Our Ref.: C/FRSC

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

5 September 2012

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

Dear Sirs,

IASB Exposure Draft of *Proposed Improvements to IFRSs* (Fifth Set)

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 this Exposure Draft (ED). Our responses to the questions raised in your Invitation to Comment are set out in the Appendix for your consideration.

We appreciate the effort that the IFRS Interpretations Committee (IFRIC) has made in addressing the issues covered in the ED. However, we have concerns over a number of proposed amendments, including those to the following standards:

- IFRS 3 *Business Combinations;*
- IFRS 8 *Operating Segments;*
- IAS 1 *Presentation of Financial Statements;* and
- IAS 7 *Statement of Cash Flows.*

For details, please refer to our response to Question 1.

Also, with regards to a number of proposed amendments (e.g. amendments to IFRS 3 and IFRS 8), we believe that they should be addressed through the Board's post-implementation review process. We noted that the Board has started the post-implementation review of IFRS 8; the Board issued Request for Information regarding post-implementation review of IFRS 8 in July 2012. Also, we note from the Board's latest project update that the Board will start the post-implementation review of IFRS 3 in early 2013. The proposed amendments to IFRS 3 set out in the Annual Improvements ED are more than 'editorial and/or maintenance' amendments – they should be addressed by the Board through its comprehensive post-implementation of the standard.

If you have any questions regarding the matters raised in our submission, please contact Winnie Chan, our Manager of Standard Setting at winniechan@hkicpa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

SR/WC/ah

Encl.

APPENDIX

Hong Kong Institute of CPAs

Comments on the IASB Exposure Draft of *Proposed Improvements to IFRSs* (Fifth Set)

<u>Question 1</u>

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

<u>IFRS 2 *Share-based Payment*</u>

We support the proposal to clarify the concept of 'vesting conditions', by providing definitions of the important terms 'performance condition' and 'service condition'.

However, we have a number of concerns regarding the proposals that are explained below.

The proposal defines 'performance condition' as a vesting condition that requires (a) the counterparty to complete a specified period of service; and (b) specified performance targets to be met while the counterparty is rendering the service required in (a). The proposal further explains that a performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options) and that a performance target might relate to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee.

Based on the above definition, it appears that the following two examples meet the definition of 'performance condition':

(a) Employees of Entity A are granted share options. Share options will vest when (a) the employees work for Entity A for a service period of 5 years and (b) the share price of the ordinary shares of Entity A has increased by at least 20% at the end of year 5 as compared to the share price of the ordinary shares of Entity A at the grant date of the share options.

(b) Employees of Entity B are granted share options. Share options will vest when (a) the employees work for Entity B for a service period of 3 years and (b) Entity B will become a listed entity by the end of Year 3.

However, we noted that proposed BC 5 accompanying the proposal states: 'The Board noted that for a target to constitute a performance condition, ***the target needs to be within the influence of the employee*** and also in the interest in the entity.' ***[Emphasis added]***

It is unclear to us whether the phrase 'the target needs to be within the influence of the employee' is needed to be in the BC; it appears that that phrase is contradictory to the proposed definition of performance condition (i.e. according to BC 5, neither example (a) and (b) would be considered to be a performance condition).

In addition, we noted that the proposed 'performance condition' definition requires the counterparty to ***complete a specified period of service. [Emphasis added]*** We believe that the phrase 'the counterparty to complete a specified period of service' should be replaced by the phrase 'the counterparty to provide specified service'. It is unclear to us why the proposed definition has to refer to a ***specified period***.

IFRS 3 *Business Combinations*

We noted the proposed amendments to IFRS 3 propose that contingent consideration other than that classified as equity should be measured at fair value at each reporting date, with any resulting gain or loss recognised in profit or loss for the period, unless the recognition of the resulting gain or loss is required in other comprehensive income in accordance with IFRS 9. Currently, before the amendments, IFRS 3.58(b) states that contingent consideration that is not within the scope of IFRS 9 should be accounted for in accordance with IAS 37 or other IFRSs as appropriate.

We do not agree with the proposal. Specifically, we believe that the proposal fails to address a number of fundamental issues:

- When a contingent consideration involves the delivery of a non-financial instrument item (e.g. a property), it is unclear to us what should be the appropriate measurement basis to account for such a contingent consideration and how should the resulting difference be accounted for. Based on the proposed amendments, it appears that such a contingent consideration must be measured at fair value at each reporting date with the difference being recognised in profit or loss.

- It is unclear to us why the Board believes that (a) contingent consideration that involves the delivery of cash or other financial assets and (b) contingent consideration that involves the delivery of non-financial instruments should be accounted for the same way (despite the fact that they are of different nature).

We did not find any discussion by the Board of the above issues in the Basis for Conclusions accompanying the proposed amendments.

In addition, we noted from the latest IASB project update that the Board will initiate a post-implementation review of the requirements of IFRS 3 to address identified application issues.

For the above reasons, we strongly believe that the Board should not deal with this proposed amendment until it addresses the fundamental conceptual issues as discussed above, and that the Board should certainly not deal with these issues through its annual improvements process. Instead, the Board should deal with these issues as part of the post-implementation review of IFRS 3.

IFRS 8 *Operating Segments*

i) Aggregation of operating segments

We do not think the proposed disclosure requirements should be introduced ahead of the post-implementation review on IFRS 8 being completed. That review is likely to provide useful evidence on a range of disclosures issues resulting from the application of the Standard. Therefore, it would be premature to make changes of this nature to the Standard ahead of the results of the review.

ii) Reconciliation of the total of reportable segments' assets to the entity's assets

We support the proposed amendment as it corrects an omission when the Standard was amended by a previous cycle of Annual Improvements.

<u>IFRS 13 *Fair Value Measurement*</u>

We do not believe that it is appropriate to introduce either requirements or exceptions to requirements only in the Basis of Conclusions as is apparent from the Exposure Draft. We believe that the clarification should be included in the applicable standards.

Specifically, whilst we support the Board's intention to clarify that it did not intend to change practice in the measurement of short-term receivables and payables when the consequential amendments flowing from IFRS 13 were made, we believe that the relevant paragraphs in IFRS 9 and IAS 39 should be reinstated to make it clear that short-term receivables and payables with no stated interest rate could be measured at invoiced amounts without discounting.

<u>IAS 1 *Presentation of Financial Statements*</u>

We note that the IASB proposes to amend IAS 1.73 to clarify that a liability is classified as non-current if an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility with the same lender, ***on the same or similar terms*. *[Emphasis added]*** We note that such a proposed amendment aims to clarify how the requirements in IAS 1 should be applied to 'roll-over' borrowings.

We are concerned that the proposed changes refer us to whether the 'roll-over' borrowings are on the same or similar terms. For example, Entity A borrowed an amount from Bank B 5 years ago at HIBOR plus 0.2 per cent. The loan agreement states that the loan can be extended by another 5 years at the discretion of Entity A and will carry interest at prevailing market rates at the time when the loan is extended. A few months before the maturity date of the the original borrowing, Entity A exercised the discretion such that the loan is roll-forwarded for another 5 years at the current market rate that takes into account the current market conditions and current credit standing of Entity A, which is HIBOR plus 2 per cent. Based on the IASB's proposal regarding 'the same or similar' terms, it appears that the borrowing has to be classified as current despite the fact that the loan is extended for another 5 years.

We are of the view that the current or non-current classification of a liability should reflect the liquidity position of the reporting entity, and that the classification should depend on whether the reporting entity has an unconditional right to defer settlement as set out in IAS 1.69(d). This view is consistent with an improvement to IAS 1 introduced by the Board set out in the Improvements to IFRSs issued in 2009. That improvement to IAS 1 dealt with how the liability component of a compound financial instrument (e.g. convertible bond) should classified as current or non-current. Paragraph BC38H accompanying IAS 1 states: 'The Board concluded that classifying the liability ***on the basis of the requirements to transfer cash or other assets rather than on settlement*** better reflects the liquidity and solvency position of an entity.' ***[Emphasis added]***

For the above reasons, we believe that the requirements regarding 'the same or similar terms' are unnecessary and should be removed from the proposal.

IAS 7 *Statement of Cash Flows*

We do not support the proposed amendment to IAS 7 in its current form for the following reasons:

- The IFRS Interpretations Committee (IFRIC) is currently in the process of considering a number of issues on classification in the statement of cash flows.

- We noted that the proposed amendments to IAS 7 merely achieve cohesiveness with the related asset classification in the statement of cash flows. However, it seems that the proposed amendments fail to consider cohesiveness with the related liability classification in the statement of cash flows. IAS 7.6 defines 'financing activities' as activities that result in changes in size and composition of the contributed equity and borrowings of the entity. As required by IAS 7, cash flows relating to obtaining or repaying of borrowings should be included in 'cash inflows/outflows from financing activities'. In addition, in our view, such a treatment is only appropriate if, under the existing IAS 7, the entity had chosen to present interest expense as an operating cash outflow. If instead the entity had chosen to present interest expense as a financing cash outflow, as is clearly permitted by IAS 7.33, then the proposed change will upset the cohesiveness that is achieved by that choice of presentation by restricting the amount of interest expense which is presented within financing, by requiring the rest of the expense to follow the purpose for which the financing was obtained. This, in our view, is not an improvement.

For the above reasons, we do not believe that amendments to IAS 7 should be made until the IFRIC and the IASB have completed consideration of other IAS 7 classification issues. This is to ensure that any decisions made by the IFRIC and the IASB are developed on the same principles.

IAS 12 *Income Taxes*

We agree with the proposed amendments.

IAS 16 *Property, Plant and Equipment*
IAS 38 *Intangible Assets*

We do not agree with the proposed amendments to paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38. We consider the proposed wording as currently drafted is unclear and difficult to understand. In addition, based on our observation, practice usually takes the approach set out in paragraph 35(b) of IAS 16 and paragraph 80(b) of IAS 38 (i.e. the accumulated depreciation is eliminated against the gross carrying amount of the asset). Consistent with the IASB's view on various matters that we should reduce diversity in practice by reducing accounting options, we believe that paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38 be deleted.

IAS 24 *Related Party Disclosures*

In general, we support the proposed amendments. However, we strongly recommend that a definition of “key management personnel services” is also included for the avoidance of doubt, such that it is clear this term refers to entities which take on the role of being the entity’s key management personnel (KMP) (or one of its KMP) and that it does not refer to entities which provide services to the entity’s KMP (such as entities that provide tax agent services to individual directors).

In addition, we believe that the amendments to IAS 24.9b(viii) should also include, as a related party, the entity, or a member of its group that provides key management personnel services to ***the parent*** of the reporting entity. This is to achieve consistency with the requirement set out in IAS 24.9(a)(iii).

We note that a practical exemption is added in new paragraph 17A which states that, if an entity hires key management personnel services from another entity (the management entity), then the entity is not required to apply the requirements in paragraph 17 to compensation paid or payable by the management entity to the management entity's employees or directors.

However, to avoid potential abuse, we believe that such an exemption should not be applied to a special purpose entity that is established solely to provide key management personnel services to the reporting entity or its parent.

IAS 36 *Impairment of Assets*

We agree with the proposed amendment to IAS 36 as it addresses inconsistencies in the disclosure requirements of that Standard.

However, we believe that apart from adding the requirement to disclose the discount rate(s) used in the measurement, other information as required in paragraph 134(e)(i)-(v) such as a description of each key underlying assumption should also be required to be disclosed in order to achieve consistency.

Question 2

Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

We agree with the proposed transition provisions and effective date of all the proposed amendments.

~ End ~