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10 September 2008

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

Dear Steve,

- (1) **HKICPA Consultation Paper on Financial Reporting
by Private Companies**
 - (2) **HKICPA Exposure Draft of Proposed Amendments to
Small and Medium-sized Entity Financial Reporting
Framework and Standards (SME-FRF & SME-FRS)
to cover Group Accounts and Cash Flow Statements**
-

I refer to your letters dated 5 and 12 June 2008 in respect of the two captioned matters and enclose our comments on the Consultation Paper (marked "A") and the Exposure Draft (marked "B").

As the provisions relating to the accounting and auditing requirements of the new Companies Bill will need to reflect any new financial reporting framework, we should be grateful if you would keep us informed of any development in the matter.

Thank you for your kind attention.

Yours sincerely,

(Edward LAU)
for Registrar of Companies



十五周年紀念

Encl.

10 September 2008

**HKICPA Consultation Paper on Financial Reporting
by Private Companies May 2008**

Our comments below are based on the recommendations of the Joint Government / HKICPA Working Group (“JWG”) to Review the Accounting and Auditing Provisions of the Companies Ordinance, Cap 32 (“CO”) adopted by, and the proposals of, the Companies Bill Team (“CBT”) of the Financial Services and the Treasury Bureau on “Small and Eligible Private and Guarantee Companies” in the Accounts and Audit part of the rewrite of the CO.

Question 1

Do you agree that relief from applying full HKFRSs should be permitted for private companies? Please explain your reasons.

1. Based on the recommendations of the JWG and SCCLR, we agree that —
 - (1) the qualifying criteria for Hong Kong incorporated companies (whether standalone companies or members of a group of companies) under section 141D should generally be aligned with those for companies incorporated outside Hong Kong to provide a level playing field for both types of companies; and
 - (2) SMEs should generally be allowed to obtain relief from the burden of full reporting requirements, subject to adequate safeguards such as absence of shareholder’s dissent and continuing to prohibit companies with a public interest dimension from using section 141D.¹

Small and Large Private Companies and Groups

2. Consequently, we propose that the qualifying criteria be relaxed and that, except for certain types of private companies mentioned in paragraph 3 below, relief from applying full HKFRSs should be permitted for —

(1) Small private companies

A private company which complies with any two of the following three criteria based on paragraph 24 of the SME-FRF —

- (a) total annual revenue² of not more than HK\$50 million for a financial year;

¹ See paragraphs 7.5 and 7.6, Chapter 7, Consultation Paper on Rewrite of the Companies Ordinance – Accounting and Auditing Provisions issued by FSTB in March 2007.

² The meaning of the terms “total revenue” and “total assets” are based on paragraph 25 of the SME-FRF. They mean the amounts that would be reflected in the financial statements of the company. In the case where the financial year is shorter or longer than twelve months, the total revenue is determined on an annualised basis.

(b) total assets² of not more than HK\$50 million at the date of the statement of financial position for that financial year; or

(c) 50 employees³

should qualify as a small company and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

(2) Small group of small private companies

In the case of a private company which is a holding company of a group of private companies, if —

(a) each private company within the group qualifies as a small private company, and

(b) the group meets any two of the following criteria —

(i) aggregate total annual revenue⁴ of not more than HK\$50 million net for a financial year;

(ii) aggregate total assets⁵ of not more than HK\$50 million net at the date of the consolidated statement of financial position of that financial year; or

(iii) aggregate total number of employees⁶ of not more than 50

the group should qualify as a small group and the holding company should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

(3) Large private companies

Furthermore, all private companies which are unable to satisfy the size criteria for a small private company under paragraph 2(1) above, should be allowed to apply the small and eligible companies provisions if they have the

³ Calculation of the number of employees is based on paragraph 26 of the SME-FRF. "Employee" means the average number of persons employed by the company during the financial year (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows —

(i) determine the number of employees as at the end of each calendar month.

(ii) add together all the monthly numbers in (i).

(iii) divide the number in (ii) by the number of months in the financial year.

⁴ (a) The aggregate total figures shall be determined by aggregating the relevant figures determined for each member of the group in accordance with consolidated financial statements;

(b) In relation to the aggregate total figures for revenue and total assets, the expression "net" means after making the set-offs and other adjustments in the case of consolidated financial statements for transaction between members of the group;

(c) The figures for aggregate total revenue and aggregate total assets shall be those included in the consolidated financial statements for the relevant financial year; and

(d) In the case where the financial year is shorter or longer than twelve months, the aggregate total revenue is determined on an annualised basis.

⁵ See footnote 4 paragraphs (a) to (c).

⁶ See footnote 3 and footnote 4 paragraph (a).

necessary shareholders' approval. Regarding the level of shareholders' approval, our proposal is that where a resolution electing to apply the small and eligible companies provisions is passed by at least 75 per cent of the total voting rights of the company⁷ and there is no objection from the remaining 25 per cent, the company can do so. This addresses the concern where a few minority shareholders who, for whatever reason, cannot be traced or where the shareholdings are so dispersed that unanimous agreement cannot easily be obtained. Protection for minority interests is also catered for as it allows any shareholder to revoke that decision at any time.

(4) Group consisting of large private companies

Following from the case of large private companies, we also propose that a group of private companies which are unable to satisfy the size criteria for a small group of small private companies under paragraph 2(2) above, should be allowed to apply the small and eligible companies provisions if they have the necessary shareholders' approval set out in paragraph 2(3) above. This category applies to a group of purely large private companies or a mixed group of large and small private companies. The shareholders' approval should be obtained in the case of each company of the group which fails to satisfy the size criteria for a small private company set out in paragraph 2(1) above.

3. While the current restrictions for certain private companies in section 141D(3) CO (such as a banking, insurance, stock-broking and deposit-taking company) to apply the small company provisions for public interest or regulatory reasons should be retained, we propose that the prohibition under section 141D(3)(f) of the existing CO for a company that owns or operates ships or aircraft engaged in the carriage of cargo between Hong Kong and a place outside Hong Kong, which is an anachronism and no longer appropriate, should be removed.

Question 2

Do you agree that the SME-FRF&FRS is an appropriate reporting option for small private companies and groups? Please explain your reasons.

1. Subject to alignment of the SME-FRF&FRS with the proposals in the rewrite of the CO in relation to small and eligible companies and their financial reporting requirements, we agree that the SME-FRF&FRS is an appropriate reporting option for the four types of private companies mentioned in paragraph 2 of our response to Question 1, namely —
 - “small private company” defined in paragraph 2(1),
 - “small group of small private companies” defined in paragraph 2(2), and

⁷ The requisite threshold for the shareholders to elect to apply the small and eligible companies provisions has changed from 75 per cent in nominal value of the shares of the company to 75 per cent of the total voting rights of the company as a result of the proposed abolition of par value shares, and in order to cover guarantee companies which, by definition, have no share capital.

- “large private company defined in paragraph 2(3) and
- “group consisting of large private companies” defined in paragraph 2(4).

Small Guarantee Companies and Groups⁸

2. Guarantee companies are often set up for non-profit making purposes, such as educational, charitable, religious or community-related purposes. The vast majority of them do not fall within the category of private companies and are therefore treated as non-private companies under the CO. As such, they are subject to the requirements which are applicable to non-private companies, such as filing annual accounts with the Registrar of Companies. Under the rewrite of the Companies Ordinance, guarantee companies will form a distinct category of companies of their own. They will generally be subject to a regulatory regime similar to non-private companies, such as the requirement to file annual accounts with the Registrar of Companies, as members of the public would expect those companies to show a higher degree of transparency. Nevertheless, guarantee companies vary in size and it will be inappropriate to require those small ones to be subject to HKFRSs that are primarily used for reporting by large companies. We therefore propose that guarantee companies that are small in size should be allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies under section 141D of the existing CO if they are able to meet certain specified qualifying criteria.

3. Moreover, in the same vein as a small group of small private companies is allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies, we propose that the application of SME-FRF-FRS be extended to the following types of guarantee companies, namely —
 - “small guarantee company”,
 - “small group of small guarantee companies”,
 - “small group of small private and small guarantee companies”.

4. With regard to the size criteria, the JWG considers that other than revenue, the other two size criteria for small private companies (i.e. assets and employees) are not necessarily appropriate to distinguish large guarantee companies from the small ones. It will not be useful to look at assets because, before the coming into effect of the new HKFRS, a lot of charities have written off their assets, even buildings, hence their assets may be very small. Alternatively, they do not have assets and do not formally have many employees, as they have voluntary helpers. The problem with applying the test that entities with a significant public interest (“SPIES”) should not be allowed to use the small and eligible company provisions are firstly, that the terms “SPIES” and public interest entities (“PIES”) have not yet been defined and cannot be easily be defined; and, secondly, the definition of “SPIES” may not be appropriate for the purpose of the carving-out because the debate at international level was in terms of applying quality assurance programs, quality review partners, etc and was not for the purpose of distinguishing entities according to the level of

⁸ See paragraphs 7.10 and 7.11, Chapter 7, Consultation Paper on Rewrite of the Companies Ordinance – Accounting and Auditing Provisions issued by FSTB in March 2007.

public interest . Other criteria, such as public interest, is recognised as an important criteria for accountability and disclosure but that factor alone cannot distinguish large guarantee companies from the small ones. Furthermore, whether or not a guarantee company has obtained a section 21 exemption or received donations from the public or subventions from the government is neither here nor there as while some of the section 21 companies and those receiving donations or subventions are large charitable organisations, others are small ones, receiving only a small amount of donations or subventions. As a result, although size alone will not necessarily indicate public interest, a simple revenue test is considered the best possible criteria available. Accordingly, an annual revenue of HK\$25 million is used as a threshold for distinguishing between large and small guarantee companies.

(1) Small guarantee company

Based on the JWG's recommendation, we propose that a guarantee company with a total annual revenue of not more than HK\$25 million in a financial year should qualify as a small guarantee company and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

(2) Small group of small guarantee companies

Following from the recommendation of the JWG with regard to a small group of small private companies, we further propose in relation to a group of guarantee companies where —

- (a) each guarantee company within the group qualifies as a small guarantee company under paragraph 4(1) above and
- (b) the aggregate total annual revenue of the group does not exceed HK\$25 million net for a financial year

the group of small guarantee companies should qualify as a small group and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

(3) Small group of small private and small guarantee companies

We further propose that in relation to a hybrid group of private companies and guarantee companies where —

- (a) each private and guarantee company within the group respectively qualifies as a small private company and a small guarantee company under paragraphs (1) of our response to Question 1 and 4(1) above and
- (b) the group meets any two of the following criteria —

- (i) aggregate total annual revenue of not more than HK\$50 million net for a financial year;
- (ii) aggregate total assets of not more than HK\$50 million net at the date of the consolidated statement of financial position for that financial year;
- (iii) aggregate total number of employees of not more than 50

the group of small private and small guarantee companies should qualify as a small group and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

5. True and fair view

Currently, the accounts of small companies are required to comply with the "true and correct view" under section 141D(1)(e)(ii) of the existing CO. We agree with the JWG that the use of the phrase "true and correct" is not appropriate. We believe that the "true and fair view" basis for preparing financial statements should also apply to SMEs.⁹ The existing SME framework should be modified and aligned to impose an obligation on the directors of small and eligible companies and group of companies¹⁰ to prepare accounts that show a true and fair view.

6. We propose adopting paragraphs 20 and 21 of the SME-FRF to define when each type of small company or small group of companies would qualify to apply, or be disqualified from applying, the small and eligible companies provisions in relation to a financial year.
7. For the purpose of considering whether the size criteria for a group of companies has been exceeded, we agree with the JWG that a distinction should be drawn depending on the reason for changing the size of a group of companies owing to —

⁹ As the IASB has issued for exposure a revised standard that would enable one to give a true and fair view of the financial statements prepared in accordance with a specified framework, once an appropriate framework for SMEs is determined by IASB, all companies, including small companies, will need to prepare "true and fair view" accounts in accordance with an appropriate framework which is proposed to be determined by a body to be appointed by the Chief Executive.

¹⁰ These include-

- (1) . "small private company" defined in paragraph 2(1),
- (2) . "small group of small private companies" defined in paragraph 2(2),
- (3) . "large private company" defined in paragraph 2(3),
- (4) . "group consisting of large private companies" defined in paragraph 2(3),
- (5) . "small guarantee company" defined in paragraph 4(1),
- (6) . "small group of small guarantee companies" defined in paragraph 4(2),
- (7) . "small group of small private and small guarantee companies" defined in paragraph 4(3).

- asset or business acquisition on the one hand and
- acquisition of a subsidiary on the other hand.

The distinction can be explained in that acquiring an asset or a business may increase the size of the business of a group ie. growth by natural development, but acquiring another subsidiary changes the composition of the group. In the former case the group can continue to be treated as a small group until the group no longer qualifies as a small group for two consecutive financial years.

Question 3

Do you agree that large private companies should be provided with an option to choose a simpler reporting framework than HKFRSs? Please explain the reasons for your view.

For the reasons mentioned in paragraphs 1 and 2 of our response to Question 1, we agree that large private companies should be provided with an option to choose a simpler reporting framework than HKFRSs.

Question 4

Do you agree with the view of Council stated in paragraph 34 above? If not, why not?

Paragraph 34 provides —

“As a result, the Council is of the view that:

- the SME-FRF&FRS does not meet the reporting needs of the users of the financial statements of large private companies; and*
- the SME-FRF&FRS should not be expanded to meet those needs.”*

We have some reservations on the view of the Council expressed in paragraph 34. We are of the view that flexibility should be given to large private members. We suggest that whether SME-FRF-FRS is adequate to meet the reporting needs of the users of the financial statements of large private companies and groups of companies should be left to be decided by the members of the private companies or private groups concerned. On this basis, we propose that large private companies should be allowed to apply SME-FRF-FRS without distinguishing the requirements between large and small private companies, and between individual companies and group of companies, if their members by a resolution as stated in paragraph 2(3) of our response to Question 1, resolve to do so.

Question 5

Do you agree that the Institute should adopt or develop a large private company financial reporting framework? Do you have a preliminary view as to which of the above options is appropriate? Please explain your views.

Save that large private companies should be allowed to elect to apply the small and eligible companies provisions which are based on SME-FRF-FRS, we have no particular view on whether a large private company financial reporting framework should be developed.

Question 6

Please identify whether you use financial statements as a preparer, auditor and/or user and the effect on you in all of these cases of the proposed introduction of a large private company framework.

10 September 2008

**Exposure Draft on Proposed Amendments to Small and Medium-sized
Entity Financial Reporting Framework and Proposed Sections of
Small and Medium-sized Entity Financial Reporting Standard May 2008**

Our comments below on Questions 1 and 2 are based on the recommendations of the Joint Government / HKICPA Working Group ("JWG") to Review the Accounting and Auditing Provisions of the Companies Ordinance, Cap 32 ("CO") adopted by, and the proposals of, the Companies Bill Team ("CBT") of the Financial Services and the Treasury Bureau on "Small and Eligible Private and Guarantee Companies" in the Accounts and Audit part of the rewrite of the CO. They are related to your proposed amendments to paragraphs 17, 18, 19, 24 and the new paragraph 28A in the Exposure Draft. We have no particular view on Questions 3 to 6 nor on the proposed amendments to the sections and provisions set out in the Exposure Draft.

Question 1:

Do you agree that the SME-FRF and SME-FRS should be amended to cover groups? If not, why not?

Groups of Small and Large Private Companies

1. We agree that section 141D of the existing CO should be amended to require a private company that applies the new "small and eligible companies provisions" which replaces section 141D of the existing CO to prepare a full set of accounts dealing with the state of affairs and profit or loss of the company as required under the SME-FRS. We also agree that a holding company which is a private company should be allowed to prepare a full set of consolidated financial statements of the company and its subsidiaries.
2. Consequently, we agree that except for certain types of private companies mentioned in paragraph 3 below, the restriction under section 141D(3)(a) of the existing CO should be removed and that the SME-FRF and SME-FRS should be amended to cover the following groups of companies —
 - "small group of small private companies" (see paragraph 1 of our response to Question 2),
 - "group consisting of large private companies" (see paragraph 2 of our response to Question 2)
3. While the current restrictions for certain private companies in section 141D(3) CO (such as a banking, insurance, stock-broking and deposit-taking company) to apply the small company provisions for public interest or regulatory reasons should be retained, the prohibition under section 141D(3)(f) of the existing CO for a

company that owns or operates ships or aircraft engaged in the carriage of cargo between Hong Kong and a place outside Hong Kong, which is an anachronism and no longer appropriate, should be removed.

Groups of Small Guarantee Companies¹

4. Guarantee companies are often set up for non-profit making purposes, such as educational, charitable, religious or community-related purposes. The vast majority of them do not fall within the category of private companies and are therefore treated as non-private companies under the CO. As such, they are subject to the requirements which are applicable to non-private companies, such as filing annual accounts with the Registrar of Companies. Under the rewrite of the Companies Ordinance, guarantee companies will form a distinct category of companies of their own. They will generally be subject to a regulatory regime similar to non-private companies, such as the requirement to file annual accounts with the Registrar of Companies, as members of the public would expect those companies to show a higher degree of transparency. Nevertheless, guarantee companies vary in size and it will be inappropriate to require those small ones to be subject to HKFRSs that are primarily used for reporting by large companies. We therefore propose that guarantee companies that are small in size should be allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies under section 141D of the existing CO if they are able to meet certain specified qualifying criteria.

5. Moreover, in the same vein as a small group of small private companies is allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies, we also propose that the application of SME-FRF-FRS be extended to the following groups of guarantee companies, namely –
 - “small group of small guarantee companies” (see paragraph 3(1) of our response to Question 2),
 - “small group of small private and small guarantee companies” (see paragraph 3(2) of our response to Question 2).

Question 2:

Do you agree that the size criteria set out in paragraph 24 of the SME-FRF appropriately identify a “small group” in Hong Kong? If not, why not?

¹ See paragraphs 7.10 and 7.11, Chapter 7, Consultation Paper on Rewrite of the Companies Ordinance – Accounting and Auditing Provisions issued by FSTB in March 2007.

Groups of Small and Large Private Companies

1. Small group of small private companies

- (1) For a **small private company**, we agree that the size criteria set out in paragraph 24 of the SME-FRF is appropriate. Paragraph 24 of the SME-FRF provides —

An entity is considered to be an SME if it does not exceed any two of the following —

- (a) *Total annual revenue of HK\$50 million.*
- (b) *Total assets of HK\$50 million at the balance sheet date.*
- (c) *50 employees.*

- (2) In the case of a private company which is a holding company of a group of private companies, we propose that if —

- (a) each private company within the group qualifies as a small private company, and
- (b) the group meets any two of the following criteria —
 - ◇ aggregate total annual revenue² of not more than HK\$50 million net for a financial year;
 - ◇ aggregate total assets³ of not more than HK\$50 million net at the date of the consolidated statement of financial position of that financial year; or
 - ◇ aggregate total number of employees⁴ of not more than 50

the group should qualify as a small group and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

² (a) The aggregate total figures shall be determined by aggregating the relevant figures determined for each member of the group in accordance with consolidated financial statements;
(b) In relation to the aggregate total figures for revenue and total assets, the expression “net” means after making the set-offs and other adjustments in the case of consolidated financial statements for transaction between members of the group;
(c) The figures for aggregate total revenue and aggregate total assets shall be those included in the consolidated financial statements for the relevant financial year; and
(d) In the case where the financial year is shorter or longer than twelve months, the aggregate total revenue is determined on an annualised basis.

³ See footnote 2 paragraphs (a) to (c).

⁴ See footnote 2 paragraph (a).

2. Groups consisting of large private companies

- (1) Based on the recommendation of the JWG for a **large private company**, we agree that all private companies which are unable to satisfy the size criteria for a small private company under paragraph 1(1) above, should be allowed to apply the small and eligible companies provisions if they have the necessary shareholders' approval. Regarding the level of **shareholders' approval**, our proposal is that where a resolution electing to apply the small and eligible companies provisions is passed by at least 75 per cent of the total voting rights of the company⁵ and there is no objection from the remaining 25 per cent, the company can do so. This addresses the concern where a few minority shareholders who, for whatever reason, cannot be traced or where the shareholdings are so dispersed that unanimous agreement cannot easily be obtained. Protection for minority interests is also catered for as it allows any shareholder to revoke that decision at any time.
- (2) Following from the case of large private companies, we also propose that a group of private companies which are unable to satisfy the size criteria for a small group of small private companies under paragraph 1(2) above, should be allowed to apply the small and eligible companies provisions if they have the necessary shareholders' approval set out in paragraph 2(1) above. This category applies to a group of purely large private companies or a mixed group of large and small private companies. The shareholders' approval should be obtained in the case of each company of the group which fails to satisfy the size criteria for a small private company set out in paragraph 1(1) above.

3. Groups of small guarantee companies

With regard to the size criteria for guarantee companies, the JWG considers that other than revenue, the other two size criteria for small private companies (i.e. assets and employees) are not necessarily appropriate to distinguish large guarantee companies from the small ones. It will not be useful to look at assets because, before the coming into effect of the new HKFRS, a lot of charities have written off their assets, even buildings, hence their assets may be very small. Alternatively, they do not have assets and do not formally have many employees, as they have voluntary helpers. The problem with applying the test that entities with a significant public interest ("SPIES") should not be allowed to use the small and eligible company provisions are firstly, that the terms "SPIES" and public interest entities ("PIES") have not yet been defined and cannot be easily be defined; and, secondly, the definition of "SPIES" may not be appropriate for the purpose of the carving-out because the debate at international level was in terms of applying quality assurance programs, quality review partners, etc and was not for the purpose of distinguishing entities according to the level of public interest.

⁵ The requisite threshold for the shareholders to elect to apply the small and eligible companies provisions has changed from *75 per cent in nominal value of the shares of the company* to *75 per cent of the total voting rights of the company* as a result of the proposed abolition of par value shares, and in order to cover guarantee companies which, by definition, have no share capital.

Other criteria, such as public interest, is recognised as an important criteria for accountability and disclosure but that factor alone cannot distinguish large guarantee companies from the small ones. Furthermore, whether or not a guarantee company has obtained a section 21 exemption or received donations from the public or subventions from the government is neither here nor there as while some of the section 21 companies and those receiving donations or subventions are large charitable organisations, others are small ones, receiving only a small amount of donations or subventions. As a result, although size alone will not necessarily indicate public interest, a simple revenue test is considered the best possible criteria available. Accordingly, an annual revenue of HK\$25 million is used as a threshold for distinguishing between large and small guarantee companies.

(1) Small group of small guarantee companies

- (a) Based on the recommendation of the JWG, we agree that a **small guarantee company** with a total annual revenue of not more than HK\$25 million in a financial year should qualify as a small guarantee company and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.
- (b) We therefore propose in relation to a group of guarantee companies where —
 - (i) each guarantee company within the group qualifies as a small guarantee company as stated in paragraph (a) and
 - (ii) the aggregate total annual revenue of the group does not exceed HK\$25 million net for a financial year,

the group of small guarantee companies should qualify as a small group and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

(2) Small group of small private and small guarantee companies

We further propose that in relation to a hybrid group of private companies and guarantee companies where —

- (a) each private and guarantee company within the group respectively qualifies as a small private company under paragraph 1(1) and a small guarantee company under paragraph 3(1)(a) and
- (b) the group meets any two of the following criteria —
 - (i) aggregate total annual revenue of not more than HK\$50 million net for a financial year;

- (ii) aggregate total assets of not more than HK\$50 million net at the date of the consolidated statement of financial position for that financial year;
- (iii) aggregate total number of employees of not more than 50

the group of small private and small guarantee companies should qualify as a small group and should automatically be allowed to apply the small and eligible companies provisions based on SME-FRF&FRS without having to obtain the shareholders' consent.

4. True and fair view

Currently, the accounts of small companies are required to comply with the "true and correct view" under section 141D(1)(e)(ii) of the existing CO. We agree with the JWG that the use of the phrase "true and correct" is not appropriate. We believe that the "true and fair view" basis for preparing financial statements should also apply to SMEs.⁶ The existing SME framework should be modified and aligned to impose an obligation on the directors of small and eligible companies and group of companies⁷ to prepare accounts that show a true and fair view.

- 5. We propose adopting paragraphs 20 and 21 of the SME-FRF to define when each type of small company or small group of companies would qualify to apply, or be disqualified from applying, the small and eligible companies provisions in relation to a financial year.
- 6. For the purpose of considering whether the size criteria for a group of companies has been exceeded, we agree with the JWG that a distinction should be drawn depending on the reason for changing the size of a group of companies owing to
 - asset or business acquisition on the one hand and
 - acquisition of a subsidiary on the other hand.

⁶ As the IASB has issued for exposure a revised standard that would enable one to give a true and fair view of the financial statements prepared in accordance with a specified framework, once an appropriate framework for SMEs is determined by IASB, all companies, including small companies, will need to prepare "true and fair view" accounts in accordance with an appropriate framework which is proposed to be determined by a body to be appointed by the Chief Executive.

⁷ These include-

- (1) . "small private company",
- (2) . "small group of small private companies",
- (3) . "large private company",
- (3) . "small group of small private companies",
- (4) . "group consisting of large private companies",
- (5) . "small guarantee company",
- (6) . "small group of small guarantee companies",
- (7) . "small group of small private and small guarantee companies".

See our comments on the HKICPA Consultation Paper on Financial Reporting by Private Companies May 2008.

The distinction can be explained in that acquiring an asset or a business may increase the size of the business of a group ie. growth by natural development, but acquiring another subsidiary changes the composition of the group. In the former case the group can continue to be treated as a small group until the group no longer qualifies as a small group for two consecutive financial years.