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Sent electronically through the IASB Website (www.ifrs.org)

21 February 2023

Dr Andreas Barckow
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Andreas,

IASB Exposure Draft ED/2022/1
Third Edition of the* IFRS for SMEs *Accounting Standard

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing, ethics and sustainability disclosures for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our views on this Exposure Draft (ED).

We welcome the IASB's proposals to align the *IFRS for SMEs* Accounting Standard with full IFRS Accounting Standards by taking into account the needs of small and medium-sized entities (SMEs) and users of their financial statements as well as the cost-benefit considerations of the proposals.

In Hong Kong, the majority of the SMEs either prepare their financial statements under the HKICPA's home-grown *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* or full HKFRS Standards. The level of application of the *HKFRS for Private Entities* (i.e. the local version of *IFRS for SMEs* Accounting Standard) is relatively limited in Hong Kong.

Considering the limited use of the *HKFRS for Private Entities/IFRS for SMEs* Accounting Standard in Hong Kong, we primarily comment on the following proposals in the ED.

Impairment of financial assets in Section 11 Financial Instruments

Our respondents expressed concern about the proposed application of the expected credit loss (ECL) model on financial assets measured at amortised cost (other than trade receivables and contract assets). In Hong Kong, non-trade related receivables from related parties and business partners are common among SMEs and our respondents anticipated that SMEs would encounter the following practical difficulties in applying the ECL model to these receivables:

a) Non-trade receivables from related parties and business partners are often one-off in nature. Most SMEs do not possess sufficient historical data, such as credit-loss experience, either internally or from its peer group for comparable financial instruments to ascertain appropriate credit loss rates.
b) The ECL model requires the use of forward-looking information and an estimate of probability and related weight for formulating multiple forward-looking scenarios. Since SMEs usually have limited resources and expertise, our respondents expressed concern about the practical challenges in identifying and obtaining relevant forward-looking information that is reasonable and supportable for measuring ECL of these receivables.

In view of the above challenges, our respondents questioned the quality of impairment information provided by SMEs using the ECL model and whether the accounting outcomes would still faithfully reflect the likelihood of the collection of future cash flows of these non-trade receivables at the reporting date.

Furthermore, SMEs in Hong Kong are usually owner-managed businesses with limited users of financial statements. Users of SMEs' financial statements generally do not have a strong demand for the more sophisticated information provided under the ECL model on non-trade receivables. In addition, considering the complexity and difficulties for SMEs to apply the ECL model properly, users of SMEs' financial statements do not consider that the expected credit loss information would provide relevant information capable of making a difference in their decisions.

Lastly, the proposals introduce two impairment models for financial assets measured at amortised cost – incurred loss model for trade receivable and contract assets, and the ECL model for all other receivables. We see little merit in having two impairment models for financial assets measured at amortised cost as it would add complexity, create confusion and not meet the principle of simplicity.

In light of the above, we consider that the ECL model would impose undue cost or effort on SMEs and may not significantly improve the usefulness of information about impairment of financial assets held by SMEs. Taking into account the costs and benefits of the proposals, we recommend the IASB retain the incurred loss model for all financial assets measured at amortised cost.

If the IASB were to go ahead with its proposals, we suggest that the IASB:

a) provide guidance or examples on the practical expedients that SMEs can apply in measuring ECL (paragraph 11.26E of the ED); and
b) clarify the considerations for SMEs in assessing the 'undue cost or effort' of obtaining reasonable and supportable information for measuring ECL, given the model would be more costly for SMEs (as compared to listed entities or corporates) to apply.

Section 23 Revenue from Contracts with Customers

We generally support the proposals in the revised Section 23 and consider that they are appropriate for SMEs and users of their financial statements. Nevertheless, we have the following comments and recommendations:

a) Certain proposed simplified requirements of IFRS 15, for example warranty (paragraph 23.27 of the ED) and options to purchase additional goods or services (paragraph 23.35 of the ED), involve the evaluation of whether the financial impact of the warranty/option is 'significant to the contract' in order to determine the accounting treatment. Such evaluation requirement does not exist in IFRS 15. To ensure consistent application of the requirement by the SMEs, we recommend that the IASB provide guidance or examples to illustrate how the 'significant' concept should be applied in those cases.

b) In order to make the proposed requirements simpler for SMEs to apply, the ED has reframed the principle in IFRS 15 for principal versus agent considerations and the criteria for revenue recognition over time. For principal versus agent considerations, the ED has reframed the principle and one indicator as circumstances that would result in an entity acting as a principal (as opposed to three indicators in IFRS 15), and the criteria for revenue recognition over time has changed from three criteria in IFRS 15.B2 to four criteria in the ED. While we on the whole agree with the IASB's simplification approach, we are concerned that the simplifications made on these two areas may unintentionally result in different accounting outcomes from full IFRS Accounting

Standards in certain situations. Accordingly, we recommend the IASB clarify whether the principles and requirements on these two areas are the same under the ED and IFRS 15 to avoid confusion.

Work undertaken by HKICPA in forming its views:
In response to this ED, the HKICPA:

a) issued an Invitation to Comment on the ED on 9 September 2022;
b) sought input from its Small and Medium-sized Practitioners Committee and its Technical Issues Working Group comprising technical and industry experts from accounting firms;
c) sought input from targeted stakeholders comprising preparers, practitioners and users of financial statements; and
d) developed its views through its Financial Reporting Standards Committee, which comprises preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

If you have any questions regarding the matters raised in this letter, please contact me (ceciliakwei@hkicpa.org.hk), George Au (georgeau@hkicpa.org.hk) or Kennis Lee (kennislee@hkicpa.org.hk), Associate Directors of the Standard Setting Department.

Sincerely,

Cecilia Kwei

Cecilia Kwei
Director, Standard Setting Department