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Research on the Impact of the Reform of Financial Instrument Standards on Ping An

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Abstract: *In 2017, China promulgated the revised Accounting Standards No. 22 - Recognition and Measurement of Financial Instruments. The new standards have made great changes in the classification and impairment of financial assets. After the restatement and adjustment of the new standard, Ping An's equity instruments available for sale under the original standard are greatly affected by reclassification, and the proportion of financial assets measured at fair value and recorded in current profit and loss is significantly increased, indicating that the promulsion of the new standard has a great impact on the financial aspect of Ping An of China.*

Keywords: *Guidelines on financial Instruments, Classification of financial assets, Ping An, Financial impact*

1. Introduction

In 2006, the Ministry of Finance of China promulgated Accounting Standards for Business Enterprises No. 22 - Recognition and Measurement of Financial Instruments (referred to as the "Original Standards"), which played a positive role in regulating financial instruments at that time. However, with the continuous development of China's economy, the existing problems in accounting financial assets under the original standards gradually emerged, such as: Enterprises use the classification of financial assets to carry out earnings management based on subjectivity, and adopt the "incurred loss method" to calculate and withdraw the impairment of financial assets which cannot meet the ever-changing financial activities. After the outbreak of the financial crisis in 2008, the International Accounting Standards Board made major changes to the accounting standards. In 2014, the International Financial Reporting Standards No. 9 - Financial Instruments (IFRS9) was officially released. In order to solve the problems existing in China's financial instruments and convergence with international standards, the Ministry of Finance of China revised the standards with reference to the relevant content of IFRS9. In 2017, "Accounting Standards for Business Enterprises No. 22 -- Recognition and Measurement of financial Instruments" (referred to as the "new Standards") was formally promulgated, and stipulated that the new standards began to be gradually implemented on January 1, 2018[1].

Compared with the original criteria, the revised criteria have significant changes in the classification and impairment of financial assets. According to the business model and contract cash flow characteristics, financial assets are divided into three categories: fair value through other comprehensive income (FVOCI); fair value through profit and loss (FVTPL); Amortized cost (AC).; Amortized Cost (AC). Among them, FVOCI is divided into debt instruments and non-trading equity instruments for accounting treatment respectively. Debt instruments carry out "double-line accounting", which not only accounts for fair value fluctuations, but also accounts for amortized cost changes. Only fluctuations in fair value are accounted for during the holding period of non-trading equity instruments. Due to the complexity and poor flexibility of accounting treatment of such financial assets, enterprises generally avoid holding such assets in the actual execution. Under the new guidelines, the characteristics of the classification changes are: the classification of financial assets is reduced, and the classification criteria are more objective. Financial assets formerly available for sale are no longer a backstop item and are classified as FVTPL for business models that directly specify and do not pass cash flow tests or do not receive, sell contract cash flows or both.

The insurance industry holds a large scale of financial assets. This paper takes Ping An, which has implemented the new criteria, as an example to study the impact of changes in the classification of financial assets on the company's finance.

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2. PingAn financial asset classification changes under the new guidelines

Ping Ann's annual report in 2018 reclassified the financial assets on December 31, 2017 according to the new guidelines. This paper sorted it out and subdivided it into Table 1 for your reference. It should be pointed out that FVTPL is accounted for in "trading financial assets". FVOCI specifically in the "other bond investment" project and "other equity instrument investment" project accounting; AC is mainly accounted for in "debt investment", "loans and advances" and "time deposits", as shown in Figure 1.

Table 1: Ping An on Dec.31st, 2017 according to the new guideline's classification and measurement changes

Items and amounts before reclassification (RMB million units)		Items after reclassification	Variable amount (RMB million units)	Percentage of change
Financial assets available for sale 775,098	Debt instruments 221,871	Other debt investments	188,793	85.08%
		Debt investment	1,539	0.7%
		Trading financial assets	31,539	14.22%
	Equity instrument 553,227	Investment in other equity instruments	206,332	37.30%
		Trading financial assets	346,895	62.70%
Hold-to-maturity investment 1,243,768		Trading financial assets	9,625	0.77%
		Debt investment	1,234,143	99.23%
Trading financial assets 141,250		Trading financial assets	141,250	100%
Loans and receivables 2,658,147		Trading financial assets	173,209	6.52%
		Other debt investments	19,514	0.7%
		Debt investment	703,252	26.46%
		Make loans and advances	1,631,688	61.38%
		Time deposit	130,511	4.94%

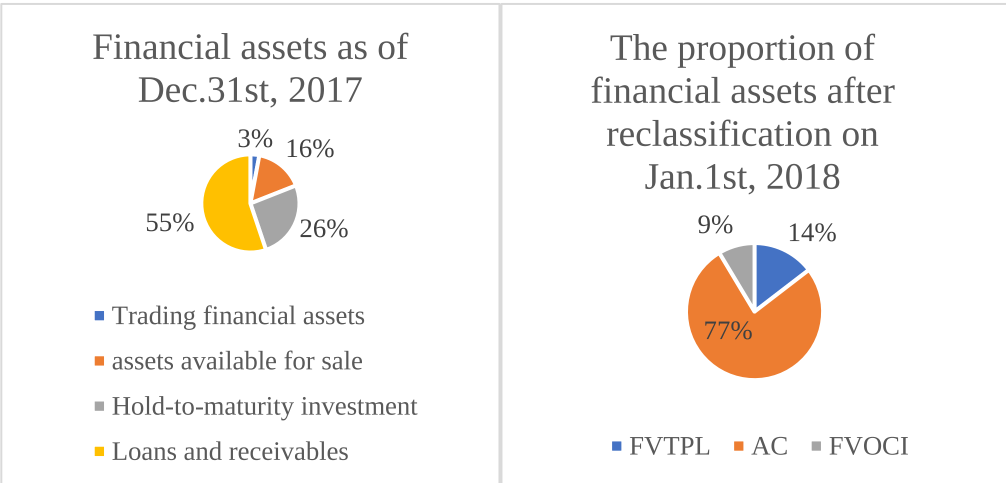

Figure 1: The proportion of financial assets of Ping An on Dec.31st, 2017 and after reclassification under the new guidelines

The financial assets available for sale under the original standard act as a "backstop" project, and almost all financial assets can be accounted through it, but the FVOCI under the new standard can only account for debt investment and investment in specially designated equity instruments that pass the contract cash flow test. From the perspective of the motivation for the revision of accounting standards, under the original standards, enterprises can manipulate financial assets available for sale to achieve the role of whitewashing profits. In order to restrict this behavior of enterprises, the new standards cancel the classification of financial assets available for sale, resulting in FVOCI.

The new standard carries out different follow-up measurement for equity instruments and debt instruments: Under the new criterion, FVOCI, through the account of "other creditor's rights investment", the follow-up measurement method has little change compared with the old criterion. Other comprehensive income generated by the change of fair value will flow into the investment income when the final sale, which also has the function of adjusting profit. The follow-up measurement of other

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creditor's rights investment has no substantive change. However, it is specially designated as FVOCI, which is accounted for through the account of "Investment in other equity instruments". All other changes except dividends incurred during the holding period cannot flow into the income statement from beginning to end.

Ping Ann's reclassification of financial assets available for sale (debt instruments) into other debt investments changed little (5% to 4%); The proportion of reclassified financial assets available for sale (equity instruments) to investment in other equity instruments decreased significantly (from 11% to 4%), which was mainly due to the loss of profit adjustment function of such financial assets. Companies generally hold such financial assets as strategic investments, unless they can obtain considerable dividend income, otherwise the significance of holding them is small.

It is worth noting that among the financial assets available for sale of Ping An of China, 14.22% of debt and 62.7% of equity are reclassified to FVTPL, which will have a significant impact on the income statement.

As shown in Figure 1, under the new guidelines, FVTPL became the "bottom pocket" project under the new guidelines. The proportion of FVTPL held by Ping An increased after the reclassification (from 3% to 14%), mainly caused by the reclassification of financial assets available for sale, but generally companies hold such financial assets mainly to earn short-term price difference or hedge risks. This is not the main business of Ping An, so the overall holding ratio is not high.

Generally speaking, Ping An holds a large proportion of loans, accounts receivable and hold-to-maturity investment (about 81%), and AC accounts for 77% after reclassification. There is no substantial change in subsequent measurement, which has little impact on finance.

3. The new criteria under the financial asset classification changes to PingAn's financial impact

3.1 Impact on the income statement

Due to the implementation of the new guidelines, the proportion of FVTPL increased, and the fluctuations of the fair value of such financial assets were reflected in the "fair value change profit and loss" item. As shown in Figure 2, the total profit and loss from changes in fair value of Ping A fluctuated wildly. It had a brief decline in 2018 and then recovered after 2018, mainly because the fair value of equity instruments in FVTPL fell sharply in 2018 (the profit from changes in fair value fell from 1 billion yuan to 28.7 billion yuan). In 2019, China's capital market was overheated and the valuation of financial assets rose rapidly, which made the fair value of equity instruments increase with a large increase (the loss of fair value changes increased from 28.7 billion yuan to 21 billion yuan).

According to Figure 3, the impact of fair value change profit and loss on total profit after the implementation of the new standard is significantly higher than that before the implementation of the new standard, indicating that after the implementation of the new standard, the value fluctuation of FVTPL is directly related to the capital market, and is fully reflected in the current income statement, clearly reflecting the actual situation of such financial assets, as shown in Table 2， main items causing changes in profit and loss from changes in fair value.

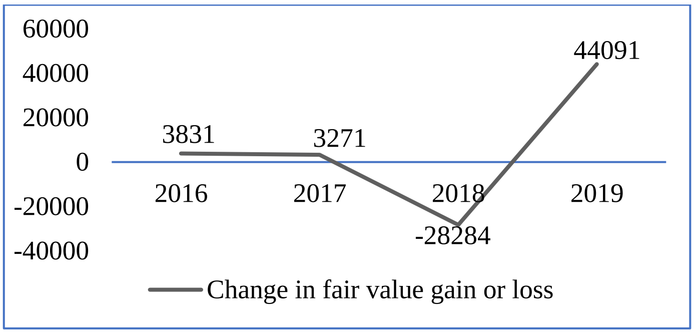

Figure 2: Change trend of fair value change profit and loss of Ping A from 2016 to 2019 (RMB million units)

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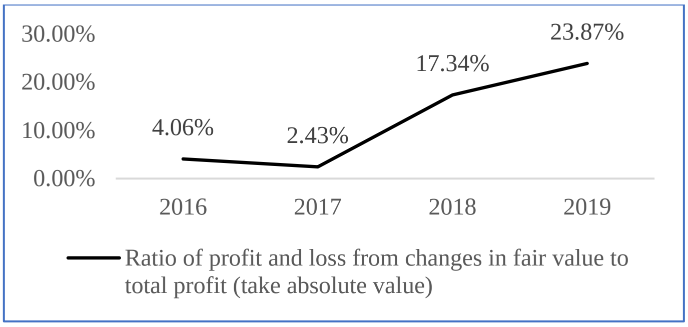

Figure 3: Ratio of profit and loss of changes in fair value to total profit (take absolute value)

Table 2: Main items causing changes in profit and loss from changes in fair value

Unit: RMB million

Major project	2016	2017	2018	2019
FVTPL (Equity Instrument)	2,733	1,000	-28,688	20,989
FVTPL (Debt Instrument)	-189	-191	1,677	340
Other assets	1,287	2,462	-1,273	22,762

3.2 Impact on balance sheet

After Ping An implemented the new criteria, the asset structure and presentation of financial assets changed, creditor's investment and equity investment in the balance sheet more clearly: AC in the balance sheet listed as "creditor's investment", "loan", "time deposit" and other items; In FVOCI, the creditor's right is listed as "other creditor's right investment" project, and the rights and interest’s department is listed as "other equity instrument investment" project respectively. FVTPL is listed as "financial assets measured at fair value and its changes booked into current profit and loss" item. On the day of the conversion of the new and old standards, FVTPL holdings increased from 1.4 billion yuan to 7 billion yuan, an increase of 80%, due to the reclassification, among which 5.6 billion yuan was transferred from the financial assets available for sale, loans and receivables and hold-to-maturity investments of the original standards. This reclassification made the financial assets from non-current assets to current assets, which would affect the company's short-term solvency. In Figure 4, the ratio of FVTOL to current liabilities increased, especially 6.5 times in 2018 compared with 2017, indicating that Ping Ann’s ability to repay short-term liabilities with FVTPL improved after the implementation of the new guidelines.

The fair value changes of FVOCI are accounted for by "other comprehensive income", but other comprehensive income generated by debt instruments can be transferred to current profit and loss upon termination of recognition, affecting the income statement. As can be seen from Figure 5, after the implementation of the new criteria, other comprehensive income that can be converted into profit and loss decreases by 94%, and the ability of such financial assets to affect shareholders' equity and profit decreases. Other comprehensive income generated by equity instruments is transferred to retained earnings without affecting total shareholders' equity.

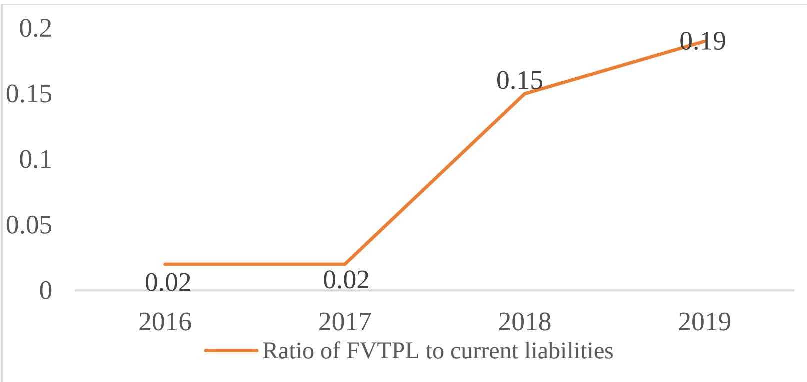

Figure 4: Ratio of FVTPL to current liabilities

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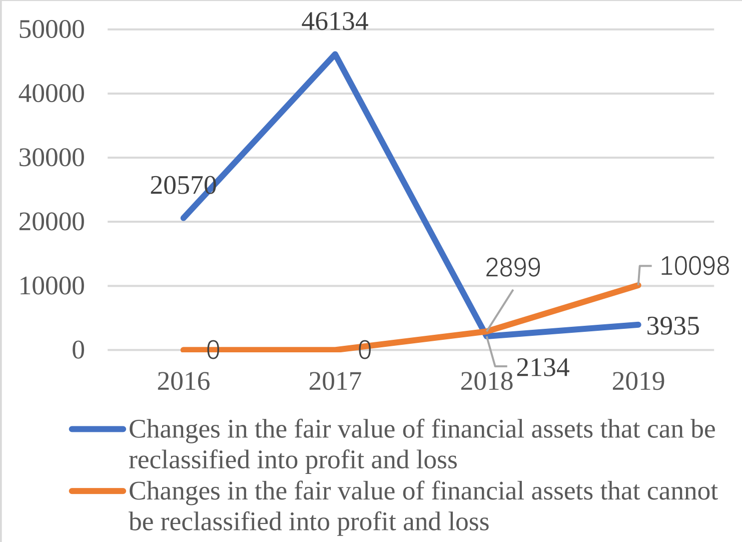

Figure 5: Subsequent reclassification of other comprehensive income (RMB million units)

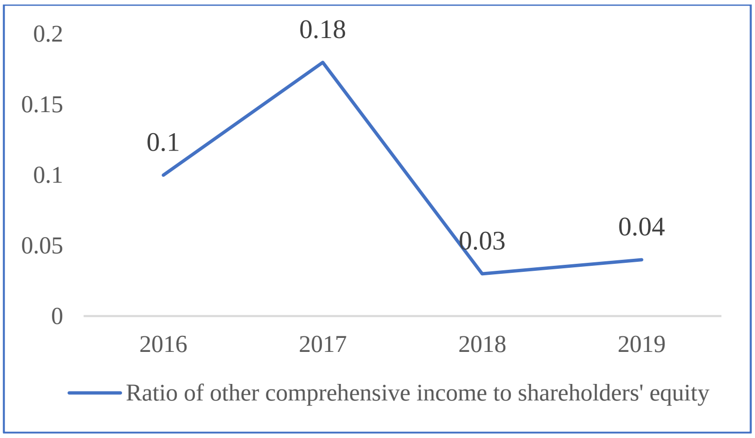

Figure 6: Ratio of other comprehensive income to shareholders' equity

The new and old criteria switch the first day, Ping A held financial assets, FVOCI holdings reduced, the new criteria between the implementation of the day and the original book value to adjust the balance between conversion day other comprehensive income and retained earnings, making the first day of the switch retained earnings increased 32.3-billion-yuan, other comprehensive income reduced 35.1-billion-yuan, net assets reduced 4.8 billion yuan. It can be seen from Figure 6 that the influence of other comprehensive income of the new criterion on shareholders' equity decreases compared with that of the old criterion.

4. Conclusions

After the above analysis, FVTPL has a large increase after reclassification, and its fair value fluctuations are reflected in the income statement, which will have a great impact on the income statement. In addition, after reclassification, part of the asset project reporting location has changed, directly affecting the short-term solvency of the enterprise, and FVOCI's equity tools generated other comprehensive income after asset disposal has become strict, resulting in Ping An holding this type of assets account for a significant reduction. It can be seen that the revised standard of new financial instruments has a greater financial impact on Ping An.

In practice, it is very difficult to confirm the fair value of some non-trading equity instruments, such as the equity instruments of non-listed companies, and it is difficult to measure the fair value fluctuations. There are certain difficulties in practical operations. Companies generally hold such financial assets as strategic investments or reclassification designations when implementing new guidelines. Other equity instrument investment accounting is designated as FVOCI, which is characterized by non-trading equity investment. The financial assets held by enterprises are not intended for trading purposes, so it is of little

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significance to reflect the fluctuation of fair value. Moreover, the current market environment in China is not mature enough. Most enterprises obtain fair value by using valuation technology, which is highly subjective. The adoption of valuation technology will not only increase the accounting cost of enterprises, but also lead to the reliability of fair value acquisition cannot be guaranteed. In addition, the current disclosure of fair value by enterprises is not specific enough, and its reference value for external users is limited. From the perspective of tax-related treatment, the introduction of fair value will cause the book value of investment in other equity instruments to be inconsistent with the tax basis, resulting in temporary differences. As long as the enterprise does not dispose of the asset, the recognized deferred income tax will be adjusted frequently with the fluctuations of the fair value, which increases the financial burden of the enterprise.

References

[1] CAS22. Accounting Standard for Business Enterprises No. 22 - Recognition and Measurement of Financial Instruments [S]. Ministry of Finance. 2017.