

# Fundamental Principles of Group Accounts



- A True and Fair View of the Group
- What make up a Group? Parent and Subsidiaries (Control-based Definition)
- No control means no group relationship and no need for consolidation
  - The “Genuine” sale situation of a Securitization transaction (sale by an originator to a party over which they have no control at all)



# A Genuine Sale Situation – Control





Parent's A/C	<u>Assets</u>  Securitized Assets <b>Removed</b> as it is sold to the SPE at \$1,000,000	<u>Liabilities</u>  Assets-backed Securities <b>Not Relevant</b> as they are NOT issued by originator	<u>Assets</u>  Securitized Assets <b>Derecognized</b>	<u>Liabilities</u>  Asset-backed Securities <b>Not Consolidated</b>	Group A/C
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# A Controlled-SPE Situation (**With** guarantee provided by the Parent)

Parent's A/C	<u>Assets</u>  Securitized Assets <b>Removed</b> as it is sold to the SPE at \$1,000,000	<u>Liabilities</u>  <b>Contingent Liability</b> disclosed in the footnote
SPE's A/C	<u>Assets</u>  Securitized Assets  \$1,000,000	<u>Liabilities</u>  Asset-backed Securities  \$1,000,000



# A Controlled-SPE Situation (**With** guarantee provided by the Parent)

Parent's A/C	<u>Assets</u>  Securitized Assets <b>Removed</b> as it is sold to the SPE at \$1,000,000	<u>Liabilities</u>  <b>Contingent Liability</b> disclosed in the footnote	<u>Assets</u>            Securitized Assets <b>Recognized</b>  \$1,000,000	<u>Liabilities</u>            Asset-backed Securities <b>Consolidated</b>  \$1,000,000	Group A/C (P+SPE)
SPE's A/C	<u>Assets</u>  Securitized Assets  \$1,000,000	<u>Liabilities</u>  Asset-backed Securities  \$1,000,000			

# A Controlled-SPE Situation (Without guarantee undertaken by the Parent)

Parent's A/C	<u>Assets</u>  Securitized Assets <b>Removed</b> as it is sold to the SPE	<u>Liabilities</u>  <b>No need to</b> record the Contingent Liability
SPE's A/C	<u>Assets</u>  Securitized Assets  \$1,000,000	<u>Liabilities</u>  Asset-backed Securities  \$1,000,000

# A Controlled-SPE Situation (Without guarantee undertaken by the Parent)



Parent's A/C	<u>Assets</u>  Securitized Assets <b>Removed</b> as it is sold to the SPE	<u>Liabilities</u>  <b>No need to</b> record the Contingent Liability	<u>Assets</u>    Securitized Assets <b>Recognized</b> \$1,000,000	<u>Liabilities</u>    Asset-backed Securities <b>Consolidated</b> \$1,000,000	Group A/C (P+SPE)
SPE's A/C	<u>Assets</u>  Securitized Assets \$1,000,000	<u>Liabilities</u>  Asset-backed Securities \$1,000,000			

# Off-Balance Sheet Treatment of a Controlled SPE

Parent's A/C	<u>Assets</u>  Securitized Assets <b>Removed</b> as it is sold to the SPE	<u>Liabilities</u>  <b>Contingent Liability or No Liability</b>
SPE's A/C	<u>Assets</u>  Securitized Assets  \$1,000,000	<u>Liabilities</u>  Asset-backed Securities  \$1,000,000

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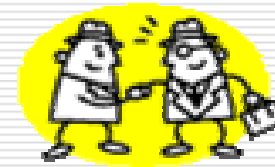
<u>Assets</u>  	<u>Liabilities</u>  	Group A/C (P+SPE)
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Note: You know what, the parent company has sold assets to a controlled SPE. Had it been consolidated, the securitized assets would amount to \$1,000,000. The asset-backed securities amount to \$1,000,000.

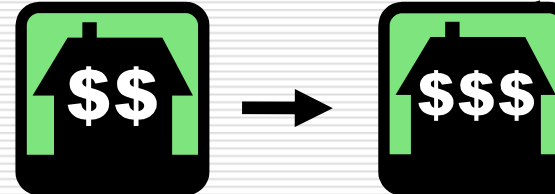


# Companies (Amendment) Bill 2004

- Align the “Control”-based Definition of CO more closely with IAS



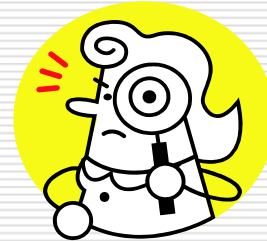
- Introduction of a “Dominant Influence” Test to Catch “Controlled-SPE” belonging to the Group



- Substance Over Form: To plug the loophole of the existing narrower consolidation requirements under CO

# Impact on Securitization Market

□ Adverse Impact on Ratios !?

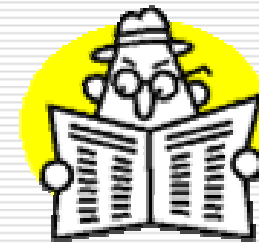


□ To Sophisticated Investors?

- They can see through off-balance-sheet window dressing all the time.

□ To General Ordinary Investors !?

- Consolidation presents a clearer picture



□ Consistency for corporations using either IAS or HKAS

□ Better Financial Reporting means Better Market Quality.

# Hong Kong as an International Financial Centre



Importance of Corporate Governance

Transparency of Financial Disclosure



Investor Protection

Market Quality



Quality of Financial Reporting Standards:  
Convergence with IFRS