

**Standing Committee on Company Law Reform**

**The Twenty-Third Annual Report**

**2006/2007**

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**Standing Committee on Company Law Reform  
Twenty-Third Report  
Subjects considered by the  
Standing Committee during 2006/2007**

<u><b>Table of Contents</b></u>		<u><b>Page No.</b></u>
PREFACE		
	(i) Terms of Reference of the Standing Committee on Company Law Reform.....	1
	(ii) Membership of the Standing Committee for 2006/2007.....	1
	(iii) Meetings held during 2006/2007.....	2
EXECUTIVE SUMMARY.....		3
CHAPTER 1	Draft Drafting Instructions in respect of Section 141D and the Eleventh Schedule of the Companies Ordinance and Mock-up of (New) Section 141D and the Eleventh Schedule prepared by the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance.....	11
CHAPTER 2	Proposals regarding the provisions of the Financial Documents and Summary Financial Reports by Companies from the Joint Government/ Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance.....	17
CHAPTER 3	The Rewrite of the Companies Ordinance.....	20
CHAPTER 4	Types of Company and Definitions of Private and Public Companies.....	23
CHAPTER 5	Companies (Revision of Accounts and Reports) Regulation.....	25
CHAPTER 6	Recommendations made by Advisory Group 2 for the Rewrite of the Companies Ordinance – Beneficial Owners’ Enjoyment of Members’ Rights.....	27
CHAPTER 7	Recommendations Made by Advisory Group 3 for the Rewrite of the Companies Ordinance on Directors’ Duties.....	29
CHAPTER 8	Recommendations Made by Advisory Group 2 for the Rewrite of the Companies Ordinance on Electronic Communications between Companies and Shareholders and Other Communication Related Matters.....	30
CHAPTER 9	Draft Consultation Paper on Proposals to Improve the Accounting and Auditing Provisions.....	33

## **PREFACE**

(i)

### **Terms of Reference of the Standing Committee on Company Law Reform**

- (1) To advise the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary.
- (2) To report annually through the Secretary for Financial Services and the Treasury to the Chief Executive in Council on those amendments to the Companies Ordinance that are under consideration from time to time by the Standing Committee.
- (3) To advise the Financial Secretary on amendments required to the Securities Ordinance and the Protection of Investors Ordinance<sup>1</sup> with the objective of providing support to the Securities and Futures Commission in its role of administering those Ordinances.

(ii)

### **Membership of the Standing Committee for 2006/2007**

**Chairman** : Mr Benjamin YU, S.C., J.P.

**Members** : Mr Michael W SCALES  
Mr William TAM Sai-ming (up to 31.1.2007)  
Mr John POON Cho-ming  
Mr David P R STANNARD  
Ms Teresa KO Yuk-yin  
Mr Godfrey LAM Wan-ho  
Ms Vanessa STOTT  
Mr Carlson TONG, J.P.  
Mr Paul F WINKELMANN  
Mr Patrick WONG Chi-kwong  
Mr Stephen HUI Chiu-chung, J.P.  
Mrs Anne CARVER (from 1.2.2007)  
Mr Felix CHAN KWOK-wai, M.H. (from 1.2.2007)  
Ms Paddy LUI Wai-yu, J.P. (from 1.2.2007)  
Ms Edith SHIH (from 1.2.2007)

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<sup>1</sup> These two Ordinances were consolidated into the Securities and Futures Ordinance which commenced on 1 April 2003.

- Ex-Officio** : Mr Andrew YOUNG  
**Members** : Chief Counsel, Legal Services Division  
The Securities & Futures Commission  
Mr Paul CHOW  
Chief Executive  
Hong Kong Exchanges and Clearing Limited
- Mr Charles BARR  
Department of Justice
- Mr E T O'CONNELL  
The Official Receiver
- Mr Gordon W E JONES, J.P.  
The Registrar of Companies
- Mr William RYBACK  
Deputy Chief Executive  
The Hong Kong Monetary Authority
- Mr John Leung  
Deputy Secretary for Financial Services and the Treasury
- Secretary** : Mr Edward LAU

(iii)

**Meetings held during 2006/2007**

One Hundred and Ninety-Sixth Meeting	-	1.4.2006
One Hundred and Ninety-Seventh Meeting	-	29.5.2006
One Hundred and Ninety-Eighth Meeting	-	2.12.2006
One Hundred and Ninety-Ninth Meeting	-	3.2.2007

## EXECUTIVE SUMMARY

The Standing Committee on Company Law Reform (“SCCLR”) was formed in 1984 to advise the Financial Secretary on amendments to the Companies Ordinance (“CO”) and other related ordinances. The SCCLR reports annually through the Secretary for Financial Services and the Treasury to the Chief Executive in Council on amendments that are under consideration.

From 1 April 2006 to 31 March 2007, the SCCLR held four meetings. Apart from continuing to vet the proposals and recommendations made by the Joint Government/Hong Kong Institute of Certified Public Accountants (“HKICPA”) Working Group (“JWG”) set up to review the accounting and auditing provisions of the CO, the main focus of the SCCLR was on the Rewrite of the CO, which commenced in mid-2006 following the setting up of the Companies Bill Team (“CBT”). In this respect, the SCCLR considered five papers including one on the general framework of the new CO and proposed workplan, one on the types of companies allowed to be formed and incorporated under the new CO and three other papers on proposals made by the Advisory Groups (“AGs”) set up to advise on specific topics in the rewrite exercise.

In addition, the SCCLR considered the draft provisions of the Companies (Revision of Accounts and Reports) Regulation which was aimed at regulating the application of the requirements in the CO to those accounts and, summary financial reports or directors’ reports revised under sections 141E and 336A of the CO<sup>2</sup>.

A brief summary of the nine chapters in this Annual Report is set out in the table below :-

Chapter	Subject Matter	Key Recommendations/Remarks
1	Draft Drafting Instructions in respect of Section 141D and the Eleventh Schedule of the Companies Ordinance and Mock-up of (new) Section 141D and the Eleventh Schedule prepared by the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance	<p>Members agreed that –</p> <ul style="list-style-type: none"> <li>• The current unanimous shareholders opt-in requirement should be relaxed.</li> <li>• Private companies (other than those carrying on business as banks, securities dealers, insurance companies and finance companies) would be automatically eligible if they met any two of the following three requirements :- <ul style="list-style-type: none"> <li>(a) Total annual revenue of not more than HK\$50 million;</li> <li>(b) Total assets of not more than HK\$50 million;</li> <li>(c) Not more than 50 employees.</li> </ul> </li> <li>• For other private companies (other than</li> </ul>

<sup>2</sup> See footnotes [33] and [34] below.

Chapter	Subject Matter	Key Recommendations/Remarks
		<p>those carrying on business as banks, securities dealers, insurance companies and finance companies), the threshold should be agreement by not less than 75 percent in nominal value of the shares with no objection from any shareholder.</p> <ul style="list-style-type: none"> <li>• The application of section 141D should be extended to the holding company of a “small group”, and a company owning and operating ships or aircraft in the carriage of goods between Hong Kong and other places.</li> <li>• Certain time factors should apply to determine whether a private company would qualify as a section 141D company in relation to a financial year.</li> <li>• Section 141D should be amended to require the preparation of financial statements (or consolidated financial statements if the company was a holding company) to deal with the financial position and financial performance of the company.</li> <li>• All the provisions in the Eleventh Schedule except paragraph 5 concerning disclosure of outstanding loans should be removed.</li> <li>• The Eleventh Schedule should be used to contain corporate governance disclosure provisions including certain proposed additional disclosure requirements, such as a new provision requiring annual accounts to state whether the accounts have been prepared in accordance with applicable accounting standards and to give particulars of any material departure from those standards and the reasons for such a departure.</li> <li>• All private companies falling within section 141D should be required only to produce a simplified form of directors’ report and there should be an overriding provision within the proposed schedule on matters to be dealt with in the directors’ report to disapply the disclosure requirements on assets value and donations to section 141D companies.</li> </ul>

Chapter	Subject Matter	Key Recommendations/Remarks
		<p>Members could not reach a consensus on whether directors of section 141D companies should prepare financial statements or consolidated financial statements on a “properly prepared” basis as opposed to the “true and correct” basis currently in force. They noted that the issue was currently being considered by the International Auditing and Assurance Standards Board (“IAASB”) and agreed that the matter should be revisited after the public consultation.</p> <p>Subject to the above, members endorsed the JWG’s recommendation that –</p> <ul style="list-style-type: none"> <li>• The auditors’ report of a section 141D company should – <ul style="list-style-type: none"> <li>– cover the financial statements, or where a company was a holding company which had prepared consolidated financial statements, the consolidated financial statements of the section 141D company; and</li> <li>– state whether, in the auditors’ opinion, the financial statements or consolidated financial statements referred to in the report had been “properly prepared”.</li> </ul> </li> <li>• Section 141D of the CO should be amended to require the directors of a section 141D company to make a directors’ declaration that the financial statements or consolidated financial statement have been “properly prepared”.</li> </ul>
2	Proposals regarding the provisions of the Financial Documents and Summary Financial Reports by Companies from the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance	<ul style="list-style-type: none"> <li>• Every member of a company should have the right to elect for either the full financial document or the summary financial report. The election, once made, should remain in force until revocation.</li> <li>• A company should have the right to ascertain its members’ preference as to the form of the financial documents and their means of delivery. A company may exercise a limited choice of its own if the members did not elect.</li> </ul>

Chapter	Subject Matter	Key Recommendations/Remarks
		<ul style="list-style-type: none"> <li>• Paragraphs 5(3)(b) and (k) of the (Summary Financial Reports of Listed Companies) Regulation should be amended to take into account the JWG’s related proposals.</li> <li>• Paragraph 5(3)(c) of the Regulation should be amended to provide that a summary financial report must contain a statement from the company’s auditors on whether the auditors’ report was qualified and, if so, further information necessary for the understanding of the qualification.</li> <li>• Paragraphs 5(3)(d), (f), (m) and (l) of the Regulation should be retained .</li> <li>• Paragraphs 5(3)(e) and (g) of the Regulation should be repealed.</li> <li>• The directors’ declaration as previously recommended by the JWG should be included in the summary financial report.</li> <li>• Section 251(7) of the UK Companies Act 1985 (“CA 1985”) including the definition of “entitled person” should be adopted.</li> </ul> <p>Members agreed also to the following proposals subject to modification :-</p> <ul style="list-style-type: none"> <li>• A company should have the choice to send to its members either the relevant financial document or a summary financial report. In the case of the latter, the member should have the option to request the relevant financial document. In the case of the former, the member should have no other option unless the company had also prepared a summary financial report and agreed to provide the members with such an option. In all cases, the documents must be in both English and Chinese unless the members had been given a choice in the first place and made a selection as to the language of the reports to be provided.</li> <li>• Paragraph 5(3)(i) of the Regulation should be retained. However, the requirement in</li> </ul>



Chapter	Subject Matter	Key Recommendations/Remarks
		<p>that paragraph that certain specified statements must be on the front cover of the summary financial report should be deleted.</p>
3	The Rewrite of the Companies Ordinance	<p>Members noted and agreed generally with the following proposed arrangements :-</p> <ul style="list-style-type: none"> <li>• The Rewrite of the CO would be carried out in two phases. For the purpose of Phase I, the Companies Bill (“CB”) would be divided tentatively into 22 parts and cover the core company law provisions. Phase II of the Rewrite would cover the winding-up and insolvency related provisions while the prospectus provisions would be taken up separately in the context of separate reviews by the Securities and Futures Commission (“SFC”).</li> <li>• A CBT comprising legal officers and administrative officers would be set up to undertake the exercise. The CBT would be supported by the Department of Justice and external consultants.</li> <li>• A Steering Committee on Companies Ordinance Rewrite (“SC”) and four AGs would also be formed.</li> <li>• A White Bill would tentatively be issued for public consultation in mid-2009 prior to the formal introduction of the CB to the Legislative Council (“LegCo”).</li> </ul> <p>With regard to the final arrangement of the winding-up and insolvency related provisions, members were unable to reach a consensus view at this stage.</p>
4	Types of Company and Definitions of Private and Public Companies	<p>Members recommended that –</p> <ul style="list-style-type: none"> <li>• There should be a separate category of companies limited by guarantee.</li> <li>• All guarantee companies should be required to file annual reports and audited accounts with the Companies Registry.</li> <li>• Depending on certain size criteria to be</li> </ul>

Chapter	Subject Matter	Key Recommendations/Remarks
		<p>formulated, guarantee companies should be subject to two different sets of accounting and disclosure requirements.</p> <ul style="list-style-type: none"> <li>• The Government would discuss with the HKICPA as to the appropriate size criteria and details of the accounting and disclosure requirements.</li> <li>• The category of unlimited liability companies not having a share capital should be abolished.</li> <li>• No change should be made to the current way of defining private and non-private companies in the CO. However, it should be clarified that a private company must be a company actually having a share capital.</li> <li>• There should not be an across-the-board application of the listed company provisions in the CO to unlisted public companies.</li> </ul>
5	Companies (Revision of Accounts and Reports) Regulation	<p>Members had no particular comments on the draft provisions but raised concern on whether the empowering provisions in the CO should go one step further to impose a duty of revising accounts and reports on directors, instead of allowing discretion for directors to do so. They invited the Administration to reconsider the issue after the relevant provisions in the CO (enacted under the Financial Reporting Council Ordinance) and the Regulation had been in operation for a period of time and in the light of experience gained.</p>
6	Recommendations made by Advisory Group 2 for the Rewrite of the Companies Ordinance – Beneficial Owners’ Enjoyment of Members’ Rights	<p>Members agreed generally with AG2’s recommendations that –</p> <ul style="list-style-type: none"> <li>• There was no need to amend the CO to facilitate the beneficial owners of listed companies, unlisted public companies and private companies to exercise members’ rights; and</li> <li>• Financial Services and the Treasury Bureau (“FSTB”) and other relevant authorities should consider introducing changes to the Central Clearing and Automated Settlement System (“CCASS”) in the context of the</li> </ul>

Chapter	Subject Matter	Key Recommendations/Remarks
		<p>proposal for a scripless securities market to facilitate investors to hold securities as registered shareholders (i.e. legal owners).</p> <p>However, members had considerable concerns regarding the progress of the implementation of the proposal to move towards a scripless securities market.</p>
7	Recommendations Made by Advisory Group 3 for the Rewrite of the Companies Ordinance on Directors' Duties	Members did not come to a consensus on whether directors' duties should be codified in the context of the rewrite of the CO. Concerns had also been raised on the scope of the codification and whether additional duties which directors did not currently have under the common law and equity should be added as in the UK Companies Act 2006 ("CA 2006"). As a result, members suggested that the issue should be put out to public consultation.
8	Recommendations Made by Advisory Group 2 for the Rewrite of the Companies Ordinance on Electronic Communications between Companies and Shareholders and Other Communication Related Matters	<p>While all members agreed that electronic communications between a company and its shareholders should be encouraged, different views were expressed on whether to adopt a system rewarding the use of the electronic medium and recognising the costs and implications of paper production.</p> <p>As members' views in respect of shareholders' rights to receive hard copies were mixed, they agreed to revisit the issue after the relevant proposals had been put out to public consultation.</p>
9	Draft Consultation Paper on Proposal to Improve the Accounting and Auditing Provisions	<p>Members endorsed the revised draft Consultation Paper subject, inter alia, to the following :-</p> <ul style="list-style-type: none"> <li>• The saving to the proposal that extension by a company of its accounting reference date would be ineffective if it occurred within five years since the last extension should be limited only to extensions for the purpose of aligning the accounting reference date with that of its holding company, but not of its subsidiary company.</li> <li>• The shareholders' consent requirement to not presenting the group accounts, if the holding company was a partially-owned subsidiary of another entity, should remain.</li> </ul>

Chapter	Subject Matter	Key Recommendations/Remarks
		<ul style="list-style-type: none"><li data-bbox="754 237 1423 342">• An indication of likely future developments in the business of the company should remain part of the business review requirements.</li><li data-bbox="754 383 1423 562">• The proposal that an auditor should be allowed to require specified persons to provide him with information, explanations or other assistance “as he thinks necessary” should remain.</li><li data-bbox="754 602 1423 819">• The proposal that auditors should be required to state in the auditors’ report on any inconsistencies between the audited accounts and financial information contained in other parts of the annual report which contains the audited accounts should remain.</li><li data-bbox="754 860 1423 1189">• Further explanations should be included in the Consultation Paper on problems relating to the “true and correct” standard currently in use; the prohibition imposed by the IAASB on the use of the term “true and fair view”; the rationale for the JWG’s proposal; the government’s position as well as the work currently being undertaken by the IAASB in this respect.</li><li data-bbox="754 1229 1423 1518">• As the proposed directors’ declaration regarding the accounts and solvency of a company is linked to the question of whether a liability should be imposed on directors for insolvent trading in Hong Kong, the SCCLR had no objection to the issue being subject to further study in Phase II of the rewrite, together with other insolvency-related issues.</li></ul>

## CHAPTER 1

### **Draft Drafting Instructions in respect of Section 141D and the Eleventh Schedule of the Companies Ordinance and Mock-up of (New) Section 141D and the Eleventh Schedule prepared by the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance**

#### **Background**

- 1.1 The Joint Government/Hong Kong Institute of Certified Public Accountants Working Group (“JWG”) reviewed and examined section 141D and the Eleventh Schedule of the Companies Ordinance (“CO”) and prepared detailed draft drafting instructions and a mock-up of (new) section 141D and the Eleventh Schedule.
- 1.2 Section 141D of the CO exempts certain private companies from most of the provisions concerning accounts if all the shareholders of the company agree<sup>3</sup>. The Eleventh Schedule provides for details with regard to the accounting requirements for these exempted private companies (“section 141D companies”).

#### **Recommendations**

- 1.3 At the 196th meeting on 1 April 2006, the Standing Committee on Company Law Reform (“SCCLR”) considered the draft drafting instructions and the mock-up of (new) section 141D and the Eleventh Schedule of the CO prepared by the JWG.
- 1.4 Members agreed with the JWG’s recommendation that section 141D should state clearly which accounting provisions in the CO would not apply to section 141D companies, and contain provisions regarding the following matters :–
  - (a) Contents of the financial statements;
  - (b) Application of the Small and Medium-sized Enterprises (“SME”) Financial Reporting Standard<sup>4</sup>;

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<sup>3</sup> Section 141D of the CO provides that all the shareholders of a private company may agree in writing, in respect of one financial year at a time, that certain accounting requirements need not be complied with and sets the requirements for the balance sheet, directors’ report and auditors’ report of such private companies that apply section 141D. The requirements for the balance sheet are more particularly set out in the Eleventh Schedule of the Ordinance. Section 141D(3) sets out the types of private companies that cannot apply section 141D. In addition, without prejudice to any other provision, if a director of a company fails to take reasonable steps to ensure compliance with the requirements for directors’ report, he is liable to imprisonment and a fine unless he can avail himself of the defence in provisos 4(a) and (b) of section 141D.

<sup>4</sup> The SME Financial Reporting Framework and SME Financial Reporting Standard were issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) in August 2005.

- (c) Directors' declaration;
- (d) Directors' report; and
- (e) Audit reporting.

1.5 Subject to some modifications, members endorsed the JWG's proposal to relax the unanimous shareholders opt-in requirement currently under section 141D along the following lines:

- (a) Private companies (other than those carrying on business as banks, securities dealers, insurance companies and finance companies) would be automatically eligible if they met certain size criteria, namely not exceeding any two of the following three thresholds<sup>5</sup> :-
  - (i) Total annual revenue of HK\$50 million for that year;
  - (ii) Total assets of HK\$50 million at the balance sheet date; and
  - (iii) 50 employees.
- (b) For other private companies<sup>6</sup>, the threshold should be agreement by shareholders holding not less than 75 percent in nominal value of the shares of the company with no objection from any of the remaining shareholders<sup>7</sup>. Once opted in, the arrangement should stay in force on a continuous basis until a change in the shareholding of the company or the revocation of the agreement by a shareholder.

1.6 With regard to the application of section 141D, members agreed with the JWG's recommendation that it should be extended to –

- (a) The holding company of a "small group" of companies so that it could prepare a consolidated financial statement pursuant to that section if similar size criteria for "small companies" were met by the "small group". As a result, the restriction on an intermediate holding company and a subsidiary company of another company formed and registered under the CO from applying section 141D should be removed.

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<sup>5</sup> The JWG's original proposal was that the criteria for determining whether a private company falls within the definition of a small company in a year should be that it satisfied either one of the following two criteria :-

- (a) total annual revenue of not more than HK\$50 million for that year; or
- (b) total assets of not more than HK\$50 million at the balance sheet date.

Members of the SCCLR considered that the inclusion of the number of employee as a size criterion would provide a double check to make sure that the company concerned was a small company.

<sup>6</sup> Also provided that they did not have public accountability.

<sup>7</sup> The JWG originally recommended that section 141D should be changed to where the shareholders holding at least 95 percent in nominal value of the shares of a private company agree in writing that section 141D shall apply with no objection to the application of the section from any shareholder. The proposal was intended to deal with cases where a few minority shareholders who for whatever reasons could not be traced or where the shareholdings are so dispersed that unanimous agreement could not be easily obtained. However, Members agreed that given the "no objection" condition, there would be no need to set the percentage level at 95 percent and considered that 75 percent, being the percentage required for the passing of a special resolution, would be reasonable.

- (b) A company owning and operating ships or aircraft in the carriage of cargo between Hong Kong and other places<sup>8</sup>.

1.7 Furthermore, members endorsed the following recommendations made by the JWG :-

- (a) The following time factors should apply in determining whether a private company would qualify as a section 141D company in relation to a financial year :-
- (i) If the size criteria were met in the company's first financial year with the incorporation date falling within or after the first financial period following the effective date of the amended section 141D.
  - (ii) In the case of the company's financial year other than the first financial year specified in (i) above, if
    - the size criteria were met in the company's preceding financial year prior to the first financial period following the effective date of the amended section 141D, or in the company's current financial year which was the first financial period following the effective date of the amended section 141D.
    - the size criteria were met in the preceding two financial years if the financial year in question was not a financial year described in (i) above.
- (b) Where a company had previously qualified for reporting under the SME Financial Reporting Framework, the company should no longer be qualified for reporting under that Framework until the company had ceased to be an SME for two consecutive reporting periods.
- (c) The same proposed time factors, with the subject changed to the group's financial year and the incorporation date of the holding company, should apply in determining whether a group of companies would qualify as a small group in relation to a financial year.
- (d) The proposed time factors should be included in the respective definitions of a section 141D company and a small group and should be put in a schedule, to facilitate future revision of the definitions.
- (e) Section 141D should also be amended to require –

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<sup>8</sup> The current prohibition for a company owning and operating ships or aircraft in the carriage of cargo between Hong Kong and other places to apply section 141D was considered to be an anachronism.

- (i) the preparation of financial statements<sup>9</sup> to deal with the financial position and financial performance of the company; or
  - (ii) where at the end of its financial year the company was a holding company, the preparation of the consolidated financial statements to deal with the financial position and financial performance of the undertakings included in the consolidated financial statements as a whole so far as concerns members of the company.
- (f) All provisions in the Eleventh Schedule should be removed<sup>10</sup> except paragraph 5 concerning disclosure of outstanding loans.
- (g) The Eleventh Schedule should instead be used to contain corporate governance disclosure provisions including the following additional disclosure requirements :–
- (i) A holding company’s balance sheet<sup>11</sup> should be included as a note to the consolidated financial statements. The holding company’s balance sheet should be in the format that would have been presented if the holding company’s balance sheet, excluding the notes was to be presented to the members as if there was no obligation to present consolidated financial statements. The consolidated financial statements must also include a note disclosing the movement in the holding company’s reserves.
  - (ii) Where, at the end of its financial year, a company was the subsidiary of another undertaking, there should be stated in a note to the company’s annual financial statements :–
    - (1) the name of the undertaking regarded by the directors as being the company’s ultimate parent undertaking; and
    - (2) if known to them :–
      - 1. where the undertaking was a body corporate, the place in which it was incorporated; and
      - 2. where the undertaking was not a body corporate, the address of its principal place of business.
  - (iii) It should be stated in the annual financial statements whether

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<sup>9</sup> Currently, the term “financial statements” includes both the balance sheet (statement of financial position) and profit and loss account (financial performance statement).

<sup>10</sup> The JWG considered paragraphs 1, 2(d) and 6 of the Eleventh Schedule unnecessary and recommended that they be removed. As the other requirements in the Eleventh Schedule (save paragraph 5 on disclosure of outstanding loans made under the authority of section 47C(4)(b) and (c) of the CO) are already covered by the SME-FRS, the JWG recommended that all the provisions in the Eleventh Schedule should be removed save and except paragraph 5.

<sup>11</sup> The JWG proposed to change the term “balance sheet” to “statement of financial position”.



the annual financial statements had been prepared in accordance with applicable accounting standards and particulars of any material departure from those standards and the reasons for it should be given.

- (h) All private companies falling within section 141D should be required only to produce a simplified form of directors' report<sup>12</sup> and there should be an overriding provision within the proposed schedule on matters to be dealt with in the directors' report to disapply the disclosure requirements on assets value and donations to section 141D companies.

1.8 However, members could not reach a consensus on whether directors of section 141D companies should prepare financial statements or consolidated financial statements on a "properly prepared" basis as opposed to the "true and correct" basis currently in force<sup>13</sup>. They noted that the issue was currently being considered by the International Auditing and Assurance Standards Board ("IAASB") and agreed that the matter should be revisited after the public consultation<sup>14</sup>.

1.9 Subject to members' views on the concept of "properly prepared", members endorsed the JWG's recommendation that -

(a) Section 141D of the CO should be amended to require the directors of a section 141D company to make a directors' declaration that the financial statements or consolidated financial statement have been "properly prepared".

(b) The auditors' report of a section 141D company should –

- cover the financial statements, or where a company was a holding company which had prepared consolidated financial statements, the consolidated financial statements of the section 141D company; and

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<sup>12</sup> This recommendation was previously endorsed by the SCCLR at its 195th meeting held on 11 February 2006. For further details, see paragraph 6.4 of the 22nd Annual Report of the SCCLR for the year 2005/2006 (available at the website: <http://www.cr.gov.hk/en/standing/reports.htm>).

<sup>13</sup> Section 141D(1)(e) currently provides that, in reporting on a section 141D company, the auditors are required to state whether they have obtained all the information and explanations they require. They must also state whether, in their opinion, the balance sheet referred to in the report is properly drawn up to exhibit a true and correct view of the state of the company's affairs according to the best of the information and the explanations given to them, and as shown by the company's books of account. SCCLR members agreed that the use of the word "correct" was inappropriate as the amount of depreciation in the financial statements was just an estimate. Nevertheless, there was no agreement whether the substitute should be "properly prepared" or "true and fair". The latter concept is currently used in section 123(1) of the CO for non-141D companies.

<sup>14</sup> At the moment, the "true and fair view" concept is restricted only to a situation where the International Financial Reporting Standard (IFRS) have been fully complied with. Consequently, it is under the IFRS accounting framework, and that framework alone, that a "true and fair view" opinion can be given. The IAASB is currently developing the international financial reporting standards for SMEs and changes are likely to be made. The Administration will revisit the issue in the light of such developments.

- state whether, in the auditors' opinion, the financial statements or consolidated financial statements referred to in the report had been "properly prepared".

## CHAPTER 2

### **Proposals regarding the provisions of the Financial Documents and Summary Financial Reports by Companies from the Joint Government/ Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance**

#### **Background**

- 2.1 The JWG reviewed sections 141CA to 141CH of the CO<sup>15</sup> and the Companies (Summary Financial Reports of Listed Companies) Regulation (“the Regulation”) and made a number of proposals regarding the provision of financial documents and summary financial reports by companies.

#### **Recommendations**

- 2.2 At the 197th meeting on 29 May 2006, the SCCLR considered the JWG’s proposals.
- 2.3 As a result of discussion, members endorsed the following proposals :–
- (a) The summary financial report regime should be extended to all companies incorporated in Hong Kong save and except section 141D companies<sup>16</sup>.
  - (b) Every member of a company should have the right to elect not to receive any financial documents or a summary financial report from the company.
  - (c) The company should have the right to ascertain the wishes of its members at any time as to whether they wanted to receive a copy of the relevant financial documents, a summary financial report in hard copy or in electronic form, or not to receive anything.
  - (d) The company should not be allowed the option of sending to a member the financial documents only in electronic form or not to send him any financial documents at all if the member failed to make an election as proposed in (b) and (c) above.
  - (e) A member’s election as to the kind of financial documents and the manner in which those documents should be sent should remain in force until being revoked by the member.

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<sup>15</sup> Sections 141CA to 141CH concern summaries of financial reports of listed companies.

<sup>16</sup> See Chapter 1 above.

- (f) Paragraph 5(3)(b) of the Regulation (which provided that certain specified statements should be set out in the summary financial report if those statements were included in the auditors' report) should be amended on account of the JWG's proposed provision of the duties of auditors.
- (g) Paragraph 5(3)(c) of the Regulation should be amended to provide that a summary financial report must contain a statement from the company's auditors as to whether the auditors' report concerned was qualified or otherwise modified or included a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report, and (if the auditors' report was qualified or otherwise modified) to set out in full the auditors' report and any further material necessary for the understanding of the qualification or other modification.
- (h) Paragraph 5(3)(d) of the Regulation (which provided that a summary financial report must contain an opinion from the company's auditor as to whether the summary financial report was consistent with the relevant financial documents from which it was derived and whether it complied with the legal requirements) should be retained.
- (i) Paragraphs 5(3)(e) and (g) of the Regulation should be repealed<sup>17</sup>.
- (j) Paragraph 5(3)(f) of the Regulation (which provided that a summary financial report must include the particulars of all important events which occurred since the end of the financial year concerned and affected the company and (if applicable) the group of companies to which the company belonged) should be retained.
- (k) Paragraph 5(3)(j) of the Regulation (which provided that a summary financial report must contain in a prominent position a statement as to how an entitled person of the company might obtain a free copy of the company's relevant financial documents from which the report had been derived) should be retained.
- (l) Paragraph 5(3)(k) of the Regulation should be revised to take into account the JWG's proposals regarding the right of the entitled person to request copies of the financial documents.
- (m) Paragraph 5(3)(l) of the Regulation (which provided that a summary financial report must state the names of the directors who signed the report on behalf of the board) should be retained.

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<sup>17</sup> Under paragraph 5(3)(e) of the Regulation, a summary financial report must include a fair review of the development of the business of the company and its subsidiaries during the financial year concerned. Under paragraph 5(3)(g), the summary financial report must indicate the likely future developments of the business of the company.

- (n) The directors' declaration as previously recommended by the JWG should also be included in the summary financial report<sup>18</sup>.
- (o) Section 251(7) of the UK Companies Act 1985 ("CA 1985") should be adopted<sup>19</sup>.
- (p) The definition of the term "entitled person" as in section 251(7) of the CA 1985 should be adopted<sup>20</sup>.

2.4 Members also agreed with the following proposals made by the JWG but recommended that they be modified in certain respect as follows :-

- (a) A company should be given the choice of sending to its members a copy of the relevant financial documents or a summary financial report. Where the company had chosen to send to its members a copy of a summary financial report, the members should have the option to request the company to send them a copy of the relevant financial documents. If the members had been sent a copy of the relevant financial documents, they should no longer have the option to request the company to send them a copy of a summary financial report. However, if the company had also prepared a summary financial report, it could provide the members with the option to request a copy of the summary financial report. If the members had not been given a choice in the first place and made a selection on the language of reports to be provided, the documents had to be provided in both the English and the Chinese languages<sup>21</sup>.
- (b) Paragraph 5(3)(i) of the Regulation should be retained. The paragraph requires that a statement to the effect that the summary financial report gave only a summary of the information and particulars contained in the company's relevant financial documents and that an entitled person of the company might obtain a free copy of those relevant financial documents must be stated in a prominent position of the summary financial report. It was considered unnecessary to require the statement to be on the front cover of the report<sup>22</sup>.

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<sup>18</sup> The JWG has recommended that the directors by a company should prepare a directors' declaration besides the directors' report.

<sup>19</sup> The JWG has previously recommended the adoption of section 240 of the CA 1985, which provides for the requirements in connection with publication of financial statements. Section 251(7) of the CA 1985 provides that section 240 shall not apply in relation to the provision to entitled persons of a summary financial statement. As section 240 will be adopted, section 251(7) should also be adopted.

<sup>20</sup> The UK definition of "entitled person" is slightly different from the definition in section 129G(1) of the CO, in that, in the former, the term covers not only persons entitled to be sent copies of the documents mentioned in that section but persons who would be so entitled.

<sup>21</sup> The JWG's original recommendation made no reference to the dual language requirement.

<sup>22</sup> The JWG's original recommendation simply stated that paragraph 5(3)(i) of the Regulation should be retained provided that the provision would be simplified.

## CHAPTER 3

### The Rewrite of the Companies Ordinance

#### **Background**

- 3.1 At the 180th meeting on 20 June 2004, the SCCLR considered the draft Terms of Reference, Framework, Workplan and Structure and Timetable for the rewrite of the CO and proposed a number of amendments to them<sup>23</sup>. Subsequently, the revised Terms of Reference were endorsed at the 181st meeting of the SCCLR on 11 September 2004.
- 3.2 The Financial Affairs Panel of the Legislative Council (“LegCo”) was first briefed on the proposal to rewrite the CO on 5 July 2004. Subsequently, the Administration developed detailed proposals regarding the process and resources required to rewrite the CO, having regard to the previous proposals submitted to the SCCLR. The LegCo Financial Affairs Panel was further briefed on the latest proposals in July and November 2005 respectively. Subsequently, on 13 January 2006, the LegCo Finance Committee formally endorsed the proposals requesting additional resources to rewrite the CO.

#### **Recommendations**

- 3.3 At its 197th meeting on 29 May 2006, the SCCLR was briefed on the latest developments regarding the rewrite exercise and their views were sought on the proposed framework and workplan. Members of the SCCLR noted the following :—
- (a) For the purpose of Phase I of the rewrite exercise, the Companies Bill (“CB”) would tentatively be divided into 22 parts. Issues arising from these parts would be classified into three categories for analysis according to their complexity and the extent to which they had already been reviewed and reformed in the context of previous company law reform exercises<sup>24</sup>. The structure of the CB and the classification of issues involved would only be indicative in nature and, therefore, would be refined in the course of the rewrite, where appropriate.
  - (b) Those parts of the existing CO regarding prospectuses, and the winding-up and insolvency related provisions would be dealt with separately in the context of separate reviews by the Securities and Futures Commission (“SFC”) and Phase II of the rewrite exercise

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<sup>23</sup> See Chapter 3 of the SCCLR’s Twenty-first Annual Report for the year 2004/2005.

<sup>24</sup> The three categories of issues are referred to as Types I, II and III issues in the rewrite exercise. Type I issues are those which will require wider public consultation before the issue of the White bill because they are complex and controversial and were not covered in previous reviews, e.g. accounting and auditing provisions, introduction of a no par value share system and capital maintenance regime, and registration of charges. Type II issues are those which do not require wider consultation before the issue of the White Bill and consultation with the SCCLR would suffice. Type III issues are mainly those which have already been subject to extensive consultation or involve the re-stating of existing provisions.

respectively. Details including the workplan and timetable of the Phase II rewrite exercise would be prepared in due course.

- (c) Apart from the formation of a dedicated Companies Bill Team (“CBT”) comprising officers from the Financial Services Branch (“FSB”) of the Financial Services and the Treasury Bureau (“FSTB”) and the Companies Registry to co-ordinate, support and take forward the rewrite exercise, a Steering Committee on Companies Ordinance Rewrite (“SC”) and four Advisory Groups (“AGs”) would also be formed. The SC<sup>25</sup> would be chaired by the Permanent Secretary for Financial Services and the Treasury (Financial Services) to oversee the entire rewrite exercise and clear all major reform proposals. The AGs<sup>26</sup>, comprising nominees from relevant professional bodies, major Chambers of Commerce and universities, would provide advice on specific areas of the CO.
- (d) The CBT would also be supported by legal officers in the Department of Justice<sup>27</sup> and an external legal consultant<sup>28</sup>.
- (e) There would be a three-tier consultative structure involving the public, the SCCLR and the AGs depending on the complexity of the issues involved. Topical public consultations were planned for several more complex issues, such as the accounting and auditing provisions of the CO, in the first quarter of 2007 and early 2008.
- (f) A White Bill would be issued for public consultation, tentatively in mid-2009, prior to the introduction of the CB into the LegCo in the third quarter of 2010.

3.4 Members agreed generally with the above arrangements. They suggested that there should be an overall review by the SCCLR before the finalization of the White Bill. During the discussion, members also raised concern on the

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<sup>25</sup> Members of the SC include the Registrar of Companies, the Official Receiver, a Deputy Secretary for Financial Services and the Treasury (Financial Services), and senior officials from the Civil Division and Law Drafting Division of the Department of Justice.

<sup>26</sup> Four AGs have been set up to advise on the following issues :-

- (a) Advisory Group 1 (“AG1”) : Share capital, distribution of profits and assets and charges provisions
- (b) Advisory Group 2 (“AG2”) : Company formation, re-registration, registration, de-registration, restructuring, and company meeting and administration provisions
- (c) Advisory Group 3 (“AG3”) : Directors and officers related provisions
- (d) Advisory Group 4 (“AG4”) : Inspections, investigations and offences and punishment provisions

<sup>27</sup> Including legal officers from the Legal Policy and Prosecution Division, the Civil Division and the Law Drafting Division.

<sup>28</sup> The external legal consultant was appointed to advise and make recommendations on the reform of those parts of the CO which are complex and largely untouched in previous reviews. These include :-

- share capital and debentures under Part II of the CO
- the distribution of profit and assets under Part IIA of the CO
- charges under Part III of the CO

final arrangement of the winding-up and insolvency related provisions which would be dealt with in Phase II of the rewrite exercise. However, members were unable to reach a consensus as to whether those provisions should be hived-off into a separate Companies (Winding-up) Ordinance, or form part of an omnibus Insolvency Ordinance, or be incorporated into the new CO<sup>29</sup>.

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<sup>29</sup> The Administration will examine this issue further in the rewrite exercise.



## CHAPTER 4

### Types of Company and Definitions of Private and Public Companies

#### **Background**

4.1 In the context of reviewing the Consultancy Report of the Review of the Hong Kong CO, the SCCLR considered the question of the division between public and private companies in company law and the different types of company and recommended, in paragraph 5.78 of its report issued on February 2000 (“the 2000 Report”)<sup>30</sup>, that there should be four categories of companies as follows :-

- (1) Private : companies limited by shares and privately-held. There is no reason to change the existing definition.
- (2) Public : companies limited by shares and not privately-held. In principle, all existing provisions regulating listed companies should apply to public companies.
- (3) Guarantee : companies limited by guarantee. In principle, they should be treated in the same manner as public companies (with appropriate modifications).
- (4) Unlimited : there is no reason to make any change (i.e. retention of the category of companies with unlimited liabilities) .

4.2 The questions referred in paragraph 4.1 above had arisen again in the context of the CO rewrite. A paper was prepared, outlining the issues on what types of company should be allowed to be formed and incorporated under the new CO, how the terms “private company” and “public company” should be defined and whether all provisions in the new CO applicable to listed companies should apply to public companies.

#### **Recommendations**

4.3 The SCCLR considered the paper at the 198th meeting on 2 December 2006 and a follow-up paper on the same subject at the 199th meeting on 3 February 2007.

4.4 As a result of discussion, members made the following recommendations : –

#### **Guarantee companies**

- (a) There should be a separate category of companies limited by guarantee.

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<sup>30</sup> The Report of the SCCLR on the Recommendations of a Consultancy Report of the Review of the Hong Kong CO, February 2000. See also paragraphs 5.79 and Recommendations 32 to 36 and 40.

- (b) All guarantee companies should be required to file –
- annual reports; and
  - audited accounts
- with the Companies Registry.
- (c) Depending on certain size criteria to be formulated, guarantee companies should be subject to two different sets of accounting and disclosure requirements.
- (d) The Government would discuss with the HKICPA the appropriate size criteria and details of the accounting and disclosure requirements.

**Types of companies to be allowed**

- (e) The category of unlimited liability companies not having a share capital should be abolished<sup>31</sup>.

**Definitions of private and public companies**

- (f) No change should be made to the current way of defining private and non-private companies in the CO<sup>32</sup>. However, it should be clarified that a private company must be a company actually having a share capital. A restriction in the company's articles on the right to transfer its non-existent shares should not be regarded as sufficient.

**Listed and unlisted public companies**

- (g) There should not be an across-the-board application of the listed company provisions in the CO to unlisted public companies.

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<sup>31</sup> As at 30 November 2006, there was no unlimited liability company not having a share capital on the public register.

<sup>32</sup> A private company is defined in section 29 of the CO as a company which by its articles –

- restricts the right of members to transfer their shares;
- limits the number of its members to 50 (excluding employees); and
- prohibits any invitation to the public to subscribe to any shares or debentures of the company.

A company which does not have any of such restrictions in its articles is not a private company.

## CHAPTER 5

### Companies (Revision of Accounts and Reports) Regulation

#### **Background**

- 5.1 The Financial Reporting Council Ordinance (Cap 588) (“FRCO”), enacted by the LegCo on 13 July 2006, has added to the CO new sections 141E<sup>33</sup> and 336A<sup>34</sup> to empower directors of Hong Kong and non-Hong Kong companies to revise accounts and, consequentially, the relevant summary financial report and directors’ report. For this purpose, section 359A of the CO was amended under the FRCO to empower the Chief Executive in Council to make regulations providing for the applications of the CO in relation to the accounts, summary financial report and directors’ report revised under section 141E and 336A of the CO.
- 5.2 Prior to submission to the Chief Executive in Council for approval under section 359A of the CO, the Administration issued the Companies (Revision of Accounts and Reports) Regulation (“Revision Regulation”) in draft form to relevant stakeholders, including the SCCLR, for consultation<sup>35</sup>.
- 5.3 In essence, the Revision Regulation is aimed at regulating the application of the relevant requirements in the principal Ordinance of the CO to revised accounts, summary financial reports or directors’ reports, subject to necessary additions, exceptions and modifications.

#### **Recommendations**

- 5.4 The SCCLR considered the draft provisions of the Revision Regulation at the 198th meeting on 2 December 2006.
- 5.5 Members had no particular comments on the draft provisions but raised concern on whether the empowering provisions in the CO should go one step further to impose a duty of revising accounts and reports on directors, instead of allowing discretion for directors to do so. Members were concerned that the current arrangements under the CO and the Revision Regulation might

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<sup>33</sup> Section 141E of the CO provides for voluntary revision of accounts, summary financial reports or directors’ reports. The revision is to be confined to those aspects in which the accounts did not comply with the CO and other necessary consequential revisions. If the original accounts have been forwarded to the Registrar under section 109 of the CO, the company shall, as soon as practicable after a decision to revise the accounts is made, deliver a warning statement to the Registrar. It is an offence if a company fails to deliver such a warning statement.

<sup>34</sup> Section 336A of the CO provides for the voluntary revision of accounts in the case of an oversea company (or a non-Hong Kong company, when Schedule 2 to the Companies (Amendment) Ordinance 2004 which contains the amendments to the CO relating to non-Hong Kong companies comes into effect). Likewise, failure to deliver a warning statement to the Registrar shall constitute an offence.

<sup>35</sup> The Regulation came into operation on 20 April 2007, save Part 4 of the Regulation concerning non-Hong Kong companies. The commencement of Part 4 of the Regulation shall tie in with that of Schedule 2 of the Companies (Amendment) Ordinance 2004.

convey to directors a wrong message that they needed not make any correction even if they were aware of certain material deficiencies in the accounts. The Administration was invited to reconsider whether the law on revision of accounts should go beyond that of voluntary revision after the relevant provisions in the CO and the Revision Regulation had been in operation for a period of time and in the light of the experience gained.

- 5.6 A letter summarizing the views of the SCCLR was sent to the FSTB on 11 December 2006<sup>36</sup>.

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<sup>36</sup> According to the Feedback Statement issued by the FSTB to the SCCLR and other consultees on 16 February 2007, the “revision of accounts” regime under sections 141E and 336A of the CO might not be construed as giving directors the liberty to choose not to secure compliance of the accounts with the CO. Under section 123 of the CO, the directors of a company formed and registered under the CO commit an offence if they fail to take all reasonable steps to secure compliance of the accounts of the company with the CO (including section 123(1) which requires the accounts to give a true and fair view of the state of affairs of the company). In addition, as regards locally-incorporated listed companies which draw a greater public interest, the Financial Reporting Council is empowered under section 50 of the Financial Reporting Council Ordinance to apply to the Court of First Instance to secure removal of non-compliances in relation to the accounts of such companies. The Revised Regulation is intended to provide a statutory mechanism detailing procedures which directors shall follow in taking necessary remedial action regarding the original accounts, but nothing in the Regulation is to be construed as affecting any right, or any obligation or liability incurred, in relation to the original accounts (c.f. section 2(4) of the Regulation).

## CHAPTER 6

### Recommendations made by Advisory Group 2 for the Rewrite of the Companies Ordinance – Beneficial Owners’ Enjoyment of Members’ Rights

#### **Background**

- 6.1 As a part of the Rewrite of the CO, four AGs<sup>37</sup> comprising representatives from relevant professional bodies, business organizations, company law academics, SCCLR members and government representatives have been set up to advise on specific areas of the rewrite.
- 6.2 Advisory Group 2 (“AG2”) considered a paper entitled Beneficial Owners’ Enjoyment of Members’ Rights on 5 October 2006 and made the following recommendations : –
- (a) There was no need to amend the CO to facilitate the beneficial owners of listed companies, unlisted public companies and private companies to exercise members’ rights; and
  - (b) The FSTB and other relevant authorities should consider introducing changes to the Central Clearing and Automated Settlement System (“CCASS”) in the context of the proposal for a scripless securities market<sup>38</sup> to facilitate investors to hold securities as registered shareholders (i.e. legal owners).

#### **Recommendations**

- 6.3 At the 198th meeting on 2 December 2006, the SCCLR considered the recommendations made by AG2 as stated in paragraph 6.2 above.
- 6.4 Members agreed generally with the recommendations but expressed considerable concerns regarding the progress of the implementation of the proposal to move towards a scripless securities market. In the light of the above, the Chairman of the SCCLR wrote to the Financial Secretary on 5 February 2007 outlining the SCCLR’s concern on the matter.

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<sup>37</sup> See paragraph 3.3(c) and footnote [26] above.

<sup>38</sup> As part of the three-prong strategy announced in his Budget Speech in March 1999 for strengthening the competitiveness of Hong Kong’s securities and futures markets, the then Financial Secretary appointed Steering Committee on the Enhancement of Financial Infrastructure (“SCEFI”) to study and recommend the necessary improvements to the financial infrastructure in Hong Kong. On 9 December 2002, the SCEFI published a report proposing, inter alia, a move towards a scripless securities market for enhanced efficiency and legal certainty.

The three-prong strategy was –

- (1) The demutualization and merger of the clearing houses;
- (2) Enhancement of the financial infrastructure to improve risk management, increase efficiency, and reduce cost; and
- (3) Regulatory and legislative reform to improve the supervisory framework and protection of market participants.

- 6.5 In response, the FSTB has conveyed the SCCLR's comments to the Hong Kong Exchanges and Clearing Limited ("HKEx") and the SFC so that they could take account of them in developing a sound and viable model for a scripless securities market in Hong Kong.

## CHAPTER 7

### Recommendations Made by Advisory Group 3 for the Rewrite of the Companies Ordinance on Directors' Duties

#### **Background**

- 7.1 Advisory Group 3 (“AG3”)<sup>39</sup> was set up to advise on the rewrite of the Directors and Officers related provisions in the CO. It considered a paper entitled “Directors’ Duties” on 25 October 2006 and made the following recommendations : –
- (a) There was no compelling need to introduce a statutory statement of directors’ duties in Hong Kong. Nevertheless, the subject should be kept under review in the light of international developments, particularly in the UK.
  - (b) There was a need to review and, if necessary, expand and improve the wording of the principles in the Non-statutory Guidelines on Directors’ Duties in Hong Kong issued by the Companies Registry outside the context of the rewrite.
  - (c) There remained no need to introduce a statutory right for directors to rely on reports and advice from third parties.

#### **Recommendations**

- 7.2 At the 199th meeting on 3 February 2007, the SCCLR considered the recommendations made by AG3 as stated above.
- 7.3 Members did not, however, come to a consensus on whether directors’ duties should be codified in the context of the rewrite of the CO. Concerns were also raised on the scope of the codification and whether additional duties which directors did not have for the time being under the common law and equity should be added as in the CA 2006<sup>40</sup>.
- 7.4 Given the controversial nature of the issue regarding the codification of directors’ duties and possible implications, members agreed that the issue and whether the UK model should be adopted in Hong Kong should be put out for public consultation.

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<sup>39</sup> See paragraph 3.3(c) and footnote [26] above.

<sup>40</sup> The UK CA 2006 has introduced a statutory statement of directors’ duties. Among these duties is the duty to promote the success of the company for the benefit of its members as a whole (section 172). This duty is one of the most controversial issues of the CA 2006 because it includes the obligation to have regard to a list of factors including employees, the environment, the community, relationships with customers and suppliers and the desirability of maintaining a reputation for high standards of business conduct.

## CHAPTER 8

### **Recommendations Made by Advisory Group 2 for the Rewrite of the Companies Ordinance on Electronic Communications between Companies and Shareholders and Other Communication Related Matters**

#### **Background**

8.1 AG2<sup>41</sup> considered a paper entitled “Electronic Communications between Companies and Shareholders and Other Communication Related Matters” on 8 November 2006 and made the following recommendations : –

- (a) The general electronic communications provisions in the CO should be subject to a company’s articles and made the default rule, however they should not be made compulsory. If a shareholder did not agree with electronic communication, the company should then provide the relevant document or information to him in hard copy form free of charge.
- (b) The provisions in the paragraphs 6&7(1) in Part 3 of Schedule 4 to the CA 2006<sup>42</sup> on the conditions and address for electronic communications to/by a company should be adopted in Hong Kong subject to further research into (i) why the UK CB allowed a company to revoke its agreement to receive electronic communications; (ii) how a company might revoke that agreement; and (iii) whether there should be any protection against a revocation which was not notified<sup>43</sup>. There was no need to have an additional requirement for listed companies to obtain members’ authorization for electronic communications as provided in the CA.

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<sup>41</sup> See paragraphs 6.1 and 6.2 above.

<sup>42</sup> As the CA 2006 only received Royal Assent on 8 November 2006, the paper, prepared for AG2 in October 2006 only made reference to the UK Companies Bill amended in the House of Commons Standing Committee and printed on 20 July 2006. For ease of reference, this and the following references have been changed to the equivalent provisions in the CA 2006.

<sup>43</sup> At the AG2 meeting on 22 March 2007, the AG considered these outstanding issues. It recommended, among others, that:

- (a) In the case of a company revoking an e-communication agreement with its members or an outsider, at least a specified number of days’ notice in advance should be given to the other party or else the revocation would be regarded as invalid.
- (b) The minimum length of the revocation notice should be 7 days or such longer period as specified by a company’s articles.



- (c) There should be a general provision, drawing on the CB, setting out the conditions for website communications by a company (applicable to both listed and non-listed companies).
- (d)
  - (i) A member of a company should be given the right to demand the company to deliver free of charge a hard copy of a document or information even if it had already been provided to him by electronic means. This should cover all kinds of documents or information available to the members.
  - (ii) The shareholder should make a request for a hard copy of the document or information within 28 days from the date of receipt of that document or information provided by electronic means. The company should then provide the document or information in hard copy form within 21 days from the date of receipt of the request. However, if the document or information related to an event which required an action to be taken (e.g. general meeting), the company should provide the document or information in hard copy form at least 7 days prior to the event provided that the shareholder had made the request at least 14 days prior to the event.
  - (iii) Non-compliance with the requirement to send hard copies to shareholders upon request without reasonable excuse should be subject to a criminal sanction (the detailed provision should be referred to AG4 for further consideration).
- (e) The documents sent by electronic means to a company should be authenticated along the lines of the provisions in section 1146 of the CA 2006, subject to any further requirements to be specified by a company.
- (f)
  - (i) There should be a general rule on deemed delivery of a document sent by a company through electronic means or by means of a website along the lines of section 1147 of the CA 2006 subject to certain modifications. A document should be deemed to have been received by the intended recipient 48 hours after it was sent by a company by electronic means; or 48 hours after the document was first made available on the website or 48 hours after a notice of posting of such document is given to the intended recipient, whichever is the later.
  - (ii) The 48-hour deemed delivery rule should be subject to contrary provisions in a company's articles, provided that the deemed delivery period was more than 48 hours.

- (g) The CBT should conduct research on the rationale behind the proposal in the UK CB to draw a distinction between serving a document on a company and sending or supplying a document to a company<sup>44</sup>.
- (h) Part 2 of Schedule 5 to the CA 2006 which sets out how a document in hard copy form must be sent or supplied by a company should be adopted in the new CO.
- (i) There should be a general provision which provides that a document or information can be validly sent to or by a company by any other means or forms agreed by the recipient.
- (j) There was no need for any general provision in Hong Kong similar to paragraphs 88 and 89 of draft UK Model Articles for public companies concerning the duty of members to provide contact details and disentitling a member from receiving further communications from the company under certain circumstances as specified in that paragraph respectively; and
- (k) Paragraph 134 of Table A of the CO regarding the sending of notices to the representative/trustee of a deceased or bankrupt member should be made the default rule in the new CO.

### **Recommendations**

- 8.2 At the 199th meeting on 3 February 2007, the SCCLR considered the recommendations made by AG 2 stated above.
- 8.3 While all members agreed that electronic communications between a company and its shareholders should be encouraged, different views were expressed on whether to adopt a system rewarding the use of the electronic medium and recognising the costs and implications of paper production.
- 8.4 As members' views in respect of shareholders' right to receive hard copy were mixed, they agreed to revisit the issue after the relevant proposals had been put out for public consultation.

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<sup>44</sup> Under the CA 2006, a distinction has been drawn between serving a document on a company (sections 1139 to 1142) and sending or supplying a document to a company (sections 1143 to 1148 of and Schedule 4). At its meeting on 22 March 2007, AG 2 considered the outstanding issue and recommended that:

- (a) Apart from the general provisions under sections 356 and 338 of the CO on how a document should be served on a company, there should be a general rule in the CO similar to Part 2 of Schedule 4 of the CA 2006 – Company Communications provisions, setting out how a document in hard copy form (not specifically required to be served on the company) should be sent or supplied to a company.
- (b) There should be a general provision to the effect that a document or information sent or supplied in hard copy form to a company should be sufficiently authenticated if it was signed by the person who sent or supplied it.

## **CHAPTER 9**

### **Draft Consultation Paper on Proposals to Improve the Accounting and Auditing Provisions**

#### **Background**

- 9.1 The JWG's proposals to improve the accounting and auditing provisions of the CO had been submitted to and considered by the SCCLR on a number of occasions and finalized with the benefit of the SCCLR's views.
- 9.2 Based on the finalized proposals, the FSTB prepared a draft Consultation Paper which was circulated to the SCCLR members for comments on 15 December 2006. A revised draft Consultation Paper was prepared by FSTB, taking into consideration comments from the SCCLR.

#### **Recommendations**

- 9.3 At the 199th meeting on 3 February 2007, the SCCLR considered the revised draft Consultation Paper referred to in paragraph 9.2 above, together with suggestions received from some SCCLR members.
- 9.4 The principal proposals in the revised draft included the following : –
- (a) Providing for an accounting reference date, an accounting reference period and a financial year in accordance with the SCCLR's previous recommendations, in order to provide greater certainty to the periods for which accounts should be prepared.
  - (b) Relieving a holding company from the obligation to prepare its own accounts, provided that the company has included its own balance sheet as a note to its group accounts.
  - (c) Making the director's report a more forward-looking, analytical and informative document by requiring the inclusion of a business review covering, inter alia, the principal risks and uncertainties facing the company and the likely future developments in its business while allowing most private companies to prepare a simplified directors' report.
  - (d) Modernizing and streamlining the provisions on directors' remuneration, along the lines of the SCCLR's previous recommendations regarding the disclosure of individual director's remuneration packages, and the introduction of a directors' remuneration report.
  - (e) Making the provisions regarding summary financial reports more user-friendly in order to enable more companies and shareholders to take advantage of them, thereby saving operational costs.

- (f) Enhancing auditors' rights including, inter alia, their access to information, and providing them with qualified privileges for statements made in the course of their duties and in respect of their resignation while increasing auditors' responsibilities, such as requiring all outgoing auditors to provide a statement of the circumstances (if any) connected with his ceasing to hold office that he considers should be brought to the attention of the members or creditors of the company.
- (g) Relaxing the somewhat restrictive qualifying criteria set out in section 141D of the CO to enable more private companies (including those which are members of a group of companies) to take advantage of simplified reporting and disclosure requirements, such as simplified accounts and simplified directors' report. Small companies limited by guarantee that meet certain qualifying criteria should also be allowed to prepare simplified accounts and simplified directors' reports.
- (h) Reviewing the relative role of the accounting disclosure requirements in the CO, such as those in the Tenth Schedule and Eleventh Schedule, and the Hong Kong Financial Reporting Standards ("HKFRSs") (which are now fully converged with the International Financial Reporting Standards ("IFRSs")) and the SME-FRS issued by the HKICPA.

9.5 Members considered the revised draft Consultation Paper and individual Members' suggestions and endorsed the revised draft subject to the following : –

- (a) The saving to the proposal that extension by a company of its accounting reference date would be ineffective if it occurred within five years since the last extension<sup>45</sup> should be limited to extensions only for the purpose of aligning the accounting reference date with that of its holding company but not of its subsidiary company.
- (b) The conditions under which a holding company would not be required to prepare group accounts along the lines of the HKFRSs with respect to a particular financial year, should remain as follows :–
  - If the holding company was a wholly-owned subsidiary of another entity.
  - If the holding company was a partially-owned subsidiary of another entity and had the consent of its other members not presenting the group accounts.

The "consent" requirement under the second condition should not be changed to a "no objection" requirement.

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<sup>45</sup> The revised JWG's proposal is that each company may alter its accounting reference date through a directors' resolution subject to not extending the accounting reference period to more than 18 months. Such alteration however is ineffective if it occurs within five years since the last extension of the period, save for the purpose of aligning the accounting reference date with that of its holding company or subsidiary.

- (c) An indication of likely future developments in the business of the company should remain part of the business review requirements<sup>46</sup>.
- (d) The proposal that an auditor should be allowed to require a specified persons<sup>47</sup> to provide him with information, explanations or other assistance “as he thinks necessary” should remain and should not be changed to “which is reasonably required.”
- (e) The proposal that auditors should be required to state in the auditors’ report on any inconsistencies between the audited accounts and financial information contained in other parts of the annual report which contains the audited accounts, such as the directors’ report should remain<sup>48</sup>.
- (f) To provide a clearer picture on the issues relating to the application of the SME-FRF and the SME-FRS, further explanations should be included in the Consultation Paper on problems relating to the “true and correct” standard, the prohibition imposed by the IAASB on the use of the term “true and fair view”, the rationale for the JWG’s proposal, the government’s position as well as the work currently being undertaken by the IAASB in this respect.
- (g) As the proposed directors’ declaration regarding the accounts and solvency of a company is linked to the question of whether a liability should be imposed on directors for insolvent trading in Hong Kong, the SCCLR had no objection to the issue being subject to further study in Phase II of the rewrite, together with other insolvency-related issues.

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<sup>46</sup> The JWG’s proposal is to require companies (unless otherwise exempted) to prepare, as part of the directors’ report, a business review which is more analytical and forward-looking than the information currently required.

<sup>47</sup> Including officers or employees of the company; any person holding or accountable of any of the company’s books, accounts or vouchers; any subsidiary undertaking of the company, which is a body corporate in Hong Kong; any officer, employee or auditor of such undertaking; any person holding or accountable for any books, accounts or vouchers of such undertaking; plus any person failing within these categories at a time to which the information required by the auditor relates.

<sup>48</sup> There is a suggestion that, instead of requiring the auditors to state any inconsistencies between audited accounts and financial information contained in other parts of the annual report in the auditors’ report, auditors should only be enabled to do so.