



Our Ref.: C/FRSC

Sent electronically via email (commentletters@ifrs.org)

15 June 2011

SME Implementation Group
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

[SME Implementation Group Question and Answer on IFRS for SMEs Section 1, Issue 2 – Captive insurance subsidiaries](#)
[IFRS for SMEs Section 1, Issue 3 – Interpretation of ‘traded in a public market’](#)
[IFRS for SMEs Section 1, Issue 4 – Investment funds with only a few participants](#)

The Hong Kong Institute of Certified Public Accountants ("the Institute") is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned paper. Our responses to the questions raised in your Q&As are set out in the Appendix for your consideration.

We note that the question addressed in the Issue 2 of the Q&A intends to provide guidance on how broadly "traded in a public market" should be interpreted in the definition of public accountability. In this regard, we would like to draw to your attention that the concept of "traded in a public market" is also used in full IFRS, including IFRS 8 *Operating Segments*. We therefore would request the SMEIG to consider carefully the appropriateness of the SMEIG to develop Questions and Answers related to terms that are also included in full IFRSs. We would recommend that the IFRS Interpretation Committee should be involved in the development if guidance in this respect is considered necessary.

If you have any questions on our comments, please do not hesitate to contact me at ong@hkiipa.org.hk.

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department

SO/AW/jn

Comments on IFRS for SMEs Section 1, Issue 2 - Captive insurance subsidiaries

A parent company that is not otherwise publicly accountable sets up a captive insurance subsidiary. The parent prepares consolidated financial statements that include the captive insurance subsidiary.

Does the captive insurance subsidiary cause the group to be publicly accountable and hence not permitted to produce consolidated financial statements in accordance with the *IFRS for SMEs*?

Is the captive insurance company itself a publicly accountable entity and hence not permitted to produce individual financial statements in accordance with the *IFRS for SMEs*?

A captive insurance company is defined in Paragraph 3 of the proposed Q&A as an insurance company that is set up with the specific objective of insuring the risks of a single entity (often its parent company) or the risks of entities within the same group of entities that are related to the captive insurance company (i.e. fellow subsidiaries or parent entities). Where this is the case, the captive insurance company holds assets in a fiduciary capacity for other group entities, which would not be considered a broad group of outsiders, hence the captive insurance company itself is not publicly accountable.

We agree in principle that, although paragraph 1.3(b) of the IFRS for SMEs mentions that insurance companies typically hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses, this does not mean that it is always the case. As the proposed Q&A mentions, it is not the case when the insurance company is only insuring the risks of a single entity or the risks of entities within the same group of entities that are related to the captive insurance company. It follows that when a captive insurance entity itself is not publicly accountable, the group will not be publicly accountable due to that captive insurance entity.

We, however, note that there may not be sufficient guidance in the proposed Q&A on whether a group of entities containing a captive insurance subsidiary is publicly accountable for the purpose of preparing consolidated financial statements if the captive insurance subsidiary itself is publicly accountable due to the selling of insurance directly to other parties such as associates, joint ventures and unrelated third parties as specified in paragraph 4 of the proposed Q&A.

We are of the view that paragraph 1.3(b) of the IFRS for SMEs could also be applied to determine whether the group of entities is publicly accountable for the purposes of preparing consolidated financial statements. In that case an assessment would be made as to whether the insurance activity with third parties is one of the group's primary businesses, as set out in paragraph 1.4 of the IFRS for SMEs. Accordingly, we would recommend that this is highlighted in the Q&A.

Furthermore, we consider that some consistency should be brought to the guidance in the proposed Q&A on Issue 2 and Issue 4 in terms of associates and joint ventures. The proposed Q&A on Issue 4 currently gives an example that "a pooled investment fund whose participants are limited to a parent, its subsidiaries and **a few** associates/joint venture" would not be considered as holding assets in a fiduciary capacity for a broad group of outsiders. We consider it useful to align the guidance in the two proposed Q&A in this respect.



IFRS for SMEs Section 1, Issue 3 - Interpretation of 'traded in a public market'

An entity has public accountability 'if its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market' (paragraph 1.3). How broadly should 'traded in a public market' be interpreted in the definition of public accountability? For example, in Europe does it include only those markets defined as 'regulated markets' for the purpose of EU accounting regulations or does it also include other markets such as growth share markets and over-the-counter markets? Also, would a listing of convenience, i.e. a market on which a 'net asset value' price is published but no trading occurs in that market, make an entity publicly accountable?

We agree that the "public market" as defined in paragraph 1.3 is not restricted to recognised and/or regulated stock exchanges and it should include all markets that bring together entities that seek capital and investors who are not involved in managing the entity. Accordingly, for a market to be public it must be accessible by a broad group of outsiders and therefore the instruments should not be considered as traded in a public market if they can only be exchanged between parties related to the entity. However, it should be noted that the words ".... are traded in a public market" are also used in the scoping paragraphs of IFRS 8, hence we question the appropriateness of the SMEIG to develop Questions and Answers related to terms that are also included in IFRSs. We consider IFRS Interpretation Committee should be involved in the development if guidance in this respect is considered necessary

We also agree that publicly advertising shares for sale by the shareholder, on a website or in a newspaper, does not in itself create an over-the-counter public market and for a market to be public, it must be accessible by a broad group of outsiders.



IFRS for SMEs Section 1, Issue 4 – Investment funds with only a few participants

An entity is publicly accountable if it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks (paragraph 1.3(b)). Does the criterion ‘broad group of outsiders’ mean that investment funds or similar entities that restrict their ownership to only a few participants are not publicly accountable under paragraph 1.3(b)?

We noted that the draft Q&A contains several examples on explaining what are the entities that do not hold assets in a fiduciary capacity for a broad group of outsiders, which include:

- a venture capital fund with a few investors all or most of whom are directly involved in the fund's investment and management decisions;
- a pooled investment fund whose participants are limited to a parent, its subsidiaries and a few associates/joint venture; and
- a pooled investment fund with only two or three participants.

It appears to us that the proposed Q&A attempts to elaborate the term "broad" mainly based on the number of participants where the document does not specify what specific number of participants would constitute the "broad" level. We are of the view that in addition to the number of participants, available information about relations between different participants should also be taken into account when interpreting the term "broad" and the meaning of "broad" may not be identical to "many". For example, we are of a view that a sizeable assembly of independent participants would constitute a broad group while a sizeable group of subsidiaries wholly owned by the same parent entity would not.

For clarity, we also recommend that paragraph 3(c) of the proposed Q&A should be changed from "a pooled investment fund with only two or three participants" to "a pooled investment fund with only a few participants." to be consistent with other examples.

In addition to the above view, we would also like to draw to your attention that one of our constituents commented that it might be difficult to base the definition on the number of ultimate participants no matter "a few" or "only two or three participants" is used in paragraph 3(c) of the proposed Q&A. A pooled investment fund could have been marketed to a broad range of outsiders but ended up with only a small number of participants. Accordingly, SMEIG may want to reconsider the wording of the guidance.

We learnt that this Q&A is mainly for addressing the interpretation issue on "broad group of outsiders" specific to investment funds or similar entities. We consider that this interpretation issue applies to all existing and potential users of IFRS for SMEs but not in isolation to investment funds or similar entities. Accordingly, we recommend that this Q&A should be written in a more principle-based manner, dealing with the term generally and not just in relation to participants in investment fund. The users of the Q&A should also be reminded that all facts and circumstances should be considered when determining whether an entity is publicly accountable under the guidance of Section 1 of IFRS for SMEs, within the parameters of a principle-based standard.

~ End ~