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)

31 January 2011

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

Dear Sirs,

IASB Request for Views on Effective Dates and Transition Methods

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 Request for Views. Our responses to the questions raised in your Request for Views are set out in the Appendix for your consideration.

We are generally supportive of the sequential approach to implementing the new standards. We believe it would be necessary for the IASB to distinguish between two groups of standards based on their complexity of application and impact on financial reporting:

- *Group 1 - Revenue from Contracts with Customers, Leases, Insurance Contracts, Financial Instruments, and Fair Value Measurements*

  We believe that the changes that may be introduced by these standards may have a pervasive impact on financial statements of a wide range of different entities and/or require extensive system changes to capture the necessary information at the point of each relevant transaction. Given their scopes of application are closely related, we consider these projects should be effective simultaneously and entities should be given a sufficient lead time to implement them. We recommend that the mandatory effective date should be no earlier than 1 January 2015.

- *Group 2 - Consolidation, Joint Arrangements, Post-Employment Benefit and Presentation of Other Comprehensive Income*

  We believe that the proposed IFRSs on Consolidations and Joint Arrangements could also have a pervasive impact on financial statements; however, the impact of consolidation or non-consolidation can be more easily described and quantified. Consequently, we would not object to these two IFRSs be effective before those in Group 1 but their effective dates should be the same.

  The other proposed IFRSs would represent more contained changes to financial statements. We would not object to the effective date of these standards being before 1 January 2015, on a case-by-case basis.

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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.

Hong Kong Institute of CPAs

Comments on the IASB Request for Views on Effective Dates and Transition Methods

<u>Question 1</u>

Please describe the entity (or the individual) responding to this Request for Views. For example:

(a) Please state whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor or other user of financial statements (including regulators and standard-setters). Please also say whether you primarily prepare, use or audit financial information prepared in accordance with IFRSs, US GAAP or both.

(b) If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the number of employees or other relevant measure), and whether you have securities registered on a securities exchange.

(c) If you are an auditor, please indicate the size of your firm and whether your practice focuses primarily on public entities, private entities or both.

(d) If you are an investor, creditor or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer/standard-setter), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialise in, if any.

(e) Please describe the degree to which each of the proposed new IFRSs is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).

(a) The Hong Kong Institute of Certified Public Accountants is a body corporate incorporated in Hong Kong on 1 January 1973 under the Professional Accountants Ordinance. Its principal activities include, inter-alia, the registration of certified public accountants, firms of certified public accountants and corporate practices and the issuance of practising certificates; the development and promulgation of financial reporting, auditing and assurance, and ethical standards and guidelines; the regulation of the practice of the accountancy profession; the operation and promotion of the Institute's qualification programme and professional examinations; representing the views of the profession; providing membership and student support services and preserving the profession's integrity and status.

Hong Kong Financial Reporting Standards were fully converged with IFRSs with effect from 1 January 2005.

(b) – (e) Not applicable.

Question 2

Focusing only on those projects included in the table in paragraph 18 as below:

Project	Transition Method
Consolidation	Limited retrospective
Fair value measurement	Prospective
Financial instruments (IFRS 9)	Retrospective
Insurance contracts	Limited retrospective
Joint arrangements	Limited retrospective
Leases	Limited retrospective
Post-employment benefits / defined benefit plans	Retrospective
Presentation of items of other comprehensive income	Retrospective
Revenue from contracts with customers	Retrospective

(a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?

(b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

(a) We believe that this will be entity specific and will therefore vary depending on the nature of each entity. However, we also consider that the answer to this question will depend greatly on the following two inter-related factors, which are as yet unknown to us:

(i) the detail of the finalised requirements, which we would expect would be different from the proposals exposed for comment, based on the comments received; and

(ii) the clarity of the revised standards, such that their application to any given fact pattern is relatively self-evident.

For example:

- in our comment letter dated 20 December 2010, we expressed significant reservations with respect to the leases proposals as to their complexity and the extensive changes that would be required if a preparer needed to comply with such proposals. Without knowing whether or not the proposals will change as a result of such comments, it is difficult to predict whether the final replacement of IAS 17 will take time to implement; and

- in our comment letter dated 22 October 2010, we expressed concerns over the lack of clarity over how the concept of “transfer of control” and “continuous transfer” should be applied to contracts for construction of real-estate and provision of services. From experience with IFRIC 15, we have seen how a lack of clarity as to how a new requirement should

be interpreted can prevent any progress on the remaining important implementation stages of educating all relevant stakeholders as to the impact of the new requirements, and making the necessary system changes to collate the relevant data. Instead, extensive amounts of time are consumed simply in trying to get agreement between preparers, regulators and auditors on what they believe the new requirement to mean.

On the assumption that the new standards will introduce substantial changes compared to the existing requirements, but these new requirements will be clearly articulated, then we consider that of the above projects, it will be the ones which impact on typical and frequent transactions that will require the most time to implement, as the implementation will require extensive retraining of accounting staff and systems' changes by the preparer to capture the data as and when the transactions occur. For this reason, we consider that the changes in lease and revenue standards will require a relatively more time to implement as they will impact on the most number of entities and their day-to-day transactions. A considerable time would be needed to perform a thorough review of all leasing arrangements and contracts with customers to determine appropriate treatment under new requirements.

In addition, some industry specific impacts will also include:

- Financial institutions will likely be mostly impacted by financial instruments, insurance, and consolidation changes.
- Construction, telecommunications and other service industries will likely be the most impacted by the revenue changes.
- The retail, airline, mining, shipping and leasing industries will likely be the most affected by the leasing proposals.

(b) The types of cost we expect entities will incur include:

- Training costs – extensive training for adoption of new standards, applying judgement and adequacy of documentation.

- IT systems development – existing systems (particularly in the leasing and revenue areas) will need to be significantly modified or developed to capture and report on the data required by the new proposals.

- Internal controls and processes – initial recording of transactions and the reassessment required (in some cases) will require significant and complex changes to existing processes and internal controls.

- Information gathering – gathering and analysing existing revenue contracts and lease arrangements will take a significant amount of time and effort.

- Stakeholder communication – a significant effort will be required to be made to educate both internal and external users of financial statements of the effects on key financial ratios and performance measures.

- Contracts with financial institutions – the impact of the proposals on financial ratios and performance measures may require revisions to agreements and contracts that embed such measures, for example financial covenants with lenders.

Question 3

Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

Financial reporting amounts are usually used as a basis for taxation, amounts available for dividends, debt covenants, and other regulatory requirements (e.g. regulatory capital requirements for financial institutions). The proposed requirements of non-recycling will also have an impact on the determination of taxable income and realised profits for the purposes of determining amounts available for dividends. In addition, given the significant estimation requirements in many of the proposed standards, auditing approaches may need to be reviewed when evaluating management's judgments about future events.

Question 4

Do you agree with the transition method as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantages of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

As noted in our comment letters to the various projects, we have some concerns in some of the transition method as proposed:

(a) ED of *Revenue from Contracts with Customers*

We understand the importance of ensuring comparability and hence preserving trend information. However, we also strongly believe that retrospective application will cause major operational problems for entities, despite the long lead time between the revenue standard's issuance and effective date. As a compromise, we would recommend allowing entities to apply the revenue standard on a limited retrospective basis. For example, similar to the approach taken to business combinations, the requirements of the new standard would only be required to be applied by the entity to contracts entered into after a certain date, or, similar to the approach taken to the Amendments to IAS 17, the restatement would be limited to the opening balances at the start of the current period i.e. with respect to contracts with customers which remain unfulfilled at that date. If the requirement is kept for full retrospective adoption then we consider that entities should be permitted an extended lead time to allow for re-analysis of past data and systems changes necessary to collate such information.

(b) ED of *Leases*

As far as lessees are concerned, we would support permitting retrospective adoption of the requirements if our proposals relating to the accounting for short-term leases, contingent rentals and the length of the lease term in our submission are accepted (please see our submission dated 15 December 2010 on the ED) as we consider that much of the measurement uncertainty would be eliminated.

In respect of the lessor accounting, the transition should follow the requirements in the revenue standard.

(c) ED of Insurance Contracts

We do not agree with the proposal to set the residual margin to zero for insurance contracts reported at the transition date. Such treatment prevents insurers from reporting a potentially significant component of profits on existing contracts through profit and loss and reduces comparability between the results on existing and new business.

We suggest that the Board should give an option of full retrospective or short-cut retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Estimates and Errors*. Only where both of these retrospective applications are impracticable may insurers may opt for the proposed transition requirements.

We consider it is preferable that the effective dates of the IFRS on insurance contracts and IFRS 9 be aligned, even if this results in a deferral of the effective date of IFRS 9. The two IFRS are complimentary, and introducing one before the other could result in financial statements over a short period of time which are comparable to neither the current ones nor the ones subsequent to adoption of both standards.

Question 5

In thinking about an overall implementation plan covering all of the standards that are the subject of this Request for Views:

(a) Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).

(b) Under a single date approach and assuming the projects noted in the introduction are completed by June 2011, what should the mandatory effective date be and why?

(c) Under the sequential approach, how should the new IFRSs be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs.

(d) Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.

We support the sequential approach by implementing the IASB projects in two batches:

(a) Group 1 – Revenue from Contracts with Customers, Leases, Insurance Contracts, Financial Instruments and Fair Value Measurements

These standards are the cornerstones of financial reporting under IFRSs and we believe that the changes would have a pervasive impact on the financial statements. Further, the scopes of application of certain of these standards are closely related, for example revenue and leases, and we consider these projects should be implemented as a package so as to maintain comparability of financial information between companies, to prevent conceptual inconsistencies, conflicting scope requirements and overlapping consequential amendments.

We recommend that the mandatory effective date is no earlier than 1 January 2015 (assuming they are all in place on 30 June 2011) to give entities sufficient lead time to understand the implications of the changes in requirements for their own transactions, to update their systems and train staff to capture comparative data in an orderly fashion.

(b) Group 2 – Consolidation, Joint Arrangements, Post-Employment Benefits and Presentation of OCI

We believe that the proposed IFRSs on Consolidations and Joint Arrangements could also have a pervasive impact on financial statements; however, the impact of consolidation or non-consolidation can be more easily described and quantified. Consequently, we would not object to these two IFRSs being effective before those in Group 1 provided that they both become effective on the same date.

Other proposed IFRSs would represent more contained changes to financial statements. We consider that companies should be provided with more flexibility in adopting the improved versions of the resulting standards early. It is suggested that the effective date of these standards should also be before those in Group 1, but could otherwise be considered on a case-by-case basis.

Question 6

Should the IASB give entities the option of adopting some or all of the new IFRSs before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

Early adoption should be permitted for projects in Group 2 (i.e. consolidation, joint arrangements, post-employment benefits and presentation of OCI) so as to enable entities have more flexibility in applying standards that are most suitable to their own circumstances.

However, for projects in Group 1 (i.e. revenue from contracts with customers, leases, insurance contracts, financial instruments and fair value measurements), we believe that a significant lead-time for implementation would be required as the changes

proposed by these projects are pervasive. In order to avoid creating a prolonged period in which the comparability of financial reports may be significantly reduced, it would not be preferable to permit early adoption.

Question 7

Do you agree that the IASB and FASB should require the same effective dates and transition methods for their comparable standards? Why or why not?

We agree that it would be preferable if the IASB and FASB required the same effective dates and transition methods, if this promotes comparability and understandability of reported financial information. However, as preparers of financial statements under IFRS are transitioning to the new requirements from current requirements which differ from US GAAP, it does not necessarily flow that the same transition method adopted by both sets of preparers will promote comparability of financial information. Likewise, the followers of IFRS may require more or less time to transition, than the followers of US GAAP depending on the extent to which the new requirements are different from the previous requirements. We therefore do not consider that aligning effective dates or transition methods should be pursued as an objective in isolation of considering the needs of those preparers who follow only one set of financial reporting requirements, be it IFRS or US GAAP.

Question 8

Should the IASB permit different adoption dates and early adoption requirements for first-time adopters of IFRSs? Why, or why not? If yes, what should those different adoption requirements be, and why?

As a pragmatic solution, we do not object to a first time adopter of IFRS having the option to early adopt a final standard that has not yet become effective as of the date of their IFRS adoption so that they would not have to adopt standards that are about to be abolished.

~ End ~