HKFRS Technical Bulletin

HKFRS for Private Entities

The countdown commences…HKFRS for Private Entities the new accounting Standard, that is likely to affect the future of HK GAAP

HKFRS for Private Entities: Your questions answered

On 20 January 2010, the Hong Kong Institute of Certified Public Accountants issued a Statement of Intent about issuing a new Hong Kong Financial Reporting Standard ("HKFRS") for Private Entities as a reporting option for private entities on 30 April 2010 to be effective immediately upon release, subject only to unforeseen commentary received before 31 March 2010. As the new HKFRS is forthcoming, the first step is to understand the background and reasons behind its purpose. As such Mazars have provided you with the answers to what we believe are the key questions surrounding the new HKFRS.

What is it?

HKFRS for Private Entities ("the new HKFRS") is a self-contained Standard, incorporating condensed and simplified accounting principles based on full HKFRSs. It is largely based on the equivalent Standard issued by the International Accounting Standards Board. Similar to full HKFRSs, the new HKFRS enables a true and fair view to be given on the financial statements. For eligible entities, it can be used as an alternative to applying full HKFRSs.

Who does it apply to?

It is intended to be applicable to all companies and businesses that do not have public accountability. Eligible entities are those that do not have their debt or equity instruments traded or in the process of applying for trading in a public market e.g. Hong Kong Stock Exchange and do not hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses e.g. banks, insurers, and securities brokers/ dealers.

The size of the entity is not relevant in determining whether or not an entity is an eligible entity.

Why should this HKFRS be issued?

The main objective is to ease the reporting burden of private entities by relieving them from the requirement to apply full HKFRSs. As compared with full HKFRSs, the new HKFRS will allow simplified accounting and require fewer disclosures. Amendments to the new HKFRS are also expected to be less frequent than full HKFRSs.

Given that the international Standard on which the new HKFRS is based is widely accepted and adopted across the world, the new HKFRS, once implemented, will also enhance international comparability and thereby improving the quality of global reporting.

How does this HKFRS fall within HKGAAP?

The current intention is that after implementation of the new HKFRS, Hong Kong will have a three-tier accounting system:

- Full HKFRSs to be applied by publicly quoted companies and private entities that choose not to use the new HKFRS and cannot apply or choose not to apply SME-FRF&FRS;
- The new HKFRS to be applied by private entities that cannot apply or choose not to apply SME-FRF&FRS and choose to use the new HKFRS
- SME-FRF&FRS to be applied by small and medium-sized entities that meet the criteria for applying SME-FRF&FRS e.g. s141D companies and overseas companies that meet certain size tests and have all shareholders' agreements.

Can full HKFRS still be applied?

The new HKFRS has specifically been tailored to be applied by entities that do not have public accountability, whereas full HKFRSs is aimed at companies operating in public capital markets.

Companies within the scope of the new HKFRS will however be allowed to apply full HKFRSs if they so wish.

Can it be applied to group financial statements?

Yes it may be applied by entities preparing group consolidated financial statements, individual separate entity financial statements and by subsidiaries that form part of a public quoted group so long as the entity or subsidiary does not have public accountability. GAAP reconciliations and adjustments will be required between full HKFRSs and the new HKFRS for group reporting purposes.

How will it impact a company and the financial statements?

There are many ways in which the new HKFRS will impact companies and their financial statements. The remainder of this technical bulletin aims to highlight some of the key issues.

HKFRS for Private Entities is likely to affect many companies whether at an individual entity level or for subsidiaries in larger groups

So why would you want to apply HKFRS for Private Entities?

You're a subsidiary company which is part of a publicly quoted group

The main benefit for publicly quoted groups is to potentially apply a single high quality financial reporting standard to subsidiaries in many parts of the world, which is based on full HKFRSs or its international equivalent that are used to prepare the group consolidated financial statements.

The key benefits are therefore:

- to ease the burden of preparing financial statements in accordance with full HKFRSs at subsidiary level; and
- to require only handling few GAAP differences between full HKFRSs and this new HKFRS.

You're an individual company in Hong Kong

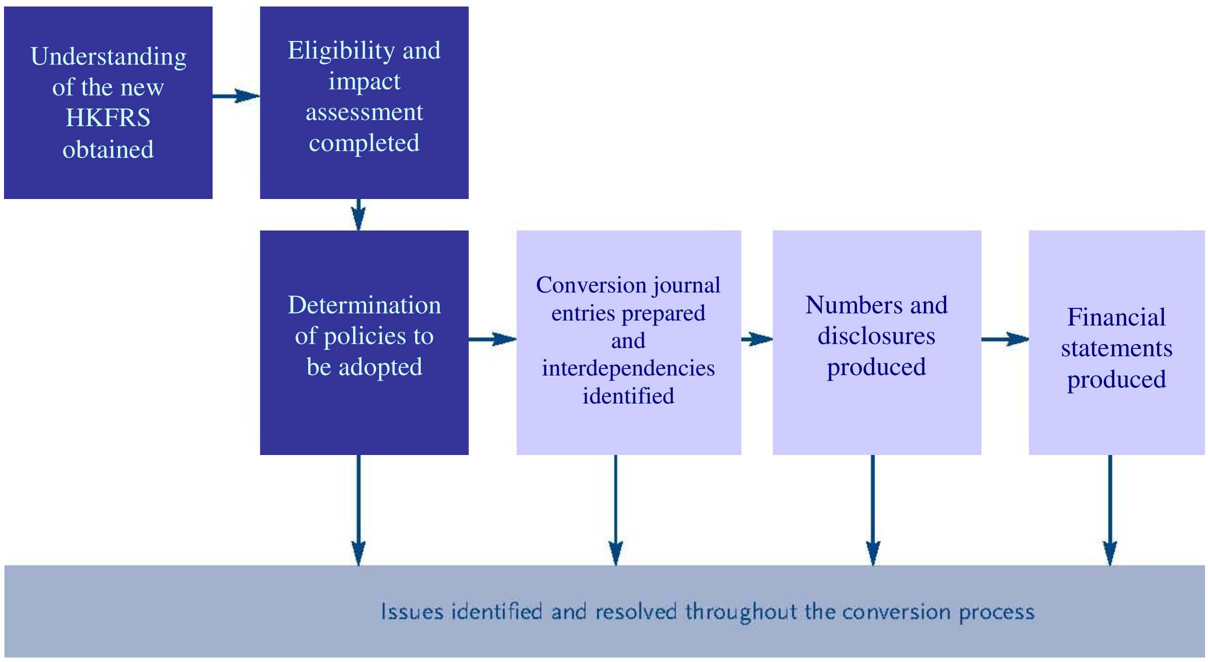
The key area for concern for all business, but especially individual companies in Hong Kong is to ensure that the benefits outweigh the costs. The principal issues are therefore to ensure that the financial costs of preparation do not increase and the needs of stakeholders are still met.

The key benefits are therefore:

- to report based on a single set of high quality and current accounting principles and concepts which are condensed and specifically tailored for private entities; and
- to ease the burden of preparing financial statements in accordance with full HKFRSs.

How do you make the transition to HKFRS for Private Entities?

The transition from full HKFRSs to the new HKFRS can be simple and cost-efficient. However, the decision to convert should not be made lightly. Eligible entities can only claim special transitional exemptions on first-time adoption of the new HKFRS. As transitional benefits would not be available on subsequent transitions into the new HKFRS, short term conversion or regular changes of the reporting Standard are not advised. Restatement of comparatives is generally required on transition to the new HKFRS. Accordingly, more work is usually required in preparing the first set of financial statements in accordance with the new HKFRS. Despite this, we believe that the conversion process should be uncomplicated and straight-forward. The following is a summary visual illustration of how this can be achieved.



HKFRS for Private Entities – Unlocking the door to the detail

This summary addresses the main points and principles about understanding the detail of the new HKFRS.

General

HKFRS for Private Entities ("'the new HKFRS") is a single, stand-alone Standard including a Basis for Conclusion to aid user's application. To aid simplicity the new HKFRS does not cross refer to full HKFRSs and given that full HKFRSs comprises of over 2,500 pages, the new HKFRS has clearly been condensed to aid understandability.

The new HKFRS is organised into 35 sections which are based on each of full HKFRSs, for example Section 13: Inventories is based on HKAS 2 'Inventories' and some of the more complex sections, for example on revenue and provisions, include appendices which contain illustrative examples to aid implementation.

The new HKFRS does not however include sections which are not applicable to private entities, for instance segment reporting, earnings per share and interim reporting.

The new HKFRS is to be issued as an option Standard to be used by eligible entities in place of full HKFRSs.

Scope

The new HKFRS has been specifically developed for use by entities that do not have public accountability and publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

An entity is defined as having public accountability if its debt or equity instruments are traded in a public market (or it is in the process of issuing its debt or equity instruments for trading in a public market), or it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

A public market means any domestic or foreign stock exchange market, or an over-the-counter market. In general, an entity that holds assets in a fiduciary capacity as one of its primary businesses includes banks, insurance companies, securities brokers/dealers, mutual funds and investment banks. However if an entity holds these assets for reasons that are incidental to their primary business, they are not considered to have public accountability and this therefore may include schools, travel agents and charities.

Recognition and measurement

The fundamental concepts and accounting principles for recognising and measuring assets, liabilities, income and expenditure in accordance with the new HKFRS are the same as those under full HKFRSs. This is because the Hong Kong Institute of Certified Public Accountants ("HKICPA") has aimed to retain these fundamental principles but have sought to make the new HKFRS a simplified version of HKFRS.

In doing so therefore the new HKFRS removes some of the accounting policy options that are allowed under full HKFRSs, namely in relation to accounting for property, plant and equipment, investment properties, employee benefits. In addition there is a focus on measuring assets and liabilities at cost as opposed to fair value, where there is an 'undue cost or effort' involved in determining the fair value. In relation to financial instruments specifically, there is an accounting policy choice to apply the simplified provisions in the new HKFRS or HKAS 39 from full HKFRSs completely. The new HKFRS also exempts the recognition of deferred taxation in relation to revaluation gains of investment properties where such tax never has to be paid.

Disclosure

One of the main aims during the development of the new HKFRS was to ensure that the cost for private entities to prepare their financial statements was not significantly increased and the main way in which this was achieved was by significantly reducing the disclosure requirements as compared to full HKFRSs.

There are around 3000 disclosure requirements in full HKFRSs and these have been reduced to around 400 in the new HKFRS.

Other

The new HKFRS is designed to be reviewed and updated on a rolling two/three-year basis by the HKICPA. What this therefore means is that there will not be a burden on companies to continually remain up to date with amendments and changes issued, as currently required under full HKFRSs. A single amendment document will therefore aim to be issued in one go which will incorporate all the amendments identified over the two/three-year period.

Please get in touch…

If you need more information or any assistance regarding the possible transition to the HKFRS for Private Entities, please talk to your usual Mazars contact or contact any of our professional teams using the following contact details:

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