SUMMARY OF SMPC TECHNICAL ISSUES WORKING GROUP MEETING (Virtual Conference)

IASB Request for Information: Comprehensive Review of the *IFRS for SMEs* Standard

Date: 13 May 2020
Time: 10:00 am – 11:30 am

Present:

Gary Poon, Poon & Co. (Chairman)
Kenneth Lau, Crowe (HK) CPA Limited (Deputy Chairman)
Anntice Lai, Baker Tilly Hong Kong Limited
Frank Lam, BDO Limited
Lok Sang Chan, Lau & Au Yeung C.P.A. Limited
Sammy Choi, TKC Corporate CPA Limited
Sharon Chan, Grant Thornton Hong Kong Limited
Teresa Lau (on behalf of Colin Chau), RSM Hong Kong
Thomas Wong, Nexia Charles Mar Fan Limited
Webster Ng, Webster Ng & Co.
Eddy Wong, Member Support, HKICPA
Canny Liu, Member Support, HKICPA
Anthony Wong, Standard Setting, HKICPA
Norman Chan, Standard Setting, HKICPA

1. Staff provided an overview of the initial development of the *IFRS for SMEs* Standard (equivalent to *HKFRS for Private Entities* (HKFRS for PE)) and the IASB's 2020 Request for Information (RFI) to the SMPC Technical Issues Working Group (TIWG). Staff proposed that the discussion at this meeting should focus on the IASB's approach for this comprehensive review, and whether and how to align specific sections of the *IFRS for SMEs* Standard with the *Conceptual Framework for Financial Reporting*, IFRS 16 *Leases*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments*.

2. The TIWG observed that most small entities prepare their financial statements either in accordance with the HKICPA's home grown Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME Standard) or full HKFRS Standards. The application of the HKFRS for PE is limited in Hong Kong. Entities that choose to use the HKFRS for PE do so

because it provides simplifications for certain accounting treatments, requires fewer disclosures as compared with the full HKFRS Standards, and the concept of “undue cost and effort” helps to balance the costs and benefits of its requirements.

3. The TIWG observed that some listed groups prepare consolidated financial statements under full HKFRS Standards while using the SME Standard to prepare the subsidiaries' financial statements. The entities considered preparing subsidiaries' financial statements under the SME Standard is more cost-effective than under full HKFRS Standards or under the HKFRS for PE. One member mentioned that only if an entity is not eligible to prepare financial statements under the SME Standard and would like to reduce the financial reporting burden due to some newer requirements of full HKFRS Standards such as HKFRS 9 *Financial Instruments*, HKFRS 15 *Revenue from Contracts with Customers* and HKFRS 16 *Leases*, would it choose to prepare its financial statements under the HKFRS for PE.

4. The TIWG generally agreed that the *IFRS for SMEs* Standard should continue to be aligned with full IFRS Standards to avoid divergence between two standards.

5. The TIWG considered that alignment should cover both principles and important definitions to ensure consistency of both standards and avoid confusion. However, they considered simplification cannot be achieved if alignment also covers the precise wordings of requirements.

6. The TIWG supported the principles of (i) relevance to SMEs, (ii) simplicity; and (iii) faithful representation, and agreed they would provide an appropriate framework to assist in determining whether and how the *IFRS for SMEs* Standard should be aligned with full IFRS Standards. One member suggested the IASB may consider giving the concept of “undue cost or effort” in Section 2 *Concepts and Pervasive Principles* more prominence by including it as another principle for consideration as “cost-effectiveness” is a major concern of small entities.

7. The TIWG agreed that the IASB should only consider changes in full IFRS Standards (including an IFRS Standard, an amendment to an IFRS Standard, or an IFRIC Interpretation) for incorporation into the *IFRS for SMEs* Standard after they are effective and practical implementation experience has been obtained. They considered the timing of consideration should be determined on a case by

case basis as some changes to full IFRS Standards may not be subject to a post-implementation review and the level of complexity of changes will vary.

8. The TIWG noted that Section 2 is currently aligned with the 1989 *Framework for the Preparation and Presentation of Financial Statements*. They considered Section 2 should be aligned with the *Conceptual Framework for Financial Reporting* issued in 2018 as most of the concepts have been updated. The TIWG emphasised that the "undue cost or effort" concept should be retained to provide simplified accounting for small entities if the requirements result in undue cost relative to the benefits of providing the information to users of their financial statements.

9. The TIWG welcomed the simplifications proposed by the IASB for aligning Section 20 *Leases* with IFRS 16. One member would like the IASB to permit the option to use a discount rate by reference to market yields on high-quality corporate bonds directly without the need to consider if the interest rate implicit in the lease and the lessee's incremental borrowing rate can be "readily determined". Overall, the TIWG agreed with the simplifications proposed by the IASB should *the IFRS for SME*s Standard be aligned with IFRS 16. However, they considered it is not desirable to align with IFRS 16 during this comprehensive review as the implementation experience of IFRS 16 is limited as it only became effective in 2019.

10. The TIWG had reservations about aligning Section 23 *Revenue* with IFRS 15 because of insufficient implementation experience of IFRS 15, as evidenced by recently issued IFRS Interpretations Committee Agenda Decisions, and so members generally preferred Alternative 3. However, out of the remaining two alternatives proposed by the IASB, the TIWG would prefer Alternative 1 - modifying Section 23 to remove the clear differences in outcome from applying Section 23 or IFRS 15, without wholly reworking Section 23. They considered Alternative 1 would better facilitate small entities' understanding and adoption of the new requirements than Alternative 2. The TIWG did not comments on possible transitional relief under Alternatives 1 and 2.

11. The TIWG did not comment on whether to supplement the list of examples in Section 11 *Basis Financial Instruments* with a principle for classifying financial assets based on their contractual cash flow characteristics.

12. The TIWG considered that application of the expected credit loss model would involve significant cost and effort for small entities. They did not think that the proposed simplified approach would achieve an appropriate balance between the benefits of the expected credit loss model and the operational cost and complexity as the entity may need to involve a valuer in performing the estimation. Overall, the TIWG did not support aligning the *IFRS for SMEs* Standard with the simplified approach to the impairment of financial assets in IFRS 9 as it would not achieve the principle of “simplicity” and would impose undue cost or effort to small entities.

13. The TIWG observed that few small entities have hedging instruments or qualify for hedge accounting. They considered the existing hedging requirements in Section 12 *Other Financial Instrument Issues* are sufficient and agreed to retain the current requirements rather than aligning Section 12 with IFRS 9.

14. The TIWG observed it is uncommon for small entities to possess complex financial instruments, and those that do choose to adopt full IFRS/HKFRS, instead of the *IFRS for SMEs*. However, they supported changing the reference to IAS/HKAS 39 *Financial Instruments: Recognition and Measurement* to permit an entity to apply the recognition and measurement requirements of IFRS 9 and the disclosure requirements of Sections 11 and 12 as IAS 39 will be withdrawn and will no longer apply under full IFRS Standards.

15. The TIWG did not have any specific comments on any topics that are not address in the *IFRS for SMEs* Standard. In general, they considered topics should first be addressed in full IFRS Standards before considering incorporation into the *IFRS for SMEs* Standard.

16. One member would like to bring the following to the IASB’s attention:

- *Paragraph 16.1 states that “… Only investment property whose fair value can be measured reliably without undue cost or effort on an ongoing basis is accounted for in accordance with this section at fair value through profit or loss. All other investment property is accounted for using the cost model in Section 17 Property, Plant and Equipment and remains within the scope of Section 17 unless a reliable measure of fair value becomes available and it is expected that fair value will be reliably measurable on an ongoing basis.”* In Hong Kong, the cost of performing the valuation for a property is not significant. Hence, it is difficult for an entity to argue undue cost will be incurred to obtain the fair value of an investment property. This eliminates the option of using cost model in measuring the investment property indirectly. As a comparatively simpler framework than full IFRS Standards, the member recommended the IASB to allow cost model in Section 16 *Investment Property* explicitly as in IAS 40 *Investment Property.*

- *Paragraph 23.8 states that "An entity usually applies the revenue recognition criteria in this section separately to each transaction. However, an entity applies the recognition criteria to the separately identifiable components of a single transaction when necessary to reflect the substance of the transaction."* However, there is no further guidance set out in the *IFRS for SMEs* Standards in relation to the application of "separately identifiable components". Hence, the member suggested the IASB include further guidance on "separately identifiable components" and noted that the ambiguity might discourage entities from adopting the *IFRS for SMEs* Standard.