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# 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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31 August, 2004.

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

Dear Sir,

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

We refer to the above Consultation Paper and have pleasure in submitting our comments and suggestions, which are based on the consultation to our members for the review and consideration of the GAAP for Small Businesses Working Group (GSBWG) and the Council.

1. **‘Differential Reporting’ and ‘SME-FRF and SME-FRS’ and the need for a SME-FRF**
  - 1.1 The proposal on the need for a financial reporting framework for SMEs is accepted by majority of members. However, there are different opinions on how it should be structured and implemented.
  - 1.2 There are pros and cons for the adoption of ‘Differential Reporting’ and ‘SME-FRF and SME-FRS’ as proposed by GSBWG.

GSBWG recommends SME-FRF and SME-FRS, which cater for the needs of SMEs. But it emphasizes on the free choice of either SME-FRS or the main GAAP, and cannot be a hybrid of the two for a qualified SME. As rightly addressed by GSBWG, a standard cannot be applicable for all situations. The too restrictive choice of either SME-FRS or main GAAP for a qualified SME would result in the financial statements not reflecting the actual financial status of SMEs.

#### *Restrictive adoption of SME-FRS*

- 1.3 SMEs could adopt the main GAAP if SME-FRS does not meet their needs, but this would defeat the intention of setting up SME-FRF and SME-FRS catering for SMEs. The adoption of main GAAP also would be too burdensome to SMEs. Hence, SMEs should be allowed to include the appropriate financial status and disclose more information in the financial statements, provided that it is appropriately stated in the financial statements. It should not only be limited to disclosure in the notes to the accounts.

#### *Cost effective and easy for conversion between main GAAP and SME-FRS*

- 1.4 After adoption of the proposed SME-FRS as recommended by GSBWG as stated in the Consultation Paper, there would be significant differences in preparing the financial statements under main GAAP and that under SME-FRS. As proposed, an entity cannot fulfill the requirements of being SME for two consecutive years, the financial statements would have to be prepared under the requirements of the main GAAP and also the comparative figures.
- 1.5 With the size of SMEs, the great majority of them cannot afford to employ members of HKSA to be their accountants or members of HKSA may not be willing to work for SMEs. It would involve significant effort by practising CPAs to prepare such financial statements including the re-examination of the previous accounting records to meet the requirements of the main GAAP in compiling the appropriate comparative figures.

- 1.6 Would GSBWG propose methods to overcome the difficulty with minimum costs, given that the consideration of adopting SME-FRS is a cost : benefit criterion. Would the 'differential reporting' with 'integrated approach for SMEs' be a solution ?

## **2. Considerations in adopting SME-FRF and SME-FRS as raised by GSBWG**

### *Cost : Benefit Criterion*

- 2.1 GSBWG emphasizes on COST : BENEFIT criterion. Members agree that Cost : Benefit is an issue to be considered, but they commented that "Risk" and "Generally Accepted by Relevant Third Parties" are more significant than that of Cost : Benefit.
- 2.2 The emphasis on COST : BENEFIT criterion may be misinterpreted by general public that the financial statements prepared under SME-FRS would be of inferior quality as cost is reduced.
- 2.3 This would also result in the management of the entity having the misconception that when adopting SME-FRS this would save the auditors a lot of time cost in auditing the books of accounts of their clients and thus fees should be significantly reduced. However, GSBWG should be aware that the 'Risk' is not reduced.

## **3. Reporting and Disclosure of SMEs' financial statements**

### *Disclosure in financial statements*

- 3.1 It has been accepted that the financial statements should meet the need and expectations of the users of financial statements. Appropriate but not restrictive disclosure would provide an easy way to read. Hence, flexibility in more voluntary disclosure should be allowed.

## *International Financial Reporting Standard (IFRS)*

- 3.2 HKSA has expressed its determination to follow international standards. Accordingly, any changes in accounting and auditing standards should be targeted towards this goal.

The traditional use of “true and fair view” and “true and correct view” follow the United Kingdom standard. With the suggestions in the Consultation Paper, the adoption of “presented properly”, “presented fairly” and “in accordance with the applicable financial reporting requirements as set out in the SME-FRF and SME-FRS” are presented for consultation. Members prefer to use “presented properly” in the auditors’ report to SMEs.

- 3.3 The concept of “true and fair view” and “true and correct view” under the United Kingdom standard should be abolished, instead the adoption of IFRS standards should be used. Thus, the present use of “true and fair view” reporting under the main GAAP as stated in the Companies Ordinance (CO) should also be amended to either “presented properly” or “presented fairly” to be in line with IFRS reporting requirement.

## **4. Entities to qualify under the SME-FRF**

### *Size Criteria*

- 4.1 The size criteria of not exceeding any two of the three:-  
(a) total revenue of \$50 million; (b) total assets of \$50 million; and  
(c) 50 employees,  
is acceptable to members.
- 4.2 Some members suggest to include another alternative, such as: at the sole discretion and election of all shareholders.

### *Public Accountability*

4.3 Public accountability is one of the major concerns on what entity is entitled to adopt SME-FRS. While members agree to this consideration and adopt the suggestions of GSBWG, a majority of them also consider the following entities should also be considered to be included under category of public accountability :

- Trust corporation
- Charitable/non-profit making organisations
- Shipping company
- Money lender company

There are different opinions as to whether other industries, such as Club or Association, Owners' Corporation of Building (incorporated under Section 8 of Building Management Ordinance) may also be regarded as having public accountability.

### *Unanimous Agreement of not less than at least 90% of the Owners of an Entity*

4.4 While SMEs usually consists of a small number of shareholders, if at least 90% of the Owners of an Entity agree, SME-FRS could be applied and financial statements should be exempted from adoption under the main GAAP.

## **5. Statutory requirements under the CO**

5.1 Section 141D of the CO originally granted certain relief exclusively to small companies in preparing financial statements under the requirement of section 141. If section 141D is intended to be replaced and amended for the use of SME-FRS, it should be so amended to include the following.

### *Tenth Schedule and Eleventh Schedule of the Companies Ordinance*

5.2 The majority of members agree to repeal the Eleventh Schedule.

- 5.3 If SME-FRS is to be stated under the CO as a statutory requirement, this should also be applicable to the main GAAP. Section 141 of the CO should also be amended to include the adoption of main GAAP under the Tenth Schedule. This would make the legislation putting the SME-FRS and the main GAAP on the same statutory recognition.

*Group accounts of companies with subsidiary(ies)*

- 5.4 Group companies of SMEs meeting the size requirement should be allowed to prepare the consolidated financial statements following the requirements of SME-FRS. The restriction under Section 141D of the CO should be removed.

*'True and Fair View' and 'True and Correct View'*

- 5.5 As mentioned in paragraph 3.3 above, the wordings 'True and Fair View' and 'True and Correct View' which follow the United Kingdom standard should be abandoned and changed to following the international standard.

*Section 141 of the CO*

- 5.6 Section 141 of the CO requires companies to prepare Profit & Loss Account. Since the GAAP has changed 'Profit & Loss Account' to 'Income Statement', the CO should also be changed accordingly, especially taking the opportunity of amending the CO. Otherwise, there might be a 'technical breach' with the CO.

*Implement arrangement to cater for when a company may qualify in one particular financial year but not another*

- 5.7 Members are concerned and foresee the difficulty and resources required when an entity can adopt the use of SME-FRS in one year and has to convert to main GAAP in another year. This would result in additional cost in re-compilation of the comparative figures and reconciliation of equity. The purposes of cost : benefit criterion would be defeated.

GSBWG is requested to devise alternative approach to solve this issue.

## **6. Applicable financial reporting requirements**

### *Re-statement of comparative figures*

- 6.1 As stated in paragraph 5.7 above, the re-statement of comparative figures would involve cost out of proportion to the benefits obtained. It also defeats the original intention of facilitating SMEs in preparing financial statements.

### *Related party transactions disclosure*

- 6.2 Information on related party transactions is relied on the disclosure made by the management of the entity. Except those disclosed in the financial records, it would be difficult and impracticable for auditors to verify its correctness. Otherwise, the cost and processes of gathering these information would be out of proportion to the benefit obtained.
- 6.3 Related party transactions disclosure for SMEs should be waived if more than 90% of shareholders agreed to do so. For SMEs, such information would not be of much use to the shareholders if they are involved in their day to day management.
- 6.4 Other users of the financial statements may be of interest on these information. Inland Revenue Department would be of most interest to these information. Banks would not rely purely on the financial statements to grant credit to the entity. They would obtain other information more pertinent to their granting of facilities.

### *Asset Revaluation*

- 6.5 Members agree that the use of historical costs would be appropriate. This applies to a great majority of the entities. However, it should not preclude some SME entities incorporating asset revaluation into their financial statements to reflect the appropriate disclosure of their true financial position, while the adoption of the main GAAP would be too costly and troublesome.

- 6.6 SME entities should be allowed to have their asset revalued provided that they are appropriately and properly disclosed in the financial statements with the basis of revaluation. This could follow the requirements of the appropriate main GAAP. Users of the financial statements would analyse the financial statements and obtain the relevant information for their use.

*Accounting Treatment or Situation of Entity not stated in SME-FRS*

- 6.7 When an entity comes across situation not stated under SME-FRS, there would be no guidelines on how to address that particular accounting recognition or measurement issue in the financial statements. If the situations are catered for in the main GAAP, entity should be allow to adopt such accounting treatment under that main GAAP which should be stated clearly in the financial statements.
- 6.8 There are quite a number of main GAAPs (approximately 36) and IAS (approximately 41) whereas there are only 15 sections in the SME-FRS. There must be situations the SME-FRS may not be catered for. The adoption of this specific main GAAP would enable appropriate accounting recognition.
- 6.9 The SME-FRS contains approximately 24 references to "Fair Value". This would present considerable problems in accounting measurement for absence of clear guidance. The reference to the main GAAP and guidelines would have to be adopted.

*Cash Flow Statements*

- 6.10 The cash flow statements should be waived for SMEs.

**Conclusion**

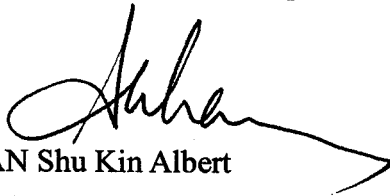
The effort put up by GSBWG in preparing the SME-FRF and SME-FRS is much appreciated. Under the current presentation of the Consultation Paper, the adoption of SME-FRS would still create many problems for SMEs and Practising CPAs. GSBWG is requested to carefully consider the comments and recommendations raised.



We are most willing to meet with the members of GSBWG for a more detailed discussion on the Consultation Paper which would have significant impact to SMEs and Practising CPAs, especially Small and Medium Size Practitioners.

Your favourable consideration to our submission is highly appreciated.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Chan Shu Kin Albert', with a long, sweeping horizontal stroke extending to the right.

CHAN Shu Kin Albert

President

The Society of Chinese Accountants and Auditors