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ALL CORRESPONDENCE SHOULD BE ADDRESSED TO:—  
COMMISSIONER OF INLAND REVENUE,  
G.P.O. BOX 132, HONG KONG.

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檔案號碼：  
File No.: AC1/GEN/42

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Dear Sir,

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

**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**

Thank you for your letters of 12 and 16 June 2008 inviting the Inland Revenue Department to comment on the Consultation Paper on Financial Reporting by Private Companies and on the Exposure Draft of the Proposed Amendments to SME-FRF & SME-FRS.


As one of the major users of financial statements for tax assessment purposes, the Department expects that the financial statements of a private company would be in a form that enables the assessable profit of the trade or business carried on by a company be readily ascertained. On this premises and on the basis that the relevant accounting framework will be consistently followed, the IRD has no objection in principle to relieving the small and medium sized private companies from complying with the full Hong Kong Financial Reporting Standards (HKFRSs) in the preparation of financial statements.

In particular, the Department has no objection to extending the SME-FRF & FRS reporting option to small private companies that constitute a group. However, as tax assessments are made on individual company basis, it will be desirable that the framework would require preparation of separate financial statements on company basis even if group accounts were prepared.

The Department has the worry that having too many sets of accounting framework to suit various classes of entities may create uncertainty and disputes on the eligibility and appropriateness in adopting a particular set of accounting framework by a specific entity. The Department therefore has reservation in developing a new set of accounting framework for large private companies.

The Department's response to the individual questions raised in the Consultation Paper and on the Exposure Draft are at Appendices A and B.

Yours faithfully,



(LI Yiu-kuen, Thomas)

Ag. Assistant Commissioner, Unit 1

Encls.

LYK/cl/d43

**Consultation Paper on Financial Reporting by Private Companies**

IRD's replies to the six questions raised in the Consultation Paper are as follows:

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

**Response:**

IRD has no objection in principle that some relief from applying full HKFRSs may be permitted for private companies in the preparation of financial statements, so long as such financial statements comply with the requirements of the Companies Ordinance, provide a consistent and fair computation of profit and loss of the companies, and meet the information need of the Department for tax assessment. IRD accepts that allowing small private companies to prepare their financial statements in a simpler accounting framework which can produce a consistent and fair basis of computing profit or loss is conducive to maintaining a simple and easy to comply tax system.

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

**Response:**

IRD agrees in general that the existing SME-FRF&FRS can be a reporting option for small private companies and groups, so long as it is consistently adopted by the companies or groups.

- (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.

**Response:**

IRD has reservation on the view of the Council that large private companies should be provided with a choice of simpler reporting option. IRD has the concern about the consistency in reporting frameworks adopted by a large private company if it is allowed to choose from time to time reporting frameworks other than the HKFRSs. This may create opportunity for large private companies to shop on the reporting frameworks that may help mitigating or deferring tax liabilities and may result in inconsistency in profit or loss computations.

- (4) Do you agree with the view of Council stated in paragraph 34<sup>1</sup> of the Consultation Paper? If not, why not?

**Response:**

IRD shares the view that the existing SME-FRF&FRS is too simple and may not meet the reporting needs of the users of the financial statements of the large private companies. As the SME-FRF&FRS is specifically designed for the small and medium enterprises, expanding it to meet the needs of the large private companies would defeat its original purpose.

- (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.

**Response:**

IRD has the worry that having too many sets of accounting frameworks that can be chosen by various groups of enterprises will create complexities in tax assessments and unnecessary disputes between taxpayers and IRD as regards the eligibility or appropriateness of the

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<sup>1</sup> The Council is of the view that:

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

choice of accounting frameworks. IRD therefore does not favour developing a third set of reporting framework for the large private companies. In view of the size and the complexity of the activities of the large private companies, we think that these companies should adopt the HKFRSs.

- (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.

**Suggested response:**

IRD is a user of financial statements. If an additional large private company framework is introduced, IRD has to mobilise its staff to get familiarized with the new accounting framework and to note the differences among various accounting frameworks that might possibly be adopted. IRD may also need to deploy more resources to settle disputes on the eligibility of a company to adopt such a reporting framework, and to take measures to prevent tax avoidance through the choice of reporting frameworks by individual companies.

**Exposure Draft of Proposed Amendments to SME-FRF & SME-FRS**

**IRD's comments on the six questions raised are as follows:**

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

**Response:**

IRD has no objection in principle to amend SME-FRF and SME-FRS to cover small groups consequential to the revision of section 141D of the Companies Ordinance. However, in the case where group accounts are prepared, it would be desirable if the company is required to prepare a separate set of financial statements for computing its own profit or loss.

- (2) Do you agree that the size criteria set out in paragraph 24<sup>1</sup> of the SME-FRF appropriately identify a "small group" in Hong Kong? If not, why not?

**Response:**

IRD agrees in principle that the size criteria set out in paragraph 24 of the SME-FRF appropriately identify a "small group" in Hong Kong.

- (3) Do you agree that at the company level, investments in associates and interests in jointly controlled entities should be accounted for using the cost method? If not, why not? Do you agree that when an investor / a venturer presents consolidated financial statements, investment in associates and interests in jointly controlled entities should be accounted for using the equity method? If not, why not?

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<sup>1</sup> In paragraph 24 of SME-FRF, 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.

**Response:**

IRD has no comment on this question.

- (4) Should a complete set of financial statements under the SME-FRS be required to include a cash flow statement? If not, why not?

**Suggested response:**

IRD has no particular views on this question.

- (5) If a cash flow statement is required, do you agree that either the direct method or indirect method can be used for reporting cash flows from operating activities, as set out in paragraph 22.7 of the SME-FRS? If not, why not?

**Suggested response:**

IRD has no comment on this question.

- (6) Are there any disclosure requirements included in sections 18 to 22 of the SME-FRS that you consider are too onerous for SMEs and therefore should be excluded? If so, what are they and why?

**Suggested response:**

IRD has no special comment with regard to this question.