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THE NEW COMPANIES ORDINANCE (CAP. 622)
EXECUTIVE SUMMARY (FROM AN ACCOUNTANT'S PERSPECTIVE)

I. STRUCTURE OF THE NEW COMPANIES ORDINANCE

- Divided into 21 Parts, comprising 921 Sections and 11 Schedules
- 12 Subordinate Legislation

II. EFFECTIVE DATE

- New CO will come into operation on 3 March 2014
- Part 9 (Accounts and Audit) will be effective for the first financial year beginning on or after the commencement date of New CO

III. MAIN OBJECTIVES OF THE COMPREHENSIVE RE-WRITE OF COMPANIES ORDINANCE

- **Enhance corporate governance**
  - Clarifying directors' duty of care, skill & diligence
  - Including a business review in the directors' report
  - Strengthening auditors' rights

- **Ensure better regulations**
  - Ensuring accuracy of information on the Public Register
  - Improving the enforcement regime for officers and auditors

- **Facilitate business**
  - Streamlining procedures e.g. for changes in share capital or holding meetings
  - Facilitating simplified reporting by SMEs
  - Facilitating business operation

- **Modernise the law**
  - Abolishing par value of shares
  - Rewriting the law in simple and plain language

IV. What's new for financial reporting

1. *Share Capital*

Executive Summary

- Automatic transition to the "no-par" regime for HK companies on the commencement date of the new CO :
  - nominal value, share premium and capital redemption reserve abolished
- No fundamental change to the distributable profits regime
- New way of amalgamating group companies introduced, without involving the courts

a. Introduction to "no-par" shares regime

Old CO	New CO
• All shares must have a "nominal value", shares must not be issued at a discount to nominal value • If shares issued for more than nominal value, excess recorded in share premium account	• Concepts of "nominal value" and "share premium" abolished • Any amounts received for issuing equity shares of a company recorded as "share capital" • Concepts of "capital redemption reserve" and "authorised share capital" also abolished

b. Transition to "no-par" regime

No action is needed to move to new regime (to save time and effort for companies by way of transitional and deeming provisions in the new CO) **<u>BUT</u> :**

- HK Companies Registry recommends "companies may wish to review their individual situation before new CO takes effect e.g. memorandum, legal documents (such as contracts and trust deeds and share certificates) to see if changes are needed
- Clients are recommended to review relevant sections of new CO and/or seek professional advice to see if detailed changes are necessary

c. Understanding the role of "share capital" under new CO

- Statement of changes in equity :
  - automatic adjustment to balances on commencement date of 3rd March, 2014
  - simple transfer of the premium account balance to share capital

d. Uses of share capital under the new CO

- Writing off the preliminary expenses of the company
- Writing off any commission paid under S148 (S46 of the Old CO)
- Writing off any other expenses of any issue of shares in the company

e. Distribution of profits and assets

- Part 6 of New CO
- No fundamental change to the distribution provision from Old CO
- Spelling of realised changed to realized

Note: For further guidance on distributable profits, HKICPA Accounting Bulletin 4 – Guidance on Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance.

f. Mergers, group reconstructions and amalgamations

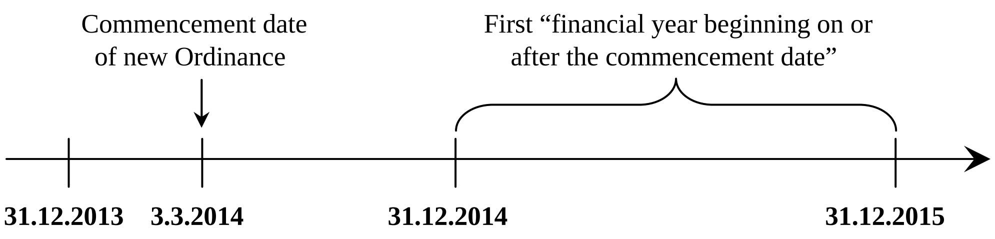
Old CO	New CO
• Relief from recording share premium when shares issued to acquire ≥ 90% equity shares of another company or non-cash assets within wholly owned group • Any other form of merger of companies can be a complex legal process	• Relief is still given when shares issued to acquire ≥ 90% equity shares of another company, or non-cash assets but calculated in a different way under "non-par" regime • New court-free amalgamation procedure introduced: wholly owned companies in same group can be amalgamated into single legal entity

2. *Simplified reporting regime for non-public companies*

Executive Summary

- New CO extends the scope of companies (and groups) which may choose to prepare simplified financial statements under the SME-FRS to include certain :
  - private companies/groups
  - companies/groups limited by guarantee
- Part 9 (Accounts and Audit) is not effective until first financial year beginning on or after commencement date of new CO
- Establishing eligibility may raise practical issues for larger "eligible" private companies/groups where shareholder approval is needed
- Companies need to consider costs/benefits before deciding to adopt simplified reporting, particularly if they are growing

a. Effective date of Part 9 – Accounts and Audit of New CO : Application in relation to financial year beginning on or after commencement date of relevant provision etc.



Examples: *For 31st March year end*
- First applicable financial year will be 31.3.2015

For 31st December year end
- First applicable financial year will be 31.12.2015

b. Eligibility for simplified reporting

	Old CO	New CO
Companies required to prepare "true and fair" financial statements	• Public companies • Other private companies/groups and companies/groups limited by guarantee	• Public companies • Other private companies/groups and companies/groups limited by guarantee
Companies permitted to prepare simplified financial statements	• S141D private companies	• Larger "eligible" private companies/groups with shareholder approval • Small "eligible" private companies or groups • Small companies or groups limited by guarantee • S141D private companies

c. Key differences if adopting simplified reporting

Financial statements exempt from requirement to give a true and fair view

⇓

Instead must comply with the applicable accounting standard "issued or specified by the Regulation"

⇓

HKICPA's Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard" ("SME-FRF" & SME-FRS")

⇓

- Home grown accounting framework, self contained accounting standard
- Simpler set of accounting requirements and disclosures than full HKFRS
- Issued in 2005 by HKICPA

d. Expanding the SME-FRS to cover group companies

	Full HKFRS	Simpler requirements in SME-FRS
Consolidation	HKFRS 10 - detailed requirements to determine control and prepare of consolidated FS	• Simpler control model • May exclude certain subsidiaries • Goodwill at cost less accumulated amortisation and impairment • Rebuttable presumption for useful economic life of goodwill $\leq$ 5 years, no annual impairment review
Associates and JVs in consolidated FS	HKAS28 - most cases use equity method for associates & JVs in consolidated FS	• Policy choice: account for associates and/or JVs at cost for both consolidated and company level FS (if use equity method in consolidated FS - amortise goodwill)
Business combinations	HKFRS 3 - detailed requirements	• Cost of acquisition: recognise contingent consideration only if probable • Identifiable net assets acquired : simpler recognition and measurement rules, (particularly for intangibles) • Step acquisitions - no rules

e. Audit report under simplified regime

Old Co	New Co
• "Prepared in accordance with" the SME-FRS • "True and correct" view • Report whether or not all information and explanations obtained	• "Properly prepared in compliance with" the Ordinance

f. Exemption from preparing a "business review" in Directors' report

- New CO introduces a requirement for companies to include a "business review" in the directors' report (see more details in Part 3 Directors' report)
- Reporting exemptions are applicable :
  - If a company is eligible for simplified reporting, it does not have to produce a business review
  - Other companies do not have to produce a business review if :
    - wholly owned subsidiary of a "body corporate"; or
    - private company (not within reporting exemption) that passes a special resolution

g. Eligibility for simplified reporting

- Eligible companies

  - Non-public companies meet the conditions of Eligibility Tests

  - Ineligible companies
    - Companies not eligible for simplified reporting which :
      - Carry on banking business under a banking licence granted under the Banking Ordinance
      - Are licensed under Securities & Futures Ordinance to carry on regulated business
      - Carry on insurance business (other than as an agent)
      - 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

      Note: Same as S141D of old CO

  - Eligible companies may opt for simplified reporting or continue to follow full HKFRS

- Eligibility tests :

  - Eligibility tests: the basics [Schedule 3 – Specified Qualified Conditions]

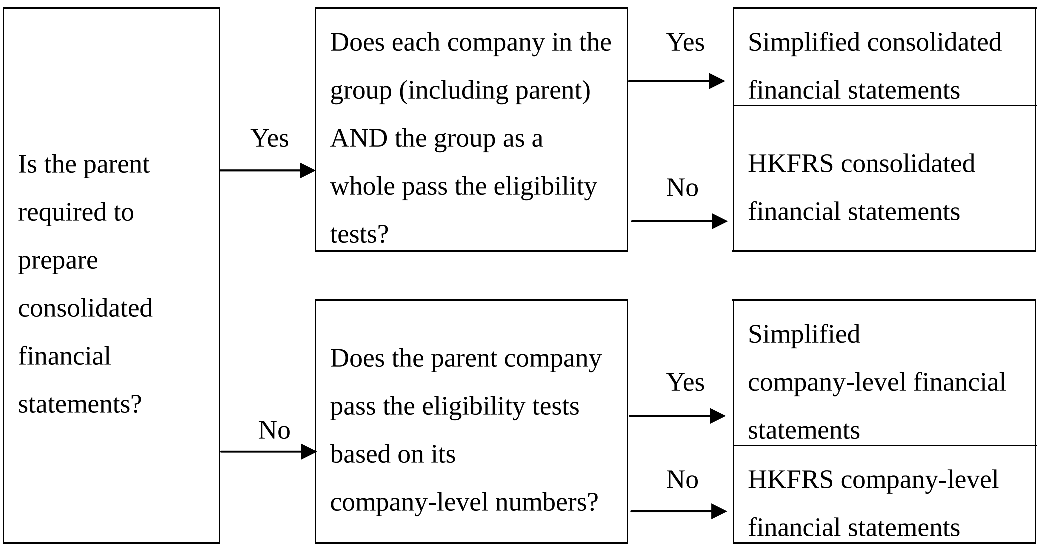
	Small guarantee co/grp[1]	Small private co/grp[1]	Larger "eligible" private co/grp[1]	"S 141D*" co[3]
Annual revenue	≤ $25m	≤ $100m[2]	≤ $200m[2]	No limit
Total assets	No limit	≤ $100m[2]	≤ $200m[2]	No limit
Average employees	No limit	≤ 100[2]	≤ 100[2]	No limit
Shareholder approval	Not required	Not required	At least 75% of members approve and none object	100% of members approve

[1] *In groups : size tests must be met for each entity in group & for group as a whole*

[2] *Must meet 2 out of the 3 tests*

[3] *Private companies with no subsidiaries and which are not subsidiaries*

  - Groups and consolidated financial statements



h. Shareholder approval requirements

- Larger "eligible" private companies/groups
  - Company: At least 75% of ALL members must pass a resolution at a general meeting that company is to fall within the reporting exemption for the financial year (with none objecting)
  - Group: All companies individually (and group in total) must be "eligible" in size and have gained shareholder approval (except for subsidiaries that meet "small private" company category")

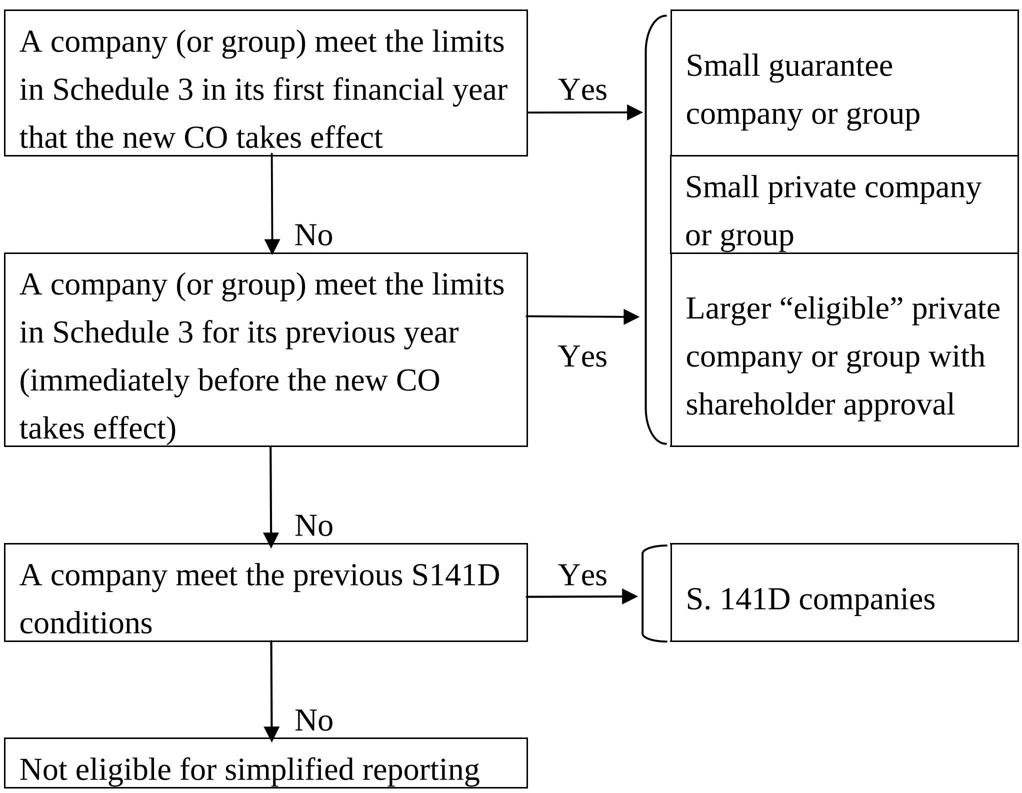
Note 1: ALL members not just those who attend meeting

Note 2: Vote is defeated if ANY shareholder votes against motion:

- at meeting; or
- in writing at least 6 months before end of financial year

i. Existing non-public company or group apply the SME limits when the new CO first applies

Conditions satisfied : Qualified as :



Note: Schedule 3 - Specified Qualified Conditions [Eligibility tests on Page 8]

3. Directors' reports and directors

Executive Summary

- Directors' report falls in new CO Part 9 (Accounts and Audit) Division 4
- Changes set out in Part 9 come into effect for the first financial year beginning on or after the commencement date of the new CO
  - 3 March 2014 ⇨ 1 January 2015 for December year ends
    ⇨ 1 April 2014 for March year ends
- New CO and Regulations make changes to disclosures including :
  - introduction of business review in directors' report
  - amended disclosures of directors' names and transactions
- Certain disclosure/consolidation exemptions are available for certain companies :
  - shareholder approval ahead of time will be required in some cases
- Restriction on corporate directorship

a. Business review in directors' reports

i. New requirement for a business review in directors' reports

- Analytical, forward looking review to be included in the directors' report
- On a consolidated basis if accompanying consolidated financial statements
- Minimum contents specified in new CO Schedule 5 [Contents of Directors' Report: Business Review]

<u>Exemptions for certain companies:</u>

- if eligible for the "reporting exemption" [Part 2 para f on Page 7]
- if wholly owned by another body corporate
- if private and special resolution obtained

ii. Minimum contents of business review

- Four core components of business review (Schedule 5 para 1)

  Year under review :
  - Fair review of company's/group's business

  Risks faced by company :
  - Principal risks and uncertainties faced by company/group

  Events post year end :
  - Important events affecting company/group since end of financial year

  Future :
  - Indication of likely future developments in company's/group's business

- Other requirements in Schedule 5 para 2
  - Analysis using financial key performance indicators
  - Discussion on company's/group's
    - environmental policies and performance
    - compliance with relevant laws and regulations that have significant impact on company/or group
    - key relationships with its employees, customers, suppliers, others that have a significant impact on company/or group and on which their success depends.

Note 1: Not required to disclose information about "impending developments or matters in the course of negotiation" if in directors' opinion this would be "seriously prejudicial" to company's (group's) interests

Note 2: The business review should be prepared on a consolidated basis if accompanying consolidated financial statements

iii. Auditors' responsibilities

Old CO	New CO
• Auditors have no specific responsibility to review or auditor directors' report	• If in the auditor's opinion, the directors' report is inconsistent with financial statements: - must disclose in auditor's report - may chose to bring to members' attention at general meeting

b. Changes in disclosure requirements relating to directors

Details included in new Regulation [Subordinate Legislation] :

- Companies (Disclosure of Information about Benefits of Directors) Regulation
- Companies (Directors' Report) Regulation

i. Closing loopholes on disclosure of directors' emoluments

Disclosures on directors' emoluments in notes to financial statements

- New CO brings forward old CO requirements but expands the scope to close loopholes
  - For example :
    - Separately disclose consideration provided to or receivable by any "third party" for services of a director
    - If consideration is non-cash benefit, disclose nature of benefit
    - "Pensions" becomes "retirement benefits" and includes "any lump sum, allowance, gratuity, periodical payment or other like benefit, any other property, or any other benefit whether in cash or otherwise" given on or after retirement or on death

ii. Change in scope of directors' material interests disclosures

- Scope widened

<table>
<tr><th>Old CO</th><th>New CO</th></tr>
<tr><td rowspan="2">Directors' report
"Contracts of significance in relation to company's business"</td><td>Directors' report
Transaction, arrangement or contract involves company's parent, subsidiary or fellow subsidiary [Note 1]</td></tr>
<tr><td>Notes to the financial statements
Transaction, arrangement or contract involves company [Note 2]</td></tr>
</table>

Note 1: Material interests of directors in a transaction, arrangement or contract of company or other group company that is significant to the company's business

- In the case of public company – it includes individual or entity "connected" with a director
- "Connected" – definition is broader than HKAS24 Related Party Transaction

Note 2: May not necessary increase the amount of audit work as already covered in the scope of HKAS24

➢ Disclosure exemptions

Exemptions available :	Companies which: Fall within reporting exemption	Companies which: Wholly owned subsidiaries of another body corporate	Companies which: Private companies & passed special resolution
New business review	Exempt	Exempt	Exempt
Arrangements : for director to acquire benefits from shares/debentures	Exempt	No exemption	No exemption
Charitable donations	Exempt	Exempt (only if HK incorp parent)	No exemption
Reason for director resigning or not seeking re-election	Exempt	No exemption	No exemption
Material interests of a director in transactions, arrangements or contracts	Exempt	No exemption	No exemption

c. Extended scope for disclosure of directors' names

Old CO	New CO
• Directors of company	• Directors of company <u>and</u> directors of any subsidiary included in consolidated FS <u>and</u> up to date of directors' report

Note: Suggested disclosure to avoid excessive details

- o Directors of company (parent) separately from those who are only directors of subsidiaries
- o Subsidiaries' directors in aggregate, rather than company by company

d. Restriction on corporate directorship

Old CO	New CO
• All public companies and private companies being members of a group of which a listed company is a member cannot appoint corporate directors	• Restriction on corporate directorship is maintained for public companies, companies limited by guarantee and private companies being members of a listed group
• The restriction does not apply to other private companies	• Subject to a grace period of 6 months after the commencement date of the New CO, all private companies (other than dormant companies) must have **at least one** director who is a natural person

e. New disclosure requirements

- A summary of reasons for resignation or not seeking re-election
  - not required for companies eligible for reporting exemption
- Permitted indemnity provisions
  - provided for indemnity against liability incurred by a director of the company to a third party

4. Other major initiatives affecting financial reporting

a. Statutory backing for HKFRSs

For full financial statements to give a "True and Fair view" must comply with :

- most recently effective HKFRS (issued by HKICPA)
- disclosure requirements of CO; and
- if listed, HK Stock Exchange Listing Rules

New Co strengthens the status of HKFRS

↓

Requires financial statements to comply with applicable accounting standards "issued or prescribed by a body prescribed by the Regulation"

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Company (Accounting Standards (Prescribed Body)) Regulation:
Prescribed body is the HKICPA

b. "True and Fair" override

If "True and Fair" is overrode, companies must:

- Include extra information in financial statements IF compliance with new CO or accounting standards would be INSUFFICIENT to give a true and fair view
- Disclose reasons for and particulars and effects of the departure from new CO or accounting standards in financial statements IF compliance with such would be INCONSISTENT with true and fair view

c. Updated terminology and wording

Old CO	New CO
"accounts"	"financial statements"
"group accounts"	"consolidated financial statements"
"balance sheet"	"statement of financial position"
"profit and loss account"	"statement of comprehensive income"
"true and fair view of the state of the company's affairs and profit and loss account"	"true and fair view of the company's financial position and financial performance"

d. Deletion of disclosure requirements already dealt with in HKFRSs

Old CO	New CO
• 10th Schedule…..long list of specific disclosures: - xx - xx - xx - xx - xx - xx - xx etc etc	• Schedule 4…. only 5 items to disclose: - whether financial statements prepared in accordance with applicable accounting standards - name of parent - auditors' remuneration - certain loans made to employees to enable them to buy shares in the company - company-level balance sheet in consolidated financial statements [Note]

Note: Disclosure of company-level balance sheet as a note to the consolidated financial statements :

Old CO	New CO
• No exemption from "true and fair view" of company-level balance sheet • Company-level balance sheet is a primary statement in group accounts : - full set of supporting notes required, sufficient to give a true and fair view of state of affairs of the company	• Only limited disclosure of company-level balance sheet information required in consolidated financial statements • New requirement : in the notes to consolidated financial statements : - company-level balance sheet - movement in company-level reserves - no other company-level notes required to support balance sheet

e. Exemptions from preparing consolidated financial statements

➢ A company with subsidiaries at reporting period end must produce consolidated financial statements unless:

Old CO	New CO
• No real value to members because of insignificant amount involved • Parent wholly owned by another body corporate • All subsidiaries excluded if (any of): impracticable/misleading/ undue expense or delay	• All subsidiaries are immaterial (Test: Individual <u>and</u> all subsidiaries in total) • Parent is wholly owned by another body corporate • Parent is a partly-owned subsidiary of another body corporate and shareholder approval obtained at least 6 months before year end [Note]

Note: Criteria for exemption from preparing consolidated financial statements if

- At least 6 months before end of financial year, directors write to members and notify them that they do not intend to produce consolidated financial statements for this financial year; and
- 3 months before financial year end no member has written to company requesting they produce consolidated financial statements.

Further information

Companies Registry website :
http://www.cr.gov.hk/en/companies_ordinance/index.htm

28 February 2014