The revised Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standards

A significant change brought by the new Hong Kong Companies Ordinance (Cap. 622) (the "new CO") is the introduction of the optional reporting exemption for certain private companies and companies limited by guarantee, subject to the satisfaction of other conditions set out in the new CO. The Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (the "SME-FRF and FRS") are the accounting standards issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") to be followed in accordance with Section 380(4) by those Hong Kong incorporated companies to take advantage of this optional reporting exemption.

This newsletter provides a brief overview of the major differences between the SME-FRF and FRS and the full Hong Kong Financial Reporting Standards ("HKFRSs"). They are summarised in below:-

Property, plant and equipment

Measurement model

- **There is no revaluation model. Only the cost model is allowed. Subsequent to initial recognition, all the property, plant and equipment should be carried at cost less accumulated depreciation and any accumulated impairment.**

Investment property

Measurement model

- **Investment property is included in property, plant and equipment and carried at cost less accumulated depreciation and any accumulated impairment losses. The fair value model is not allowed for investment property.**

Intangible assets

Assessment of useful lives

- **Intangible assets are amortised under a rebuttable assumption that the useful life will not exceed ten years from the first date it was available for use. Indefinite useful life is not applicable.**

Recognition of intangible assets

- **Intangible assets acquired in a business combination should only be recognised if the fair value is readily apparent or can be measured reliably without undue cost. Under full HKFRSs, the acquirers shall measure all identifiable assets acquired at the acquisition date fair values.**

Financial instruments

Recognition of financial instruments

- **SME-FRS only provides requirements on investments in securities. They should be initially measured at cost. Subsequent measurement would be subject to the lower of cost or net realisable value ("NRV") for current investments and cost less accumulated impairment losses for long-term investments. For held-to-maturity debt securities, amortised cost is used. For derivatives, only forward foreign exchange contracts are specifically covered by SME-FRS.**

Investments in subsidiaries, joint ventures and associates

- **In the separate financial statements of a company, investments in subsidiaries, joint ventures and associates should be recorded at cost. Under full HKFRSs, these investments could be recognised at fair value in accordance with HKFRS 9 "Financial Instruments".**

Borrowing costs

Treatment of borrowing costs

- **An alternative policy of expensing all borrowing costs to the statement of profit or loss is allowed. Under full HKFRSs, capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a "qualifying asset" as defined under HKAS 23 "Borrowing Costs" is compulsory.**

Income tax
Components of tax
- **Tax accounting is limited to current tax liabilities and losses. Deferred tax should not be recognised.**

Business combinations
Measurement principles – contingent consideration
- **Adjustment to the cost of the combination should be included if it is probable and can be measured reliably.**

Measurement principles – intangible assets
- **Intangible assets are recognised only if their fair values are readily apparent or can be measured without undue cost or effort.**

Preparation of consolidated financial statements
The concept of "control"
- **Control is presumed to exist when the parent owns, directly or indirectly, more than half of the voting power of an entity.**

Exclusion of subsidiaries from consolidation
- **One or more subsidiaries may be excluded from consolidation if their exclusion is not material or their inclusion would involve expense and delay out of proportion to the value of the members. Under full HKFRSs, an entity must present consolidated financial statements of the parent and all of its subsidiaries.**

Accounting treatments for goodwill
Measurement for goodwill
- **Goodwill is carried at cost less accumulated amortisation and impairment losses, if any. There is a rebuttable presumption that the useful life of goodwill will not exceed five years. Test for impairment is not required unless there is an indication that impairment exists. Under full HKFRSs, goodwill is subject to annual impairment testing irrespective of whether there is any impairment indication.**

Associates and joint ventures
Accounting treatment for associates and joint ventures
- **An investor could account for its associates or joint ventures using the cost model for both the company's financial statements and consolidated financial statements. An investor may also adopt the alternative policy to apply equity method for the consolidated financial statements only. Under full HKFRSs, an investor shall account for its associates or joint ventures using the equity method except for when paragraph 17 of HKAS 28 "Investments in Associates and Joint Ventures" applies.**

Statement of cash flows
Requirement of the presentation
- **The inclusion of a cash flow statement in SME-FRS financial statements is optional.**

Should you wish to discuss the implications of the SME-FRF and FRS, please contact your Moore Stephens director or Gary Cheng of the Technical Department.