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

Meeting with SMPC Technical Issues Working Group
(via teleconference)

Date: 22 April 2020, Wednesday
Time: 3:00 p.m. – 5:30 p.m.

Members Present: Gary Poon, Poon & Co.
Kenneth Lau, Crowe (HK) CPA Limited
Chan Lok Sang, Lau & Au Yeung C.P.A. Limited
Wing Chan, BDO Limited
Colin Chau, RSM Hong Kong
Sammy Choi, TKC Corporate CPA Limited
Philip Fung, Lak & Associates CPA Limited
Anntice Lai, Baker Tilly Hong Kong Limited
Frank Lam, BDO Limited
Elizabeth Law, Law & Partners CPA Limited
Webster Ng, Webster Ng & Co.
Thomas Wong, Nexia Charles Mar Fan & Co.
Jimmy Yip, Mazars CPA Limited

Staff in attendance: Joni Kan, Associate Director, Standard Setting, HKICPA
Katherine Leung, Associate Director, Standard Setting, HKICPA

1. Operating Category

- Most members considered that the proposed description of the operating category is too broad and recommended the IASB should provide more guidance on how to determine the entity's main business activities.

- A member shared an example that a real estate company may present the changes in the fair value of an investment property in the operating category under the proposals. However, the member noted that this is an unrealised gain and so it should not be included in the operating category because many investors view the operating profit as a realised profit.

- Another member shared an example of a trading company that holds a property for rental purposes. Management may consider the property rental is part of the company's main business activities and include changes in the fair value of that property in the operating category. The fair value change may be large and could distort the operating results of the trading company, which could significantly impact on how a user of financial statements interprets the trading company's performance.

2. Investing Category

- The proposed description of the investing category includes income and expenses from assets that generate a return individually and largely independently of other resources held by the entity, and excludes any income and expenses generated in the course of the entity's main business activities. Most members considered that applying the term 'largely independently' would be subjective and difficult without clearer guidance on how to interpret 'largely independently' and 'entity's main business activities'.

- Most members considered that the proposed requirement to separate the income and expenses from investments generated in the course of the entity's main business activities from those that are not generated in the course of the entity's main business activities would be based on management's arbitrary allocation and open to abuse.

3. Financing Category

- A member did not agree the IASB's reasons for classifying income and expenses from cash and cash equivalents in the financing category in paragraph BC40(a) of the ED, ie that cash and cash equivalents represent a reasonable proxy for excess cash and the temporary investments of excess cash. He considered that it is confusing to classify income and expenses from cash and cash equivalents in the financing category as cash and cash equivalents comprise bank deposits, highly liquid investments, etc. that are generally for an entity's investment purposes.

- A member recommended the IASB to clarify why interest expenses on lease liabilities are classified in the financing category, when the leased assets are used in the production of goods and their depreciation is classified in the operating category.

4. Integral and non-integral associates and joint ventures

- A member shared an example of a shipping company which jointly operates all of its ships with joint venture companies. Applying the proposals, the shipping company would be required to present the income and expenses from joint ventures below the operating profit. Only the company's operating expenses will be classified in the operating category, which may result in an operating loss. The member noted the operating loss would be meaningless and misleading to the users of financial statements. Although the IASB has proposed a new subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures', users of the financial statements often focus on the operating profit or loss first. The member considered that the proposals on the presentation of integral and non-integral associates and joint ventures do not fit to all industries and business models.

- A member commented that all equity-accounted joint ventures should be considered integral to entity's main business activities as the joint venture company is jointly operated by the entity and the venture partner.

- Most members considered that the proposed definition and indicators in proposed paragraph 20D of IFRS 12 *Disclosure of Interests in Other Entities* are insufficient for companies to be able to distinguish between integral and non-integral associates and joint ventures. They recommended the IASB to provide more guidance on how to distinguish whether an associate/joint venture is integral or non-integral and also provide illustrative examples of applying the requirements.

5. Aggregation and disaggregation

- Some members considered that the IASB's proposed disclosure requirements for groups of immaterial items in paragraph 28 of the ED will add burden to preparers of the financial statements.

- Two members recommended that the IASB should consider requiring entities to present all income and expenses in the statement of financial performance, eg following the aggregation requirements to determine appropriate line items, but without the need to categorise the income and expense as operating, investing or financing (eg similar to the presentation of information in a trial balance). They noted users of the financial statements could get all information that they need from this presentation.

6. Analysis of operating expenses

- Members have no major comments on the proposed requirements to present an analysis of operating expenses using a single method and the corresponding application guidance, and the disclosure requirements for the analysis of operating expenses.

- A member asked if an entity presents cost of goods sold in the statement of profit or loss, whether in the notes to the financial statements it has to analyse such amount by categories of inventory as shown on page 11 of the illustrative example accompanying the ED (ie. separately present the changes in inventories of finished goods and work in progress, and raw material used). He suggested that if there is no specific requirement to do this under IAS 2 *Inventories*, such an analysis should not be included in the illustrative examples otherwise this may confuse readers as to whether it is required by the standard. He noted many readers consider illustrative examples are part of the standard, with similar authority.[1]

7. Unusual income and expenses

- A member considered the proposed unusual income and expenses are similar to extraordinary items previously in IAS 1. The term extraordinary items created a lot of issues in the past. He expressed his concern that the introduction of unusual income and expenses adds complexity for preparers that may not justify the benefit of the information to users of financial statements.

- A member shared his observation that many public companies disclose unusual items in their management discussions and analysis and the proposed disclosure in the notes to the financial statements would duplicate this information. In addition, the proposed disclosures may increase the burden for the auditors as it is difficult to verify the related information and also the information may be manipulated by management in order to present their performance in a better light, using adjusted numbers excluding the unusual items.

- Some members raised concerns that the proposed definition of unusual income and expenses is based on an entity's future forecasts. One member questioned how an entity can support the 'forward-looking' information if there is no forecast prepared and approved by management. Another member considered the main purpose of financial statements is reporting the historical position and performance of an entity. It would be inconsistent with such purpose if future forecasts are incorporated in the financial statements and it would be difficult for an auditor to provide an opinion on those forecasts. One of them suggested to change the proposed definition to be based on the nature of income and expenses instead of an entity's future forecasts.

- A member considered the proposed definition of unusual income and expenses is too judgemental. For example, an entity may consider additional costs incurred related to covid-19 are unusual expenses for the current year because it is unlikely there will be another outbreak of covid-19 in the following year. However, if there is an outbreak of covid-19 again in 2021, can an entity still classify the covid-19-related additional costs as unusual? Besides, it is unclear whether the classification for 2020 as unusual would therefore be inappropriate and require a prior year adjustment to be made.

[1] Paragraph 39 of IAS 2 requires an entity to disclose the cost recognised as an expense for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period when the "nature of expense' method is adopted.

- A member commented that the proposed definition is not helpful as it fails to capture the non-recognised items, for example, a significant decrease in revenue due to covid-19.

8. Management Performance Measures (MPM)

- MPM are not commonly seen by members and so members did not have a detailed discussion.

- A member considered that the proposed requirements for MPM should only apply to public entities, and not private entities.

9. Statement of cash flows

- Members had no major comments on the IASB's proposed targeted improvements to the statement of cash flows.

- A member observed that there may be a potential change in the classification of interest paid on loans from operating cash flows (current practice) to financing cash flows under the proposal.

10. Illustrative examples

- A member raised concerns on the changes in terminology used in the ED, for example, 'equity shareholders of the company' used under IAS 1 is replaced by 'holders of claims against parent classified as equity' in page 6 of the illustrative examples accompanying the ED. They questioned the reasons for the change as this increases the difficulties in understanding the financial statements and creates confusion.

11. Others

- A member commented that the IASB's proposals are becoming more complicated. He considered that the IASB should not only focus on satisfying particular types of stakeholder (ie investors and analysts) when developing a proposal. He commented that the IASB's proposals are burdensome for preparers and practitioners, and recommended the IASB to consider to require company to disclose all income and expenses in the statement of financial performance without categorising the income and expense as operating, investing or financing (as noted above) in order to save management's time in the classification of income and expenses in the different proposed categories.

- A member recommended the IASB should require the disclosure of net current assets/liabilities subtotal in the statement of financial position because this is a focus of many users of financial statements.