New Companies Ordinance – an accountant’s perspective

Catherine Morley, Partner, Professional Practice

CUHK Third Company Law Colloquium
30 January 2013
Areas of focus for accountants

Financial reporting
• True & fair accounts (company or group)
• True & correct accounts for s141D entities
• Directors’ disclosures – directors’ report, transactions, emoluments, loans etc
• Summary financial reports
• Revision of financial reports

Auditors’ rights and obligations
• Appointment & resignation
• Rights to information
• Obligations to report opinions
• Attendance at meetings

Capital maintenance rules
• Share premium & share premium “merger relief”
• Redemption/repurchase of capital
• Distribution of profits by reference to net realised profits
Impact of the new Companies Ordinance on our areas of focus

What’s stayed the same?

- True & fair accounts for public and non-exempt private companies
- Directors’ disclosures (mostly)
- Rules re revision of financial reports
- Most of the auditors’ rights and obligations
- Merger relief (mostly)
- Distribution of profits by reference to “net realised profits”

What’s new?

- Business review for public and non-exempt private companies
- Statutory backing for HKFRS
- Extended scope for private company reporting exemption
- Opt out regime for summary financial report
- Enhanced auditors’ rights to information
- Auditors’ liability for omitted statements
- Redemption/repurchase of capital rules relaxed
## Overview of financial reporting regimes

<table>
<thead>
<tr>
<th></th>
<th>Current Ordinance</th>
<th>New Ordinance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Full reporting regime</strong></td>
<td>Directors report</td>
<td>Directors report including business review</td>
</tr>
<tr>
<td></td>
<td>“True and fair” financial statements – group and/or company</td>
<td>“True and fair” financial statements – group or company in accordance with standards issued or specified by the HKICPA</td>
</tr>
<tr>
<td></td>
<td>“True and fair” audit opinion</td>
<td>“True and fair” audit opinion</td>
</tr>
</tbody>
</table>
New content in director’s report: business review (s. 388 and schedule 5)

A fair review of the company’s/group’s business using financial key performance indicators and discussion

Description of company’s/group’s principal risks and uncertainties

Particulars of important events affecting the company/group since the end of the year

Indication of likely future development of company/group

However, most private companies are exempt from preparing a business review…
Exemption from preparing non-consolidated financial statements

**Current CO**
- Wholly-owned subsidiary; or
- Where all subsidiaries can be excluded as for each it is:
  - impracticable;
  - misleading;
  - no real value to members; or
  - involves expense or delay out of proportion to the value to members

**New CO**
- Wholly-owned subsidiary; or
- Partially owned subsidiary provided these procedures are followed:
  - At least 6 months before year end the directors notify members in writing of intention not to prepare consolidated financial statements
  - As at 3 months before year-end no member has responded requesting consolidated financial statements
## Overview of financial reporting regimes

<table>
<thead>
<tr>
<th></th>
<th>Current Ordinance</th>
<th>New Ordinance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Full reporting regime</strong></td>
<td>Directors report</td>
<td>Directors report including business review</td>
</tr>
<tr>
<td></td>
<td>“True and fair” financial statements – group and/or company</td>
<td>“True and fair” financial statements – group or company in accordance with standards issued or specified by the HKICPA</td>
</tr>
<tr>
<td></td>
<td>“True and fair” audit opinion</td>
<td>“True and fair” audit opinion</td>
</tr>
<tr>
<td><strong>Simplified reporting regime (optional)</strong></td>
<td>Section 141D – very limited eligibility</td>
<td>Much broader eligibility</td>
</tr>
<tr>
<td></td>
<td>Brief directors’ report</td>
<td>Directors’ report (excl. business review)</td>
</tr>
<tr>
<td></td>
<td>Balance Sheet per 11(^{th}) Sch</td>
<td>Financial statements per HKICPA SME FRF &amp; FRS</td>
</tr>
<tr>
<td></td>
<td>“True and correct” audit opinion (full scope audit)</td>
<td>“Properly prepared” audit opinion (full scope audit)</td>
</tr>
</tbody>
</table>
Eligibility for simplified reporting

- S141D companies
- Widened exemption for SME reporting
- Small private company or group
- Small guarantee company or group
- Larger ("eligible") private company or group with shareholder approval
# Summary of eligibility criteria

<table>
<thead>
<tr>
<th>S 141D co’s</th>
<th>Small private co.grp¹</th>
<th>Small guarantee co.grp¹</th>
<th>Larger (&quot;eligible&quot;) private co.grp¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual revenue</td>
<td>No limit</td>
<td>≤ $100m²</td>
<td>≤ $25m</td>
</tr>
<tr>
<td>Total assets</td>
<td>No limit</td>
<td>≤ $100m²</td>
<td>No limit</td>
</tr>
<tr>
<td>Average employees</td>
<td>No limit</td>
<td>≤ 100²</td>
<td>No limit/ n/a?</td>
</tr>
<tr>
<td>Shareholder approval</td>
<td>100% of members approve</td>
<td>Not required</td>
<td>Not required</td>
</tr>
</tbody>
</table>

¹ *In groups these tests have to be met for each entity in the group and for the group as a whole on a consolidated basis*

² *Need to meet at least 2 out of the 3 tests*
Reminder of HKICPA SME FRF & FRS

- Home grown accounting framework and self-contained accounting standard
- Historical cost accounting resulting in a “properly prepared” opinion
- Simplifications in current version:
  - Applies to company level financial statements only
  - No cash flow statement
  - No deferred tax
  - Fair value re-measurement not permitted
  - Fewer disclosures
- Current version is under review
Summary financial reports: new opt out regime

Opt in regime

• Positive confirmation from shareholder needed
• Default: full set of annual report

Opt out regime

• Shareholder given a chance to choose
• Default: Summary financial report
Implementation: the devil is in the detail

What will not change?

What must be changed?

What is now possible?

What work is needed?

HOW WILL THE NEW ORDINANCE IMPACT ME AND THOSE I DEAL WITH?
Further details on eligibility criteria for private company reporting exemption
Ineligible private companies – companies which ...

- carry on banking business under a banking license granted under the Banking Ordinance; or
- are licensed under SFC to carry on regulated business; or
- carry on insurance business otherwise than as an agent; or
- accept by way of trade or business loans of money at interest or repayable at a premium, otherwise than on terms involving the issue of debentures or other securities.

Source: section 359(4)
Section 141D companies still eligible …

- Eligibility criteria:
  - Private company not carrying out ineligible business
  - No subsidiaries and not a subsidiary of another company
  - 100% shareholder approval obtained on year by year basis

- No size criteria

- Source: section 359(1)(b)
“Small private companies or groups”

New statutory backing for the HKICPA’s SME FRF & FRS …

- Automatic eligibility for SME reporting if company satisfies at least 2 out of 3 size tests:
  - Total annual revenue not more than HKD 100 million
  - Total assets not more than HKD 100 million
  - Average number of employees during the year not more than 100

- If company has subsidiaries:
  - each company in the group must qualify as a small private company; and
  - above tests also have to be met based on consolidated numbers

- Specific rules to deal with change in SME status, long/short accounting periods, fluctuating work force

- Source: sections 359(1)(a), 359(2), 361, 364, Schedule 3
“Small guarantee companies or groups”

Similar to small private companies or groups – but have to be smaller …

- Automatic eligibility for SME reporting if company satisfies a single monetary size test:
  - Total annual revenue not more than HKD 25 million
- If company has subsidiaries:
  - each company in the group must qualify as a small guarantee company
  - above test has to be met based on consolidated numbers
- Specific rules to deal with change in SME status, long/short accounting periods
- Source: sections 359(1)(a), 359(3), 363, 366, Schedule 3
Larger ("eligible") private companies or groups – size tests

- Company must satisfy at least 2 out of 3 size tests:
  - Total annual revenue not more than HKD 200 million
  - Total assets not more than HKD 200 million
  - Average number of employees during the year not more than 100

- If company has subsidiaries:
  - each company in the group has to qualify as an eligible private entity under above size tests; and
  - above tests also have to be met based on consolidated numbers

- Specific rules to deal with change in SME status, long/short accounting periods, fluctuating work force

- Source: sections 359(1)(c), 359(2), Schedule 3
Larger (“eligible”) private companies or groups - shareholder approval

- Shareholder approval required each year by way of a general meeting resolution following special notice
- Resolution has to be passed by the members holding at least 75% of the voting rights of the company
- Not effective if any members holding the remaining rights vote against the resolution
  - Effective objections can also be lodged in writing up to 6 months before the end of the financial year
- If the company has subsidiaries then this resolution is required for each subsidiary which is not a “small private company”
- Source: sections 359(c), 359(2), 360
Which companies are exempt from preparing the business review?

- Any company that falls within the “reporting exemption” (i.e. small/larger private companies or groups, etc per section 359)
- Wholly owned subsidiary of another body corporate
- Any other private company which does not fall within the reporting exemption, provided a special resolution is passed by members
  - Resolution must be passed at least 6 months before the end of the financial year
  - Effectiveness of resolution can be made to roll from one year to the next until revoked
  - May only be revoked by special resolution
- Source: section 388(3)
Thank you.

Disclaimer: The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2013 KPMG, a Hong Kong partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in Hong Kong.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.