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

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

31 December 2015

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

Dear Hans,

IASB Request for Views *2015 Agenda Consultation*

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Request for Views.

We welcome the IASB agenda consultation and believe that such consultation would help the IASB identify the needs of the IFRS users and strengthen the transparency of the IASB's agenda setting process.

In terms of the current workplan, we believe that the IASB's main priority is to issue the upcoming standard on Leases and complete the Insurance Contracts project after undertaking comprehensive effects analysis. The two cross-cutting projects, Conceptual Framework and Disclosure Initiative, should also be the IASB's high priorities as they are fundamental to the preparation of financial statements.

As for the IASB's research activities, we consider that the IASB should prioritise the following projects as they are either highly integral to the Conceptual Framework or the Disclosure Initiative, or they require urgent and fundamental review of the relevant standards:

- Financial instruments with characteristics of equity;
- Equity method;
- Disclosure initiative – Principle of disclosure; and
- Primary Financial Statements.

Other research projects that should be the IASB's high priority, after taking into account the urgency and importance of the issues involved, include:

- Goodwill and impairment;
- Business combinations under common control;
- Definition of a business; and
- Provisions, contingent liabilities and contingent assets.

Our response to the questions raised in this Request for Views are explained in more detail in the Appendix.

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Finally, we would like the IASB to consider a short-term project that assesses the usefulness of the exemption criteria for preparing consolidated financial statements under IFRS 10 *Consolidated Financial Statements.* We believe that the condition set out in paragraph 4(a)(iv) of IFRS 10 appears to have no clear rationale and is inconsistent with the thinking reflected in paragraph 3.24 of the IASB's Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* in relation to the boundary of a reporting entity. We consider that such inconsistency and the lack of clear principle for consolidation exemption could hinder the use of IFRS in jurisdictions where IFRS is not mandatory to be used for preparing statutory financial statements. We, therefore, request that the IASB adds this project to its workplan and, considers whether the condition in paragraph 4(a)(iv) of IFRS 10 should be deleted entirely.

If you have any questions regarding the matters raised in this letter, please contact me or Eky Liu, Associate Director of the Standard Setting Department (eky@hkicpa.org.hk).

Yours sincerely,

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Christina Ng
Head of Financial Reporting

CN/EL

Encl

Detailed comments on IASB Request for Views *2015 Agenda Consultation*

<u>Question 1</u>

The IASB's work plan includes five main areas of technical projects:

(a) its research programme;
(b) its Standards-level programme;
(c) the Conceptual Framework;
(d) the Disclosure Initiative; and
(e) maintenance and implementation projects.

What factors should the IASB consider in deciding how much of its resources should be allocated to each area listed above?

We consider that the factors set out in paragraph 55 of the Request for Views are appropriate for the IASB to consider when prioritising individual projects on its work plan and allocating resources to the projects. Having said that, we suggest that the IASB clearly communicates how it assesses and weighs those factors when prioritising the projects.

<u>Question 2</u>

The IASB's research programme is laid out in paragraph 32 and a further potential research topic on IFRS 5 is noted in paragraph 33.

Should the IASB:

(a) Add any further projects to its research programme? Which projects, and why? Please also explain which current research projects should be given a lower priority to create the capacity for the IASB to make progress on the project(s) that you suggested adding.
(b) Remove from its research programme the projects on foreign currency translation (see paragraphs 39 – 41) and high inflation (see paragraphs 42 – 43)? Why or why not?
(c) Remove any other projects from its research programme?

<u>New research projects</u>
We do not have any new projects that we would like to add to the IASB's research programme.

<u>Removal of inactive research projects</u>
We do not object to removing the projects on foreign currency translation and high inflation from the research programme as these two projects are not pervasive in our jurisdiction at the moment.

For the same reason, we do not object to removing the project on extractive activities/intangible assets/research and development from the research programme. We think that the IASB should be cautious in undertaking projects that mainly focus on a specific industry especially in light of its resource constraints. In view of this, we recommend the IASB focuses on completing the Conceptual Framework and if necessary, revisits the principles of relevant standards, e.g. IAS 38 *Intangible Assets* to ensure that the principles of the standard are clear and there is sufficient application guidance to supplement those principles.

Question 3

For each project on the research programme, including any new projects suggested by you in response to Question 2, please indicate its relative importance (high/medium/low) and urgency (high/medium/low).

Please also describe the factors that led you to assign those rankings, particularly for those items you ranked as high or low.

The table below summarises our proposed prioritisation of research projects based on the relative importance and urgency.

Urgency / Importance	High	Medium	Low
High	• Financial Instruments with Characteristics of Equity • Equity method • Disclosure Initiative – Principles of Disclosure • Primary Financial Statements	• Goodwill and Impairment • Business Combinations under Common Control • Definition of a Business • Provisions, Contingent Liabilities and Contingent Assets	
Medium		• Share-based Payment	• Discount Rates • Income Taxes
Low			• Pollutant Pricing Mechanisms • Post-employment Benefits • Dynamic Risk Management
Projects that we support removing from the research programme for the time being: • Foreign Currency Translation • High Inflation • Extractive Activities/Intangible Assets/Research and Development			

Projects of high importance and high urgency

Projects that are high-importance-high-urgency are either fundamental to the preparation of financial statements or in need of an urgent and fundamental review of existing standards. We consider that resources should be prioritised for these projects first. Our reasons are outlined below.

- Financial instruments with characteristics of equity

  This project is highly integral to the Conceptual Framework project in relation to the notion of liability versus equity. The project should not just focus on the current application issues of IAS 32 *Financial Instruments: Presentation*. Instead, the IASB should do a fundamental review of the concepts (or requirements) underpinning the standard.

Because we see this project as an extension of the Conceptual Framework project, it would make sense that the IASB expedites this project following the completion of its Conceptual Framework project.

In particular, we would like to draw the IASB's attention to the following two issues under IAS 32:

1. Economic compulsion: The application of the principles and rules in IAS 32 sometimes results in an inconsistent distinction between equity instruments and non-equity instruments. The emphasis on the existence of a contractual obligation to deliver cash or other financial assets, while ignoring economic compulsion, may lead to instruments with economic characteristics of liabilities being classified as equity.
2. 'Fixed for fixed' rule: The current 'fixed for fixed' rule in IAS 32.16(b)(ii) in some situations does not result in a faithful representation of the economic characteristics of equity-linked instruments. One typical example is where the conversion option of a convertible bond denominated in a foreign currency is required to be classified as a derivative liability, even though the vast majority of the fair value movement on remeasurement may be attributable to movements in the underlying equity price.

- Equity method

There have long been conceptual issues and practical difficulties in applying the equity method to account for investments in associates and this has increased with recent piecemeal amendments which lacked a consistent conceptual basis. Concerns have been raised about the complexity of the equity method in terms of the use of many relevant consolidation procedures and impairment testing. The level of information required to apply the equity method also poses practical difficulties to apply the method properly. This is particularly the case when one listed entity is an investor in another listed entity and there may be restrictions over the amount and timing of release of price sensitive information.

In addition, we note a growing number of preference shares with various features (ordinarily accounted for under IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement* by the issuer as liabilities) that provide the investors with certain rights that could result in the investor having significant influence over the investee. This further undermines any conceptual basis for a requirement to use the equity method whenever there is significant influence present, irrespective of the level of equity interest.

We understand that the IASB is undertaking, in the short term, a narrow-scope project to simplify the equity method and address the implementation issues identified by the Interpretations Committee and, in the longer term, a more fundamental assessment of the objective and principles of the equity method.

While we initially agreed with the approach taken by the IASB, we now believe that there is an urgency for a fundamental review of the objective of the equity method (the 'why') before the IASB undertakes any more narrow-scope or temporary improvements to the 'how' of the equity method. That is, the focus should as a matter of urgency be on whether the equity method serves any useful purpose in the sense of providing faithful and decision-useful information at a reasonable cost and if so, whether this useful purpose is only apparent in situations of joint control, rather than significant influence. Related to this fundamental question is the question of what the equity method is trying to portray: is it a form of one-line consolidation (as appears to be its original intent, as articulated in paragraph 26 of IAS 28 *Investments in Associates and Joint Ventures*) or is it a way to measure the carrying value of an investment which falls outside the scope of IAS 39 (as implied in paragraphs BCZ45-46 of IAS 28)? Until the IASB has articulated the need for or the objective of the equity method, we are concerned that any amendments to the method might further complicate the accounting without any comparable benefit or conceptual basis. We, therefore, think that the IASB should place a high priority on the fundamental review of the objective of the equity method of accounting.

- 'Disclosure initiative – Principles of disclosure' and 'Primary financial statements'

  We can foresee the significant beneficial outcomes of the IASB's Disclosure Initiative project, including the Primary Financial Statements project. We think that these projects will contribute to a widespread improvement in reporting quality globally. Therefore, these projects should be prioritised.

<u>Projects of high importance and medium urgency</u>

We consider that the following projects are of high importance but less urgent than the projects mentioned directly above if the availability of resources is an issue.

- Goodwill and impairment

  Despite changing the accounting for goodwill (particularly from amortisation to impairment-only model) for conceptual reasons just 10 years ago, we believe that there is enough issues in practice that warrant the IASB's attention to revisit the accounting for goodwill.

  Conceptually, we consider that the current approach fails to address the fact that, over time, purchased goodwill in most cases is inevitably replaced by goodwill that is generated internally. We also note the practical difficulties and challenges in the existing requirements of goodwill accounting, including the application of IAS 36 *Impairment of Assets* for goodwill, the tension on the identification and valuation of intangible assets from goodwill during business combinations and the arbitrary allocation of goodwill to cash-generating units, especially when a group re-organizes or makes partial disposals many years after the original acquisition. These issues are explained in more detail in our submission on the IASB's *Post-Implementation Review: IFRS 3 Business Combinations*[1].

  Goodwill and impairment accounting affects a wide range of entities and users of financial reports globally. We also consider it inevitable that, the longer the non-

[1] The Institute's submission on the IASB's *Post-Implementation Review: IFRS 3 Business Combinations* is available at http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/submission-pdf/2014/sub_ifrs3.pdf.

amortisation model remains in place, the more apparent it will become that the model is flawed, as any connection between the unamortized purchased goodwill and the performance of the business will become increasingly detached and arbitrary. Accordingly, we think that this project is of high importance.

We believe that the IASB could potentially speed up the progress of this project as it has received feedback on the accounting for goodwill and impairment from its post-implementation review of IFRS 3. In addition, we understand that European Financial Reporting Advisory Group (EFRAG), and the standard setters of Italy and Japan have conducted a joint research on goodwill accounting in 2014[2]. We think that the findings of such research may have some merit for the IASB's consideration.

- Business combinations under common control

  Business combinations under common control are a regular occurrence in Hong Kong and around the region. Currently, such transactions are excluded from the scope of IFRS 3 *Business Combinations* and other IFRS standards do not address the issue explicitly. Because of the frequency of such transactions in Hong Kong, the Institute developed Accounting Guideline 5 *Merger Accounting for Common Control Combinations* that gives guidance on how to apply the merger accounting concept for recognising a common control combination. We note that the International Organisation of Securities Commissions has identified divergent accounting treatments relating to common control transactions. We believe that good standard-setting entails providing the appropriate requirements or guidance for the accounting of a common issue such as this. Our view expressed above is consistent with our submission on the IASB's Request for Views *Agenda Consultation 2011*[3].

  We understand that some jurisdictions in the Asian-Oceanian region also share the same concern and consider that this research project should be a high priority.

  In light of the above, we believe that development of a global standard which sets out the principles for accounting for business combinations under common control is needed in view of the widespread impact to users of financial reports globally.

- Definition of a business

  Due to the different accounting consequences under IFRS for the acquisition of a 'business' as opposed to a group of assets, the definition of a 'business' is an important gating concept which comes under pressure from preparers. However, there is only limited guidance about the definition of a business in IFRS 3 which may lead to diversity in practice.

[2] The joint research on goodwill accounting conducted by EFRAG, and the standard setters of Italy and Japan can be accessed at http://www.efrag.org/Front/n1-1440/EFRAG--the-OIC-and-the-ASBJ-have-published-a-feedback-statement-that-summarises-the-responses-received-on-the-Discussion-Paper--Should-Goodwill-Still-Not-Be-Amortised----Accounting-and-Disclosure-for-Goodwill.aspx

[3] The Institute's submission on the IASB's Request for Views *Agenda Consultation 2011* is available at http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/submission-pdf/2011/agenda%20cons.pdf

We note that the IASB collected feedback on this issue from the post-implementation review of IFRS 3 and is considering whether to address this issue by clarifying the existing definition of a business or by eliminating the differences between the two accounting treatments. We, therefore, believe that the IASB should continue with the project as a matter of priority, in order to reduce diversity in practice.

- Provisions, contingent liabilities and contingent assets

  In our submission on the IASB's Exposure Draft ED/2015/3 *Conceptual Framework for Financial Report*[4], we highlighted an issue on the inconsistency in the notion of liabilities between IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and ED/2015/3. To prevent any diversity in practice in applying the liability notion, we think that the IASB should address the inconsistency as a high priority.

  Having said that, we think that IAS 37 is still largely operational and therefore, in terms of urgency, this project is classified as medium urgency while it is of high importance.

Projects of medium priority

We are aware that there are certain application issues with the relevant standards associated with the Share-based Payment, Discount Rates, and Income Taxes projects.

We think that if the IASB were to undertake research on these topics, the research should be a comprehensive review of the existing requirements, and therefore will require a significant level of resources. Furthermore, we think that the existing standards associated with these projects are still largely operational, and therefore, these projects are not as important nor urgent as those that we classify as high priority.

Projects of low priority

In Hong Kong, we have not had any major implementation issues on the relevant standards, or major need for the projects, outlined below.

- Pollutant pricing mechanisms
- Post-employment benefits
- Dynamic risk management

Having said that, we understand that some of these projects are pervasive in a few jurisdictions. We, therefore, think that the IASB and the national standard-setters (NSSs) of these jurisdictions should work together in dealing with these projects. The IASB could potentially request the help of these NSSs to undertake a significant aspect of the research first before deciding what, and how much, resources the IASB needs on these projects.

[4]The Institute's submission on the IASB's Exposure Draft *Conceptual Framework for Financial Reporting* is available at
http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/submission-pdf/2015/sub_1503.pdf.

Question 4

Do you have any comments on the IASB's current work plan for major projects?

We welcome the expected issuance of the upcoming standards on Leases and Insurance Contracts and support the IASB's decision to devote time and resources to these projects. We also support the IASB's decision to focus on making progress on the Conceptual Framework and Disclosure Initiative projects.

The IASB should be prepared for the high possibility of having to provide resources to attend to questions about, or requests to clarify, the standards during the implementation period of the major standards, including IFRS 9 *Financial Instruments,* IFRS 15 *Revenue from Contracts with Customers* and the upcoming standards on Leases and Insurance Contracts.

Question 5

Are the IASB and the Interpretations Committee providing the right mix of implementation support to meet stakeholders' needs and is that support sufficient (see paragraphs 19-23 and 50-53)?

We are concerned about the IASB's current approach in issuing major standards and subsequently tinkering with them by issuing narrow-scope amendments immediately after the major standards are issued. For example, subsequent amendments were made to IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 15 *Revenue from Contracts with Customers* immediately after the standards were issued. This may create an impression that there are shortcomings with the IASB's standard-setting process, for example, a lack of sufficient effects analysis. Furthermore, multiple versions of a standard immediately after it is first issued may confuse the users of IFRS.

We are aware that the IASB's due process already includes a formal consultation period, and for more complex projects, further consultation with targeted preparers, practitioners, financial statement users and NSSs prior to issuing new standards. We are also aware that the issuance of new standards is subject to the Due Process Oversight Committee's requirements. But the IASB could consider conducting further extended consultation with targeted stakeholders or provide more time for preparers and practitioners to make fatal flaw comments at the final stage in drafting the standards. We understand the possible negative implications in providing more time for consultation as it may result in delay in issuing standards, but we would prefer waiting for a higher quality standard to be issued, than to have to contend with a flawed standard followed by amendments. We also believe that many of our constituents would share this view.

In terms of the activities to support the consistency of application and implementation of IFRS, we found the transition resource groups (TRG) to be helpful in supporting preparers and practitioners in understanding the new standards. The TRG process also provides a public platform for stakeholders to discuss and exchange views on potential implementation issues of the new standards, which is educational for constituents. However, we believe that a TRG would be even more useful if it were set up earlier as part of the standard's due process stages so that the TRG could help perform fatal flaw review of the near-final draft standard, and any implementation issues raised by the TRG could be dealt with by the IASB before the issuance of the standard. This may in turn reduce the problem of having subsequent narrow-scope amendments.

There should also be a mechanism for regular consultation between the IASB or the Interpretations Committee and the NSSs and regulators for reporting IFRS implementation/application issues in practice. For example, the IASB could make use of the International Forum of Accounting Standard Setters meeting as a platform by requesting NSSs to report on any issues in practice. The IASB and NSSs could also develop a documented and agreed process for reporting IFRS implementation issues in practice on an ongoing basis.

In terms of education initiative, we are cautious about having educational materials which go beyond the IASB published material as we are concerned that readers may assume that the educational materials are authoritative and have been through the IASB's formal due process. We believe that the current approach of incorporating application guidance and illustrative examples in the standards is the most useful and appropriate way to support the consistency of application and implementation of IFRS. However, we support the issuance of educational materials which seek to introduce and explain the text of the material issued by the IASB. Although such educational material may not be providing new guidance, it is useful to have slide decks and speaker notes based on the IASB issued text available off-the-shelf as this saves re-inventing the wheel and promotes consistency in understanding.

Question 6

Does the IASB's work plan as a whole deliver change at the right pace and at a level of detail that is appropriate to principle-based standard-setting? Why or why not?

We think that the major projects are delivered at the right pace; however, as mentioned in our response to question 5, there have been too many narrow-scope amendments to standards immediately after issuance.

We are satisfied with the level of detail for principle-based standard-setting but would urge the IASB to use simpler and more direct / straightforward English language in the standards and to provide robust application guidance to supplement the principle of the standards. Application guidance should include fact patterns that are both simple and more complex to cater for developing, emerging and developed economies.

Question 7

Do you have any other comments on the IASB's work plan?

We would like the IASB to consider a short-term project that assesses the usefulness of the exemption criteria for preparing consolidated financial statements under IFRS 10. We think that this project could be added to the IASB's maintenance and implementation programme but understand if further research may be necessary to consider this request. That said, we think that any necessary research would not require significant resources.

The Institute submitted a letter[5] to the IASB in 2014 regarding the proposal above to delete paragraph 4(a)(iv) of IFRS 10. This paragraph sets out one of the conditions for when a parent entity is not required to present consolidated financial statements:

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

As stated in our letter, there appears to be no clear rationale for the above condition.

We believe that the test for any conditions set must be whether the resulting information from passing or failing those tests is useful to those users to help them understand the financial performance and financial position of the reporting entity (here: an intermediate holding company (IHC)). However, concerning paragraph 4(a)(iv) of IFRS 10, 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. We also note that our view appears consistent with the thinking reflected in paragraph 3.24 of the IASB's Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting,* which states that 'consolidated financial statements of the parent are not intended to provide information to users of a subsidiary's financial statements'. Our views on this issue are explained in more detail in our letter to the IASB in response to ED/2015/3.

We believe that the above inconsistency and lack of clear principle for this part of the consolidation exemption could hinder the use of IFRS in jurisdictions where IFRS is not mandatory to be used for preparing statutory financial statements. Therefore, we request that the IASB adds this project to its maintenance and implementation programme and, consider whether paragraph 4(a)(iv) of IFRS 10 should be deleted entirely.

<u>Question 8</u>

Because of the time needed to complete individual major projects, the IASB proposes that a five year interval between Agenda Consultations is more appropriate than the three year interval currently required. Do you agree? Why or Why not?

If not, what interval do you suggest? Why?

We agree with the IASB's proposal to extend the current three-year consultation cycle to five years. We believe that the proposed five year interval between agenda consultations is an appropriate timeframe to take stock on the IASB's workplan when major projects usually take more than three years to complete.

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[5] The Institute's letter to the IASB regarding the proposal to delete paragraph 4(a)(iv) of IFRS 10 is available at http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/submission-pdf/2014/sub_ifrs10.pdf.

However, if the IASB were to proceed with a five-year consultation cycle, we suggest that the IASB reports back on the progress of its projects on an annual basis, and considers an interim consultation that is of a smaller scale, when necessary, for example, when there is a change in economic environment that warrants a change in direction of its projects or that leads to an emerging issue.

~ End ~