



BY E-MAIL AND BY POST

Our Ref.: C/GSBWG

17 September 2004

Mr. Paul Pacter
Director of Standards for SMEs
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr Pacter,

***IASB Discussion Paper Preliminary Views on Accounting Standards
for Small and Medium-sized Entities***

We welcome the opportunity to comment on the IASB's Discussion Paper on the Board's Preliminary Views on (International) Accounting Standards for Small and Medium-sized Entities. Our comments are attached to this letter.

In keeping with our standard setting due process, and our policy of converging Hong Kong's Financial Reporting Standards with those issued by the IASB, the Hong Kong Institute of Certified Public Accountants (HKICPA), formerly known as the Hong Kong Society of Accountants, issued an Invitation to Comment on the IASB Discussion Paper, a copy of which appears on the HKICPA website at:
http://www.HKICPA.org.hk/professionaltechnical/accounting/exposedraft/IASB_250604.pdf.
In preparing our comments, we have also consulted with members of the HKICPA's GAAP for Small Businesses Working Group, who had earlier been tasked with drafting the HKICPA Small GAAP Consultation Paper, also referred to in our comments attached.

If you have any questions on our comments, please contact Mr Simon Riley, Technical Director (Financial Reporting), at the HKICPA.

Yours sincerely,

WINNIE C.W. CHEUNG
CHIEF EXECUTIVE & REGISTRAR

WCC/SR/al

HKICPA's Comments on the IASB Discussion Paper
Preliminary Views on Accounting Standards for Small and Medium-sized Entities

Overview

We express our general disagreement with the IASB's Preliminary Views (PV).

We appreciate the IASB's difficulty in achieving a consensus view on the matter. This has been the HKICPA Working Group's experience in formulating a First Consultation Paper in 2002 and, in follow up to the comments received on that round of consultation, the Second Consultation Paper issued by the HKICPA on 17 May 2004.

We consider that our experience from the First Consultation in 2002 and the proposals currently in issue in Hong Kong for public comment would assist in providing further detail about our views on the IASB Discussion Paper and on how the IASB's small GAAP project should proceed. Relevant links are as follows:

First Consultation (2002)

Consultation Paper:

http://www.HKICPA.org.hk/professionaltechnical/accounting/rm/consultation_paper.pdf

Comment letters received:

http://www.HKICPA.org.hk/professionaltechnical/accounting/rm/ias_consultation_paper.php

Second Consultation (2004)

Consultation Paper:

http://www.HKICPA.org.hk/professionaltechnical/accounting/exposedraft/SME-GAAP_CP-IIcl.pdf

Draft SME Financial Reporting Framework:

http://www.HKICPA.org.hk/professionaltechnical/accounting/exposedraft/SME-FRF_CP-IIcl.pdf

Draft SME Financial Reporting Standard:

http://www.HKICPA.org.hk/professionaltechnical/accounting/exposedraft/SME-FRS_CP-IIcl.pdf

Our comments make extensive reference to the Second Consultation documents. Accordingly, we would like to have those documents taken into account together with the comments expressed in this letter.

We consider that, if it proceeds with the Small GAAP project, the IASB should develop a separate framework explaining the rationale for having small GAAP in place and the basis on which the different requirements are developed. This is what the Draft Framework issued by the HKICPA for Consultation seeks to achieve.

Issue 1 - Development of IASB Small GAAP

Question 1(a): We disagree with the proposition that full IFRS are suitable for all entities. The rationale for this is reflected in the Draft Framework issued with the HKICPA's Second Consultation Paper - circulates around the cost:benefit issue and different needs of users of SME financial statements (there being a different user group).

Question 1(b): Concern was expressed that the IASB's development of a separate set of financial statements for SMEs could be in contravention of the IASB's Constitution where it states at paragraph 2(a) that one of the IASB Foundation's objectives is to "develop ... a single set of high quality, understandable and enforceable global accounting standards ...".

Question 1(c): Disagreement that the IASB can override local law. Also disagreement that there ought to be cherry picking permitted for which body of Standards to apply - Small GAAP or main GAAP.

Issue 2 - Objectives

Question 2: Objectives (b) and (c) in Preliminary View (PV) 2 are inconsistent. In response to the HKICPA's First Consultation on Small GAAP (2002), we received comments that provided strong intuitive evidence that no meaningful financial reporting (compliance cost) relief would be provided for preparers if a small GAAP framework consistent with PV 2 objective (c) were implemented. Compliance cost is a key underlying rationale for the development of small GAAP - if it weren't for this issue there would be little reason for developing a small GAAP framework, and/or either a differentiated or separate set of financial reporting requirements for qualifying entities. To this extent, PV 2 objectives (c) and (d) would also be internally inconsistent. Commentators also suggested that a small GAAP framework developed to meet PV 2 objective (d), by permitting relaxations from main GAAP for qualifying entities - even if these relaxations were primarily limited to disclosure items - would not result in financial statements that provided the type of high quality financial information consistent with the IASB's conceptual framework. The Hong Kong First Consultation Paper proposed a "Differential Reporting" framework integrated within main GAAP, not unlike PV 2 objective (c). Objective (e) is considered to be unnecessary especially given that IFRS 1 on First-time Adoption of IFRS would apply in any case and the number of IPOs (for example) in Europe in one year is a tiny fraction of the number of entities in that jurisdiction that ought to be able to apply IASB Small GAAP. If small GAAP were so close to main GAAP there would appear to be little purpose in having small GAAP in place and, if so, objective (d) would not be achieved.

Issue 3 - Applicability

Question 3(a): Some members commented that IASB Small GAAP should contain a quantitative size threshold in the interest of developing a Standard that would be applied consistently on a global basis. Members did, however, consider there would be purchasing power parity issues when considering the level at which such thresholds could reasonably apply in one economy as compared with another (e.g. producer price levels, including wage rates etc., are significantly different in Mainland China as compared with Hong Kong).

Question 3(b): If the IASB is to develop small GAAP specifically applicable to "Small and Medium-sized Entities" then size criteria should be established, at least the basis on which size levels for individual jurisdictions ought to be developed so that there is a degree of international consistency in applying the Small GAAP Framework.

Question 3(c): We consider that the appropriate criteria consisted of a lack of public accountability, lack of regulated element (e.g. non-listed bank) and size criteria. This, and the rationale behind it, is set out in the Draft Framework currently in issue for public comment in Hong Kong (see the above link).

Question 3(d): The requirement for unanimous agreement is proposed in the Hong Kong Second Consultation Paper at paragraph 4.4.3 and the Framework at paragraph 16.

Question 3(e): The proposed approach in the Hong Kong Second Small GAAP Consultation Paper is that any entity that qualifies on a stand-alone basis should be permitted to apply small GAAP (the qualification basis proposed is set out in the Draft Framework at paragraphs 16-22 i.e. no public accountability, not in a regulated industry, meets the size test and has the unanimous agreement of owners), regardless of whether that entity is a subsidiary, parent entity, associate or joint venture. The proposed approach in the Hong Kong Second Consultation Paper is, however, if an entity qualifies and does apply small GAAP then it may do so only in respect of its separate financial statements. The proposition in PV 3.6 cannot apply in the case of associates or joint ventures - these are not under the unilateral control of the relevant investor. The IASB ought not to assume that the GAAP applied by associates and joint ventures can be determined by the investor.

Issue 4 - Fallback to main GAAP

Question 4: PV 2 objective (c) suggests that the same conceptual framework would apply to IASB main GAAP as it does for small GAAP. This approach is similar to that the HKICPA proposed for implementation in Hong Kong in the First Consultation Paper (2002) and which the Hong Kong constituency rejected. Under the approach now proposed in the Second Consultation Paper the HKICPA have proposed the implementation of a completely separate, Historical Cost, framework with fallback to the historical cost convention (and not main GAAP) for any issue that is not covered in the Small GAAP financial reporting standard.

Issue 5 - Optional reversion back to main GAAP

Members disagree with IASB's suggestion that if an entity that is eligible to use IASB Standards for SMEs elects or is required to revert to one or more IFRSs while continuing to use IASB Standards or SMEs for the remainder of its financial reporting, its financial statements could be described as conforming to IASB Standards for SMEs. The reason is simple: apple is apple.

Questions 5(a), (b): Consistent with the approach proposed in the HKICPA's Second Consultation Paper, and as explained therein [refer para 4.4.6], we do not support the availability of "cherry picking" between small GAAP and main GAAP.

Issue 6 - Small GAAP Standard Setting - IFRS as a starting point

Question 6: Consistent with the approach proposed in the HKICPA Second Consultation Paper, the small GAAP framework desirably should be separate from the main GAAP framework. The umbilical cord with main GAAP should be cut (contrast with the UK FRSSE, compliance with which would still result in the financial statements giving a "true and fair view" and therefore the FRSSE needs to keep pace with developments in main GAAP). Implementing a similar standard setting framework as for main GAAP (including, presumably, an interpretations process) we believe is not desirable. In proposing a small GAAP framework for Hong Kong, based on the historical cost convention, we believe that small GAAP should, from a standard setting point-of-view be relatively uncomplicated to

maintain. Part of the compliance cost issue currently faced by preparers and auditors of SME financial statements includes difficulties in keeping up with such significant and widespread changes that have occurred in main GAAP in recent years. Having a “stable platform” based on historical cost concepts which have remained largely unchanged for decades, and which is (and is likely to remain) genuinely stable, would go some way to redress the compliance cost objective we seek to achieve in implementing small GAAP.

Issue 7 - Basis on which main GAAP should be modified

Consistent with the proposals and explanations set out in the HKICPA’s 2nd Consultation Paper (and consistent with the response to q.6) we disagree with the proposition that main GAAP should be the starting point for developing Small GAAP. Issue 7 of the IASB’s DP formed the backbone of the HKICPA’s First Consultation Paper issued for comment in 2002 and this proposition was rejected by the constituency - particularly so in the case of the proposal to allow virtually no measurement relaxations. We generally agree that there should be virtually no recognition differences as between main GAAP and small GAAP but, as proposed in the draft small GAAP FRS, there should be no deferred tax recognised (such items, per the main GAAP conceptual framework, ought not to be recognised on the balance sheet).

Issue 8 - Publication format

Members believed that in order to justify any disclosure and presentation modifications or measurement simplification, IASB should consider including a Basis for Conclusion for each IASB Standard for SMEs. The reason is simple: a prerequisite for a high quality international standard.

Question 8(a): Agree with PV 8.1.

Question 8(b): No preference expressed.

Question 8(c): The HKICPA’s Draft SME Financial Reporting Standards (SME-FRS) contains a glossary. No summary or objective statement is included within the SME-FRS but illustrative examples, relevant to applying the SME-FRS, are included in the Appendices to the SME-FRS.

Issue 9 – Other issues

Consistent with objective (d) in PV 2, the IASB should consider field testing the proposed Small GAAP IFRS and/or conducting a survey in order to ascertain the extent to which a Small GAAP IFRS based substantially on main IFRS would result in compliance cost saving for SMEs. The IASB could also consider ascertaining the extent to which compliance cost savings would be achieved if a small GAAP IFRS based on a separate conceptual framework not linked to main IFRS GAAP (i.e. the approach currently proposed for adoption in Hong Kong).

We express our concerns about the interpretation of, and monitoring compliance with, IFRS Small GAAP. We consider that there ought not be a separate Interpretations Committee for dealing with small GAAP interpretation matters. The most that should be contemplated, relevant to the objectives, should be an informal mechanism of providing guidance.