



Hong Kong Financial Reporting Standards for Private Entities ("HKFRS for Private Entities")

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The Institute's Standard Setting Department welcomes your comments and feedback on this paper, which should be sent to commentletters@hkicpa.org.hk.

Introduction

1. The Institute adopted HKFRS for Private Entities as a reporting option for entities in Hong Kong which have no public accountability on 30 April 2010. The objective is to ease the reporting burden of eligible entities by relieving them of the requirement to apply full Hong Kong Financial Reporting Standards ("HKFRSs").
2. With the adoption of HKFRS for Private Entities as a reporting option, the scope and applicability of the existing HKFRSs and Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard ("SME-FRF&FRS") remain unchanged. Entities are not required to adopt HKFRS for Private Entities even if they are eligible to do so.
3. Eligible entities are permitted to use HKFRS for Private Entities to prepare their financial statements for any financial period (i.e. even if the financial period ends on or before the date of adoption of HKFRS for Private Entities by the Institute, which is 30 April 2010).

General Guidance included in the literature of HKFRS for Private Entities

4. As stated in paragraphs 1.1 and 1.2 of HKFRS for Private Entities, the Standard is intended for use by Private Entities and Private Entities are defined as entities that:
 - (a) do not have public accountability, and
 - (b) 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.



5. As defined in paragraph 1.3 of HKFRS for Private Entities, an entity has public accountability if:
 - (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
 - (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.
6. Paragraph 1.4 of HKFRS for Private Entities further clarifies that some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services, such as utility companies), that does not make them automatically publicly accountable.
7. The Basis for Conclusions, specifically paragraphs BC55 to BC80, have documented the IASB's view and thought process on the applicability of the standard.

General principle of applicability of HKFRS for Private Entities

8. The FRSC is of the view that entities should go through the thought process described below in determining whether or not they are eligible to use HKFRS for Private Entities.

Statutory financial reporting requirement

9. There may be statutory requirements for an entity to prepare its accounts in accordance with specific accounting requirements. For example: the Education Bureau ("EB") requires the accounts of schools (including both Incorporated Management Committee ("IMC") schools and non-IMC schools) to be prepared in accordance with its Code of Aid and other related accounting instructions.
10. The entity should identify whether any specific statutory financial reporting requirements applies. The entity can use HKFRS for Private Entities to prepare its accounts for statutory purpose, provided it has no public accountability after considering the entity-specific facts and circumstances. However, the entity should also follow the relevant statutory requirement in preparing its accounts for statutory purposes.



11. Statutory requirements may require an entity to prepare financial statements which give a true and fair view. For example: the Building Management Ordinance (BMO) requires the Management Committee ("MC"), or a professional property manager employed by the Owners' Corporation ("OC") or its MC, to prepare the annual financial statements which give a true and fair view of the financial transactions and financial position of the OC.
12. As stated in paragraph 3.2 of HKFRS for Private Entities, the application of HKFRS for Private Entities, with additional disclosure when necessary, is presumed to result in financial statements that achieve a true and fair view of the financial position, financial performance and cash flows of Private Entities. The FRSC is of the view that an eligible entity can use HKFRS for Private Entities to prepare its general purpose financial statements, for the purposes of a relevant statute which requires the entity to prepare general purpose financial statements which are true and fair.

Other arrangements

13. There may be other arrangements in place, apart from statutory requirements, which require an entity to prepare financial statements in accordance with a specific set of accounting standards (for example: full HKFRSs). There may be specific provisions in an entity's memorandum and articles of association, in business or shareholder agreements or other documents requiring the entity to apply a specific set of accounting standards to prepare its financial statements. Eligible entities should consider such other arrangements in determining whether or not to use HKFRS for Private Entities to prepare their general purpose financial statements.

Commonly asked questions regarding applicability of HKFRS for Private Entities

Q1: *Is HKFRS for Private Entities applicable to financial institutions?*

A1: As stated in paragraph BC59 of the Basis for Conclusions, the primary business of banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. This means that such an entity acts in a public fiduciary capacity, and therefore it is publicly accountable. Hence, it is the view of the FRSC that HKFRS for Private Entities is not applicable to financial institutions and entities mentioned above.

Q2: *Is HKFRS for Private Entities applicable to companies limited by guarantee or unlimited companies?*

A2: A company limited by guarantee refers to a company whose members' liability is limited to such an amount as they have undertaken to contribute to the assets of the company in the event of winding up and an unlimited company refers to a company whose members' liabilities are not limited.

It is the view of the FRSC that being a company limited by guarantee or an unlimited company in itself would not expressly make that company a Private Entity. The entity would also need to consider other facts and circumstances specific to the entity for determination of the applicability of HKFRS for Private Entities.



Q3: *Is HKFRS for Private Entities applicable to an entity which is a subsidiary whose parent uses full HKFRS or IFRS?*

A3: As stated in paragraph 1.6 of HKFRS for Private Entities, a subsidiary whose parent uses full HKFRSs or IFRSs, or a subsidiary which is part of a consolidated group that uses full HKFRSs or IFRSs, is not prohibited from using HKFRS for Private Entities in its own financial statements if that subsidiary itself does not have public accountability.

Q4: *Under the Hong Kong Companies Ordinance, limited companies may be classified as private or public companies. Does this classification of limited companies affect the applicability of HKFRS for Private Entities?*

A4: Private companies under Section 29 of the Companies Ordinance are companies which by their articles:

- restrict the right to transfer their shares;
- limit their members to 50; and
- prohibit any invitation to the public to subscribe for their shares or debentures.

All other limited companies are classified as public companies.

It is the view of the FRSC that the classification of limited companies (i.e. as a private company or a public company) should not be the sole factor the entity considers when determining whether it has public accountability. For example: even though a private company is prohibited from inviting the public to subscribe for its shares or debentures, it may still have public accountability by holding assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. On the other hand, even though a public company is permitted to invite the public to subscribe for its shares or debentures, it may not necessarily do so and hence a public company may not have public accountability solely by being classified as public.

An entity should also consider the entity-specific facts and circumstances for determination of the applicability of HKFRS for Private Entities.

Q5: *Is HKFRS for Private Entities applicable to small publicly traded entities?*

A5: FRSC is of the view that HKFRS for Private Entities cannot be used by publicly traded entities whether the entity is big or small, for financial reporting. The fact that the entity is publicly traded places the entity outside the scope of HKFRS for Private Entities.

As stated in paragraph BC76 of the Basis for Conclusions, entities, large or small, whose debt or equity instruments are traded in public capital markets have chosen to seek capital from outside investors who are not involved in managing the business and who do not have the power to demand information that they might find useful. Full HKFRSs have been designed to serve public capital markets by providing financial information especially intended for investors and creditors in such markets.



Q6: *Is HKFRS for Private Entities applicable to not-for-profit organisations?*

A6: As explained in paragraph 1.4 of HKFRS for Private Entities and in paragraph 6 above, entities (including charitable organisations) may not necessarily be publicly accountable even if they hold assets in a fiduciary capacity for a broad group of outsiders provided they do so for reasons incidental to a primary business (i.e. conducting charitable programmes and activities).

The FRSC is of the view that not-for-profit organisations (including charitable organisations) solely by their nature are not prohibited to use HKFRS for Private Entities for preparing their general purpose financial statements.

However, as explained in paragraphs 8-13, entities would also need to consider if there are any statutory requirements in place or other entity-specific facts and circumstances requiring entities to prepare their accounts in accordance with specific accounting requirements for statutory or other purposes.

Q7: *Is HKFRS for Private Entities applicable to the preparation of financial statements of Owners' Corporations of Buildings?*

A7: Under the BMO, a professional property manager employed by the OC or its MC, is required to prepare annual financial statements which give a true and fair view of the financial transactions and financial position of the OC.

The OC may hold and manage resources entrusted to it by property owners who may not be actively involved in the management of the building (for example: building management and maintenance fund, etc.). The FRSC is of the view that the above situation does not necessarily make the OC publicly accountable and an OC, in general, is a Private Entity by its nature provided there are no other specific facts and circumstances that make the OC publicly accountable.

Q8: *Is HKFRS for Private Entities applicable to the preparation of financial statements of schools (including both Incorporated Management Committee ("IMC") schools and non-IMC schools)?*

A8: As stated in paragraph 9, the EB requires schools (including both IMC and non-IMC schools) to prepare their financial statements in accordance with the Code of Aid and other related accounting instructions. Those schools should adhere to the relevant requirements of EB, and not just HKFRS for Private Entities, to prepare financial statements for that purpose.

Schools may hold and manage resources entrusted to them by other parties who may not be actively involved in the management of the school (for example: school maintenance funds, school development funds, issuance of debentures which are not publicly traded, etc.). The FRSC is of the view that the above situation does not in itself make a school publicly accountable and schools, in general, are Private Entities by nature, provided there are no other specific facts and circumstances which make the school publicly accountable. Accordingly, the FRSC is of the view that a school, on the basis of its nature, can use HKFRS for Private Entities to prepare general purpose financial statements, in addition to the accounts prepared solely for statutory purposes.



Q9: *Is HKFRS for Private Entities applicable to the preparation of financial statements of solicitor firms?*

A9: Despite that solicitors hold client monies, this is incidental to the primary business (i.e. provision of legal services). FRSC is of the view that that a solicitor firm is a Private Entity by its nature provided there are no other specific facts and circumstances that would make the solicitor firm publicly accountable under the definition of HKFRS for Private Entities.

Q10: *Is HKFRS for Private Entities applicable to the preparation of financial statements of securities brokers?*

A10: The FRSC is of the view that the primary business of securities brokers is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Securities brokers are hence publicly accountable as they act in a public fiduciary capacity and therefore they would not fall within the scope of HKFRS for Private Entities.

Q11: *Is shareholders' approval required for an entity to adopt HKFRS for Private Entities?*

A11: HKFRS for Private Entities does not contain the requirement for an entity to obtain shareholders' approval for adoption of the standard.

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