

**SECTION E**

**SMALL AND MEDIUM-SIZED  
ENTITY FINANCIAL REPORTING  
FRAMEWORK AND FINANCIAL  
REPORTING STANDARD**

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## Chapter 22 The SME-FRF and SME-FRS

### Introduction

In Hong Kong, there are two options for simplified reporting for non-listed and smaller entities:

- Hong Kong Financial Reporting Standards for Private Entities (“HKFRS for Private Entities”); and
- Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (“SME-FRF and SME-FRS”).

HKFRS for Private Entities is a financial reporting option for non-listed companies that do not meet the criteria to use the SME-FRF and SME-FRS. This book covers detailed explanation and analysis of the relevant HKFRSs and two Sections of HKFRS for Private Entities (Section 20 Leases and Section 23 Revenue) that apply to Private Entities, except in three areas: hyperinflation, specialised activities and transition to the HKFRS for Private Entities.

This chapter will address the SME-FRF and SME-FRS.

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## ¶29-100 The SME-FRF and SME-FRS

[SME-FRF: 3, 4 & 5]

The objective of financial statements for small and medium-sized entities (SMEs) is to provide information about the financial position and performance of an entity that is useful to users of such information. Furthermore, financial statements should show the results of management's stewardship (i.e., management's accountability for the resources entrusted to it).

For SMEs incorporated in Hong Kong, the most significant users are likely to be the owners, creditors (e.g., vendors that sell to SMEs, banks that make loans to SMEs) and government (in the form of the Inland Revenue Department), who may have the power to obtain information further to that contained in the financial statements. These users do not generally require extensive information disclosures required by HKFRS. Therefore, simplified reporting is demanded by SMEs in order to balance the costs of preparing the financial statements with the expected benefits.

The SME-FRF and SME-FRS is an optional financial reporting alternative to the HKFRS for qualifying entities. The SME-FRF sets out the conceptual basis and qualifying criteria for the preparation of financial statements in accordance with the SME-FRS. The SME-FRS is a self-contained document derived from HKFRS that sets out the recognition, measurement, presentation, and disclosure requirements for qualifying entities that prepare the financial statements in accordance with the SME-FRS. The SME-FRS contains simpler measurement requirements than under HKFRS and requires fewer disclosures.

## ¶29-200 Qualifying entities

Both Hong Kong and overseas companies may qualify for simplified reporting under the SME-FRF and prepare financial statements in accordance with the SME-FRS.

### Qualifying Hong Kong companies

[SME-FRF: 22 & 24]

A company incorporated under the Hong Kong Companies Ordinance qualifies for simplified reporting under the SME-FRF if it satisfies the "reporting exemption" criteria set out in s.359 of the new Companies Ordinance ("new CO"). At a minimum, these companies must be private companies or companies limited by guarantee.

[SME-FRF: 34-39, 39A & 41-43]

The qualifying categories are shown in the table below:

<b>Types of companies</b>	<b>Size tests</b>	<b>Shareholder / Member approval</b>
A private company which does not have subsidiaries and is not a subsidiary of another company	Any size	100% approval from shareholders in writing is required each year.
A small private company	Must not exceed two of the following conditions (“size tests”): 1. Total annual revenue of HK\$100m 2. Total assets of HK\$100m at the end of the reporting period 3. 100 employees*	No shareholder approval is required.
A group of small private companies (which may include non-Hong Kong body corporates)	Each company in the group must qualify as a small private company. Each non-Hong Kong body corporate in the group would have been qualified as a small private company for the financial year had it been incorporated under the new CO.  The aggregate amounts for the group in total must not exceed two of three of the size tests for small private companies.	No shareholder approval is required.
A small guarantee company	Total annual revenue must not exceed HK\$25m.	No member approval is required.
A group of small guarantee companies (which may include non-Hong Kong body corporates)	Each company in the group must qualify as a small guarantee company. Each non-Hong Kong body corporate in the group would have been qualified as a small guarantee company for the financial year had it been incorporated under the new CO.  The aggregate annual revenue of the group must not exceed HK\$25m.	No member approval is required.

Types of companies	Size tests	Shareholder / Member approval
A larger “eligible” private company	<p>Must not exceed two of the following conditions (“size tests”):</p> <ol style="list-style-type: none"> <li>1. Total annual revenue of HK\$200m</li> <li>2. Total assets of HK\$200m at the end of the reporting period</li> <li>3. 100 employees (not 200 employees)*</li> </ol>	75% shareholder approval is required and none of the members holding the remaining voting rights vote against the resolution.
A group of “eligible” companies (which may include non-Hong Kong body corporates)	<p>Each company in the group must meet the size tests as either a small private company or a larger “eligible” private company.</p> <p>Each non-Hong Kong body corporate in the group would have been qualified as either a small private company or a larger “eligible” private company for the financial year had it been incorporated under the new CO on basis of its size.</p> <p>The aggregate amounts for the group must not exceed two of three of the size tests for larger eligible companies.</p>	75% shareholder approval of the holding (i.e., parent) company of the group is required and none of the members holding the remaining voting rights vote against the resolution.
A mixed group (i.e., a group comprising a mix of (i) one or more small and/or eligible private companies and (ii) one or more small guarantee companies) (which may include non-Hong incorporated body corporates)	<p>If the holding company is a small private company, the aggregate amounts for the mixed group must not exceed two of three of the size tests for a group of small private companies.</p> <p>If the holding company is an eligible private company, the aggregate amounts for the mixed group must not exceed two of three of the size tests for a group of larger “eligible” companies.</p> <p>If the holding company is a small guarantee company, the aggregate annual revenue of the mixed group must not exceed HK\$25m.</p>	No shareholder approval is required if the mixed group does not exceed the small private company size limits or small guarantee company size limits.

\*The number of employees represents the average number of employees (full-time and part-time) during the reporting period calculated by adding together the number of employees at the end of each month and then dividing the total by the number of months in the reporting period. [SME-FRF: 40(d)]

### **Example 1**

A small private company has 80 employees. The company's revenue for the year was HK\$75 million and total assets at year-end were HK\$160 million.

In this case, although the company's total assets at year-end exceed HK\$100 million, the company can apply the SME-FRF and SME-FRS in preparing its financial statements because the other two conditions of the "size tests" are met.

### **Meeting the size tests in all subsequent financial years**

[SME-FRF: 31 & 32]

A company must pass the size tests for at least two consecutive reporting periods before becoming eligible in the third reporting period. Conversely, once a company becomes a qualifying entity, the company is permitted to report under the SME-FRF and SME-FRS unless it fails the size tests for two consecutive reporting periods.

### **Example 2**

A small private company does not qualify as an entity to take the reporting exemption and apply the SME-FRF and SME-FRS in preparing its financial statements for the year ended 31 December 2019 because it fails the size tests. The company passes the size tests starting from the year ended 31 December 2020 and thereafter.

In this case, the small private company qualifies for reporting under the SME-FRF and SME-FRS in preparing and presenting its financial statements starting from the year ended 31 December 2021.

### **Ineligible companies**

[SME-FRF: 27 & 27A]

According to s.359(4) of the new CO, the following companies are not permitted to take the reporting exemption and therefore cannot apply the SME-FRF and SME-FRS:

- the company carries on any banking business and holds a valid banking licence granted under the Banking Ordinance (Cap. 155);
- the companies 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;

- the company is licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on a business in any regulated activity within the meaning of that Ordinance; or
- the entity carries on any insurance business, otherwise than solely as an agent.

In addition, a holding company is not permitted to take the reporting exemption when its group includes such a company stated above or includes a non-Hong Kong body corporate that:

- carries on any business that, had it been carried on in Hong Kong, would be required to be carried out under a valid banking licence granted under the Banking Ordinance (Cap. 155);
- accepts, 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;
- carries on any business that, had it been carried on in Hong Kong, would be required to be carried out under a licence under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on a business in any regulated activity within the meaning of that activity;
- carries on any insurance business, otherwise than solely as an agent; or
- would have fallen within the meaning of public company in section 12 of the new CO had it been incorporated under the new CO.

### **Qualifying overseas companies**

[SME-FRF: 23]

Subject to any specific requirements imposed by the law of the overseas company's place of incorporation and subject to its constitution, an overseas company is permitted to take the reporting exemption to apply the SME-FRF and SME-FRS if the company meets the same requirements that a Hong Kong incorporated company is required to meet under s.359 of the new CO.

### **¶29-300 Financial reporting framework for SMEs**

Apart from the qualifying criteria, the SME-FRF sets out the conceptual basis for the preparation of financial statements in accordance with the SME-FRS.

#### **Underlying assumptions**

[SME-FRF: 6]

Financial statements are prepared on the accrual basis of accounting and on the assumption that the entity is a going concern and will continue to operate for at least the foreseeable future.



## Qualitative characteristics

[SME-FRF: 7 & 8]

The four principal qualitative characteristics that make the information provided in financial statements useful to users are understandability, relevance, reliability and comparability. The balance between benefit and cost is a pervasive constraint.

## Recognition and measurement

[SME-FRF: 15 & 17]

An item that meets the definition of an element (i.e., asset, liability, equity, income and expense) should be recognised if:

- it is probable that any future economic benefit associated with the item will flow to or from the entity; and
- the item has a cost or value that can be measured with reliability.

The measurement base most commonly adopted by SMEs in preparing their financial statements is historical cost. This may be combined with other measurement basis for certain specific items, as referred to in the SME-FRS (e.g., *see* Section 15 The Effects of Changes in Foreign Exchange Rates).

## ¶29-400 Contents and requirements of SME-FRS

The SME-FRS sets out the recognition, measurement, presentation and disclosure requirements for an entity that prepares and presents the financial statements in accordance with the SME-FRS.

### Section 1 Presentation of Financial Statements

[SME-FRF: 20]

The most significant reporting exemption for the purposes of the SME-FRS is the exemption from the requirements for the financial statements to give a true and fair view as set out in s.380(7) of the new CO. Instead, financial statements prepared by qualifying entities are required to be properly prepared in accordance with the SME-FRF and SME-FRS.

### Section 1 Presentation of Financial Statements

[Section 1.1]

A complete set of financial statements prepared in accordance with SME-FRS includes the following components:

- a statement of financial position;
- an income statement (i.e., a statement of profit or loss); and
- accounting policies and explanatory notes.

A cash flow statement is not required. However, if an entity voluntarily includes a cash flow statement, then this cash flow statement should be

prepared in accordance with the requirements of Section 20 Cash Flow Statement.

These financial statements should be consolidated financial statements unless the entity is exempt from the preparation of consolidated financial statement in accordance with Section 19.1 (*see* ¶29-700) or the entity has no subsidiaries.

[Section 1.2 & 1.3]

Financial statements should properly present the financial position and financial performance of an entity. The appropriate application of the SME-FRS, with additional disclosure when necessary, would result in financial statements that achieve a proper presentation appropriate for SMEs. In the event that the SME-FRS does not cover an event or a transaction undertaken by an entity, management may consider the SME-FRF for guidance on developing an appropriate accounting policy, consistent with the historical cost convention, for the particular event or transaction.

An entity whose financial statements complying with the SME-FRS should disclose that fact. Such financial statements should not be described as complying with HKFRS.

The SME-FRS contains 22 sections that each section deals with an accounting topic, as listed in the table as follows:

<b>Section</b>	<b>Financial Reporting Topics</b>
1	Presentation of Financial Statements
2	Accounting Policies, Changes in Accounting Estimates and Errors
3	Property, Plant and Equipment
4	Intangible Assets
5	Leases
6	Investments
7	Inventories
8	Construction Contracts
9	Impairment of Assets
10	Provisions, Contingent Liabilities and Contingent Assets
11	Revenue
12	Government Grants and Other Government Assistance
13	Borrowing Costs
14	Income Taxes
15	The Effects of Changes in Foreign Exchange Rates
16	Related Party Disclosures
17	Events After the End of the Reporting Period
18	Business Combinations and Goodwill

- 19 Consolidation and Company-Level Financial Statements
- 20 Investments in Associates
- 21 Interests in Joint Ventures and Other Forms of Joint Arrangements
- 22 Cash Flow Statement (Optional)

Each section of the SME-FRS sets out the basic principles and the required disclosure requirements. The SME-FRS does not cover complicated accounting issues in HKFRS and matters associated with listed entities, such as earnings per share, interim financial statements, operating segments, financial instruments and share-based payments.

The SME-FRS includes simplifications of HKFRS financial reporting that reflect the particular information needs of the users of SMEs' financial statements and the cost-benefit considerations of the preparers. It facilitates SMEs' financial reporting by:

- adopting the principles from the previous HKFRS rather than the current HKFRS (e.g., accounting for leases is based on the superseded HKAS 17 rather than HKFRS 16).
- simplifying certain recognition and measurement principles in HKFRS (e.g., historical cost basis is primary used for measurement).
- eliminating accounting and disclosure requirements that are generally not applicable to SMEs (e.g., there is no requirement for present a cash flow statement).
- removing accounting treatment option allowed by HKFRS (e.g., revaluation model is not permitted for property, plant and equipment and intangible assets).

#### **¶29-410 Recognition and measurement**

The SME-FRS simplifies certain HKFRS recognition and measurement principles. Major simplifications include the following:

- Property, plant and equipment  
Only the cost model is allowed. No revaluation model can be used. Thus, property, plant and equipment are carried at cost less any accumulated depreciation and any accumulated impairment losses.
- Investment property  
There is no separate investment property classification. The definition of property, plant and equipment includes properties held for rental and/or for investment potential (i.e., investment property).

- Intangible assets

Only the cost model is allowed. Thus, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

All intangible assets are regarded to have a finite useful life. Furthermore, there is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years when the asset is available for use.

- Non-current assets held for sale

There is no separate non-current assets held-for-sale classification.

- Deferred tax liabilities or assets

An entity is prohibited from recognising deferred tax liabilities or assets.

### ¶29-420 Presentation and disclosure

The SME-FRS has simplified certain financial statements presentation and reduced disclosure requirements in HKFRS for the following reasons:

- The disclosures relate to recognition and measurement principles in HKFRS that have already been simplified by the SME-FRS.
- The disclosures relate to the use of revaluation model in HKFRS that are not allowed by the SME-FRS.
- The disclosures relate to topics in HKFRS but are omitted from the SME-FRS.
- Certain disclosures in HKFRS are considered unnecessary on the basis of the special needs of the users of SMEs' financial statements.

Specifically, the simplification in presenting financial statements include the following:

- An entity is not required to present a cash flow statement.
- An entity is permitted to present changes in equity in the notes rather than as a separate component of the financial statements.

### ¶29-430 Omitted topics in HKFRS

The SME-FRS does not deal with the following accounting issues that are covered in HKFRS:

- Earnings per share
- Interim financial reporting