HKEx 香港交易所

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

13 March 2009

BY FAX (2865 6603)
AND BY POST

Our Ref: LD/CC/018-09

Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

RECEIVED HKICPA 2009 MAR 18 PM 12:03

Dear Steve,

IASB Discussion Paper on Preliminary Views on Financial Statement Presentation ("Discussion Paper")

I refer to your letter dated 31 December 2008 on the above Discussion Paper to our Mr. Paul Chow which has been passed to me for my attention.

We have completed our review of the Discussion Paper and our views are set out in the paragraphs below.

<u>General</u>

The Discussion Paper sets out the preliminary views of the IASB on proposals to amend the current mandatory rules on the presentation of financial statements included in IAS 1 "Presentation of Financial Statements". We agree that uniformity in presentation would assist users in comparing the performance and financial condition of reporting entities and note that the proposed formats aim at providing users with more information. We support the IASB's initiative to improving disclosures and the usefulness of information in financial statements.

However, we have concerns that the proposed presentation formats appear to add more complexity to financial statements due to the extent of detailed information provided on the face of the financial statements. The result is that an overall general picture or a financial snap-shot of the reporting entity is lost, which we believe should be the objective of the primary financial statements. We would suggest that a possible alternative could be that the proposed standard should require less mandatory key line disclosures on the face of the primary financial statements but these be supplemented by supporting notes. We believe that sometimes "less is more" and this is true for primary financial statements.

香港交易及結算所有限公司
Hong Kong Exchanges and Clearing Limited
香港中環港景街一號國際金融中心一期12樓
12/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong
電話 Tel: +852 2522 1122 傳真 Fax: +852 2295 3106 網址 Website: www.hkex.com.hk 電郵 E-mail: info@hkex.com.hk

The examples of proposed disclosures provided in the Discussion Paper were in respect of companies whose core businesses are easily identifiable. We believe that in the case of a conglomerate which is involved in many diversified businesses the proposals would be more problematic to apply in practice.

To achieve the objective of cohesiveness, an alternative approach would be to include a very brief narrative commentary in the financial statements focused on highlighting significant transactions and events that arose during the financial period together with a brief commentary on significant changes in balance sheet items, commitments and contingent liabilities. The current proposed approach to achieve cohesiveness through more detailed line items seems to blur rather than enhance clarity and understanding.

We also believe that to satisfy the cohesiveness objective of linking the statement of comprehensive income to the statement of financial position, which is possible as both are prepared on an accruals basis, as a minimum there should be visible link of the amounts shown. Currently, the total comprehensive income shown in the statement of comprehensive income on page 107 of the Discussion Paper cannot be directly linked to the statement of financial position shown on page 109. This could be remedied if the statement of financial position disclosed the comprehensive income for the year together with the amount brought forward and the amount carried forward. Moreover, the summary of total assets and liabilities shown at the foot of the statement of financial position should include a "total liabilities and equity" figure. This will then show visibly how it reconciles to total assets.

Although we appreciate that a presentation standard on financial statements would necessarily be more rule-based in that certain line item disclosures should be mandatory, in developing the rules, we believe that there should be key underlying principles on the criteria for classification of assets and liabilities into the various categories such as "operating activities" and financing activities". Some of the allocations and classifications appear to be arbitrary and would be different to the way management manages the entity. Paragraph 2.48 of the Discussion Paper indicates that the proposed presentation model relies on a "management approach" but the rules on classification appear to disregard how management manages the enterprise.

In summary, we believe that the primary financial statements should be confined to providing a quick snap-shot picture of the entity as a whole and a segmental reporting standard such as IFRS 8 should address the issue of further analysis of information by function or nature of activity.

<u>Change in classification</u>

Paragraph 2.42 of the Discussion Paper states that the IASB has yet to discuss how a change in an asset or liability is used should be presented in the financial statements. We believe that this issue is critical as it will raise fundamental recognition and measurement

issues and will impact on other accounting standards. Currently, different recognition and measurement rules apply because of the different functions assigned to an asset or liability, for example, the different accounting treatments are applied to assets held for short-term trading compared to those that are applied for long-term investments.

Moreover, we are concerned with the proposal under paragraph 2.41 of the Discussion Paper. The proposal appears to suggest that a change in an entity's classification policy should be implemented through "retrospective" application of the new classification policy to prior periods. Currently, a change in the classification or function of an asset does not normally require retrospective adjustment. We believe the IASB should reconsider this issue as its adoption would be problematic and would not reflect management's use of asset at the relevant dates.

<u>Short-term / long-term distinction</u>

Under the current practice the distinction of current and non-current assets takes into account the need to consider the entity's business cycle. Under the proposed revisions, these will be replaced by a short-term / long-term classification. We believe the 12-month cut-off for short-term assets may be problematic for certain enterprises such as property development companies which will need to somehow divide their costs incurred in "projects under development" into both short-term and long-term categories. The division would be arbitrary and the resulting disclosures may not be meaningful.

<u>Basket transactions</u>

We note from paragraph 3.90 of the Discussion Paper that the IASB has not reached a preliminary view on how to present basket transactions (e.g. a sale of a subsidiary). We believe that this is one of the key weaknesses in the proposed presentation model which attempts to classify assets and liabilities by function or activity rather than looking at the entity as a whole. We believe that all the alternatives suggested in paragraphs 3.91 to 3.95, namely, whether there is allocation or no allocation into the relevant classification sections or categories, would be arbitrary. This issue perhaps is the indicator that the proposal to disaggregate, and particularly in the statement of comprehensive income, may be very difficult to apply in practice.

<u>Additional costs to preparers and investors</u>

We appreciate that it is difficult to achieve the right balance of disclosures to satisfy all users of general purpose financial statements as they have different needs. We are nevertheless concerned that the extent of the proposed disclosures may add considerably to the cost of preparing financial statements and having them audited. Applying the disaggregation objective to the extent proposed results in more detailed line item disclosures which we believe will add costs to preparers especially where such details are not captured by their financial reporting systems or required by management. The cost of audits would also increase as the materiality thresholds in audit tests would need to be reduced to cover smaller value items. We believe that if more information is disclosed it should be made in the notes to the financial statements and materially should be a consideration when deciding on line item requirements.

Moreover, we believe that investors and analysts may incur additional costs as they would also need to amend their systems to capture and re-group information into the classifications they believe are useful to their decision making.

Reconciliation of cash flows to comprehensive income

We understand that the intention of the reconciliation is to show the link between the cash flow statement and the statement of comprehensive income. This is a deviation from the current practice adopted in cash flow statements which merely attempt to show the inter-relationships between the profit and loss account and how it links into the cash and equivalents balance shown in the balance sheet.

We have two concerns. First, the reconciliation provides excessive additional information and is also unduly complex. Second, it may give the wrong impression that the two statements can be linked directly. For example, the reconciliation statement shown on page 118 of the Discussion Paper attempts to reconcile "Cash received from wholesale customers" of $1,928,798 appearing in the cash flow statement in 2009 with "Sales-wholesale" of $2,591,400 appearing in the statement of comprehensive income. The reconciling item categorised under the heading "Accruals, allocations and other" is $662,602 (net) but there is no further elaboration of what this is. The reconciling item therefore just appears to be a balancing item. It also combines three types of adjustments which are different in nature. We believe that for a reconciliation to be useful, the nature and amount of each reconciling item should be shown, but only allowing similar nature items to be grouped. Furthermore, the "Cash received from wholesale customers" in 2009 of $1,928,798 would include receipts arising from accounts receivable recognised in 2008 and prior years. These debtors may not be the same customers reflected in "Sales-wholesale" appearing in the statement of comprehensive income. This type of information would have been useful.

Cash flows and accrual accounting are two different concepts which are designed to achieve different objectives. The IASB should perhaps consider an alternative approach. Rather than reconciling amounts shown in the cash flow statement to the statement of comprehensive income, a narrative explanation of the objectives of the cash flow statement should be included together with a discussion of key performance indicators. To reduce complexity, rather than providing full details on "operating activities" on the face of the cash flow statement, the details could be restricted to the proposed major sub-totals. Further details if needed, should be provided in the notes to the financial statements.

Transitional period

If the IASB decides to proceed with its proposals, we would suggest that there should be substantial lead time before the requirements become effective so that all interested parties have time to prepare and revise their financial reporting systems.

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. Paul Chow – Chief Executive
Mr. Mark Dickens – Head of Listing