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

Our Ref.: C/FRSC

Sent electronically through email strategyreview-comm@ifrs.org

24 February 2011

IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IFRS Foundation Paper for Public Consultation – Status of Trustee's Strategy Review

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

We appreciate the initiative of the IFRS Foundation to seek views of stakeholders on four strategic fronts — the Foundation's mission, governance, the standard-setting process, and financing, which are important to the achievement of the Foundation's ultimate objective of developing a single high-quality globally accepted set of accounting standards.

The salient features of our comments are:

- On public interest – The IASB may consider the principles-based framework for public interest which has been recently been exposed in an International Federation of Accountants consultation in order to add clarity and consistency to the understanding of "public interest".

- On financial stability – We are concerned about the notion of financial stability being an objective for IFRSs because political or economic agenda of governments and regulators should not take precedence over the needs of users of general purpose financial statements.

- On the Monitoring Board – We consider it would seem more logical for the IFRS Trustees and the IASB to be accountable to jurisdictions that have or are in the process of adopting IFRSs rather than specific bodies, some of which are from jurisdictions that have not adopted IFRSs. If the Monitoring Board is to be seen to represent jurisdictions, we would suggest that further transparency over the appointment procedure for members of the Monitoring Board should be introduced.

- On the process to achieve high quality standards –

  - Development of conceptual framework

    We believe that the completion of the review of the conceptual framework should be given priority and that fundamental changes to existing standards should not be made until they can be guided by and debated within the conceptual framework.

  - Voting benchmark of the IASB

    The IFRS Foundation may wish to consider whether it would be appropriate to introduce a higher percentage supporting vote for new or revised standards to be issued. Furthermore, we believe that it is important that IASB members do not use their status of being independent from specific interest groups as a justification for taking technical positions and making changes which do not have broad support. In our view, different accounting solutions can be of equally high quality, and the one that is most acceptable to the public at large is usually the one that should be retained.

  - Convergence

    There are occasions that the standards separately proposed by the IASB and FASB do not result in converged financial reporting standards. We consider that IASB and FASB should resolve the differences in financial reporting standards and seek more cooperation such that a single set of global accounting standards can become a reality.

- Others – concept of realisation – We observe that the concept of income recognition under IFRS is increasingly unrelated to the concept of realisation, which makes the performance statement less and less useful for directors as a basis for determining the level of dividends to be proposed and for investors to make assessments as to the company's dividend trends and policy. We are concerned that it is increasingly becoming necessary to supplement IFRS performance information on such key pieces of decision-useful information with reconciliations or alternative measures of "profit" for distribution purposes.

If you have any questions on our comments, please do not hesitate to contact our Steve Ong, Director of Standard Setting at ong@hkicpa.org.hk or myself.

Yours faithfully,

Chris Joy
Executive Director

Encl.

Hong Kong Institute of CPAs

IFRS Foundation Paper for Public Consultation – Status of Trustee's strategy Review

Mission: How should the organisation best define the public interest to which it is committed?

Question 1

The current Constitution states, "These standards [IFRSs] should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions." Should this objective be subject to revision?

We consider that the mission as stated in the Constitution is generally appropriate in terms of working in the public interest. We also consider that a focus on users in capital markets making economic decisions is generally appropriate, because the focus of attention should be general purpose financial statements. However, we consider there may be a need to provide more specific elaboration, especially on "high quality" , "public interest" and "other financial reporting" to enhance the understandability and clarity of the mission as stated in the Constitution. To better define "public interest", the IASB may consider the principles-based framework for public interest which has recently been exposed in an International Federation of Accountants consultation.

We consider that there should be a wider view of "world's capital markets" that incorporates all capital markets where market participants rely on general purpose financial statements. We think this would include less-developed listed and private sector capital markets. Accordingly, we appreciate the IFRS Foundation's initiative in developing IFRS for Small and Medium-sized Entities in the past years and are of a view that the IFRS Foundation should continue to implement initiatives to cater for the less-developed listed and private sector capital markets as well as the sizeable capital markets.

Question 2

The financial crisis has raised questions among policymakers and other stakeholders regarding the interaction between financial reporting standards and other public policy concerns, particularly financial stability requirements. To what extent can and should the two perspectives be reconciled?

The primary objective of the IASB should be to continue to provide high quality global accounting standards required by the world's capital markets. We acknowledge the interrelationship between financial reporting and economic consequences and consider that while IASB should understand and consider potential economic consequences this should not be the primary consideration during the process of standard setting.

We consider that developing a set of high quality, transparent and neutral accounting standards would facilitate informed judgment and decision making by stakeholders. This also helps to promote investor confidence in financial statements and capital markets and is consistent with financial stability. Trying to avoid transparency for the sake of financial stability cannot be conducive to meaningful reporting.

We would also be concerned about the notion of financial stability being an objective for IFRSs because the political or economic agenda of governments and regulators should not take precedence over the needs of general purpose users. Governments and regulators have their own mechanisms for obtaining the information that they need to play their role in financial stability and capital market operations. We consider that the presentation of financial statement items should be measured based on accounting standards for the purpose of general purpose financial reporting in order to uphold the comparability of financial statements. Accounting standards should however continue to allow preparers to make additional disclosures to fulfill regulatory requirements, including but not limited to the inclusion of reconciliations between reported amounts under the accounting standard and required amounts under the regulatory requirements.

However, we are of the view that standard-setting can potentially be inconsistent with the objective of financial stability when there are frequent changes in the requirements and/or where the new requirements are counter-intuitive or too complex for professionals as well as lay readers to understand. For example, we expect that many users of financial statements would find it counter-intuitive that a gain should be recognised on step-up from an interest in an associate to a subsidiary (when in fact no disposal has occurred) but no gain may be recognised when part of that holding is subsequently disposed of to the non-controlling interests (when in fact a genuine transaction with third parties has occurred). Likewise, we consider that the proposed requirements under the IASB Exposure Draft on Leases are unduly complex and would require an extensive amount of re-measurement based on future expectations of contingencies and renewals which could impair understandability and decision-usefulness of the information provided to users of financial statements. We consider that the potentially negative impact on financial stability that could arise from a lack of market acceptance or understanding of new requirements should be considered carefully by the IASB when developing standards.

<u>Governance: how should the organisation best balance independence with accountability?</u>

Question 3

The current governance of the IFRS Foundation is organised into three major tiers: the Monitoring Board, IFRS Foundation Trustees, and the IASB (and IFRS Foundation Secretariat). Does this three-tier structure remain appropriate?

We consider that there is a need to reconstitute the Monitoring Board to provide more accountability to jurisdictions that have adopted IFRSs or are undertaking a formal process of convergence to IFRSs. It would seem more logical for the IFRS Trustees and the IASB to be accountable to jurisdictions that have or are in the process of adopting IFRSs rather than specific bodies, some of which are from jurisdictions that have not adopted IFRSs. If the Monitoring Board is to be seen to represent jurisdictions, we would suggest that further transparency over the appointment procedure for members of the Monitoring Board should be introduced.

Save for the above, we generally agree that the current governance structure which consists of the Monitoring Board, IFRS Foundation Trustees, and the IASB remain appropriate where the Monitoring Board is viewed as an avenue for providing public comments if the Trustees and the IASB are not functioning effectively.

Question 4

Some stakeholders have raised concerns about the lack of formal political endorsement of the Monitoring Board arrangement and about continued insufficient public accountability associated with a private-sector Trustee body being the primary governance body. Are further steps required to bolster the legitimacy of the governance arrangements (including in the areas of representation of and linkages to public authorities?

See our response to question 3 above.

Process: how should the organisation best ensure that its standards are high quality, meet the requirements of a well functioning capital market and are implemented consistently across the world?

Question 5

Is the standard-setting process currently in place structured in such a way to ensure the quality of the standards and appropriate priorities for the IASB work programme?

We consider that the separation achieved between the oversight/funding of standard setting (through the Trustees) and standard setting (through the IASB) is critical and must be maintained because they are fundamentally different roles and separation is needed to avoid conflicts that might otherwise arise.

We have been disappointed that there have been occasions where adequate processes seem not to have been followed during the decision-making of the IASB due to a number of reasons. It is particularly important that the IASB continues to follow due process at the current time when the combined effects of the following events are influencing activities:

- the global financial crisis;
- the somewhat unbalanced and urgent efforts for US GAAP/IFRSs convergence;
- the transition to IFRSs in some other jurisdictions; and,
- the maturation of some important long-running projects.

Responses to these influences have, on occasion seemed to have taken place too quickly to achieve high quality consistent outcomes, or at least threatened the chances of achieving such outcomes.

In addition, we have the following comments in relation to the current standard-setting process:

Development of conceptual framework

We believe that the Trustees and the IASB must seek a mechanism to find high-quality answers which have broad consensus support at earlier stages of the standard-setting process, rather than issuing exposure drafts which are later aborted, like the IASB Exposure Draft on income taxes and, we hope, many of the proposals for leases.

We believe that fundamental changes to any existing standards should not be made before these changes have been debated at conceptual level first. The IASB should refrain from making any substantial changes to individual standards until completion of the review of the conceptual framework. We believe the conceptual framework should be core to the development of accounting standards as this will ensure consistency of specific standards to a single cohesive body of key underlying concepts and principles for financial reporting. We would reluctantly point out that recently released discussion papers and exposure drafts introduce conflicting concepts and principles, which leads to confusion and results in the development of incoherent rule-based standards rather than principle-based standards.

In October 2010 the IASB issued a request for views on the timing for implementing new or amended IFRSs and acknowledged the fact that the volume of proposed amendments to IFRSs would be a burden to stakeholders. We also note that the development of the conceptual framework has been delayed. We believe that IFRS Foundation should seriously re-consider its and the IASB's priorities and approach to setting accounting standards.

Voting benchmark

We understand that currently the approval of a new or revised standard only requires nine votes out of the fifteen IASB members. We believe a 40% dissenting vote indicates that there is legitimate cause for concern that the standard is in some way deficient or weak. The IFRS Foundation may wish to consider whether a higher percentage supporting vote should be introduced. Furthermore, we believe that it is important that IASB members do not use their status of being independent from specific interest groups as a justification for taking technical positions and making changes which do not have broad support. In our view, different accounting solutions can be of equally high quality, and the one that is most acceptable to the public at large is usually the one that should be retained. IASB have the objective of issuing "globally accepted standards". In this regard well accepted and well understood standards are likely to be better applied in practice both by preparers and users.

Field testing

We also believe that the IASB should undertake thorough field testing of its proposed standards before they are issued as standards given their wider implications as they affect a larger number of stakeholders, capital markets and the economies that adopt the standards. Thorough field testing by the IASB should ensure that the full implications of proposed standard are understood and that the IASB has sufficient evidence that if the standard is to be released the standard is worthwhile and workable in practice.

Transparency on responses to comments received from constituents

Although IASB has procedures to consider comments received on discussion papers and exposure drafts, we are troubled that concerns from constituents sometimes do not appear to be fully and properly addressed.

There are also occasions where a majority of commentators have expressed serious concerns about a proposed standard but their comments are rejected on the grounds that they have raised no new arguments and that these arguments have already been considered by the IASB during the development of the proposed standard. The fact that comments continue to be raised by a majority of significant commentators during every stage of the standard-setting process should oblige the IASB to address the concerns again and to reconsider the impact assessment and needs analysis in order to assess whether all practical implications have been appropriately considered.

We believe that considerable time and effort is spent by stakeholders to prepare and submit comment letters to the IASB and IASB should consider ways to improve the transparency of how it deals with contrary views. The IASB should also consider exploring more effective means of communicating results of its assessments, including direct communication with commentators.

Convergence

On the convergence front, we acknowledge the importance and potential advantages of convergence with US GAAP. However, we believe that the main emphasis of the IASB should be on the development and adoption of high quality global financial reporting standards. We are concerned about the undue time pressure the IASB and FASB MoU on convergence has caused and its impact on the quality of the resulting exposure drafts. Sufficient time needs to be allowed to carefully adjust the proposals in the exposure drafts where needed, making them fully operational, and to ensure that the proposals result in better standards and improve financial reporting.

We noticed that the IASB has proposed substantial changes to IFRSs with the intent to converge with US GAAP, such proposed changes include but are not limited to changes in the standards on revenue recognition, leases, insurance contracts, financial instruments. There are occasions that the standards separately proposed by the IASB and FASB do not result in converged financial reporting standards. We consider that IASB and FASB should resolve the differences in financial reporting standards and seek more cooperation such that a single set of global accounting standards can become a reality. Otherwise, there will not be a level playing field despite all the efforts by IFRSs adopters to keep up with the constant changes.

Question 6

Will the IASB need to pay greater attention to issues related to the consistent application and implementation issues as the standards are adopted and implemented on a global basis?

We note the importance of consistent application and implementation of standards on a global basis. The education section of the IFRS Foundation could consider making the technical databases and experiences of the larger firms and other large educators into sources for the training of accountants and regulators around the world. The educational materials developed for the IFRS for SMEs are also a good reference point.

In addition, we consider the IFRS Foundation can consider putting in place liaison groups that monitor implementation of new standards, in particular controversial ones, similar to action taken by the International Auditing and Assurance Standards Board (IAASB) for its auditing standard clarification project. We consider this arrangement may help the IFRS Foundation to better understand and respond to practical issues in relation to the adoption of new and controversial standards. Further information in relation to the initiative by the IAASB can be accessed at http://web.ifac.org/download/IAASB-Implementation-Monitoring-Clarified-ISAs.pdf.

<u>Financing: how should the organisation best ensure forms of financing that permit it to operate effectively and efficiently?</u>

<u>Question 7</u>

Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?

We generally support the four criteria established by the Trustee in seeking contributions from donors, namely that any system should be broad-based, compelling, open-ended and country-specific. Having said that, we believe that the IFRS Foundation may consider working towards some form of direct or indirect levy system on users of IFRSs as there is an increasing use of IFRSs across global capital markets and higher visibility of the IFRS Foundation.

A secure and stable funding mechanism will enable the IASB to function independently and is important to ensure that there are sufficient resources to develop high quality financial reporting standards on a timely basis.

<u>Other issues</u>

<u>Question 8</u>

Are there any other issues that the Trustees should consider?

We observe that the concept of income recognition under IFRSs is increasingly unrelated to the concept of realisation, which makes the performance statement less and less useful for directors as a basis for determining the level of dividends to be proposed and for investors to make assessments as to the company's dividend trends and policy. Since the extent to which a company has generated distributable profits and has determined whether or not to distribute those profits are key pieces of decision-useful information, we are concerned that it is increasingly becoming necessary to supplement IFRSs performance information with reconciliations or alternative measures of "profit" for distribution purposes.

For example, once IFRS 9 is adopted, companies may need to maintain separate memorandum information on the portfolio of equity securities to identify realised profits and losses, as neither the "fair value through profit and loss" nor the "fair value through other comprehensive income" model under IFRS 9 will provide such information. We also see a lack of conceptual consistency in requiring fair value changes on illiquid investment property to be reported within profit or loss, whereas changes in liquid equity securities are reported in other comprehensive income.

Such differences between accounting treatments within IFRSs and the concept of realised profits and losses have led to the development of extensive guidance published by the ICAEW and ICAS, and adopted by the HKICPA, on the question of "generally accepted accounting principles for the purposes of determining realised profits and losses" (our guidance can be accessed at http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeII/ab4.pdf). In our view the need for such guidance on how to adjust IFRSs "profit" to arrive at a more useful measure of performance runs the risk of undermining the credibility of

IFRSs, particularly where there is no consistent conceptual basis on which the IFRS "profit" has been determined.

We therefore consider that it is important for the IASB to re-focus on the importance of performance statements for users of the financial statements. Such a re-focus should include articulating in the conceptual framework the conceptual difference between "profit" and "other comprehensive income", with due regard to commonly accepted concepts of distributable profits and with a view to reducing the extent of reconciling adjustments to IFRS "profit" that are required to arrive at a consistently prepared measure of "realised" profit.

~ End ~