



Our Ref.: C/FRSC

**Sent electronically through the IASB Website ([www.iasb.org](http://www.iasb.org))**

26 November 2008

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

Dear Sirs,

**IASB Exposure Draft of Proposed Improvements to IFRSs**

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 the captioned Exposure Draft. Our responses to the questions raised in the Exposure Draft are set out in the Appendix for your consideration.

We generally agree that the proposed amendments are appropriate matters to be addressed in the Annual Improvements Project except for the following two matters which we have some concerns:

- (a) *IAS 7 Statement of Cash Flows* - Classification of expenditures on unrecognised assets.

The proposed amendment to IAS 7 changes the classification of cash flows arising from investing activities from a principle-based approach to a rule-based approach. We are concerned that the proposed amendments would lead to the classification of a cash flow as operating activity instead of investing activity when an expenditure economically represents an investing activity but does not result in a recognised asset. We would prefer this issue to be addressed in the recent Discussion Paper on *Financial Statement Presentation* rather than as part of the Annual Improvements Project.

- (b) *IAS 39 Financial Instruments: Recognition and Measurement* – Application of fair value option

We are concerned that the proposal to clarify that the fair value option in paragraph 11A applies only to financial instruments with embedded derivative may mean a substantial change to many preparers. We would recommend that the IASB expands the amendment to clarify the accounting treatment in the area where the host contract is outside the scope of IAS 39 and deal with the proposed amendment in a specific exposure draft instead of within the scope of the Annual Improvements Project.

The Appendix also sets out our other comments on some of the proposed amendments.



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

If you have any questions on our comments, please do not hesitate to contact me at [ong@hki CPA.org.hk](mailto:ong@hki CPA.org.hk).

Yours faithfully,

Steve Ong, FCA, FCPA  
Deputy Director, Standard Setting Department

SO/WC/ac

## Hong Kong Institute of CPAs

### Comments on the IASB Exposure Draft of Proposed Improvements to IFRSs

#### Question 1

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

#### Question 2

Do you agree with the proposed transition provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

We set out our responses to those proposed amendments which we have particular concerns or suggestions as follows.

#### a. IAS 7 Statement of Cash Flows – Classification of expenditures on unrecognised assets

We do not agree with the proposed amendment to IAS 7 to state explicitly that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activities. The proposed amendment changes the classification of cash flows arising from investing activities ("resources intended to generate future income and cash flows") from a principle-based approach to a rule-based approach. We are concerned that the proposed amendment would lead to the classification of a cash flow as operating activity instead of investing activity when an expenditure economically represents an investing activity but does not result in a recognised asset. For example, initial expenditure for development activities that do not meet the "asset recognition rule" would be allocated to "operating activities" under the proposed amendment even if the expenditure may have been made as part of an entity's investing activities. We believe that the classification of cash flows should be based on the business activity of an entity and the policy used to classify the cash flows under each category should be transparent and be clearly disclosed to the users.

We are aware that the recent Discussion Paper on *Financial Statement Presentation* proposes new guidance in this regard. Therefore, we would prefer that this issue be addressed in the Financial Statement Presentation project rather than as part of the Annual Improvements Project.

#### b. IAS 39 Financial Instruments: Recognition and Measurement – Application of fair value option

We appreciate the intent of the proposed amendment to clarify the situations where the fair value option can be applied in paragraph 11A of IAS 39. However, we are concerned that providing clarification in this way may mean a substantial change to many preparers, in particular, for those contracts relating to the purchase of commodities (often energy purchases/sales). For example, consider a contract to purchase a fixed amount of electricity per annum at a price based on the price of coal. In the case that the purchaser has a business need for electricity,

the contract as a whole would be outside of the scope of IAS 39. The price clause that causes the payments under the contract to vary with coal prices is regarded as an embedded derivative that is not closely related to the contract, and accordingly would be separated and accounted for at fair value through profit or loss. Due to the lack of guidance on accounting embedded derivatives in the host contract that is outside the scope of IAS 39, preparers may just simply follow the principles applicable to financial instruments (i.e. interpreting IAS 39.11A as allowing the entire contract to be accounted for as at fair value through profit or loss, without needing to separately account for the embedded derivative).

We would recommend that the IASB expands the amendment to clarify the accounting treatment in the area where the host contract is outside the scope of IAS 39 and deal with the proposed amendment in a specific exposure draft instead of within the scope of the Annual Improvements Project.

**c. IAS 39 Financial Instruments: Recognition and Measurement – Bifurcation of an embedded foreign currency derivative**

We support the objective of the proposed amendment which is to clarify what the 'economic environment' is in determining whether a currency is commonly used in contracts to buy or sell non-financial items and therefore whether it is closely related to the host contract.

However, we consider that the proposal does not achieve the purpose of enhancing clarification as intended. In the proposed amendment, IAS 39.AG33(d)(iii) states that 'a currency that has one or more of the characteristics of a functional currency, as set out in paragraph 9 of IAS 21 [*The Effects of Changes in Foreign Exchange Rates*], of a substantial party to the contract' is a currency which results in an embedded foreign currency derivative meeting the condition of being closely related. Accordingly, an entity does not account for the embedded derivative separately from the host contract. We are concerned that this proposed amendment seems to overlap with the existing requirement of IAS 39.AG33(d)(i) (functional currency of any substantial party to that contract). Therefore, we do not believe that the proposed amendment achieves any greater clarity than the existing guidance.

We note that IAS39.BC18-19 provide a more comprehensive explanation of the principle of the amendment - embedded foreign currency derivatives shall not be separated from the host contract if they are integral to the contractual arrangement, i.e. they have been entered into for reasons that are clearly not based on achieving a desired accounting result or for speculative purposes. Hence, we would suggest IASB redrafts the amendment in the light of the IAS 39.BC18 with clear definition to the term "integral to the arrangement" and moves IAS 39.BC19 to the application guidance as a list of examples where the principle will be met.

Regarding the effective date of the proposed amendment and the transitional provisions, we consider that it is unclear on how to interpret "prospective application". Does prospective means that an entity should stop accounting for existing contracts with embedded derivatives separately from the effective date with no adjustment of comparatives or does it mean that the amendment only applies to contracts entered into on or after the effective date.

**d. IFRS 8 Operating Segments – Disclosure of information about segment assets**

We agree with the objective of this amendment. As explained in paragraph BC10 of IFRS 8, the management approach for segment reporting allows users to review an entity's operations from the same perspective as management. It follows that disclosure of information about segment assets should not be required if it is not reviewed by the Chief Operating Decision Maker and paragraph BC35 appears to be in contradiction with paragraph BC10 of the extant IFRS 8.

However, we are of the opinion that the clarification should be made by amending the wording of paragraph 23 of IFRS 8 rather than only amending the Basis for Conclusions. We propose changing paragraph 23 of IFRS 8 as "An entity shall report a measure of profit or loss and ~~total assets~~ for each reporting segment. An entity shall report a measure of total assets and liabilities for each reporting segment if such an amount is regularly provided to the chief operating decision maker. ...". We consider that the Basis for Conclusions should be used for explaining the reason of the Standard instead of, containing requirements or guidance of the Standard.

We understand that the clarification is to be reflected in the Basis for Conclusions only and therefore the exposure draft does not propose an effective date for the amendment. However, as suggested above, we would like the amendment be made in the Standard itself to enhance the clarity in this respect with the rationale behind included in the Basis for Conclusions. Accordingly, we believe that an effective date of 1 January 2010 should be added with a requirement of retrospective application.

**Question 3**

**The Board proposes to include in the Appendix of IAS 18 *Revenue* guidance on determining whether an entity is acting as a principal or as an agent. What indicators, if any, other than those considered by the Board should be included in the guidance proposed?**

While we support IASB's proposal to include guidance to address the issue of whether an entity is acting as a principal or as an agent, we express our concern that the proposed guidance included in the Appendix of IAS 18 will not form part of the Standard. We therefore suggest presenting this guidance as application guidance.

We note that some of the indicators provided are consistent with some of those provided in US GAAP (in EITF 99-19). We believe that some of the other indicators in EITF 99-19 are useful indicators that the entity is acting as principal merit inclusion:

- The company changes the product or performs part of the service (EITF 99-19 paragraph 10).
- The company has discretion in supplier selection (EITF 99-19 paragraph 10).



- The company is involved in the determination of product or service specifications. (EITF 99-19 paragraph 10).

We also note that EITF 99-19 paragraph 6 states that none of the indicators should be considered presumptive or determinative and the relative strength of each indicator should be considered. We would suggest to the IASB that similar guidance should be included in the proposed amendment.

We propose that an effective date of 1 January 2010 with no transitional requirements and permitting earlier application should be added in respect of the proposed amendment.

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