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

3 November 2005

By e-mail and by post

Our Ref.: C/FRSC

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

Attention: Mr. Alan Teixeira, Senior Project Manager

Dear Sirs,

Comment Letter
IASB Exposure Drafts of Proposed Amendments to:
(a) IFRS 3 *Business Combinations*
(b) IAS 27 *Consolidated and Separate Financial Statements*
(c) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*

The Hong Kong Institute of CPAs welcomes the opportunity to provide you with our comments on the captioned Exposure Drafts. Our responses to the questions raised in these Exposure Drafts are set out in the attached Appendix to this letter.

In general, we consider that the proposed amendments in these Exposure Drafts are technically sound. However, we are concerned about the practicability of some of the proposals, in particular their measurement aspects.

In respect of the proposed amendments to IFRS 3 and IAS 27, we believe that, without robust guidance or framework on valuing an entity or a business, the requirement for the acquirer to measure the fair value of the acquiree, as a whole, as of the acquisition date would, in many cases, become a mechanical exercise. This might result in meaningless, if not misleading, figures (particularly, the measured of total goodwill) being reported in the financial statements. In order to prevent this undesirable outcome, we suggest that IASB work with the valuation profession to develop a robust methodology for valuing an entity or a business before proceeding with the model proposed in these Exposure Drafts.

In respect of the proposed amendments to IAS 37, we consider that applying the conditional and unconditional obligations model in practice could be subjective and problematic. We are also doubtful that unconditional obligations (sometimes referred to as stand ready obligations) can, except in extremely rare cases, be measured reliably given that observable market data is unlikely to be available. If the IASB decides to go ahead with its proposals, we recommend that:

(1) more robust guidance on when an unconditional obligation exists and how to measure such obligation should be included in the final Standards; and

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(2) instead of including a note about measurement, the actual working of the measurement of the unconditional obligation should be specified in the relevant examples in the appendix to the final Standards.

Until further guidance is in place, we would expect that entities would have to rely on the proposed exemption for not recognising the unconditional obligation because it cannot be measured reliably but disclose the information required more often than in extremely rare cases as suggested in the proposed Standard.

In respect of the proposed amendments to IAS 19, we consider that there are some inconsistencies between the proposals under IAS 37 concerning an unconditional obligation and the proposals under IAS 19 concerning termination benefits (see our response to Question 2 relating to IAS 19). We therefore suggest that the IASB should consider these identified inconsistencies and either make appropriate changes to the relevant proposal or explain in the Basis for Conclusions on IAS 19 how they reconcile the identified inconsistencies.

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

Yours faithfully,

Stephen Chan
Executive Director

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APPENDIX

HONG KONG INSTITUTE OF CPAs' RESPONSES TO THE QUESTIONS RAISED IN THE EXPOSURE DRAFTS

IFRS 3 *Business Combinations*

Question 1—Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

We generally consider the objective and the definition of a business combination appropriate for accounting for all business combinations.

However, we are concerned about the continuing scope exclusion of business combinations involving entities and businesses under common control, given the prevalence of these transactions in practice. We consider that there is a great demand in the market for guidance on such and urge the IASB to assign a high priority to this project. We also encourage the IASB to clarify whether forming a non-operating company to acquire control over another entity meets the definition of a business combination and, if not, how such transactions should be recognized.

Question 2—Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

We consider the definition of a business and the additional guidance appropriate and sufficient. However, we support the provision of any additional guidance that provides clarity and promotes consistency in practice.

Question 3—In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

We consider that it is theoretically correct to recognise 100 percent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest in a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date. However, we see difficulties in practice in determining the full fair value of the acquiree where less than 100% is acquired. Without any robust guidance or framework on how to value an entity or a business (see also our comments on question 4 below), we believe that this requirement could become an mechanical exercise and might result in meaningless figures for goodwill being reported in the financial statements.

Question 4—Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

No. We do not consider the guidance sufficient. The examples provided deal with straight forward situations and do not address the more complex situations that preparers encounter in practice. For example, we note the development of the practices behind acquisition accounting in China and the resultant difficulties in identifying fair values of the businesses acquired.

We therefore suggest the Board working with the valuation profession to develop more robust guidance on the basis on which the full fair value of the acquiree should be determined so that preparers of the financial statements can have a clear framework to follow when dealing with more difficult situations.

Question 5—Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

We agree that the acquisition date fair value of the consideration transferred in exchange for control is the best evidence of the fair value of the interest acquired at that date.

Question 6—Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

We consider that the accounting for contingent consideration after the acquisition date appropriate.

Question 7—Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

We agree that the costs that the acquirer incurs in connection with a business combination are not assets in their own right and are not part of the consideration for the acquisition. We therefore consider that they should be excluded from the measurement of the consideration. This is consistent with the fair value treatment of the consideration transferred.

Question 8—Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

We consider that the proposed changes to the accounting for business combinations are technically appropriate. However, we see difficulties in determining the fair value of individual contingencies. We recommend that the revised Standard require note disclosure where measurement is not sufficiently reliable for an item to be recognised.

Question 9—Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

We agree that the exceptions to the fair value principle are appropriate at this time. We urge the IASB to revise the Standards containing the exceptions so that acquisitions can be recognised at fair value in the future and differences between fair value and carrying amounts can be excluded from goodwill.

Question 10—Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

We consider that it is appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree.

Question 11—Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

We agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest.

Question 12—Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

We are not aware of any circumstances under which amount of overpayment could be measured reliably.

Question 13—Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

We agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments for the purpose of enhancing the comparability of the financial statements.

Question 14—Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

We consider that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree. However, we welcome any further guidance that provides clarity and promotes consistency in practice.

Question 15—Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

We agree with the disclosure objectives and the minimum disclosure requirements.

Question 16—Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:

(a) the intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability; and

(b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

We are not aware of any circumstances where an intangible asset that is identifiable cannot be measured with sufficient reliability to be recognised separately from goodwill.

Question 17—Do you agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

We agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination.

Question 18—Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

We consider that the disclosures should be harmonized to the extent possible, subject to the requirements of other standards that are not currently being reconsidered by the Boards.

Question 19—Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

We found the style of the Exposure Draft helpful and generally consistent with the format of recent International Financial Reporting Standards.

IAS 27 *Consolidated and Separate Financial Statements*

Question 1—Draft paragraph 30A proposes that changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes would be recognised in profit or loss (see paragraph BC4 of the Basis for Conclusions). Do you agree? If not, why not and what alternative would you propose?

We agree with the proposal that changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders.

Question 2—Paragraph 30D proposes that on loss of control of a subsidiary any non-controlling equity investment remaining in the former subsidiary should be remeasured to its fair value in the consolidated financial statements at the date control is lost. Paragraph 30C proposes that the gain or loss on such remeasurement be included in the determination of the gain or loss arising on loss of control (see paragraph BC7 of the Basis for Conclusions).

Do you agree that the remaining non-controlling equity investment should be remeasured to fair value in these circumstances? If not, why not and what alternative would you propose?

Do you agree with the proposal to include any gain or loss resulting from such remeasurement in the calculation of the gain or loss arising on loss of control? If not, why not, and what alternative would you propose?

We agree that the remaining non-controlling equity investment should be remeasured to fair value as this is consistent with the requirement under IAS 39 *Financial Instruments: Recognition and Measurement.* We also agree with the proposal to include any gain or loss resulting from such remeasurement in the calculation of the gain or loss arising on loss of control as they both arise from a single transaction.

Question 3—As explained in Question 1, the Exposure Draft proposes that changes in a parent's ownership interest in a subsidiary that do not result in a loss of control should be treated as transactions with equity holders in their capacity as equity holders. Therefore, no gain or loss would be recognised in profit or loss. However, a decrease in the parent's ownership interest resulting in the loss of control of a subsidiary would result in any gain or loss being recognised in profit or loss for the period. The Board is aware that differences in accounting that depend on whether a change in control occurs could create opportunities for entities to structure transactions to achieve a particular accounting result. To reduce this risk, the Exposure Draft proposes that if one or more of the indicators in paragraph 30F are present, it is presumed that two or more disposal transactions or arrangements that result in a loss of control should be accounted for as a single transaction or arrangement. This presumption can be overcome if the entity can demonstrate *clearly that such accounting would be inappropriate (see paragraphs BC9-BC13 of the Basis for Conclusions).*

Do you agree that it is appropriate to presume that multiple arrangements that result in a loss of control should be accounted for as a single arrangement when the indicators in paragraph 30F are present? Are the proposed factors suitable indicators? If not, what alternative indicators would you propose?

We agree that it is appropriate to presume that multiple arrangements that result in a loss of control should be accounted for as a single arrangement when the indicators in paragraph 30F are present.

Question 4*—Paragraph 35 proposes that losses applicable to the non-controlling interest in a subsidiary should be allocated to the non-controlling interest even if such losses exceed the non-controlling interest in the subsidiary's equity. Non-controlling interests are part of the equity of the group and, therefore, participate proportionally in the risks and rewards of investment in the subsidiary.*

Do you agree with the proposed loss allocation? Do you agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately? If not, why not, and what alternative treatment would you propose?

We agree with the proposed loss allocation. We also agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately.

Question 5*—The transitional provisions in the Exposure Draft propose that all of its requirements should apply retrospectively, except in limited circumstances in which the Board believes that retrospective application is likely to be impracticable.*

Do you agree that proposed paragraphs 30A, 30C and 30D should apply on a prospective basis in the cases set out in paragraph 43B? Do you believe that retrospective application is inappropriate for any other proposals addressed by the Exposure Draft? If so, what other proposals do you believe should be applied prospectively and why?

We agree that proposed paragraphs 30A, 30C and 30D should apply on a prospective basis in the cases set out in paragraph 43B. We believe that retrospective application is appropriate for any other proposals addressed by the Exposure Draft.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*

Question 1 – Scope of IAS 37 and terminology

(a) Do you agree that IAS 37 should be applied in accounting for all non-financial liabilities that are not within the scope of other Standards? If not, for which type of liabilities do you regard its requirements as inappropriate and why?

(b) Do you agree with not using 'provision' as a defined term? If not, why not?

We consider that the *Framework* should be the starting point for identifying an element of financial statements, including a liability. Once an element is identified, the measurement or disclosure of that element should be made with reference to an appropriate Standard. We therefore agree that a specific Standard that applies to liabilities that are not specifically addressed by other Standards could be helpful. However, we have some concern about the reliance of IAS 37 as being the "residual" Standard for liabilities without any adequate guidance of the types of liabilities within its scope. We therefore suggest that the IASB should consider adding in a positive definition of a non-financial liability within IAS 37.

We agree with not using "provision" in order to avoid confusion with the use of the term for items that do not satisfy the definition of a liability (e.g. for assets valuation allowances). However, given that this term is commonly used in practice as an item with some uncertainty attached, we expect that the term will still remain in use at least for some time.

Question 2 – Contingent liabilities

(a) Do you agree with eliminating the term 'contingent liability'? If not, why not?

(b) Do you agree that when the amount that will be required to settle a liability (unconditional obligation) is contingent on the occurrence or non-occurrence of one or more uncertain future events, the liability should be recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur)? If not, why not?

We agree with eliminating the term "contingent liability" as part of the revisions currently proposed. We however consider that the conditional and unconditional obligations model, although technically sound, could be difficult to apply in practice (see our comments below on question 6).

Question 3 – Contingent assets

(a) Do you agree with eliminating the term 'contingent asset'? If not, why not?

(b) Do you agree that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38? If not, why not?

We agree with eliminating the term "contingent asset" as part of the revisions currently proposed. We agree that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38.

Question 4 – Constructive obligations

(a) Do you agree with the proposed amendment to the definition of a constructive obligation? If not, why not? How would you define one and why?

(b) Is the additional guidance for determining whether an entity has incurred a constructive obligation appropriate and helpful? If not, why not? Is it sufficient? If not, what other guidance should be provided?

We agree with the proposed amendment to the definition of a constructive obligation. We consider the additional guidance for determining whether an entity has incurred a constructive obligation appropriate and helpful.

Question 5 – Probability recognition criterion

Do you agree with the analysis of the probability recognition criterion and, therefore, with the reasons for omitting it from the Standard? If not, how would you apply the probability recognition criterion to examples such as product warranties, written options and other unconditional obligations that incorporate conditional obligations?

Conceptually, we agree with the analysis of the probability recognition criterion and therefore with the reason for omitting it from the Standard.

We are, however, concerned that the IASB is proposing changing requirements in IAS 37 ahead of the *Framework*. We would prefer that the IASB review the relevant parts of the *Framework* to ensure that this change is consistent with the overall direction of measurement before changing Standards such that they appear to conflict with the *Framework*.

Question 6 – Measurement

Do you agree with the proposed amendments to the measurement requirements? If not, why not? What measurement would you propose and why?

We agree in principle that a non-financial liability should be measured at the amount that an entity would rationally pay to settle or transfer to a third party. This approach better measures the economic burden of having such a liability. However, we consider applying the conditional and unconditional obligations model in practice could be highly subjective and problematic. We would therefore suggest that:

1. more guidance on when an unconditional obligation (sometimes referred to as a stand ready obligation) exists and how to measure such obligation should be included in the Standard; and

2. instead of including a note about measurement, the actual working of the measurement of the unconditional obligation could be specified in the relevant examples in the appendix to the Standard.

We also consider it important to emphasise in the Standard that the proposed disclosure requirement for a non-financial liability that is not recognised because it cannot be measured reliably would apply equally to a liability arising from an unconditional obligation.

Question 7 – Reimbursements

Do you agree with the proposed amendment to the recognition requirements for reimbursements? If not, why not? What recognition requirements would you propose and why?

We agree with the proposed amendment to the recognition requirements for reimbursements. We, however, consider it useful to expand the guidance to cover subsequent measurement of the reimbursements or to make reference to appropriate Standards for subsequent accounting of the reimbursements.

Question 8 – Onerous contracts

(a) Do you agree with the proposed amendment that a liability for a contract that becomes onerous as a result of the entity's own actions should be recognised only when the entity has taken that action? If not, when should it be recognised and why?

(b) Do you agree with the additional guidance for clarifying the measurement of a liability for an onerous operating lease? If not, why not? How would you measure the liability?

(c) If you do not agree, would you be prepared to accept the amendments to achieve convergence?

We agree that a liability for a contract that becomes onerous as a result of the entity's own actions should only be recognised when the entity has taken that action. We agree also with the additional guidance on measurement of a liability for an onerous operating lease.

Question 9 – Restructuring provisions

(a) Do you agree that a liability for each cost associated with a restructuring should be recognised when the entity has a liability for that cost, in contrast to the current approach of recognising at a specified point a single liability for all of the costs associated with the restructuring? If not, why not?

(b) Is the guidance for applying the Standard's principles to costs associated with a restructuring appropriate? If not, why not? Is it sufficient? If not, what other guidance should be added?

We agree that a liability for each cost associated with a restructuring should be recognised when the entity has a liability for that cost. This is in line with the principles established in the *Framework*. We also consider the guidance for applying the Standard's principles to costs associated with a restructuring appropriate. However, we welcome any additional guidance that provides clarity and promotes consistency in practice.

IAS 19 *Employee Benefits*

Question 1 – Definition of termination benefits

Do you agree with this amendment? If not, how would you characterise such benefits, and why?

Yes, we agree with the proposed amendments to the definition of termination benefits. However, we recommend clarification as to the intended meaning of "a short period" in order to avoid divergent or unacceptable practices.

Question 2 – Recognition of termination benefits

Is recognition of a liability for voluntary and involuntary termination benefits at these points appropriate? If not, when should they be recognised and why?

We accept the proposals for recognition of voluntary and involuntary termination benefits. However, we see some inconsistencies between these proposals and the proposals under IAS 37 *Non-financial Liabilities* in the following respects:

(a) Paragraph 24 of the proposed revised IAS 37 recognises an unconditional liability that sometimes referred to as a 'stand ready' obligation. The proposed revised IAS 19 however does not make reference to a stand ready obligation that can arise when the entity is making an offer of voluntary termination benefits to its employees; and

(b) Similar to the above, the proposed revised IAS 19 does not make reference a stand ready obligation that can arise when the entity communicates the plan to the affected employees about the involuntary termination payments.

Given that the proposed amendments to IAS 19 are consequential on the proposed amendments to IAS 37, we consider the proposals under the two Standards should be brought into line. If the Board does not perceive a discrepancy between the proposals under the two Standards, we suggest that the Board should specify its reasons in the Basis for Conclusions.

Question 3 – Recognition of involuntary termination benefits that relate to future service

Do you agree with the criteria for determining whether involuntary termination benefits are provided in exchange for future services? If not, why not and what criteria would you propose? In these cases, is recognition of a liability over the future service period appropriate? If not, when should it be recognised and why?

We agree with the three criteria and the recognition of a liability over the future service period. We however consider it useful to emphasise that the involuntary termination benefits referred to in such cases are the amounts incremental to what the employee would otherwise be entitled and not the total payment up to the date termination. We also consider it useful to clarify that the amount that the employee would otherwise be entitled to is the amount not provided in accordance with terms of an ongoing benefit plan or the amount to be paid to an employee if that employee is not retained beyond the minimum retention period or does not meet the vesting condition.