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Mr. Steve Ong
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Hong Kong Institute of Certified Public Accountants
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Dear Steve,

IFRS Foundation Report of the Trustees' Strategy Review – IFRSs as the Global Standard: Setting a Strategy for the Foundation's Second Decade (the "Paper")

At your request and for the purpose of the Roundtable meeting with the IFRS Foundation Trustees in Hong Kong, we have completed our review of the Paper which sets out the Trustees' recommendations on the future strategy of the IFRS Foundation. We understand that the Trustees' recommendations have been made after considering the comments made by respondents on the IFRS Foundation's earlier consultation paper "Status of Trustees' Strategy Review" published in November 2010. Our views on the earlier consultation paper were set out in our letter to you dated 31 January 2011 and in this submission we further elaborate on those views and highlight other matters which we believe the Trustees should consider.

We generally support the proposals and our detailed comments including areas of concern are discussed further below.

<u>"Financial reporting" versus "financial statements"</u>

The Paper states that the IFRS Foundation's mission as the standard setting body is to develop financial reporting standards that provide a faithful representation of an entity's financial position and performance. Page 8 of the Paper further states that the global standards it develops *"require high quality, transparent and comparable information in <u>financial statements</u> and other <u>financial reporting</u> to help investors, other participants in the world's capital markets and other users of financial information make economic decisions"*.

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In formulating its long term strategy, it is important that the Trustees clearly define the scope of its work. We believe that "financial reporting" is significantly wider in scope than "financial statements" and the Trustees should establish clear boundaries of information that will be presented in "financial reports" vis-a-vis "financial statements" as this will have an important impact on the work undertaken by the Foundation and on those responsible for their preparation, and whether the information is or should be subject to audit. The IFRS Foundation may wish to primarily focus its attention on "financial statements" rather than the broader responsibilities of "financial reporting".

To illustrate the difference, currently IFRS standards appear to be focused primarily on "financial statements". The IASB nevertheless in December 2010 published a practice statement on Management Commentary, which is intended to provide guidance to improve the usefulness of the information provided in an entity's financial statements. However, the practice statement was not issued as a standard. Consequently, an entity need not comply with the practice statement but is required to comply with IFRSs. We believe "financial reporting" should incorporate a management commentary and other information as financial statements alone do not provide shareholders and other stakeholders the information they require to enable them to make informed economic decisions. For example, even with segmental reporting, reading the financial statements alone a reader may not clearly and fully understand the nature and scope of a reporting entity's businesses and its future prospects. This and other critical information is usually found elsewhere in annual reports, the content of which is not governed by an IFRS. Moreover, we believe that the Trustees should also consider the role and positioning of the IFRS Foundation given the move towards "Integrated Reporting", which we understand is an attempt to provide a more holistic approach of communication between an entity and its stakeholders.

<u>"True and fair view" and "Materiality"</u>

We believe that high quality reporting depends on the entity's board and management or those charged with governance. They are responsible for the preparation of financial statements that give a "true and fair view" or equivalent terms such as "present fairly" and "faithful representation".

We believe that whether financial information is reliable, verifiable and auditable should be one of criteria for information to be included in "financial statements" or at least in the "primary financial statements" and supporting detailed explanatory notes. An audit plays an important role in providing an independent view on the reliability of the information. If information is not verifiable or non-auditable, we believe it should normally be placed outside the "financial statements". We note that the International Auditing and Assurance Standards Board ("IAASB") has also issued a useful discussion paper on "The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications". The paper raises issues concerning disclosures, whether all required disclosures under IFRSs are material and what disclosures are in fact auditable.

We believe that the Trustees' strategy should therefore revisit the meaning of the key terms "material" and "true and fair view" as these are fundamental in the development of high quality accounting standards. Currently, these terms are not fully discussed and explained. There is only a brief description available on "materiality" (see paragraph QC 11 of Conceptual Framework for Financial Reporting – 2010 version) and paragraph 15 of IAS 1 "Presentation of Financial Statements" only briefly describes what amounts to a "true and fair view" which should be the ultimate goal of information provided in financial statements. Without clarity on the concept of "materiality" and "true and fair view", we believe it will be difficult to apply IFRSs on a consistent basis.

We would also suggest that the Trustees should ensure that the IASB co-ordinates its efforts with the IAASB so that the two bodies have a similar framework or view on "materiality" and "true and fair view" when developing their separate standards.

<u>Conceptual Framework issues</u>

In the Paper, the Trustees state that *"the IASB should develop financial reporting standards that provide a faithful presentation of an entity's financial position and performance"*. The Trustees also reaffirmed the current focus on the development of financial reporting standards aimed at capital allocation decisions. We believe that financial statements should also assist in the assessment of management stewardship and facilitate the easy determination of distributable profits. We have stressed many times in our comment letters that these issues are not being satisfactorily dealt with either in the Conceptual Framework project or specific IFRS projects.

We note in the Trustees' paper that, based on the analysis of respondents' comments on its earlier consultation paper of its strategy review, a significant number of respondents cited finalisation of the Conceptual Framework as a priority. We believe that there should be a targeted timeline for the development and completion of the Conceptual Framework. The Foundation should allocate more time and resources to the Conceptual Framework project as it represents the core benchmark against which all detailed IFRSs should be measured. We have significant concerns that recently released discussion papers, exposure drafts and finalised standards introduce conflicting concepts and principles and we believe these inconsistencies could have been avoided if the Conceptual Framework was developed and completed first.

For example, we observe that the meaning of "income" in the exposure draft on "Revenue from Contracts with Customers" published in June 2010 is different from the meaning used in the existing Conceptual Framework. In particular, we note that under the current Conceptual Framework "income" encompasses both "revenues" and "gains". However, under the proposals this distinction is lost. We believe that there should be a clear linkage between the concept of realisation and the recognition of income and gains and the principle should be applied consistently. Unfortunately, it is not the case.

We are also concerned that IFRS 13 "Fair Value Measurement" released in May 2011 adopts an "exit price" definition for determination of fair value and emphasises that fair value is a market-based measurement, not an entity-specific measurement. We believe that an "exit price" under *"all"* circumstances is conceptually inconsistent with some other existing standards and conflicts with the underlying assumption in the preparation of financial statements that an entity is a going concern and will continue in operation for the foreseeable future. In particular, the going concern assumption assumes that assets will be used or consumed in its operations and will not be sold (the "exit price") at the reporting date. Fair value re-measurement is inconsistent with the going concern concept.

We believe that the Trustees should consider as a matter of priority the fundamental question of what financial statements are intended to portray and its main focus. We believe that financial statements should focus on accounting for "actual transactions" by an entity with other third parties as only these result in real cash flows. This does not prohibit adjustments for impairment allowances where there are doubts on the recoverability of outstanding balances arising from those original transactions. We believe that fair value re-measurement after initial recognition is not generally appropriate as they represent recognising "hypothetical transactions" with "hypothetical parties" at "hypothetical prices". Although fair value information subsequent to initial recognition is useful, as they represent "proforma" and "as if" information the information should be presented outside the primary financial statements.

<u>Governance</u>

We agree with the Trustees' recommendation to further clarify the respective responsibilities and roles of the Monitoring Board, the Trustees and the IASB. This exercise may lead to a conclusion on whether the three-tier structure is in fact appropriate.

We also note that the Trustees plan that refine the scope of IFRS Interpretations Committee's activities. We would prefer the Trustees revise the responsibilities of the IFRS Interpretations Committee, especially its role in the standard setting process. Under current practice the pre-ballot draft of an IFRS to be released is normally sent to the IFRS Interpretations Committee for a fatal flaw review (paragraph 78 of Due Process Handbook). We believe its review of discussion papers and exposure drafts before they are published for public comment is perhaps more important. Its role should also include some post implementation reviews so that they obtain direct hands on knowledge of the practical aspects and problems arising from interpreting and implementation of the standards.

IASB due process and work plan

We strongly support the Trustees' recommendations on actions to improve the IASB's due process. We are however concerned that the Trustees view convergence with US GAAP as being the highest priority for the IASB's work. Rather, we believe that the release of high quality "principle-based" standards should be its first priority. There is nothing preventing the IASB from making reference to US GAAP, where deemed appropriate, in developing its own accounting standards. We also believe that the Foundation should be more receptive to the views of other constituents that have agreed/committed to adopt IFRS as they are obliged to comply with the standards once released by the IASB.

We note that the Trustees plan to enhance its Due Process Oversight Committee's involvement in the standard setting process. We believe that the Foundation could also be more transparent in providing feedback to respondents that have taken the time and effort to consider and comment on its discussion papers and exposure drafts and especially those that have contrary views to those proposed in discussion papers and exposure drafts.

Moreover, we believe that the Trustees and the IASB must ensure that thorough field testing is a "formal" step in the standard setting process in view of its importance and this should be carried out at a very early stage before a standard or preferably an exposure draft is finalised and issued. More resources should be allocated to this step to ensure field testing is carried out properly and effectively. In addition, we believe the Foundation should carefully re-consider the timing and the effective date on which new standards become mandatory to reduce the compliance burden and confusion to the markets.

Financing

We are pleased that the Trustees recognise the importance and urgency to expand the funding base for the IFRS Foundation. We believe the Trustees could improve the transparency of its budget setting process and disclose in reasonable detail its annual budget and how the funds will be used. This would support its funding efforts and at the same time may assist in increasing public appreciation and confidence in the Foundation's work. To meet its mission to work in the public interest and to encourage the adoption of IFRSs, the Trustees should make its final standards (and not only its discussion papers and exposure drafts) freely available for download from its website.

We hope that the above comments are useful.

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

Colin Chau
Senior Vice President
Listing Division

CC/ESA/el

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