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)

28 January 2015

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

Dear Sirs,

IASB Exposure Draft *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on this Exposure Draft (ED). Our responses to the questions raised in the ED are set out in the Appendix for your consideration.

We support the proposal in the ED that the unit of account for investments in subsidiaries, joint ventures and associates is the investment as a whole.

However, we think that the proposed amendments for the fair value measurement of quoted investments in subsidiaries, joint ventures or associates as the product of the quoted price multiplied by the quantity of financial instruments held would be inconsistent with the proposed unit of account being the investment as a whole. We think that this proposal ignores adjustments that reflect the nature of the investment as a whole which may include, for example, premiums for control or having the right to board representation.

If you have any questions regarding the matters raised in our comment letter, please contact Ben Lo, our Associate Director of Standard Setting at ben@hkicpa.org.hk.

Yours faithfully,

Christina Ng
Head of Financial Reporting

CN/BL

Encl.

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓

Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603

Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

Comment on IASB Exposure Draft *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*

Question 1 – The unit of account for investments in subsidiaries, joint ventures and associates

The IASB concluded that the unit of account for investments within the scope of IFRS 10, IAS 27 and IAS 28 is the investment as a whole rather than the individual financial instruments included within that investment (see paragraphs BC3-BC7).

Do you agree with this conclusion? If not, why and what alternative do you propose?

Yes, we support the proposed clarification that the unit of account for investments in subsidiaries, joint ventures and associates is the investment as a whole instead of the individual financial instruments that make up the investment for the reason contained in paragraph BC6 (that is, the relationship with an investee is the relevant characteristic for such an investment to be included within the scope of IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* and that characteristic indicates the appropriate unit of account for such an investment should be the investment as a whole).

In this connection, we suggest that the IASB should include the rationale in paragraph BC6 of the ED in the body of the relevant standards rather than simply embedding it in the basis for conclusions.

Moreover, we recommend that the IASB should make a more holistic assessment of how the proposal could impact other standards and consider consequential amendments to those standards, such as:

i. investments that are classified as held-for-sale (IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*), and investments to be distributed to owners (paragraph 11 of IFRIC 17 *Distributions of Non-cash Assets to Owners*);

ii. previously-held interests in acquirees in business combinations achieved in stages (paragraph 42 of IFRS 3), business combinations in which the acquiree is listed including fair value measurements of non-controlling interests on acquisition of a listed subsidiary (paragraphs 19 and 33 of IFRS 3); and

iii. the retained interests in the scope of IAS 28 following a loss of control (paragraph 25 of IFRS 10 and paragraph 22 of IAS 28).

Question 2 – Interaction between Level 1 inputs and the unit of account for investments in subsidiaries, joint ventures and associates

The IASB proposes to amend IFRS 10, IFRS 12, IAS 27 and IAS 28 to clarify that the fair value measurement of quoted investments in subsidiaries, joint ventures and associates should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q), or P x Q, without adjustments (see paragraphs BC8-BC14).

Do you agree with the proposed amendments? If not, why and what alternative do you propose? Please explain your reasons, including commenting on the usefulness of the information provided to users of financial statements.

No. We believe that the proposed amendments may be operationally simpler for preparers to apply and a quoted price is a more objective measure. However, we think that the proposed amendments would not be consistent with the unit of account being the investment as a whole. Moreover, the proposed amendments would create an inconsistency for fair value measurement between quoted and unquoted investments.

As the unit of account for such investments is the investment as a whole, the individual instruments' Level 1 input need not be the sole determinant of the fair value of the investments. While we acknowledge that in some circumstances the mathematical product P x Q would be an objective measurement or a good starting point for fair value measurement of such investments, the proposals ignore adjustments that take into account the characteristics of the investment as a whole (for example, the price paid for such an investment may include premiums for control or having the right to board representation), which may or may not be reflected in the quoted price of the individual financial instruments. In this connection, the IASB should also address a possible conflict stemming from the current wording of paragraph 69 of IFRS 13 regarding the unit of account and how to differentiate between 'a premium or discount' and 'a blockage factor'.

Having said that, we acknowledge that such adjustment on the basis of unit of account would be highly judgmental and there is difference in views with regards to the existence and extent of applying a premium or a discount on investments. As such, if the IASB agrees with our view that adjustments to Level 1 fair value measurement should be allowed to reflect control premiums, for example, we also suggest that the IASB requires additional disclosure that explains the reason for such adjustments, as well as the basis and assumptions adopted.

<u>Question 3 – Measuring the fair value of a CGU that corresponds to a quoted entity</u>

The IASB proposes to align the fair value measurement of a quoted CGU to the fair value measurement of a quoted investment. It proposes to amend IAS 36 to clarify that the recoverable amount of a CGU that corresponds to a quoted entity measured on the basis of fair value less costs of disposal should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q), or P x Q, without adjustments (see paragraphs BC15-BC19). To determine fair value less costs of disposal, disposal costs are deducted from the fair value amount measured on this basis.

Do you agree with the proposed amendments? If not, why and what alternative do you propose?

Similar to our comments in Question 2, we disagree with these proposed amendments because the proposed measurement basis (i.e., P x Q) for a CGU is contrary to the core principles contained in IFRS 13 (i.e., to measure fair value of an asset on a basis that is consistent with its appropriate unit of account).

The ED refers to CGUs that correspond to a quoted entity. IAS 36 defines a CGU as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets. Even if a CGU is largely consistent with a listed entity, the CGU would likely exclude items such as liabilities and tax. As such, situations where CGUs are identical to listed entities may be rare. Furthermore, the use of the term 'corresponds' in the ED is not clear. Accordingly, it is unclear as to whether the IASB intends for the proposed requirements to apply to:

- only those situations where the CGU is identical to the listed entity; or
- in some, or all, situations where a CGU is similar to, but not necessarily identical to, a listed entity.

<u>Question 4 – Portfolios</u>

The IASB proposes to include an illustrative example to IFRS 13 to illustrate the application of paragraph 48 of that Standard to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy. The example illustrates that the fair value of an entity's net exposure to market risks arising from such a group of financial assets and financial liabilities is to be measured in accordance with the corresponding Level 1 prices.

Do you think that the proposed additional illustrative example for IFRS 13 illustrates the application of paragraph 48 of IFRS 13? If not, why and what alternative do you propose?

We think that the proposed example for IFRS 13 illustrates the application of paragraph 48, however, we suggest that the IASB should also include a clarification in the body of IFRS 13, such as in the application guidance.

<u>Question 5 – Transition provisions</u>

The IASB proposes that for the amendments to IFRS 10, IAS 27 and IAS 28, an entity should adjust its opening retained earnings, or other component of equity, as appropriate, to account for any difference between the previous carrying amount of the quoted investment(s) in subsidiaries, joint ventures or associates and the carrying amount of those quoted investment(s) at the beginning of the reporting period in which the amendments are applied. The IASB proposes that the amendments to IFRS 12 and IAS 36 should be applied prospectively.

The IASB also proposes disclosure requirements on transition (see paragraphs BC32-BC33) and to permit early application (see paragraph BC35).

Do you agree with the transition methods proposed (see paragraphs BC30-BC35)? If not, why and what alternative do you propose?

If the IASB agrees with our view in Question 2, we do not agree with the proposed transition provisions. We think that fair value measurement is an estimate by nature and the proposed amendments would result in changes in estimates. Therefore, we suggest the IASB should require prospective application for all amendments proposed in this ED which we consider as consistent with the prospective application requirement of IFRS 13 when entities first applied the standard.

On the other hand, we agree with the proposed transition provisions if the IASB were to finalise the amendments proposed in Question 2 (that is, if the IASB were to conclude that there is no better way than P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in active market) in order to provide comparable information to users.

Other comments

Along with our request to allow adjustments to Level 1 prices of an investee and include a requirement to disclose the reasons for, and the basis and assumptions of such adjustments in Question 2 above, we note that in general there is no specific disclosure requirement on the fair value measurement of assets and liabilities initially recognised at fair value (and subsequently carried as deemed cost) upon the application of acquisition accounting. In some cases, such fair value measurement could have a significant impact to the income statement, e.g. business combination in exchange for non-monetary consideration and remeasurement of previously held interest, etc. We therefore suggest the IASB to consider developing disclosure requirements (either in IFRS 3 or IFRS 13) for fair value determination on application of acquisition accounting to provide users with relevant financial information.

In addition, the current proposals highlight the need for establishing very clear unit of account principles in the Conceptual Framework.

~ End ~