



# The New Companies Ordinance

Companies Registry



## Part 9

# Accounts and Audit





## Application of new CO provisions to first financial year (s 358)

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- The requirements in the new CO in relation to accounting records (ss 373, 374, 376 & 377), simplified reporting (s 359), financial statements (ss 379 & 436), directors' report (s 388), laying reporting documents before AGM (s 429), summary financial report (s 439) and revision of financial statements (s 449) apply to a financial year that begins on or after commencement of the new CO.
- Corresponding requirements in Cap 32 continue to apply in relation to books of account, accounts, directors' report, laying of accounts before AGM, summary financial report and revision of accounts for a financial year beginning before commencement of the new CO (Schedule 11 ss 76, 77, 78, 83, 84 and 107(2)).



## Accounting reference period

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- S 367 provides for the determination of a company's **first financial year** and subsequent financial years by reference to its **accounting reference period**.
- A company's first financial year after the commencement of the new CO begins on the first day of its first accounting reference period and ends on the last day of that period (s 367(1)).
- For an existing company, the first accounting reference period begins on the day immediately following the end date of the company's accounts for the financial year immediately before the commencement of the new CO and ends on the first anniversary of that date (ss 368(1), 369(1) to (4)).
- The financial year is the period by reference to which the company's financial statements are to be prepared (s 379(1)).



## Accounting reference period (cont'd)

- Examples

Commencement date of new CO : 3 March 2014

Company A

- ◆ Current financial year : 1 April 2013 to 31 March 2014
- ◆ End date of company's accounts prepared under Cap 32 : 31 March 2014
- ◆ Company's first accounting reference period under the new CO :  
1 April 2014 to 31 March 2015

Company B

- ◆ Current financial year : 1 January 2014 to 31 December 2014
- ◆ End date of company's accounts prepared under Cap 32 : 31 December 2014
- ◆ Company's first accounting reference period under the new CO:  
1 January 2015 to 31 December 2015

5



## Accounting reference period (cont'd)

- For a company formed and registered under the new CO, the first accounting reference period begins on the incorporation date and ends on –
  - ◆ a date specified by the directors falling within 18 months after the company's incorporation; or
  - ◆ if none specified, the last day of the month of the first anniversary of the company's incorporation (ss 368(2), 369(5) to (7)).
- Every subsequent accounting reference period is a period of 12 months beginning immediately after the end of the previous accounting reference period and ending on the company's accounting reference date (s 368(3)).

6



## Accounting reference date (s 370)

- For an existing company, the accounting reference date is the anniversary of the end date of the company's accounts for the financial year immediately before the commencement of the new CO.
- For a company formed and registered under the new CO, it is a date specified by the directors, or the anniversary of the company's incorporation (s 369(5) to (7)).



## Accounting records (ss 373 to 378)

- S 121(2) of Cap 32 provides that proper books of accounts shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.
- Under the new CO, the requirement is modified –
  - ◆ The requirement is to keep accounting records that must be sufficient to —
    - (a) show and explain the company's transactions;
    - (b) disclose with reasonable accuracy the company's financial position and financial performance; and
    - (c) enable the directors to ensure that the financial statements comply with the new CO (s 373(2)).



## Accounting records (cont'd)

- ◆ A company that has a subsidiary undertaking must take all reasonable steps to secure that the subsidiary undertaking keeps accounting records that are sufficient to enable the company's directors to ensure that the financial statements comply with the new CO requirements (s 373(4)).
- Other new requirements
  - ◆ S 375 gives a director an express right to make a copy of the accounting records during inspection or request for a copy of the accounting records. Currently, Cap 32 only provides a right of inspection of books of accounts by the directors.
  - ◆ S 378 provides that a director may apply to Court to authorize a person to inspect the company's accounting records on the director's behalf. A person so authorized may make copies of the accounting records.

9



## Financial statements

- Directors must prepare financial statements for each financial year complying with the statutory requirements (ss 379 to 387, Schedule 4)
- Alignment of terminologies with financial reporting standards and UKCA 2006
  - ◆ "accounts" → "financial statements" (ss 357, 379)
  - ◆ "group accounts" → "consolidated financial statements" / "consolidated statements" (ss 379(2), 380(2))
  - ◆ "balance sheet" → "statement of financial position" (s 387)
  - ◆ "profit and loss account" → "statement of comprehensive income" (s 436(6))
  - ◆ "books of account" → "accounting records" (s 373)
- "Reporting documents" means the financial statements, directors' report and the auditor's report on the financial statements that are required to be laid at AGM or sent to members (ss 357(2), 429(1), 430(1), (3)).

10



## Financial statements (cont'd)

- To align accounting and auditing provisions with the Hong Kong Financial Reporting Standards, the requirement for accounts to comply with the 10th and 11th Schedules to Cap 32 is repealed.
- Financial statements are to comply with reporting standards issued or specified by the HKICPA (Companies (Accounting Standards (Prescribed Body) Regulation LN 9/2013 and s 380(4), (8)).
- Accounting disclosures in Schedule 4 replace the detailed requirements in the 10th and 11th Schedules to Cap 32 (s 380(3)).
- Information on directors' emoluments etc (cf ss 161, 161B, 161BB Cap 32) required to be contained in notes to financial statements (s 383). The detailed prescribed disclosures are set out in Companies (Disclosure of Information about Benefits of Directors) Regulation LN 35/2013 as amended by the Companies (Disclosure of Information about Benefits of Directors) (Amendment) Regulation 2013 LN 76 of 2013.

11



## Financial statements (cont'd)

- Consolidated financial statements
  - ◆ A holding company (except one that is a subsidiary of another body corporate) must, instead of preparing financial statements, prepare consolidated financial statements (s 379).
  - ◆ For a partially owned subsidiary, the exception only applies if the directors have notified the members of their intention not to prepare consolidated statements and no member has requested otherwise.
  - ◆ The holding company's statement of financial position must be contained in the notes to the consolidated statements (Schedule 4 s 2).

12



## Directors' report (ss 388 to 391)

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- Compared to section 129D of Cap 32, a new matter required to be covered in a directors' report is the company's business review which should include the following information of a company
  - ◆ a fair review of its business
  - ◆ a description of its principal risks and uncertainties
  - ◆ particulars of any important events affecting it which have occurred since the end of the financial year
  - ◆ an indication of likely future development in its business

13



## Directors' report (cont'd)

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- ◆ if having a significant impact on its business,
  - a discussion on its environmental policies and performance, including compliance with the relevant laws and regulations
  - an account of its key relationships with employees, customers, suppliers and others, on which its success depends

(S 388, Schedule 5)

14



## Directors' report (cont'd)

- The following companies are not required to prepare a business review -
  - ◆ companies falling with the reporting exemption
  - ◆ a private company that does not fall within the reporting exemption with 75% approval from members
  - ◆ a wholly owned subsidiary of a body corporate
- Prescribed disclosures set out in Companies (Directors' Report) Regulation Cap 622D

15



## Auditor's rights

- Auditor's rights to information
  - ◆ S 412 empowers auditors to require information and explanation for the performance of their duties from a wider range of persons –
    - (a) an officer of the company
    - (b) a HK incorporated subsidiary of the company
    - (c) an officer or auditor of such a subsidiary
    - (d) a person holding or accountable for the accounting records of the company or such a subsidiary
    - (e) any of the above persons or subsidiary at the time to which the information or explanation relates

16





## Auditor's rights (cont'd)

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- ◆ The auditor of a holding company may require the company to obtain information or explanation from its subsidiary undertaking that is not a HK incorporated company, an officer or auditor of such a subsidiary undertaking and a person holding or accountable for the accounting records of such a subsidiary undertaking.
- Auditor's rights in relation to general meetings and written resolutions (ss 411, 555, 559, 575)
  - ◆ S 575 requires a company to give notice of or any other document relating to a general meeting to the auditor at the same time as the notice or document is given to its members.
  - ◆ S 559 requires the company to send to the auditor notice of the fact that a written resolution is passed.

17



## Auditor's rights (cont'd)

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- Qualified privilege
  - ◆ S 410 provides that in the absence of malice, an auditor is not liable for defamation in respect of any statement made by the auditor in the course of performing duties as auditor of the company.
  - ◆ "Performing duties as auditor of a company" includes making a statement of circumstances or a cessation statement upon the resignation or removal of the auditor or when the auditor is not reappointed.

18



## Auditor's rights (cont'd)

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- Outgoing auditor's statement of circumstances
  - ◆ Under s 425(1), the auditor's duty to make a statement of circumstances connected with the cessation of office is extended to situations where the auditor is removed from office and where a retiring auditor is not reappointed.
  - ◆ Currently, such a requirement only applies to a resigning auditor (s 140A Cap 32).
  - ◆ A company is not bound to circulate the statement if the Court is satisfied that the auditor has abused the use of the statement or is using the statement to secure needless publicity for defamatory matter (s 427).
  - ◆ The auditor must deliver a copy of the statement to the Registrar for registration within the prescribed time (ss 426(5) and 427(5)).

19



## Auditor's rights (cont'd)

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- Outgoing auditor may provide information to incoming auditor (s 414)
  - ◆ A person who is or has been an auditor of a company does not contravene any duty in law by reason only that the person gives information of which he became aware in the capacity of auditor to another person —
    - (a) who is an auditor of the company;
    - (b) who has been appointed as auditor of the company but whose term of office has not yet begun; or
    - (c) to whom the company has offered the position as auditor but who has not yet been appointed.

20



## Provisions protecting auditor from liability

- Currently s 165 of Cap 32 provides that –
  - ◆ Any provision exempting or indemnifying any officer or auditor from liability in respect of negligence, default, breach of duty or breach of trust in relation to the company or a related company is void.
  - ◆ A company may purchase and maintain insurance for an officer or auditor against such liability (except for fraud) to the company, a related company or any other party.
  - ◆ A company may indemnify an officer or auditor against liability incurred in defending proceedings in which judgment is given in his favour or in which he is acquitted; or in connection with an application in which relief is granted to him.

21



## Provisions protecting auditor from liability (cont'd)

- Section 415 modifies the existing law by –
  - ◆ removing the prohibition against exempting an auditor from liability to a related company. The exemption is problematic since a company is not capable of "exempting" an auditor's liability to another company
  - ◆ extending the prohibition against indemnifying the liability of an auditor of an associated company (s 415(3))
  - ◆ extending the permission to take out and keep in force insurance to cover the liability of an auditor of an associated company (s 415(4))

22



## Provisions protecting auditor from liability (cont'd)

- ◆ providing that the making of a cessation statement or statement of circumstances by an outgoing auditor falls within "performance of the auditor's duties" (s 415(6)) so that the prohibitions and the permitted insurance include the auditor's liability arising from the making of such statements



## Laying of reporting documents at AGM

- Currently s 122 of Cap 32 requires accounts to be laid before the company at its AGM. The accounts shall be made up to a date falling not more than 6 months, or, in the case of a private company (other than one that was a member of a corporate group consisting of a non-private company) and a company limited by guarantee, not more than 9 months before the date of the AGM.
- As a company may dispense with the holding of AGM under s 612 of the new CO, the requirement to lay accounts made up to 6 / 9 months before the AGM is changed to a requirement to lay reporting documents within the following period –



## Laying of reporting documents at AGM (cont'd)

- ◆ a private company (that is not a subsidiary of a public company) or a company limited by guarantee, within 9 months after the end of financial year (s 431(1)(a))
- ◆ in the case of any other company the period is 6 months (s 431(1)(b))
- ◆ same period for sending copy of reporting documents to members if AGM not required to be held (ss 430(3) and 431(1))

25



## Summary financial reports and revision of financial statements

- Summary financial report provisions are extended to all companies except those that prepare simplified accounts (s 438)
  - ◆ Currently summary financial report provisions apply to listed companies only (ss 141CA to 141CG Cap 32)
  - ◆ Unless prohibited (s 446), companies have a choice of sending to its members a copy of the summary financial report instead of reporting documents (ss 439, 441, 442).
  - ◆ Companies (Summary Financial Reports) Regulation Cap 622E replaces Companies (Summary Financial Reports of Listed Companies) Regulation Cap 32M.
- Voluntary revision of financial statements and reports (ss 449 & 450)(cf section 141E Cap 32)
  - ◆ Prescribed requirements set out in Companies (Revision of Financial Statements and Reports) Regulation Cap 622F which replaces Companies (Revision of Accounts and Reports) Regulation Cap 32N.

26



## Part 10

# Directors and Company Secretaries



### Corporate directors

- Currently corporate directors not permitted, except for private company (other than a private company that is a member of a group of companies of which a listed company is a member) (CO s 154A)
- Private company (other than one that is a member of a group of companies of which a listed company is a member) must have at least one director who is a natural person (s 457). Existing companies have 6 months from commencement of s 457 to comply (Schedule 11 Part 10 s 89)
- S 457 does not apply to a company which, on the commencement of the section, is deemed to be a dormant company under s 344A of the current CO



## Directors' duty of care, skill and diligence

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- A director must exercise reasonable care, skill and diligence, i.e. the care, skill and diligence that would be exercised by a reasonably diligent person with –
  - ◆ the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company ("objective test"); and
  - ◆ the general knowledge, skill and experience that the director has ("subjective test")
- The duty has effect in place of the common law rules and equitable principles as regards the duty to exercise reasonable care, skill and diligence (s 465(4))
- The duty applies to a shadow director (s 465(5))
- The consequences of breach are the same as would apply if the common law rules or equitable principles that it replaces applied (s.466)

29



## Part 11

# Fair Dealing by Directors



30



## Transactions with directors or their connected entities

- Expand the prohibitions on loans and similar transactions to cover a wider category of persons connected with a director. For example, adult children, cohabitees, parents (s 486)
  - ◆ Connected entity means family members (s 487), person in cohabitation relationship, associated body corporate (s 488), specified categories of trustees and partner
- Require disinterested members' approval in the case of public companies (ss 496(2)(b)(ii), (5), 515(1)(b)(ii), (4), 518(2)(b)(ii), (4), 532(2)(b)(ii)(4)
  - ◆ Interested parties: the relevant directors, connected entities and any person who holds any shares in the company in trust for these persons/entities
- Require members' approval for directors' employment exceeding three years (s 534)

31



## Part 12

# Company Administration and Procedure



32





## Dispensation with the holding of AGM

- Circumstances in which company not required to hold AGM
  - ◆ If done by written resolution (s 612(1)).
  - ◆ Single member company (s 612(2)(a)).
  - ◆ Members' unanimous resolution to dispense with the holding of AGM in respect of a particular financial year or for subsequent financial years (ss 612(2)(b) and 613). Copy of the resolution is required to be delivered to the Registrar for registration (s 622(1)(g)).
  - ◆ A dormant company as defined in section 5 (s 611).

33



## Dispensation with the holding of AGM (cont'd)

- Where no AGM is held –
  - ◆ Directors (failing which members) may appoint the company's first auditor for the company's first financial year (ss 395(3), 396(6)).
  - ◆ Copy of financial statements and reports to be sent to the members (s 430(3)).
  - ◆ Current auditor deemed to be re-appointed unless he declines (s 403). For other exceptions to deemed reappointment see s 403(2)).
  - ◆ If reappointment declined members replace retiring auditor at a general meeting (s 396(3), (4)).
  - ◆ Members holding at least 5% of total voting rights may request directors to call a meeting (s 566).

34



## Dispensation with the holding of AGM (cont'd)

- When AGM required to be held after dispensation
  - ◆ Any member may request the company to convene an AGM for a particular financial year by giving notice to the company not later than 3 months before the end of the statutory period for holding an AGM (s 613(5)).
  - ◆ The unanimous resolution for dispensing with holding an AGM is revocable by an ordinary resolution (s 614).
- For transitional and saving arrangement – Schedule 11 s 107

35



## Part 13

# Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back

36



## Scheme of Arrangement - headcount test

- Headcount test in current CO
  - ◆ S 166(2)... “majority in number” (“headcount test”) “representing three-fourths in value of the creditors... or members...” (“share value test”). Court may sanction scheme which will be binding on all creditors or members, i.e. court still has discretion whether or not to sanction scheme even if both tests are satisfied.
  - ◆ The problem of share splitting *Re PCCW Ltd* case
  - ◆ Australia amended the Corporations Act in 2007 to give the court a discretion to approve a members’ scheme even though majority in number is not obtained.

37



## Scheme of Arrangement - headcount test (cont’d)

- ◆ Listed companies must also satisfy rule 2.10(b) of the Takeovers Code, i.e. number of votes cast against the scheme must not be more than 10% of the votes attaching to disinterested shares
- ◆ The provision originally only applied to insolvent company schemes until extended to non-insolvent schemes in 1900
- ◆ Headcount test inconsistent with “one share one vote” principle
- ◆ Most shares in listed companies within the Central Clearing and Settlement Scheme (CCASS) are registered in the name of HKSCC Nominees Ltd.

38



## Scheme of Arrangement - headcount test (cont'd)

- Headcount test retained for creditors' schemes (s 674(1)(a), (b))
- For members' schemes the headcount test is retained but the court may order otherwise (s 674(1)(c)(ii)), but for an arrangement involving a general offer (s 707) or a takeover offer the test is at least 75% in value of members voting and the votes cast against the arrangement do not exceed 10% of the total voting rights attached to all disinterested shares (s 674(2)(a)(ii), (b)(ii) & 674(3))
- Specific provision as to costs (s 676)
- Schemes for facilitating reconstruction and amalgamation of companies (s 675)
  - ◆ Revising definition of "property" and "liabilities" in current CO s 167(4) to permit transfer of contract of personal service, thus reversing the effect of *Nokes v Doncaster Amalgamated Collieries Ltd* (1940)

39



## New court-free statutory amalgamation procedure

- Confined to wholly-owned intra-group companies
- Vertical amalgamation (i.e. between holding company and one or more of wholly owned subsidiaries) (s 680) or horizontal (i.e. between two or more subsidiaries of the same holding company (s 681))
- Amalgamation proposal
  - ◆ solvency statement (s 679)
  - ◆ shareholders' approval (ss 680(3), (4) & 681(3))
  - ◆ notice of amalgamation
  - ◆ if floating charge over assets, creditor must consent to the amalgamation
  - ◆ registration of amalgamation (s 684)
  - ◆ creditors' and shareholders' right to apply to court (s 686)
- Effect of amalgamation (s 685)

40