

Bills Committee on Companies Bill

Part 9 of the Companies Bill

PURPOSE

This paper explains the major proposals and policy issues in Part 9 (Accounts and Audit) of the Companies Bill. It also outlines relevant overseas experience, public views received during earlier public consultation on the major proposals and our responses.

DETAILS

2. Details of Part 9 are contained in the Annex.

ADVICE SOUGHT

3. Members are invited to note the contents of the paper and provide their views.

Financial Services and the Treasury Bureau

Companies Registry

11 April 2011

Bills Committee on Companies Bill

Part 9 – Accounts and Audit

INTRODUCTION

This paper outlines the major proposals in Part 9 (Accounts and Audit) of the Companies Bill (“the Bill”), which contains the accounting and auditing requirements, namely 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 enterprises (“SMEs”) to take advantage of simplified accounting and reporting, to require public and other large companies to include an analytical business review in directors’ reports, and to enhance auditors’ right to information.

POLICY OBJECTIVES AND MAJOR PROPOSALS

2. This Part contains initiatives that aim at business facilitation, namely –

- (a) Relaxing the criteria for small companies to prepare simplified financial and directors’ reports (paragraphs 6 to 13 below); and
- (b) Making the summary financial report provisions more user-friendly and extending their application to all companies (paragraphs 14 to 20 below).

3. There are also initiatives to enhance corporate governance, namely –

- (a) Requiring public companies and other companies that do not qualify for simplified reporting to prepare a “business review”

within the directors' report, whilst allowing private companies to opt out by special resolution (paragraphs 21 to 27 below);

- (b) Empowering auditors to request information from a wider range of persons for the performance of their duties (paragraphs 28 to 32 below); and
- (c) Improving transparency with regard to circumstances of cessation of office of an auditor (paragraphs 33 to 39 below).

4. This Part also modernises and improves the law by –

- (a) Clarifying the financial year of a company (paragraphs 40 to 45 below); and
- (b) Streamlining disclosure requirements that overlap with the accounting standards (paragraphs 46 to 52 below).

5. The details of the major proposals in Part 9 are set out in paragraphs 6 to 52 below.

Relaxing the criteria for small companies to prepare simplified financial and directors' reports (Clauses 358 to 362 and Schedule 3)

Current position

6. Section 141D of the Companies Ordinance ("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 ("SME-FRF") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), a Hong Kong company qualifies for reporting based on the SME-Financial Reporting Standard ("SME-FRS") if it satisfies the requirement under section 141D. Currently the SME-FRF is not applicable to groups of companies or guarantee companies at all.

Proposal

7. After consulting the HKICPA, we consider there is room to relax the criteria for small companies to prepare simplified financial and directors' reports along the following lines –

- (a) a private company (except for a banking/deposit-taking company, an insurance company or a stock-broking company) will automatically be qualified for simplified reporting if it is a “small private company”, i.e. a private company that satisfies any two of the following conditions:
 - (i) Total annual revenue of not more than HK\$50 million.
 - (ii) Total assets of not more than HK\$50 million.
 - (iii) No more than 50 employees;

- (b) a private company that is the holding company of a “group of small private companies”, i.e. a group of private companies that satisfies any two of the following conditions is qualified for simplified reporting:
 - (i) Aggregate total annual revenue of not more than HK\$50 million net.
 - (ii) Aggregate total assets of not more than HK\$50 million net.
 - (iii) No more than 50 employees; and

- (c) “a small guarantee company” or a guarantee company that is the holding company of a “group of small guarantee companies” (total annual revenue must be not more than HK\$25 million) is also qualified for simplified reporting¹.

Key provisions in the Bill

8. **Clauses 358(1) and (2), 359, 361 and sections 1(1), (5) and (6)**

¹ For guarantee companies, the total assets and number of employees may not be suitable criteria to distinguish the large from the small ones.

of **Schedule 3** set out the qualifying conditions for a “small private company” and a “group of small private companies” which may benefit from simplified reporting (referred to as “reporting exemption” in the Bill). The qualifying conditions for a “small guarantee company” and a “group of small guarantee companies” are set out in **clauses 358(1), (3), 360 and 362 and sections 1(3) and (8) of Schedule 3**. The qualifying conditions in Schedule 3 may be amended by the Financial Secretary by notice published in the Gazette. The notice is subject to negative vetting by the Legislative Council.

9. **Clause 376(4)(b) and 8(a)** provide that the financial statements must comply with the accounting standards applicable to the financial statements which are issued by a body to be prescribed by Regulation (we have in mind the HKICPA). The simplified reporting requirements enjoyed by companies falling within the reporting exemption are summarized in **Appendix 1**.

Overseas experience

10. The proposal has been developed in light of our local circumstances and in consultation with the HKICPA. Other jurisdictions often prescribe different accounting and reporting requirements for companies of different sizes. The criteria for categorisation as small companies and groups for the purposes of simplified reporting vary from country to country.²

Public consultation

11. During the second phase public consultation of the Draft Bill conducted in May to August 2010, HKICPA and most major accounting firms expressed reservations about the proposal in the Draft Bill at the time to extend the possible use of SME-FRS to private companies/groups of any size, where members holding 75% of the voting rights so resolve and no member objects. Their reservations mainly stemmed from the

² In the United Kingdom (“UK”), sections 381 to 384 of the United Kingdom Companies Act 2006 (“UKCA 2006”) provide the qualifying conditions for companies subject to the small companies regime. In Australia, a small proprietary company is not required to prepare a financial report and directors’ report, or to have the financial report audited, unless it is directed to do so by shareholders with at least 5% of the votes in the company or by Australian Securities and Investments Commission : sections 45A, 292 to 294 of the Australia Corporation Act 2001 (“ACA”).

fact that SME-FRS was developed essentially for SMEs as an alternative to the full HKFRSs and generally has much simpler accounting requirements. Therefore, SME-FRS might not be able to reflect, with the degree of transparency that would be expected, the state of affairs of sizeable companies/groups with more complex accounts.

12. HKICPA also did not support the proposal in the Draft Bill that all companies incorporated in Hong Kong should be required to present their financial statements in accordance with a “true and fair view”. According to HKICPA, auditors are currently not permitted to express a “true and fair” opinion on financial statements prepared under SME-FRF and SME-FRS, as this is considered a compliance framework, as defined in the Hong Kong Standard on Auditing (HKSA) 200 (Clarified). Instead, for financial statements prepared under such framework, auditors should express an opinion as to whether the relevant financial statements are prepared, in all material respects, in accordance with the framework.

13. In the light of the above concerns and the fact that a simpler Hong Kong Financial Reporting Standard for Private Entities is now available as a reporting option for the larger private companies/groups that do not satisfy the qualifying criteria for simplified reporting, we decide not to introduce the option for larger private companies/groups to opt for simplified reporting requirements based on approval by members holding 75% voting rights and no objection from the remaining members. We have also exempted the financial statements of the companies preparing simplified financial reports from the “true and fair view” requirement (clause 376(7)).³

Making the summary financial report provisions more user-friendly and extending application to all companies (Clauses 429 to 437)

Current position

14. Under sections 141CA to 141CH of the CO, a listed company

³ The financial statements of such a company are required to comply with the accounting disclosures in Schedule 4 Part 1, the applicable accounting standards and any other requirements of the new Ordinance in relation to financial statements (clauses 376(3) and (4)). The auditor of such a company is required to state in the auditor’s report whether the financial statements have been properly prepared in compliance with the new Ordinance, which includes compliance with the applicable accounting standards.

may send a summary financial report to its members and debenture holders in place of the accounts, directors' and auditor's reports required to be sent under section 129G of the CO provided that it has obtained the agreement of those persons. Very few listed companies have offered the alternative of providing summary financial reports to members under those sections, partly due to cost considerations and partly because the company has to obtain the members' consent by complying with complex rules for sending notification to and receiving a response from the members.

15. Currently, there is no exemption for listed companies incorporated in Hong Kong not to send out accounts and reports or summary financial reports. However, in some other jurisdictions, those documents need not be sent if the members so request⁴.

Proposal

16. We propose to make the summary financial report provisions more user-friendly so as to encourage the publication of summary financial reports and help save operating costs. The provisions will be applicable to all companies (other than those qualified for simplified reporting) rather than being only applicable to listed companies as in the CO. Unlike the CO, members' consent is not required before a company can send a copy of summary financial report.

Key provisions in the Bill

17. Under **clause 432**, companies (other than those qualified for simplified reporting) are given a choice of sending a copy of the summary financial report instead of a copy of the full "reporting documents" (defined in **clause 356(2)** to mean the financial statements, directors' and auditor's reports for the financial year) to their members. This will avoid the complex rules which require a company to ask its members in advance before it can send them a copy of the summary financial report. Members receiving summary financial reports may request a copy of the full reporting documents from the company (**clause 436**).

⁴ See section 316(1)(a) of the ACA and section 203A(3) of the Singapore Companies Act ("SCA") and regulation 3(1)(f)(iii) of the Singaporean Companies (Summary Financial Statement) Regulations.

18. Under **clause 433**, the company can at any time ascertain the wishes of its members or potential members through a “notification” which allows them to elect to receive a copy of the reporting documents, or a copy of the summary financial report in hard copy form, or electronic form, or by making it available on a website; or not to receive any copies of the documents.

Overseas experience

19. There are similar provisions facilitating the use of summary financial reports in Australia, Singapore and the UK⁵.

Public consultation

20. During the public consultation on the accounting and auditing provisions of the CO conducted in 2007, there was broad support for the proposal to make the summary financial report provisions more user-friendly⁶. During the second phase public consultation of the Draft Bill, there were no substantive comments on the proposal.

Requiring public companies and other companies that do not qualify for simplified reporting to prepare a “business review” within the directors’ report, whilst allowing private companies to opt out by special resolution (Clause 380 and Schedule 5)

Current position

21. The directors’ report is basically a report of the company information that people may wish to know about but is not included in the accounts. Section 129D of the CO sets out the detailed information required. The report must be approved by the board of directors. A copy of the report must be sent to every member and debenture holder of the company together with a copy of the accounts and the auditors’ report.

⁵ The provisions are sections 314 and 316 of the ACA, section 203A of the SCA and section 426 of the UKCA 2006.

⁶ See Appendix III to Consultation Conclusions on the Accounting and Auditing Provisions of the CO (March 2008) available at www.fstb.gov.hk/fsb/co_rewrite.

Proposal

22. To provide more useful information for members of the company and to enhance shareholder engagement, we propose that all public companies and “large” private companies or “large” guarantee companies (i.e. those not qualified for simplified reporting, see paragraph 7 above) should be required to prepare as part of the directors’ report, a business review which is more analytical and forward-looking than the information currently required under the CO. We also propose that “large” private companies may opt out of the requirement to prepare a business review if so approved by a special resolution.

23. Modelled on section 417 of the United Kingdom Companies Act (“UKCA 2006”), the business review will provide additional information for shareholders and help 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.

Key provisions in the Bill

24. **Clause 380** and **Schedule 5** provide for the directors’ duty to prepare a directors’ report and the detailed requirements of a business review. The business review consists of 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. 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 and on which the company’s success depends. Schedule 5 may be amended by the Financial Secretary by notice

published in the Gazette. The notice is subject to negative vetting by the Legislative Council. The exemptions from preparation of a business review are set out in **Clause 380(3)** which include wholly-owned subsidiary companies. The holding company of such companies will prepare the business review unless it is exempted on other grounds.

25. To encourage meaningful reporting and to limit directors' civil liability for statements or omissions in the directors' report, **clause 439** provides a "safe harbour" clause along the lines of section 463 of the UKCA 2006. Directors are liable to the company only in respect of loss suffered by it as result of any untrue or misleading statements or the omission of anything required to be included. The directors are only liable if they knew a statement was made in bad faith or recklessly, or an omission was made for deliberate and dishonest concealment of material facts.

Overseas experience

26. The proposal is substantially based on provisions in the UKCA 2006 (particularly section 417), with modifications made in light of the feedback received in public consultations (see paragraph 27 below).

Public consultation

27. During the second phase public consultation of the Draft Bill, we received a number of comments on the proposal. The major comments and our response are summarised below –

Major comments	Administration's response
Some respondents did not see the need for private companies to prepare a business review and were concerned about the additional cost involved.	In addition to those SMEs that are already eligible for simplified reporting, private companies can opt out of the business review requirement by special resolution. We consider that this would address the concern about the requirement being too onerous for

Major comments	Administration's response
	private companies.
Some considered that wholly-owned subsidiary companies (whether public or private) should be exempted as they are similar to that of owner-managed companies.	Wholly-owned subsidiary companies are exempted from the business review requirement (see paragraph 24 above).
HKICPA and a few other respondents suggested adding a "safe harbour" clause which would provide directors with protection from civil liability for statements or omissions in the directors' report.	A "safe harbour" provision along the lines of section 463 of the UKCA 2006 (paragraph 25 above) has been added.
Some respondents queried that prohibiting disclosure by cross-referring to the directors' report under clause 9.32 of the Draft Bill was unnecessarily restrictive. Currently, for listed companies, a business review is normally included as a separate section from the directors' report in the annual report. For presentation purposes, listed companies should have the flexibility to cross-refer to information in the annual report.	The provision prohibiting disclosure by cross-reference has been deleted.
There was concern over the lack of objective measure to judge the meaning of "balanced and	We have deleted the requirement for a "balanced and comprehensive analysis" as the

Major comments	Administration's response
comprehensive analysis" in clause 9.31(2) ⁷ of the Draft Bill rendering this requirement unduly burdensome to directors.	contents of the business review are adequately covered by the provisions in Schedule 5.

Empowering auditors to obtain information from a wider range of persons for the performance of their duties (Clause 403)

Current position

28. To ensure that an auditor will be in a position to perform his oversight functions in an effective manner, it is important for him to have access to the relevant information regarding the state of affairs of the company. The auditor's current rights to information as set out in sections 133(1) and 141(5) of the CO are considered to be too restrictive. For example, under section 133(1), only a Hong Kong subsidiary and its auditor have the duty to give information and explanations.

Proposal

29. We propose to empower auditors to require a wider range of persons to provide them with information and explanations as they reasonably require for the performance of their duties.

Key provisions in the Bill

30. **Clause 403** provides that auditors will be empowered to require information and explanations that they reasonably require for the performance of their duties as auditors from a wider range of persons, namely -

- a person holding or accountable for any accounting records of the company;

⁷ Clause 9.31(2) stipulated that a business review must be a balanced and comprehensive analysis, consistent with the size and complexity of the company's business, of:-

- (a) the development and performance of the company's business during the financial year; and
- (b) the position of the company's business at the end of the financial year.

- any such person or a former officer of the company at a time to which the information and explanation relates;

(where there is a Hong Kong incorporated subsidiary)

- a person holding or accountable for any accounting records or an officer of a Hong Kong incorporated subsidiary;
- any such person, a former officer or former auditor of such a Hong Kong incorporated subsidiary at a time to which the information and explanation relates;
- a former Hong Kong incorporated subsidiary at a time to which the information and explanation relates;

(where there is a subsidiary undertaking that is not a Hong Kong incorporated subsidiary)

- a person holding or accountable for any accounting records, an officer or an auditor of a subsidiary undertaking that is not a Hong Kong incorporated subsidiary;
- any such person, a former officer or former auditor of such a subsidiary undertaking at a time to which the information and explanation relates.

Failure to comply with the requirement to provide information, etc. to auditors will be subject to criminal sanctions under **Clause 404**.

Overseas experience

31. The proposal is modelled on sections 499 and 500 of the UKCA 2006, with modifications made in light of the feedback received in public consultations (see paragraph 32 below).

Public consultation

32. During the second phase public consultation of the Draft Bill, we have received a number of comments on the proposal in clause 9.56 of the Draft Bill. The major comments and our response are summarized below –

Major comments	Administration’s response
<p>A number of respondents were concerned that the scope of persons that were required to provide information (e.g. covering employees or ex-employees of the company and subsidiaries) in the draft Bill was too wide. Subjecting employees and ex-employees to criminal sanctions for failing to provide information to auditors was potentially unfair and oppressive.</p>	<p>We have removed “employee” and ex-employees of companies or their subsidiary undertakings from the scope of persons liable to give information to the auditors.</p>
<p>There was concern that requiring the provision of “assistance” to auditors (in addition to information and explanations) in the draft Bill was too broad and over-reaching.</p>	<p>We have removed the requirement to give “assistance” to auditors.</p>
<p>Other drafting comments on the draft Bill:</p> <ul style="list-style-type: none"> • terms such as “without delay” are too vague and should be more clearly defined; and • the requirement should not be based on what “the auditor thinks necessary for the performance of his duties as auditor of the company”, but rather on what is reasonably necessary for the performance of his duties. 	<p>We have substituted:</p> <ul style="list-style-type: none"> • “as soon as practicable” for “without delay” to address the concern about vagueness of the term (clause 403(3) & (6)); and • “that the auditor reasonably requires” for “that the auditor thinks necessary” to address the concern about the lack of an objective test in the requirement (clause 403(2)).

Improving transparency with regard to circumstances of cessation of office of an auditor (Clauses 412 to 418)

Current position

33. Under section 140A(2) of the CO, a resigning auditor is required to make a statement in the notice of resignation as to whether there are any circumstances connected with his resignation that he considers should be brought to the notice of the members or creditors of the company, and if so, a statement of any such circumstances (“statement of circumstances”). Auditors who have ceased office owing to other reasons, e.g. removal or not being re-appointed after retirement, are not required to make such a statement.

Proposal

34. To improve transparency and corporate governance, we propose to expand an outgoing auditor’s rights to make a statement of circumstances so that it will be extended to an auditor who has been removed and a retiring auditor who has not been reappointed.

Key provisions in the Bill

35. **Clauses 415 and 416** provide for an outgoing auditor’s duties to give the company a statement of circumstances connected with the resignation or the termination of appointment due to removal from office or retirement without reappointment. The company must send a copy of the statement to the members or apply to the Court of First Instance for an order directing copies of the statement not to be sent to the members (**clause 417**). **Clause 418** provides for the court’s powers to give the directions if the court is satisfied that the outgoing auditor has abused the use of the statement.

36. If the outgoing auditor has not received notice of an application to the court within 21 days of the company receiving the statement, the auditor must send a copy of the statement to the Registrar within a further 7 days (**clause 417(5)**). The outgoing auditor is also required to do so if he / she receives notice that the court does not grant the application not to

send the statement to the members (**clause 418(5)**).⁸

37. **Clause 401** is new and gives auditors qualified privilege for statements made in the course of their duties as auditors. A cessation statement and a statement of circumstances made by an outgoing auditor will be covered by such privilege so that an outgoing auditor will not, in the absence of malice on his part, be liable in any action for defamation in respect of the cessation statement or the statement of circumstances made by him under **clauses 413 to 416**.

Overseas experience

38. There are similar provisions in the UKCA 2006⁹. Clause 401 (auditors' qualified privilege) is modeled on section 208 of the SCA.

Public consultation

39. During the second phase public consultation of the Draft Bill, we received a number of comments on the proposal. The major comments and our response are summarised below –

Major comments	Administration's response
A respondent suggested that there should be a requirement in all cases of an auditor ceasing to hold office for the auditor's statement of circumstances to be filed with the Registrar. In order to facilitate regulatory oversight of changes in auditors, an outgoing auditor's statement of circumstances should be sent to the appropriate audit and financial statements regulators.	The Bill confines the cases in which an outgoing auditor is required to give a statement of circumstances to potentially controversial cases, such as resignation, removal and retirement without reappointment only. Delivery of the statement to the Registrar is required in such cases. It is considered unnecessary to require an outgoing auditor to give a statement in other cases.

⁸ Under sections 140A(3) and (6) of the CO, it is the duty of the company to send a copy of the statement to the Registrar.

⁹ The comparable provisions in the UK are sections 516, 519 to 521 of the UKCA 2006.

Clarifying the financial year of a company (Clauses 363 to 367)

Current position

40. At present, the CO does not provide for a company's accounting reference period. Section 122 of the CO requires accounts to be made out every year and to be laid before the company at its annual general meeting ("AGM"), and those accounts must be made up to a date falling not more than a specified number of months before the date of the AGM. The financial year is defined in section 2(1) of the CO as the period in respect of which the accounts so laid are made up. Section 111 of the CO requires every company to hold an AGM in each year and not more than 15 months is to elapse between the date of one AGM and the next but there are no rules on shorter accounting periods. In addition, there is currently no provision to regulate the first accounting period, except that the first AGM has to be held within 18 months of incorporation.

Proposal

41. We propose to introduce provisions for the determination of the financial year of a company.

Key provisions in the Bill

42. **Clause 363** deals with the beginning and end date of a company's first financial year after the Bill comes into operation, and that of subsequent financial years. That is determined by reference to a company's accounting reference period (**clause 364**) and accounting reference date (**clause 365 and 366**). A company's accounting reference period is the same as its financial year except that the company's directors may alter the last day of the financial year by plus or minus 7 days, so as to allow for a certain degree of flexibility in fixing the financial year (**clause 363(2)**). The end date of the financial year can be altered by a directors' resolution, subject to a number of conditions and exceptions set out in **clause 367**. A simple guide on the how the provisions will apply to companies formed before or after the Bill is contained in **Appendix 2**.

Overseas experience

43. The proposal is modelled on sections 390 to 392 of the UKCA 2006.

Public consultation

44. During the public consultation on the accounting and auditing provisions of the CO conducted in 2007, the majority of the respondents supported the proposal in general and considered that it would provide assurance to shareholders and investors that the financial reports would be prepared in a timely and efficient manner.

45. During the public consultation on the Draft Bill in 2010, a respondent questioned whether there was a need for the provision allowing the company's directors to alter the last day of the financial year by plus or minus seven days. Such flexibility would allegedly create difficulties in the year-on-year comparisons of the financial statements of the company and might cause confusion to the shareholders and other users of the financial statements. We consider that the flexibility is appropriate and reflects the conclusions of the topical public consultation conducted in 2007.

Streamlining disclosure requirements that overlap with the accounting standards (Schedule 4)

Current position

46. At present, there are certain inconsistencies between the accounting requirements under the CO and the accounting standards, particularly in respect of the simplified accounting requirements in section 141D. Compared with the requirements under section 141D, the SME-FRS requires a more complete set of accounts and more disclosures.¹⁰

¹⁰ For example, pursuant to section 141D(1)(e), the auditor's report of a company which applies section 141D covers only the balance sheet but not the profit and loss account.

47. The CO also provides for certain disclosure requirements as to the contents of the accounts in the Eleventh Schedule (for companies that apply section 141D) and the Tenth Schedule (for other companies). These requirements essentially overlap with the disclosure requirements in the SME-FRS and HKFRSs respectively. As accounting standards are constantly evolving, it is very difficult to keep the statutory requirements up-to-date. This can give rise to potential conflict between the two.

Proposal

48. To avoid any potential conflict between the Tenth Schedule and HKFRSs and between the Eleventh Schedule and SME-FRS, both Schedules will be repealed, with only a small number of public interest disclosure requirements not covered by the HKFRSs or SME-FRS being retained in **Schedule 4**. The HKFRSs and SME-FRS will be given indirect statutory recognition, as financial statements are required to comply with the applicable accounting standards issued by a body prescribed by regulation (**clause 376(4)(b)**); see paragraph 9 above).

Key provisions in the Bill

49. **Schedule 4** includes such public interest disclosures like –
- (a) the aggregate amount of any outstanding loans to directors and employees to acquire shares in the company made under the authority of clauses 276 and 277 of the Bill (see paragraphs 9(1)(c) and 5 respectively of the Tenth and Eleventh Schedules);
 - (b) information regarding a company's ultimate parent undertaking (currently required under section 129A of the CO); and
 - (c) auditors' remuneration (which applies to companies not qualified for simplified reporting, currently required under paragraph 15 of the Tenth Schedule of the CO).

50. **Section 4 of Part 1 of Schedule 4** further requires a statement to be made in the financial statements as to whether they have been prepared in accordance with the applicable accounting standards, and to give the particulars of, and the reasons for, any material departure from those standards.

Overseas experience

51. Some jurisdictions like Australia and Singapore¹¹ have given statutory backing to accounting standards. This involves incorporating all the accounting standards in the legislation and timely amendment to keep the legislation up-to-date with developments in the accounting standards. While legally-backed accounting standards can facilitate enforcement by the regulators and provide clear and more certain avenues of private enforcement by members of companies, we do not recommend this approach in the Hong Kong context. As accounting standards are constantly evolving, particularly with the full convergence of the HKFRSs with the International Financial Reporting Standards (“IFRSs”), it would be very difficult to keep them up-to-date if they are written into the law. This would affect Hong Kong’s ability to ensure that its financial reporting standards are commensurate with those expected in a major international business and financial centre with consequential adverse impact on the international perceptions of Hong Kong’s corporate governance and regulatory standards.

Public consultation

52. During the public consultation on the accounting and auditing provisions of the CO conducted in 2007, the majority of the respondents supported the proposal to avoid overlapping of and retain flexibility for the financial reporting standards to align with IFRSs.

¹¹ See sections 296(1) and 334 of the Australian Corporations Act 2001 and sections 201(1A), (3) and (3A) of the Singaporean Companies Act and Singaporean Companies (Accounting Standards) Regulations.

PUBLIC COMMENTS

53. We consulted the public on the accounting and auditing provisions of the CO in March to June 2007¹². We have consulted the public on the Draft Bill in two phases in December 2009 to March 2010 and May to August 2010 respectively. Part 9 was covered by the second phase consultation. The public comments on our major proposals are discussed above. As for the comments on other provisions in Part 9 and our response, they are set out in Appendix III to the consultation conclusions issued on 25 October 2010.¹³

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Companies Registry
11 April 2011**

¹² See Consultation Conclusions on the Accounting and Auditing Provisions of the CO (March 2008) available at www.fstb.gov.hk/fsb/co_rewrite.

¹³ Available at http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/ccsp_conclusion_e.pdf.

**Simplified reporting requirements for
companies that fall within the reporting exemption**

	Clauses in the Bill	Paragraphs in the Paper
Preparation of financial statements in compliance with the applicable accounting standards i.e. SME-FRS and FRF, which are less onerous than HKFRSs.	376(4)(b) and 8(a) 377(2) Paragraph 4 of Part 1 of Schedule 4	9, 48
Exemption from disclosure of auditor's remuneration in the financial statements.	376(3)(a) Part 1 of Schedule 4	49(c)
Exemption from preparing a business review and from disclosure of other information ¹ in a directors' report.	380(3)(a)	22
The auditor must state his / her opinion in the auditor's report as to whether the financial statements have been properly prepared in compliance with the new Ordinance, which includes compliance with the applicable accounting standards. There is no requirement to state whether the financial statements give a true and fair view of the financial position and financial performance of the company.	376(7) 397(1)(a)	13, footnote 3

¹ Examples are company donations, recommended dividends and the resigning director's reasons for disagreement with the management of the company. The exemption will be provided in the Regulation to be made by the Financial Secretary under Clause 380(1)(b).

“Financial Year” of a Company under the Companies Bill

- Clauses 363 to 367 of the Companies Bill (the Bill) provide for the determination of a company’s financial year and the alteration of the accounting reference date.
- When the Bill commences operation, the current Companies Ordinance (CO) (Cap.32) provisions on accounts will continue to apply to a company’s financial year which has already begun. The Bill will provide rules to determine the first financial year of a company under the Bill, i.e. when the company has to follow the Bill’s requirements.
- The proposal may be summarized as follows –

For companies formed after the commencement of the Bill

- The first financial year of a company begins on the date of its incorporation and ends on the last day of the month in which the first anniversary of its incorporation falls. (Clause 365(4)(b) [For example, for a company incorporated on 19 October 2014, its first financial year will run from 19 October 2014 to 31 October 2015.]
- Alternatively, the directors may before the last day of the month in which the first anniversary falls specify another date as the end of the financial year but such date must fall within 18 months after the date of the company’s incorporation. (Clause 365(4)(a), (5) & (6)) [For example, the directors may, before 31 October 2015 in the above example, specify a date from 19 October 2014 to 18 April 2016 as the end of the first financial year.]

For companies formed before the commencement of the Bill

- Such a company is required under the CO to lay its accounts at the AGM under section 122 or send the accounts to members under section 111(6). The first financial year after the commencement of the Bill will begin on the date after the end date of the accounts. (Clauses 364(1), 365(1)(a)) [For example, assuming that the Bill commences on 1 April 2014, if the accounts so laid or sent are for the period ended on 30 June 2014, the “first financial year” will begin on 1 July 2014.]

- If for whatever reason the accounts have not been laid or sent after it is due for the company to hold an AGM under section 111, the “first financial year” will begin on the date after the due date. (Clauses 364(1), 365(1)(b))
- The “first financial year” ends on the date before the anniversary of the starting date of the financial year (Clauses 364(1)) [For example, a financial year starting on 1 July 2014 will end on 30 June 2015.]
- The end date of the financial year can be altered by a directors’ resolution, subject to a number of conditions and exceptions. The details are set out in clause 367 of the Bill.