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Dear Steve,

IASB Exposure Draft on Conceptual Framework for Financial Reporting: The Reporting Entity ("Exposure Draft")

I refer to your letter to our Mark Dickens dated 5 May 2010 on the above Exposure Draft which has been passed to me for my attention.

We have completed our review of the Exposure Draft and our views are set out below.

General

The Exposure Draft proposes what a reporting entity is and also includes discussion on when an entity controls another entity. Under the Exposure Draft, a reporting entity is defined as *"a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided"*.

We generally agree with the Exposure Draft's proposed description of a reporting entity which attempts to cover a broad range of financial information. We note it will include what normally would not be regarded as general purpose financial statements. If the intention is to make it as wide as possible, we believe it could be perhaps described more simply as *"a separately identifiable unit of economic activities whose financial information provides useful information to its proposed intended users"*.

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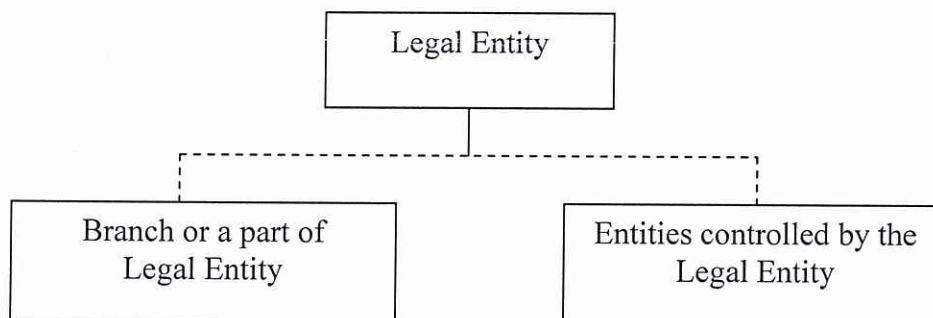
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We note the Exposure Draft describes how to determine a reporting entity and also touches on “control” in determining the circumscribed area. We believe this complicates the issue and believe that the meaning of “control” could be developed and expanded elsewhere in detailed accounting standards which provide guidance on how” and “what” information on the reporting entity should be presented.

Description of a reporting entity

Although we agree that a reporting entity need not necessarily be a legal entity, we believe using a legal entity as starting reference point is useful in explaining the concept of a reporting entity as the existence of a legal entity normally triggers a reporting requirement either under the law of its place of incorporation or under accounting standards. As illustrated in the below diagram, a reporting entity depends on the perspective one looks:

- (a) At the legal entity level;
- (b) At the branch level;
- (c) At the group level.



Depending on the proposed users’ requirements and needs, as proposed under the Exposure Draft it is also possible to have any “carve out” of the information of any part(s) of the above. We believe the use of a pictorial diagram with reference to a legal entity as a starting point will promote understanding and should be used.

Sufficiency of legal entity

Paragraph RE4 of the Exposure Draft states that “*The existence of a legal entity is neither necessary nor sufficient to identify a reporting entity*”. We disagree with this statement and believe that the existence of a legal entity would normally be sufficient to identify a reporting entity and this is in fact the case under section 126 of the Hong Kong Companies Ordinance which currently requires the financial statements of the company (the legal entity) to be prepared in the first instance, and if the company has subsidiaries, the need to prepare “group accounts” which may not necessarily be presented in the form of “consolidated financial statements”.

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Commingled activities

Paragraph RE5 of the Exposure Draft states that *“a single legal entity may not qualify as a reporting entity if, for example, its economic activities are commingled with the economic activities of another entity and there is no basis for objectively distinguishing their activities”*.

Paragraph BC9 of the Exposure Draft further states that *“Some respondents said that all legal entities should qualify as reporting entities by themselves. The Board disagreed because in some situations the boundaries between two legal entities may be artificial. For example, two legal entities may commingle their resources, claims and operations to the extent that the economic activities of the two entities cannot be objectively distinguished”*.

We believe that the meaning of *“commingled”* should be further explained by including an illustrative example as we believe that commingling without objectively distinguishable activities will not be a common occurrence. Moreover, if a legal entity does exist, it is likely that it would have reporting and other filing obligations (e.g. tax) which would require it to be able to distinguish its activities from others even if the activities are somehow commingled with others.

We have similar views to the “some respondents” as explained above in our reference to the current requirements of the Hong Kong Companies Ordinance. A legal entity will normally create a reporting entity but this does not preclude the legal entity from preparing information on a wider reporting entity, namely, group accounts where this is useful information.

Methods of presenting financial statements of the reporting entity

The Exposure Draft briefly discusses the following types of financial statements:

- (a) Parent-only financial statements;
- (b) Consolidated financial statements;
- (c) Combined financial statements;
- (d) Proportionate consolidation; and
- (e) Branch accounts and carve-outs.

We are of the opinion that the above types of financial statements are just methods of presenting financial statements. As the method of presenting financial statements depends on the purpose of preparing the financial statements, we believe that it is unnecessary for the Conceptual Framework to address the specific methods of presentation as this would fall under specific standards which should include detailed guidance.

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However, if the IASB decides to retain a discussion on the methods of presentation, we have the following comments: -

(a) "A reporting entity" versus "General purpose financial statements"

General purpose financial statements are usually those prepared for shareholders of a company who are not involved in the day-to-day management of the company. General purpose financial statements are also important to creditors of the company. We believe general purpose financial statements are normally regarded as synonymous to financial statements presented to shareholders at the annual general meeting of a company. These are different from financial statements that merely comprise the branch of the legal entity which would normally only be relevant to management. Moreover, carve-out information would normally only be relevant for management purposes although this method is sometimes used for specific purposes such as in an initial public offering prospectus and transaction circulars. We therefore firmly believe that how information is presented (namely, financial statements) is a separate issue from the concept of a reporting entity.

(b) "Consolidated financial statements" versus "Parent-only financial statements"

The Exposure Draft states in paragraph RE8 that "... if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements". We believe this is too prescriptive and is also inconsistent with the current requirements in paragraph 10 of IAS 27 which states that:

"A parent need not present consolidated financial statements if and only if:

- (a) the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;*
- (b) the parent's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);*
- (c) the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and*
- (d) the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with International Financial Reporting Standards."*

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We would also point out that consolidated financial statements is only one form of presenting group financial statements that may be permitted in some jurisdictions such as under the current Hong Kong Companies Ordinance. Accordingly, it may be more appropriate to add “normally” in paragraph RE8 of the Exposure Draft to read as follows:

“Accordingly, if an entity that controls one or more entities prepares financial reports, it should normally present consolidated financial statements.”

Paragraph RE11 of the Exposure Draft states that *“Such ‘parent-only’ financial statements might provide useful information if they are presented together with consolidated financial statements”*. We agree that ‘parent-only’ financial statements together with consolidated financial statements will be useful especially where the parent has substantive transactions in its own right and also for listed companies where investors are interested in resources and dividends that are legally distributable by the listed entity.

(c) Levels of control

The Exposure Draft introduces several levels of “control” as follows:

- (a) “Control” under paragraph RE7 – *“An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself.”*
- (b) “Joint control” under paragraph RE9 – *“Two or more entities may share the power to direct the activities of another entity to generate benefits for (or limit losses to) themselves.”*
- (c) “Significant influence” under paragraph RE10 – *“If one entity has significant influence over another entity, it does not control that other entity.”*
- (d) “Entities under common control” under paragraph RE12 – *“Combined financial statements include information about two or more commonly controlled entities.”*

We do not believe the different levels of “control” are sufficiently explained together with their significance, and as they do not relate to the conceptual issue of the reporting entity they need not be mentioned. However, if there is a need to mention control to introduce the concept of a group controlled by a reporting entity we would suggest the word “control” should be consistently described and have the same meaning in all detailed accounting standards. We note that words used RE7 are different from that currently included in the current IAS 27 “Consolidated and separate financial statements” which reads - *“Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities”*.

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IASB to consider a “Definition” chapter

To simplify accounting standards and to avoid the use of similar terms with different meanings, we recommend that the IASB should consider amending its approach to writing accounting standards by creating a separate standard or a chapter that deals with “definitions” that are used throughout the Conceptual Framework and detailed accounting standards. When these terms appear in an individual standard or statement, the terms should be shown in bold or a specific type-face to indicate that the term has a specific and defined meaning. This will promote consistency and would remove the need to repeat definitions in each individual standard. For example, the Exposure Draft uses the term “parent-only financial statements” which is different from the term “*separate financial statements*” currently used in IAS 27 – the Consolidated and Separate Financial Statements. We believe that the IASB should use consistent terms to avoid confusion.

We hope that the above comments are helpful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited



Colin Chau
Senior Vice President
Listing Division

CC/el

c.c. Mr. Mark Dickens – Head of Listing