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Research on optimization of financial asset classification

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Abstract: *The new financial instruments standard promulgated in 2017 optimizes the classification of financial assets into "three categories". So far, the financial assets measured at fair value and whose changes are included in other comprehensive income have been gradually weakened in practice due to the complexity and poor flexibility of accounting treatment. Based on the analysis of the changes of financial assets held by securities companies before and after the revision of the standards, and combined with the characteristics of financial assets, this paper discusses the feasibility of optimizing the classification of financial assets, so as to provide reference for the further improvement of relevant accounting standards.*

Keywords: *Classification of financial assets, Other debt investments, Investment in other equity instruments, Securities company*

1. Introduction

In order to standardize financial instruments recognition, measurement and related information disclosure as well as convergence with international standards, in 2017 our country promulgated the "business accounting Standard No. 22 -- financial instruments recognition and measurement" for short "new financial instruments standard", the new financial instruments standard divides financial assets into three types: fair value through other comprehensive income(FVOCI); fair value through profit and loss(FVTPL);Amortized cost(AC). FVOCI are divided into debt instruments and non-trading equity instruments for accounting treatment respectively[1]. Debt instruments carry out "two-track 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.

2. Analysis of financial assets holdings before and after the revision of securities company guidelines

The main business of securities companies is financial management and investment, and the holding of financial assets is relatively high. In this paper, 34 securities companies listed on the A-share market that have implemented the new financial instruments criteria are taken as the research objects, and relevant information of financial assets held by each company from 2017 to 2020 is collected and sorted out. Through analysis, it is found that before the implementation of the new criteria. It mainly holds receivables and loans, trading financial assets and financial assets available for sale. After the implementation of the new standards, the distribution of financial assets is mainly concentrated in FVTPL- and AC, while FVTPL are low. The detailed proportions are shown in Figures 1 and 2 below. By comparing Figure 1 and Figure 2, it can be clearly seen that the average proportion of original financial assets available for sale is 20.76%, while the average proportion of FVOCI is 15.83%, showing a downward trend.

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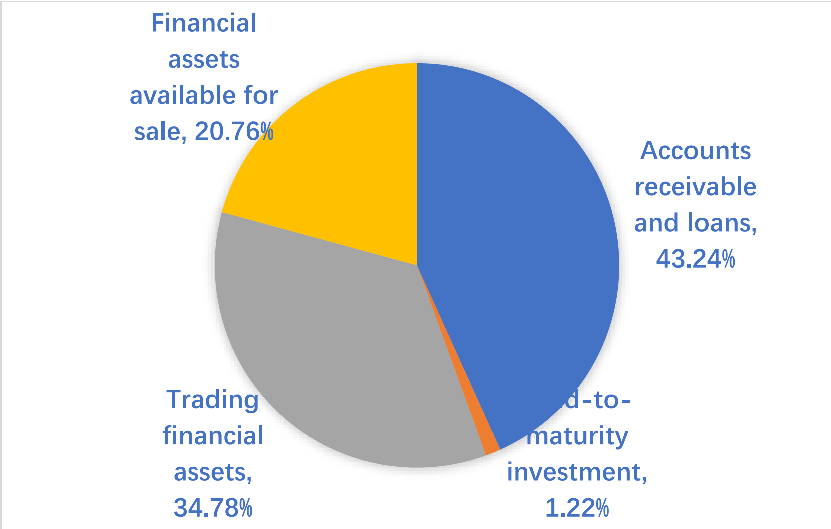
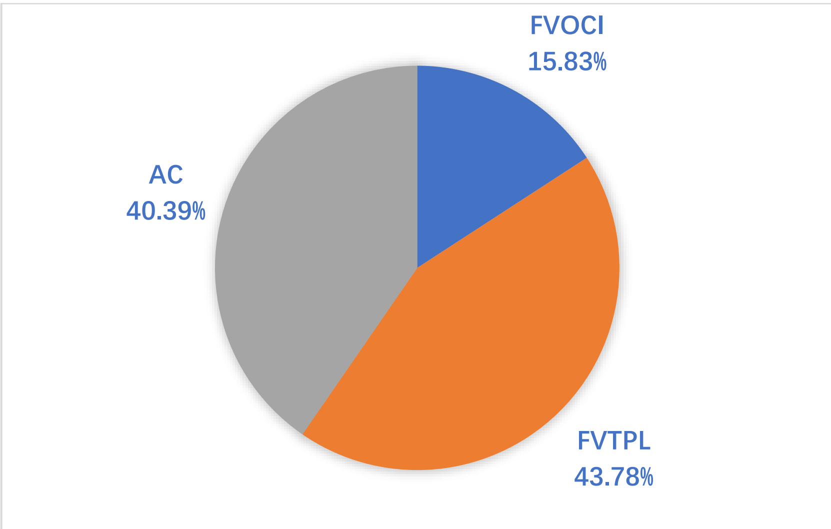


Note: The proportion of financial assets is the proportion held by each enterprise in the year before the implementation of the new guidelines.
Data source: Annual financial statements of each enterprise from 2017 to 2020.

Figure 1: Distribution of financial assets of securities companies before the revision of the guidelines.



Note: The proportion of financial assets is the average of the proportion of financial assets held by each company from the end of the year when the new rule is implemented to the end of 2020.
Data source: Annual financial statements of each enterprise from 2017 to 2020.

Figure 2: Distribution of financial assets of securities companies after the revised criteria

3. Other creditor's rights investment existing accounting problems

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. However, under the new criteria, the subsequent measurement of other creditor's rights investment has no substantive change, and its fair value fluctuations are hidden in the owners' equity, which is transferred to current profit and loss when disposed, and still retains the function of adjusting profit. Because of its implementation of "double-line accounting", not only to account for fair value fluctuations, but also to account for amortized cost changes, so there are several problems in the actual accounting treatment:

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3.1 Impairment accounting treatment violates the principle of caution

The principle of prudence requires that enterprises should not overestimate assets or income, underestimate liabilities or expenses. From the aspect of quality requirements of accounting information, the author believes that the impairment of other creditor's rights investment and the fair value presentation are not in line with the quality requirements of accounting information. Impairment of financial instruments means that an enterprise must check the book value of all financial assets except those designated as FVTPL on each balance sheet date. If there is objective evidence of impairment of financial assets, it should make provision for impairment and record the impairment loss into current profit and loss. Impairments on financial instruments are based on expected credit losses, which are the weighted average of credit losses on financial instruments weighted by the risk of default occurring. When other creditor's rights investment is expected to be impaired, "credit impairment loss" is debited, "other comprehensive income" is credited, and the book value of assets is not affected, thus destroying the prudent principle of accounting information.

3.2 The presentation of financial statements violates the principle of comprehensibility

The principle of comprehensibility requires that the accounting information provided by enterprises should be clear and clear, so as to facilitate the understanding and use of financial report users. AC is listed as amortized cost in the statement, which can directly reflect the purpose of the enterprise holding such assets is to collect contract cash flow; The FVTPL list, which reflects the current "offload" price of assets held by the company; The fluctuation of fair value can reflect the purpose of the enterprise to obtain cash flow by selling assets, and the amortization of initial cost can reflect the purpose of the enterprise to collect contract cash flow from such assets. However, other debt investment items are listed in the fair value in the statement, which does not directly reflect the purpose of "collecting" held by the enterprise. Nor can it reflect the situation of its impairment, thus destroying the intelligibility of the statement information.

3.3 Tax-related accounting is complicated

In terms of tax-related treatment, the tax-related treatment of other creditor's rights investment is more complicated. The fair value fluctuation and impairment of the asset will cause the book value and tax basis to be inconsistent, and the deferred income tax caused by the temporary difference of the former will be included in the "other comprehensive income" account, affecting the owner's equity. The deferred income tax caused by the temporary difference of the latter is included in the "income tax expense" subject, which affects the profit and loss. Moreover, when deferred income tax is rolled back, the current book value should be compared with the initial tax basis: when the current book value is still less than the initial tax basis, it belongs to the deferred income tax rolled back caused by the impairment, and it should correspond to the "income tax expense". And the book value is higher than the initial tax basis, belongs to the fair value fluctuations and deferred income tax, to be transferred back to the corresponding "other comprehensive income". Thus, the tax treatment process of other creditor's rights investment is complicated, requiring financial personnel to master and apply relevant professional knowledge.

4. Problems existing in current accounting of investment in other equity instruments

4.1 The specific practical operation of the enterprise is difficult

Accounting Standards for Business Enterprises No. 2—Long-term Equity Investment (2014) regulates the recognition and measurement of qualified equity investments. The investing enterprise does not have common control or significant influence on the invested entity[2]. And in the active market, there is no quotation, the fair value cannot be measured reliably for equity investment applicable to the Accounting Standards for Business Enterprises No. 22 - Recognition and measurement of financial instruments. The revision of the criteria for long-term equity investment will report the equity investment which does not have an important influence on the invested entity and has no market price from long-term equity investment to investment in other equity instruments. However, paradoxically, according to the provisions of the criteria for new financial instruments, other equity instrument investment must be measured by fair value. However, 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, resulting in certain difficulties in practical operations. Generally, the financial assets held by the company are designated for strategic investment or reclassification when implementing the new guidelines. Unless the financial assets can bring substantial dividend income to the company, it is of little significance for the company to hold.

4.2 Increase enterprise accounting cost by fair value measurement

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 significance to reflect the fluctuation of fair value. Moreover, the current market environment of our country is not mature, enterprises to obtain the fair value mostly use valuation technology to estimate, the subjective is strong, the adoption of valuation technology will not only increase the cost of enterprise accounting, but also lead to the reliability of the fair value 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.

4.3 Tax-related accounting is complicated

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.

5. Conclusions

The new standard has just been promulgated for four years, and it is difficult for enterprises to adjust and apply the standard. The complexity of practical operation of financial assets measured at fair value and their changes included in other comprehensive income and the high standard requirements for financial personnel make the flexibility of such financial assets poor and the enterprise holdings small. According to the distribution of financial assets of the above securities companies and the problems existing in the current accounting methods of investment in other equity instruments and other debt investments, the author puts forward the following ideas to optimize the classification of financial assets.

5.1 Investment in other equity instruments

Other equity instruments will be included back into the long-term equity investment criteria, continue to use cost measurement, and in accordance with the Accounting Standards for Business Enterprises No. 8 - Asset impairment requirements for impairment. The purpose of investment of other equity instruments held by enterprises is non-transaction, and they can increase their shares in the future to achieve significant influence, joint control and even control. The essence of their transactions is closely related to the accounting content of long-term equity investment. When other equity instruments are changed into long-term equity investments, the cost method can not only reflect the asset impairment situation, but also in the enterprise income tax accounting, the accounting standards are consistent with the tax law, which greatly simplifies the tax-related accounting treatment, reduces the difficulty of asset management for investment units and saves operating costs.

5.2 Other creditor's rights investment

If the enterprise currently holds the investment vehicle for the purpose of collecting contract cash flow, the asset is directly divided into AC. When the enterprise changes its business model of managing financial assets, it is reclassified in FVTPL. In this way, such assets in the provision of impairment debit "credit impairment loss", credit "debt investment impairment reserve", reduce the book value of assets, in line with the principle of prudence; when an enterprise changes its business model of managing financial assets, it is reclassified into FVTPL. Although impairment is no longer deducted, the fluctuations of fair value can reflect the increase and impairment of the asset held by the enterprise, and the fair value is listed in the statement, reflecting the current "offloading" price of the asset, which can reflect the enterprise's tendency to hold the financial asset. Meet the intelligibility requirements of financial statements; it also reduces the difficulty of accounting for such assets, improves flexibility, and eliminates the possibility of companies manipulating profits through such assets.

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