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

40th ANNIVERSARY 計 往開來四十年 Accounting for Hong Kong since 1973

Our Ref.: C/FRSC

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

3 February 2014

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

Dear Sirs,

IASB Exposure Draft of Equity Method in Separate Financial Statements (Proposed amendments to IAS 27)

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 do not object to the proposed amendments to IAS 27 *Separate Financial Statements* to allow the use of the equity method to account for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements if it can reduce the compliance costs for preparers. However,

- we do not support the objective of the proposed consequential amendments to IAS 28.25 if the purpose of that amendment is to require that an entity remeasures any remaining investment to fair value in accordance with the principles of IFRS 10 if an investor loses control over a subsidiary and retains an interest in the former subsidiary, as appears to be implied in paragraph BC11. The principles of IFRS 10 are applicable to consolidated financial statements only and we do not accept that an entity should be required to apply those principles in separate financial statements; and

- we consider that the IASB should provide relief from full retrospective application to entities that opt to use the equity method to account for subsidiaries in their separate financial statements.

In addition, we have concerns that the arguments articulated in BC4, which explains that the changes were requested by a number of constituents who highlighted that equity method is required in some jurisdictions to comply with local regulations in preparing separate financial statements, and the remainder of the discussion in paragraphs BC5-BC6, fail to explain why the IASB finds this a sufficient basis for restoring the option to use equity method. Instead, we believe that the IASB should take this opportunity to address a broader issue of clarifying the objective of separate financial statements, including whether separate financial statements are presented just to satisfy local statutory requirements. Also, based on the ED, when an entity prepares separate financial statements, it can account for investments in subsidiaries, joint ventures and associates either at cost, in accordance with IFRS 9, or using the equity method provided that the same accounting is applied for each category of investments. We consider that there is no conceptual basis why investment in subsidiaries, joint ventures and associates in the separate financial statements are not accounted for in a consistent way and how the

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different accounting treatments correspond to the objective of preparing separate financial statements. As an interim measure to address this concern in this “quick fix” amendment and increase the comparability of financial information within the same jurisdiction, entities should be recommended to follow the requirements of respective jurisdiction laws in selecting the accounting policy options.

We would finally note that we continue to be concerned that the IASB has proposed a number of piecemeal amendments recently in the area of equity accounting seemingly without a coherent principle. We strongly believe that the IASB needs to resist the temptation to tinker with its standards on a regular basis as new issues are identified. A multiplicity of changes however small, are a significant distraction for constituents, particularly in respect of the problematic area of the equity method. We note that the IASB Work Plan indicated that it would undertake a research project that will involve a fundamental assessment of the equity method of accounting. We encourage the IASB to prioritise this research project in view of the complexity of applying this measurement method in practice and to refrain from attempting to resolve any diversity in practice of the equity method of accounting in the meantime by introducing further complexity to the method.

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

Yours faithfully,

Simon Riley
Acting Director, Standard Setting

SR/WC

Encl.

Hong Kong Institute of CPAs

Comment on IASB Exposure Draft of Equity Method in Separate Financial Statements (Proposed amendments to IAS 27)

Question 1—Use of the equity method

The IASB proposes to permit the equity method as one of the options to account for an entity's investments in subsidiaries, joint ventures and associates in the entity's separate financial statements.

Do you agree with the inclusion of the equity method as one of the options? If not, why?

We do not object to the proposed amendments to IAS 27 *Separate Financial Statements* to allow the use of the equity method to account for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements.

However, we consider that the IASB should provide more guidance on the application of the equity method to investments in subsidiaries in separate financial statements. Paragraph BC10 of the ED notes that there could be situations in which applying the equity method to investments in subsidiaries in separate financial statements would give a different result compared to the consolidated financial statements such as with the impairment of goodwill. However, we note that further differences may, for example, arise in accounting for the costs of acquisition and changes in ownership interest in subsidiaries. Therefore, we believe that additional guidance on the application of the equity method should be included in the applicable standards. It might also be useful to users if a reconciliation of the differences is presented in the notes to the financial statements.

Applying a different method of accounting to the cost of investment would result in differences to the net assets and profit or loss reported in the separate financial statements. To increase the comparability of financial information within the same jurisdiction, entities should be recommended to follow the requirements of respective jurisdiction laws in selecting the accounting policy options.

Question 2—Transition provisions

The IASB proposes that an entity electing to change to the equity method would be required to apply that change retrospectively, and therefore would be required to apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Do you agree with the proposed transition provisions? If not, why and what alternative do you propose?

We consider that the IASB should provide relief from full retrospective application to entities that opt to use the equity method to account for subsidiaries in their separate financial statements. As differences can arise between the separate and consolidated financial statements in the application of the equity method to subsidiaries, we believe it is not always possible to derive the carrying amount under the equity method directly

from the consolidated financial statements. Therefore, we suggest the following transitional provisions for both first-time adopters and existing users:

- Use the carrying amount under the consolidated financial statements as the deemed amount in the separate financial statements at the commencement of the comparative year.
- Deem the carrying amount as zero for those subsidiaries that have negative net assets, unless the parent has to recognise the obligation as required by IAS 28 (i.e. an obligation to make good any accumulated net losses). Subsequent gains (or reduction in the negative net asset position) will be recognised in accordance with IAS 28.

Question 3—First-time adopters

The IASB does not propose to provide any special relief for first-time adopters. A first-time adopter electing to use the equity method would be required to apply the method from the date of transition to IFRSs in accordance with the general requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Do you agree that a special relief is not required for a first-time adopter? If not, why and what alternative do you propose?

As explained in our response to Q2, we consider that the IASB should provide relief for first-time adopters. Paragraph D15 of IFRS 1 permits a first-time adopter electing the cost method to measure investments in subsidiaries, associates and joint ventures in its separate financial statements at deemed cost in its opening statement of financial position. The Basis for Conclusions on IFRS 1 explains the rationale for this exemption to be the difficulty and cost in applying IAS 27 retrospectively. We believe the same argument is true when an entity applies the equity method. Therefore, we believe the IASB should consider amending paragraph D15 of IFRS 1, so that it also applies to a first-time adopter electing to use the equity method in its separate financial statements.

Question 4—Consequential amendment to IAS 28 *Investments in Associates and Joint Ventures*

The IASB proposes to amend paragraph 25 of IAS 28 in order to avoid a conflict with the principles of IFRS 10 *Consolidated Financial Statements* in situations in which an entity loses control of a subsidiary but retains an ownership interest in the former subsidiary that gives the entity significant influence or joint control, and the entity elects to use the equity method to account for the investments in its separate financial statements.

Do you agree with the proposed consequential amendment? If not, why?

IAS 27 currently fails to address how disposals of interests in subsidiaries, joint ventures and associates should be reflected in separate financial statements. We do not consider that the wording of the proposed amendment to paragraph 25 of IAS 28

will address this deficiency and in fact may well add to the confusion, as it creates a further area on which the standards appear "silent" (being the step down from subsidiary to associate of an investee which is reflected in the separate financial statements using the equity method).

Furthermore, we do not support the objective of the proposed consequential amendments to IAS 28 if the purpose of those amendments is to require that an entity remeasures any remaining investment to fair value in accordance with the principles of IFRS 10 if an investor loses control over a subsidiary and retains an interest in the former subsidiary as appears to be implied in paragraph BC11. The principles of IFRS 10 are applicable to consolidated financial statements only and we do not accept that an entity should be required to apply those principles in separate financial statements.

Finally, if the IASB continues with this amendment then we note that, neither the proposed wording in the ED nor the discussion in BC11 are clear enough to achieve this objective. The Board should clarify the purpose of this consequential amendment, the principles to justify such treatment, to what situations it should be applied, and whether the principles in IFRS 10 should also be used in separate financial statements when acquiring additional ownership interest that turns an associate into a subsidiary, under the equity method. This should also be considered together with other detailed guidance on step acquisition / disposal and clarify whether the treatment would apply when there is change in ownership interest of a subsidiary that is accounted for at cost or fair value.

Question 5—Other comments

Do you have any other comments on the proposals?

We do not have any further comments.

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