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 October 2008

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

Dear Sirs,

IASB Discussion Paper on *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

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 Discussion Paper. Our responses to the questions raised in your Discussion Papers are set out in the Appendix for your consideration.

We are generally supportive of the proposals make in the Discussion Paper. In particular, we agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities. The Conceptual Framework should provide a broad description of what constitutes a reporting entity rather than a precise definition, so as to maintain the ability to apply judgement. Furthermore we agree that a broad definition of what constitutes control is appropriate at the Conceptual Framework level. We agree that the definition of control should refer to both power and benefits and that control is the appropriate basis for determining the composition of the group reporting entity.

However, we are concerned that consolidated financial statements are presented from the perspective of the group reporting entity and not from the perspective of the parent company's stakeholders. We believe that information regarding an entity's performance is most relevant if it provides that information from the perspective of the parent company's stakeholders. Presenting information from the economic entity perspective does not provide decision-useful information to either shareholders of the parent, or of shareholders of subsidiaries (minority interests), as the performance of the entity of most relevance to them is combined with those of other parts of the reporting in which they have no interest. Treating purchases of additional interests from minority interests as transactions with third parties does, on the other hand, provide decision-useful information, as it enables capital providers to determine whether the acquisition (or disposal) is a sound business decision, while not diminishing decision-usefulness from the perspective of the minority interest (non-controlling interest).

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

Yours faithfully,

Steve Ong, FCA, FCPA
Deputy Director, Standard Setting Department

SO/WC/ac

Encl.

Hong Kong Institute of CPAs

Section 1: The reporting entity concept

Q1. Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

We agree with the preliminary view that what constitutes a reporting entity should not be limited to those business activities that are structured as legal entities. Concepts should be built around the reporting entity such as to reflect the economic phenomena rather than rely on the legal structure of business entities, building around the theory of "substance over legal form".

Q2. Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders, and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders, and other capital providers in the description (or definition) of a reporting entity? If so, why?

We agree that the conceptual framework should broadly describe a reporting entity as circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers. We support the inclusion of a broad description of a reporting entity, rather than a precise definition, so as to maintain the ability of individuals to apply judgement, while providing sufficient parameters to support consistency in the application of that judgement.

A precise definition would limit the exercise of professional judgement and potentially limit the issuance of decision-useful information to interested parties.

However, if the term "business activity" is to be used, we believe the IASB should clarify whether business activity is intended to mean the definition of a business as defined in IFRS 3 *Business Combinations*. This needs further clarification as it is uncertain whether a reporting entity is required to have economically integrated operations as in IFRS 3 and whether the term "business activity" would preclude at least some special purpose entities.

Section 2: Group reporting entity

Q3. Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?

We agree that the risks and rewards model is insufficient as a conceptually robust basis for determining the composition of a group reporting entity. Risks and rewards, however, is an important aspect of all the facts and circumstances that need to be considered in determining whether control exists. We note that the Discussion Paper already addresses this in paragraphs 102 and 103.

Q4. Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:
(a) control should be defined at the conceptual level?
(b) the definition of control should refer to both power and benefits?
If not, why? For example, do you have an alternative proposed definition of control?

We agree that a broad definition of what constitutes control is appropriate at the Conceptual Framework level. However, specific guidance regarding circumstances in which control exists should be addressed at the standards level. We agree that the definition of control should refer to both power and benefits.

Q5. Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

We agree that control is the appropriate basis for determining the composition of a group reporting entity.

Q6. Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity? If not, why?

We agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity.

Q7. Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.

We agree that common control model is appropriate for use in some limited circumstances.

Section 3: Parent entity financial reporting

Q8. Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

We believe that information regarding an entity's performance is most relevant if it provides that information from the perspective of the parent company's stakeholders. Presenting information from the economic entity perspective does not provide decision-useful information to either shareholders of the parent, or of shareholders of subsidiaries (minority interests), as the performance of the entity of most relevance to them is combined with those of other parts of the reporting in which they have no interest. Treating purchases of additional interests from minority interests as transactions with third parties does, on the other hand, provide decision-useful information, as it enables capital providers to determine whether the acquisition (or disposal) is a sound business decision, while not diminishing decision-usefulness from the perspective of the minority interest (non-controlling interest).

Q9. Do you agree that consolidated financial statements provide useful information to equity investors, lenders, and other capital providers? If not, why?

We agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers.

Q10. Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

We agree with the IASB's view that the Conceptual Framework should not preclude entities that wish to present parent-only financial statements. Parent-only financial statements serve a different purpose and have its usefulness for users, and the accounting in separate financial statements should be addressed at the standards level. However, we do not agree that IFRSs should impose a condition that parent-only financial statements can only be presented if they are included in the same financial report as the consolidated financial statements (as implied in paragraph 140 of the discussion paper), nor would we even consider it necessary for consolidated financial statements to be available to the users of the parent-only financial statements in all cases. For example, we would not consider it necessary that wholly-owned parent entities produce consolidated financial statements and for this reason we would not support an amendment to IAS 27 which deleted the exemptions currently contained in paragraph 10. Instead, we consider that the question of the type of financial statements published by a parent entity (i.e. whether consolidated or parent-only) should be primarily a matter for local company legislation to mandate or restrict, with IFRSs concerned primarily only with the content of those different types of financial statements.

Section 4: Control issues

Q11. With regard to the concept of control, in the context of one entity having control over another, do you agree that:

(a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?

(b) the concept of control should include situations in which control exists but might be temporary? If not, why?

(c) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?

(d) in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?

(e) to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?

(f) having "significant influence" over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

Subject to our above comments, we agree that establishing whether control exists should involve assessing all existing facts and circumstances, with no one condition being determinative.

Q12. Should any of the above control issues be addressed at the standards-level rather than at the concepts level? If so, which issues and why?

We believe that control should be defined at the conceptual level and put into practice at the standards level. Further application guidance can be put into standards for clarification purposes, where appropriate,

Q13. Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in [the Discussion Papers] and should be addressed at the conceptual level? If so, which issues and why?

We have not identified other conceptual issues that have not already been noted in the Discussion Paper.