

立法會

Legislative Council

LC Paper No. CB(1)162/04-05(01)

Ref:CB1/BC/3/04

Bills committee on Companies (Amendment) Bill 2004

Background Brief

Purpose

This paper sets out the background of the Companies (Amendment) Bill 2004, and summarizes the major concerns expressed by Members when the relevant proposals were deliberated at the meeting of the Panel on Financial Affairs (FA Panel) on 7 April 2003 and by various organizations in their submissions to the Bills Committee on Companies (Amendment) Bill 2003 (the 2003 Bills Committee).

Background

2. The Companies Ordinance (CO) (Cap. 32) is one of the largest and most complex pieces of legislation in Hong Kong. Since its last major review in 1984, continuous efforts have been made to update the Ordinance to keep it attuned to business needs. In June 2003, the Administration introduced the Companies (Amendment) Bill 2003 (the 2003 Bill) into the Legislative Council (LegCo). The four main groups of proposed legislative amendments were set out in Schedules 1 to 4 of the 2003 Bill, including Schedule 2 which sought to make the meaning of “subsidiary” in the CO more closely in alignment with that in the International Accounting Standards (IASs) in the context of group accounts. The 2003 Bills Committee was formed to scrutinize the 2003 Bill. At the later stage of the Bills Committee’s deliberation, the Administration advised members that in view of time and resource constraints, it had decided to delete Schedule 2 and the related consequential amendments from the 2003 Bill. The 2003 Bill with Schedule 2 and the related consequential amendments removed was subsequently passed in July 2004.

3. On 13 October 2004, the Administration introduced the Companies (Amendment) Bill 2004 (the 2004 Bill) into LegCo in order to implement the proposals relating to group accounts. According to the Administration, apart from some textual amendments of minor nature, the 2004 Bill is the same in substance as the relevant proposals in the 2003 Bill. A mark-up copy of the

2004 Bill showing the minor amendments is attached in Annex B to the LegCo Brief.

Objectives of the Bill

4. Section 124 of the CO requires a company having subsidiaries to lay before the company in general meeting accounts dealing with the state of affairs and the profit and loss of company itself and its subsidiaries. These accounts are known as group accounts. The definition of the term “subsidiary” in section 2(4) which applies to accounting and other provisions in the CO is narrower than that adopted in the IASs. The Administration considers it necessary to amend the statutory definition for the purposes of group accounts to make it more closely in alignment with the IASs. This would ensure that under the law, the group accounts would better reflect the financial position of the company. The definition of “subsidiary” for purposes other than the preparation of group accounts would not be affected.

5. The 2004 Bill covers the following major proposed amendments –

- (a) To introduce new terms of “subsidiary undertaking”, “parent company” and “parent undertaking”;
- (b) To add “the right to exercise a dominant influence over another undertaking” (defined as the right to give directions with respect to the operating and financial policies of that other undertaking which its directors will be obliged to comply with) to the existing tests of determining the existence of a parent/subsidiary relationship; and
- (c) To introduce “true and fair view override” provisions to the effect that if compliance with the requirements of the CO does not result in a true and fair view of the state of affairs of the company or the group, the directors should depart from these requirements to the extent necessary to give a true and fair view.

Members’ major concerns expressed at Panel meeting

6. At its meeting on 7 April 2003, the FA Panel was briefed on the proposed amendments to the CO, including the proposed amendments to amend the definition of the term “subsidiary” in the Ordinance for the purposes of group accounts. Some members enquired about whether changes would be introduced to existing accounting rules and regulations for companies to allow for the calculation of tax on a group account basis so that losses incurred by subsidiaries would offset profits of the parent company. The Administration

confirmed that the proposed changes would not affect the present tax regime. To facilitate Members in scrutinizing the proposed amendments, the Administration was urged to provide a comparison between the relevant legislation of overseas jurisdictions and the Administration's proposed amendments when the relevant bill was introduced into LegCo.

7. An extract from the minutes of the FA Panel meeting on 7 April 2003 (LC Paper No. CB(1)2046/02-03) is attached in **Appendix I**.

Major concerns expressed by various organizations to the Bills Committee on Companies (Amendment) Bill 2003

8. Notwithstanding that the 2003 Bills Committee has not deliberated on the proposals relating to group accounts, it has received submissions from the following organizations and academic on the proposals -

- (a) The Stock Exchange of Hong Kong;
- (b) The Chinese General Chamber of Commerce (CGCC);
- (c) The Hong Kong Chinese Enterprises Association (HKCEA);
- (d) Linklaters;
- (e) The Hong Kong Capital Markets Association (HKCMA); and
- (f) A Lecturer of the Department of Professional Legal Education, University of Hong Kong.

9. The major concerns of the above organizations are summarized as follows:

- (a) As there are differences in the accounting practices between Hong Kong and the Mainland, some Mainland companies may have difficulties in preparing their group accounts in accordance with the new statutory requirement (*CGCC*);
- (b) The proposed amendments to extend the meaning of "subsidiary" for the purposes of preparing group accounts to include "subsidiary undertaking" and "the right to exercise a dominant influence over another undertaking" would likely have a negative impact on the development of the asset securitization market in Hong Kong. The consolidation of special purpose entities brought about by the extended definition of "subsidiary" would undermine the incentive for asset securitization (*HKCEA, Linklaters and HKCMA*);

- (c) Since the IASs are under review and may be subject to modification, the consultation and consideration period for the proposed amendments should be extended (*HKCMA*);
- (d) It would be important to clarify whether more than one entity can exercise a “dominant influence” over another undertaking in the Hong Kong context, e.g. through joint control (*Linklaters*);
- (e) On the proposal to add “the right to exercise a dominant influence over another undertaking” to the existing test of determining the existence of a parent/subsidiary relationship, this additional test goes further than the tests outlined under the current Hong Kong Generally Accepted Accounting Principles and IASs, and may add further ambiguity to the treatment of special purpose entities (*HKCMA*); and
- (f) The discretion for directors to apply the “true and fair view override” provisions without more specific guidance or without the reference to “special circumstances” as in the case of their UK equivalents may create problems or uncertainties on how the discretion should be exercised. The Hong Kong Institute of Certified Public Accountants should provide practical guidelines on the application of the relevant provisions, and the provisions should not become effective until such guidelines have been developed (*Linklaters*).

10. An extract from the “Summary of deputations’ views” (LC Paper No. CB(1)74/03-04(04)) for the consideration of the 2003 Bills Committee is attached in **Appendix II**.

References

11. A list of relevant papers is set out in **Appendix III**.

**Extract from the minutes of meeting
of the Panel on Financial Affairs on 7 April 2003**



Action

IV Briefing on the legislative proposals on the Companies (Amendment) Bill 2003

(LC Paper No. CB(1) 1133/02-03(06))

5. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)(DS(FS)) briefed members on the proposals to amend the Companies Ordinance (CO) (Cap. 32) to facilitate offers of shares and debentures, enhance shareholder remedies, define "subsidiary" for the purposes of group accounts, enable electronic incorporation and update the provision on partner limit. The Administration was drafting the above legislative amendments with a view to including them in the Companies (Amendment) Bill 2003 (the Bill) to be submitted to Legislative Council (the Council) in the 2002-03 session.

Discussion with members

Access to company records

6. Noting that the proposal allowing shareholders' access to company records might be subject to abuse, Mr Henry WU enquired about checks and balances to be put in place to address the problem. In reply, DS(FS) explained that as the order for inspection of records would be made by the court on condition that the applicant was acting in good faith and the inspection was for a proper purpose, sufficient checks and balances would be provided in the system.

Facilitation in the offers of shares and debentures

7. Regarding proposals to facilitate the offer of shares and debentures (i.e. paragraphs 6 and 7 of the paper), Mr James TIEN asked how investors would be protected against misleading or false information disclosed by companies on their business and performance in its marketing materials. In reply, Mr William PEARSON, Director, Corporate Finance, Securities and Futures Commission remarked that only factual and procedural rather than promotional information would be permitted in the issue of "awareness advertisements". Such

advertisements would not constitute prospectuses nor prohibited advertisements under relevant securities laws.

Definition of "subsidiary" for the purposes of group accounts

8. In response to Mr James TIEN's question, DS(FS) explained that the definition of a subsidiary under section 2(4) of CO was narrower than those adopted in the International Accounting Standards (IAS) and the Hong Kong Statements of Standard Accounting Practice (SSAP), the Administration considered it necessary to amend the statutory definition to more closely align with them.

9. As to Mr James TIEN's enquiry about whether accounting rules and regulations would be changed accordingly to allow for the calculation of tax on a group account basis so that losses incurred by subsidiaries would offset profits of the parent company, DS(FS) confirmed that the proposed changes would not affect the present tax regime.

Reference to overseas experience

10. Mr Henry WU remarked that the approach of making reference to company laws of different overseas jurisdictions might result in inconsistencies in the legislation and cautioned against the piecemeal adoption of systems in overseas legislation. In reply, DS(FS) advised that the Administration's policy was to adopt the best practices of different overseas jurisdictions. In working out the current proposals on shareholder remedies, reference had been made to relevant legislation in Australia as it had a well-developed regime for protecting shareholders' rights. On the definition of subsidiary, reference was made to the IAS and UK Companies Act as the UK's accounting system and company law regime were similar to those in Hong Kong.

11. The Chairman opined that it would facilitate members in scrutinizing the Bill if the Administration would provide information comparing the legislation of overseas jurisdictions and the present proposals. He urged the Administration to provide the information when introducing the Bill into the Council.

* * * * *

Bills Committee on Companies (Amendment) Bill 2003

**Summary of deputations' views
(position as at 15 October 2003)**

(Only relevant extracts, i.e. pages 13 to 16 of the summary, are attached)

Section No. of Schedule 2 / Subject	Name of organizations/individuals	Major views on the Bill
General comments on Schedule 2	The Stock Exchange of Hong Kong Limited (SEHK)	SEHK supports the amendments to introduce the concepts from the United Kingdom (UK) of an "undertaking" and control by virtue of "the right to exercise of a dominant influence over another undertaking". SEHK will propose further amendments to its Listing Rules particularly in the area of notifiable transactions upon implementation of the Bill.
	The Chinese General Chamber of Commerce (CGCC)	CGCC supports the proposal to modify the term of "subsidiary" in the Ordinance to more closely align with international practices. CGCC anticipates that the modification will not have significant effect on Hong Kong companies. However as there are differences in the accounting practices between Hong Kong and the Mainland, some Mainland companies may have difficulties in preparing their group accounts in accordance with the new statutory requirement.
	The Hong Kong Chinese Enterprises Association Linklaters The Hong Kong Capital Markets Association (HKCMA)	The proposed amendments to extend the meaning of "subsidiary" for the purposes of preparing group accounts to include "subsidiary undertaking" and "the right to exercise a dominant influence over another undertaking" would likely have a negative effect on the development of the asset securitisation market in Hong Kong. The consolidation of special purpose entities (SPEs) brought about by the extended definition of "subsidiary" would undermine the incentive for asset securitization.
	HKCMA	HKCMA is concerned that the combined effects of adopting the SSAP32 ¹ , IAS ² (in its current evolving format) and the proposed amendments to the Companies Ordinance will greatly hamper the development of the securitisation market in Hong Kong, in a manner that would be disadvantageous to companies that account under HKGAAP (Hong Kong Generally Accepted Accounting Principles) against those that account under, for example, United States GAAP.

¹ SSAP32 denotes the Hong Kong Society of Accountant's statement of Standard Accounting Practice for Consolidated Financial Statements and Accounting for Investments in Subsidiaries.

² IAS denotes International Accounting Standards.

Section No. of Schedule 2 / Subject	Name of organizations/individuals	Major views on the Bill
<p>General comments on Schedule 2 (<i>Cont'd</i>)</p>	<p>HKCMA (<i>Cont'd</i>)</p>	<p>The relevant IAS (IAS27, IAS39 and SIC 12) are currently being reviewed and may be modified further to accommodate the concerns of financial services industry professionals. Should the International Accounting Standards Board (IASB) significantly amend IAS to address issues pertaining to the consolidation of special purpose entities, HKSA would most likely follow, and that may require another change to the definition of "subsidiary" under the Companies Ordinance.</p> <p>It is also probable that the proposed amendments to the Companies Ordinance may not ultimately be entirely in accordance with the results of the convergence review of current international accounting standards being undertaken by the Financial Accounting Standards Board (FASB) in the United States and the IASB. If there is a change of approach as a result of the review (scheduled for completion by January 2005), Hong Kong's legislation may become outdated, possibly even before it has come into effect.</p> <p>Premature application of the proposed legislative amendments and the resultant consolidation of securitisation SPEs may also have the inadvertent effect of misleading investors and analysts into thinking that a company that has securitised assets (the Originator) has more assets at its disposal than it actually does.</p> <p>HKCMA requests that the consultation and consideration period for the proposed amendments be extended until at least such time as there is further clarity on the position of the IASB in relation to the proposed amendments to IAS27, IAS39 and other relevant standards.</p>

Section No. of Schedule 2 / Subject	Name of organizations/individuals	Major views on the Bill
General comments on Schedule 2 <i>(Cont'd)</i>	Linklaters	In the light of the current of flux in relation to the accounts consolidation treatment of special purpose entities formed for the purpose of securitization, a better alternative at this stage is to provide a clear "carve out" in the Schedule 2 amendments to exclude their application to securitization transactions and special purpose entities specifically.
Section 1 - <i>Section added (Construction of references to parent company, etc.)</i> Proposed Twenty-third Schedule - <i>Parent and subsidiary undertakings</i>	Ms Alice CHAN, Lecturer of Department of Professional Legal Education, University of Hong Kong	<p>By virtue of proposed new section 2B(3), all references to a "subsidiary" in the Third Schedule (<i>Matters to be Specified in Prospectus and Reports to be set out therein</i>) will be deemed to include a subsidiary undertaking.</p> <p>Under the Bill, there are three scenarios (<i>as specified in section 2 of Twenty-third Schedule</i>) whereby an entity will be deemed to be a "subsidiary undertaking" of another entity. Ms CHAN is of the view that one uniform test, namely the criteria under section 2(1)(b) of the Twenty-third Schedule, should apply to both bodies corporate and non-bodies corporate. Under UK Companies Act the same test is applicable irrespective of the legal nature of the entity.</p> <p>With respect to sections 2(1)(b)(ii) and (iii) of the Twenty-third Schedule, the requirement that the parent undertaking be a "member" of the subsidiary undertaking is a potential loophole. The drafting of the relevant provisions should be tightened instead of simply transplanting the corresponding wording from the UK statute. (<i>In her submission, Ms CHAN quoted some related comments from Gore-Browne on Companies, a leading UK company law textbook.</i>)</p>

Section No. of Schedule 2 / Subject	Name of organizations/individuals	Major views on the Bill
Sections 2 and 4 - <i>Contents and form of accounts</i>	Linklaters	<p>Linklaters is concerned that the discretion for directors to exercise the "true and fair view override" under the proposed sections 124(4A) and 126(5) without more specific guidance or without the reference to "special circumstances" as in the case of their UK equivalents may create problems or uncertainties on how the discretion should be exercised.</p> <p>Linklaters suggests that the Hong Kong Society of Accountants should provide practical guidelines on the application of the "override" provisions, and that the proposed amendments in sections 2 and 4 of Schedule 2 should not become effective until such guidelines have been developed.</p>
Proposed Twenty-third Schedule - <i>Parent and subsidiary undertakings</i>	Linklaters	<p>On sections 2(1)(c) and 2(4) of the Twenty-third Schedule, it would be important to clarify whether more than one entity can exercise a "dominant influence" over another undertaking in the Hong Kong context, e.g. through joint control.</p> <p>"Control contracts" are not common in relation to UK companies in practice. They are more relevant to European companies. Hence, it seems that the meaning of "control contracts" under the Hong Kong provisions may need to be more specifically considered.</p>
	HKCMA	<p>On the proposal to add the <i>"right to exercise a dominant influence over another undertaking"</i> to the existing test of determining the existence of a parent/subsidiary relationship, HKCMA notes that this additional test goes further than the tests outlined under current HKGAAP and IAS, and may add further ambiguity to the treatment of SPEs.</p>

Companies (Amendment) Bill 2004

List of relevant papers (Position as at 15 October 2004)

Paper	LC Paper No.
Administration's paper on "Summary of the Proposals in the Companies (Amendment) Bill 2003"	CB(1)2434/02-03(03) <i>(issued in September 2003 to the Bills Committee on Companies (Amendment) Bill 2003)</i>
Paper prepared by the Legislative Council Secretariat on "Summary of deputations' views (position as at 15 October 2003)"	CB(1)74/03-04(04) <i>(issued in October 2003 to the Bills Committee on Companies (Amendment) Bill 2003)</i>
Report of the Bills Committee on Companies (Amendment) Bill 2003	CB(1)2264/03-04 <i>(issued in June 2004)</i>
Administration's paper on "Overall Review of the Companies Ordinance"	CB(1)2254/03-04(05) <i>(discussed at the FA Panel meeting on 5 July 2004)</i>
Legislative Council Brief on Companies (Amendment) Bill 2004	File Ref: C2/1/57/2(04) Pt. 5 <i>(issued by the Financial Secretary and the Treasury Bureau on 6 October 2004)</i>
Legal Service Division Report on Companies (Amendment) Bill 2004	LS2/04-05 <i>(issued on 14 October 2004)</i>