Financial reporting under the new Companies Ordinance

Paul Yeung and Benny Tang look at some of the changes and challenges that companies will have to take note of once subsidiary legislation is enacted and the law becomes effective next year

Hong Kong's new Companies Ordinance was gazetted on 10 August 2012, following the passage of the Companies Bill by the Legislative Council on 12 July 2012. The new ordinance is expected to become effective in 2014 after subsidiary legislation is enacted. It will supersede the existing Companies Ordinance (Cap. 32). In this article, we discuss some of the significant issues and changes introduced by the new ordinance.

Financial statements

Part 9, Division 3 of the new ordinance sets out detailed and complicated requirements for a company's financial reporting periods, introducing new terms such as "primary accounting reference date" and "first accounting reference period." In simple terms, the requirements of the new ordinance regarding financial reporting apply to financial years beginning on or after the commencement date of the new ordinance.

This principle that most accountants find familiar with applies well to simple cases when companies regularly prepare annual financial statements. Problematic cases may occur if a company does not prepare annual financial statements on a regular basis according to the requirements of Cap. 32. A literal interpretation does not suggest the possibility of an early application of the new ordinance.

The following examples suppose that the commencement date of the new ordinance is 1 January 2014. For a company that prepares annual financial statements ending on 31 December each year:

- the financial reporting requirements of the new ordinance do not apply to the company's financial statements for the year ending 31 December 2013. These financial statements are subject to Cap. 32;
- the first financial year under the new ordinance is the one that begins on 1 January 2014.

For a company prepares annual financial statements ending on 30 September each year:

- the financial statements for the year ending 30 September 2014 are subject to the relevant sections of Cap. 32. This is because the financial year began before and ends after the assumed commencement date of the new ordinance. According to Schedule 11 Paragraph 78 of the new ordinance, relevant sections of Cap. 32 continue to apply even though Cap. 32 is superseded by the new ordinance;
- the first financial year under the new ordinance is the one that begins on 1 October 2014.

Reporting exemptions

Part 9, Division 2 of the new ordinance sets out detailed requirements on reporting exemptions. In general, a company falling under the reporting exemption:

- is not required to prepare financial statements that give a true and fair view. Its financial statements are only required to comply with applicable accounting standards. The notion of "true and correct" in Cap. 32 is removed;
- may exclude one or more of its subsidiaries from its annual consolidated financial statements, provided that such exclusion complies with relevant accounting standards;
- need not disclose in its financial statements the remuneration of auditor;
- shall not prepare summary financial report in accordance with Part 9, Division 7 of the new ordinance.

Eligible companies

In general, the following private companies qualify for the reporting exemption:

- a "private company" which is not a subsidiary of another company and does not have a subsidiary, provided that all members of that company agree in writing that the reporting exemption applies;
- a "small private company"; a private company is considered small if any two of the following three conditions are satisfied: (a) its total annual revenue does not exceed HK$100 million; (b) its total assets do not exceed HK$100 million; and (c) the number of employees does not exceed 100;
- the holding company of a "group of small private companies";
- an "eligible private company", provided that: (a) at least 75 percent of members agree the reporting exemption applies in a general meeting; and (b) no member objects at the general meeting or at least six months before the end of the financial year; A private company is an "eligible private company" if any two of the following three conditions are satisfied: (i) its total annual revenue does not exceed HK$200 million; (ii) its total assets do not exceed HK$200 million; and (iii) the number of employees does not exceed 100;
- the holding company of a "group of eligible private companies."

A "small guarantee company" and the holding company of a "group of company limited by guarantee" also qualify for reporting exemption.

Given that HKFRSs and the HKFRS for Private Entities are fair presentation frameworks intended for financial statements giving a "true and fair" view, those companies taking

advantage of the reporting exemption under the new ordinance may adopt a compliance framework instead.

The existing reporting framework for small- and medium-sized enterprises would be a suitable tool, subject to appropriate amendment of its scope to make it in line with the new ordinance's reporting exemption.

Financial reporting standards

For the first time in Hong Kong, financial reporting standards have the so-called "statutory backing," as the new ordinance explicitly requires compliance with applicable accounting standards.

It is almost certain that the Hong Kong Institute of CPAs would be a body prescribed by the relevant subsidiary regulation of the new ordinance for setting applicable financial reporting standards.

This however adds uncertainty as to whether a company governed by the new ordinance is allowed to adopt IFRSs or not. Unless the International Accounting Standard Boards is also a prescribed body under the new ordinance, adoption of IFRSs alone by a company governed by the new ordinance may end up in an obvious technical non-compliance.

Financial year and its alteration

Cap. 32 does not have an explicit requirement on the length of the financial reporting period. In reality many accountants treat the 18-month limit for holding a company's first annual general meeting as the limit of the financial reporting period permitted by Cap. 32.

The new ordinance sets very specific requirements on the financial reporting period and its alteration. In general:

- the financial reporting period of a company should be 12 months;
- an alteration of the financial year shall not result in a reporting period longer than 18 months;
- an alternation of the reporting period for a current financial year shall not be made if the required period for laying out the financial statements at a general meeting has expired;
- the financial period shall not be extended if the company had extended an earlier financial period within the past five years, unless the change is made to coincide with the holding company's financial year or is approved by a member's resolution.

Consolidated financial statements

Cap. 32 suggests that a holding company shall, at the minimum, prepare consolidated financial statements as well as its own balance sheet and some additional notes on profit or loss at the company level. The new ordinance, however, requires that the directors of a holding company "must instead prepare" consolidated statements.

While this may suggest that an entity level balance sheet and the related note on company's profit or loss are no longer required by the new ordinance, Schedule 4 clarifies that the holding company must include in the notes to annual consolidated financial statements the following:

- the holding company's statement of financial position;
- the movement in the holding company's reserves (and no other notes on the holding company's statement of financial position is required).

More importantly, the new ordinance allows a holding company, which is itself a partially owned subsidiary of another body corporate, not to prepare consolidated financial statements if:

- the directors notify members in writing six months before the end of each financial year that they intend not to prepare consolidated financial statements;
- no request for consolidated financial statements is made to the directors by a member in writing three months before the end of each financial year.

Together with the effects of reporting exemption, it is expected that many meaningless consolidations of the financial statements of intermediate holding companies of private groups or unnecessary qualifications in auditor's reports would no longer happen.

Shares with no par value

Cap. 32 requires companies to ascribe a par value to their shares. The new ordinance, however, requires that shares in a company shall have no nominal value.

The abolition of par value renders the concepts "share premium" and "capital redemption reserve" redundant. They become part of the company's share capital under the new ordinance.

These changes also apply to shares issued before the start of the new ordinance. Section 37 of Schedule 11 requires that all share premium and capital redemption reserves that exist at the start date of the new ordinance shall become a part of the company's share capital.

Notes to the financial statements

Cap. 32 sets out various disclosures to be made in the notes to financial statements in its main body and schedules. The extent of disclosure requirements is significantly reduced in the new ordinance, as evidenced by the relatively simple Section 383 and Schedule 4.

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