



RECEIVED
19 DEC 2011
BY: WJN 16 5700

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

15 December 2011

BY FAX (2865 6776)
AND BY POST

Our Ref: LD/CC/118-11

Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Dear Steve,

IASB Exposure Draft on Investment Entities (the "Exposure Draft")

I refer to your letter dated 15 November 2011 on the above to our Mr. Mark Dickens which has been passed to me for my attention.

The Exposure Draft seeks views on the proposal for an exception from the requirement in IFRS 10 "Consolidated Financial Statements" to consolidate interests held in controlled entities, that is, subsidiaries, when the parent entity meets the definition of an "investment entity". The Exposure Draft proposes that once an entity has determined that it controls an investee, it will need to consider whether or not it meets the criteria for qualifying as an investment entity. If the entity meets the criteria, its investments held in controlled investees would not be consolidated but would be measured at fair value through profit or loss in accordance with IFRS 9 "Financial Instruments".

We are pleased to be given the opportunity to comment on the Exposure Draft and our comments are set out below.

General

We fully support the dissenting views and comments of the three IASB Board members, Mr. Warren J McGregor, Sir David Tweedie, and Mr. Tatsumi Yamada which are set out in pages 45 to 49 of the Exposure Draft and likewise do not agree with the proposals as they will be a departure from the basic principle that consolidated financial statements should normally be prepared by parent entities that have interests in subsidiaries.

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

We believe that the proposals are unduly complex and would result in the presentation of financial statements that are less representationally faithful than would be the case if the subsidiaries were consolidated. We believe consolidated financial statements provide the best information to the greatest number of users about the performance and the underlying assets and liabilities of the reporting group as a whole.

We would also stress that consolidated financial statements require elimination of all intra-group transactions and balances but this would not be done under the Exposure Draft's proposals.

Fundamental conceptual issues

The concept of "control", which is the effective holding of the risks and rewards of "majority ownership" and the power of "majority control", is fundamental to the preparation and presentation of financial statements, at both the individual legal entity level and at the group reporting level.

The Exposure Draft's proposals will be a departure from this principle and we believe that the proposals are unduly complex, rule-based and will result in financial statements that are difficult to understand. Moreover, the resulting financial statements will not be comparable to other reporting groups that also have subsidiaries.

We believe that the rationale put forward for the exception is not justified, namely, that for "investment entities" the fair value of its interests in investees is more relevant and the investments should be stated at fair value. As expressed in my earlier letters to the Institute, we believe that fair value re-measurements should not be recognized in the income statement or the statement of other comprehensive income ("OCI") as fair value re-measurements represent the recognition of hypothetical transactions between hypothetical parties and at hypothetical prices. Although fair value information is useful, we believe that fair value information is better presented in the notes to the financial statements. We note from paragraph AV8 of the Exposure Draft that some IASB Board members also take this view.

The real issue is not whether subsidiaries should be excluded from consolidation but whether investment entities as well as other companies should be permitted to recognise fair value re-measurements in their primary financial statements. This issue should be deliberated in the Conceptual Framework project.

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

The IASB has yet to deliberate on the conceptual basis for regular re-measurements of selected assets and liabilities to fair value with the resulting gains and losses being recognized in the income statement or OCI and address the question of whether this results in a true reflection of the actual performance and financial position of the reporting entity. Until this basic fundamental conceptual issue has been discussed and resolved, we believe that it is premature to consider the proposed exception in IFRS 10 by introducing more detailed rules which are highly subjective and will likely be subject to different interpretations and abuse.

Moreover, as mentioned in our earlier letter to you dated 9 November 2011 on the IASB's "Agenda Consultation 2011", there is a need to revisit a number of conceptual matters including the following: -

- (a) what should be accounted for and included in the primary financial statements to show the true performance and financial position of a reporting entity;
- (b) the conceptual rationale and purpose of presenting group or consolidated financial statements; and
- (c) the conceptual rationale and purpose of equity accounting for interests in associates and joint ventures.

These conceptual matters should be deliberated and resolved before the development and revision of detailed accounting standards.

Intention of the acquisition in a subsidiary

We also believe a key question that needs to be addressed is why an investment entity would acquire majority control over another entity if it has no intention to have power and direct the use of its underlying assets and liabilities. We would expect that most investments held by investment entities should be below the threshold of "major controlling" interest and these would normally be held for trading or are available for sale.

We believe there may be some circumstances where it would sometimes be appropriate to not consolidate a subsidiary and possibilities include where the investment is intended to be temporary and will be disposed of within twelve months after its acquisition. This would be the case where the acquisition is the result of exercising rights over collateral for non-repayment of a loan. Another reasonable exception from consolidation could be where the parent is acting solely as an intermediate holding company and its parent prepares consolidated financial statements and those statements are made available to the same investors and interested parties.

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

Criteria for an “investment entity”

Under the proposals under page 12 of the Exposure Draft, an investment entity is an entity that meets all of the following criteria: -

- “2(a) The entity’s only substantive activities are investing in multiple investments for capital appreciation, investment income (such as dividends or interest), or both (see paragraphs B1 – B6 – nature of the investment activity).*
- (b) The entity makes an explicit commitment to its investors that the purpose of the entity is investing to earn capital appreciation, investment income (such as dividends or interest), or both (see paragraphs B7 – B11 – business purpose).*
- (c) Ownership in the entity is represented by units of investments, such as shares or partnership interests, to which proportionate shares of net assets are attributed (see paragraphs B12 and B13 – unit ownership).*
- (d) The funds of the entity’s investors are pooled so that the investors can benefit from professional investment management. The entity has investors that are unrelated to the parent (if any), and in aggregate hold a significant ownership interest in the entity (see paragraphs B14 – B16 – pooling of funds).*
- (e) Substantially all of the investments of the entity are managed, and their performance is evaluated, on a fair value basis (see paragraph B17 - fair value management).*
- (f) The entity provides financial information about its investment activities to its investors. The entity can be, but does not need to be, a legal entity (see paragraphs B18 - B20 - disclosures).”*

We have concerns on the proposed criteria for investment entities and believe that the only unique feature that may distinguish investment entities from other companies is perhaps criteria 2(e). All the other characteristics or criteria would appear to equally apply to all other business entities. Accordingly, we believe that the proposed criteria are insufficient to separately identify “investment entities” from other entities.

Moreover, as a drafting convention we would comment that the wording of standards should be simple and self-explanatory and there should not normally be the need to refer to guidance contained elsewhere. The current draft is worded in such a way that the unique meaning of the criteria is unclear and requires the reader to make reference to the additional guidance which we believe is also open to different interpretations.

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

Change in status of investment entities

The Exposure Draft only briefly discusses how a change in the status of an investment entity should be treated and proposes that the change in status should be accounted for prospectively from the date of the change in status. A change in status may result solely from a change in meeting one of the proposed criteria for an investment entity as mentioned above. However, we would note that the criteria bear no relationship to the company's "holding" of a majority controlling interest in a subsidiary.

We believe that accounting for the effect of a change in status will be more complicated to deal with than the Exposure Draft seems to suggest. Currently, consolidation and how fair values of the assets and liabilities of a subsidiary are determined are based solely on changes in the percentage interest in the investee and the timing of when majority control is obtained. Other transactions and other characteristics such as the criteria as mentioned above are not taken into account. The Exposure Draft therefore introduces other factors in determining whether consolidated financial statements should be prepared.

In summary, under the proposals there can be a change in the status of the investment entity which may trigger consolidation or non-consolidation even when its controlling interest in a subsidiary has not changed.

We also believe that it is necessary for the IASB to clearly distinguish the accounting required at the separate legal entity level and the accounting required when preparing consolidated financial statements of a reporting group. We believe they have different purposes. The latter is an attempt to show the underlying assets and liabilities of all the subsidiaries in the group after elimination of intra-group transactions and balances between all the companies within the reporting group.

Pooling of funds

Paragraphs B14 to B16 touch on issues which we would regard as falling under the accounting issues that arise in circumstances where there is "common control". Paragraph B14 states that "*Investors that are considered to be related to the parent shall be treated as a single investor for the purposes of applying this criterion.*" We note that the IASB has yet to deliberate and consider the related topic of "business combinations under common control" and we believe that care needs to be taken to ensure that the IASB's proposals in the Exposure Draft and other standards are conceptually sound, consistent across all standards, and will be able to stand the test of time.

The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

Specialised accounting

Finally, we note that in page 11 of the Exposure Draft it is commented that the proposals are intended to provide “specialised accounting” for specific types of entities. We believe that this raises a larger and more fundamental issue that should be deliberated by the IASB as currently the intent and focus of the IASB is to produce “general purpose accounting standards” that should be applied by all companies irrespective of the specific industry in which a company operates. If “specialised accounting” is the way forward, the IASB should consider whether specialised accounting should be developed for other specialised industry sectors such as the bank, insurance and securities industries.

We hope that the above comments are useful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited



Colin Chau
Senior Vice President
Listing Division

CC/KYS/el

c.c. Mr. Mark Dickens JP – Head of Listing