



18 October 2018

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

**HKICPA REQUEST FOR INFORMATION:
Post-implementation Review of Small and Medium-sized Entity Financial
Reporting Framework and Financial Reporting Standard**

The Financial Reporting Standards Committee ("FRSC") of the Hong Kong Institute of Certified Public Accountants ("Institute") is requesting information on the application of its Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard ("SME Standard"). The Request for Information is available on the Institute's website:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/>

The Institute issued this Request for Information ("RFI") to conduct a post-implementation review ("PIR") of the SME Standard. A PIR is a key part of our standard-setting process to proactively seek constituents' feedback on, and assess the benefits, challenges and other effects of applying the principles and procedures outlined in the pronouncement. The Institute welcomes feedback from everyone: preparers of financial statements, market regulators, auditors, academics as well as investors or other users of financial statements. The feedback will provide the FRSC with useful information to consider its next steps, which may involve assessing areas of the SME Standard that may need improvement. A PIR does not formally commit us to undertake a project to revise the SME Standard.

The Institute requests your response **by 18 February 2019**. Your response should be supported by specific reasoning and should ideally be submitted in written form. The Institute would also welcome the opportunity to meet in person with interested parties to discuss the RFI.

Responses 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 respondent.

Comments due by
18 February 2019

Request for Information on

Post-implementation Review:

Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard



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

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Introduction

In 2005, the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard ("SME Standard") was developed and issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") after two rounds of extensive consultation from 2002 to 2004. Based on the feedback received, the HKICPA Council decided that the SME Standard should be straightforward for entities with simple businesses or transactions to apply. As a result, the SME Standard is a predominantly cost-based measurement standard. The SME Standard was then revised in 2014 to cater for the new requirements set out in the Hong Kong Companies Ordinance ("CO") enacted in 2012, and again in 2015 to clarify a few changes to the CO.

In recent years, major new HKFRS/IFRS standards were issued with significant changes in accounting requirements for financial instrument, revenue and leases. This led to questions about whether the SME Standard would be reviewed against the changes in HKFRS/IFRS standards. The Financial Reporting Standards Committee ("FRSC") of the HKICPA decided it should first observe and analyse the implementation experience of IFRS/HKFRS adopters before considering whether to introduce the relevant new requirements into the SME Standard, which is intended to be a simplified reporting standard.

The FRSC also decided to conduct a post-implementation review ("PIR") of the SME Standard as it had not been reviewed, holistically, since it was first issued. The first phase of the PIR was a targeted outreach with the FRSC's SME Standard Advisory Panel and a few interested parties, including other auditors from small and medium-sized accounting firms and users of financial statements. Findings from the first phase indicated a number of areas that should be considered as part of the PIR. Other than that, the targeted stakeholders commented that overall the SME Standard is working as intended. The second phase of the PIR is this Request for Information, which focuses on areas in the SME Standard that were recommended for review and new areas that were recommended to be added to the SME Standard based on user needs.

A PIR is a key part of HKICPA's standard-setting process to proactively seek constituents' feedback on and assess the benefits, challenges and other effects of applying its pronouncements. The HKICPA welcomes feedback from everyone: preparers of financial statements, market regulators, auditors, academics as well as investors or other users of financial statements. The feedback will provide the HKICPA with useful information to consider its next steps, which may involve assessing areas of the SME Standard that may need improvement. A PIR does not formally commit us to undertake a project to revise the SME Standard.

Request for Information

This RFI focuses on specific areas of the SME Standard that have been identified as important by targeted stakeholders as mentioned in the Introduction.

In particular, this RFI aims to assess whether: (a) certain accounting requirements should be added to the SME Standard; (b) certain accounting requirements of the SME Standard should be clarified/simplified; (c) the SME Standard should require more relevant information for the benefit of users of financial statements; and (d) there are other challenges and benefits experienced by companies, auditors, regulators and other users of the SME financial reports that have not been identified in the first phase of the PIR.

HKICPA will consider the responses received via written submission along with information gathered through a range of outreach activities to assist with gathering feedback to this RFI. The process is open and transparent—all responses received and meeting notes from its discussions will be published on the HKICPA's website (unless respondents request confidentiality).

Findings from the RFI will be analysed and a feedback statement summarizing the findings and planned next steps will be published.

You do not have to answer every question in this RFI. You are encouraged to provide supportable and sufficient information on any matters that you think are relevant for HKICPA's review.

HKICPA will consider all responses received by 18 February 2019 and make its assessment on the merits of the information provided, not on the number of responses to each question.

1. Your background and experience

It is easier for HKICPA to understand the information that you give us if we know what your role is with respect to financial reporting and what your experience is in applying the SME Standard.

Question 1
(a) Please tell us about your role with respect to financial reporting (for example, preparer of financial statements, auditor, regulator, academic, accounting professional body, or user of financial statements and, if so, the type of user ¹) and your experience in applying the SME Standard.
(b) If you are a preparer, we would like to know the following: (i) Which standard(s) are applied in preparing your company or group financial statements (for example, SME Standard, HKFRS for Private

¹ Type of user includes: buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, other (please specify).

Entities or HKFRS)?
(ii) Why you are applying the respective standard(s) mentioned in question 1(b)(i)?
(iii) (If relevant) How many sets of financial statements are prepared within your group?

2. Accounting requirements recommended to be added to the SME Standard

Section 5 Leases

Section 5 of the SME Standard sets out the accounting requirements for finance and operating leases for lessees only, and not lessors. This is not consistent with other Hong Kong financial reporting standards. Some stakeholders suggested that the accounting for lessors should be added to the SME Standard as many SMEs are lessors and hold properties for rental income and/or for capital appreciation.

Question 2
(a) (This questions is for lessors) As the SME Standard currently does not include accounting requirements for lessors, how have you accounted for leases?
(b) Do you support adding accounting requirements for lessors to the SME Standard? Why, or why not?

Section 15 The Effects of Changes in Foreign Exchange Rates

Paragraph 15.1 of the SME Standard states that "Each entity should identify its reporting currency. An entity's reporting currency is the currency of the primary economic environment in which the entity operates." However, the SME Standard does not explicitly allow or include the accounting requirement for an entity to use a reporting currency other than the currency of the primary economic environment in which the entity operates. Some stakeholders highlighted that SMEs nowadays have operations that are based outside of Hong Kong but report Hong Kong dollars as their reporting currency. These stakeholders suggested to consider adding the 'presentation currency' concept, i.e. the currency in which financial statements are presented, to the SME Standard and apply 'reporting currency' in the same way as 'functional currency' as defined in HKAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Question 3
(a) Have you been impacted by the SME Standard which currently does not explicitly allow or include a 'presentation currency' concept as in HKAS 21?
(b) Do you support adding the 'presentation currency' concept to the SME Standard? Why, or why not?

Others

The SME Standard was developed with entities with simple businesses or transactions in mind, and therefore the standard does not include accounting requirements for complex items or transactions. Nevertheless, some stakeholders think that SME businesses have evolved and are dealing with some complex instruments or transactions, such as derivatives and embedded derivatives, which currently may be off-balance sheet. Some

information pertaining to these instruments or transactions may be important to assess the risk of an entity. It would therefore be useful to readers of financial statements and more complete for the SME Standard to include accounting and/or disclosure requirements for derivatives (e.g. notional amount, cost, background of transaction).

Question 4

- (a) Have you been impacted by the SME Standard which currently does not include accounting and/or disclosure requirements for derivatives?
- (b) Do you support adding accounting and/or disclosure requirements for derivatives to the SME Standard? Why, or why not?
- (c) Are there other accounting and/or disclosure requirements that are not currently in the SME Standard with which you have experienced issues? Please provide sufficient details and explains about the items you encountered issues in accounting and why accounting and/or disclosure requirements are necessary.

3. Accounting requirements recommended to be clarified/simplified

Section 19 Consolidated and Company-Level Financial Statements

Paragraph 19.16 of the SME Standard sets out the disclosure requirements for consolidated and company-level financial statements. Most of the requirements are not applicable for company-level financial statements (paragraphs 19.16(b), (c), (d) and (g)) but apply to consolidated financial statement only. However, they are grouped under the same paragraph, which have led to confusion. Some stakeholders recommended HKICPA to clarify which requirements are needed for company-level financial statements only.

Paragraph 19.16(g)(vi) of the SME Standard requires an entity to disclose information about each subsidiary that has been excluded from consolidation in accordance with paragraph 19.2(b) including: a summarised financial information of the excluded subsidiary, which includes revenue, profit before tax, income tax expense, profit after tax, total assets, and total liabilities. Some stakeholders suggested that, for groups with more than one subsidiary, such a disclosure could be presented by aggregation if such presentation is more useful to users of financial statements.

Question 5

Have you experienced difficulties in applying the disclosure requirements in paragraph 19.16 of the SME Standard? If yes, please explain in detail.

Transitioning from a different reporting framework to the SME Standard

When transitioning from a different reporting framework to the SME Standard, an entity is required to restate the comparative information that were previously measured on a different basis, unless it involves undue cost or effort.

However, it is judgmental and difficult to justify what constitutes 'undue cost or effort'. In respect of property, plant, equipment and intangible asset which can be measured at fair value in other reporting frameworks, an entity that seeks to report under the SME Standard is required to restate the comparative information to cost less accumulated

depreciation/amortization.

To facilitate transitions and address the undue cost or effort problem, some stakeholders suggested that the transition provisions of the SME Standard can be aligned with paragraphs 35.10(c) and 35.10(d) of the *HKFRS for Private Entities*, which exempt the restatement of comparative information in these cases when an entity prepares its first financial statements under the SME Standard. A first-time adopter of the SME Standard could therefore use the carrying amounts (measured at fair value or cost less accumulated depreciation/amortization) of the property, plant, equipment and intangible asset in the previous reporting framework at the date of transition as its deemed cost.

Question 6

Have you experienced challenges in restating comparative information of property, plant, equipment, intangible asset or any other financial statement item when an entity transitioned from a different reporting framework to the SME Standard? If yes, please explain in detail.

Section 18 Business Combinations and Goodwill

Paragraph 18.20 of the SME Standard states that "Goodwill should be amortised on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of goodwill will not exceed 5 years from initial recognition." Some stakeholders suggested changing the rebuttable presumption of 5 years to 10 years to align with paragraph 19.23 of *HKFRS for Private Entities*. This would reduce the transitional adjustments between the SME Standard and the *HKFRS for Private Entities*.

Question 7

Have you experienced difficulties with or or have any other comments about applying a useful life of five years for goodwill accounting? If yes, please explain in detail.

Others

Question 8

Would you recommend clarifying/simplifying other accounting requirements of the SME Standard? Please explain the requirements you propose to be clarified/simplified and why it is necessary.

4. Other application challenges/benefits

In the Introduction of this RFI, we mentioned that the SME Standard is intended for entities with simple businesses or transactions to apply. Therefore, the SME Standard is a predominantly cost-based measurement standard. To ensure Hong Kong financial reporting standards remain relevant and useful, our standard-setting process requires a regular PIR of the standards after allowing sufficient time and experience in applying the standards—typically three to five years after effective date. Other reasons for performing a PIR could be changes in regulatory or other reporting requirements and developments that would influence the usefulness of financial reports.

Question 9

- (a) Have you experienced any other challenges or benefits when applying the SME Standard? If you are a user of financial reports prepared under the SME Standard, have you experienced any challenges or benefits with such reports? Please explain in detail, for example, whether you found a predominantly cost-based measurement reporting useful?
- (b) Do you have other comments, including feedback on the HKICPA's PIR process?

In the Introduction of this RFI, we also mentioned that, major new standards (i.e. HKFRS 9 *Financial Instruments*, HKFRS 15 *Revenue from Contracts with Customers*, HKFRS 16 *Leases* and HKFRS 17 *Insurance Contracts*) were issued that led to questions about whether the SME Standard would be reviewed against these new standards. The FRSC decided it should first observe and analyse the implementation experience of IFRS/HKFRS adopters before considering whether to introduce the relevant new requirements into the SME Standard, which is intended to be a simplified reporting standard.

Question 10

Do you have comments on the FRSC's approach to wait for a review of implementation experience of the major new HKFRS standards before considering whether to introduce the relevant new requirements into the SME Standard? Please explain why and when is an appropriate time, if you disagree with the FRSC's decision.