香港華人會計師公會
The Society of Chinese Accountants & Auditors
(在香港註冊成立之有限公司)
(Incorporated in Hong Kong as a company limited by guarantee)
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Founded in 1913
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Ms. Patricia McBride,
Executive Director,
Hong Kong Institute of Certified Public Accountants,
37th Floor, Wu Chung House,
213 Queen's Road East,
Hong Kong

Dear Ms. McBride

Comments on IASB Exposure Draft of Proposed International Financial Reporting Standard for Small and Medium-sized Entities

We refer to your letter dated 29 June 2007 and in response to your circular dated 28 February 2007, we would like to submit our comments on the above Exposure Draft of the Proposed International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).

The Society of Chinese Accountants and Auditors ("SCAA") is an incorporated body of professional accountants in Hong Kong established since 1913. Our members are practicing members of the Hong Kong Institute of Certified Public Accountants ("the Institute") and representing a significant number of practicing firms of accountants in Hong Kong. SCAA strives to assist its members in maintaining high standards of professional standards.

In view of the complexity and severe requirements in the International and Hong Kong Financial Reporting Standards, we definitely support having a stand-alone set of financial reporting standards tailored for small and medium-sized entities (SMEs) for the preparation of the general purpose financial statements. We appreciate very much that the Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) and Financial Reporting Standard (SME-FRS), which the Institute established, have clearly fulfilled that objective for Hong Kong purposes. They have adopted and followed the traditional basis of historical cost which has been used and tested for a lot of years in real practice.

Nonetheless, the Institute's SME-FRF and SME-FRS have been adopted and applied in Hong Kong since 2005. We understand that they are well-received by practitioners, accountants, business persons, shareholders and financial statements users not only from Hong Kong, but also from other parts of the world that have business and companies in Hong Kong. We have received feedback from our members and those who used the SME-FRF and SME-FRS that they are practical, theoretically sound and suitable for the needs of SMEs in Hong Kong.

We, however, have reservations on whether the proposed IFRS for SMEs can serve the same purpose as the SME-FRF and SME-FRS and can meet the needs of the SMEs. In particular, the proposed IFRS for SMEs would demand fair value accounting on certain areas: for example, the financial instruments other than those measured at amortised cost would be measured at fair value through profit or loss.

Certain practices in the IFRS for SMEs not only increase the cost of applying the standard (for example requiring the use of independent valuation) but also impose uncertainty on certain areas (for example, the possible tax consequence on the unrealised gain recognised in profit or loss). These practices clearly cannot meet the purposes of reducing the cost to the SMEs or the objective of qualitative characteristics of reliability and being understandable.

In consequence, we recommend the Institute to share and voice the same advice to the International Accounting Standard Board ("IASB") and simultaneously consider the implication of implementing such proposal in Hong Kong at this proposed format and contents.

In case the IFRS for SMEs is finalised similar to the current proposal, we strongly advise the Institute not to adopt that in Hong Kong. We are of the opinion that Hong Kong should retain its own SME-FRF and SME-FRS, which can better serve the needs of SMEs and reduce the uncertainties to the operations of SMEs.

We are in the process of making a submission to the IASB and the attached Appendix will form the essential part of our comments on the Exposure Draft. We should be grateful if you would review our draft proposed submission and provide your support.

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We should be glad to discuss with you our comments in further details if so required. Please contact the undersigned at our email address at info@scaacpa.com.hk, facsimile no. 2526-6434 or telephone no. 2550-8965.

Yours sincerely
For and on behalf of
The Society of Chinese Accountants and Auditors

Tenny Leung
President

Appendix

General Comments for the Proposed IFRS for SMEs

We are of the opinion that the proposed International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) has not achieved the objectives intended to be achieved by the proposal, that is "to provide a <u>simplified</u>, self-contained set of accounting principles that are <u>appropriate</u> for smaller, non-listed companies and are based on full International Financial Reporting Standards (IFRSs), developed primarily for listed companies", based on the following observation and reasons.

<u>Accounting Principles Not Simplified</u>
The proposal has not simplified the accounting principles but rather has complicated the principles by introducing some other new practices for similar items covered in IFRSs. These other new practices, for example, include:

1. Paragraph 11.8 of IFRS for SMEs states that "with the exception of those financial instruments measured at cost or amortised cost less impairment in accordance with paragraph 11.7, at each reporting date an entity shall measure all financial instruments at fair value, without any deduction for transaction costs it may incur on sale or other disposal, and recognise changes in fair value recognised in profit or loss."

   The above practice is not adopted in any IFRSs, including IAS 39. In other words, it has created a new practice in accounting for the financial instruments. All entities and practitioners have to learn a new practice and use different practices in different cases, rather than have a simplified version.

2. More choices can be found in some practices, including joint venture, and associates. They are also not found in the IFRSs.

3. Paragraph 28.6 of IFRS for SMEs states that "some temporary differences arise when income or expense is included in accounting profit or loss in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences." In addition, examples of timing differences are also provided. It is not clear the usage of it while a new practice is also introduced.

<u>Appropriate or uncertainty</u>
Certain proposals in the IFRS for SME have created uncertainty to and reduced comparability between the SMEs in their financial statements. For example:

1. The recognition of fair value changes on financial instrument in the income statement implies the recognition of unrealised gains which may be subject to tax in certain tax jurisdictions, including Hong Kong.

   On one hand, the recognition of such unrealised gain on some financial instruments held for a longer term should not be part of the operating performance of an entity but it has been recognised in the income statement. It may distort the financial performance of such entity.

On the other hand, no one can ensure the tax implication on such gain recognised in the income statement. It would definitely introduce uncertainty in the tax perspective and may also penalise the entity adopted the IFRS for SMEs.

2. The choices imposed, for example, in accounting for associates and joint venture would reduce the comparability between the entities adopted the IFRS for SMEs.

Cost and benefit
The cost in preparing financial statements should include the cost in learning and complying the relevant financial reporting standards and necessary consultation fee incurred for the preparation.

As discussed above, new practice implies time in learning and complying the IFRS for SMEs. It certainly imposes additional costs to the SMEs. In addition, consultation fee may also be required to retain some independent valuers to arrive at the fair value of certain items and balances in order to fulfil the IFRS for SMEs.