HONG KONG SOCIETY OF ACCOUNTANTS
(Incorporated by the Professional Accountants Ordinance, Cap. 50)

香港會計師公會

香港金鐘道八十九號力寶中心二座四樓

17 May 2004

To: HKSA members
All other interested parties

Consultation Paper – Proposed Implementation of a Small and Medium-Sized Entity Financial Reporting Framework and Financial Reporting Standard

Comments to be received by 31 August 2004

Issued by the Council,
Hong Kong Society of Accountants

The Hong Kong Society of Accountants' Council (Council) has issued a consultation paper on a proposed implementation of a Small and Medium-Sized Entity Financial Reporting Framework and Financial Reporting Standard in Hong Kong.

A copy of the consultation paper and the draft Small and Medium-Sized Entity Financial Reporting Framework and Financial Reporting Standard, to which the consultation paper refers, are attached. The consultation paper can also be found on-line at: http://www.hksa.org.hk/professionaltechnical/accounting/exposuredraft/.

The Council invites comments from any interested party on the issues raised in the consultation paper. Comments should be supported by specific reasoning and should be submitted in written form.

Comments are requested to be received by **31 August 2004** and may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

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Hong Kong Society of Accountants

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Consultation Paper – Proposed Implementation of a Small and Medium-Sized Entity Financial Reporting Framework and Financial Reporting Standard

1. Background – summary of the first consultation

1.1 In August 2002, the Hong Kong Society of Accountants (HKSA) released for public comment a "Consultation Paper on a Proposed Framework for Differential Reporting" (CP-I) with comments requested by 31 October 2002. In CP-I, proposals were put forward on the development of a differential reporting framework that would have provided qualifying entities with (primarily) disclosure exemptions from the financial reporting requirements while still permitting such financial statements to give a true and fair view in accordance with Hong Kong Financial Reporting Standards and Statements of Standard Accounting Practice (HKFRS). Comments were invited on a number of issues including the following:

- ✓ Is there a need for differential reporting in Hong Kong?
- ✓ Should differential reporting be based on a cost:benefit criterion?
- ✓ Is public accountability; separation of owners and governing body; and size appropriate surrogates for the cost:benefit criterion?
- ✓ Should access to differential reporting be restricted solely to small entities?
- ✓ Should small groups, that are not otherwise publicly accountable, still be required to prepare consolidated financial statements because of legal requirement under the Companies Ordinance?
- ✓ Should an entity be deemed to be small if it does not exceed any two of the following criteria? (total revenue of $50 million; total assets of $50 million; 50 employees)
- ✓ Should differential reporting exemptions apply immediately if an entity qualifies?

2. Consideration of comments received

2.1 The HKSA GAAP for Small Businesses Working Group (GSBWG) considered comments received on CP-I. Comment letters have been posted on the HKSA website at http://www.hksa.org.hk/professionaltechnical/accounting/rm/. CP-I proposed a financial reporting framework for small and medium-sized entities (SME) that was integrated within the true and fair view financial reporting framework (main GAAP). Under CP-I, financial statements prepared under the differentiated basis, that is with significantly less disclosure than for the financial statements of non-qualifying entities even if accounting measurement was substantially the same, would still be considered to give a 'true and fair view'. Significant issues arising from the first round of consultation were as follows:

- ✓ Significant support in principle for a differential reporting framework;
- ✓ Preparation of financial statements on a differentiated basis does not result in the financial statements giving a 'true and fair view';
- ✓ The reporting framework applicable to SMEs should redress the cost:benefit issue to a greater extent than that apparent in the first consultation paper;

- ✓ To achieve greater simplification and redress in the cost:benefit of financial reporting for smaller entities, the SME financial reporting framework could expand upon the "true and correct" requirements contained in the Companies Ordinance.

2.2 As a result of the first consultation, the GSBWG concluded that:

2.2.1 Differential reporting along the lines on which comments were requested in CP-I does not necessarily result in a significant redress of the cost:benefit issue that underpins the need for differentiated reporting requirements to apply to small and medium-sized entities.

2.2.2 Taking into account the comparative fewer resources typically available to small and medium-sized entities, and the financial reporting needs of a significantly less diverse range of users, it is not essential for SMEs to prepare financial statements within the financial reporting framework underlying main GAAP.

2.2.3 The approach set out under section 141D of the Companies Ordinance would, in principle, form an appropriate starting point for SME corporate external financial reporting. Accordingly, the underlying intent of section 141D should be retained, and enhanced, to give effect to a separate financial reporting framework for qualifying companies.

2.3 Accordingly, the GSBWG considered that it is necessary to develop a framework that is separate from main GAAP and that specifies a measurement framework that was more appropriate to the financial reporting resources available to SMEs and more appropriate to the users' financial reporting needs.

2.4 The GSBWG's approach, and thus the need for further consultation on a number of issues, is set out in the remainder of this Paper.

3. A second consultation – the proposed way forward

3.1 Having considered the comments received from the first consultation in late 2002, and as a result of further consideration of the issues relevant to SME financial reporting, the GSBWG have developed the Second Consultation Paper (CP-II) with proposals designed to implement a financial reporting framework specific to SMEs.

3.2 Accompanying this Consultation Paper are the two draft documents that the GSBWG currently envisages would comprise the SME financial reporting regime, specifically:

- ✓ A financial reporting framework for SMEs (SME-FRF), to provide the conceptual underpinning for SME financial reporting in Hong Kong; and

- ✓ A financial reporting standard for SMEs (SME-FRS), to provide, within one standard, the recognition, measurement, disclosure and presentation matters relevant to SME financial reporting in Hong Kong.

Appended to the SME-FRS is a draft illustrative set of financial statements to provide an example of the nature of financial reporting envisaged by the GSBWG on implementation of the SME-FRS.

3.3 In inviting comment on the draft SME-FRF and SME-FRS, the GSBWG seeks your views on a number of issues connected with SME financial reporting in Hong Kong, discussed in section 4 of this Consultation Paper. The issues include:

- ✓ The need for a separate financial reporting framework for qualifying entities
- ✓ The principles underlying SME financial reporting
- ✓ Whether SME financial statements need give a true and fair view
- ✓ Which entities should qualify to prepare financial statements under the SME-FRF
- ✓ Statutory requirements applicable to SME financial reporting
- ✓ Applicable financial reporting requirements

3.4 From the comments received from this round of consultation, the GSBWG would envisage making a final set of recommendations to the HKSA Council for the implementation of a financial reporting framework and a financial reporting standard applicable to all small and medium-sized entities. The proposed SME-FRF and SME-FRS would be a completely separate financial reporting framework and standard applicable only to qualifying entities. Entities that would not qualify under the SME-FRF would continue to apply the *Framework for the Preparation and Presentation of Financial Statements* and the HKFRSs (collectively referred to in this document as "main GAAP") when preparing financial statements in accordance with accounting principles generally accepted in Hong Kong and which give a "true and fair view" of an entity's financial position and performance for a given financial period.

4. Issues raised for further consultation

4.1 Issue 1 – The need for a financial reporting framework for SMEs

4.1.1 A case for applying a differentiated set of financial reporting requirements to SMEs was put forward in CP-I. The introduction to CP-I stated the following:

"Currently, Hong Kong SSAPs generally apply to all proprietary enterprises. As a result, profit-oriented enterprises are governed by almost the same financial reporting requirements regardless of their size or the extent of the public interest in them. Existing distinctions include segment disclosures and disclosure of earnings per share, required generally only for listed companies.

Recent years have been marked by rapid and widespread developments in financial reporting. A number of these developments have been designed primarily to address the information needs of the users of financial statements of listed companies. Many of these developments derive from the international convergence of accounting standards, which is driven by the globalisation of financial markets and the need to meet the concerns of securities regulators.

While these developments can be justified for listed companies on the grounds of public interest, applying the same financial reporting standards to all profit-oriented enterprises, with minor exceptions only, has become more and more debatable. A number of interested parties have questioned whether it continues to be appropriate to burden private companies that are accountable to only a few users with the extensive financial reporting requirements designed primarily for listed companies active in public capital markets.

An argument has been advanced that small entities should be exempted from the application of certain requirements on the basis that the costs of complying with the requirements exceeds the benefits that flow from that compliance. The term "accounting standards overload" has emerged to refer collectively to the problem of reporting burdens imposed on small entities."

4.1.2 In 2003 the United Nations' Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) issued a draft document, "Accounting and Financial Reporting Requirements for Small and Medium-Sized Enterprises" (SMEGA). As stated in the Preface to SMEGA, the underlying rationale for issuing the document is that "the standards (IASs) issued by the IASB have been created largely with the financial reporting needs of listed companies in mind. Consequently, it has often been difficult to apply them to SMEs, particularly those in developing countries and countries with economies in transition. Further, many businesses in these countries are not profitable enough to be able to afford what professional help is available."

4.1.3 ISAR have identified two fundamental issues associated with SME financial reporting, namely, whether the financial information provided to users of SME's financial statements is appropriate to users' needs and the compliance cost borne by the entity preparing the financial information (these issues are considered further under 4.2 below). The draft SMEGA is intended for significant commercial and business enterprises that issue neither public securities nor financial reports to the general public. ISAR has developed a single set of requirements that have been derived from the IASs issued by the IASB, but embodying only requirements for the most regularly encountered transactions.

4.1.4 The International Accounting Standards Board has an active project to develop a set of International Financial Reporting Standards (IFRS) for SMEs. Details on the project, and the IASB's tentative decisions made to date, can be found on the IASB's website at: http://www.iasb.org/current/active_projects.asp. At the time of issue of this Consultation Paper, the IASB has not issued an exposure draft set of proposals for SME financial reporting under IFRS and the IASB's approach to the project is subject to further development. The GSBWG will continue to monitor progress in the IASB's project and make recommendations to the HKSA Council at such time that the IASB's proposals become clearer.

4.1.5 The GSBWG considers there is a strong case for permitting SMEs to prepare financial statements on a basis different from main GAAP. This case is summarised as follows:

- ✓ Different users of financial information to those for main GAAP companies
- ✓ Different users have different needs – a different framework can apply to meet those needs and address the cost:benefit of providing financial information
- ✓ The nature of the users of the financial statements for a typical SME is significantly different than for an entity that has public accountability. Financial information for entities where the owners are all essentially insiders – and have access to management accounting information – need not be prepared on the same basis as for those entities that are larger, have public accountability requirements where users and their needs are more diverse and of the nature as outlined in the main GAAP framework.

- ✓ Prevalence of IFRS for setting Hong Kong FRS – considered that the cost burden of compliance far outweighs the benefits obtained, bearing in mind the typically limited user group of smaller entity financial statements.

- ✓ SMEs typically have fewer resources available and the cost of compliance with main GAAP is more likely to outweigh the benefit obtained from financial reporting, given also that the SME typically has a significantly smaller and less diverse user group with more limited financial reporting needs than a non-SME.

- ✓ Feedback from the first consultation overwhelmingly supported the need for small GAAP.

4.1.6 There is currently no framework setting out the basis on which certain entities are permitted to report on a basis other than main GAAP. Requirements that are currently in place in Hong Kong apply only to companies that satisfy the criteria in section 141D of the Companies Ordinance. The GSBWG considers that a SME-FRF should be available, subject to qualifying criteria, to a broader range of entities including companies, associations, and unincorporated entities that present audited financial statements.

4.2 Issue 2 – The principles underlying SME financial reporting

4.2.1 The draft Framework in CP-I set out the principles on which SME financial reporting should be different to that under main GAAP. The GSBWG have reviewed these principles and, despite the change in approach from a Framework for Differential Reporting to a SME-FRF that is separate from main GAAP, considers that the principles, outlined in the paragraphs below, are relevant to explain why separate financial reporting requirements should be in place for SMEs.

4.2.2 Fundamentally, the principles underlying SME financial reporting are that:

a. Compliance with accounting standards such as HKFRSs creates costs (usually for the reporting entity) and benefits in terms of accountability and access to decision-useful information (usually for users of the financial statements);

b. Compliance should be required only when the benefits of compliance exceed the costs;

c. Accounting standards will be more generally accepted if they apply only where benefits are generally agreed to exceed costs.

Cost:benefit Criterion

4.2.3 The cost:benefit criterion is met when the benefits of financial reporting requirements outweigh the costs imposed.

4.2.4 Costs of financial reporting are mainly incurred by the entity reporting, though information users and standard setters also incur costs. All costs should be considered when applying the cost:benefit criterion to financial reporting requirements.

4.2.5 The benefits arising from financial reporting are more difficult to determine and to measure than the costs. Benefits may be derived by the entity itself, by those to whom the entity is accountable or by those who have some other interest in the entity.

4.2.6 The benefits of financial reporting reflect the value of information to the users of the financial statements. The benefits, therefore, will usually correlate with:

a. the number and diversity of users;

b. their information needs; and

c. the qualitative characteristics of the information, such as reliability, relevance and timeliness.

4.2.7 The financial reporting requirements applicable to any entity should meet the cost:benefit criterion. HKFRS (main GAAP) is justified where the marginal benefits of their application exceed the marginal costs of their application, and this is particularly the case for larger entities and/or entities that have public accountability. Financial reporting regulation (including HKFRS) imposes costs of preparing and revising HKFRS, costs of compliance (where compliance changes existing practice), and costs of enforcement.

Application of the Cost:benefit Criterion

4.2.8 To measure the costs and benefits of financial reporting requirements is difficult and the Framework therefore uses surrogates based on broad assumptions.

4.2.9 The broad assumptions are:

a. More benefits are derived from the financial statements of entities with public accountability, including companies reporting in accordance with the 'true and fair view' requirements of the Companies Ordinance and other contractual or regulatory requirement such as Stock Exchange Listing Rules, because the reports of such entities are likely to have more users.

b. There is generally no accountability requirement when all of the owners of an entity consent unanimously to the entity's financial statements being prepared on a basis differentiated from that applying to financial statements that give a "true and fair view". However, where the owners and the governing body of an entity are different, and no such unanimous consent exists, an accountability requirement arises. In this case, the value of the entity's financial statements to users may be expected to increase, and greater benefit is likely to be derived.

c. In general, the larger the entity, the more extensive the group of users benefiting from the information provided in its financial statements, and the greater the benefit likely to be derived.

4.2.10 For SMEs where there is either no public accountability requirement and/or accountability to owners who are not involved in the day-to-day management of the entity (or who, for example, otherwise have access to the entity's accounting records) satisfied from the preparation of main GAAP-compliant financial statements, the GSBWG considers that it is appropriate for the SME-FRF to simplify the measurement and disclosure requirements found in main GAAP to redress the balance between the cost of financial statement preparation and benefit obtained by the users of such financial information.

4.3 Issue 3 – Whether SME financial statements should give a true and fair view

4.3.1 CP-I put forward a proposition that a framework for differential reporting, and specific financial reporting requirements applying to qualifying entities, would be integrated within main GAAP and thus would enable SMEs to prepare financial statements that gave a "true and fair view", consistent with main GAAP. Such financial statements would, however, be differentiated from those of non-qualifying entities primarily on grounds of the degree of disclosure.

4.3.2 Comments received on CP-I suggested that the degree of disclosure exemption would call into question both whether such financial statements could be considered to actually give a true and fair view and whether such a differentiation resulted in a significant redress of the cost:benefit objective of implementing separate financial reporting requirements for SMEs. The GSBWG agrees with these comments.

4.3.3 As recognised in the proposed Framework, there is a different user group for SME financial statements and these users have different financial reporting needs from the diverse range of users for non-qualifying entities.

4.3.4 The GSBWG considered that, in order to both redress the cost:benefit issue and yet to still require meaningful financial information to be provided to users of SME financial statements, appropriate to the users' needs, it would be necessary to develop a financial reporting framework and financial reporting standard specifically for qualifying SMEs, regardless of whether they are incorporated under the Companies Ordinance, that contained significant measurement differences from main GAAP. Accordingly, in proposing a SME-FRF and SME-FRS that is separate from main GAAP, the GSBWG recommends that instead of qualifying entities' financial statements providing a "true and fair view" under main GAAP, such financial statements would be "properly presented" (or words to that effect) "in accordance with the applicable financial reporting requirements" (that is, in accordance with the SME-FRF and SME-FRS). For the time being however, Hong Kong companies' financial statements prepared under s.141D of the Hong Kong Companies Ordinance would continue to give a "true and correct view" in accordance with statutory requirements (see section 4.5 below).

4.4 Issue 4 – Which entities should qualify

4.4.1 Building on the proposals contained in CP-I, the GSBWG considers it is appropriate to permit the entities that meet the following criteria to apply the SME-FRS:

- ✓ Companies incorporated under the Hong Kong Companies Ordinance that meet the criteria in section 141D of that Ordinance.
- ✓ Entities other than companies incorporated under the Hong Kong Companies Ordinance that are "small" as defined in 4.4.2 below.
- ✓ Have the unanimous consent of owners, or the group within the entity most closely resembling "owners", as discussed below.
- ✓ Have no public accountability.

Size

4.4.2 An entity is small if it does not exceed any two of the following:

a. total revenue of $50 million;

b. total assets of $50 million;

c. 50 employees.

For the purposes of the application of the size criteria the total revenue and total assets are determined on the basis of applying the SME-FRS. The size criteria specified above is consistent with that proposed in CP-I. The GSBWG have reviewed the criteria and found them to be appropriate and recommend that the criteria, once the SME-FRF is in place, be reviewed from time to time. In reviewing the criteria, the GSBWG obtained statistics from a government agency that indicated (in the year 2001) that approximately 87% of Hong Kong companies had total revenue of $50 million or less. The GSBWG believes that a wide range of entities in Hong Kong could apply the proposed SME financial reporting framework.

Unanimous Agreement Between Owners of an Entity

4.4.3 Where every owner of an entity agrees to the financial statements being prepared under the SME-FRS, there is no accountability requirement between the governing body and the owners. Subject to meeting the size criteria, in such circumstances the entity will qualify provided it does not have public accountability. The unanimous agreement of owners could be achieved by way of resolution at a properly constituted meeting of the entity, or as part of the entrenched financial reporting requirements that may be built into the entity's constitution.

4.4.4 The definition of an owner identifies an owner as a party that has a beneficial interest in the residual value of the entity's assets. When the entity is an incorporated society or association, the members are considered to be owners for the purposes of the SME-FRF.

Public Accountability

4.4.5 An entity has public accountability for the purposes of the Framework if:

a. at any time during the current or the preceding reporting period, the entity (whether in the public or the private sector) is an issuer of securities, that is, its equity or debt securities are publicly traded or it is in the process of issuing publicly traded equity or debt securities;
b. the entity is an institution authorised under the Banking Ordinance;
c. the entity is an insurer authorised under the Insurance Companies Ordinance; or
d. the entity is a dealer and/or an investment adviser authorised under the Securities and Futures Ordinance.

Other matters

4.4.6 A qualifying entity would have a free choice as to whether to present its financial statements in accordance with SME-FRS or in accordance with main GAAP but not a hybrid of the two.

4.5 Issue 5 – Statutory requirements under the Companies Ordinance

4.5.1 Under the Hong Kong Companies Ordinance, companies (other than those to which s.141D applies) must prepare financial statements that provide a "true and fair view" of the company's financial position and financial performance for the year.

4.5.2 Section 141D permits qualifying companies to prepare financial statements that give a "true and correct view" and such financial statements are prepared in accordance with the Eleventh Schedule of the Companies Ordinance and audited in terms of Auditing Practice Note PN 600.2 issued by the HKSA. Companies qualify on the following basis:

✓ Must be a private company under s.29 of the Ordinance

✓ Must neither have a parent company incorporated under the Ordinance nor any subsidiaries

✓ Must have the unanimous written consent of shareholders

4.5.3 The GSBWG considers that it is necessary to retain the present statutory framework provided by s.141D of the Companies Ordinance by which companies that so qualify are permitted to prepare their financial statements on a basis other than that consistent with main GAAP. Under the present statutory requirement, section 141D requires such qualifying entities to prepare financial statements that are "true and correct" and, hence, are not in conformity with main GAAP.

4.5.4 If the entity is a company incorporated under the Hong Kong Companies Ordinance the company must satisfy the criteria set out in section 141D of the Ordinance to qualify for reporting under the SME-FRS. At the present time, companies that have a parent company registered under the Ordinance and/or one or more subsidiaries, would not qualify in terms of the criteria laid out in section 141D.

4.5.5 The GSBWG considers that companies should qualify under section 141D on a basis consistent with the SME-FRF (including the size criteria, which is not presently a requirement of section 141D) and that the SME-FRS should be available to individual companies within a group that qualify on the basis of unanimous consent, size, and lack of public accountability. The GSBWG would propose recommending that the HKSA seek an amendment to the Companies Ordinance to give effect to the above proposals and, in particular, to the following:

- ✓ Remove the restriction against companies that have a parent and/or one or more subsidiaries from being able to qualify;

- ✓ To permit the ultimate holding company within a small group (where the small group satisfied all the qualifying criteria specified in the SME-FRF) an exemption from the requirement to prepare consolidated financial statements;

- ✓ Require companies to qualify on the basis of size. Until such time as the Ordinance is changed, however, companies registered under the Hong Kong Companies Ordinance would qualify based on the criteria specified in s.141D and not in the SME-FRF.

4.5.6 The GSBWG considers that the SME-FRS should not apply to the consolidated financial statements of a group. Consolidated financial statements should be prepared in accordance with main GAAP.

4.5.7 The GSBWG also considers that, once the SME-FRF is implemented, compliance with the SME-FRS would be necessary in order for financial statements to give a "true and correct view" when a Hong Kong company prepares its financial statements in accordance with s.141D of the Companies Ordinance.

4.6 Issue 6 – Applicable financial reporting requirements

4.6.1 In CP-I, comments were invited on proposed financial reporting requirements that, for qualifying entities, would be differentiated – primarily on the basis of financial statement disclosure – from those applying to listed companies and other non-qualifying entities. Such "differential reporting" exemptions from main GAAP were proposed but the effect of the proposals would have been that SME financial reporting would still have been integrated within main GAAP financial reporting.

4.6.2 CP-I contained an extensive discussion on the format of the proposed financial reporting requirements applying to SMEs. Two approaches were considered: the Integrated approach and the Separate approach.

4.6.3 Taking into account comments received on CP-I the GSBWG considers that, in order to achieve the objective of SME financial reporting, it is necessary to specify a framework that contains significant measurement and disclosure simplifications compared to main GAAP. Consistent with this, the GSBWG believes it is necessary to develop financial reporting requirements independently of main GAAP but which nonetheless provides a comprehensive basis of accounting relevant to the objectives of SME financial reporting.

A separate SME-FRS

4.6.4 The GSBWG proposes to develop a separate SME-FRS within an accounting framework distinct from main GAAP. The accompanying draft SME-FRS is based largely on the proposals released for comment earlier in 2003 by the ISAR (discussed in 4.1 above). The GSBWG would also propose, subsequent to this consultation but prior to recommending to the HKSA Council adoption of a finalised SME-FRS, to conduct a review of terminology appearing in the SME-FRS to ensure consistency with main GAAP, especially in the light of recent revisions to Hong Kong accounting standards.

Would a separate historical cost-based SME-FRS result in real compliance cost savings?

4.6.5 It is not possible to provide a global quantification of the compliance cost savings that may result from the implementation of a SME-FRS in the attached form proposed. Different entities will have different circumstances and, relevant to their present financial reporting arrangements, the proposed SME-FRS may impact different entities in different ways. The GSBWG's expectation on the whole, however, is that the degree of measurement simplification provided by the proposed SME-FRS should reduce the costs involved in connection with the preparation and presentation of financial statements.

5. The proposed way forward – a summary and comments invited

5.1 Your comments are invited on the GSBWG's proposals, which are summarised below.

Issue 1 – The need for a SME Financial Reporting Framework (SME-FRF)

5.2 The GSBWG proposes to recommend the implementation of a SME-FRF along the lines discussed in this Paper. Do you agree with this proposal and, if so, do you consider the draft SME-FRF that accompanies this paper to be adequate?

Issue 2 – The principles underlying SME financial reporting

5.3 The broad principles underlying SME-FRF financial reporting are proposed in section 4.2 above. Do you agree with these principles and the proposal that qualifying entities should be permitted to prepare their financial statements in accordance with the historical cost measurement basis as outlined in paragraph 15 of the SME-FRF?

Issue 3 – Whether SME financial statements need give a true and fair view

5.4 In implementing a SME-FRF that operates outside of main GAAP, the GSBWG is recommending that the financial statements of qualifying entities need not give a "true and fair view" (in accordance with main GAAP) but rather would be "properly presented" (or similar words to that effect) "in accordance with the applicable financial reporting requirements" as set out in the SME-FRF and SME-FRS. Do you agree with this approach?

Issue 4 – Which entities should qualify under the SME-FRF

5.5 The GSBWG proposes that entities qualify under the SME-FRF on the basis of size, unanimity of owner agreement and absence of public accountability. Do you agree with this proposal?

Issue 5 – Statutory requirements applicable to SME financial reporting

5.6 A Joint Working Group (JWG) of the Government and the HKSA are currently reviewing proposed changes to the accounting and auditing sections of the Companies Ordinance (CO). The GSBWG would propose making the following recommendations for consideration by the JWG:

- ✓ Repeal the Eleventh Schedule of the CO;

- ✓ Implement a size restriction and public accountability restriction consistent with that specified in SME-FRF for qualifying under s.141D;
- ✓ Remove the current group company restriction on applying s.141D;
- ✓ Amend the current "true and correct" reporting requirement under s.141D to "properly presented" (or words to that effect) "in accordance with the applicable financial reporting requirements" as discussed in paragraph 4.3.4 above;
- ✓ Implement transitional arrangements to cater for when a company may qualify in one particular financial year but not another;
- ✓ Permit the ultimate holding company within a small group (where the small group satisfied all the qualifying criteria specified in the SME-FRF) an exemption from the requirement to prepare consolidated financial statements.

Do you agree with the GSBWG's recommendations for amendment to the CO as outlined above?

Issue 6 – Applicable financial reporting requirements

5.7 The GSBWG proposes to develop a separate financial reporting standard (SME-FRS), based primarily on the ISAR draft. With the implementation of a SME-FRS at the earliest possible time the GSBWG would also propose the consequential withdrawal of PN 600.2. The GSBWG also proposes that compliance with the SME-FRS would be necessary in order for financial statements to give a "true and correct view" when a Hong Kong company prepares its financial statements in accordance with s.141D of the CO.

Do you agree with these proposals?

5.8 That a qualifying entity would have the free choice as to whether to prepare financial statements under either the SME-FRS or main GAAP but it must apply one or the other, not a hybrid of the two. Do you agree with this proposal?

5.9 That the SME-FRS would apply only in respect of a single entity's financial statements. If an entity wishes to prepare consolidated financial statements, it would have to apply main GAAP. Do you agree with this proposal?

5.10 On first time adoption of the SME-FRS, the SME-FRF proposes that an entity's financial statements and comparatives should be prepared in full compliance with the SME-FRS, except to the extent that it is impracticable to do so. A reconciliation of the equity reported on first-time application of the SME-FRS to that reported under previous GAAP should be presented. Do you agree with this proposal?

5.11 Do you have any other specific comments on the contents of the draft SME-FRS?