Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.iasb.org)

30 November 2012

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Request for Information on Comprehensive Review of the IFRS for SMEs

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the above-mentioned Request for Information. Our responses to the questions raised the Request for Information are set out in the Appendix for your consideration.

It is our understanding that the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) is designed for use by small and medium-sized entities (SMEs), which include all entities that are not publicly traded and that are not banks or similar financial institutions. We consider SMEs in general can normally afford less resource for financial reporting as compared with listed entities. Cost and benefit considerations are of particular importance and therefore we consider that any proposed change to the IFRS for SMEs should be assessed from the perspective of SMEs in this context.

If you have any questions regarding the matters raised in our submission, please contact Ambrose Wong, Manager of Standard Setting at ambrose@hkicpa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

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Encl.

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓

Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603

Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

Hong Kong Institute of CPAs

Comments on the Comprehensive Review of the IFRS for SMEs

Part A – Specific questions on Section 1-35 of the IFRS for SMEs

Question S1 – Use by publicly traded entities (Section 1)

Are the scope requirements of the IFRS for SMEs currently too restrictive for publicly traded entities?

We do not consider there is a need to change the current applicability requirement of IFRS for SMEs to exclude publicly traded entities (i.e. choice A). Entities whose debt or equity instruments that are traded in a public market should continue to be prohibited from using the Standard. IFRS for SMEs was initially developed for entities that do not have public accountability. The accounting requirements of the standard were therefore designed largely based on such an assumption.

Having said that, we recommend the IASB to consider changing the definition of "publicly traded" in the context of the standard for SMEs. Currently, "publicly traded (debt or equity instruments)" include those which are traded, or in the process of being issued for trading, in any over-the-counter market. We believe this definition is too wide as there may be privately held entities which may have certain types of debt (or borrowing) which are traded in over-the-counter markets with limited market participants. Concerns have been expressed as to why these privately held entities are not allowed to use the IFRS for SMEs; they may not be different from other SMEs in terms of the size of the operation. We believe such entities do not have public accountability and hence the IASB should consider changing the definition so that such entities would be entitled to use the IFRS for SMEs.

Question S2 – Use by financial institutions (Section 1)

Are the scope requirements of the IFRS for SMEs currently too restrictive for financial institutions and similar entities?

We are not supportive of changing the current scope requirements of the IFRS for SMEs to include publicly traded entities (i.e. choice A). We consider that all financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses should continue to be prohibited from using the Standard.

However, we recommend the IASB to consider amending the definition of "public accountability" in order to better clarify the term. Under paragraph 1.3(b) of IFRS for SMEs, banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks are quoted as typical entities with public accountability. However, there are certain circumstances when these entities are in fact not publicly accountable as they do not hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses. For example: there may be certain "restricted license" banks which are not deposit-taking but can only engage in certain restricted banking activities which do not involve holding clients' assets in a fiduciary capacity. Another example is securities or insurance brokers which act as agents of clients and the clients know that these entities are transacting in the capacity as their agent with the respective securities houses or insurers. We therefore recommend the IASB to consider amending the definition of "public accountability" to ensure such entities do not fall under the definition.

<u>Question S3 – Classification of use by non-for-profit entities (NPF entity) (Section 1)</u>

Should the IFRS for SMEs be revised to clarify whether an NFP entity is eligible to use it?

It is our understanding that a not-for-profit entity would not normally be publicly accountable as it would neither have its debt or equity instruments traded in a public market, nor hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. We believe the current version of the standard is sufficiently clear that the soliciting or accepting of contributions may not necessary make the concerned entity publicly accountable.

However, we do not object to incorporate further clarification on this topic in the standard, provided that such guidance is clearly worded to avoid unintended misuse by entities (i.e. choice A).

<u>Question S4 – Consideration of recent changes to the consolidation guidance in full IFRSs (Section 9)</u>

Should the changes outlines in the Request for Information on recent changes to the consolidation guidance in full IFRSs be considered, but modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

We recommend the IASB to not incorporate the requirements of IFRS 10 *Consolidated Financial Statements*, as highlighted in the Request for Information in IFRS for SMEs, as a result of this post-implementation review (i.e. choice A). Alternatively, we would recommend the IASB to consider whether to reflect the IFRS 10 requirements to the IFRS for SMEs after a post-implementation review of IFRS 10 in order to avoid having the SMEs dealing with implementation issues of the standard. This is because, in our view, one objective of having the IFRS for SMEs is that Eisthis standard should be more straight-forward to apply than the full IFRSs.

We consider that SMEs in general can only afford limited resources for financial reporting (as compared with listed entities of which the size of operation is normally bigger than SMEs). Cost and benefit considerations are of particular importance and therefore we consider that proposed changes should be assessed from the perspective of SMEs and costs and benefits before any changes are to be incorporated into the IFRS for SMEs. On this basis, we believe that any significant changes introduced by IFRS 10 (compared to IAS 27) should be considered from the perspective of SMEs. IFRS 10 is much more complex to apply than IAS 27 *Consolidated and Separate Financial Statements* and significant judgments are generally required to be exercised in applying IFRS 10.

<u>Question S5 – Use of recognition and measurement provisions in full IFRSs for financial instruments (Section 11)</u>

How should the current option to use IAS 39 in the *IFRS for SMEs* be updated once IFRS 9 has become effective?

We consider that it is not unreasonable to update the IFRS for SMEs to give entities the option of following the recognition and measurement provisions of IFRS 9 *Financial Instruments* with disclosure requirements of Section 11 and 12 when the standard is effective (i.e. choice B).

It is our understanding that the IASB is undergoing a limited reconsideration of IFRS 9, mainly due to the interaction with the insurance contracts project and classification and measurement of financial assets under IFRS 9. We consider that such refinement to IFRS 9 on classification and measurement requirements should be completed before the proposed option to follow the recognition and measurement provisions of IFRS 9 in IFRS for SMEs become effective.

<u>Question S6 – Guidance on fair value measurement for financial and non-financial items (Section 11 and other sections)</u>

Should the fair value guidance in Section 11 be expanded to reflect the principles in IFRS 13, modified as appropriate to reflect the needs of users of SME financial statements and the specific circumstances of SMEs (for example, it would take into account their often more limited access to markets, valuation expertise, and other cost-benefit considerations)?

We consider the current guidance for fair value measurements in paragraphs 11.27-11.32 are sufficient for financial and non-financial items and therefore recommend no changes to the current requirements (i.e. choice A).

We note that the IASB is of a view that applying the guidance of IFRS 13 *Fair Value Measurement* on fair value would have no impact on the way fair value measurements are made under IFRS for SMEs in straightforward cases. Accordingly, we propose not to change the current requirements to avoid having SMEs spending extra resources on implementing changes that may result in only limited benefits. SMEs should be provided with a more stable financial reporting platform without making changes to the standard that will result in preparers bearing undue cost or effort.

<u>Question S7 – Positioning of fair value guidance in the Standard (Section 11)</u>

Should the guidance be moved into a separate section? The benefit would be to make clear that the guidance is applicable to all references to fair value in the *IFRS for SMEs*, not just to financial instruments.

We note that the fair value guidance in the standard is also relevant in cases other than for financial instruments, including accounting for investment properties, associates, business combination, etc.. Accordingly, we believe it is preferable to place such guidance in a separate section to enhance understandability of the Standard (i.e. choice B).

<u>Question S8 – Consideration of recent changes to accounting for joint ventures in full IFRSs (Section 15)</u>

Should the changes above to joint venture accounting in full IFRSs be reflected in the *IFRS for SMEs*, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

We consider the existing Section 15 is appropriate for SMEs and would recommend no change to the current requirements (i.e. choice A). SMEs should continue to classify arrangements as between jointly controlled assets, jointly controlled operations and jointly controlled entities (terminology and classification based on IAS 31 *Interests in Joint Ventures*).

We recommend IASB to not incorporate IFRS 11 requirements in IFRS for SMEs at this post-implementation review, for the same reasons set out in our response to S4.

<u>Question S9 – Revaluation of property, plant and equipment (Section 17)</u>

Should an option to use the revaluation model for PPE be added to the *IFRS for SMEs*?

We consider that the IFRS for SMEs should be revised to permit an entity to choose, for each major class of PPE, whether to apply the cost-depreciation-impairment model or the revaluation model (i.e. choice B).

It is considered that the carrying value of PPE may form a significant portion of a SME entity's assets and that these SME entities may wish to measure their PPE at fair value, for example, because of debt-equity ratio covenants in their loan financing facilities. It is also considered that the revaluation model accounting on PPE is relatively simple to understand and apply in practice. We therefore consider that it may not be appropriate to deprive SMEs from such an accounting option.

Question S10 – Capitalisation of development costs (Section 18)

Should the *IFRS for SMEs* be changed to require capitalisation of development costs meeting criteria for capitalisation (on the basis of on the criteria in IAS 38)?

IAS 38 requires all research costs to be charged to expense when incurred, but development costs incurred after the project is deemed to be commercially viable are to be capitalised. Accordingly, an intangible asset arising from development activities shall only be recognised if an entity can demonstrate all the criteria in paragraph 57 of IAS 38 *Intangible Assets* are met.

It is our understanding that the IFRS for SMEs currently requires all research and development costs to be recognised as expenses when incurred mainly because many preparers and auditors of SMEs' financial statements are of a view that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis.

We are of the view that SMEs should be allowed to capitalise development costs provided that they are able to demonstrate that all of the criteria set out in paragraph 57 of IAS 38 are met (i.e. choice B). Alternatively, if SMEs are not able to do so, SMEs should expense the development costs when they are incurred.

Question S11 – Amortisation period for goodwill and other intangible assets (Section 18)

Should paragraph 18.20 be modified to state: "If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years unless a shorter period can be justified"?

We support the initiative by the IASB to clarify that a shorter period than ten years should be used to amortise an intangible asset if a reliable estimate can be made. However, we consider the IASB may wish to reconsider the wording in the draft amendment as it may cause confusion partly because the ten-year period is not expressed as a ceiling to the useful life, i.e. a useful life of more than ten years can be used to amortise an intangible asset if it can be reliably estimated, and is justified based on fact pattern.

We would recommend the guidance to be worded clearly, for example to "If an entity is unable to estimate the useful life reliably, the useful life shall be determined based on management's best estimate and judgement, and such useful life so determined shall not exceed ten years".

<u>Question S12 – Consideration of changes to accounting for business combinations in full IFRSs (Section 19)</u>

Should Section 19 be amended to incorporate the changes highlighted in the Request for Information, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

We consider the current approach in Section 19, based on IFRS 3 *Business Combinations* (2004) is suitable for SMEs and recommend that no change be made to the current requirements (i.e. choice A).

<u>Question S13 – Presentation of share subscriptions receivable (Section 22)</u>

Should paragraph 22.7(a) be amended either to permit or require the presentation of the receivable as an asset?

We recommend removing such guidance in IFRS for SMEs, consistent with that in full IFRS, which is silent on this topic. In our view, the determination of whether the subscription receivable is an asset or an offset against equity depends on facts and circumstances, which vary from country to country and from case to case. Such determination should be based on the facts and circumstances and by reference to the basic principle of whether the subscription receivable meets the definition of an asset.

<u>Question S14 – Capitalisation of borrowing costs on qualifying assets (Section 25)</u>

Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with all other borrowing costs recognised as an expense when incurred?

We believe that an accounting policy option should be provided to permit capitalisation of borrowing costs similar to that under the superseded IAS 23 *Borrowing Costs*, to provide an appropriate degree of financial reporting relief for SMEs which are subsidiaries of listed entities.

<u>Question S15 – Presentation of actuarial gains or losses (Section 28)</u>

Should the option to recognise actuarial gains and losses in profit or loss be removed from paragraph 28.24?

We consider the IFRS for SMEs should be revised so that an entity is required to recognise all actuarial gains and losses in other comprehensive income (i.e. choice B). We consider it is appropriate to remove the profit or loss option in paragraph 28.24 of the standard as the proposal will not require additional work by preparers and would in turn enhance the comparability of financial statements. It is also a complexity that has been removed from full IFRSs.

<u>Question S16 – Approach for accounting for deferred income taxes (Section 29)</u>

Should SMEs recognise deferred income taxes and, if so, how should they be recognised?

We have mixed views on this question in our jurisdiction.

Certain constituents in our jurisdiction expressed the view that the cost and benefit for recognising deferred income taxes would need to be carefully investigated from the perspective of SMEs. Despite there being no size criteria for a company to be eligible to use IFRS for SMEs, companies which are relatively smaller in size may consider that the costs of recognising deferred income taxes could easily outweigh the benefits. In that case, the taxes payable method may be more suitable for their circumstances (i.e. choice (d)).

Certain constituents expressed the view that the standard should continue to require recognition of deferred taxes as it provides useful information to financial statements users. However, it may be preferable to adopt the liability method approach by considering the underlying costs and benefits from the perspective of SMEs and their financial statements users (i.e. choice (c)).

<u>Question S17 – Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12 (Section 29)</u>

Should Section 29 be revised to conform it to IAS 12, modified as appropriate to reflect the needs of the users of SME financial statements?

The accounting for income taxes contained in IFRS for SMEs closely follows proposals contained in the IASB Exposure Draft which was intended to replace IAS 12 *Income Taxes*. Substantial concerns were raised by commentators on the Exposure Draft, including concerning its understandability, and the IASB has indicated that it is unlikely that the project will proceed in its current form, we considered that it is more appropriate to replace the recognition and measurement principles contained in Section 29 of IFRS for SMEs with those contained in the then IAS 12 Income Taxes. We believe these requirements are more generally understood, albeit with modifications as detailed in our response to Question S18 above, while retaining the current disclosure requirements in the IFRS for SMEs.

Accordingly, we consider that Section 29 should be revised to conform to the current IAS 12, modified as appropriate for SMEs (i.e. choice B).

<u>Question S18 – Rebuttable presumption that investment property at fair value is recovered through sale (Section 29)</u>

Should Section 29 be revised to incorporate a similar exemption from paragraph 29.20 for investment property at fair value?

By introducing a presumption that the recovery of the carrying amount will normally be through sale, the standard provides a practical solution to the difficulties on assessing whether the recovery of the carrying amount of the investment properties carried at fair value is through use or through sale.

Accordingly, we strongly support IASB to incorporate the exemption for investment property at fair value (the approach in IAS 12) in the IFRS for SMEs (i.e. choice B).

<u>Question S19 – Inclusion of additional topics in the IFRS for SMES</u>

Are there any topics that are not specifically addressed in the *IFRS for SMEs* that you think should be covered (ie where the general guidance in paragraphs 10.4 – 10.6 is not sufficient)?

We are not aware of any additional topics that should be addressed in the IFRS for SMEs for the time being.

Question S20 – Opportunity to add specific issues

Are there any additional issues that you would like to bring to the IASB's attention on specific requirements in the sections of the *IFRS for SMEs*?

We are not aware of any issue that we want to bring to the attention of IASB on specific requirements in the sections of the IFRS for SMEs at the present time.

Part B – General questions

Question G1 – Consideration of minor improvements to full IFRSs

How should the IASB deal with such minor improvements, where the *IFRS for SMEs* is based on old wording from full IFRSs?

We consider all types of information, including amendments to full IFRSs, findings in post-implementation reviews and other outreaching activities, should be considered when amending the IFRS for SMEs. As highlighted in our response to Question S4, SMEs in general can afford fewer resources for financial reporting as compared with listed entities. Cost and benefit consideration is of particular importance and therefore we consider minor improvements should be assessed from the perspective of SMEs before an improvement be incorporated into the IFRS for SMEs.

Question G2 – Further need for Q&As

Do you believe that the current, limited programme for developing Q&As should continue after this comprehensive review is completed?

We consider the current Q&A programme has served its purpose and should not be continued (i.e. choice B). We consider that the IASB should avoid creating an extensive amount of literature (in addition to the standard itself) in order to be able to prepare financial statements in accordance with the IFRS for SMEs, especially the fundamental implementation issues should have been identified and resolved in this review.

However, in case the current Q&A programme is to be continued, we urge the IASB to continue to limit the issuance of Q&As to those that are genuinely causing difficulty in practice and to also seek to incorporate the responses into any future review of the standard itself. We also recommend that the IFRS Interpretation Committee should be involved in the development if guidance in this respect is considered necessary.

Question G3 – Treatment of existing Q&As

Should the Q&As be incorporated into the *IFRS for SMEs*?

Depending on the detail of the guidance, we consider the Q&As should be incorporated into the IFRS for SMEs or the training material (i.e. choice A). However, we believe the IASB should take extra care when incorporating the Q&As into the standard in order to avoid creating unintended new financial reporting requirements.

Question G4 – Training material

Do you have any comments on the IFRS Foundation's *IFRS for SMEs* training material available on the link above?

It is our understanding that it is the intention of IFRS Foundation to develop 35 stand-alone training modules, one for each section of the IFRS for SMEs. We acknowledge the objective for the training materials is to assist adoption of the standard by various jurisdictions, especially for those which do not possess previous experience in full IFRSs, and to promote consistent application of the standard internationally. We note that the quantity of the training modules is extensive and lengthy but this stems largely from the fact that the IFRS for SMEs still retain a significant degree of complexity from the full IFRSs. We would therefore recommend the IFRS Foundation to consider acknowledging the objective clearly in the training modules.

The IASB should consider placing disclaimer wording in the training modules to warn users of full IFRSs not to use the training modules for their full IFRSs adoption, which is also not the original intention of the IASB in the production of training modules.

We have noted that only 30 training modules were published since the issuance of Standard in 2009. We would recommend the IFRS Foundation to consider publishing the outstanding training modules in due course for reference by interested practitioners. We would also expect the IFRS Foundation would update the training modules when the standard is being updated followed by the post-implementation review.

Question G5 – Opportunity to add further general issues

Are there any additional issues you would like to bring to the IASB's attention relating to the *IFRS for SMEs*?

Please see our response to Question G6.

Question G6

Is the *IFRS for SMEs* currently used in your country/jurisdiction?

In 2010, the HKICPA issued our equivalent of IFRS for SMEs, with slight modifications to suit local circumstances, in the form of "HKFRS for Private Entities" as a reporting option for private companies which have no public accountability. Anecdotal evidence suggests that the Standard is not widely used by eligible entities in our jurisdiction (i.e. choice C).

If the *IFRS for SMEs* is used in your country/jurisdiction, in your judgment what have been the principal benefits of the *IFRS for SMEs* and the principal practical problems in implementing the Standard?

The principal benefit of implementing IFRS for SMEs in our jurisdiction is that the SMEs are provided with a financial reporting option to adopt a comparatively simpler framework than the full IFRSs for statutory reporting purposes. Having said that, anecdotal evidence suggests that many practitioners consider the requirements in the standard are not substantially simpler than that in the full IFRSs and thus do not consider worthwhile to adopt such standard.

We actually have difficulty recommending because the problem here is that globally, it may not be possible for one size of IFRS for SMEs to fit all circumstances intended by the standard.

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