Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

30 November 2011

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Request for Views on Agenda Consultation 2011

The Hong Kong Institute of Certified Public Accountants 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 Consultation Paper. Our responses to the questions raised in your Consultation Paper are set out in the Appendix for your consideration.

We welcome the three-yearly public IASB agenda consultation, introduced as a result of the second Consultation Review of the IFRS Foundation in 2010. We believe that such public consultation will help the IASB to become better aware of the financial reporting needs of the IFRS users and strengthen the transparency of the IASB's agenda setting process.

Given the increasing and diverse range of jurisdictions adopting IFRSs, we understand that the needs and priorities of users would be different. We consider that the IASB's reasons for accepting or rejecting each project that has been proposed should be published in order to make the IASB's final decision as transparent and understandable as possible. We believe that stakeholders' confidence over the agenda is a necessary first step in achieving stakeholders' buy-in to the standard-setting process and the resulting standards.

We would like to commend the IASB for making significant progress over the past few years in the journey towards a single set of high quality global accounting standards. We also appreciate the focus towards increasing stakeholder engagements and seeking views from constituents as part of the process of developing new standards. However, it is noted that the IASB's agenda over the last few years had put much emphasis on the objective to reach convergence, in particular between the IFRS and US GAAP. We believe that in the coming years, the agenda of the IASB should focus on the needs of all IFRS users and that no single region or country should be able to have a dominant influence on the new agenda and the Board's priorities.

Given the multitude of new standards which has been finished recently (e.g. IFRS 9 Classification and Measurement, IFRS 10, 11, 12, 13) and those which may be finished by the end of the next year (e.g. impairment of financial instruments, hedge accounting, leases and revenue recognition), we generally favour a "period of calm". We believe that it is essential to let preparers, users and other stakeholders participate

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in the application of IFRS have a stable platform to learn and understand the new standards to ensure the consistency and quality of application of existing IFRS.

In terms of further developing financial reporting, we believe that in the next three years the IASB should focus on making progress in the conceptual framework project, in particular in establishing principles for the concepts of profit, OCI and recycling. We believe this is a strategically important project as it will establish clear and consistent principles to follow when establishing standards for various subject matters, including the following cross-cutting issues:

a. discounting;
b. transactions between entities under common control in consolidated financial statements prepared by intermediate parents and stand-alone financial statements; and
c. addressing disclosure overload

We believe that, other than the cross-cutting issues mentioned above, the IASB should refrain from making any further substantial changes to individual standards until completion of the review of the relevant parts of the conceptual framework. We therefore consider that consideration should be given to deferring the project on leases until after the framework concepts of present obligations and executory contracts have been resolved.

We consider it consistent with a period of calm to undertake limited scope amendments which will reduce or eliminate unnecessary complexity or resolve current diversity in practice due to unclear principles in existing standards. We therefore consider that higher priority should be placed on developing or completing the following standards-level and limited scope projects:

- Financial instruments with characteristics of equity - the fixed for fixed rule
- Limited amendment to IAS 41 Agriculture – bearer biological assets
- Equity method of accounting for associates – simplification of the measurement method

In respect of all other projects listed in Appendix C, we consider that none of these projects should be progressed until the review of the relevant parts of the conceptual framework review is completed. This is particularly the case for the following projects:

- Emissions trading schemes
- Extractive industries
- Foreign currency translation
- Government grants
- Income taxes
- Intangible assets
- Liabilities – amendments to IAS 37
- Post-employment benefits
- Rate-regulated activities
- Share-based payment

The following projects would be of lowest priority, taking into account urgency and resource constraints:

- Country-by-country reporting
- Interim reporting
- Inflation accounting
- Earnings per share

Our reasons for the priority of the above projects are set out in the appendix.

We believe that the IASB should also continue with, and possibly increase, its practice of engaging national standard setters to work on projects where the national standard setters have extensive relevant experience in their jurisdictions. National standard setters usually have established networks and mechanisms built up over many years for engaging with local constituents.

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

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department

SO/WC/jn

Encl.

Comments on the IASB Request for Views on Agenda Consultation 2011

<u>Question 1</u>

What do you think should be the IASB's strategic priorities, and how should it balance them over the next three years?

<u>Question 1(a)</u>

Do you agree with the two categories we identified and the five strategic areas within them? If you disagree, how do you think the IASB should develop its agenda, and why?

We agree with the two categories identified and the five strategic areas within them. We consider that the IASB's strategic priorities in the next three years should be focused on ensuring that both existing and any new IFRSs are of high quality, understandable, globally accepted, conceptually based and conceptually consistent.

<u>Question 1(b)</u>

How would you balance the two categories and five strategic areas? If you have identified other areas for the IASB's agenda, please include these in your answer.

Given the multitude of new standards which has been finished recently (e.g. IFRS 9 Classification and Measurement, IFRS 10, 11, 12, 13) and those which should be finished by the end of the next year (e.g. impairment of financial instruments, hedge accounting, leases and revenue recognition), we generally favour a "period of calm" as we believe that it is essential to let preparers, users and other stakeholders that participate in the application of IFRS have a stable platform to learn and understand the new standards to ensure the consistency and quality of application of existing IFRSs.

In further developing financial reporting, we believe that the IASB should focus on making further progress in the work on the conceptual framework and address certain important cross-cutting issues. We consider that less effort should be placed on researching new issues for financial reporting for the time being and that new, major standard-level projects should be limited.

The IASB should also continue with, and possibly increase, its practice of engaging national standard setters to work on projects where the national standard setters have extensive relevant experience in their jurisdictions. National standard setters usually have established networks and mechanisms built up over many years for engaging with local constituents.

Question 2

What do you see as the most pressing financial reporting needs for standard-setting action from the IASB?

Question 2(a)

Considering the various constraints, to which projects should the IASB give priority, and why? Where possible, please explain whether you think that a comprehensive project is needed or whether a narrow, targeted improvement would suffice?

We consider that the IASB should focus on completing the four main projects on its current agenda (revenue recognition, leases, insurance contracts and financial instruments) first. In respect of the leases project, we consider that further work needs to be done on resolving the concepts of present obligations and executory contracts in the conceptual framework project before finalizing the fundamental new models currently proposed in the accounting for leases and that therefore consideration should be given to deferring the project on leases until after progress has been made on the conceptual framework project. Afterwards, we would like to propose a period of calm in standard-setting.

Instead of starting many new projects, the IASB should focus on making progress in strategically important projects, such as the relevant parts of the conceptual framework, as well as certain cross-cutting issues described below and certain limited scope amendments to reduce the burden on preparers (as highlighted in our response to question 2(b)):

- *Completing the conceptual framework, in particular establishing principles for the concepts of profit, OCI and recycling*

  The conceptual framework was added to the IASB's agenda in October 2004. The Board decided to address the project in eight phases; phase A "Objectives and qualitative characteristics" was finished in September 2010, the exposure draft of phase D "The reporting entity" was published in March 2010 and the work on three other phases was then in process. However, at the end of 2010, this work was deferred due to other urgent projects.

  We strongly urge the IASB to complete the project in a timely manner. Having a robust conceptual framework will be useful for the IASB to ensure that there is consistency in existing and future standards. It will also be helpful for preparers when there is no specific guidance in an IFRS for a particular transaction or circumstance.

  We believe that the IASB should refrain from making any further substantial changes to individual standards until completion of the review of the conceptual framework, or at least the relevant parts of the framework. It is noted that in certain respects the recently released discussion papers and exposure drafts (in particular the leases exposure draft) introduced conflicting concepts and principles, which, if implemented would have led to confusion and the development of rule-based standards rather than principle-based standards.

As part of the work on the conceptual framework, we consider that as a matter of priority the IASB should focus on confirming the principles for performance measurement, so as to develop consistent concepts of "profit" (or loss), and "Other comprehensive income" (OCI). We are concerned at the recent trend of including ad hoc items in OCI without a robust conceptual basis, as well as the introduction of inconsistent rule-based requirements in the recycling of accumulated OCI. For example, the recycling of accumulated OCI is prohibited in IAS 19 and IFRS 9, whereas it is required in other standards such as cash-flow hedges under IAS 39 and translation differences under IAS 21. We believe that a conceptual basis for OCI is important and needed as a matter of priority in order to give meaning to the information that is separately contained in profit or loss and OCI in the statement of comprehensive income. The conceptual basis should cover which items should be in OCI and whether, and if so when, the items should be reclassified from OCI to profit or loss (recycling).

- *Other cross-cutting issues*

a. Discounting

Discounting has been identified as a topic of great significance that cuts across a wide range of projects areas and we consider there is potential for improvements to be made in financial reporting in this area. For example, IAS 17 *Leases*, IAS 19 *Employee Benefits*, IAS 36 *Impairment of Assets*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 39 *Financial Instruments: Recognition and Measurement*/IFRS 9 *Financial Instruments* each include requirements relating to discounting cash flows.

In this regard, the HKICPA and the Australian Accounting Standards Board (AASB) are planning to conduct a research project on discounting estimated future cash flows in the context of general purpose financial reporting, which may include establishing a working group under the Asian-Oceanian Standard-Setters Group (AOSSG). The aim would be to provide findings that would be useful for the IASB to consider in revising its various requirements. A research paper with findings is proposed to be published in the mid 2013.

b. Transactions between entities under common control in consolidated financial statements prepared by intermediate parents and stand-alone financial statements

Originally, business combinations under common control were included in the workplan of the IASB. Work on the project was deferred in 2009 as a consequence of the multitude of other (more urgent) convergence projects and the financial crisis.

The urgency of such a project becomes apparent when the combinations between entities or businesses under common control frequently occur in many jurisdictions that apply IFRSs. IFRSs do not provide guidance on the accounting for those transactions. Combinations between entities or businesses under common control are excluded from the scope of IFRS 3. Other standards do not address the issue explicitly. The lack of guidance on combinations between entities or businesses under common control under

IFRSs and differing guidance of national standard-setters has created divergence in practice.

However, we believe that a potential agenda project on common control transactions should not be limited to business combinations between entities or businesses under common control. Entities under common control engage on a daily basis in numerous transactions other than business combinations. In 2002, the IFRIC discussed whether transactions between entities under common control that are not at arm’s length should be accounted for as a capital contribution from and/or distribution to the party having common control. The IFRIC did not reach a conclusion on this matter.

We consider that there would be conceptual merit in addressing all types of transactions between entities under common control in order to identify appropriate principles to be used in the sub-consolidated financial statements of an intermediate parent within a larger group in respect of reporting transactions with entities in that larger group.

In addition, we believe that the project should also address how to recognise the cost of combinations between entities or businesses under common control and other transactions between entities under common control in the stand-alone financial statements of the entities involved. This would require some further conceptual consideration of the role of stand-alone financial statements.

We understand that EFRAG, Autorité des Normes Comptables (ANC) and OrganismItaliano di Contabilità (OIC) have jointly published Discussion Paper *Accounting for Business Combinations under Common Control* which aims to start a debate on business combinations under common control and how it should be reflected in financial statements. We urge the Board to consider the work on this Discussion Paper when considering whether to include the project on its agenda and the scope of the project.

c. *Addressing disclosure overload*

A common complaint about IFRSs is the voluminous disclosures required in financial statements. Many consider that the lengthy detailed disclosures could obscure users to appreciate the key information in financial statements. Excessive disclosures also make it difficult for entities to communicate key aspects of the entity's performance to users. We believe that disclosures within the IFRS should be reduced to a reasonable level. The development of a disclosure framework would be helpful in ensuring that in the future disclosure requirements are only introduced if they are consistent, free of redundancy and provide information that is really useful to the majority of users.

We understand that work has already been done in this area internationally in response to constituents' concerns, for example, the New Zealand Institute of Chartered Accountants (NZICA) and the Institute of Chartered Accountants of Scotland's (ICAS) joint report to the IASB on reducing the disclosure requirements in IFRSs, *Losing the excess baggage – Reducing disclosures in financial statements to what's important*, provides a good starting point for this project. We would urge the IASB to continue the debate on this issue by issuing a discussion paper on this subject matter for broader consultation.

Other observation: Post-implementation reviews

We acknowledge the consistent application/implementation of IFRSs is important. The post-implementation review is one of the sources for revealing any deficiencies in the existing requirements.

However, we consider that carrying out a post-implementation review on new standards or major amendment two years after their mandatory application date may be too late. We consider that the timing for the review should be reconsidered in order to make the review of new standards more useful and meaningful. We recommend that the IASB establish a pre-implementation mechanism similar to that which the International Auditing and Assurance Standards Board has adopted to enhance its responsiveness to practical issues of standards adoption identified by early adopters or those working through their transition projects.

We also suggest that the IASB should focus its post-implementation review effort on some of the older standards that are not under the current work plan but which entities are still finding difficult to understand or are difficult to apply in practice. For example: IAS 36 *Impairment of Assets* is commonly viewed as more problematic in practice than IFRS 8 *Operating Segments* and IFRS 3 *Business Combinations* but does not appear to have been subject to any post-implementation review since its issuance.

<u>**Question 2(b)**</u>

Adding new projects to the IASB's agenda will require the balancing of agenda priorities with the resources available. Which of the projects previously added to the IASB's agenda but deferred (see table page 14) would you remove from the agenda in order to make room for new projects, and why? Which of the projects previously added to the IASB's agenda but deferred do you think should be reactivated, and why?

Please link your answer to your answer to question 2(a).

As mentioned in Q1, we consider the IASB should focus its projects within the category of maintaining existing IFRS. In our response to question 2(a) we requested a period of calm while the IASB makes progress on the conceptual framework and addressing the issue of disclosure overload.

However, we consider it consistent with a period of calm to undertake limited scope amendments which will reduce or eliminate unnecessary complexity or resolve current diversity in practice due to unclear principles. We therefore consider that higher priority should be placed on developing or completing the following standards-level and limited scope projects:

- *Financial instruments with characteristics of equity – fixed for fixed rule*

  IAS 32 *Financial Instruments: Presentation* (paragraph 16) provides that a derivative is an equity instrument only if it will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments (the "fixed for fixed" criterion). We believe that the "fixed for fixed" criterion is a bright line rule that lacks a clear conceptual basis. Additionally, the application of the "fixed for fixed" criterion has caused numerous issues in practice, particularly where the exercise prices of equity-related contracts are denominated in a foreign currency (i.e. not the reporting entity's functional currency). For example, many businesses operating in China, and listed overseas, would have Renminbi as their functional currency. However, since the Renminbi is not a freely convertible currency, it cannot typically be used as the issuing currency for convertible debt to international investors, resulting in the use of a foreign currency (typically HKD or USD). In such cases, under the current "fixed for fixed" rule, the conversion options are required to be classified as derivatives, with the result that the full movement in their fair value is recognised in profit or loss on remeasurement, even though the vast majority of that movement is attributable to movements in the underlying equity price, rather than being due to changes in foreign exchange rates.

We believe that the IASB should address the classification of derivative contracts on an entity's own equity in IAS 32 as a matter of urgency. We consider that a model that has a clear principle for when a derivative contract that will or may not be settled through the delivery of the issuers own equity instruments can qualify for equity classification should be developed.

- *Limited amendment to IAS 41 Agriculture – bearer biological assets*

  We understand that a number of jurisdictions in the Asian-Oceanian Region have suggested that accounting treatments of agriculture are problematic, especially regarding those of bearer biological assets (such as palm trees). For entities engaged in plantation businesses, bearer biological assets are, by nature, similar to factories, and many believe that it should be accounted for based on a cost model under IAS 16 rather than a fair-value model.

  It is noted that as the AOSSG Working Group (led by India and Malaysia) has carried out preliminary work on the project, we anticipate that the IASB could quickly proceed with the project by leveraging the results of their research. In addition, it is believed that most of the issues can be resolved with the reasonably limited number of amendments.

- *Equity method of accounting for associates – simplification of the measurement method*

  We consider that there are both conceptual concerns and practical difficulties in the application of equity accounting to investments in associates. We would therefore request the IASB as a matter of priority to consider whether the equity method of accounting continues to be an appropriate method for investments in associates once IFRS 10 becomes effective or whether a simpler method would achieve the measurement objective equally or more effectively. Further details of our concerns are as follows:

  It is our understanding that the equity method was first introduced many years ago to combat perceived structuring of investments deliberately designed to fail the then legalistic definition of "subsidiary" whilst the entity still retained significant and often dominant board presence. Its original nature therefore was one of anti-abuse and semi-consolidation and this appears to be confirmed by the references in IAS 28 to the use of many of the procedures relevant to consolidations as applying to equity accounting. However, increasingly the IASB has indicated that equity accounting is simply a basis of measurement for an investment in an associate[1]. This leads to divergent views as to whether equity accounting is a measurement basis for a single investment balance or whether it is a single-line consolidation and also complexity and confusion in how to apply the method.

For example, impairment is required to be measured in three stages for an equity accounted investment. The first stage is the measurement of any impairment of the underlying assets at the investee level. Second is the extension of those impairment procedures using the fair values of the investee's assets identified at the date of acquiring an interest in the investee, adjusted for any post-acquisition changes in those values already recognised. The third level is the testing of the carrying value of the investment in the associate for impairment if the IAS 39 indicators of impairment are present as described in paragraphs 40-43 of IAS 28 (revised).

The first two stages of impairment testing are consistent with the notion of a single-line consolidation and require detailed information from the associate in order to compute the adjustments required. The third stage of impairment testing is consistent with the notion of a single investment because the testing will be performed at the level of the shares held by the investor.

These contrasting concepts illustrate inconsistencies in the accounting requirements applicable to associates compared to other similar assets. That is, at the date of initial recognition the investor is required to consider the principles of IFRS 3 to identify goodwill, and yet when recognising an impairment loss, the investor is prohibited from acknowledging that any impairments which arise at stage 3 of the testing must in principle relate to this acquired goodwill, if steps 1 and 2 have been performed correctly. Consequently, the entity is required to follow a treatment for this impairment loss which is neither consistent with the requirements of IAS 36 relating to goodwill, nor consistent with the requirements in IAS 39 concerning equity investments.

In addition to the conceptual inconsistencies and complexity caused by applying the equity method to investments in associates, we are also aware that many entities encounter practical difficulties in obtaining the level of detail necessary to apply the requirements and in time for their own reporting deadlines. This is particularly the case when one listed entity is an investor in another listed entity, and there may be restrictions over the timing of release of price sensitive information and/or a significant amount of goodwill inherent in the cost of acquiring that interest. Apart from regulatory constraints, there may also be commercial reason for the whole board not agreeing to the preparation and release of additional information to satisfy the information need of a particular shareholder.

In our view, once IFRS 10 becomes effective and therefore the scope of consolidation extends to include entities which are under the de facto control of an investor, the imperative for maintaining a semi-consolidation style of measurement method for associates is reduced to such an extent that the costs and complexity of

[1] See, for example the discussion in BC24 to BC28 of IAS 28

applying the method to those remaining associate investments outweigh the decision usefulness of the resulting measurement.

We therefore consider that the IASB could undertake a relatively limited scope project to limit the use of the equity method to joint arrangements under IFRS 11. So far as investments in associates are concerned, we consider that the measurement requirements relating to investments in associates should be simplified by making them broadly consistent with those for other equity investments which do not give the investor control or joint control i.e. to measure investments in associates at fair value. The disclosure requirements under IFRS 12 applicable to associates would be only minimally affected by this change in measurement method and in our view would provide sufficient useful additional information about the particular nature of the investment and the entity's influence over it. Although this amendment to IAS 28 is contrary to our wish for a period of calm in standard setting, we consider that it could be regarded as a completion of the IFRS 10 to 12 project, and we expect it would be a welcome relief to constituents.

In respect of all other projects listed in Appendix C, we consider that none of these projects should be progressed until the review of the relevant parts of conceptual framework review is completed as discussed in our response to question 2(a). This is particularly the case for the following projects, in addition to those conceptual projects mentioned in our response to question 2(a):

- Emissions trading schemes
- Extractive industries
- Foreign currency translation
- Government grants
- Income taxes
- Intangible assets
- Liabilities – amendments to IAS 37
- Post-employment benefits
- Rate-regulated activities
- Share-based payment

We consider that a robust framework with clear principles is essential before any further attempts are made to amend the above standards or introduce industry specific accounting solutions such as for emissions trading schemes.

The following projects would be of lowest priority, taking into account urgency and resource constraints:

- *Country-by-country reporting*

  Although there is a request for improved transparency regarding country-by-country reporting, we are not convinced that this reporting would be decision-useful in capital markets or to business counterparties. We are inclined to support the view that those wanting such reporting should seek to secure it by other means such as through regulatory reporting requirements.

- *Interim reporting*

  We believe that the issue of whether an interim report is a report for a discrete period or is prepared under a year-to-date principle and as an update of the previous annual report should be considered as part of the work on the conceptual framework. Until that consideration is complete we do not consider that there should be further amendment to IAS 34.

- *Inflation accounting*

  Although there are a number of jurisdictions that have experienced inflation recently in the Asia-Oceanian region, we are not convinced that there is an urgent need to re-address inflation accounting, considering that IAS 29 *Financial Reporting in Hyperinflationary Economies* was recently revised. We consider that inflation accounting is not a priority for the IASB in the next three years.

- *Earnings per share*

  We consider that the need for EPS disclosure is a relevant topic to be considered under any project on reducing the extent of disclosures in financial statements (see comments above in our response to question 2(a)). However, we do not see an urgent need to amend the existing requirements in IAS 33.

~ End ~