

By fax to 2865 6776 and by mail

RECEIVED  
HESA  
2004 AUG 30 AM 10:45

20 August 2004

Technical Director (Financial Reporting)  
Hong Kong Society of Accountants  
4<sup>th</sup> Floor, Tower Two, Lippo Centre  
89 Queensway  
Hong Kong

Dear Sir,

**Comments on Consultation Paper on Proposed Implementation of a Small and Medium-Sized Entity Financial Reporting Framework (“SME-FRF”) and Financial Reporting Standard (“SME-FRS”)**

I welcome the early implementation of SME-FRF and SME-FRS generally and would like to comment on the issues set forth in the above captioned paper (“Paper”).

**Issue 1 – The need for a SME-FRF**

1.1 I got the point of “accounting standard overload”, and therefore would advocate on the early implementing of a differential financial reporting framework. I considered the six reasons mentioned in paragraph 4.1.5 would be strong enough for the above proposal, especially most of which pointed out the fundamental purpose of preparation of financial reports – *to meet the needs of users of financial statements*, which I considered is the crux of the Paper.

1.2 By and large, I consider that draft SME-FRF could adequately address concern of all stakeholders of financial statements, except for certain fine-tuning areas as discussed in later sections.

1.3 I understand that directors, bankers and certain government departments are all common users of financial statements. Since the financial statements are prepared for the users, their requirements and inputs should absolutely be *equally important* to the accountants’. I would, therefore,

advise HKSA to carefully consider comments from these bodies; on the other hand, the parties being approached should exercise all reasonable endeavors in giving their unbiased views to the HKSA, in balancing the pros and cons of all parties as a whole. The following organisations should not be missed out in finalising the framework:

- ♦ Hong Kong Institute of Directors
- ♦ Hong Kong Monetary Authority
- ♦ Hong Kong Society of Banks
- ♦ Inland Revenue Department

## Issue 2 – The principles underlying SME financial reporting

2.1 In general, I agreed upon the principles regarding costs and benefits, the application of cost:benefit criterion as mentioned in paragraphs 4.2.2 – 4.2.9 of the Paper, and the adoption of simplified measurement and disclosure requirements as discussed in paragraph 4.2.10 of the Paper.

2.2 Regarding the historical cost convention, I noted that the SME-FRF gives no guidance on whether *investment properties* fall within such convention. Under SSAP13.12, private company may carry their investment properties at cost provided that the aggregate open value of the company's investment properties is either less than HK\$50 million or less than 15% of the company's carrying amount of total assets. Coincidentally, the first criterion is consistent with the size condition (i.e. total assets of HK\$50million) as stated in paragraph 4.4.2b of the Paper. I wonder whether the two HK\$50 million requirements, set out in SSAP13.12 and paragraph 4.4.2b of the Paper, are established based on the same principle. If so, special remarkable sentence should be added explicitly. As the size criteria of either side may change subject to re-assessment on market condition, *reciprocal changes would be expected*.

2.3 In order to enhance the awareness of users of the financial statements, I also recommend that HKSA should issue *a list of exceptional items* not disclosed under the historical convention. Examples include fixed assets under impairment, equity investments, etc. In parallel, the explanatory notes to the financial statements (Re: P.62 paragraph 1 of the SME-FRS, Appendix 2

Illustrative Financial Statements) should also concisely state the fact.

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

3.1 I ***strongly object*** the proposed “properly presented” view or any other similar words other than “true and fair view”. In fact, the “true and fair view” could always be made possible, disregarding which reporting framework is adopting. As long as basis of opinion could clearly address to which framework is using for preparation of financial statements, users of the financial statements could be well directed.

3.2 In fact, I could see no difference to the opinion of “true and fair view” and “properly prepared” in the eyes of users. Except there exists strong reason from legal perspective in defining “true and fair view” and “properly prepared”, I considered the change in auditors’ opinion in adopting “properly presented” view too confusing. One variable (basis of preparation) should be definitely be better than two variables (basis of preparation plus opinion)

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

4.1 I agreed with the principle of the qualifying criteria under the SME-FRF on the basis of size, unanimity of power agreement and absence of public accountability. Some refinements are suggested in respect of the basis of size and accountability.

#### ***Basis of size:***

4.2 Paragraph 22 of the SME-FRF does not exactly mention the ***exact timing*** of the criteria, although it could be assumed to be on annual basis for total revenue and on year-end snapshot for total assets and number of employees. Since these criteria are critical determining factors for the cutoff between main GAAP and SME-FRF, I would suggest specifically state the timing to avoid ambiguity, similar to the FRSSE of UK. HKSA may also consider the appropriateness of assigning the year-end snapshot as some enterprises may intentionally *window-dress* amongst companies within the group at year-end in order to escape from the preparation under main GAAP.

A moving-average figure may be considered as an alternative.

4.3 These criteria are set by adopting the same criteria as defined as “*small*” under the Hong Kong Companies Ordinance. I am rather reluctant to simply accept such definition, as it should be established years ago, when the economic environment should be totally different nowadays. Although limited statistics is stated in paragraph 4.4.2 of the Paper to substantiate the total revenue, it gives no support on total asset and number of employees. Since an enterprise can stay under the umbrella of SME-FRF if it satisfies two of the three criteria, which may be detrimental to certain users of financial statements, additional research should be performed to verify the appropriateness of the size criteria.

***Public accountability:***

4.4 From the discussion paper on “Preliminary Views on Accounting Standards for Small and Medium-sized Entities” issued by the International Accounting Standards Board, I noticed that *public utility* or similar entity that provides an essential public services may also be considered as a public accountable body, and therefore is not qualified under the SME-FRF.

4.5 For that kind of entity, there may be a high degree of outside interest from the non-management investors or other stakeholders, who depend primarily on external financial reporting as their only means of obtaining financial information about the entity. I think this is why the existing FRSSE of UK has classified *building society* as a public-accountable body which should follow the main GAAP. For building society, where credibility of it may be crucial in determining credit terms or banking facilities, a more comprehensive financial reporting package may be of utmost importance.

4.6 HKSA may therefore decide on whether this sort of company should be fall outside the scope of the SME-FRF. At present, there may not be many of such kind of companies which are unlisted. However, nobody could tell whether the existing companies are going to privatise or would there be any new entrants who incline to operate as private companies.

### **Issue 5 – Statutory requirements applicable to SME financial reporting**

5.1 As the proposed SME-FRF and Section 141D of the Companies Ordinance (“Ordinance”) both share the same objective, for differential reporting, I could not see any grounds on having two different set of qualifying criteria. Therefore, I entirely agree with HKSA on amendment of the Ordinance as stated under paragraph 5.6 of the Paper, except for the fourth point on “properly presented”, for reason stated in paragraph 3 above.

### **Issue 6 – Applicable financial reporting requirements**

6.1 Re: paragraph 5.7 of the Paper, I agree on early implementation of SME-FRS and the consequential withdrawal of PN600.2, for reason mentioned in paragraph 1 above.

6.2 Re: paragraph 5.8 of the Paper, I also agree on not allowing a hybrid of SME-FRS and main GAAP in preparation of financial statements to avoid company, in preparing the financial statements, making use of the pros and giving up the cons of each standard.

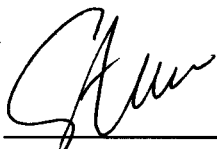
6.3 Re: paragraph 5.9 of the Paper, I do not agree on requiring consolidated financial statements to be followed under main GAAP, except the users of financial statements and that of the consolidated financial statements are different, which is usually not the case.

6.4 Re: paragraph 5.10 of the Paper, I agree with the reconciling requirement on first time adoption of SME-FRS, so as to make things clearer.

6.5 Re: paragraph 5.11 of the Paper, I would like to address my concern on that there is currently no consistent definition of “SME”. So long as the proposed framework and standard are entitled as “SME-FRF” and “SME-FRS”, the size criteria set out under the “SME-FRF” may be benchmarked by other organisations in Hong Kong or even other jurisdictions as the definition of “SME”. On the other hand, if any specialised organisation later come out with another size definition of “SME”, the size criteria set under SME-FRF may be easily challenged, and HKSA may be in an embarrassed position. As such, I would propose a more *generic term* such as “Differential Reporting”.

If I could be of any further assistance regarding the above, please do not hesitate to contact me.

Yours faithfully,



---

Stella Chan

Membership Number: A21746