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

Our Ref.: C/FRSC

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

17 January 2008

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

Dear Sirs,

IASB Exposure Draft of proposed Improvements to International Financial Reporting Standards

The Hong Kong Institute of CPAs 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 Exposure Draft. We have not specifically responded to those questions where we agree with the proposed amendments.

In principle, we support the IASB's objectives in the Improvements project to streamline the process for dealing effectively with a collection of miscellaneous, non-urgent but necessary minor amendments. However, we find that, in some cases, the proposed changes to existing Standards in the exposure draft are more than "minor amendments" to be made within the scope of the Improvements project. This is particularly so where unanimous agreement cannot be reached by IASB members. We believe that, in these circumstances, the proposed amendments should be withdrawn and be dealt with as separate projects under the normal due process. Those proposed amendments that are outside the scope of an annual improvements project are identified in the Appendix to this letter.

If you have any questions on our comments, please do not hesitate to contact me at patricia@hkicpa.org.hk.

Yours sincerely,

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PM/WC/ac

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APPENDIX

Hong Kong Institute of CPAs

Comments on the IASB Exposure Draft
Proposed Improvements to International Financial Reporting Standards

IAS 1 – Statement of compliance with IFRSs

Question 4: Do you agree with the proposal to require an entity that cannot make an unreserved statement of compliance with IFRSs to describe how its financial statements would have been different if prepared in full compliance with IFRSs? If not, why?

In principle, we support the objective of the IASB to introduce measures to help financial statement users to identify the differences between a financial reporting framework based on some IFRSs and one that applies the complete set of current IFRSs. However, we consider that the annual improvements process is not an appropriate vehicle for addressing this issue. We believe that it is more a regulatory issue rather than a standard setting issue, especially given the dissent within the Board.

The proposal is presumably aimed at those countries where the national framework is an IFRS variant. We believe that the proposed amendment may not achieve its objective since the IASB does not have jurisdiction over those countries and their process of setting financial reporting standards, including adopting IFRSs. A national variant could simply avoid the disclosure of the departures by not requiring compliance with proposed IAS 1.16A . We agree with the dissenting views of Mr. Leisenring and Mr. McGregor that it is hard to believe that entities that have failed to comply with other IFRS requirements will comply with this proposed requirement.

We think that a better way for the IASB to achieve this objective is to work closely with national standard setters and encourage the inclusion of the proposed requirement in the national framework. We believe that this will be more effective than just expecting individual entities to comply with the proposed requirement.

IAS 1 – Current/non-current classification of convertible instruments

Question 5: Do you agree with the proposal to clarify that the potential settlement of a liability by the issue of equity is not relevant to its classification as current? If not, why?

Yes, we agree that in general the potential settlement of a liability by the issue of equity is not relevant to its classification as current. However, where an obligation is settled by the issue of a variable number of shares, according to paragraph 21 of IAS 32 *Financial Instruments: Presentation* the obligation is a financial liability and the classification as current or non-current should depend on the due date for settlement.

IAS 10 – Dividends declared after the end of the reporting period

Question 8: Do you agree with the proposal to amend paragraph 13 of IAS 10 to clarify why a dividend declared after the reporting period does not result in the recognition of a liability at the end of the reporting period? If not, why?

Yes, we agree with the proposal. However, we recommend that the IASB include the technical reference to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in the Basis for Conclusions as useful background information.

IAS 17 – Classification of leases on land and building

Question 11: Do you agree with the proposal to amend paragraphs 14 and 15 of IAS 17 to eliminate a perceived inconsistency between the specific classification guidance for leases of land and buildings and the general lease classification guidance in IAS 17? If not, why?

Yes, we agree with the proposal. We agree that the substance of the transaction should determine the lease classification of land and buildings. In a long-term lease of land, the significant risks and rewards of ownership are in substance transferred to the lessee. However, we also recognise that the change from a rule to a principles-based standard may bring uncertainty to the preparers of financial statements. We recommend the development of implementation guidance or discussion in the Basis for Conclusions which leads users of the standards through the decision process involved in classifying a long-term land lease (such as a 50-year lease or a 999-year lease) as a finance lease or an operating lease.

We further note that the proposed amendments could lead to a reclassification of existing operating leases as finance leases. Under IAS 17.13, lease classification is made at the inception of the lease and reclassification of lease is not allowed other than due to the change in the provisions of the lease. Since there is a change in rule in the proposed amendments, we recommend that the IASB clarify whether the change in the standard over-rides IAS 17.13 or whether retrospective application under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is required.

IAS 19 – Replacement of the term falling due

Question 16: Do you agree with the proposal to replace in IAS 19 the term 'fall due' with the notion of employee entitlement in the definitions of short-term employee benefits and other long-term employee benefits? If not, why?

We agree with the IASB's objective of clarifying this matter. We are however of the view that the proposed amendment does not achieve this objective. We do not agree with the proposal to replace the term "fall due" with the term "to which the employee becomes entitled". The classification between "short term" and "long term" is for the purpose of determining the measurement basis. Long-term employee benefits are accounted for at the present value of the obligation while short-term employee benefits are calculated without discounting. We are concerned that the change in classification based on entitlement could have a significant impact on current practice. For example, an employee may be entitled to vested sick leave within 12 months, but it may not be settled until an employee leaves the company. Under the proposed amendment, such compensated absences would be classified as short term and would not be discounted, even though the cash outflows is not expected within 12 months.

If the IASB wants to pursue this amendment, we recommend that it be included in a full revision of IAS 19.

IAS 20 – Government Loans with a below-market rate of interest

Question 19: Do you agree with the proposed amendments to IAS 20 to clarify that the benefit of a loan received from a government with a below-market rate of interest should be quantified by the imputation of interest in accordance with IAS 39? If not, why?

We do not agree with the proposed amendment as we consider it is fundamentally inconsistent with the approach taken in IAS 20. Specifically the proposal is inconsistent with IAS 20.23 which does not require an entity to fair value non-monetary grants received. In addition, it is also inconsistent within IAS 20 if the proposed amendments only apply to "forgivable loans", since these are, in substance, the same as government grants which become repayable if certain conditions are not met.

We consider the nature of loans granted by governments is generally not equivalent to those issued in private markets. The purpose of these loans is generally to assist those who often would not be able to obtain funding in the market or if they did obtain it, it would be at punitive interest rates, given the nature of the activities of the enterprise e.g. a charity, a start-up industry or business in an unattractive location. Hence, it seems contrary to the nature of such loans to impose the fair value principles of IAS 39 and impracticable or misleading to attempt to estimate what the market interest rate for such loan would be.

Further, we note that IAS 20 is an old standard and needs extensive revision to align it with other standards and the Framework. We believe that the proposal should therefore be removed from this project and dealt with as part of the planned revisions to IAS 20.

IAS 28 – Impairment of investment in associate

Question 23: Do you agree with the proposal to amend paragraph 33 of IAS 28 to clarify the circumstances in which an impairment charge against an investment in an associate should be reversed? If not, why?

While we agree that this is an area of IAS 28 that needs clarification, we do not agree with the proposal not to allocate any additional impairment losses to the goodwill included in the investment in the associate. We agree with the dissenting view of an IASB member and believe that if an associate has applied IAS 36 *Impairment of Assets* properly to its own assets and liabilities, any further impairment loss recognised by an investor should, by definition, relate to the goodwill that arose on acquisition by an investor of the associate. Therefore, according to the principle in IAS 36.124, such impairment losses should not later be reversed.

We believe that the matter of the allocation of impairment losses under investments in associates would be such a difficult area that it should not be as part of the annual improvements project, especially given the dissenting view, and should be the subject of a more extensive due process.

IAS 38 – Advertising and promotional activities

Question 28(a): Do you agree that IAS 38 should emphasise that an entity should recognise expenditure on an intangible item as an expense when it has access to the goods or has received the services? If not, why?

Question 28(b): Do you agree that paragraph 70 of IAS 38 should be amended to allow an entity to recognise a prepayment only until it has access to the related goods or has received the related services? If not, why?

We do not agree with this proposal and doubt the appropriateness of using "access to goods" as a determining point for expensing the cost. For example, it is unclear in the proposed amendments as to why an entity can recognise a prepayment for the production of catalogues by a third party, but appears to need to expense those costs when the catalogue is delivered to the company i.e. when the company has "access to" the catalogues. We believe there is little difference in substance between such events, and recommend that the standard clarify that catalogues may be classified as an asset such as inventory. Without such clarification, we are concerned that this rule may encourage entities to structure transactions so as to fit their accounting "needs".

We consider that, although the proposed amendments specifically address advertising and promotional expenses, they will be interpreted more broadly and, as a result, have a wider implication than those expected from an annual improvement. We believe that the issue of when it is appropriate to recognise expenditure on advertising and promotional activities as an asset or an expense would better be addressed as a separate project, especially given the dissenting view of an IASB member that IAS 38 is not relevant for determining whether goods acquired by an entity should be recognised as an asset.

Question 29: Do you agree with the proposal to remove the last sentence of paragraph 98 of IAS 38 regarding the amortisation method used for intangible assets? If not, why?

We support the proposed amendment to paragraph 98, but consider that further clarification is required to avoid inconsistency with other Standards.

We wrote to the Board on 23 May 2005 regarding an inconsistency between IAS 17 *Leases* and IAS 38 *Intangible Assets* concerning the useful life of an asset where the legal rights are conveyed for a limited period of time. We noted that IAS 38.94 requires the renewal period to be included in the determination of the useful life of the intangible asset if there is evidence to support renewal by the entity without significant cost. In contrast, in IAS 17, options for extending the lease term that are not at the discretion of the lessee are not taken into account by the lessee in determining the lease term. Given there is little conceptual difference between the legal term of an intangible asset and the legal term in a lease contract, length of useful life will differ when IAS 38 rather than IAS 17 is applied. We consider the proposed amendments have not addressed this difficulty and therefore we recommend that the IASB consider addressing this issue as well.

IAS 39 – Definition of a derivative

Question 30: Do you agree with the proposal to amend IAS 39 by removing from the definition of a derivative the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract? If not, why?

We do not agree with the proposed amendments and believe that the changes are not "minor" and are significant enough to be a separate project. We consider the changed definition of a derivative may inappropriately bring a wide range of contracts within the definition of a derivative, such as loans with repayment or interest schedules that are linked to earnings performance of the borrower e.g. property development loans where the repayment was contractually dependent on the sales performance of a specific property development. On the basis of IAS 39.AG12A, it is clear that in such cases the loans are not derivatives as the lender is bearing its own business risk other than simply the credit risk. However, the proposed amendment could "capture" the loan within the scope of a derivative. Under the proposed amendments, an embedded derivative might have to be identified and all of its valuation fluctuations might have to be recognised through the income statement of the lender even though the property developer themselves could not recognise any profits on the development until the properties are both completed and sold.

IAS 40 – Property under construction or development for future use as investment property

Question 35: The exposure draft proposes to include property under construction or development for future use as an investment property within the scope of IAS 40. Do you agree with the proposal? If not, why?

Yes, we agree with the proposal to include investment property under construction or development for future use as an investment property within the scope of IAS 40. We agree that this better aligns the accounting for such development properties with the accounting for the redevelopment of an existing investment property.

However, we are concerned that a fair value of an investment property under construction may not be able to be reliably determined during the construction period in some cases. For entities applying the fair value model for investment property, this would then prevent an investment property under construction being measured at fair value when completed and brought into use. We therefore suggest that the IASB considers granting an exemption to investment property during the construction period from complying with IAS 40.53 and allow an entity to revert to the fair value model as soon as construction of the investment property is completed.