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

Meeting with the SMPC Working Group on Technical Issues
(via video-conference)

Date: 18 March 2021
Time: 2:30-4:30pm

IASB Request for Information (RFI) – Post-implementation Review (PIR) of IFRS 10, 11 and 12

- Working Group members noted the objective of the meeting is to seek their feedback on the RFI.
- Members received an overview of the PIR and a brief summary on the areas of focus of the RFI.

IFRS 10 Consolidated Financial Statements

a) Power over an investee

- A member shared his view that the general consolidation principle should include both effective ownership (i.e. having the rights to possess and direct the use of the asset as an owner) and control over the investee. The elements of control are specified in paragraph 7 of IFRS 10, while the element of effective ownership is not clear in IFRS 10. In this member's views, the owner is the one who has the legal title or has ownership over an investee through contracts, and has the ability to use its power to affect the investee's returns so that effectively the returns would flow to the owner. He also considered this general consolidation principle could help assess whether a decision maker is a principal or an agent (i.e. the principal is the owner).
- This member also shared an example that determining whether right is substantive or protective is challenging. A university establishes an entity, which obtains funding from the government subject to certain conditions. Diversity in views is noted in considering whether the right entitled by the government to restrict the activities of the entity is substantive or protective, which in turn affects whether the university or the government has power over the entity.
- A member commented that the application examples in paragraph B13 of IFRS 10 provide a list of factors for determination of which investor has power over an investee and it would be more helpful if a conclusive answer could be provided for each of the illustrative examples.
- This member agreed with the stakeholders' feedback obtained by the IASB in phase

one of the PIR that the identification of relevant activities when two or more investors each have rights that give them unilateral ability to direct different activities at different times is challenging and involves significant judgement.

- A member shared his experience in a de facto control assessment, which is considered to be challenging, though it is not common in practice. A listed company A invested in 40% equity interest in another listed company B. Some of the shareholders of listed company B rarely involved in voting historically, so the overall voting participation is around 70%-80% only. Hence, management concludes that listed company A has voting rights of 50-57% effectively and has de facto control over listed company B. However, as the voting pattern changes for every shareholders' meeting and the shareholdings in listed company B changes over time, it is practically difficult and burdensome for listed company A to carry out the control reassessment continuously. Questions also arise as to whether listed company A loses or obtains control over listed company B whenever the voting pattern or the shareholdings in listed company B changes.
- This member also shared his views that it is practically difficult to assess whether rights are substantive or protective, for example, whether right to approve borrowing over a certain amount is substantive or protective, and this may be subject to facts and circumstances. This member observed that local preparers do not fully make use of available information in applying the requirements of the standard. However, he considered that this is not the problem of the Standard and standard-setters could not help much in this regard.

b) The link between power and returns

- No major comments noted from the members.

c) Investment entities consolidation exception

- Most members noted that there is not much local experience of applying the investment entities consolidation exception in IFRS 10.
- A member suggested that the IASB should reconsider the underlying rationale of providing the consolidation exception for investment entities. This member considered that investment entities effectively own and control the underlying assets and liabilities of their investees. Therefore, investment entities should consolidate every line items of the investees instead of measuring them at fair value. In this member's views, measuring those investees at fair value at the year-end or a particular point in time would not be useful and relevant when investment entities hold their investments for

long-term purposes.

- A member noted that the disclosure requirements in IFRS 12 for investment entities may compensate for some of the information loss (as raised by the stakeholders in phase one of the PIR) as a result of applying the investment entities consolidation exception.
- Another member noted a case where a large company sets up an investment vehicle to hold investments as venture capital fund, and would like to apply the investment entities consolidation exception for this sub-group. However, during the start-up stage, there are only 2 – 3 shareholders who are all related parties and there is no external investor yet. The entity cannot meet the definition of investment entities under paragraph 27 and the typical characteristics of investment entities in paragraph 28 of IFRS 10. Accordingly, the entity cannot apply the investment entities consolidation exception. This member considered that the definition of investment entities is robust but preparers may not fully understand the underlying rationale of the requirements in IFRS 10.
- A member noted that IAS 28 *Investment in Associates and Joint Ventures* provides an option for venture capital organisations, mutual funds and trust funds to measure their equity-accounted investees at fair value. This member considered that IAS 28 seems to allow a wider group of entities than only investment entities to measure their investments in associates and joint ventures at fair value, while the investment entities consolidation exception seems to be more restrictive.

d) Accounting requirements – change in the relationship between an investor and an investee

- Members do not have major comments on the accounting requirements in relation to change in the relationship between an investor and an investee.
- A member noted that in her experience, transactions that alter the relationship between an investor and an investee and that are not addressed in IFRS (particularly for transactions involving joint operations) are not common in Hong Kong.

e) Accounting requirements – partial acquisition of a subsidiary that does not constitute a business

- Most members noted that partial acquisition of a subsidiary that does not constitute a business are not common in Hong Kong.
- A member considered that if an investor acquires a partial interest in a subsidiary that does not constitute a business, then such transaction is an asset acquisition. In such case, the investor would allocate the consideration paid to the assets and/or liabilities

acquired. For example, if the subsidiary acquired only holds an investment property, then the investor would recognise the investment property according to IAS 40 *Investment Property.*

- Another member considered that the investor should consolidate the investee and recognise the non-controlling interests according to IFRS 10, but that the investor would not measure the assets and liabilities acquired at fair value at the date of acquisition because the acquired subsidiary does not constitute a business under IFRS 3. This member considered that there may be an accounting issue when the subsidiary later constitutes a business if no non-controlling interests is recognised at the beginning.

IFRS 11 *Joint Arrangements*

- Most of the members shared that joint arrangements are not common in their experience.
- A member suggested the IASB provides guidance or develops financial reporting principles for collaborative arrangements as there is a lack of guidance in IFRS on how to account for collaborative arrangements.
- A member considered that the IFRIC March 2015 Agenda Decision[1] does not provide sufficient guidance on how to account for situations when the joint operator's share of output purchased differs from its share of ownership interest, and suggested the IASB provides clear guidance on how to determine the appropriate accounting on the disproportion between the share of output and the share of ownership interest.
- A member commented that IFRIC Agenda Decisions are accounting guidelines explaining how to apply IFRS. However, many stakeholders find it difficult to keep track of the IFRIC Agenda Decisions as they are not included in the HKICPA Members' Handbook. In addition, he commented that it is arguable that applying IFRIC Agenda Decisions would result in change in accounting policy as there is no change to the Standards.

IFRS 12 *Disclosure of Interests in Other Entities*

- Most of the members considered that the disclosure requirements in IFRS 12 are adequate and there is no need to further expand the disclosure requirements.
- A member commented that there is an inconsistency between the IFRIC January 2015 Agenda Decision and paragraph B11 of IFRS 12 in assessing whether a subsidiary has non-controlling interests that are material to the reporting entity. IFRIC January 2015 Agenda Decision suggests that the materiality assessment would be performed on a basis

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[1] *Accounting by the joint operator: the accounting treatment when the joint operator's share of output purchased differs from its share of ownership interest in the joint operation (IFRS 11 Joint Arrangements).*

that is consistent with the information included in the consolidated financial statements of the reporting entity while paragraph B11 of IFRS 12 requires the reporting entity discloses the summarized financial information of the subsidiary with material non-controlling interests before inter-company eliminations. He considered that the disclosure of the summarized financial information of the subsidiary with material non-controlling interests before inter-company eliminations is meaningless and this summarized financial information should be after inter-company eliminations in order to align with the materiality assessment stated in the IFRIC Agenda Decision.