Our Ref.: C/FRSC

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

7 March 2014

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

Dear Sirs,

IASB discussion on proposed amendments to paragraph 4(a)(iv) of IFRS 10: Request to broaden the discussion beyond the impact of the investment entities amendment and to consider deleting this condition

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 have noted that the IFRS Interpretations Committee has referred an issue concerning paragraph 4(a)(iv) of IFRS 10 to the IASB and that the Staff of the IASB has been instructed to prepare papers for further discussion at the next IASB meeting. The purpose of this letter is to request that the IASB broaden the discussion beyond the impact of the investment entities amendment and to consider deleting this condition. Further details of this request are as follows.

We note that, as reported in the IASB Update report of the February 2014 meeting, the specific issue under consideration by the Board relates to whether the exemption in paragraph 4 of IFRS 10 from preparing consolidated financial statements is available to an intermediate parent that is included in its investment entity parent's financial statements at fair value rather than consolidated on a line-by-line basis. We also note from the report of the January meeting of the IFRS Interpretations Committee that the focus is on the situation where the conditions set out in paragraph 4(a)(i)–(iii) are met but the condition set out in paragraph 4(a)(iv) is not met because the Ultimate Parent prepares financial statements in which all of its subsidiaries are measured at fair value in accordance with paragraph 31 of IFRS 10.

As explained in the Appendix to this letter, we believe that the discussion relating to the relevance of the condition set out in paragraph 4(a)(iv) has broader applicability beyond the situation immediately facing intermediate holding companies which are subsidiaries of investment entities. The purpose of this letter is therefore:

(a) To support the analysis and views expressed by Staff in Staff Paper 5B which was prepared for the January meeting of the IFRS Interpretations Committee by providing details of the issue as it manifests itself in Hong Kong, particularly in respect of private companies; and

(b) To request that the IASB broaden their consideration of this issue to consider whether paragraph 4(a)(iv) should be deleted, on the basis that it is inconsistent with the purpose of general purpose financial statements as set out in paragraph OB2 of the Conceptual Framework and lacks a basis in principle.

This matter is of concern to us, as one possible alternative solution of amending the equivalent wording of paragraph 4(a) of HKFRS 10 unilaterally would be an unprecedented departure from our policy of adopting IFRSs word-for-word since 2005. We also believe, for the reasons explained in the Appendix, that this is not a concern caused by unusual circumstances in Hong Kong. It is instead, we believe, a concern caused by condition 4(a)(iv) being inconsistent with the purpose of general purpose financial statements as set out in paragraph OB2 of the Conceptual Framework and lacking a basis in principle.

We therefore also request that, if the IASB decide to retain condition (iv) in whole or in part, the IASB articulates the underlying principle to each part of this condition retained and its intended objective, over and above the protection for users of the intermediate holding company's financial statements that would already be achieved through compliance with the conditions set out in paragraph 4(a)(i) to (iii). This will enable us, and any other jurisdictions facing the same issues relating to the impact on private companies, to better consider whether this objective is relevant for private companies incorporated in the respective jurisdictions.

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

Yours faithfully,

Simon Riley
Acting Director, Standard Setting

SR/AW

Encl.

Hong Kong Institute of CPAs

IASB discussion on proposed amendments to paragraph 4(a)(iv) of IFRS 10: Request to broaden the discussion beyond the impact of the investment entities amendment and to consider deleting this condition

As explained in our covering letter, we believe that the discussion relating to the relevance of the condition set out in paragraph 4(a)(iv) of IFRS 10 has broader applicability beyond the situation immediately facing intermediate holding companies (IHCs) which are subsidiaries of investment entities. The purpose of this letter is therefore:

(a) To support the analysis and views expressed by Staff in Staff Paper 5B which was prepared for the January meeting of the IFRS Interpretations Committee by providing details of the issue as it manifests itself in Hong Kong, particularly in respect of private companies; and

(b) To request that the IASB broaden their consideration of this issue to consider whether paragraph 4(a)(iv) should be deleted entirely, on the basis that it is inconsistent with the purpose of general purpose financial statements as set out in paragraph OB2 of the Conceptual Framework and lacks a basis in principle.

This matter is of concern to us, as one possible alternative solution of amending the equivalent wording of paragraph 4(a) of HKFRS 10 unilaterally, would be an unprecedented departure from our policy of adopting IFRS word-for-word since 2005.

We therefore also request that, if the IASB decide to retain condition (iv) in whole or in part, the IASB articulates the underlying principle to each part of this condition retained and its intended objective, over and above the protection for users of the IHC's financial statements that would already be achieved through compliance with the conditions set out in paragraph 4(a)(i) to (iii). This will enable us, and any other jurisdictions facing the same issues relating to the impact on private companies, to better consider whether this objective is relevant for private companies incorporated in the respective jurisdictions.

(a) The impact of paragraph 4(a)(iv) of IFRS 10 in the Hong Kong legislative environment

As you may be aware, Hong Kong has a long history of adopting individual International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) on a word-for-word basis as individual Hong Kong Accounting Standards (HKASs) and Hong Kong Financial Reporting Standards (HKFRSs). This programme of standard-by-standard convergence was completed in 2005, since which date the full suite of currently effective IASs, IFRSs 1 to 13 and Interpretations has been adopted in Hong Kong, with all amendments and new standards being adopted with the same effective dates as the IFRS equivalents. Consequently, HKFRS 10 is currently a word-for-word adoption of IFRS 10.

HKFRSs are applied widely in Hong Kong as the basis on which a Hong Kong incorporated company may prepare financial statements which give a true and fair view. The requirement to prepare such financial statements is contained in our Companies Ordinance, which applies to both private companies and public companies. These financial statements are required to be presented to shareholders on an annual basis and are also generally required to be submitted to the Inland Revenue Department as part of a company's tax filing. Public companies and companies limited by guarantee are required to file their annual financial statements with the Hong Kong Companies Registrar and additionally, companies in regulated sectors (such as banking and insurance) are required to file their financial statements with their respective industry regulators. However, in general private companies are not required to file their financial statements with the Companies Registrar and are not otherwise required to place their financial statements on public record.

In July 2012 a new Companies Ordinance (NCO) was passed by our Legislative Council, which came into effect on 3 March 2014. This Companies Ordinance takes the form of a comprehensive re-write of Hong Kong companies legislation in order to modernise the law, enhance corporate governance, ensure better regulations and facilitate business. The following aspects of the NCO are of relevance here:

1 The NCO introduced statutory backing for accounting standards issued by the HKICPA by making it a provision of the law that the financial statements must comply with the accounting standards applicable to the financial statements (s. 380(4)). Previously the Companies Ordinance was not explicit on the relevance of accounting standards to achieving a true and fair view.

2 Although, the NCO has given statutory backing for, and compliance with, accounting standards it has retained the fundamental decision-making capacity as to what constitutes a group and thus which companies must prepare consolidated financial statements.

   Specifically, the law takes the form of a general requirement for holding companies to prepare consolidated financial statements which give a true and fair view of the financial position of the company and all its subsidiary undertakings as a whole (sections 379(2) and 380(2)). Section 379(3) sets out the specific exemptions from that requirement by stating that section 379(2) (the requirement for a holding company to prepare consolidated financial statements) "does not apply:

   (a) if the company is a wholly owned subsidiary of another body corporate in the financial year; or

   (b) if:

      (i) the company is a partially owned subsidiary of another body corporate in the financial year;

      (ii) at least 6 months before the end of the financial year, the directors notify the members in writing of the directors' intention not to prepare consolidated statements for the financial year, and the notification does not relate to any other financial year; and

(iii) as at a date falling 3 months before the end of the financial year, no member has responded to the notification by giving the directors a written request for the preparation of consolidated statements for the financial year."

3 The NCO did not change the filing regime referred to above: under the NCO private companies are still not required to file their financial statements with the Companies Registrar nor otherwise to place their financial statements on public record.

As mentioned, HKFRS 10 is a word-for-word copy of IFRS 10 as a result of Hong Kong's full convergence policy. Consequently, paragraph 4(a) of HKFRS 10 currently contains the same criteria as paragraph 4(a) of IFRS 10, namely that a parent entity need not prepare consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with HKFRSs or International Financial Reporting Standards.

Comparing the exemption conditions set out in section 379(3) of the NCO with paragraph 4(a) of HKFRS 10, it can be seen that the condition in paragraph 4(a)(i) is dealt with more robustly under section 379(3) than in HKFRS 10. Also, although the conditions set out in (ii) and (iii) are not explicitly dealt with in the NCO (and were not included in the Companies Ordinance in force prior to 3 March 2014), these have generally not proved problematic in Hong Kong, as those two particular scenarios deal with financial statements prepared for a broader group of public interest stakeholders than simply the members of the company and the Inland Revenue Department.

However, the condition set out in (iv) has proved problematic to satisfy for many Hong Kong IHCs which satisfy conditions (i) through (iii). Consistent with the analysis in paragraph 15 of Staff Paper 5B, we can identify the following common cases of IHCs, which may often be wholly-owned subsidiaries without public debt, which would clearly fail to meet at least one of the three tests in condition (iv):

(a) the IHC is a subsidiary of a Hong Kong private company

In this case, the IHC would fail condition (iv) because although this ultimate parent would prepare consolidated financial statements which comply with HKFRSs, it would not normally make these financial statements available for public use; or

(b) the IHC is part of a group headed by an overseas company in a non-IFRS jurisdiction, for example a US parent

In this case, the IHC would fail condition (iv) because although this ultimate parent may prepare consolidated financial statements and may even make them available for public use, these consolidated financial statements would not be prepared in accordance with IFRS or HKFRS.

A further common scenario is that the IHC is part of a group headed by a parent in a jurisdiction whose standards are almost fully converged with IFRS, but not entirely, for example, if the parent of the group is listed in the EU. In this case the parent prepares consolidated financial statements available for public use in accordance with "IFRSs as adopted in the EU" and the question arises as to whether this is sufficient for the purposes of condition (iv). In general, many entities' consolidated financial statements which are prepared in accordance with IFRSs as adopted in the EU are to all intents and purposes also in compliance with IFRSs. However, doubts about this conclusion arise where for example, as is the case in 2013, "IFRSs in the EU" are temporarily different from IFRSs due to differences in effective dates of new standards.

In each of the above situations, the outcome of the analysis against the three tests in condition (iv) has a direct impact on the costs and efforts being demanded of the IHC, which in Hong Kong is typically a private company and often wholly-owned. Given this, and consistent with the views expressed by the Staff in paragraphs 15 to 16 of Staff Paper 5B, we cannot see the logic of the three tests in condition (iv) in that we cannot see how requiring the IHC in such circumstances to prepare consolidated financial statements provides any users of that information with any benefits which justify those costs. For example:

- in the scenario where the IHC is a subsidiary of a Hong Kong private company, the IHC fails condition (iv) because its parent's consolidated financial statements are not publicly available. However, there is no logic to requiring IHC itself to prepare consolidated financial statements as a result of this "deficiency" as IHC is also a private company and so it will not make these consolidated financial statements available for public use;

- in the scenario of the IHC being part of an overseas group which follows a near-IFRS GAAP (such as "IFRS as adopted in the EU"), the question we face is how is condition (iv) to be interpreted in such cases? For example, should the Hong Kong incorporated IHC prepare consolidated financial statements for one year simply because further up the group the accounting framework may be temporarily out of date in respect of a matter which might have no bearing whatsoever on the way in which the IHC is incorporated into those financial statements? In years when "IFRS as adopted in the EU" is identical to IFRS, the users of IHC's financial statements are given company-level information and this is fully compliant with HKFRS 10.4(a):

how is it logical to regard this information in respect of the IHC as deficient, simply because of changes in the reporting framework adopted by the group of which it may only be a small part?

The above issues are not new for Hong Kong, as prior to adopting IFRS 10 in the form of HKFRS 10, paragraph 10 of HKAS 27 contained the same wording as was found in paragraph 10 of IAS 27, while the then effective Companies Ordinance included an exemption from consolidation for wholly owned subsidiaries. However, the matter has become more pressing under the NCO, given the explicit requirement in s380(4) to comply with accounting standards in the preparation of financial statements, as well as to comply with the NCO itself. In this regard, sections 379 and 380 of the NCO come into operation for the first financial year beginning on or after 3 March 2014. We expect that the first companies to be affected will be those with a 31 March year end, for the year ending 31 March 2015.

(b) Request to broaden the discussion of paragraph 4(a)(iv) of IFRS 10 to consider whether paragraph 4(a)(iv) should be deleted

For the reasons explained above, we acknowledge that it is extremely timely for us that the IASB is focusing on the role and purpose of condition (iv). In fact, we had already reached the conclusion that we needed to bring this matter to the IASB's attention, before we noted that the IFRS Interpretations Committee had a related topic on their agenda discussions. However, we also believe, for the reasons explained below, that this is not a concern caused by unusual circumstances in Hong Kong. It is instead, we believe, a concern caused by condition (iv) being inconsistent with the purpose of general purpose financial statements as set out in paragraph OB2 of the Conceptual Framework and lacking a basis in principle.

We are therefore seeking a broader discussion concerning the future of paragraph 4(a)(iv) of IFRS 10 than simply how it may adversely affect IHCs which are subsidiaries of investment entities.

We note that paragraph OB2 of the Conceptual Framework states that (emphasis added):

"The objective of general purpose financial reporting is to provide financial information <u>about the reporting entity</u> that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity."

In this particular case, the reporting entity in question is the IHC and the issue is whether the IHC should provide company-level or consolidated financial information about its financial performance and financial position to its users. Therefore the test for any conditions set in this regard must surely be whether the resulting information from passing or failing those tests is useful to those users to help them understand more about the IHC's financial performance and financial position.

As discussed above, we consider that conditions (i) to (iii) are appropriate conditions consistent with the above objective, as they focus on meeting the needs of the owners of the IHC and other public interest stakeholders who would have access to the IHC's financial statements.

However, as also discussed above, we cannot reach the same conclusion concerning condition (iv). That is, we cannot see the relevance of the type or availability of financial statements prepared by the ultimate parent to the question of the usefulness of company level information prepared by the IHC. In many cases, specific financial information relating to the IHC or its subsidiaries will not be identifiable from the consolidated financial statements of the ultimate parent as the IHC will just be one of many sub-groups within the larger group, and in all cases any intra group transactions involving the IHC or its subsidiaries and the larger group will be eliminated in those ultimate parent financial statements. This lack of information pertaining to the IHC sub-group will typically be the case irrespective of whether or not the ultimate parent follows IFRS or some other GAAP.

In short, there appears to be no underlying principle in condition (iv) which serves to indicate that IHC's company-level financial statements are sufficient for IHC's users when all three tests in condition (iv) are passed but are deficient for those same users when one or more of the three tests in condition (iv) is failed.

For this reason, we request that the IASB broaden their consideration of this issue to consider whether condition (iv) should be deleted entirely in order to eliminate a cost burden on IHCs (many of which are wholly-owned subsidiaries) which serves no useful purpose.

We also request that, if the IASB decide to retain condition (iv) in whole or in part, that the IASB articulate the underlying principle to each one of the three tests in this condition that is retained and its intended objective, over and above the protection for users of IHC's financial statements that would already be achieved through compliance with the conditions set out in conditions (i) to (iii). This will enable us, and any other jurisdictions facing the same issues relating to the impact on private companies, to better consider whether this objective is relevant for private companies incorporated in the respective jurisdictions.

~ End ~