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.ifrs.org)**

10 May 2021

Mr Hans Hoogervorst
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

**IASB Request for Information**
***Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities***

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants in Hong Kong. We are grateful for the opportunity to provide our comments and the comments of our stakeholders on this Request for Information (RFI).

The HKICPA has carefully reviewed the RFI and performed outreach with local stakeholders to seek feedback. We provide detailed comments in the Appendix, and summarise our primary suggestions and observations below.

*Overall*
The HKICPA considers the application of IFRS 10, IFRS 11 and IFRS 12 can be challenging and often involves significant judgement. We suggest that the IASB reiterate the need for preparers to disclose clearly any significant judgements made when applying the entity's accounting policies in accordance with paragraph 122 of IAS 1 *Presentation of Financial Statements*.

*Control assessment under IFRS 10*
The HKICPA considers the principle of control in IFRS 10 has been operating largely as intended. However, we noted practical difficulties in the following areas related to performing the control assessment under IFRS 10:

- determination of whether rights are substantive or protective;
- assessment of de facto control;
- assessment of whether a decision maker is a principal or an agent; and
- assessment of the existence of de facto agency relationships.

We observed that challenges are more pervasive in some industries, and complexity increases when special purpose entities are involved. We provide examples where complexity arises in the Appendix.

While we appreciate that the existing guidance in IFRS 10 on these areas are helpful to a certain extent, there are limited application examples. Having said that, we acknowledge that challenges faced in practice often relate to fact-specific cases and that it is unavoidable that judgement will have to be exercised to arrive at the appropriate accounting. Nevertheless, there are some relatively common examples where more guidance would be appreciated. We particularly recommend the IASB developing

additional non-industry specific examples to illustrate the principles in the above areas to facilitate application.

*Accounting for a loss of control*

The HKICPA has observed diversity in practice in accounting for a partial disposal of a subsidiary that results in a loss of control where the subsidiary does not constitute a business. Some companies remeasure the retained interest at fair value while others adopt a cost-based approach.

Questions also arise as to the interaction between IFRS 10.25(b) and the recognition of gain or loss in other Standards when accounting for transactions involving single-asset entities/corporate wrappers; in particular, whether the accounting should be driven by substance or form. Accordingly, the HKICPA recommends that the IASB consider the accounting for transactions involving single-asset entities/corporate wrappers more holistically, including whether the requirement in IFRS 10.25(b) is applicable to disposals of a subsidiary when the subsidiary does not constitute a business and how it interacts with the recognition of gain or loss in other Standards.

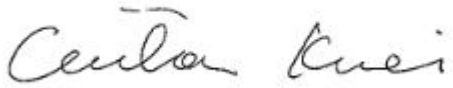
*Accounting for collaborative arrangements and classifying joint arrangements*

The HKICPA recommends that the IASB develop clear principles for collaborative arrangements outside the scope of IFRS 11 to better reflect their substance. There is currently a lack of guidance in this area and challenges arise in determining how to characterise or classify such arrangements, with resulting diversity in practice. The accounting treatments used in practice do not always provide relevant or useful information for such arrangements.

The HKICPA also recommends that the IASB provide more detailed guidance on the application of the 'other facts and circumstances' guidance in IFRS 11, for which we have observed challenges in applying in practice.

If you have any questions regarding the matters raised in this letter, please contact me (ceciliakwei@hkicpa.org.hk) or Eky Liu (eky@hkicpa.org.hk), Associate Director of the Standard Setting Department.

Sincerely,



Cecilia Kwei
Director, Standard Setting Department

# Appendix

**Detailed comments on IASB Request for Information (RFI) on the Post-implementation Review (PIR) of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, and IFRS 12 *Disclosure of Interests in Other Entities***

## Background

### Question 1: Background

1. The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting for professional accountants in Hong Kong.

2. In collecting feedback on the RFI, the HKICPA:
   - issued an Invitation to Comment on the RFI on 10 December 2020 to its members and other stakeholders;
   - consulted its Quality and Assurance Department and read through their annual reports on practice review findings;
   - sought input from its Business Combinations and Reporting Entity Advisory Panel, and Small and Medium Practitioners Working Group on Technical Issues, which are mainly comprised of technical and industry experts from large as well as small and medium accounting firms (collectively, Practitioners); and
   - held a public roundtable discussion on 8 April 2021, comprising investors, analysts, preparers and practitioners, with IASB Board member and staff participation.

3. The HKICPA also discussed the RFI and the respondents' feedback with its Financial Reporting Standards Committee, which comprises academics, preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

4. This submission summarises our respondents' feedback and our comments on the RFI.

## IFRS 10 *Consolidated Financial Statements*

### Question 2(a): Power over an investee—Relevant activities

5. The HKICPA observed that identification of relevant activities is generally not a significant issue for preparers and auditors, particularly after they understood the commercial rationale and business model of the investee.

6. Respondents did however consider that identifying relevant activities involves significant judgement in complex situations. The following scenarios were shared:
   - A government is a shareholder of a company (e.g. utilities or public transport company) and the price setting arrangement of the entity is regulated by the government. Questions arise as to whether price setting is a relevant activity of the company, and whether the regulation of pricing by the government should be interpreted as the government acting in its capacity as a shareholder or as a regulatory body.
   - Two or more investors direct different relevant activities at different times

during a contractual period. For example, in a real estate company, one party directs the construction and the other party directs the sale of properties, or in a pharmaceutical company, one party is responsible for research and development of a new drug while another party is responsible for manufacturing and sales of the new drug. There seems to be a change in relevant activities, and therefore a shift of power, over the life cycle. Difficulties are noted in identifying relevant activities throughout the life cycle and determining the time of shift of power over the life cycle.

- Multiple parties have different responsibilities in an arrangement. This is common among state-owned enterprises, franchise arrangements and just-in-time processing arrangements. For example, one party determines the manufacturing decisions and the other party determines the selling decisions. This creates challenges in determining which relevant activities should be given greater weight in the assessment of control.
- When special purpose entities (SPE) are involved in an arrangement.

7. Having said that, the HKICPA noted judgement is unavoidable in these situations. We generally consider the current related requirements and application guidance in IFRS 10 are sufficient and working as intended.

**Question 2(b): Power over an investee—Rights that give an investor power**

8. The HKICPA observed that the determination of whether rights are substantive or protective is challenging. We noted from our respondents that challenges are often seen in the real estate industry, asset management industry and when investment trusts or SPE are involved.

9. Some respondents, mainly practitioners, had split views on whether the concepts of substantive rights and protective rights are adequate and useful. Some of the supporters of the existing requirements agreed with the principles in IFRS 10.B22-B24 and B26-B33, and considered the factors listed in IFRS 10.B23 are easy to apply and helpful in conducting the assessment; particularly for cases involving the exercise of options and potential voting rights (though application requires judgement).

10. In contrast, a few practitioners considered the concepts are unclear, and commented that all rights (including substantive rights) may be viewed as protecting the investors. As IFRS 10.13 states that the ability to direct the activities that most significantly affect the returns of the investee confers power, these few practitioners believe that all rights therefore have to be considered in determining whether an investor has power regardless of the type of rights. These respondents considered the current requirement to identify whether rights are protective or substantive may be unnecessary, and that the definition of protective rights is unclear and could be improved upon.

11. The following scenarios were shared by some of our respondents as being challenging to assess:
    - In the property development industry, borrowing decisions over a certain threshold often have to be approved by all shareholders, including non-controlling shareholders, while other key activities such as construction decisions are solely determined by the major shareholders. Questions arise as to whether the right over such borrowing decisions is a substantive right.
    - It is often observed that a lender could obtain control over the investee upon default, and it is difficult to evaluate in practice whether, and at which point in time, the lender's rights become substantive—i.e. at the inception of the

contract (when the lender entitles to the rights) or upon default (when the rights are crystallized).

- Diversity in practice is noted in determining whether a veto right on investment decisions of the borrower (a SPE) entitled to by the lender (usually a financial institution) is substantive or protective. IFRS 10.B28(a) would imply such a right is protective. However, as the investment decisions are significant to the returns of the SPE, such a right could also be viewed as substantive.
- Regulatory bodies often mandate certain requirements regarding the roles of a trustee to protect minority shareholders. Questions arise as to whether those requirements would result in substantive rights for the trustee, in which case the trust manager might have no power to control the trust (and would only be an agent or have joint control of the trust with the trustee).
- Due to different regulatory or corporate governance requirements in different jurisdictions and/or industries, the board of directors of some companies includes both executive directors (ED) and independent non-executive directors (INED). These INED have voting rights to protect the interests of the shareholders. Questions arise as to whether the rights held by the INED are substantive or protective (i.e. the purpose of the INED is to protect the minority shareholders; however, the rights held by the INED may not be solely protective and rather considered as substantive from an accounting perspective). Complexity increases if the number of ED and INED is comparable.
- Challenges arise when applying IFRS 10.B31 to determine whether the rights of a franchisor are substantive or protective in nature. In particular, it is common for franchisors to have rights over activities that may serve to both protect the brand's reputation as well as significantly affect the returns of franchisees, e.g. pricing, sales and marketing activities, and staff training.

12. The HKICPA considers the principle of differentiating rights into substantive and protective rights and the related application guidance in IFRS 10 useful. However, based on our respondents' feedback, we consider that the guidance could be difficult to apply and highly judgmental, and it is practically challenging in some cases to assess whether rights are substantive or protective.

13. Accordingly, the HKICPA recommends the IASB consider clarifying the definition of protective rights and providing further guidance, for instance in the form of illustrative examples, on how to determine whether rights (e.g. rights to participate in borrowing decisions and veto rights) are substantive or protective using similar scenarios as shared by our respondents in paragraph 11 above.

**Question 2(c): Power over an investee—Control without a majority of the voting rights**

14. The HKICPA noted that challenges in assessing de facto control arise regularly in Hong Kong and mainland China. The increasing use of sophisticated structures is exacerbating this problem in addition to placing more pressure on the general control assessment.

15. Respondents generally agreed with the principles in the application guidance. The majority of our respondents commented that significant judgement is involved in de facto control assessments and questions may arise as to whether that judgement is appropriate.

16. Respondents shared the following practically challenging situations:
    - An investor has de facto control over an investee originally; however, the

percentage of shareholding held by the investor decreases over time due to dilution, and there are no other changes in facts and circumstances. The assessment becomes subjective and highly judgemental for determining when the investor loses control over the investee.

- An investor makes a new investment and concludes that there is no de facto control over the investee based on IFRS 10.B46 initially because there is insufficient information to demonstrate it has de facto control at the time of purchase. Due to the passage of time, more evidence arises to support that the investor ***has*** de facto control since the time of purchase. Some people questioned then whether the initial assessment and conclusion that there was no de facto control is appropriate.
- Company A invests in 40% equity interest in another company B. Some of the shareholders of company B were rarely involved in voting historically, and the overall voting participation is around 70%-80%. Hence, management concludes that company A effectively has voting rights of 50%-57% and has de facto control over company B. However, as the voting pattern and the shareholders in company B change over time, it is practically difficult and burdensome for company A to carry out the control reassessment continuously. Questions also arise as to whether company A loses or obtains control whenever the voting pattern or the shareholdings in company B changes.
- A company has only a few shareholders that are all state-owned enterprises, each holding 10% to 20% of the shares of the company. After considering contractual arrangements with other shareholders, de facto agent relationships and/or representation on the board, it may be concluded that the major shareholder has power over the company despite its low percentage shareholding. Questions nevertheless arise as to whether a minimum level of shareholding is required in order to establish de facto control, and if so how such a level could be determined.

17. Respondents also shared that de facto control assessments sometimes link with the de facto agent assessments, which increases complexity. Examples include:
    - How to apply the requirements appropriately among group companies where one company has a substantial interest (42%) in an investee, and another related company has a minority interest stake (5%) in the same investee. Questions may arise as to whether one of the group companies is always acting as a de facto agent of the other, and whether they collectively have de facto control over the investee when none have de facto control individually.
    - An individual A holds 60% equity interest in company P. Company P holds 48% equity interest in company Q. Some people argue that company P does not have de facto control over company Q because company P is merely acting as the de facto agent of individual A. However, it is questionable whether a company that holds equity interests in another company can be regarded as acting as a de facto agent of its controlling shareholder.

18. The HKICPA noted IFRS 10 does not provide a minimum level of voting rights needed to achieve de facto control, and requires companies to look at all facts and circumstances. Hence, application of the requirements and guidance in IFRS 10 is highly judgemental and similar fact patterns could be interpreted differently.

19. The HKICPA suggests the IASB provide more comprehensive examples to illustrate factors for consideration to support a holistic assessment (e.g. to cover a combination of factors for consideration as listed in IFRS 10.B38 in a single example), and clarify whether de facto control exists in some of the scenarios as shared by our respondents in paragraphs 16 and 17.

**Question 3(a): The link between power and returns—Principals and agents**

20. The HKICPA observed that it can be challenging and highly judgemental to assess whether the decision maker is a principal or an agent, particularly in the fund and asset management industries. Examples shared by our respondents include:
    - In a limited partnership fund structure, the limited partners (LP) usually provide most of the funding through debt instruments earning a fixed return while the general partner (GP) provides a much lower level of funding through holding significant equity interests that are subject to significant variability. The asset manager typically would have minimal equity interests in the fund but is exposed to potentially significant variable returns through remuneration that is linked to the performance of the fund. Questions arise as to whether the asset manager is a principal or an agent given its minimal equity interests but potentially significant variability in returns.
    - In practice, if the asset manager in the structure described above is determined to be an agent and the investors delegate all their investment decision making power to the asset manager, then the investors seem to have no power. It is unclear from the application guidance in IFRS 10 whether the investors should consider the power of their delegate (i.e. the asset manager) when carrying out the control assessment. The IFRS Interpretations Committee (IFRIC) discussed a related issue in 2017 in respect of whether the decision-making authority held by a fund manager in the capacity of an agent should be taken into account when assessing whether the fund manager has significant influence over a fund. No conclusion was reached in the corresponding agenda decision[1].
    - At the inception of a fund, where there are only a few or no other investors, the fund manager may provide the initial seed money to the fund. The seed money investor would then be, at inception, the majority shareholder of the fund (with up to 100% ownership). However, by design and as time passes, there would be other investors, and the fund manager's relative interest in the fund would be reduced to the point where the fund manager becomes a minority shareholder, or has no shareholding as the seed money is ejected. In such cases, questions arise as to who the principal is and who has control over the life of the fund, and when the fund manager should deconsolidate the fund.

21. A few practitioners considered that assessing the exposure to variability of returns from other interests inevitably involves judgement, and there is limited guidance on whether more emphasis should be placed on magnitude or the variability of the returns, and how the different nature of returns impacts that assessment (IFRS 10.B72). For example, in the asset management industry, there are cases where the absolute amount of returns is small while the variability is still substantial. Questions may arise as to whether other factors should also be considered, e.g. the amount as a percentage of the total expected returns. In addition, respondents questioned whether the magnitude of the return should be a probability weighted amount, e.g. whether the likelihood of reaching a hurdle for a fund manager to be entitled to a performance fee should be considered, and then multiplying the probability percentage with the performance fee to arrive at the magnitude of the returns.

22. While some practitioners considered the existing examples on this topic in IFRS 10 helpful, a few noted these examples are specific to investment funds and suggested the IASB provide other non-industry specific examples to illustrate the principles. Others however thought that specific examples may lead to unintended

[1] https://cdn.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/ias-28-fund-managers-assessment-of-significant-march-2017.pdf

consequences, such that stakeholders may interpret the examples as a 'bright line' in determining whether the decision maker is a principal or an agent given companies often seek to find a threshold for this assessment. In practice this would depend heavily on facts and circumstances and examples may not be suitable for all jurisdictions or industries. They hence suggested the IASB consider working with local standard-setters to develop local examples.

23. Respondents, mainly preparers, also shared that additional clarification in the following areas would be helpful:
    - In the asset management industry, an investor engages a fund manager and delegates investment decision rights to the fund manager. The examples accompanying IFRS 10 (examples 13-15) illustrate the application of the guidance to identify whether the investor or the fund manager is the principal when assessing the link between power and returns. In the case that the fund manager is determined to be an agent, the investor then has to consider again whether it has power over the investee and its exposure to variable returns before concluding whether it has control. This overall flow of assessment is not well aligned to what is being assessed, and it seems like the assessment is looping from the third element of control (the link between power and returns) back to the first element (power). Further clarification/additional guidance for the investor to assess whether it has power in the first place could be provided. This may involve considering the link between power and returns upfront in such cases.
    - In the context of exposure to variability of returns from other interests, it is not clear how a company should consider financial guarantees and whether they should be treated as a credit enhancement (IFRS 10.B71-B72). Factors for consideration could be provided through illustrative examples.
    - More guidance could be provided for how to consider the impact of indirect interests, such as interests held by an intermediary in which the investor has an interest, but which it does not control.

24. In light of the above, the HKICPA recommends the IASB should provide clarification or develop non-industry specific examples to illustrate how to perform the assessment.

**Question 3(b): The link between power and returns—Non-contractual agency relationships**

25. The HKICPA generally observed that de facto agency relationships are common among group companies, in the asset management industry, and when SPE are involved. Challenging examples encountered by some of our respondents are as follows:
    - Where multiple group companies each hold a small percentage of shareholdings in an investee and collectively hold a majority of the shares of the investee. If there is no contractual arrangement between these group companies, questions arise as to whether there is a non-contractual agency relationship such that these group companies collectively control the investee.
    - In closely held funds or private equity structures, power and returns may be split between different parties for structuring reasons, e.g. regulatory or tax purposes. It is difficult to carry out the de facto agency assessment in this case.

26. Some respondents, mainly practitioners, believed that the de facto agency guidance is intended to be helpful and discourages structuring opportunities as the substance of the arrangement and relationships between parties have to be considered even there is no contractual arrangement between them. Nevertheless,

the guidance can be hard to operationalize, and it is difficult to rely only on the guidance to support whether an investor has control over an investee and otherwise prove the existence of a de facto agency relationship.

27. Some practitioners commented that non-contractual agency relationships do exist in practice but are difficult and controversial to assess. A few of them suggested that it may be helpful to set a rebuttable presumption that there is a de facto agency relationship in certain situations (e.g. where the asset manager has minimal variability and over 99% of the variability of returns is held by the investors; or when the structure involves entities that are under common control), unless proven otherwise. On the other hand, others disagreed that a rebuttable presumption would be helpful because contractual rights and obligations are the key factors in the control assessment. Those who disagreed with the rebuttable presumption considered that the non-contractual agency relationship guidance should not constitute an overriding principle.

28. The HKICPA agrees with our respondents that it is practically difficult to determine whether a de facto agency relationship exists in the absence of a contractual arrangement. We believe that the de facto agency guidance is well-meant, but it is hard to operationalise and highly judgemental to apply in practice.

29. The HKICPA suggests the IASB consider whether it would be appropriate to set a rebuttable presumption in certain circumstances or a principle for assessing whether there is a non-contractual agency relationship in an arrangement to minimise structuring opportunities. We also recommend the IASB consider developing illustrative examples to improve consistent application of the guidance in IFRS 10.B73-B75.

**Question 4(a): Investment entities—Criteria for identifying an investment entity**

30. The HKICPA does not find the application of the investment entities consolidation exception to be common among Hong Kong entities. Having said that, some firms do audit investment entities (mostly as intermediate holding companies) that are incorporated overseas.

31. A few practitioners observed that there is diversity in practice in how ‘investment-related services’ and ‘management services’ in IFRS 10.B85C and IFRS 10.B85D have been interpreted, particularly in real estate investment trusts. They would also like more guidance on the extent of documentation required to provide evidence that the investment entity has an exit strategy for its investments, and whether there are any requirements (e.g. an upper limit) for how long an investment entity could hold the investments in order to show that there is an exit strategy.

32. Others generally considered that there are no significant issues with the criteria for identifying an investment entity.

**Question 4(b): Investment entities—Subsidiaries that are investment entities**

33. The HKICPA noted the following comments made by our respondents:
    - A few respondents considered that requiring an investment entity to measure an investment in a subsidiary that is an investment entity itself at fair value results in a loss of information about the intermediate subsidiary. This information is considered useful and cannot be adequately compensated for by providing additional disclosures. This is particularly the case for wholly-owned intermediate subsidiaries that are set up solely for tax purposes. These

respondents considered that in such cases, the intermediate subsidiaries are extensions of the investment entities, and therefore should be consolidated. They suggested that the IASB reconsider the accounting for the intermediate subsidiaries for these cases.

- However, some other respondents noted that certain companies provide voluntary disclosures about intermediate subsidiaries to meet users' information needs, and users generally find the additional information useful. Accordingly, they suggested that the IASB consider requiring companies to provide additional disclosures about the intermediate subsidiaries to enhance comparability among companies instead of changing the existing measurement approach.

34. The HKICPA noted that the IASB and the IFRIC had considered this issue[2], and noted difficulties in identifying a conceptual basis or a practical way to distinguish different types of subsidiaries that are investment entities. In this regard, we considered that additional disclosure requirements would be helpful to address the potential loss of information on intermediate subsidiaries, and that the IASB could further explore what information would be useful to users.

**Question 5(a): Accounting requirements—Change in the relationship between an investor and an investee**

35. The HKICPA observed that there is diversity in practice in accounting for a partial disposal of a subsidiary that results in a loss of control where the subsidiary does not constitute a business. Some companies remeasure the retained interest (being an associate or a joint venture) at fair value applying IFRS 10.25(b), while others adopt a cost-based approach (i.e. no remeasurement of the retained interest).

    The reasons for companies applying a cost-based approach are:

    - They think there should be symmetry between how an acquirer and a seller account for such a transaction – either as a purchase/sale of shares or a purchase/sale of assets, with the assessment of whether the subsidiary constitutes a business driving that decision:
        - If the subsidiary constitutes a business, then it should be accounted for as a purchase/sale of shares in which case IFRS 3 *Business Combinations* and IFRS 10 apply;
        - If the subsidiary does not constitute a business, then the transaction should be accounted for as a purchase/sale of assets in which case neither IFRS 3 nor IFRS 10 applies.
    - Even though the guidance in IFRS 10.25(b) and B98(b)(iii) does not distinguish between subsidiaries that are businesses from those that are not, practice has emerged to take this factor into account in part due to the introduction of the 'business or non-business' concept from a *seller's* perspective in the *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28 *Investments in Associates and Joint Ventures*).

    We believe that the IASB should clarify this issue.

36. We further observed that transactions involving single-asset entities/corporate wrappers (i.e. a company that is set up solely to hold an asset) are common in the real estate industry in Hong Kong and mainland China. Questions often arise as to whether a company that sells its properties through a corporate wrapper should account for the transaction as sale of properties under IFRS 15 *Revenue from*

[2] Paragraph BC272 of IFRS 10 and IFRIC March 2014 Agenda Decision on Investment Entities Amendments – the definition of investment-related services or activities (IFRS 10)

*Contracts with Customers* (which reflects the substance of the transaction) or as a disposal of a subsidiary under IFRS 10 (which follows the form of the transaction). Some of our respondents considered that applying IFRS 10.25(b) in such cases to recognise a net gain/loss instead of applying IFRS 15 to recognise gross revenue and the related costs of sale may not always provide useful information.

37. We noted similar topics were discussed at IASB and IFRIC meetings on submissions about the sale of a subsidiary to a customer[3], and sale and leaseback of an asset in a single-asset entity[4]. Many respondents considered that the underlying question in both situations is similar – i.e. whether the form of a transaction (sale of an equity interest in a single-asset entity rather than a direct sale of the asset within the entity) should result in any difference in accounting. These respondents questioned the technical basis and the apparent lack of consistency between the IFRIC's preliminary conclusions on these two issues.

38. In light of the above, we recommend that the IASB carry out a fundamental review of the accounting for transactions involving single-asset entities/corporate wrappers, including whether the requirement in IFRS 10.25(b) is applicable to disposals of a subsidiary when the subsidiary does not constitute a business and how it interacts with the recognition of gain or loss in other Standards.

**Question 5(b): Accounting requirements—Partial acquisition of a subsidiary that does not constitute a business**

39. The HKICPA does not find this accounting issue to be persuasive in Hong Kong.

**IFRS 11 *Joint Arrangements***

**Question 6: Collaborative arrangements outside the scope of IFRS 11**

40. Collaborative arrangements that are outside the scope of IFRS 11 are common in pharmaceutical, technology, entertainment, media and increasingly in the telecommunications industries in Hong Kong.

41. Based on respondents' feedback, the HKICPA considers that it is often very difficult to characterise collaborative arrangements appropriately, i.e. is it a joint arrangement, an associate, an equity investment under IFRS 9 *Financial Instruments*, a debt-type loan, a supplier-customer relationship, a prepayment for future expenditure, etc?

42. In some cases, these collaborative arrangements are not joint arrangements because the contractual terms imply one party has control and another has significant influence (despite the arrangement being collaborative in nature); or there are other factors that affect the voting power of the arrangement (for example, when regulation requires votes to be cast by independent directors or others who are not shareholders of the arrangement).

43. These arrangements are often project-based and may not necessarily be structured through a separate legal entity, which amplifies the challenges for characterising the arrangement. In practice, collaborative arrangements are often accounted for

[3] https://cdn.ifrs.org/-/media/feature/meetings/2020/june/iasb/ap12a-maintenance-and-consistent-application.pdf
[4] https://cdn.ifrs.org/-/media/feature/meetings/2021/february/ifric/ap02-sale-and-leaseback-of-an-asset-in-a-single-asset-entity.pdf

under IAS 28 (analogising to associates), IFRS 11 (analogising to a party that participates in but does not have joint control of a joint operation), IFRS 15 (depending on whether the arrangement is housed in a legal structure) or IFRS 9, depending on facts and circumstances. Respondents however considered that such accounting outcomes do not provide useful information. A few practitioners questioned whether it is appropriate to apply equity method accounting to a collaborative arrangement if it is not structured through a separate legal entity. Some respondents considered that accounting for commonly seen collaborative arrangements similarly to joint operations would more faithfully represent the substance of those arrangements.

44. Given the challenges noted above, and that it is expected that these arrangements will be more pervasive in the future (particularly in the telecommunications industry), the HKICPA recommends that the IASB develop clear principles for collaborative arrangements to better reflect the substance of those arrangements.

**Question 7: Classifying joint arrangements**

45. Respondents shared that it is common to consider 'other facts and circumstances' in IFRS 11 to determine the classification of joint arrangements in the oil and gas industry, real estate industry and telecommunications industry.

46. However, respondents generally found the consideration of 'other facts and circumstances' in IFRS 11.B29-B32 challenging to apply as it is subjective. It also opens up structuring opportunities by allowing/requiring management to look beyond the contractual provisions. For example, by asserting through other facts and circumstances that the parties to an arrangement have or do not have rights to the net assets, the joint venture/joint operation classification could be made to achieve a desired outcome (e.g. a company could argue there had been a change in facts and circumstances to reclassify a loss-making joint operation to a joint venture to stop recognising further losses under equity method accounting).

47. Classification challenges also arise when arrangements are structured through a separate vehicle and the legal form is not clearly representative of the underlying economics. Preparer and practitioner respondents noted there are cases where it is difficult for 'other facts and circumstances' to override the legal form, particularly when an arrangement is structured through a separate vehicle but multiple entities share directly in the underlying assets and liabilities of the arrangement (e.g. where multiple real estate developers are entitled to the full rights and obligations attached to different portions of a big piece of land, but that land can be legally held only by one company). There are debates as to whether 'silo accounting' under IFRS 10 or accounting for joint operations under IFRS 11 could be applied. Preparers may find it challenging to draft appropriate contractual terms that can enable such arrangements to be accounted for as a joint operation. It is also often difficult for auditors to use 'other facts and circumstances' to challenge management's classification based on the legal form and contractual terms of the arrangement.

48. Given the complexity of these arrangements in practice, it is often challenging to determine whether the arrangements are primarily designed for the provision of output to the parties, or that the parties in essence have an obligation for the liabilities relating to the arrangement.

49. In light of the above, the HKICPA recommends that the IASB provide more detailed guidance that can be objectively applied in this regard.

**Question 8: Accounting requirements for joint operations**

50. The HKICPA noted from the respondents that joint operations are common only in specific industries and therefore application issues of accounting for joint operations are not pervasive in Hong Kong.

51. The HKICPA notes that there is a lack of guidance on how to determine the joint operator's share of assets, liabilities, revenue and expenses. This is particularly the case when the joint operator's share of output purchased differs from its share of ownership interest in a joint operation (the IFRIC March 2015 Agenda Decision[5] only highlighted the importance of understanding the difference between the two without providing further guidance) or if the share of output is not specified, which may lead to diversity in practice.

**IFRS 12 *Disclosure of Interests in Other Entities***

**Question 9: Disclosure of interests in other entities**

52. The HKICPA agrees with respondents' feedback that the disclosure requirements in IFRS 12 are adequate and there is not a need to further expand the disclosure requirements.

53. Be that as it may, a preparer noted that it is common to have customer-supplier relationships in the aircraft leasing industry arranged through a structured entity. Depending on how the arrangement is structured, a typical customer-supplier relationship may not meet the definition of interest in other entities and will not fall into the disclosure requirements in IFRS 12. The difference in actual circumstances, and in some cases maybe inconsistent application of the Standards, have led to diversity in practice as regards the extent of disclosures provided in terms of IFRS 12 (i.e. whether excluded or included as structured entities). We suggest that the IASB consider clarifying this matter.

**~ End ~**

[5] https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/ifrs-11-accounting-by-the-joint-operator-the-accounting-treatment.pdf