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Exposure Draft

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Response Due Date  
31 January 2020

*Exposure Draft*

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**Proposed Amendments to the 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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The Exposure Draft can also be found on the Institute's website at:  
[www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/](http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/)

## Introduction

In October 2018 the Financial Reporting Standards Committee (FRSC) of the Institute issued a [Request for Information](#) to conduct a post-implementation review (PIR) of the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (*SME-FRF* & *SME-FRS*). The comment period closed on 18 February 2019.

The aim of the PIR was to proactively seek constituents' feedback on, and assess the benefits, challenges and other effects of applying, the *SME-FRF* & *SME-FRS*.

The PIR [Feedback Statement](#), issued in July 2019, provides an overview of the Institute's PIR process, and a summary of responses received from constituents, including the key issues being identified.

Based on the feedback received, the FRSC:

- (a) noted that the *SME-FRF* & *SME-FRS* appear to be working as intended, and remains suitable for entities with simple businesses or transactions to apply; and
- (b) proposes only to make certain limited amendments with rationale as follow:

Proposed amendments	Rationale
Allow an entity to use the fair value or the carrying amount of all items in a class of property, plant, equipment or intangible asset as deemed cost at the date of transition when transitioning from another financial reporting framework to the <i>SME-FRF</i> & <i>SME-FRS</i> ( <i>paragraph 44 of SME-FRF</i> )	The FRSC proposes this transitional relief for cost-benefit reasons.
Add lessor accounting requirements to the <i>SME-FRF</i> & <i>SME-FRS</i> ( <i>paragraph 5.11A to 5.11I of SME-FRS</i> )	The FRSC suggests adding the accounting requirements for lessors as <ul style="list-style-type: none"> <li>• requiring lessors to provide information on leases would be useful to users (e.g. banks) of SME financial reports;</li> <li>• leasing out investment properties under operating leases appears to be a common transaction of SMEs and hence it would improve the completeness of the <i>SME-FRF</i> &amp; <i>SME-FRS</i> to add such requirements;</li> <li>• prevents diversity in lessor accounting as there are no specific requirements in the existing <i>SME-FRF</i> &amp; <i>SME-FRS</i>; and</li> <li>• the additional cost to SMEs for complying with the additional lessor accounting requirements is not expected to be significant based on feedback from the PIR.</li> </ul>
Add presentation currency concept to the <i>SME-FRF</i> & <i>SME-FRS</i> ( <i>paragraphs 15.8 and 15.15 of SME-FRS</i> )	The FRSC suggests adding the 'presentation currency' concept as SMEs nowadays more often have operations

	<p>that are based outside of Hong Kong but report Hong Kong dollars as their reporting currency.</p> <p>It also appears to be common for SMEs to have subsidiaries outside of Hong Kong and so it would improve the completeness of the SME-FRF &amp; SME-FRS to add such requirements and avoid diversity in application.</p> <p>Besides, the FRSC does not think it would add cost and complexity to the SME-FRF &amp; SME-FRS as the requirements would be similar to those in paragraph 15.8 of the SME-FRF &amp; SME-FRS regarding translation of a foreign operation.</p>
<p>Clarify that the disclosure requirements in paragraphs 19.16(b), (c), (d) and (g) of the SME-FRF &amp; SME-FRS apply to consolidated financial statements only (<i>paragraph 19.16A of SME-FRS</i>)</p>	<p>The FRSC noted that paragraph 19.16 combines disclosure requirements that are applicable to company-level and consolidated financial statements, and this may have caused confusion as to which requirement applies to company-level financial statement. The FRSC proposes to clarify that the disclosure requirements in paragraphs 19.16(b), (c), (d) and (g) apply to consolidated financial statements only.</p>
<p>Permit but not require aggregation of the financial information of subsidiaries excluded from consolidation (<i>paragraph 19.16B of SME-FRS</i>)</p>	<p>The FRSC proposes permitting but not requiring aggregation. This is because, depending on circumstances, aggregation/disaggregation may impose additional cost on preparers and disaggregation/aggregation may be a better method of presenting such information.</p>

## **Amendments to the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (Amendments to the SME-FRF & SME-FRS)**

### **[Draft] Amendments to Small and Medium-sized Entity Financial Reporting Framework**

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Paragraph 44 of the SME-FRF and paragraph 15.8 of the SME-FRS are amended. Paragraph 55 of the SME-FRF, paragraphs 5.11A – I, 15.15 and 19.16A – B of the SME-FRS and related definition are added. New text is underlined and deleted text is struck through. Paragraph 19.16 of the SME-FRS has not been amended but is included for ease of reference.

### **Transitioning from a different GAAP to SME-FRF and SME-FRS**

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44. The transition from ~~a different~~ the entity's previous GAAP (for example the transition from reporting in accordance with Hong Kong Financial Reporting Standards) to the SME-FRF and SME-FRS is accounted for as follows:

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(c) All items recognised ~~previously~~ under ~~a different~~ the entity's previous GAAP, which meet the recognition criteria under the SME-FRF and SME-FRS, but which were previously measured on a basis inconsistent with the SME-FRF and SME-FRS (for example, unamortised goodwill) are to be re-measured in accordance with the relevant section of the SME-FRS and dealt with as a change of accounting policy under section 2 of the SME-FRS. An entity may also use the following exemptions for each class of property, plant and equipment\* or intangible assets in preparing its first financial statements that conform to the SME-FRF and SME-FRS:

- (i) Previous GAAP carrying amount as deemed cost: An entity may elect to measure all items in each class of assets at their previous GAAP carrying amount on transition; or
- (ii) Fair value as deemed cost: An entity may elect to measure all items in each class of assets at their fair value on transition.

### **Effective Date**

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55. Amendments to the SME-FRF & SME-FRS, issued in [date to be decided after exposure], amended paragraph 44 of the SME-FRF and paragraph 15.8 of the

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\* The definition of property, plant and equipment in the SME-FRS includes property classified as investment property applying HKFRS or the HKFRS for Private Entities.

SME-FRS, and added paragraphs 5.11A – I, 15.15 and 19.16A – B and related definition to the SME-FRS. An entity shall apply those paragraphs for annual periods beginning on or after [date to be decided after exposure]. Amendments to the SME-FRF & SME-FRS shall be applied retrospectively in accordance with paragraph 2.7 of SME-FRS. Earlier application of Amendments to the SME-FRF & SME-FRS is permitted. If an entity applies Amendments to the SME-FRF & SME-FRS for an earlier period it shall disclose that fact.

## **[Draft] Amendments to the Definitions**

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The definition of presentation currency and previous GAAP are added after the definition of predecessor Company Ordinance.

**Presentation currency** is the currency in which the financial statements are presented.

**Previous GAAP** is the basis of accounting that an entity used immediately before adopting SME-FRF and SME-FRS.

## **[Draft] Amendments to the Small and Medium-sized Entity Financial Reporting Standard**

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### **Section 5 Leases**

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A heading is added after paragraph 5.3.

#### **Leases in the financial statements of lessees**

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#### **Leases in the financial statements of lessors**

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##### **Finance leases**

**5.11A** Lessors should recognise assets held under a finance lease in their statement of financial position, and present them as a receivable at an amount equal to the net investment in the lease. The net investment in a lease is the lessor's gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:

(a) the minimum lease payments receivable by the lessor under a finance

lease, and

(b) any unguaranteed residual value accruing to the lessor.

Unguaranteed residual value is that portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.

5.11B The recognition of finance income should be based on a pattern reflecting a constant periodic rate on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in profit or loss.

### **Disclosure**

5.11C Lessors should disclose for a finance lease at the end of the reporting period the present value of minimum lease payments receivable, for each of the following periods:

(a) not later than one year; and

(b) later than one year.

### **Operating leases**

5.11D Lessors should present assets subject to operating leases in their statement of financial position according to the nature of the asset.

5.11E The lessor should recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term, unless another systematic basis is more representative of the pattern in which benefit from the leased asset is diminished.

5.11F The lessor should recognise costs, including depreciation, incurred in earning the lease income as an expense. The depreciation policy for depreciable

leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

5.11G The lessor should add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.

5.11H To determine whether a leased asset has become impaired and to account for any impairment loss identified, a lessor shall apply Section 9 *Impairment of Assets*.

### **Disclosure**

5.11I Lessors should disclose the total of future minimum lease payments receivable under non-cancellable operating leases for each of the following periods:

- (a) not later than one year; and
- (b) later than one year.

### **Section 15 The Effects of Changes in Foreign Exchange Rates**

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#### **Translation of a foreign operation****Use of a presentation currency other than the reporting currency**

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~~15.8 Where a foreign operation does not form an integral part of the entity and operates as a separate business with local finance, it is not uncommon that the foreign operation would report in a currency which is different from the reporting currency of the entity. Where this is the case, the results and financial position of the foreign operation should be translated into the reporting currency of the entity using the following procedures: An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's reporting currency, the entity should translate its items of income and expense and financial position into the presentation currency. For example, when a group contains individual entities with different reporting currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented. An entity should translate its results and financial position into a different presentation currency using the following procedures:~~



- (a) assets and liabilities for each statement of financial position presented (i.e. including comparatives) should be translated at the closing rate at the end of that reporting period;
- (b) income and expenses for each income statement (i.e. including comparatives) should be translated at average rate for the period or closing rate at the end of that reporting period; and
- (c) all resulting exchange differences should be recognised as a separate component of equity.

### **Disclosure**

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15.15 An entity should disclose the currency in which the financial statements are presented. When the presentation currency is different from the reporting currency, an entity should state that fact and should disclose the reporting currency and the reason for using a different presentation currency.

### **Section 19 Consolidated and Company-Level Financial Statements**

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### **Disclosure**

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19.16 An entity should disclose:

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- (b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
- (c) the basis for concluding that control does not exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an investee, if applicable;
- (d) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements;

...

- (g) particulars of each subsidiary that has been excluded from consolidation in accordance with paragraph 19.2(b) including:
  - (i) the name of the subsidiary;
  - (ii) the principal place of operation and place of incorporation and an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held;

- (iii) any amounts recognised in the entity's income statement in respect of:
  - a. dividends received or receivable from the excluded subsidiary;
  - b. impairment losses relating to the investment in the excluded subsidiary;
  - c. other transactions with the excluded subsidiary;
- (iv) amounts recognised in the entity's statement of financial position in respect of:
  - a. investment in the excluded subsidiary;
  - b. any balances due to or from the excluded subsidiary;
- (v) whether the excluded subsidiary prepares audited financial statements;
- (vi) summarised financial information in respect of the excluded subsidiary, including the excluded subsidiary's:
  - a. revenue;
  - b. profit before tax;
  - c. income tax expense;
  - d. profit after tax;
  - e. total assets; and
  - f. total liabilities; and
- (vii) the basis of preparation of the summarised financial information disclosed in respect of the excluded subsidiary, including:
  - a. the period covered by the information;
  - b. the accounting framework adopted in its preparation; and
  - c. whether the information has been extracted from audited financial statements and if not, why not.

19.16A The disclosure requirements in paragraphs 19.16(b), (c), (d) and (g) apply to consolidated financial statements only.

19.16B The summarised financial information in paragraphs 19.16(g)(vi) can be aggregated if there is more than one excluded subsidiary. The inter-company transactions between those excluded subsidiaries should be eliminated for aggregated summarised financial information.