



香港會計師公會

HONG KONG SOCIETY OF ACCOUNTANTS

(Incorporated by the Professional Accountants Ordinance, Cap. 50)

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Our. Ref.: C/FASC

31 October 2002

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

Dear Sir/Madam,

Exposure Draft
ED 1 First-time Application of International
Financial Reporting Standards

The Hong Kong Society of Accountants (HKSA) welcomes the opportunity to provide you with our comments on the Exposure Draft ED 1 First-Time Application of International Financial Reporting Standard ("exposure draft").

We set out in the attachment our response to the questions raised in your Invitation to Comment.

As an overall comment, although we consider ourselves in general agreement with the approach proposed by the IASB in applying IFRS for the first time, we did find the detail of the exposure draft difficult to understand. We consider that for first time adopters, who may be coming to these standards for the first time, it is essential that the requirements are clearly and simply set out in plain language.

Whilst we think we understand and agree with the principles underlying the proposals, we found that a lot of these principles were not clearly spelt out. For example, the recognition and measurement bases are not clearly distinguished, the underlying requirements of paragraphs 7 and 13 as currently written are very confusing.

The HKSA has a policy of converging its Statements of Standard Accounting Practice with the International Accounting Standards Board's Standards. The standard setting due process applied in Hong Kong (details of which are available on the HKSA's website) acts to support this policy. The HKSA's Financial Accounting Standards Committee (FASC) issued an Invitation to Comment on the exposure draft with a comment period concurrent with that set by the IASB. Accordingly, the accompanying comments reflect the views not only of members of the FASC but of constituents in Hong Kong who provided comments to the HKSA.



If you have any questions on our comments, please contact our Deputy Director - Accounting, Mr. Simon Riley, in the first instance.

Yours faithfully,

A handwritten signature in grey ink, appearing to read 'Winnie Cheung', is positioned above the typed name.

WINNIE C.W. CHEUNG
SENIOR DIRECTOR
PROFESSIONAL & TECHNICAL DEVELOPMENT
HONG KONG SOCIETY OF ACCOUNTANTS

WCC/SR/al

Hong Kong Society of Accountants' comments on the Exposure Draft ED 1 First-Time Application of International Financial Reporting Standards

Question 1

The proposed IFRS would apply when an entity first adopts International Financial Reporting Standards (IFRSs) as its new basis of accounting, by an explicit and unreserved statement of compliance with all IFRSs (paragraphs 1-5 and paragraphs BC4-BC10 of the Basis for Conclusions). Is this an appropriate description of the circumstances when this proposed IFRS should apply? If not, what changes would you suggest, and why?

Yes, we generally agree with the description. However, we have the following comments on the guidance set out in paragraphs 1 to 5 of the Exposure Draft

Paragraphs 2 and 3: Given the proposals under paragraphs 2(a)(ii) and 3(c), we believe that whether an entity's previous financial statements contained an explicit and unreserved statement of compliance would become the main determining factor as to whether the entity is a first time adopter or not. The fact of whether the previous financial statements prepared were actually in compliance with IFRS would become less relevant. We are therefore concerned that this may, in practice, encourage entities that have plans to convert to IFRS to start including a statement of compliance in their financial statements, especially when the financial statements are currently prepared in accordance with a GAAP which bears a high degree of similarity with IFRS, even if it would result in a qualification, in order to subsequently avoid being treated as first time adopters on the actual adoption of IFRSs.

Paragraph 5: We concur with the Board's proposals to allow certain subsidiaries not to be treated as first-time adopters as we consider that without such an allowance the cost of compliance would outweigh the benefits to users. However, we consider that the reason given in the Exposure Draft for such an allowance (i.e. to avoid restatement of IFRS measurements already reported to the parent) may not be conceptually sound as IAS 27 already recognises that a number of adjustments would have to be made during the consolidation procedures. Accordingly, we would suggest replacing the stated reason in paragraph 5 with wording that is clear to the readers that this allowance is a special concession granted by the Board on balancing between the relevant cost and benefit.

Other paragraphs: We suggest the Board to give more guidance on an entity having reorganisation under common control during the reporting period. For example, whether an entity is a first-time adopter if:

- (a) A new parent with all combined entities presented financial statements complying with IFRS in previous periods;
- (b) A new parent with some combined entities presented financial statements complying with IFRS in previous periods but some not; and
- (c) An existing entity presented financial statements complying with IFRS but not for all other combining entities.

Question 2

The proposed IFRS proposes a requirement that an entity shall prepare its opening IFRS balance sheet using accounting policies that comply with each IFRS effective at the reporting date for its first IFRS financial statements. Paragraphs 13-24 propose limited exemptions from this requirement. Are all of these exemptions appropriate? Should the Board amend any of these exemptions or create any further exemptions (paragraphs BC11- BC89)? If so, why?

In general, we support the proposals. However, we have the following comments on the guidance set out in paragraphs 7 to 24:

Paragraph 7: The current wording in paragraph 7 does not appear to have taken into account the exemptions from requirements in other IFRSs as set out in paragraph 13 of the proposed IFRS. We therefore suggest that the wording “subject to exemptions set out in paragraph 13 of this Standard” should be added to paragraph 7 of this proposed Standard.

Paragraph 9: In the situation where a new IFRS that permits prospective application becomes effective subsequent to the earliest period reported in an entity’s first IFRS financial statements, the current wording in paragraph 9 suggests that the entity would still require to apply the IFRS retrospectively in its first IFRS financial statements if no corresponding exemption is included in this proposed Standard. We have reservations about this treatment, as it appears to penalise those choosing to adopt the exemptions in this proposed Standard as compared to those choosing for full retrospective application of IFRSs. Accordingly, we believe that it is important for the Board to continue monitoring the exemption granted under this Exposure Draft, especially when a new or revised IFRS that permits prospective application is issued, to ensure that a new exemption be added to this proposed Statement, if appropriate.

Paragraph 13: The current wording in paragraph 13 is unclear as to whether the Board’s intention is to allow the exemptions set out in paragraphs 14 to 24 on a “selective” basis or an “all or nothing” basis. Paragraph 14 and the Basis of Conclusion (BC60) however appear to suggest it is the latter case. We however consider that the Board should allow selective application of the exemptions but require disclosure in the financial statements as to which exemptions have been applied. Given that the main principle set out in paragraph 7 of the Exposure Draft is to require full retrospective application of IFRS, we don’t believe that it is appropriate or in-principle correct to restrict the application of all the (non-interdependent) exemptions granted under the Exposure Draft. For example, if an entity does have all the relevant information relating to an earlier business combination, we believe that the entity should not be precluded from applying IAS 22 retrospectively to that earlier business combination. Nevertheless, once the Board has finalised its decision on this issue, we believe that the Board’s intention in this respect should be made clear in paragraph 13 of this proposed Standard for the avoidance of doubt.

Paragraph 14 et seq.: The guidance in paragraph 14 et seq. contains a number of references to the phrase “undue cost or effort”. Although we understand the phrase is also used in the recent IASB Exposure Draft on Proposed Improvements to IASs, we believe that, in the absence of any clear guidance and examples in these exposure drafts, such references would result in a wide diversity of application.

Paragraph 18: We believe that it is highly unlikely that an investment property company would not have records of each individual property, given that the focus of such a business should be on monitoring rental yields by property. Accordingly, we consider that the proposed exemptions under paragraphs 16 and 17 should not be extended to investment properties.

Paragraph 19: We would suggest that more guidance be given on the meaning, and in particular the limitation, of what could be considered to be an “event” under this paragraph.

Paragraph 24: The current wording in paragraph 24 is written in the context of the existing IAS 39. We note that the IASB is currently proposing a significant revision to the transitional arrangements in IAS 39 in its recent Exposure Draft on Improvements to IAS 32 and IAS 39. Accordingly, we believe that certain

corresponding revisions would be needed to paragraph 24 and Appendix C once that Exposure Draft is finalised.

Question 3

Paragraphs 28-37 of the proposed IFRS deal with presentation and disclosure requirements (see also paragraphs BC90-BC97). Are all of these disclosures appropriate? Should the Board require any further disclosures or eliminate or amend any of the proposed disclosure requirements? If so, why?

In general, we support the disclosure requirements. However, we have the following comments:

- We support the additional disclosure requirement for the opening IFRS balance sheet and income statement. However, the Exposure Draft does not give any specific guidance on the presentation of the reconciliation between the entity's first IFRS financial statements and those reported under previous GAAP. We consider that a line-by-line reconciliation for balance sheet and profit and loss may be overly excessive. Under existing practice, e.g. a prospectus, a reconciliation is normally performed to the net assets or shareholders' fund on the balance sheet or net profit on the profit and loss. We therefore suggest that specific guidance along the line of the existing practice should be included in the Exposure Draft.
- We consider that, in some cases, it might be difficult, if not impractical, to explain material adjustments to the cash flow statements. We therefore consider that the explanation on how the transition from previous GAAP to IFRSs affected an entity's cash flows should focus on the differences and reclassifications in cash and cash equivalents.
- We consider that an explanation of the material adjustments to previously reported segments, earnings per share, and discontinuing operations should be encouraged, if not required.
- Since historical summaries would not normally form part of the financial statements, we believe that the guidance in paragraph 36 concerning historical summaries should be removed from the proposed Standard and included in the Implementation Guidance or an Appendix instead.
- We recommend that the Board should make clear in paragraph 31 (b) that a reconciliation of the profit or loss **after taxation** should be required.
- Paragraph 35 only requires the disclosure of using fair value as deemed cost for certain items mentioned in paragraphs 16 to 18, i.e. property, plant and equipment. We recommend that disclosure of using other measurements as deemed cost should also be required. For example, event-driven fair value measurement and carrying amount of assets or liabilities acquired in business combinations mentioned paragraphs 19 and 20 respectively. We recommend that the following disclosure should be made:
 - a. a brief description of the event and business combinations;
 - b. at which date the deemed cost is stated;
 - c. the accounting treatment that was applied under local GAAP in respect of those deemed costs; and
 - d. the aggregate of those deemed costs at a particular date and respective carrying values at the reporting date.

The deemed cost is the initial cost for subsequent measurement under IFRS. We believe that more disclosures enhance better comparability to other first-time adopters in the first financial year presented and other entities using IFRS over future periods presented.

Question 4

Do you have any other comments on the Exposure Draft?

Exposure Draft

Structure: While we generally support the proposals under the Exposure Draft, we find that the Exposure Draft is difficult to read and follow. We believe that the structure of the Exposure Draft could be improved by specifying more clearly the principles by using bold typeface and by ensuring that the provisions are consistent with each other. On the basis that paragraphs that contain an imperative (i.e. the word “shall”), we consider the following should be in bold typeface: paragraphs 1, 2 (first sentence only), 7, 10 (first sentence only), 12, 13 (third sentence only), 14 (first sentence only), 30 and 38 (first sentence only). We also consider that paragraphs 7, 8, 13 and 14 should be reworded to achieve consistency of these provisions. In cases where we believe only part of a paragraph ought to appear in bold typeface, we would also recommend that the paragraph be split into one bold typeface paragraph and one plain typeface paragraph.

Principles: We believe that this Exposure Draft generally covers two broad principles: One is that an entity may apply IFRS for the first time as if it had always applied IFRS. The other is that an entity may apply IFRS for the first time, taking advantage of relief in certain areas relating to property, plant and equipment, business combinations, pensions, financial instruments and cumulative differences as articulated in this Exposure Draft. We recommend that the Board should state clearly the two principles at the beginning of the Standard, immediately after the scope section, as, we believe, these two important principles currently do not stand out in the Exposure Draft. We also recommend that the Standard should include a separate (brief) section explaining how retrospective applications should be applied when the exemptions are not used, following on from the clear expression of the principle.

Appendix B: Paragraph B1 of Appendix B is the same as paragraphs 20 and 21, except point (a), last sentence of point (b) and point (e). We suggest removing B1 from the Appendix and merging these different points with paragraphs 20 and 21.

IFRS: We suggest using “IFRS” through the Standard, on the basis that it is a collective acronym that can be used in both the singular and plural.

BC 19: We suggest including Basis of Conclusion BC 19 in the Standard itself.

Basis of Conclusions

BC20(a): Based on the existing IAS 39, the paragraph reference of IAS 39 included in paragraph BC20(a) of Basis for Conclusions should be paragraph 172(h) rather than paragraph 172(g).