



28 February 2007

To: **Members of the Hong Kong Institute of CPAs**
All other interested parties

**INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB) EXPOSURE
DRAFT OF PROPOSED *INTERNATIONAL FINANCIAL REPORTING STANDARD
FOR SMALL AND MEDIUM-SIZED ENTITIES***

The International Accounting Standards Board (IASB) has issued an Exposure Draft of Proposed *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*. The aims of the IASB in developing the *IFRS for SMEs* are to:

- provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- reduce the financial reporting burden on SMEs that want to use global standards; and
- meet the needs of users of SME financial statements.

The IASB's Exposure Draft and the related press release have been posted on the website of the Hong Kong Institute of CPAs (Institute) at www.hkicpa.org.hk/professionaltechnical/accounting/exposedraft/content.php which can also be found on-line at: www.iasb.org.

The proposed standard is intended for use only by SMEs, where SMEs are defined as entities that (1) do not have public accountability and (2) publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

The Institute's Financial Reporting Standards Committee (FRSC) invites comments on the IASB's Exposure Draft from any interested party. In addition to the matters raised in the IASB's Invitation to Comment, the FRSC would like to seek specific views from commentators in Hong Kong regarding whether the proposed IFRS for SMEs, upon its finalisation, should be adopted in Hong Kong to replace the existing Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF & SME&FRS) or whether the SME-FRF & SME-FRS should be retained. The FRSC would like to hear from both those who agree and those who do not agree with the proposals contained in it and those who support and those who do not support the adoption of the IASB's final approved *IFRS for SMEs* in Hong Kong. Comments should preferably be supported by specific reasoning and are requested by **1 September 2007**. Comments 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.

ADDITIONAL MATTERS FOR COMMENTATORS IN HONG KONG

Current position

Currently, Hong Kong has two separate sets of accounting standards – Hong Kong Financial Reporting Standards (HKFRSs) and the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF & SME-FRS).

HKFRSs, in general, are financial reporting standards that are converged with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). HKFRSs are designed to apply to general purpose financial statements and other financial reporting of all profit-oriented entities. The application of HKFRSs, with additional disclosure when necessary, is presumed to result in financial statements that give a true and fair view.

The SME-FRF & SME-FRS, which are effective for accounting periods beginning on or after 1 January 2005, were developed locally in Hong Kong. The measurement base under the SME-FRF is primarily historical cost. The SME-FRF & SME-FRS are applicable to companies incorporated under the Hong Kong Companies Ordinance (CO) that meet the criteria set out in section 141D of the CO and other entities that have no public accountability and are considered to be SMEs in terms of their size. Unanimous consent from shareholders is required for the SME-FRF & SME-FRS to be used. For companies applying section 141D of the CO, compliance with the SME-FRF & SME-FRS is necessary in order for financial statements to give a true and correct view. For other entities that qualify for reporting under the SME-FRF, the appropriate application of the SME-FRS, with additional disclosure when necessary, would result in financial statements that achieve a proper presentation appropriate for SMEs.

Possible adoption of the IASB proposed IFRS for SMEs and resulting changes

The Exposure Draft of the proposed IFRS for SMEs that is currently under consultation by the IASB is intended to apply to general purpose financial statements of SMEs. SMEs are defined in this Exposure Draft as entities that do not have public accountability and publish general-purpose financial statements for external users. Although the definition of an SME does not include a quantified “size test”, the Exposure Draft recognises that individual jurisdictions, in deciding to adopt this IFRS for SMEs, may choose to prescribe a quantified size test. It is intended that the application of the IFRS for SMEs by an SME, with additional disclosure when necessary, is presumed to result in the financial statements that gives a true and fair view of the financial position, financial performance and cash flows of an SME.

The measurement bases under the proposed IFRS for SMEs are similar to the mix of fair value and cost used in HKFRSs. As compared with IFRSs, with which HKFRSs are converged, the proposed IFRS for SMEs allows more options, includes some measurement and recognition simplifications and requires fewer disclosures. As compared with the SME-FRF & SME-FRS, which is based primarily on the historical cost convention, the proposed IFRS for SMEs would, in general, require or permit more use of fair value and require more disclosures. The Institute will prepare and place on its website by 30 March 2007 an overview of the key differences between the proposed IFRS for SMEs and SME-FRS.

In the light of this proposed IFRS for SMEs, the question now faced by Hong Kong is whether the proposed IFRS for SMEs, upon its finalisation, should be adopted in Hong Kong to replace the SME-FRF & SME-FRS or whether the SME-FRF & SME-FRS should be retained.

The choice would depend on which standard works best for SMEs in Hong Kong. In order to have a fairer comparison, this choice should be made without regard to the differences in the qualifying criteria between those set out in the IASB proposed IFRS for SMEs and those in the SME-FRF & SME-FRS.

The Institute, being a member body of the International Federation of Accountants (IFAC), is well aware of its obligation under the IFAC's Statement of Membership Obligation (SMO) 7 "International Financial Reporting Standards" that it should use its best endeavours to incorporate the requirements of IFRSs in its national accounting requirements. According to the proposed IFRS for SMEs, decisions on which entities are required or permitted to use the IASB's standards rest with national regulatory authorities and standard-setters. This is true for full IFRSs and for IFRS for SMEs. On the basis that the current Hong Kong Financial Reporting Standards are fully converged with IFRSs, the Institute will liaise with the IFAC to ascertain whether, without prejudice to its SMO compliance status, it is open to the Institute to choose not to adopt the proposed IFRS for SMEs in the case where the Hong Kong community considers it inappropriate to adopt the proposed IFRS for SMEs for entities in Hong Kong.

Subject to the above, the FRSC would therefore like to seek specific views from commentators in Hong Kong regarding whether the proposed IFRS for SMEs, upon its finalisation, should be adopted in Hong Kong to replace the SME-FRF & SME-FRS or whether the SME-FRF & SME-FRS should be retained.

Responses to the above questions should be supported by specific reasoning and should be submitted in written form. Responses will be used in deciding the way forward with the proposed IFRS for SMEs in Hong Kong and the amendments needed to achieve the option taken.