



New Companies Ordinance in Hong Kong

How does the new CO affect
accountants in preparing
financial statements?



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Authors:
William Lim
Candy Fong
Cecilia Kwei

Foreword by Stephen Taylor

The new Companies Ordinance in Hong Kong (Cap. 622) became effective on 3 March 2014 and supersedes the old Companies Ordinance (Cap. 32) that has been in place for more than 5 decades.

The new Companies Ordinance in Hong Kong (new CO) is a comprehensive rewrite of the old Companies Ordinance (Cap. 32) that commenced in mid-2006 with the aim of modernising Hong Kong's company law and further enhancing Hong Kong's status as a major international business and financial centre.

Unlike the old CO, the new CO has been written in 'simple and plain English' so that its users (including directors, company secretaries and accountants) should have less difficulty in interpreting its requirements.

The new CO contains thousands of pages of requirements. Specifically, it contains 921 sections and 11 schedules that cover many different aspects including forms of companies, company formation and registration, share capital, preparation of financial statements and directors' report, audits etc.).

This publication is not intended to cover all aspects of the new CO. Instead, it aims to give a high-level illustration of areas of the new CO that may have accounting implications, for example:

- How the abolition of the par value of share under the new CO should be reflected in the financial statements and the related accounting implications.
- How the new CO streamlines the disclosures in annual financial statements.

This publication also includes a number of frequently asked questions relating to the preparation of financial statements.

While we focus on the accounting impact of the new CO in this publication, we would recommend companies to seek guidance from their legal advisers and company secretaries regarding how the new CO will affect them in other areas.

Finally, we hope that this publication will help you get a good appreciation of the changes introduced by the new CO (from accountants' perspective).

Stephen Taylor

*Partner, National Technical
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Table of Contents

1.	Introduction	1
2.	Summary of key areas of the new CO that may have accounting implications	2

Provisions that are immediately effective upon the commencement date of the new CO (i.e. 3 March 2014)

3.	Abolition of par value of shares and its accounting implications	3
4.	How to account for reduction of share capital, share redemption or share buy-back under the no-par regime	18
5.	Distribution of profits and assets to members of a company	21
6.	Arrangements, amalgamation, and compulsory share acquisition in takeover and share buy-back	22

Provisions that are effective for annual periods that begin on or after 3 March 2014

7.	Preparation of financial statements and directors' reports	29
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The following references are used throughout this publication:

HKICPA	Hong Kong Institute of Certified Public Accountants
IASB	International Accounting Standards Board
HKFRS(s)	Hong Kong Financial Reporting Standard(s)
IFRS(s)	International Financial Reporting Standard(s)
SME-FRF & SME-FRS	Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard

1. Introduction

The requirements of the new Companies Ordinance in Hong Kong (new CO), which primarily affect companies incorporated in Hong Kong, are immediately effective upon its commencement date 3 March 2014, except for most of the sections set out in Part 9 of the new CO relating to the preparation of accounts by companies, together with a few other provisions, which will come into effect in the first annual period beginning on or after 3 March 2014 (see s 358 of the new CO).



The new CO which contains thousands of pages of requirements includes 21 parts and more than 900 sections. This publication focuses on areas of the new CO which may have accounting implications, for example:

- How the abolition of par value of share capital should be reflected in a company's financial statements;
- How the abolition of par value would affect share capital transactions (e.g. bonus issue and issue of new shares); and
- A number of issues relating to preparation of financial statements and directors' reports.

This publication is intended to provide a high level illustration of certain areas of the new CO that may have accounting implications. It does not address the requirements, tests, qualifications or other limitations imposed by the new CO on these or other matters. Accordingly, companies are reminded to seek guidance from their legal advisers and company secretaries regarding how the new CO will affect them.

For companies listed in Hong Kong, they should also refer to Frequently Asked Questions Series 26 ('SEHK FAQ 26') issued by the Hong Kong Stock Exchange on 21 February 2014 relating to the new CO and its impact on listed entities. SEHK FAQ 26 can be downloaded at http://www.hkex.com.hk/eng/rulesreg/listrules/latestrelease/latest_release.htm.

All references to parts, sections, or schedules below refer to the new CO unless otherwise stated. The new CO can be downloaded at http://www.cr.gov.hk/en/companies_ordinance/.

Furthermore, all references to HKFRS apply equally to IFRS, unless otherwise specified. And all companies in the illustrate examples in this publication are Hong Kong incorporated companies.

2. Summary of key areas of the new CO that may have accounting implications

The table below lists certain parts of the new CO that may have accounting implications:

Relevant Part of the new CO	Particulars addressed in this publication	Section in this publication
Part 4 Share Capital	<ul style="list-style-type: none"> How the abolition of par value of shares should be reflected in a company's financial statements How to deal with merger relief under the no-par regime How to deal with group reconstruction relief under the no-par regime 	Section 3
Part 5 Transactions in relation to Share Capital	<ul style="list-style-type: none"> How to account for reduction of share capital under the no-par regime How to account for share redemptions and share buy-backs under the no-par regime 	Section 4
Part 6 Distribution of Profits and Assets	<ul style="list-style-type: none"> How to determine realised profits for distribution purposes 	Section 5
Part 13 Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back	<ul style="list-style-type: none"> Court-free amalgamations¹ and the accounting implications 	Section 6
Part 9 Accounts and audits	<ul style="list-style-type: none"> Whether or not a company can prepare financial statements in accordance with accounting standards other than HKFRSs When a company is required to prepare consolidated financial statements How the new CO streamlines the disclosure requirements in financial statements How the new CO relaxes criteria to allow more SMEs to qualify for simplified reporting New requirement in a directors' report - business review Extended scope for disclosures of directors' names in a directors' report 	Section 7

¹ In terms of the old CO, companies must obtain court sanction in order to effect an amalgamation (ss 166-167 of old CO). However, these provisions involved complex procedures and high compliance costs. To address this issue, the new CO introduced amalgamation procedures for wholly-owned companies within the same group, without the involvement of courts. The requirements for this type of court-free amalgamation are set out in sections 678-686 of the new CO. Please refer to section 6 of this publication for more details.

3. Abolition of par value of shares and its accounting implications

3.1 Share capital

One significant change in the new CO is that the new CO has abolished the concept of 'par value' of shares for all Hong Kong incorporated companies (s 135). The no-par regime is immediately effective upon the commencement date of the new CO (i.e. 3 March 2014).

As a result of the abolition of the par value, related concepts such as share premium, capital redemption reserve and the requirement for authorised share capital have become redundant and have been abolished simultaneously.

The abolition of par value is in line with the international trend to provide companies with greater flexibility in structuring their share capital, as it has been generally accepted that par value of shares no longer serves its original purpose of protecting creditors and shareholders, and in many instances it may even be misleading because the par value often does not indicate the real value of a company's shares.

The no par requirement under the new CO is applicable to all shares, including all shares issued before the commencement date of the new CO (i.e. before 3 March 2014). And the new requirement is immediately effective upon the commencement date of the new CO regardless of when the accounting period of a company starts. The following are illustrations:

Year-end date	When should the no-par regime be reflected in the financial statements?
31 December	Year ending 31 December 2014
31 March	Year ending 31 March 2014
30 June	Year ending 30 June 2014

In the first year in which the new CO comes into effect (e.g. year ending 31 December 2014 for a December year end entity), the existing share premium and capital redemption reserve as of 3 March 2014 (i.e. the commencement date of the new CO) would become part of the company's share capital (Schedule 11.37(1)). Comparative figures in the financial statements are not restated.

Full proceeds of any share issue after 3 March 2014 will be credited directly to the company's share capital, rather than being allocated between share capital and share premium (s 170(2)(a)). With the abolition of par value, there will no longer be a minimum price at which shares can be issued.

Division 2 of Schedule 11 contains detailed transitional provisions relating to the abolition of par value so that existing companies do not need to take steps to change their existing share capital and constitutional documents to reflect the no-par regime. The transitional provisions also cater for contractual provisions that refer to par value to ensure that they will not be affected by the abolition of par value. With the specific transitional provisions for the no-par regime, a company does not need to pass any resolution or carry out other company secretarial procedures to convert its par value shares into no par value shares.

Notwithstanding these changes, the concepts of issued capital, paid up capital and partly paid shares continue to remain relevant. However, under the new CO, ‘fully paid’ means that the full consideration (issue price) for the shares have been paid (not that the shareholder has paid the full *nominal value* of those shares). By the same token, ‘partly paid’ mean that the full issue price has not been paid.

Notwithstanding the transitional arrangements contained in Schedule 11, companies should assess their particular circumstances to determine whether they should make changes to their company documents (such as the articles of association, contracts and share certificates) to reflect the abolition of the par value regime. Also, while the transitional arrangements provide some legal safeguards in respect of contracts that refer to par value and related concepts under Hong Kong laws, they may not necessarily be applied by courts outside Hong Kong, particularly if the governing laws of the relevant contract are not Hong Kong laws. Such contracts may need to be reviewed to determine whether clarifying amendments should be requested.

We reiterate here, that companies are reminded to seek appropriate legal advice promptly on the impact that the new CO may have on them.

Below is a list of examples that illustrates the application of the no-par value regime to commonly-encountered share capital situations or transactions.

- Example 3.1.1 – How to move from par value regime to no-par value regime
- Example 3.1.2 – Share consolidation /share split/issue of new shares for consideration
- Example 3.1.3 - Bonus share issue/ capitalisation of profits

Example 3.1.1 – How to move to par value regime to no-par value regime

H Limited is a company incorporated in Hong Kong under the old CO. Since its incorporation, H Limited has had various share issues and repurchases which had resulted in share premium and capital redemption reserve, as well as an outstanding number of shares of 50m of nominal value of HK\$1 each at 1 January 2013. Share issues and share repurchases that took place prior to 1 January 2013 gave rise to share premium and capital redemption reserve amounting to HK\$10 million each. There was no change in the number of shares in H Limited nor were there any other transactions with H Limited's share capital during 2013 or 2014. Assume that H Limited earned profits (and total comprehensive income) of HK\$20m during each of 2013 and 2014.

The tables below illustrate extracts of H Limited's statement of financial position as at 31 December 2014, as well as the statement of changes in equity and the share capital note for the year then ended, together with the comparative figures. The comparative figures are not adjusted as the new CO only came into effect since 3 March 2014.

Statement of financial position (extract only)	2014		2013	
Capital and reserves	HK\$m		HK\$m	
Share capital	70		50	
Reserves	720		720	
Total equity	790		770	

Statement of changes in equity (HK\$m) (extract only)	Share capital	Share premium	Capital redemption reserve	Retained earnings	Total
At 1 January 2013	50	10	10	680	750
Profit and total comprehensive income	-	-	-	20	20
At 31 December 2013 and 1 January 2014	50	10	10	700	770
Profit and total comprehensive income	-	-	-	20	20
Transfer upon abolition of par value under the new Hong Kong Companies Ordinance (<i>Note</i>)	20	(10)	(10)	-	-
At 31 December 2014	70	-	-	720	790

31. Share capital

	Number of shares (m)	HK\$m
Authorised		
At 1 January 2013, 31 December 2013 and 1 January 2014		
- Ordinary shares of HK\$1 each	100	100
At 31 December 2014	N/A (<i>Note</i>) ²	
Issued and fully paid		
At 1 January 2013, 31 December 2013 and 1 January 2014		
- Ordinary shares of HK\$1 each	50	50
Transfer from share premium and capital redemption reserve upon abolition of par value	-	20
At 31 December 2014		
- Ordinary shares with no par value	50	70

Note: The Company has no authorised share capital and its shares have no par value from the commencement date of the new Hong Kong Companies Ordinance (i.e. 3 March 2014).

For companies that disclose earnings per share (EPS) information in accordance with HKAS 33 Earnings per Share, since the denominator is calculated by reference to the number of shares and not to the dollar value of the share capital, the abolition of par value in itself will have no impact on the EPS or diluted EPS information.

² The new CO has abolished the concept of 'authorised share capital'. However, the new CO still allows companies to include a maximum number of shares to be issued in its articles of association (s 85(2)). If a company chooses to have a maximum number of shares to be included in its articles of association, it should include details of the maximum number of shares in the share capital note.

Example 3.1.2 – Share consolidation/share split/issue of new shares for consideration

(Continuation of Example 3.1.1)

Assume, in 2015, H Limited undertakes the following transactions with its share capital:

1. February: 10 into 1 share consolidation;
2. May: fresh issue of 10m shares to new subscribers at HK\$17 each; share issue expense of HK\$5m was incurred;
3. September: 5 for 3 share split.

Below illustrates how the above transactions will be reflected in the share capital note (extract only).

31. Share capital (extract only)

	Notes	Number of shares (m)	HK\$m
Issued and fully paid			
At 1 January 2014			
- Ordinary shares of HK\$1 each		50	50
Transfer from share premium and capital redemption reserve upon abolition of par value under the new Hong Kong Companies Ordinance effective on 3 March 2014		-	20
At 31 December 2014 and 1 January 2015			
Ordinary shares with no par value		50	70
Share consolidation	1	(45)	-
Issue of new shares for cash	2	10	170
Share issue expense		-	(5)
Share split	3	10	-
At 31 December 2015			
Ordinary shares with no par value		25	235

Notes:

- 1) Every 10 shares are consolidated into 1 share ($50/10 = 5$; $50-5 = 45$). No change in the aggregate dollar value of share capital.
- 2) The entire consideration received is credited directly to share capital. Share issue expense is charged against share capital in accordance with section 149(c).
- 3) Every 3 shares are split into 5 shares ($15/3 \times 5 = 25$; $25-15 = 10$). No change in the aggregate dollar value of share capital.

Example 3.1.3 – Bonus share issue/ capitalisation of profits

A company can still issue bonus shares under the no-par value regime (s 170(2)(d)). When the company issues bonus shares, it can decide whether or not to capitalise its profits at the same time (s 170(2)(c)).

As the shares no longer have a par value, upon a bonus issue there is no need to transfer the par value of the shares issued from reserves to share capital. The amount capitalised is at the discretion of the company. The amount capitalised does not depend on the number of shares issued as bonus shares.

(Continuation of Example 3.1.1)

Assume, in 2015, H Limited decides to conduct a 1 for 5 bonus issue, in other words, to increase the number of shares from 50m to 60m. Assume H Limited earns HK\$20m profit (and total comprehensive income) in 2015. As mentioned above, H Limited can decide whether or not to capitalise its profits when it issues bonus shares. The tables below illustrate the impact on share capital and other reserves assuming:

- A) H Limited decides to capitalise HK\$10m of the company's reserves (e.g. retained earnings)
- B) H Limited decides not to capitalise any reserves.

A) Bonus issue of shares with capitalisation of HK\$10m of reserves

Statement of changes in equity (HK\$m) (extract only)	Share capital	Retained earnings	Total
At 1 January 2015	70	720	790
Profit and total comprehensive income	-	20	20
Capitalisation of profits	10	(10)	-
At 31 December 2015	80	730	810

31. Share capital (extract only)

	Number of shares (m)	HK\$m
Issued and fully paid		
At 1 January 2015	50	70
Bonus issue of shares	10	-
Capitalisation of profits	-	10
At 31 December 2015	60	80

B) Bonus issue of shares without capitalisation of reserves

Statement of changes in equity (HK\$m) (extract only)	Share capital	Retained earnings	Total
At 1 January 2015	70	720	790
Profit and total comprehensive income	-	20	20
At 31 December 2015	70	740	810

31. Share capital (extract only)

	Number of shares (m)	HK\$m
Issued and fully paid		
At 1 January 2015	50	70
Bonus issue of shares	10	-
At 31 December 2015	60	70

As can be seen in examples 3.1.3A and 3.1.3B, regardless of whether there is a simultaneous capitalisation of reserves at the time of the bonus issue, the number of shares after the bonus issue is 60m.

C) Capitalisation of profits without bonus issue of shares

Statement of changes in equity (HK\$m) (extract only)	Share capital	Retained earnings	Total
At 1 January 2015	70	720	790
Profit and total comprehensive income	-	20	20
Capitalisation of profits	10	(10)	-
At 31 December 2015	80	730	810

31. Share capital (extract only)

	Number of shares (m)	HK\$m
Issued and fully paid		
At 1 January 2015	50	70
Capitalisation of profits	-	10
At 31 December 2015	50	80

3.2 *Merger relief*

Merger relief refers to the exemption granted by the old and new CO from recording in share capital, the full value of the shares issued by a company (parent) in a situation in which at least 90% of the shares of another company (investee) are acquired (s 196). Merger relief is important because it may affect the amount of distributable reserve at the parent's level (see example 3.2.1 below for details). It should be noted, however, that application of the ***merger relief is an election*** and not a requirement of the old or new CO. If a company decides not to take the merger relief at the date when the relevant transaction takes place, it cannot retrospectively apply the merger relief to that transaction.

If a company elects to apply the merger relief, the minimum amount of consideration that it must record as share capital in respect of the shares issued is the subscribed capital of the acquired company attributable to the shares acquired (s 196(2)). The value of the shares acquired (i.e. the 'investment in investee' asset recorded on the company's statement of financial position), however, has to be measured and recognised in accordance with the applicable HKFRS, for example, HKAS 27 *Separate Financial Statements*. Any excess of the amount at which the shares acquired are initially recognised in accordance with the applicable HKFRS, over the amount credited to share capital, should be recognised in the company's reserve, which is commonly known as the merger reserve.

The merger reserve is in law a profit and is initially treated as unrealised but becomes realised upon disposal or scrapping of the related asset (i.e. the shares in the investee), impairment, depreciation or amortisation of the asset, or distribution of the related asset in specie (AB 4.2.11, 3.9(f)).

The principles underpinning the merger relief have been brought forward unchanged from the old CO, and the example below illustrates their application to no par value shares. Specifically, the example illustrates the impact on the parent company's separate statement of financial position of applying and not applying merger relief.

Example 3.2.1

The diagrams and table below illustrate the shareholding in H Ltd and S Ltd at 30 November 2014, as well as the companies' respective statement of financial position at that date. Both companies have a December year end.

Mr H

100%

H Ltd

Mr S

100%

S Ltd

	H Ltd	S Ltd
	HK\$'000s	HK\$'000s
Net assets	200	100
Share capital	150	70
Retained earnings	50	30
Total equity	200	100

Mr H and Mr S are unrelated to each other. On 1 December 2014, H Ltd issues 40,000 of its own shares to Mr S for 100% of his shares in S Ltd. The fair value of H Ltd's 40,000 shares issued is assumed to be HK\$125,000. S Ltd meets the definition of a business and H Ltd acquires control over S Ltd as a result of the transaction.

The diagram and table below illustrate the group structure and H Ltd's separate statement of financial position after the transaction.

Mr H and Mr S

100%

H Ltd

100%

S Ltd

	Notes	Without merger relief HK\$'000s	With merger relief HK\$'000s
Net assets		200	200
Investment in S Ltd	1	125	125
		325	325
Share capital	2	275	220
Merger reserve	2	-	55
Retained earnings		50	50
Total equity		325	325

Notes:

1. The investment in S Ltd is recorded at cost in terms of HKAS 27.10, being the fair value of H Ltd's 40,000 shares issued.

2. The merger relief is optional: on the date of the acquisition of S Ltd, H Ltd can elect to take advantage of the merger relief. However, if H Ltd decides not to take the merger relief on acquisition date, H Ltd cannot retrospectively apply the merger relief to this transaction on a later date.
- Without the merger relief, H Ltd would have to credit the full cost of the investment to share capital: $150k + 125k = 275k$.
 - With the merger relief, the increase in H Ltd's share capital is limited to the amount of S Ltd's subscribed capital acquired, which is $100\% * \$70k = 70k$. The balance of the consideration is recorded in merger reserve, which is outside of H Ltd's share capital.
3. The merger reserve will remain in the Group on consolidation.

The journal entry upon application of the merger relief is as follows (HK\$ '000s):

Dr Investment in S Ltd	125	
Cr Share capital		70
Cr Merger reserve		55

How taking the merger relief avoids a dividend trap

Assume that S Ltd declares all of its retained earnings as dividend on 1 December 2014 immediately after the share swap transaction. Further assume that the HK\$30,000 retained earnings of S Ltd were accumulated over many years (i.e. not in 2014 alone).

Analysis:

In this case, in the separate financial statements of H Ltd, it would recognise dividend income from S Ltd regardless of the fact that the entire amount is a pre-acquisition dividend (HKAS 27.12), and it will need to assess its investment in S Ltd for impairment in accordance with HKAS 36.12(h) as the following indicators of impairment loss exist:

- The carrying amount of the investment in S Ltd (HK\$125k) exceeds S Ltd's net assets in H Ltd's consolidated financial statements (100k – 30k (dividend) + 25k goodwill assumed to be associated with S Ltd = 105k)³; and
- The HK\$30k dividend exceeds the total comprehensive income of S Ltd in 2014.

Assume that H Ltd concludes that its investment in S Ltd is impaired by HK\$30k as a result of the distribution. H Ltd records the dividend income and impairment loss separately in its separate financial statements.

Statement of financial position of H Ltd (extract only)

	Note	Without merger relief		With merger relief	
		Before distribution HK\$'000s	After distribution HK\$'000s	Before distribution HK\$'000s	After distribution HK\$'000s
Other net assets		200	230	200	230
Investment in S Ltd		125	95	125	95
		325	325	325	325
Share capital		275	275	220	220
Merger reserve	1	-	-	55	25
Retained earnings	1	50	50	50	80
Total equity		325	325	325	325

³ HKAS 36.12(h) requires that, when an investor receives dividend income from its subsidiary, joint venture or associate, the investor should assess impairment if a) the carrying amount of the respective investment in the separate financial statements of the investor exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill, or b) the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared. Goodwill of HK\$ 25,000 is calculated based on the excess of the fair value of the shares issued (HK\$ 125,000) less the carrying amounts of the net assets of S Limited at the date of the acquisition which are assumed to be equal to the fair value of the net assets of S Limited at the date of the acquisition.

Note 1:

Without merger relief	With merger relief
<p>Since the dividend received from S Ltd is effectively offset by the impairment of the investment in S Ltd, the dividend is trapped at H Ltd’s level and cannot be distributed. This is an example of the ‘dividend trap’.</p> <p>One way for H Ltd to pass on the dividend received to its shareholders would be through a formal share capital reduction process (please see below for details).</p>	<p>Similar to the situation without the merger relief, H Ltd would record the dividend received and the subsequent impairment of the investment.</p> <p>However, a key distinction with the merger relief is that AB 4.3.9(f)(iv) deems an impairment of the asset which gave rise to the merger relief to be a realisation of the merger reserve to the extent of the impairment. Accordingly, HK\$30k of the merger reserve is considered to be realised upon impairment of the investment in S Ltd, and H Ltd may transfer it to retained earnings to increase distributable reserves back up to HK\$80k. In other words, the transfer from the merger reserve effectively offsets the impairment loss, and the dividend received from S Ltd is ‘free’ to be distributed to H Ltd’s shareholders.</p>
<p>The journal entries recorded by H Ltd in its separate financial statements upon the receipt of dividend, impairment and transfer of merger reserve (where merger relief is elected) are as follows:</p>	
Dr Cash	30
Cr Dividend income	30
Dr Impairment loss	30
Cr Investment in S Ltd	30
Dr Merger reserve	30
Cr Retained earnings	30

3.3 Group reconstruction relief

As its name suggests, the group reconstruction relief can only be applied in a group scenario where a wholly-owned subsidiary ('S Ltd') issues its own shares to the holding company ('H Ltd') or another wholly-owned subsidiary of H Ltd for the transfer of non-cash assets from these companies (s 195(1)). The relief refers to the exemption granted to S Ltd from recording in its share capital, the full value of the shares issued by S Ltd in return for the transferred assets (s 195(2)).

Similar to merger relief, it is not a must for a company to apply the group reconstruction relief. If a company elects to do so, the minimum amount of consideration that it must record as share capital in respect of the shares issued is the *net base value* of the assets transferred (s 195(2)).⁴ The value of the non-cash asset acquired, however, has to be measured and recognised in accordance with the applicable HKFRS (see example 5 for details). Any excess of the amount at which the non-cash asset acquired is initially recognised in accordance with the applicable HKFRS, over the amount credited to share capital, should be recognised in the company's reserves. For ease of reference, this reserve has been termed the 'group reconstruction reserve' in this publication; however, the company may recognise the difference in other capital reserves. Regardless of the name of the reserve, the company should disclose the nature and purpose of such a reserve (HKAS 1.79(b)).

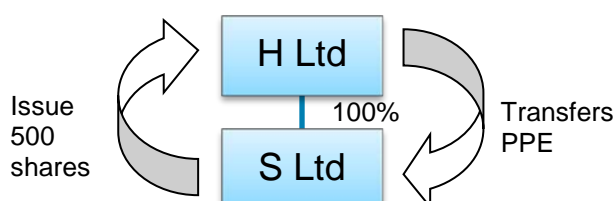
Similar to the merger relief, the application of the group reconstruction relief helps avoid a dividend trap. The related reserve is in law a profit and is initially treated as unrealised but becomes realised upon disposal or scrapping of the related asset (i.e. the transferred asset), impairment, depreciation or amortisation of the asset, or distribution of the related asset in specie (AB 4.2.11, 3.9(f)).

The principles underpinning the group reconstruction relief have been brought forward unchanged from the old CO, and the example below illustrates their application under the no-par regime.

⁴ The 'net base value' of the assets transferred is the excess of the base value of the assets transferred over the base value of the liabilities transferred (s 195(3)). The 'base value' of an asset is explained in example 3.3.1 and a similar concept applies to the 'base value' of a liability.

Example 3.3.1

S Ltd is a wholly-owned subsidiary of H Ltd. On 31 December 2014, H Ltd transfers a manufacturing plant to S Ltd in return for a fresh issue of 500 shares by S Ltd. H Ltd measures the manufacturing plant under the cost model and on the date of transfer, the plant has a carrying amount of HK\$100k and a fair value of HK\$500k. The original cost of the plant is HK\$400k.



Statement of financial position of S Ltd

	Notes	Before	After without group reconstruction relief	After with group reconstruction relief
		HK\$'000s	HK\$'000s	HK\$'000s
Other net assets		200	200	200
Manufacturing plant	1	-	500	500
		200	700	700
Share capital	2	50	550	150
Group reconstruction reserve	2	-	-	400
Retained earnings		150	150	150
Total equity		200	700	700

Notes:

- It is assumed that S Ltd recognises the manufacturing plant at its cost, which is determined by reference to the fair value of the manufacturing plant acquired on the date of transfer, in accordance with HKAS 16.15. Cost is generally the fair value of the consideration given up (500 of S Ltd's shares in this case) but assuming that the fair value of S Ltd's shares cannot be reliably measured in this instance, reference should be made to the fair value of the asset received (HKAS 16.26). Recognising the plant at its fair value on initial recognition is also supported by HKFRS 2.10, in terms of which the increase in equity is measured directly at the fair value of the goods received in an equity-settled share-based payment transaction.

Alternatively, as the manufacturing plant is controlled by the same ultimate controlling party (H Ltd) before and after the transaction, this is a transaction between entities under common control and applying the principles of merger accounting commonly adopted for common control combinations, it would be appropriate for S Ltd to recognise the manufacturing plant at the carrying amount reflected in H Ltd's financial statements. If S Ltd elects to record the plant at its carrying amount of HK\$100k on the date of transfer, the group reconstruction relief would not be applicable as both the asset and share capital would be recorded at the same value (see note 2 below for details).

2. The group reconstruction relief is optional: on the date of acquisition of the manufacturing plant, S Ltd can elect to take advantage of the group reconstruction relief. However, if S Ltd decides not to take the group reconstruction relief on acquisition date, it cannot retrospectively apply the group reconstruction relief to this transaction on a later date.
 - Without the group reconstruction relief, S Ltd would have to credit the full value of the manufacturing plant to share capital: $50k + 500k = 550k$.
 - With the group reconstruction relief, the minimum amount of consideration required to be recorded as share capital by S Ltd is the base value of the asset transferred. The base value of an asset is the lesser of:
 - (i) the cost of those assets to the transferor company (i.e. the cost to H Ltd of HK\$400k);
 - (ii) the amount at which those assets are stated in the transferor company's accounting records immediately before the transfer (i.e. HK\$100k).

Accordingly, the increase in S Ltd's share capital is limited to the carrying amount of the manufacturing plant to H Ltd which is HK\$100k. The balance of the cost of the PPE is recorded in group reconstruction reserve, outside of S Ltd's share capital.

3. The group reconstruction reserve will be eliminated on consolidation against H Ltd's additional cost of investment in S Ltd of HK\$500k.

The journal entry in S Ltd's records to record this transaction is as follows:

Dr Manufacturing plant	500k	
Cr Share capital		100k
Cr Group reconstruction reserve		400k

Similar to the merger reserve, the group reconstruction reserve becomes realised upon disposal or scrapping of the related asset, impairment, depreciation or amortisation of the asset, or distribution of the related asset in specie (AB 4.3.9(f)). By recording the excess of the fair value of the asset acquired over its cost in a reserve outside of S Ltd's statutory measure of share capital can help avoid a dividend trap, which is illustrated below.

Assume that S Ltd subsequently sells the manufacturing plant at HK\$500k to a third party on 1 February 2015. The effect on reserves with and without application of the group reconstruction relief is as follows:

Statement of financial position of S Ltd (extract only)	Note	Without group reconstruction relief		With group reconstruction relief	
		Before sale HK\$'000s	After sale HK\$'000s	Before sale HK\$'000s	After sale HK\$'000s
Other net assets		200	700	200	700
Manufacturing plant		500	-	500	-
		700	700	700	700
Share capital		550	550	150	150
Group reconstruction reserve	1	-	-	400	-
Retained earnings	1	150	150	150	550
Total equity		700	700	700	700

Note 1:

Without group reconstruction relief	With group reconstruction relief
<p>Since S Ltd recognised the manufacturing plant initially at its fair value, no profit is recorded on the sale of the PPE. The increase in the PPE's value is effectively capitalised in the share capital of S Ltd, and this increase in value is trapped in S Ltd's level and cannot be distributed. This is an example of the 'dividend trap'.</p> <p>One way for S Ltd to pass on the gain realised through disposal of the PPE to its shareholders would be through a formal share capital reduction process (please see below for details).</p>	<p>As AB 4.3.9(f)(iv) considers a disposal of the asset which gave rise to the group reconstruction relief to be a realisation of the said reserve, HK\$400k of the group reconstruction reserve is considered realised upon the sale of the manufacturing plant and S Ltd may transfer it to retained earnings to increase distributable reserves by HK\$400k effective 'gain on disposal'. This amount is 'free' to be distributed to S Ltd's shareholders.</p>

The journal entries recorded by S Ltd upon the sale of the manufacturing plant and transfer of group reconstruction reserve (where group reconstruction relief is elected) are as follows:

Dr Bank	500k	
Cr Manufacturing plant		500k
Dr Group reconstruction reserve	400k	
Cr Retained earnings		400k

4. How to account for reduction of share capital, share redemption or share buy-back under the no-par regime

4.1 Reduction of share capital

The reduction of share capital section in the new CO applies to a) companies limited by shares and b) companies limited by guarantee having a share capital formed under the old CO (s 209).

Under section 211 of the new CO, a company may reduce its share capital, subject to a) the reduction of share capital would not result in no members holding shares of the company (other than redeemable shares) and b) restrictions set out in the company's articles (s 210):

- a) by a special resolution supported by a solvency statement (court-free reduction of share capital); or
- b) by a special resolution confirmed by the Court.

The solvency statement referred to point (a) above must contain the following features (s 216):

- All directors of the company must make a solvency statement in relation to the reduction of share capital (ss 204 – 208).
- The special resolution for reduction of share capital must be passed within 15 days after the date of the solvency statement.
- If the special resolution is proposed as a written resolution, a copy of the solvency statement must be sent to every member of the company at or before the time when the proposed resolution is sent to them.
- If the special resolution is proposed at a meeting, a copy of the insolvency statement must be made available for inspection by members at the meeting.

In addition to the above-mentioned solvency statement, other key features of the court-free reduction of share capital include the followings:

- The company must publish notices with relevant information in the Gazette and newspapers and must register the solvency statement with the Registrar of Companies ('the Registrar') (s 218);
- Any creditor or non-approving member of the company may, within five weeks after the special resolution is passed, apply to the court for cancellation of the resolution (ss 220 to 222). During this five-week period, the company must make available the special resolution and solvency statement for members' and creditors' inspection (s 219); and

- The company must deliver after the five-week period (but no later than seven weeks) to the Registrar a return in specified form if there is no court application (s 224), or within 15 days after the court makes the order confirming the special resolution or the proceedings are ended without determination by the court (s 225). The reduction of share capital takes effect when the return is registered by the Registrar.

Upon a successful reduction in share capital, the company may either (s 210):

- repay any paid-up capital in excess of the amount the company wants; or
- cancel any paid-up share capital. The reserve created in this instance is regarded as realised profit for the purposes of Part 6 and is available for distribution (s 214).

The example below illustrates the accounting treatment for each of the two options above.

Example 4.1.1

H Ltd has a total share capital of HK\$1m with 50,000 shares in issue. In 2014, H Ltd decides to reduce share capital by repaying HK\$100k paid-up capital to its members.

The journal entries upon the effective date of the share capital reduction would be as follows under the 2 different scenarios:

Reduction in share capital – Repay HK\$100k paid up capital to members of H Ltd:

Dr Share capital	100k	
Cr Bank		100k

Reduction in share capital – Cancel HK\$100k paid up capital with no repayment to members of H Ltd:

Dr Share capital	100k	
Cr Other reserves (distributable)		100k

4.2 Share redemptions or share buy-backs

The table below sets out the general requirements for share redemptions and share buy-backs insofar as accounting impacts are concerned:

Reference of the new CO	Requirements of the new CO
s 257(1)	Shares redeemed or bought back must be paid for at the time of the redemption or buy-back.
s 257(2)	<p>The payment for the redemption or buy-back may be made:</p> <ul style="list-style-type: none"> a) out of the company's distributable profits; b) out of the proceeds of a fresh issue of shares made for the purpose of the redemption or buy-back; or c) out of capital. The new CO contains other specific provisions to be met where the redemption or buy-back is made 'out of capital'. <p>Section 257(3) of the new CO states that a listed company must not make a payment out of capital in respect of a buy-back of its own shares on a recognised stock exchange or on an approved stock exchange under section 239.</p>

The following example illustrates the journal entry and impact to share capital if the payment is made out of capital or distributable profits (assuming the applicable provisions set out in the new CO are met).

Example 4.2.1

In 2014, the directors of H Ltd pass a resolution to buy back 1,000 shares at HK\$100 each proportionately from all of its shareholders. H Ltd has 40,000 shares in issue immediately before the share buy-back totalling HK\$3.6m. The journal entries that will be processed upon such a repurchase, as well as the impact on the 'share capital' note in the financial statements, are illustrated below:

Share buy-back paid out of capital:

Dr Share capital	100k	
Cr Bank		100k

Share buy-back paid out of distributable profits:

Dr Other reserves (distributable)	100k	
Cr Bank		100k

31. Share capital	Buy-back paid out of capital		Buy-back paid out of distributable profits	
	Number of shares '000s	HK\$'000	Number of shares '000s	HK\$'000
Year ended 2014				
Issued and fully paid				
At 1 January	40	3,600	40	3,600
Share buy-back	(1)	(100)	(1)	-
31 December 2014	39	3,500	39	3,600

5. Distribution of profits and assets


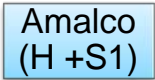
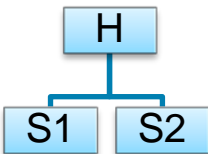
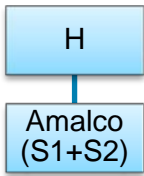
Part 6 of the new CO covers distribution of profits and assets to members of a company. These sections have been brought forward largely unchanged from the old CO and are based on the principle that a company may only pay a dividend, or distribute assets, out of its accumulated realised profits less accumulated realised losses (s 297). A few years ago, the HKICPA issued Accounting Bulletin 4 *Guidance on the determination of realised profits and losses in the context of distributions under the Hong Kong Companies Ordinance* that provides guidance on the determination of realised profits and losses.

At the time of writing, the HKICPA has not yet updated AB 4 for the new CO. Nonetheless, companies may continue to refer to the principles expounded in AB 4 as there are no substantive differences between Part 6 of the new CO and the related requirements under the old CO.

6 Arrangements, amalgamation, and compulsory share acquisition in takeover and share buy-back

6.1 Court-free amalgamation

The new CO introduces a new form of court-free amalgamation procedure for companies which are wholly-owned within the same group, whereby these companies can be amalgamated into a single legal entity (ss 678 – 686). These amalgamations are of two types:

Vertical amalgamation (s 680)		Horizontal amalgamation (s 681)	
A company and one or more of its wholly-owned subsidiaries amalgamate to continue as one company.		Two or more of the wholly owned subsidiaries of a company amalgamating to continue as one company.	
Before	After	Before	After
			
The holding company will always be the continuing company in a vertical amalgamation, and the shares of each of the amalgamating subsidiaries (S1 in this case) will be cancelled without payment or other consideration (s 680(2)(a)).		One of the amalgamating subsidiaries (either S1 or S2) will be selected as the continuing amalgamated company. The shares of all the other amalgamating subsidiaries will be cancelled without payment or other consideration (s 681(2)(a)).	

Upon the effective date of an amalgamation:

- each amalgamating company ceases to exist as an entity separate from the amalgamated company (Amalco in the above illustration); and
- Amalco succeeds to all the property, rights and privileges, and all the liabilities and obligations of each amalgamating company. (s 685)

The term Amalco has been used to refer to the new, amalgamated company in the rest of this section for ease of identification.

6.2 Accounting implications of an amalgamation

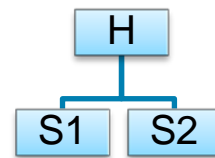
As these ‘court-free’ amalgamations can only take place between wholly-owned subsidiaries or between them and their holding company, these amalgamations will necessarily constitute combinations under common control. In the financial statements of Amalco, it would be appropriate to apply the principles of merger accounting commonly adopted for business combinations involving entities under common control.

The principle of merger accounting is that no acquisition has occurred and that there has been a continuation of the risks and benefits to the controlling party that existed prior to the combination. In short, this requires the net assets of the combining entities or businesses to be consolidated using the existing book values as stated in the consolidated financial statements of the controlling party (in a horizontal amalgamation (see above), the controlling party refers to H Limited).

As regards the share capital of Amalco, s 678(2) states that a cancellation of shares under [Division 3 of Part 13] is not a reduction of capital for the purposes of Part 5 of the new CO. Accordingly, the shares of the amalgamated companies are cancelled upon the amalgamation (ss 680(2)(a) and 681(2)(a)). The examples below illustrate the effect of various types of amalgamation.

Example 6.2.1

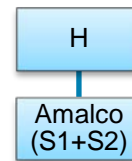
The diagram alongside and table below reflect the structure and the financial statements of H Group before the amalgamation. H established S1 and S2 upon their formation many years ago.



	Company level			Consolidated
	H	S1	S2	
	\$'000s	\$'000s	\$'000s	\$'000s
Investment in S1	80	-	-	-
Investment in S2	50	-	-	-
Other net assets	120	150	90	360
Total	250	150	90	360
Share capital	100	80	50	100
Reserves	150	70	40	260
Total	250	150	90	360
Number of shares in issue	100	80	50	100

A) Horizontal amalgamation

The diagram alongside and table below reflect the structure and the relevant financial statements if S1 is amalgamated with S2 to form Amalco (S1+S2). Assume that S1 is chosen as the continuing company after the amalgamation.



	Company level		Consolidated
	H	Amalco (S1 + S2)	
	\$'000s	\$'000s	\$'000s
Investment in Amalco (S1 + S2)	130	-	-
Other net assets	120	240	360
Total	250	240	360
Share capital	100	80	100
Reserves	150	160	260
Total	250	240	360
Number of shares in issue	100	80	100

It is assumed that the net assets of S2 are incorporated into the financial statements of Amalco (previously S1) at their existing carrying values, with a corresponding increase in reserves of \$90k. The shares of S2 are cancelled upon the amalgamation and this cancellation has the effect of reducing the combined share capital of the amalgamating subsidiaries.

The journal entries in the books of Amalco (previously S1) upon the coming into effect of the amalgamation are as follows:

Amalco (S1 + S2)

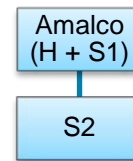
Dr Other net assets	90	
Cr Reserves (deemed capital contribution from H)		90

The recognition of \$90k in reserves represents effectively a capital contribution from H, as Amalco receives the net assets of S2 for nil consideration in this particular example.

On consolidation, the investment in Amalco (\$130k) will be eliminated against the share capital of Amalco (\$80k) and reserves to the extent of \$50k, effectively being the original share capital of S2 which is cancelled upon the amalgamation. As can be seen above, the consolidated financial statements of H Group after the horizontal amalgamation are not affected by the amalgamation. The share capital of Amalco reflects the number of shares of S1 as it is chosen as the continuing company after the amalgamation.

B) Vertical amalgamation

The diagram alongside and table below reflect the structure and the relevant financial statements if H is amalgamated with S1 to form Amalco (H+S1).



	Company level		Consolidated
	Amalco (H + S1)	S2	
	\$'000s	\$'000s	\$'000s
Investment in S2	50	-	-
Other net assets	270	90	360
Total	320	90	360
Share capital	100	50	100
Reserves	220	40	260
Total	320	90	360
Number of shares in issue	100	50	100

As can be seen above, the consolidated financial statements of H Group after the vertical amalgamation are not affected by the amalgamation.

The journal entries in the books of Amalco (previously H) upon the coming into effect of the amalgamation are as follows:

Amalco (H + S1)

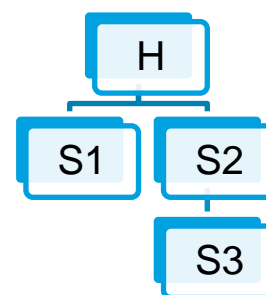
Dr Other net assets	150	
Cr P/L (deemed distribution income)		70
Cr Investment in S1		80

To include S1's assets and liabilities into the financial records of Amalco (H + S1) at their previous carrying amounts.

The recognition of \$70k in profit or loss effectively represents a distribution of net assets by S1 to its parent prior to S1 ceasing to exist as a separate legal entity.

Example 6.2.2

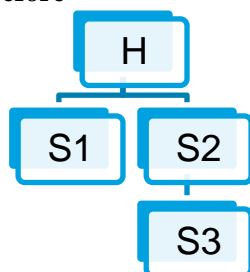
The diagram alongside and table below reflect the structure and the financial statements of H Group before the amalgamation. Assume that H established all three subsidiaries upon their formation many years ago.



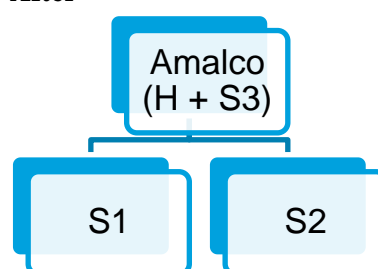
	Company level			
	H	S1	S2	S3
	\$'000s	\$'000s	\$'000s	\$'000s
Investment in S1	80	-	-	-
Investment in S2	50	-	-	-
Investment in S3	-	-	30	-
Other net assets	120	150	90	50
Total	250	150	120	50
Share capital	100	80	50	30
Reserves	150	70	70	20
Total	250	150	120	50

A) Vertical amalgamation

Before



After



Journal entries in the respective company's financial records upon amalgamation:

S1

No change

S2

Dr Reserves (deemed distribution to H)

30

Cr Investment in S3

30

Recognition of the deemed distribution of shares of S3 to H, recorded at the carrying amount of the investment distributed (HK (IFRIC) 17 does not apply as S3 is ultimately controlled by H both before and after the amalgamation (HK (IFRIC) 17.5)). The shares of S3 will be cancelled upon the amalgamation.

S3

Derecognise all assets, liabilities and equity items

Amalco (H + S3)

Dr Other net assets	50	
Cr P/L (deemed distribution income)		50

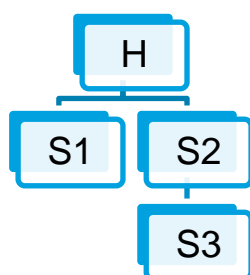
Recognition of deemed distribution income received from S2, recorded at the carrying amount of the net assets of S3 (applying the principles of merger accounting) assuming the investment in S2 is not impaired as a result of the amalgamation (see below).

The deemed distribution to H of \$30k recorded in S2's records differs from the deemed distribution income received by Amalco by an amount of \$20k, representing the reserves of S3 existing at the date of the amalgamation. This is the outcome as it is assumed in this example that S2 accounted for its investment in S3 at cost, without reflecting the post-acquisition changes in reserves of S3.

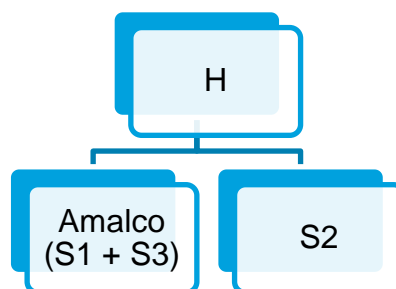
Amalco may also need to assess S2 for impairment. However, given that the investment was made on inception of S2 and there are retained profits in S2, and the impairment indicators in HKAS 36.12(h) are not met (the carrying amount of the investment in S2 of \$50k does not exceed S2's net assets in the consolidated statement of financial position of Amalco (\$90k)), it is considered that no impairment is necessary in this case.

B) Horizontal amalgamation

Before



After



The amalgamation of S1 and S3 is a horizontal amalgamation, as S3 is not a wholly-owned subsidiary of S1 so s 680 does not apply. However, as S1 and S3 are both wholly-owned subsidiaries of H, the definition of a horizontal amalgamation is met (s 681). It is assumed here that S1 is the continuing company after the amalgamation.

Journal entries in the respective company's financial records upon amalgamation:

Amalco (S1 + S3)

Dr Other net assets	50	
Cr Reserves (deemed capital contribution from H)		50

Recognition of deemed capital contribution from H, recorded at the carrying amount of the net assets of S3 (applying the principles of merger accounting).

S2

Dr Reserves (deemed distribution to H)	30	
Cr Investment in S3		30

Recognition of the deemed distribution of shares of S3 to H, recorded at the carrying amount of the investment distributed (IFRIC 17 does not apply as S3 is ultimately controlled by H both before and after the amalgamation (IFRIC 17.5)). The shares of S3 will be cancelled upon the amalgamation.

S3

Derecognise all assets, liabilities and equity items

H

Dr Investment in Amalco (S1+S3)	110	
Cr Investment in S1		80
Cr P/L (deemed distribution income from S2)		30

The amalgamation can be considered as a distribution by S2 of S3 to H, which then contributes S3 to S1 for amalgamation purposes. The deemed distribution of the shares of S3 to H is recorded at the carrying amount of the investment distributed.

The investment in S1 is derecognised, replaced by the investment in Amalco (S1+S3) at the existing carrying amount of the investment in S1 (80) plus the deemed investment in Amalco as a result of the distribution from S2 (30).

Alternatively, H can view that as it continues to hold the same number of shares in S1, being the continuing amalgamated company, after the coming into effect of the amalgamation, no accounting entries are required at the time of the amalgamation.

General note:

As these 'court-free' amalgamations can only take place between wholly-owned group companies, at the consolidated financial statements level these amalgamations are all accounted for as intra-group transactions which will be eliminated in full on consolidation.

7. Preparation of financial statements and directors' reports

Part 9 of the new CO titled *Accounts and Audit* contains requirements regarding the preparation of financial statements and directors' reports, as follows:

- a company's directors' responsibility to prepare financial statements and requirements for financial statements (ss 379 – 387); and
- a company's directors' responsibility to prepare directors' report and requirements for directors' reports (ss 388 – 391).

Most of the sections of Part 9 as well as the entire Schedule 4 that deals with the accounting disclosures are effective for *financial years beginning on or after the commencement date of the new CO (i.e. 3 March 2014)* (s 358). For example, for a December year-end entity, these provisions will be effective for its annual financial year ending 31 December 2015. This is different from the effective date applicable to the other parts of the new CO, for instance the no-par regime. As mentioned in section 2 of this publication, the no-par regime is immediately effective upon the commencement date of the new CO.

This section contains three subsections:

- Section 7.1 - Frequently-asked questions relating to the preparation of financial statements.
- Section 7.2 - New requirement to include a business review in a directors' report.
- Section 7.3 – Extended scope for disclosures of a directors' report.

7.1. Frequently-asked questions relating to the preparation of financial statements

Question 1: Can a Hong Kong-incorporated company prepare financial statements in accordance with IFRSs?

Response:

According to the new CO, the financial statements must be prepared in accordance with the accounting standards applicable to the financial statements which are defined as statements of standard accounting practice issued or specified by a body prescribed by the Regulation (which is the HKICPA) (ss 380(4)(b) and 380(8)(a)). The accounting standards issued by the HKICPA are the full HKFRSs, HKFRS for Private Entities and SME-FRF & SME-FRS.

With the above requirements, a Hong Kong incorporated company *technically* cannot prepare its financial statements in accordance with International Financial Reporting Standards (IFRSs) until the HKICPA specifies IFRSs as one of the appropriate accounting standards for the purposes of meeting the new CO requirements.

Question 2: Under the new CO, when is a Hong Kong-incorporated parent company required to prepare consolidated financial statements? Are the requirements on this aspect under the new CO different from those under the old CO?

Response:

Under the old CO, a company is required to prepare consolidated financial statements when it has subsidiaries at the end of the financial year subject to a few exceptions. One exception is that the company is a wholly-owned subsidiary of another body corporate at the end of the financial year. Another exception is that it is in the opinion of the directors of the company that the consolidated financial statements should not be prepared on certain grounds (e.g. impracticability, having no real value to members of the company or the company and the subsidiaries being engaged in different nature of businesses) (s 124(2) of the old CO).

Same as the old CO, the new CO requires a company to prepare consolidated financial statements if it is a holding company at the end of the financial year (s 379(2)). However, the requirements as to when a company is exempted from preparing consolidated financial statements have been changed. Under the new CO, a company is exempted from preparing consolidated financial statements when:

- the company is a wholly owned subsidiary of another body corporate in the financial year (s 379(3)(a));
- the company is a partially owned subsidiary of another body corporate in the financial year, the directors have notified members in writing about the directors' intention not to prepare consolidated financial statements at least 6 months before the end of the financial year, and no member objects to the directors' proposal as at a date falling 3 months before the end of the financial year (s 379(3)(b)); or
- all subsidiaries are not material (s 381(3)).

It is important to note that the conditions for exemption from preparation of consolidated financial statements under the new CO are different from those set out in HKFRS 10 *Consolidated Financial Statements*. HKFRS 10 contains additional conditions, all of which have to be fulfilled if a parent does not want to present consolidated financial statements; namely a) the company's debt or equity instruments are not traded in a public market; b) the company did not file, nor in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, and c) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with HKFRSs or IFRSs.

To address such differences, the HKICPA has recently submitted a letter to the IASB that highlights the issues in our jurisdiction and asks the IASB to consider amending the scope requirements set out

in IFRS 10 (which is identical to HKFRS 10 on all material aspects) when it deals with other potential amendments to IFRS 10.

Until the difference between the new CO and HKFRS 10 is eliminated, when a Hong Kong incorporated company that is a holding company determines whether it is exempted from preparing consolidated financial statements, it should take into account both the requirements under the new CO and HKFRS 10.

Question 3: The old CO requires a true and fair view to be given in respect of a company's statement of financial position despite the fact that the company prepares consolidated financial statements instead and that the consolidated financial statements would give a true and fair view (ss 123 and 125 of the old CO). To comply with such a requirement under the old CO, companies normally include the company's statement of financial position as one of the primary statements in its consolidated financial statements (with the related notes included in the notes to the consolidated financial statements), with a true and fair view being given on the consolidated financial statements as well as on the company's statement of financial position.

Is there any change in the new CO with regard to the above requirement?

Response:

The new CO does not require a true and fair view to be given in respect of the company's statement of financial position when the company prepares consolidated financial statements.

Instead, the new CO requires that the consolidated financial statements of a company should contain the company's statement of financial position and movement in the company's reserves (included in the notes to the annual consolidated financial statements) (s 2 of Schedule 4(Part 1)). There is no need to include notes to the company's statement of financial position (s 2(2) of Schedule 4(Part 1)).

Question 4: Is the definition of a subsidiary under HKFRS 10 the same as that set out in the new CO?

Response:

HKFRS 10 defines a subsidiary as an entity that is controlled by another entity. An entity has control over an investee when the entity has [HKFRS 10: 7]:

- power over the investee;
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the investor's returns.

HKFRS 10 uses the control concept in determining whether an investee is a subsidiary of an entity and hence whether the entity needs to prepare consolidated financial statements.

However, it seems that the approach taken by the new CO is different from that set out in HKFRS 10. Most of the definition of a subsidiary undertaking under the new CO is carried forward unchanged from the old CO. Basically, the new CO focuses on whether the company has a) the majority voting rights and b) right to appoint or remove a majority of the board of directors of the investee. Appendix 2 to this publication gives a summary as to when an entity is a parent entity of another undertaking under the new CO.

This difference between the new CO and HKFRS 10 gives rise to the following 2 issues:

Issue	Our comments
<p>1) An investee is a subsidiary in accordance with HKFRS 10 (but is not a subsidiary undertaking in accordance with the new CO)</p> <p><i>Example: A company owns less than the majority of voting rights of an investee but concludes that it has de facto control over the investee in accordance with HKFRS 10.</i></p>	<p>We noted that, the new CO requires a company that is a holding company at the end of the financial year to prepare consolidated financial statements that includes all the subsidiary undertakings unless those that are not material (ss 379(2), 380(2) and 381(3)).</p> <p>However, the new CO does not prohibit a company to include subsidiaries that are included in order to satisfy the applicable accounting standards. Indeed, section 380(4) of the new CO does require that consolidated financial statements should also comply with the applicable accounting standards.</p> <p>With the above requirements, it is important for the company to include those subsidiaries that meet the definition of a subsidiary in accordance with HKFRS 10 when it prepares its consolidated financial statements in accordance with HKFRS 10 (despite the fact that those subsidiaries do not fall within the definition of a subsidiary undertaking under the new CO).</p>
<p>2) An investor needs to prepare consolidated financial statements in accordance with the new CO (but those subsidiary undertakings do not meet the definition of a subsidiary under HKFRS 10 or HKFRS 10 does not require the preparation of consolidated financial statements)</p> <p><i>Example: A company that is an investment entity in accordance with HKFRS 10 is not allowed to prepare consolidated financial statements – instead, the company should in general measure all its subsidiaries at fair value at the end of each reporting period, with changes in fair value being recognised in profit or loss.</i></p> <p><i>The 'investment entity' requirements set out in HKFRS 10 are mandatorily effective for annual periods beginning on or after 1 January 2014.</i></p>	<p>The new CO requires the financial statements to be prepared in accordance with a) the requirements set out in the new CO and b) the applicable accounting standards (s 380(4)).</p> <p>If a company prepares consolidated financial statements in accordance with the new CO (which is not allowed under the applicable accounting standard (e.g. the investment entity example), there will be a material departure from the accounting standard assuming the subsidiaries are material. In that situation, the new CO requires the details of and reasons for the departure to be disclosed. [s 4 of Schedule 4 (Part 1)]</p> <p>At the time of writing, this potential difference has yet to be resolved. Appropriate actions (e.g. amendments to the new CO) may have to be taken by the Companies Registry to eliminate such a potential issue arising from this difference.</p>

Question 5: How does the new CO streamline the disclosure requirements in the annual financial statements?

Response:

One big improvement in the new CO regarding the preparation of annual financial statements is that it contains a significantly reduced number of disclosure requirements compared to those contained in the Tenth Schedule of the old CO. When Part 9 and Schedule 4 of the new CO (that sets out the accounting disclosures) come into operation, the disclosure requirements set out in the Tenth Schedule of the old CO will be repealed. The changes are made to avoid duplication as the accounting standards already require many disclosures anyway.

As examples, the following disclosures required under the old CO are no longer required by the new CO:

- Details about certain statement of financial statement items, including:
 - authorised and issued share capital;
 - debentures;
 - provisions and reserves;
 - land (whether it is classified as long, medium-term or short lease); and
 - inventories.
- Details about certain statement of profit or loss items, including:
 - turnover and how the amount of turnover is arrived at;
 - depreciation and impairment;
 - interest expense (separately disclose how much attributable to borrowings that are repayable within 5 years and those that are not repayable within 5 years);
 - taxation and the basis for computation; and
 - income from listed and unlisted investments.

Instead, Schedule 4 of the new CO just requires the following disclosures:

- a) the aggregate amount of any outstanding loans to directors and employees to acquire shares in the company authorised under ss 280 and 281 of the new CO;
- b) a statement in the financial statements as to whether it has prepared the financial statements in accordance with the applicable accounting standards, and where there is any material departure from the accounting standards, particulars of, and the reasons for the departure.

- c) in case that the company is preparing consolidated financial statements, the company's statement of financial position and movement in the company's reserves (included in the notes to the consolidated financial statements);
- d) in case that the company is a subsidiary and is preparing its financial statements, particulars of the ultimate parent undertaking; and
- e) auditor's remuneration.

Items (a) – (d) are required regardless of whether the company falls within the reporting exemption (see Question 7 below).

Item (e) is required for companies that do not fall within the reporting exemption. In other words, for companies that fall within the reporting exemption, there is no need to disclose auditor's remuneration.

Question 6: Does the new CO require any disclosures regarding the directors' emoluments and other matters that involve directors in the notes to the financial statements?

Response:

Section 383 of the new CO requires the following information to be disclosed in the notes to the financial statements:

- the directors' emoluments;
- the directors' retirement benefits;
- payments made or benefit provided in respect of the termination of the service of directors, whether in the capacity of directors or in other capacity while directors;
- loans, quasi-loans and other dealings in favour of a) directors of the company and a holding company of the company; b) bodies corporate controlled by such directors; c) entities connected with such directors;
- material interests of directors in transactions, arrangements or contracts entered into by the company or another company in the same group of companies;
- consideration provided to or receivable by third parties for making available the services of a person as a director or in any other capacity while director.

In addition, the new CO requires that the financial statements for a financial year must contain, under separate headings, the aggregate amount of any outstanding loans made to directors under the authority of sections 280 and 281 of the new CO during the financial year (s 1 of Schedule 4 (Part 1)).

Question 7: How does the new CO allow more small and medium-sized entities (SME) to qualify for simplified reporting? What benefits do companies have when they fall within the reporting exemption?

Response:

Another improvement in the new CO regarding the preparation of financial statements is that the new CO has relaxed the criteria to allow more SMEs to qualify for simplified reporting.

Section 141D of the old CO provides that a private company (other than a company which is a member of a corporate group and certain companies specifically excluded, such as insurance and stock-broking companies) may, with the written agreement of all its shareholders, prepare simplified accounts and simplified directors' reports in respect of one financial year at a time. According to the Small and Medium-sized Entity-Financial Reporting Framework issued by the HKICPA in 2005 ('SME-FRF (2005)'), a company qualifies for reporting based on the SME-Financial Reporting Standard issued by the HKICPA in 2005 ('SME-FRS (2005)') if it satisfies the requirement under section 141D of the old CO (SME-FRF (2005).16).

The new CO expands on the exemption criteria in section 141D of the old CO to allow more SMEs and groups of SMEs meeting certain size criteria to adopt simplified reporting. The reporting exemptions set out in section 141D of the old CO are repealed.

Companies which qualify for simplified reporting are referred to in the new CO as 'companies falling within the reporting exemption'.

When companies fall within the reporting exemption

Sections 359 – 366 of the new CO specify when companies falling within the reporting exemption. Appendix 3 to this publication gives a summary of criteria to be met to fall within the reporting exemption.

What benefits companies have when they fall within the reporting exemption

Benefit 1 – Companies have a choice to adopt SME-FRF & SME-FRS

Companies that fall within the reporting exemption have a choice to prepare their financial statements in accordance with SME-FRF and SME-FRS, which is a home-grown accounting standard developed by the HKICPA and is a much simplified version as compared to full HKFRSs and HKFRS for Private Entities.

Recently, the HKICPA has issued a revised version of SME-FRF and SME-FRS (see below for details). The revised SME-FRF states in paragraph 1 that the revised SME-FRF and SME-FRS are the accounting standards that are to be followed in accordance with section 380(4) of the new CO.

Companies falling within the reporting exemption may elect to adopt the revised SME-FRF and SME-

FRS but are not required to do so. In other words, such companies may adopt full HKFRSs or HKFRS for Private Entities if they so wish.

The effective date of the revised SME-FRF & SME-FRS is aligned with the date that section 359 of the new CO comes into operation. Consequently, the revised SME-FRF & SME-FRS is effective for financial years beginning on or after 3 March 2014. As early adoption of section 359 is not permitted under the new CO, early application of the revised SME-FRF & SME-FRS is also not permitted.

The revised SME-FRF and SME-FRS are much simpler and briefer as compared to the full HKFRSs and HKFRS for Private Entities. The items below are examples of areas where the revised SME-FRF & SME-FRS are simpler than full HKFRSs and HKFRS for Private Entities:

- There is no requirement to prepare and present a statement of cash flows.
- Deferred tax assets and liabilities are not recognised.
- Investments are categorised into two types: current and long-term investments: current investments are measured at the lower of cost and net realisable value whilst long-term investments are measured at cost less impairment.
- Investments in associates and joint ventures are allowed to be accounted for using the cost model.
- Much simpler accounting rules for business combinations.

Full SME-FRF and SME-FRS can be accessed through the link below

<http://app1.hkicpa.org.hk/ebook/index.php>

Benefit 2 – Less disclosures are required in the financial statements

Less disclosure are required to be made in the financial statements when companies fall within the reporting exemption. Specifically, such companies are only required to make the accounting disclosures set out in Part 1 of Schedule 4 of the new CO (rather than Parts 1 and 2 of Schedule 4 of the new CO) (Schedule 4: 1 – 4).

Part 1 of Schedule 4 of the new CO requires only:

- where the annual consolidated financial statements are prepared - the holding company's statement of financial position and the movement in the holding company's reserves in the notes to the annual consolidated financial statements;
- where the subsidiary's financial statements are prepared - particulars of the ultimate parent undertaking;
- whether the financial statements for a financial year have been prepared in accordance with the applicable accounting standards, and the particulars of any material departure (if any); and
- the aggregate amount of any outstanding loans made under sections 280 and 281.

Benefit 3 – No need to give a true and fair view on financial statements

When a company falls within the reporting exemption for a financial year, the company is *exempted* from the requirement to prepare annual financial statements that give a true and fair view (ss 380(1), (2) and (7)). The exemption from the requirement to give a true and fair view does not mean that no statutory audit is required. The new CO still requires statutory audit regardless of whether or not a company falls within the reporting exemption. As mentioned above, companies fall within the reporting exemption can choose either to use full HKFRSs, HKFRS for Private Entities and SME-FRF & SME-FRS. For companies that choose to prepare financial statements in accordance with full HKFRSs or HKFRS for Private Entities, they are still required to give a true and fair view required by the accounting standards (HKAS 1.15 and HKFRS for Private Entities (section 3 paragraph 3.2) respectively). With the above requirements, only companies that opt for preparing financial statements in accordance with SME-FRF & SME-FRS would be exempted from the 'true and fair view' requirement.

Benefit 4: No need to include a business review in a directors' report

Companies falling within the reporting exemption are exempted from the requirement to prepare a business review to be included in the directors' report (see below for details).

7.2 *New requirement to include a business review in a directors' report*

Section 388(1) of the new CO requires that a company's directors must prepare directors' report for each financial year. Specifically, the new CO introduces a new requirement within the directors' report – that is, to prepare a business review.

With the specific exemptions set out in the new CO, the following companies do not need to include a business review in the directors' reports (s 388(3)):

- companies falling within the reporting exemption for the financial year (see above for details as to when a company would fall within the reporting exemption);
- companies that are wholly-owned subsidiaries of another body corporate in the financial year; or
- private companies that do not fall within the reporting exemption for the financial year (but a special resolution is passed by members to the effect that companies are not to prepare the business review).

A business review is an analytical and forward-looking analysis that aims to provide additional information for members and to help them assess how the directors have performed their duties. In particular, the requirement to include information relating to environmental and employee matters that have a significant impact on the company is in line with international trends to promote corporate social responsibility.

As required under section 388 and Schedule 5 of the new CO, a business review consists of at least:

- a fair review of the company's business;
- a description of the principal risks and uncertainties facing the company;
- particulars of important events affecting the company that have occurred since the end of the financial year; and
- an indication of likely future development in the company's business.

In addition, to the extent necessary for an understanding of the development, performance or position of the company's business, a business review must include:

- an analysis using financial key performance indicators;
- a discussion on the company's environmental policies and performance and the company's compliance with the relevant laws and regulations that have a significant impact on the company; and
- an account of the company's key relationships with its employees, customers and suppliers and others that have a significant impact on the company on which the company's success depends.

Where a company is required to prepare consolidated financial statements, the directors' report should also be prepared on a consolidated basis (i.e. the business review should cover not only the company but also its subsidiaries).

In February 2014, the HKICPA has issued an exposure draft of Accounting Bulletin 5 *Guidance for the Preparation of a Business Review under the Hong Kong Companies Ordinance Cap. 622* ('AB 5') which will set out the key elements for the contents of a business review, including details on particular matters that should be disclosed to meet the minimum requirements of the new CO. It will also be accompanied by an Implementation Guidance which will contain application examples. Comment period of the exposure draft will end on 22 April 2014. The exposure draft can be downloaded at <http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/>.

7.3 *Extended scope for disclosures of a directors' report*

Section 390(1) of the new CO requires a directors' report to contain the following information:

- the name of every person who was a director of the company during the financial year; or during the period beginning with the end of the financial year and ending on the date of the report; and
- the principal activities of the company for the financial year.

Section 390(3) of the new CO states that the reference to 'the company' above refers to 'the company and its subsidiaries' when the company prepares consolidated financial statements.

With the requirements set out in section 390(3), it appears that a directors' report may have to disclose not only the names of the directors of the company but also the names of the directors of the subsidiaries of the company when the company is a holding company and prepares consolidated financial statements.

It is unclear to us why the new CO would require names of directors of subsidiaries to be disclosed in the directors' report of a holding company and the usefulness of such information being disclosed. Apparently, the disclosure of names of all directors of all subsidiaries could result in the directors' report having many more pages (particularly in a situation where the company has a lot of subsidiaries) and could be time-consuming and costly for the company to collect all the necessary information for disclosures in the directors' report.

We believe that this is an area where clarification should be sought from the Companies Registry and, until clarification is obtained, companies should seek guidance from their legal advisers and company secretaries as to whether names of directors of subsidiaries need to be disclosed in the directors' report and the level of details to be included (e.g. whether names of directors of *all* subsidiaries or just names of directors of *material* subsidiaries are required).

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Appendix 1 – Overview of the organisation of the new CO

The table below gives an overview of the organisation of the new CO and the main contents of the different parts of the new CO.

Part	Title	Content
1	Preliminary	Sets out the title of the new CO, the commencement provision, and the definitions of various terms and expressions that are used in the new CO.
2	Registrar of Companies and Companies Register	Deals with the general functions and powers of the Registrar of Companies (“the Registrar”).
3	Company Formation and Related Matters, and Re-registration of Company	Deals with company formation, registration and related matters.
4	Share Capital	Deals with the core concepts of share capital, its creation, transfer and alteration. In particular, this Part introduces a mandatory no-par regime for all companies with a share capital to modernise the share capital regime.
5	Transactions in relation to Share Capital	Contains the provisions concerning capital maintenance (reduction of capital and purchase of a company’s own shares) and the giving of financial assistance by a company to another party for the purpose of acquiring shares of that company or its holding company. To facilitate business operation, this Part streamlines and rationalises the existing rules by introducing new exceptions based on the solvency test for reduction of capital, buy-backs and financial assistance.
6	Distribution of Profits and Assets	Deals with the distribution of profits and assets to members. The usual form of distribution is through payment of dividends. While there is no fundamental change to the current rules, the modernised language should facilitate easier understanding.
7	Debentures	Deals with a miscellany of matters concerning debentures.
8	Registration of Charges	Deals with the registration of charges by both Hong Kong and registered non-Hong Kong companies. It sets out the types of charges which require registration, the registration procedures and the consequences of non-compliance.
9	Accounts and Audit	Contains the accounting and auditing provisions in relation to the keeping of accounting records, the preparation and circulation of annual financial statements, directors’ and auditor’s reports and the appointment and rights of auditors. New provisions are introduced to facilitate small and medium-sized entities (SMEs) to take advantage of simplified accounting and reporting requirements, to require public and large companies to include an analytical business review in directors’ reports, and to enhance auditors’ right to information.

Part	Title	Content
10	Directors and Company Secretaries	Deals with directors and company secretaries of a company. It mainly reorganises, with some modifications, the existing provisions of the Companies Ordinance (Cap. 32) relating to the appointment, removal and resignation of directors and company secretaries. This Part also clarifies the standard of directors' duty of care, skill and diligence.
11	Fair Dealing by Directors	Covers fair dealing by directors and deals with specified situations in which a director is perceived to have a conflict of interest.
12	Company Administration and Procedure	Governs resolutions and meetings, registers (including registers of members, directors and company secretaries), company records, registered offices, publication of company names and annual returns.
13	Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back	Restates, with some amendments, the provisions of Companies Ordinance (Cap. 32) concerning schemes of arrangement, reconstructions or amalgamations of a company with other companies, and compulsory acquisitions.
14	Remedies for Protection of Companies' or Member's' Interests	Consolidates the existing provisions concerning shareholder remedies under the Companies Ordinance (Cap. 32). The scope and operation of the unfair prejudice remedy are refined.
15	Dissolution by Striking Off or Deregistration	Sets out the provisions on striking off and deregistration of defunct companies, restoration of companies that have been struck off or deregistered, and related matters (including treatment of properties of dissolved companies). It introduces changes which streamline the existing procedures for striking-off and restoration of companies. This Part also imposes new requirements to prevent any possible abuse of the deregistration procedure.
16	Non-Hong Kong Companies	Deals with companies incorporated outside Hong Kong which have established a place of business in Hong Kong. There is no fundamental change to the current rules.
17	Companies Not Formed, but Registrable, under this Ordinance	Deals with companies not formed under the new CO or a former Companies Ordinance but are eligible to be registered under the new CO. There is no fundamental change to the current rules.
18	Communications to and by Companies	Builds on the rules governing communications by a company to another person introduced in the Companies (Amendment) Ordinance 2010. The new rules will also facilitate electronic communications by a company's members and debenture holders to the company.
19	Investigations and Enquiries	Deals with investigations and enquiries into a company's affairs by inspectors and the Financial Secretary.

Part	Title	Content
20	Miscellaneous	Contains a number of miscellaneous provisions, including miscellaneous offences and the new power for the Registrar to compound specified offences.
21	Consequential Amendments, and Transitional and Saving Provisions	Deals with the transitional and saving provisions and consequential amendments that are required for the commencement of the new CO.

Appendix 2 – Definitions of a parent undertaking and a subsidiary undertaking under the new CO

The table below gives a summary as to when an entity is a parent entity of another undertaking under the new CO.

Under the new CO, an undertaking (note 1) is a parent of another undertaking if:		
Situation 1: Applicable to situations where both the parent and subsidiary undertakings are bodies corporate (note 2) [Schedule 1:2(1)(a)]	Situation 2: Applicable to situations other than those described under Situation 1 [Schedule 1:2(1)(b)]	Situation 3: Applicable to all cases [Schedule 1:2(2)]
it is a holding company of the latter undertaking (note 3).	it holds a majority of the voting rights in the latter undertaking; <i>or</i>	it has the right to exercise a dominant influence over the latter undertaking by virtue of: (a) the provisions contained in any document constituting or regulating the latter undertaking, or (b) a contract in writing that (i) is of a kind authorised by any document constituting or regulating the latter undertaking; and (ii) is permitted by the law under which the latter undertaking is established. An undertaking does not have the right to exercise a dominant influence over another undertaking unless:[Schedule 1:2(7)] (a) it has a right to give directions with respect to the operating and financial policies of that other undertaking; and (b) that other undertaking's directors are, or a majority of them is, obliged to comply with the directions, whether or not the directions are for that other undertaking's benefit.
	it is a member of the latter undertaking and has the right to appoint or remove a majority of the board of directors of the latter undertaking; <i>or</i>	
	it is a member of the latter undertaking and controls alone, pursuant to an agreement with the other shareholders or members, a majority of the voting rights in the latter undertaking.	
Note 1	An undertaking means a body corporate, a partnership, or an unincorporated association carrying on trade or business, whether for profit or loss. [Schedule 1:1]	
Note 2	A body corporate includes a company incorporated inside or outside Hong Kong, but excludes a corporation sole. [s 2(1)]	

Under the new CO, an undertaking (note 1) is a parent of another undertaking if:

Note 3	<p>A body corporate is a holding company of another body corporate if: [s 13(1)]</p> <ul style="list-style-type: none">(a) it controls the composition of that other body corporate's board of directors;(b) it controls more than half of the voting rights in that other body corporate; or(c) it holds more than half of that other body corporate's issued share capital. <p>A body corporate controls the composition of another body corporate's board of directors if it has power to appoint or remove all, or a majority, of that other body corporate's directors without any other person's consent.</p> <p>A body corporate is also a holding company of another body corporate if it is a holding company of a body corporate that is that other body corporate's holding company.[s 13(2)]</p>
Note 4	<p>Under the new <i>Companies Ordinance</i>, an undertaking is a subsidiary undertaking of another undertaking if that other undertaking is a parent undertaking of it. [Schedule 1:4(1)] Furthermore, an undertaking is also a subsidiary undertaking of another undertaking if a parent undertaking of it is a subsidiary undertaking of that other undertaking. [Schedule 1:4(2)]</p>

Appendix 3 – Overview of requirements of the new CO as to when a company falls within the reporting exemption

The table below sets out the requirements of the new CO as to when a company falls within the reporting exemption for a financial year.

Reference in the new CO	Details of the requirements under the new CO
Section 359(1)(a)	<p>A company falls within the reporting exemption for a financial year if the company is a <i>small private company</i> or <i>small guarantee company</i> for the financial year, and it is not a company specified in section 359(4)⁵ at any time during the financial year.</p> <p>What is the definition of a small private company?</p> <p>Definition of a small private company (see section 361 and Schedule 3:1(1)) – a company is a private company formed, registered under the Companies Ordinance, and meets any two of the following conditions:</p> <ul style="list-style-type: none"> the amount of the company's total revenue for the financial year does not exceed HKD 100 million; the amount of the company's total assets at the date of the statement of financial position for the financial year does not exceed HKD 100 million; and the average number of the company's employees during the financial year does not exceed 100. <p>What is the definition of a small guarantee company?</p> <p>Definition of a small guarantee company (see section 363 and Schedule 3:1(5)) - a company is a company limited by guarantee formed, registered under the Companies Ordinance, and the amount of the company's total revenue for the financial year does not exceed HKD 25 million.</p>

⁵ The company specified under section 359(4) is:

- one that carries on any banking business and holds valid banking licence granted under the Banking Ordinance (Cap 155);
- one that is a corporation licensed under Part V of the Securities and Futures Ordinance (Cap 571) to carry on a business in any regulated activity within the meaning of that Ordinance; or
- one that carries on any insurance business otherwise than solely as an agent; or accepts, by way of trade or business (other than banking business), loans of money at interest or repayable at a premium, otherwise than on terms involving the issue of debentures or other securities.

Reference in the new CO	Details of the requirements under the new CO
Section 359(1)(b)	<p>A company also falls within the reporting exemption for a financial year if:</p> <ul style="list-style-type: none"> • it is a <i>private company</i> at all times, and is not a company specified in section 359(4) (see above) at any time during the financial year; • it does not have any subsidiary and is not a subsidiary of another company; and • all members of the company agree in writing that the company is to fall within the reporting exemption for the financial year only.
Section 359(1)(c)	<p>A company also falls within the reporting exemption for a financial year if:</p> <ul style="list-style-type: none"> • it is a <i>private company</i> at all times, and is not a company specified in section 359(4) (see above) at any time during the financial year; • it is <i>qualified as an eligible private company</i> for the financial year; and • the conditions set out in section 360(1) are satisfied (i.e. a resolution is passed at a general meeting by the members holding at least 75% of the voting rights in the company to the effect that the company is to fall within the reporting exemption for the financial year, and the members holding the remaining voting rights do not vote against the resolution). <p><i>What is the definition of an eligible private company?</i></p> <p>Definition of an eligible private company (see section 362 and Schedule 3:1(3)) – a company is a private company formed, registered under the Companies Ordinance, and meets any two of the following conditions:</p> <ul style="list-style-type: none"> • the amount of the company's total revenue for the financial year does not exceed HKD 200 million; • the amount of the company's total assets at the date of the statement of financial position for the financial year does not exceed HKD 200 million; and • the average number of the company's employees during the financial year does not exceed 100.

Reference in the new CO	Details of the requirements under the new CO
Section 359(2)	<p>A company also falls within the reporting exemption for a financial year if:</p> <ul style="list-style-type: none"> • it is a <i>private company</i> at all times, and is not a company specified in section 359(4) (see above) at any time during the financial year; • it is the holding company of a group of companies, of which no member is a company specified in section 359(4) (see above) at any time during the financial year; and • the group of companies is qualified as a) <i>a group of small private companies</i> for the financial year; or b) <i>a group of eligible private companies</i> for the financial year and the conditions specified in section 360(2) are met (i.e. a resolution is passed at a general meeting by the members holding at least 75% of the voting rights in each company in the group that is not qualified as a small private company to the effect that company is to fall within the reporting exemption for the financial year; and the members holding the remaining voting rights do not vote against the resolution). <p><i>What is the definition of a group of small private companies?</i></p> <p>Definition of a group of small private companies (see section 364, Schedule 3:1(7) and Schedule 3:1(8)) – a group is qualified as a group of small private companies if the holding company is formed and registered under the Companies Ordinance, meets the condition that each company in the group is qualified as a small private company for the financial year, and meets any two of the following conditions:</p> <ul style="list-style-type: none"> • the aggregate amount of the group's total revenue for the financial year does not exceed HKD 100 million; • the aggregate amount of the group's total assets at the date of the statement of financial position for the financial year does not exceed HKD 100 million; and • the average number of the group's employees during the financial year does not exceed 100.

Reference in the new CO	Details of the requirements under the new CO
	<p>What is the definition of a group of eligible private companies?</p> <p>Definition of a group of eligible private companies (see section 365, Schedule 3:1(10) and Schedule 3:1(11)) – a group is qualified as a group of eligible private companies if the holding company is formed and registered under the Companies Ordinance, meets the condition that each company in the group is qualified as an eligible private company for the financial year, and meets any two of the following conditions:</p> <ul style="list-style-type: none"> • the aggregate amount of the group's total revenue for the financial year does not exceed HKD 200 million; • the aggregate amount of the group's total assets at the date of the statement of financial position for the financial year does not exceed HKD 200 million; and • the average number of the group's employees during the financial year does not exceed 100.
Section 359(3)	<p>A company also falls within the reporting exemption for a financial year if:</p> <ul style="list-style-type: none"> • it is a <i>company limited by guarantee</i> at all times, and is not a company specified in section 359(4) (see above) at any time during the financial year; • it is the holding company of a group of companies, of which no member is a company specified in section 359(4) (see above) at any time during the financial year; and • the group of companies is qualified as <i>a group of small guarantee companies</i> for the financial year. <p>What is the definition of a group of small guarantee companies?</p> <p>Definition of a group of small guarantee companies (see section 366 and Schedule 3:1(13)) – a group is qualified as a group of small guarantee companies if the holding company is formed and registered under the Companies Ordinance, and meets the following conditions:</p> <ul style="list-style-type: none"> • each company in the group is qualified as a small guarantee company for the financial year; and • the aggregate amount of the group's total revenue for the financial year does not exceed HKD 25 million.

Contact us

If you have any questions regarding the matters discussed above, please feel free to contact us.

Authors



William Lim

– Technical partner

wilim@deloitte.com.hk



Candy Fong

– Technical partner

cfong@deloitte.com.hk



Cecilia Kwei

– Technical manager

ckwei@deloitte.com.hk

Contact details for Deloitte's China Practice

Beijing

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Beijing Branch**
8/F Deloitte Tower
The Towers, Oriental Plaza
1 East Chang An Avenue
Beijing 100738, PRC
Tel: +86 10 8520 7788
Fax: +86 10 8518 1218

Chengdu

**Deloitte & Touche Financial Advisory
Services Limited**
Unit 3406, 34/F Yanlord Landmark Office
Tower
No. 1 Section 2, Renmin South Road
Chengdu 610016, PRC
Tel : +86 28 6210 2383
Fax : +86 28 6210 2385

Chongqing

**Deloitte & Touche Financial Advisory
Services (China) Limited**
Room 8, 33/F International Financial Center
28 Ming Quan Road
YuZhong District
Chongqing 400010, PRC
Tel: +86 23 6310 6206
Fax: +86 23 6310 61700

Dalian

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Dalian Branch**
Room 1503 Senmao Building
147 Zhongshan Road
Dalian 116011, PRC
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297

Guangzhou

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Guangzhou Branch**
26/F Teemtower
208 Tianhe Road
Guangzhou 510620, PRC
Tel: +86 20 8396 9228
Fax: +86 20 3888 0119 / 0121

Hangzhou

**Deloitte Business Advisory Services
(Hangzhou) Company Limited**
Room 605, Partition A
EAC Corporate Office
18 Jiaogong Road
Hangzhou 310013, PRC
Tel: +86 571 2811 1900
Fax: +86 571 2811 190

Harbin

**Deloitte Consulting (Shanghai)
Company Limited
Harbin Branch**
Room 1618, Development Zone Mansion
368 Changjiang Road
Nangang District
Harbin 150090, PRC
Tel: +86 451 8586 0060
Fax: +86 451 8586 0056

Hong Kong

Deloitte Touche Tohmatsu
35/F One Pacific Place
88 Queensway
Hong Kong
Tel: +852 2852 1600
Fax: +852 2541 1911

Jinan

**Deloitte & Touche Financial Advisory
Services Limited
Jinan Liaison Office**
Unit 1018, 10/F, Tower A, Citic Plaza
150 Luo Yuan Street
Jinan 250011, PRC
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068

Macau

Deloitte Touche Tohmatsu
19/F The Macau Square Apartment H-N
43-53A Av. do Infante D. Henrique
Macau
Tel: +853 2871 2998
Fax: +853 2871 3033

Nanjing

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Nanjing Branch**
11/F Golden Eagle Plaza
89 Hanzhong Road
Nanjing 210029, PRC
Tel: +86 25 5790 8880
Fax: +86 25 8691 8776

Shanghai

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP**
30/F Bund Center
222 Yan An Road East
Shanghai 200002, PRC
Tel: +86 21 6141 8888
Fax: +86 21 6335 0003

Shenzhen

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Shenzhen Branch**
13/F China Resources Building
5001 Shennan Road East
Shenzhen 518010, PRC
Tel: +86 755 8246 3255
Fax: +86 755 8246 3186

Suzhou

**Deloitte Business Advisory Services
(Shanghai) Limited
Suzhou Branch**
23/F Building 1
Global Wealth Square
88 Su Hui Road, Industrial Park
Suzhou 215021, PRC
Tel: +86 512 6289 1238
Fax: +86 512 6762 3338 / 3318

Tianjin

**Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Tianjin Branch**
30/F The Exchange North Tower
189 Nanjing Road
Heping District
Tianjin 300051, PRC
Tel: +86 22 2320 6688
Fax: +86 22 2320 6699

Wuhan

**Deloitte & Touche Financial Advisory
Services Limited
Wuhan Liaison Office**
Unit 2, 38/F New World International Trade
Tower
568 Jianshe Avenue
Wuhan 430022, PRC
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032

Xiamen

**Deloitte & Touche Financial Advisory
Services Limited
Xiamen Liaison Office**
Unit E, 26/F International Plaza
8 Lujiang Road, Siming District
Xiamen 361001, PRC
Tel: +86 592 2107 298
Fax: +86 592 2107 259

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