

# Small- and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (Revised)

The new Hong Kong Companies Ordinance (Cap. 622) allows additional non-public companies to prepare simplified financial statements (i.e. the use of Small- and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard), by opting out of the full reporting regime.

The new ordinance carries forward the exemption criteria in section 141D of the predecessor ordinance, as one category of exempt company. In addition, simplified reporting can be adopted by private groups, private companies that are subsidiaries of other companies, and companies or groups limited by guarantee provided that:

- (i) They fall within the new size tests; and
- (ii) In the case of larger private companies, they obtain at least 75 percent shareholder approval, with none objecting.

The Institute has recently issued the SME-FRF and SME-FRS (Revised) in response to the new ordinance. In developing the revised standard, the Institute's Financial Reporting Standards Committee incorporated the proposals from the 2008 exposure draft, and the 2013 limited invitation to comment, modified to reflect the comments received on those consultations.

## Qualifying criteria for SME-FRF and SME-FRS (Revised)

The qualifying criteria for simplified reporting (i.e. the use of SME-FRF and SME-FRS (Revised)) are highlighted in paragraphs 22-43 of SME-FRF (Revised). In summary, the criteria apply as follows:

### Companies incorporated under the new or predecessor Companies Ordinances

A company qualifies for reporting under the SME-FRF and SME-FRS (Revised) if it satisfies the criteria for eligibility for the "reporting exemption," as set out in section 359 of the new ordinance, and the sections and schedules to which that section refers. The qualifying categories are shown on Table A.

The following types of company are not

eligible for the reporting exemption under the new ordinance and so are not permitted to prepare their financial statements in accordance with SME-FRF and SME-FRS:

- (i) Companies that are authorized under the Banking Ordinance to carry out banking business;
- (ii) Companies that accept, by way of trade or business (other than banking business) loans of money at interest or repayable at a premium, other than on terms involving the issue of debentures or other securities;
- (iii) Companies that are licensed under part V of the Securities and Futures Ordinance to carry on a regulated business; or
- (iv) Companies that carry on any insurance business, other than solely as an agent.

Groups that contain such companies are also not eligible for the reporting exemption and so cannot prepare consolidated financial statements under the SME-FRF and SME-FRS.

### Companies not incorporated under either the new or the old Companies Ordinances

Subject to any specific requirements imposed by the law of the company's place of incorporation and subject to its constitution, these companies qualify for reporting under the SME-FRF when they meet the same requirements that a Hong Kong incorporated company is required to meet under section 359 of the new ordinance.

### Summary of main changes in the new SME-FRS as compared to the previous standard

- A summary of the criteria for "qualifying entities" with cross-references to the new ordinance has been included;
- The accounting requirements are expanded to cover consolidated financial statements, business combinations and investments in other entities accounted for by application of the equity method;
- Guidance on presenting a cash flow statement has been included – the preparation of a cash flow statement is optional. However, if a cash flow statement

is presented then this guidance should be followed;

- Additional guidance material has been added on the non-exempted disclosure requirements in the new ordinance and certain other provisions of the new ordinance which are relevant to the SME-FRF and SME-FRS;
- Guidance has been added on the concept of "realized profits and losses" and the relationship between these and "recognized profits and losses" reported under the SME-FRS (section 79B of the predecessor ordinance, together with related sections, has been brought forward into the new ordinance substantially unaltered);
- Specific disclosure requirements have been added to the SME-FRF to cover the first year that a company transitions from a different set of generally accepted accounting principles (for example full HKFRS) to SME-FRS;
- Additional disclosure requirements have been added to the Income Taxes section to require the disclosure of applicable tax rates and unused tax losses;
- New guidance has been added on determining the "reporting currency" of an entity (which is based on the concept of functional currency in full HKFRS);
- The definition of "related party" has been updated to align with the current definition in full HKFRS;
- The definitions of "active market" and "fair value" have been updated to be consistent with HKFRS 13 *Fair Value Measurement*; and
- Guidance on determining whether an entity is acting as an agent or principal has been added to the appendix.

### Effective date of the standard

The effective date of the revised standard is aligned with the commencement date of the new ordinance and the date that section 359 comes into operation. Consequently, the revised standard is effective for a qualifying entity's financial statements that cover a period beginning

Table A

Eligible categories	Size test*	Approval from shareholders
1. A private company that has no subsidiary and is not a subsidiary of another company (i.e. this is the type of private company, which would have qualified for the reporting exemption under section 141D of the predecessor Companies Ordinance) (SME-FRF paragraph 43)	No size test is required	100 percent written approval from shareholders is required for each year (Note: if the private company also qualifies under category 2 below, approval from shareholders would not be required)
2. Small private company (SME-FRF paragraphs 36-37)	The small private company must not exceed any two of the following: (a) Total annual revenue of HK\$100 million (b) Total assets of HK\$100 million at the end of the reporting period (c) 100 employees	Approval from shareholders is not required under the Companies Ordinance
3. A group of small private companies (SME-FRF paragraphs 36-37)	(a) Each company in the group must qualify as a small private company; and (b) The aggregate amounts for the group must not exceed two out of three of the size tests for small private companies	Approval from shareholders is not required under the Companies Ordinance
4. Small company limited by guarantee (SME-FRF paragraphs 34-35)	The total annual revenue of the small company limited by guarantee must not exceed HK\$25 million.	Approval from shareholders is not required under the Companies Ordinance
5. A group of small companies each limited by guarantee (SME-FRF paragraphs 34-35)	(a) Each company in the group must qualify as a small company limited by guarantee; and (b) The aggregate annual revenue of the group must not exceed HK\$25 million	Approval from shareholders is not required under the Companies Ordinance
6. Larger "eligible" private company (SME-FRF paragraphs 38-39 and 42)	The private company must not exceed any two of the following: (a) Total annual revenue of HK\$200 million (b) Total assets of HK\$200 million at the end of the reporting period (c) 100 employees	At least 75 percent of all the shareholders must pass a resolution at a general meeting that the company is to fall within the reporting exemption for the financial year, with none objecting either at the meeting or otherwise in writing*
7. A group of "eligible" companies (SME-FRF paragraphs 38-39 and 42)	(a) Each company in the group must meet either the size test of small private company or larger "eligible" private company; and (b) The aggregate amounts for the group in total must not exceed two out of three of the size tests for larger "eligible" private companies	All the companies in the group individually, as well as the parent of the group, must have obtained the necessary shareholder approval* (except for those subsidiaries within the group that fall within the "small private company" category)

\*The new ordinance sets out specific requirements relating to determining which years are relevant for passing the size tests. In general, a company will have to pass the size tests for two consecutive years in order to become eligible in the third year. Similarly, a company would generally have to fail the tests for two consecutive years in order to become ineligible in the third year. However, there are specific transitional rules in this regard which apply in the first year that this part of the new ordinance comes into operation and also in any year in which a group acquires a new subsidiary. It is therefore important to take care to refer to the relevant sections of the new ordinance when testing whether a company is eligible.

\*For the larger "eligible" category of private companies or groups (categories 6 and 7), the 75 percent vote is calculated as a percentage of the entire shareholding of a company, not simply as a percentage of the shareholders who attend the general meeting. The resolution is defeated if any member objects either at the meeting or at any time by giving notice in writing to the company, provided that written notice is given at least six months before the end of the financial year to which the objection relates.

on or after 3 March 2014. As early adoption of section 359 is not permitted under the new ordinance, early application of the revised standard is also not permitted. For example, for those companies with a December year-end, the revised standard will first apply to the financial statements for the year ending 31 December 2015.

### Learning events

To facilitate members' understanding on the SME-FRF and SME-FRS (Revised), the Institute's Technical Learning and Support Team will organize seminars on the subject.

Visit the Institute's SME-FRF and SME-FRS webpage for the standard and related resources at [www.hkicpa.org.hk](http://www.hkicpa.org.hk).



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