes historical cost accounting due to resulting asset figures do not become additive. However, his proposal also yields the same result. Suggesting that assets are accounted at resale value, he set a different rule for inventories. Inventories are valued at replacement cost, but they are limited to the degree of their resale value. Fixed assets are reported at resale values if available, or may be accounted by the initial cost derived from specific index numbers.

Ijiri formulates three axioms by employing inductive methodology. He believes that conventional accounting practice is derived from those axioms. As a supporter of the historical cost, he provides rationale in favor of this principle.

The following three axioms are set by (Ijiri, 2018):

Axiom of control: The set of all resources under the control of an entity at time t can be identified uniquely at that time or later.

Axiom of quantities: All resources under the control of an entity at time t can be uniquely partitioned into classes of resources at

that time or later in such a way that for each class a nonnegative and additive quantity measure is defined. This measure has the property that two sets of resources in the same class are treated as being substitutable in the uses of the resources if and only if their quantities are the same.

Axiom of exchanges: Every change in the set of resources under the control of the entity can be classified uniquely as it occurs either as terminator of an old simple exchange or an initiator of a new simple exchange with an estimated terminator (Kabir, 2005).

This reference suggests that almost everybody has the "right to know."

There are three major reasoning of Ijiri in favor of the historical cost principle. First, accountability functions properly on the basis of proper records of past activities whereby the historical cost demands to record all actual transactions. Second, this principle can be used for continuous recording thus brings the most useful performance measure. Ijiri further explains that value is a two-dimensional concept which consists of sacrifice value and benefit value. He prefers sacrifice value i.e., historical cost due to its "hardness" of the measure. Third, in general, historical cost is useful to economic decisions (Ijiri, 2018).

Historical cost is not viewed as perfect by Ijiri. Only those contracts at least one part of which has been performed are recorded. Executory contracts in which no party has performed his/her part are not recorded under the principle. For this reason, Ijiri recommends switching from the present accounting practice to commitment accounting. Executory contracts are recorded in commitment accounting.

2.3. Positive Accounting Theories

Positive accounting theory in particular covers questions such as: Do firms substitute alternative ways of financing assets when the rules governing the accounting for leases change? Which firms are more likely to use straight-line depreciation rather than diminishing-balance depreciation, and why? The theory used to answer these questions generally revolves around managers' incentives to maximize bonuses based on their companies' profits, their incentives to avoid breaching accounting-based debt covenants and thereby reducing the cost of debt, or their incentives to use accounting techniques to divert attention from their high profits if those profits would attract public or government scrutiny, and perhaps lead to higher taxes (Watts and Zimmerman, 1990).

2.3.1. Agency theory

Watts and Zimmerman (1983) define "an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent" (Fay and Haydon, 2017). It is really possible that the agent will not always act in the best interests of the principal assuming both parties aim to maximize their own utility. For that reason, the principal can try to align his interests with the agent's by providing appropriate incentives and incurring monitoring costs. In certain circumstances, the principal can go further by paying the agent to incur bonding costs as a guarantee that he will not take harmful actions for the principal; otherwise, the principal will be compensated if he does take such actions. Zero agency cost is generally impossible; therefore, the principal and the agent will incur positive monitoring and bonding costs (monetary or non-monetary). Furthermore, there is also "residual loss" in addition to monitoring and bonding costs. Residual loss is defined as the dollar equivalent of the reduction in welfare experienced by the principal as a result of divergence between the agent's decisions and those decisions that maximize the principal's welfare. They determine agency costs as the sum of:

1. The monitoring expenditures by the principal,
2. The bonding expenditures by the agent,
3. The residual loss.

2.3.2. Disclosure of nonproprietary information

(Dyer et al., 2008) explains about why management might withhold nonproprietary information as well as the impacts of modifying various assumptions underlying these theories. Proprietary information here means any information whose disclosure potentially alters a firm's future earnings gross of senior management's compensation. In general, it is believed that managers have information regarding the firms they handle i.e., annual earnings' forecasts, whose release would alter the firms' prices but not the distribution of future earnings.

2.3.3. Determination of accounting standards

One of the masterpieces in positive accounting theory is a paper written by (Watts and Zimmerman, 1990) that explores factors influencing management's attitudes on accounting standards which are likely to affect corporate lobbying on accounting standards. Factors such as taxes, regulation, management compensation plans, bookkeeping costs, and political costs are likely to affect a firm's cash flows and in turn are affected by accounting standards. Thus, those (firms) who favor the change are the ones who experience reduced earnings due to changed accounting standards. On the other hand, if the additional bookkeeping costs justify the cost of lobbying, all other firms will oppose the change.

2.4. International Financial Reporting Standard 9 Financial Instruments

IFRS 9 is developed by IASB in three phases, covering separately the classification and measurement of financial assets, impairment and hedging. Certain aspects of IAS 39 are carried over with hardly any modification, including scope, recognition, and derecognition of financial assets (IFRS Foundation, 2014).

3. METHODOLOGY

Sekaran (2006) define "research as simply the process of finding solutions to a problem after a thorough study and analysis of the situational factors." They believe that research can be helpful in decision making within organization. As the difference between good and poor decision-making often lies on its process, a well-conducted research can provide knowledge about the various steps concerned to find solutions. Therefore, the method of which a research employs can determine the quality of its findings.

"Method" means "a procedure or process for attaining an object: such as a (1): A systematic procedure, technique, or mode of inquiry employed by or proper to a particular discipline or art (2): A systematic plan followed in presenting material for instruction" (Sekaran, 2014). This research employs exploratory method. Exploratory research questions are typically developed when: (a) Not much is known about a particular phenomenon; (b) existing research results are unclear or suffer from serious limitations; (c) the topic is highly complex; or (d) there is not enough theory available to guide the development of a theoretical framework (Suryana et al., 2013).

Because exploratory research is conducted when a phenomenon is not much known and available theories do not suffice, it is classified as qualitative research. Qualitative research is a type of scientific research (Sekaran, 2014) describe in general terms, scientific research consists of an investigation that:

- Seeks answers to a question,
- Systematically uses a predefined set of procedures to answer the question,
- Collects evidence,
- Produces findings that were not determined in advance,
- Produces findings that are applicable beyond the immediate boundaries of the study.

Unlike quantitative research, neither exploratory nor descriptive research develops a theoretical framework and tests hypotheses. Qualitative research is also more flexible because its question format is open-ended. Open-ended questions have advantages in term of its richness and exploratory nature thus it can evoke unanticipated answer(s) by the researcher.

4. RESULTS AND DISCUSSION

4.1. Research Findings and Discussion

As this research employs source triangulation for the sake of "credibility" of data, Annual Report and Accounts 2015–2017 and Report on Transition to IFRS 9 "Financial Instruments" have been obtained from two credible sources. Those sources of data are:

a. HSBC group's website - Investor relations - Group results and reporting - Annual report.
b. London stock exchange's website - prices and markets - stocks - HSBA (HSBC holdings Plc).

It appears that there is no difference between the data obtained from both sources, because London stock exchange states in each of its published documents that it is not responsible for and does not check its content. However, because the independent auditors (PWC) have given their opinion that the financial statements prepared by HSBC give a true and fair view of the state of the Group's and Parent Company's affairs and have been prepared in accordance to IFRS and Companies Act 2006, this researcher believes that the data are credible. The only exception to the data credibility applies for Report on Transition to IFRS 9 "Financial Instruments" due to certain forward-looking statements with respect to HSBC's financial condition, results of operations and business (De George et al., 2013; IFRS Foundation, 2014; PWC, 2017).

4.2. Adoption of IFRS 9 in 2015–2017 Financial Statements

4.2.1. Annual report and accounts 2015

In 2015, HSBC has not adopted IFRS 9 "Financial Instruments" yet although the completed version was already released in July 2014. This is because EU endorses the standard on 22 November 2016 of which this information is also reflected in notes on the Financial Statements of HSBC. The Group decides to delay the standard implementation until it has been endorsed for use in the region.

IFRS 9 does not influence the financial statements' presentation of 2015 since it is yet to be implemented. However, the group realizes that this standard is a major new IFRS and thus, it has started its implementation program since 2012. Besides that, the corporation also provides valuable information on how the Group expects to implement the new standard as well as the standard's requirements.

4.2.2. IFRS 9 implementation program

Within HSBC, a joint global risk and global finance IFRS 9 Implementation Program ("the Program)" has been set up to prepare for implementation of IFRS 9 since 2012 and significant preparatory and design work has taken place. The Program is sponsored by the Group Chief Risk Officer and Group Finance Director. A Steering Committee comprising senior management from Risk, Finance and HSBC Operations, Services and Technology has been established. In common with all significant change programs in HSBC, the Program is managed according to the Group's business transformation framework. Delivery of the required changes will be undertaken by individual work streams, with Global Risk leading the work to calculate impairments and Global Finance leading the development of financial reporting systems and processes. Significant legal entities in the Group have established steering committees to manage implementation locally, within this global framework. Global businesses have been engaged but are not themselves responsible for the implementation activity.

To date, the Program has been directed towards preliminary impact analysis, documenting Group accounting policy, developing the operating and system target operating models and developing risk modelling methodologies for the calculation of impairment. In addition, an impact assessment of the classification and measurement requirements was performed during 2015. The Program's focus is now on the impairment models and processes which need to be developed by the end of 2016 as HSBC intends to perform a parallel run during 2017 to gain a better understanding of the potential effect of the new standard. The Program has a defined governance framework to operate over the impairment process once it becomes live. The framework includes dedicated committees to review, challenge and sign off the assumptions used and the results in each significant legal entity, and second-line assurance capabilities for each key step in the process. An expert panel will be established to govern the setting of forward-looking economic assumptions used in the process. Governance over the impairment process is the responsibility of the Global Risk and Global Finance functions, operating within each member company of the Group. Global businesses are consulted but are not granted decision making power.

HSBC intends to quantify the potential impact of IFRS 9 once it is practicable to provide reliable estimates, which will be no later than in the Annual Report and Accounts 2017.

Until sufficient models have been developed and tested, HSBC will not have a reliable understanding of the potential impact on its financial statements and any consequential effects on regulatory capital requirements. In the absence of information on whether there will be any changes to the regulatory requirements, assumptions will have to be made about how the existing regulatory requirements will be interpreted when IFRS 9 is adopted. For example, the relationship between specific and general credit risk adjustments in accordance with Basel requirements and the IFRS 9 stages is unclear. The Basel Committee is considering the implications of the new accounting requirements for existing regulatory requirements (Novotny-Farkas, 2016; Onali and Ginesti, 2014; PWC, 2017).

4.2.3. IFRS 9 requirements

4.2.3.1. Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortized cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVPL). In many instances, the classification and measurement outcomes will be similar to IAS 39, although differences will arise. For example, under IFRS 9, embedded derivatives are not separated from host financial assets and equity securities are measured at FVPL or, in limited circumstances, fair value movements will be shown in OCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortized cost or fair value compared with IAS 39. The classification of financial liabilities is essentially unchanged. For certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in OCI.

HSBC conducted an assessment of potential classification and measurement changes to financial assets based on the composition of the balance sheet as at 31 December 2014. This may not be fully representative of the impact as at 1 January 2018 because IFRS 9 requires that business models be assessed based on the facts and circumstances from the date of initial application. In addition, the contractual terms and conditions of the financial assets assessed as at 31 December 2014 may not reflect the contractual terms and conditions of HSBC's financial assets at transition. However, based on the assessment of financial assets as at 31 December 2014 and expectations around changes to balance sheet composition, HSBC expects that generally:

- Loans and advances to banks and to customers and non-trading reverse repurchase agreements that are classified as loans and receivables under IAS 39 will be measured at amortized cost under IFRS 9;
- Financial assets designated at FVPL will remain at FVPL, because it is required under IFRS 9 or designation will continue;
- Debt securities classified as available for sale will primarily be measured at amortized cost or FVOCI, with a small minority at FVPL either because of their contractual cash flow characteristics or the business model within which they are held;
- Debt securities classified as held to maturity will be measured at amortized cost;
- Treasury and other eligible bills classified as available for sale will be measured at amortized cost or FVOCI depending upon the business model in which they are held; and
- All equity securities will remain measured at fair value. A significant majority will have fair value movements shown in profit or loss, while a minority will have fair value movements presented in OCI. The equity securities for which fair value movements will be shown in OCI are business facilitation and other similar investments where HSBC holds the investments other than to generate a capital return.

4.2.3.2. Impairment

The impairment requirements apply to financial assets measured at amortized cost and FVOCI, and lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses (ECL) resulting from default events that are possible within the next 12 months (ECL). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ("lifetime ECL"). Financial assets where 12-month ECL is recognized are considered to be "Stage 1;" financial assets which are considered to have experienced a significant increase in credit risk are in "Stage 2;" and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in "Stage 3."

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39 (Duh et al., 2012; Lim et al., 2013; Walton, 2004).

4.2.3.3. Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Based on the analysis performed to date, HSBC expects to exercise the accounting policy choice to continue IAS 39 hedge accounting and therefore is not currently planning to change hedge accounting, although it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 "Financial Instruments: Disclosures" (Nadia and Rosa, 2014; Zango et al., 2015).

4.2.3.4. Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. HSBC intends to revise the presentation of fair value gains and losses relating to the entity's own credit risk on certain liabilities as soon as permitted by EU law. If this presentation was applied at December 31, 2015, the effect would be to decrease profit before tax with the opposite effect on OCI based on the change in fair value attributable to changes in HSBC's credit risk for the year, with no effect on net assets.

HSBC is assessing the impact that the financial asset classification and impairment requirements will have on the financial statements (Fiechter, 2011).

4.2.4. Annual report and accounts 2016

For the year ended 31 December 2016, HSBC has adopted the requirements of IFRS 9 "Financial Instruments" relating to the presentation of gains and losses on financial liabilities designated at fair value in the separate financial statements of HSBC Holdings. Because not all of the standard's requirements are fulfilled, it is considered as partial adoption. The adoption is in accordance with "*Paragraph 5.7.7 Liabilities Designated as at Fair Value through Profit or Loss*" of IFRS 9.

Paragraph 5.7.7. An entity shall present a gain or loss on a financial liability that is designated as at fair value through profit or loss in accordance with paragraph 4.2.2 or paragraph 4.3.5 as follows:

(a) The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in OCI (paragraphs B5.7.13–B5.7.20), and
(b) The remaining amount of change in the fair value of the liability shall be presented in profit or loss

Unless the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in profit or loss (in which case paragraph 5.7.8 applies). Paragraphs B5.7.5–B5.7.7 and B5.7.10–B5.7.12 provide guidance on determining whether an accounting mismatch would be created or enlarged.

Although there is an option to designate a financial liability at fair value through profit or loss under Paragraph 4.2.2 of which HSBC has chosen to do so, it is important to notice that such practice is irrevocable and only allowed because it is permitted by Paragraph 4.3.5 or when doing so results in more relevant information, because either:

(a) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as "an accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases (paragraphs B4.1.29–B4.1.32); or
(b) A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 Related Party Disclosures), for example, the entity's board of directors and chief executive officer (paragraphs B4.1.33–B4.1.36).

As a result of the IFRS 9 partial adoption, the effects of changes in those liabilities' credit risk are presented in OCI with the remaining effect presented in profit or loss. In accordance with the transitional requirements of the standard, comparatives have not been restated. Adoption increased profit after tax by $896m with the opposite effect on OCI, with no effect on net assets.

Without the adoption of IFRS 9 relating to the presentation of gains and losses on financial liabilities designated at fair value, "*Net (expense)/income from financial instruments designated at fair value*" in HSBC Holdings Income Statement should be showing an amount of $1,079m loss before tax arising on:

- Changes in own credit spread on long-term debt of $1,030 m loss,
- Derivatives managed in conjunction with HSBC Holdings' issued debt securities of $642 m loss,
- Other changes in fair value of $593m profit.

However, due to the amount of "*changes in own credit spread on long-term debt*" has been moved to HSBC Holdings Statement of Comprehensive Income, "*Net (expense)/income from financial instruments designated at fair value"* in HSBC Holdings Income Statement only shows an amount of $49m loss as shown on the next page.

Since the Group adopts the standard only in the separate financial statements of HSBC Holdings, it does not affect the consolidated financial statements. This is why its Consolidated Statement of Comprehensive Income does not show the amount of "*Changes in fair value of financial liabilities designated at fair value due to movement in own credit risk*." Furthermore, it also observable

that the amount of $2,666m "*Net income/(expense) from financial instruments designated at fair value*" is presented in the Consolidated Income Statement with its details presented in "Financial Review" section.

The majority of HSBC's financial liabilities designated at fair value are fixed-rate, long-term debt issuances, and are managed in conjunction with interest rate swaps as part of its interest rate management strategy. Thus, Paragraph 4.2.2 of IFRS 9 is applicable because those financial liabilities are managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. The Group recorded a net expense from financial instruments designated at fair value of $2.7bn in 2016, compared with net income of $1.5bn in 2015. In 2016, there were unfavorable movements of $1.8bn in the fair value of its own long-term debt reflecting changes in credit spread, compared with favorable movements of $1.0bn in 2015. The decrease was also as a result of "*Other changes in fair value*" on its long-term debt and related derivatives, which reflected:

- Higher adverse movements of $1.7bn in 2016 compared with minimal movements in 2015 on foreign currency debt designated at fair value and issued as part of our overall funding strategy (offset by assets held as economic hedges in "*Net trading income*"); and
- Higher adverse movements of $0.2bn relating to the economic hedging of interest and exchange rate risk on our long-term debt.

By contrast, net income from financial assets held to meet liabilities under insurance and investment contracts of $1.5bn was $0.9bn higher than in 2015. This was primarily driven by improved equity market performance in Asia and Europe in 2016, partly offset by the disposal of HSBC's operations in Brazil in July 2016. Net income arising from financial assets held to meet liabilities under insurance and investment contracts results in a corresponding movement in liabilities to customers, reflecting the extent to which they participate in the investment performance of the associated asset portfolio. These offsetting movements are recorded in "*Net income/(expense) arising from liabilities to customers under investment contracts*" and "*Net insurance claims and benefits paid and movement in liabilities to policyholders*." In 2016, the majority of the variance arose in unit-linked contracts where the policyholder bears the investment risk, and was therefore offset by movements in liabilities to customers.

4.2.5. Annual Report and Accounts 2017

HSBC has adopted the requirements of IFRS 9 "Financial Instruments" relating to the presentation of gains and losses on financial liabilities designated at fair value from 1 January 2017 in the consolidated financial statements. Since the Group does not adopt all of the standard's requirements, it is regarded as partial adoption. The practice complies with "*Paragraph 5.7.7 Liabilities Designated as at Fair Value through Profit or Loss*" of IFRS 9.

The partial adoption of IFRS 9 results in the presentation of the effects of changes in "liabilities designated as at fair value through profit or loss" in OCI with the remaining effect presented in profit or loss. As permitted by the transitional requirements of the standard, comparatives have not been restated. Adoption increased profit after tax by $2,024m and basic and diluted earnings per share by $0.10 with the opposite effect on OCI and no effect on net assets. These requirements were adopted in the separate financial statements of HSBC Holdings in 2016.

If HSBC does not adopt the requirements of IFRS 9 relating to the presentation of gains and losses on financial liabilities designated at fair value, the "*Net income/(expense) from financial instruments designated at fair value*" should be presented at an amount of $1,289m profit instead of $3,698m profit. This is based on the recalculation of $(3,698–2,409) m assuming the component of "*changes in own credit spread on long-term debt*" is added back.

The practice brings a higher profit in the Consolidated Income Statement but an opposite effect in the Consolidated Statement of Comprehensive Income. It is because the loss of $2,024 m is just simply moved to another financial statement. Correspondingly, the same logic also applies to the financial statements of HSBC Holdings.

"Own credit spread" includes the fair value movements on HSBC's long-term debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt. This does not include fair value changes due to own credit risk in respect of trading liabilities or derivative liabilities. In accordance with IFRS 9 "Financial Instruments," fair value movements attributable to changes in own credit spread on the Group's own debt designated at fair value are now reported in OCI; by contrast, 2016 included adverse movements of $1.8bn in the fair value of its long-term debt reflecting changes in credit spread. Furthermore, it is evident that significant items in long-term debt issued and related derivatives have been offset by the movement of "*change in own credit spread on long-term debt*" into consolidated statement of comprehensive income.

Net income from financial instruments designated at fair value was $3.7bn in 2017, compared with a net expense of $2.7bn in 2016. This included a net favourable movement in significant items and currency translation of $1.7bn, primarily due to the effects of adverse fair value movements attributable to changes in HSBC's own credit spread on its own debt designated at fair value of $1.8bn in 2016, now reported in OCI, as mentioned above. The remaining movement reflected an increase in "*Other changes in fair value*" on its long-term debt and related derivatives, which included:

- Favorable movements of $0.3bn compared with adverse movements of $1.6bn in 2016 on foreign currency debt designated at fair value and issued as part of the Group's overall funding strategy (offset in "*Net trading income*" by assets held as economic hedges); and
- Favorable movements of $0.1bn compared with adverse movements of $0.3bn in 2016 relating to the economic hedging of interest and exchange rate risk on the Group's long-term debt, reported in Corporate Centre.

In addition, net income from financial assets and liabilities from insurance and investment contracts increased by $1.6bn, primarily due to improved equity market performance in Asia and Europe

in 2017. Net income arising from financial assets held to meet liabilities under insurance and investment contracts results in a corresponding movement in liabilities to customers, reflecting the extent to which they participate in the investment performance of the associated asset portfolio. These offsetting movements are recorded in "*Net income/(expense) arising from liabilities to customers under investment contracts*" and "*Net insurance claims and benefits paid and movement in liabilities to policyholders*."

As HSBC has opted to adopt the requirements set in "*Paragraph 5.7.7 and 5.7.8*," it also implies that it has conformed to the meaning of "credit risk" and how to determine the effects of changes in credit risk as ruled in the Application Guidance of IFRS 9.

4.2.6. The meaning of "credit risk" (paragraphs 5.7.7 and 5.7.8)

Appendices B5.7.13 IFRS 7 defines credit risk as "the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation." The requirement in paragraph 5.7.7(a) relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the creditworthiness of the issuer. For example, if an entity issues a collateralized liability and a non-collateralized liability that are otherwise identical, the credit risk of those two liabilities will be different, even though they are issued by the same entity. The credit risk on the collateralized liability will be less than the credit risk of the non-collateralized liability. The credit risk for a collateralized liability may be close to zero.

Appendices B5.7.14. For the purposes of applying the requirement in paragraph 5.7.7(a), credit risk is different from asset-specific performance risk. Asset-specific performance risk is not related to the risk that an entity will fail to discharge a particular obligation but instead it is related to the risk that a single asset or a group of assets will perform poorly (or not at all).

Appendices B5.7.15 The following are examples of asset-specific performance risk:

(a) A liability with a unit-linking feature whereby the amount due to investors is contractually determined on the basis of the performance of specified assets. The effect of that unit-linking feature on the fair value of the liability is asset-specific performance risk, not credit risk.
(b) A liability issued by a structured entity with the following characteristics. The entity is legally isolated so the assets in the entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The entity enters into no other transactions and the assets in the entity cannot be hypothecated. Amounts are due to the entity's investors only if the ring-fenced assets generate cash flows. Thus, changes in the fair value of the liability primarily reflect changes in the fair value of the assets. The effect of the performance of the assets on the fair value of the liability is asset-specific performance risk, not credit risk.

4.2.7. Determining the effects of changes in credit risk

Appendices B5.7.16 For the purposes of applying the requirement in paragraph 5.7.7(a), an entity shall determine the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability either:

(a) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (paragraphs B5.7.17 and B5.7.18); or
(b) Using an alternative method the entity believes more faithfully represents the amount of change in the liability's fair value that is attributable to changes in its credit risk.

Appendices B5.7.17 Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates.

Appendices B5.7.18 If the only significant relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, the amount in paragraph B5.7.16(a) can be estimated as follows:

(a) First, the entity computes the liability's internal rate of return at the start of the period using the fair value of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
(b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).
(c) The difference between the fair value of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in OCI in accordance with paragraph 5.7.7(a).

Appendices B5.7.19 The example in paragraph B5.7.18 assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in observed (benchmark) interest rates are not significant. This method would not be appropriate if changes in fair value arising from other factors are significant. In those cases, an entity is required to use an alternative method that more faithfully measures the effects of changes in the liability's credit risk (paragraph B5.7.16(b)). For example, if the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be presented in OCI in accordance with paragraph 5.7.7(a).

Appendices B5.7.20 As with all fair value measurements, an entity's measurement method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of relevant observable inputs and minimum use of unobservable inputs.

4.3. Possible Impacts of IFRS 9 Full Adoption

On 1 January 2018, HSBC implemented the requirements of IFRS 9 "Financial Instruments." The implementation is in accordance

with "*Paragraph 7.1.1 Effective Date*" which states that an entity shall apply this Standard for annual periods beginning on or after 1 January 2018 with a permission to opt for earlier application. Since this is a major new IFRS, the Group provides information relevant to understanding the impact of the new accounting standard on HSBC's financial position at 1 January 2018. A notable message of this report is the estimation of ECL and related impacts remains subject to change until finalization of the financial statements for the year ending 31 December 2018, since the Group is still in the progress of continued testing and refining the new accounting processes.

HSBC adopted the requirements of IFRS 9 "Financial Instruments" on 1 January 2018, with the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted on 1 January 2017. The impact of transitioning to IFRS 9 at 1 January 2018 on the consolidated financial statements of HSBC was a decrease in net assets of $1,004m, arising from:

- A decrease of $2,232m from additional impairment allowances;
- An increase of $908m from the remeasurement of financial assets and liabilities as a consequence of classification changes, mainly from revoking fair value accounting designations for certain long-dated issued debt instruments; and
- An increase in net deferred tax assets of $320m.

HSBC claims that it remains strongly capitalized following the adoption of IFRS 9 which, based on the transition impact, will result in a 12bps increase in the common equity tier 1 ratio, applying the EU regulatory transitional arrangements, and a 1bp increase on a fully loaded basis at 1 January 2018.

A decrease of $2,232 m from additional impairment allowances is derived from the reclassification and remeasurement activities to comply with the requirements of IFRS 9. The following components constitute the amount of increase in impairment allowances:

- Cash and balances at central banks: $3m (remeasurement)
- Loans and advances to banks: $23m (remeasurement)
- Loans and advances to customers: $1,859m (reclassification and remeasurement)
- Financial investments: $16m (reclassification and remeasurement)
- Prepayments, accrued income and other assets: $47m (remeasurement)
- Provisions (loan commitments and financial guarantees): $284m (remeasurement).

Total: $2,232m

The pre-tax net asset impact of additional impairment allowances on adoption of IFRS 9 is $2,232m; $1,948m in respect of financial assets at amortized cost and $284m related to loan commitments and financial guarantee contracts.

An increase of $908m from the remeasurement of financial assets and liabilities as a consequence of classification changes is the remaining effect of a decrease in net assets of $1,004m, after accounting for a decrease of $2,232m from additional impairment allowances and an increase in net deferred tax assets of $320m. Basically, the increase in net deferred tax assets arises from IFRS 9 remeasurement including ECL:

- $38m of increase in "Deferred tax assets;" and
- $282m of decrease in "Deferred tax liabilities."

The revocation of fair value accounting designations for certain long-dated issued debt instruments in forward-looking statements by HSBC are in accordance with the "*Paragraph 7.2.9 and 7.2.10 Transition for Classification and Measurement*" of IFRS 9. Those requirements apply if only the practice eliminates or significantly reduces a measurement or recognition inconsistency. Such inconsistency (sometimes referred to as an "accounting mismatch)" would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.

Paragraph 7.2.9. At the date of initial application an entity:

(a) Shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if that financial asset does not meet the condition in paragraph 4.1.5.
(b) May revoke its previous designation of a financial asset as measured at fair value through profit or loss if that financial asset meets the condition in paragraph 4.1.5.

Such a revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

Paragraph 7.2.10 At the date of initial application, an entity:

(a) May designate a financial liability as measured at fair value through profit or loss in accordance with paragraph 4.2.2(a).
(b) Shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with the condition now in paragraph 4.2.2(a) and such designation does not satisfy that condition at the date of initial application.
(c) May revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with the condition now in paragraph 4.2.2(a) and such designation satisfies that condition at the date of initial application.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

IFRS 9 full adoption results in an increase of $2,416 credit-related allowances/provisions. "ECL 12M" represents the increase in the allowance between IAS 39/IAS 37 and an IFRS 9 ECL associated with defaults in the next 12 months across all stages incorporating only the "Central" scenario. The $1,280m increase is mainly a result of moving to an expected credit loss model from an incurred-loss model with loss emergence periods of generally less than

12 months. "ECL lifetime" represents the incremental stage 2 ECL associated with defaults beyond 12 months under a lifetime expected credit loss estimation incorporating only the Central scenario ($804m). "Multiple economic scenarios" represents the increase in ECL as a result of using multiple economic scenarios rather than a single Central scenario ($332m).

The term of "significant items" in HSBC Annual Report and Accounts describe collectively the group of individual adjustments excluded from reported results when arriving at adjusted performance. These items, which are detailed below, are ones that management and investors would ordinarily identify and consider separately when assessing performance to understand better the underlying trends in the business. Significant items and currency translation of financial instruments designated at fair value affected by IFRS 9 are supposed to be presented in OCI regardless the standard implementation. This is because "*Paragraph 7 Definitions*" of IAS 1 has provided a guideline regarding the items to be presented at OCI. Moreover, the guideline also emphasizes on the practices introduced by IFRS 9 which shows an agreement among the standards.

Paragraph 7 --- OCI comprises items of income and expense (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other IFRSs.

The components of OCI include:

(a) changes in revaluation surplus (IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets);
(b) remeasurements of defined benefit plans (IAS 19 Employee Benefits);
(c) gains and losses arising from translating the financial statements of a foreign operation (IAS 21 The Effects of Changes in Foreign Exchange Rates);
(d) gains and losses from investments in equity instruments designated at FVOCI in accordance with paragraph 5.7.5 of IFRS 9 Financial Instruments;
(da) gains and losses on financial assets measured at FVOCI in accordance with paragraph 4.1.2A of IFRS 9.
(e) the effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at FVOCI in accordance with paragraph 5.7.5 of IFRS 9 (Chapter 6 of IFRS 9);
(f) for particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk (paragraph 5.7.7 of IFRS 9);
(g) Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value (Chapter 6 of IFRS 9); and
(h) Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument (Chapter 6 of IFRS 9).

If we compare the findings of this research with the relevant researches conducted in EU AND Indonesia (see literature review), there is no deviant case of a bank that does not comply to applicable IFRS. Although this research does not measure the extent of HSBC compliance of IFRS 9, the findings do not show inconsistency between what have been stated in the Group's annual report and their applicable standards. A logical explanation behind this phenomenon is that banks face tremendous compliance pressures due to the global financial crisis in 2008 and hence, any deviant behavior will be challenging as the regulators pay more attention on this industry. Furthermore, EU has maintained a political influence on the IASB's standard-setting *ex ante*. The preceding explanation is also supported by the lack of evidences that the previous transition to IAS 39 causes a less timely provisioning under the stricter requirements of a new accounting standard (Gebhardt, 2016; Huian, 2012; Lopes and Rodrigues, 2008).

5. CONCLUSION

Although it is more unfavorable for financial institutions to record ECL that become a considerable "burden" in their financial statements, it is to be noted that IFRS 9 will contribute in providing a more objective and prospective view of financial industry. Financial statements users also benefit from the standard's requirements. In the end, accounting should serve its purpose to provide reliable information thus interested stakeholders can make decision based on a set of "sound" numbers.

The results of this research also indicate a certain extent of agreement with MacNeal's suggestion which is to provide two major sections of income statement. The first section presents current profits or losses (e.g., profits or losses from business operation) and the second section presents capital profits or losses. Although the concept is quite similar with Income Statement and Statement of Comprehensive Income, it does not reflect the ECL model since the model itself is an engine that incorporates the data of macroeconomic scenarios to generate an amount of expected losses. In other words, the concept of forward-looking has never been considered before by MacNeal.

Lastly, a positive theory introduced by Watts and Zimmerman that predict managers have lower incentives to choose accounting standards which report higher earnings is somehow true as suggested by the findings of this research. This is because the adoption of IFRS 9's requirements relating to the presentation of gains and losses on financial liabilities designated at fair value only impacts how such gains and losses are presented but not the amount itself. However, it is also undeniable that the practice brings a more optimistic view in the income statement with the opposite effect in OCI.

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