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Subcommittee on Subsidiary Legislation Made under the New Companies Ordinance

Updated background brief (as at 8 April 2013)

Purpose

This paper provides background information on the subsidiary legislation to implement the new Companies Ordinance ("CO"). It also summarizes the discussions of the Bills Committee on Companies Bill ("the Bills Committee") and the Panel on Financial Affairs ("the FA Panel") on issues related to the second batch of two pieces of subsidiary legislation made under the new CO which was gazetted on 22 March 2013.

Background

2. The CO was enacted in 1932 with its major provisions originated from the 1929 Companies Act of the United Kingdom ("UK"). The legislation provides the legal framework which enables the business community to form and operate companies, and sets out the parameters within which companies must operate so as to safeguard the interests of those parties who have dealings with them such as shareholders and creditors. In order to modernize the company law to further enhance Hong Kong's status as a major international business and financial centre, the Administration launched a comprehensive rewrite of the CO ("CO Rewrite") in mid-2006, and conducted three topical public consultations in 2007 and 2008 to gauge public views. A draft bill was published for further public consultation in two phases from December 2009 to August 2010.

3. In view of the extensive nature of the CO Rewrite, the Administration has adopted a phased approach by tackling the provisions which affect the operation of live companies in Hong Kong by introducing the Companies Bill ("CB") into the Legislative Council ("LegCo") in January 2011. The Bills Committee was formed in February 2011 to scrutinize the CB. The hyperlink of the Bills Committee's report is in **Appendix I**. The CB[1] was enacted on 12 July 2012.

Subsidiary legislation to be made for implementation of the new Companies Ordinance

4. The new CO has adopted the same approach as the existing CO of prescribing technical requirements, operational details and fees items in subsidiary legislation so as to facilitate future updates. The Administration has identified 13 pieces of subsidiary legislation that are required to implement the new CO, amongst which 12 pieces will be made by the Financial Secretary ("FS") and subject to the negative vetting procedures of the LegCo, and one piece will be made by the Chief Justice ("CJ") and subject to the positive vetting procedures. A list of the subsidiary legislation is in **Appendix II**.

5. The Financial Services and the Treasury Bureau and the Companies Registry ("CR") have jointly published documents for public consultation on the subsidiary legislation for implementation of the new CO in two phases in September and November 2012[2]. According to the Administration, a total of 34 submissions were received by end-2012 and the respondents were generally supportive of the proposed subsidiary legislation. The Administration's plan is to introduce the subsidiary legislation subject to negative vetting in batches beginning from the first quarter of 2013. As regards the subsidiary legislation subject to positive vetting, it will be introduced as and when ready. Subject to LegCo's scrutiny, the subsidiary legislation will commence operation together with the new CO, tentatively in the first quarter of 2014. At the meeting of the FA Panel on 7 January 2013, the Administration provided an overview on the 13 pieces of proposed subsidiary legislation and its plan to submit the subsidiary legislation to LegCo in batches[3].

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1 The enacted CB was published in the gazette on 10 August 2012 as the new CO (Ordinance no. 28 of 2012). The new CO will be given a new Chapter number. The existing CO is still Cap. 32 but re-titled as Companies (Winding up and Miscellaneous Provisions) Ordinance.

2 The hyperlinks of the Administration's consultation papers containing details of the scope and draft provisions of the proposed subsidiary legislation are available at Appendix I.

3 The Administration issued an information paper "New arrangement for the inspection of personal information on the Companies Register under the new Companies Ordinance" to FA Panel on 28 March 2013 indicating its plan not to make the subsidiary legislation concerning the new inspection arrangement at this stage, and not to include the relevant provisions in the commencement notice to be made in the fourth quarter of 2013 for commencing the new CO.

6. At the House Committee meeting on 8 February 2013, Members agreed to form a single subcommittee to study the 13 pieces of subsidiary legislation to be made under the new CO. The first batch of five pieces of subsidiary legislation was gazetted on 1 February 2013 and tabled at LegCo for negative vetting on 6 February 2013[4]. The Subcommittee on Subsidiary Legislation Made under the New Companies Ordinance has completed scrutiny of the first batch of subsidiary legislation and reported its deliberations to the House Committee in March 2013. The First Report of the Subcommittee is hyperlinked in **Appendix I**.

7. The second batch of two pieces of subsidiary legislation subject to the negative vetting procedures of LegCo were gazetted on 22 March 2013 and tabled at the LegCo meeting of 27 March 2013. A brief description on the subsidiary legislation is given below –

(a) Companies (Revision of Financial Statements and Reports) Regulation (made by FS under section 450 of the new CO) – to prescribe various matters relating to the revision of financial statements and reports by a company, including the contents of the revised relevant documents; requirements relating to the approval and signature of revised statement of financial position, revised directors' report and revised summary financial report; the preparation of an auditor's report on the revised financial statements; and the obligations on a company to inform relevant parties of the revisions made to the revised relevant documents. The general principle underpinning the Regulation is that the obligations and arrangements, including audit requirements and the auditor's liability, concerning the original documents will apply to the revised relevant documents.

(b) Companies (Disclosure of Information about Benefits of Directors) Regulation (made by FS under sections 451 and 452(2) of the new CO) to prescribe –

(i) the particulars to be disclosed in respect of directors' emoluments, directors' retirement benefits, payments made or benefit provided in respect of the termination of the service of directors and consideration provided to or receivable by third parties for making available the services of persons as directors;

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[4] The first batch of five pieces of subsidiary legislation are: Companies (Words and Expressions in Company Names) order; Companies (Disclosure of Company Name and Liability Status) Regulation; Companies (Accounting Standards (Prescribed Body)) Regulation; Companies (Directors' Report) Regulation; and Companies (Summary Financial Reports) Regulation.

(ii) the particulars to be disclosed in respect of specified dealings in favour of directors, their controlled bodies corporate and their connected entities; as well as the requirements concerning the provision of information by way of a statement in the notes to the financial statements, and provides for the disclosure requirements applicable to authorized financial institutions[5]; and

(iii) the particulars to be disclosed in respect of directors' material interests in transactions, arrangements or contracts entered into by a company.

Major concerns/views expressed by Members

8. The ensuing paragraphs summarize the major views and concerns raised by Members at the meetings of the Bills Committee and the FA Panel meeting on 7 January 2013 which may be relevant to the above two pieces of subsidiary legislation.

Directors' reports and directors' benefits

9. Under the existing CO, the directors' report must be approved by the board of directors, and a copy must be sent to every member and debenture holder of the company together with a copy of the accounts and the auditor's report. Under the new CO, all public companies, and large private companies or large guarantee companies not qualified for simplified reporting are required to prepare as part of the directors' report, a business review which is more analytical and forward-looking than what are required under the existing CO. Section 388 of the new CO provides for the directors' duty to prepare a directors' report, and Schedule 5 to the new CO stipulated the detailed requirements of a business review. The information that is required to be contained in a directors' report will be prescribed by regulation to be make by FS under section 452 of the new CO.

10. On the requirement for a business review in the directors' report, the Bills Committee noted that deputations had expressed different views on the matter. While some organizations considered it unnecessary to impose a statutory requirement on this respect, others opined that the scope of business review should be extended to cover the company's policies and performance in relation to human rights and labour issues in order to enhance the corporate social responsibilities of companies.

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[5] Authorized financial institutions refer to licensed banks, restricted licence banks and deposit-taking companies under the Banking Ordinance (Cap. 155).

11. Bills Committee members had enquired the reasons for not requiring a company to prepare separate directors' remuneration report. The Administration advised that during the public consultation on the draft CB, the majority of respondents did not support the proposal on concern that it would be too onerous and would increase compliance costs for unlisted companies, the vast majority of which were small and medium-sized enterprises. Unlisted companies would be required to include information such as directors' emoluments, retirement benefits etc. by regulations to be made by the FS. As for listed companies, any improvements to the disclosure of the remuneration of directors of listed companies would be considered under the Listing Rules and/or the Securities and Futures Ordinance (Cap. 571). The Administration has invited the Securities and Futures Commission and the Hong Kong Exchanges and Clearing Limited to keep under review the compliance and effectiveness of the relevant Listing Rules.

Offences relating to contents of auditor's report

12. Bills Committee members considered that it was of paramount importance to ensure that an effective regulatory regime for auditors, who had a statutory duty to report on the financial statements prepared by companies, was in place in Hong Kong. They generally agreed to impose appropriate criminal sanctions on auditors' deliberate omission of important information in the auditor's report, i.e. section 408 of the new CO[6], in enhancing the accountability of auditors and integrity of the financial reporting system thus inspiring investors' confidence in the auditor's work and the company's accounts. Taking on board views from the Bills Committee and deputations about the wide scope of the offence provision covering an officer, partner, employee and agent of the auditor, the Administration proposed Committee Stage amendments ("CSAs") to remove the references to officer, partner, employee and agent of the auditor from the offence clause to make it clear that only the persons who signed the auditor's report or perform managerial functions in relation to the audit, and who knowingly or recklessly caused the relevant statements to be omitted from the auditor's report would be liable. However, during the passage of the new CO by LegCo, it was noted that there was room for future improvement to the drafting of the offence clause to address industry concerns and bridge potential implementation gaps. The Administration's proposed CSAs were not passed and the original offence clause was incorporated in the new CO.

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[6] Under section 407 the new CO (i.e. clause 398 of the CB), if the auditor is of the opinion that the financial statements of the company are not in agreement with its accounting records in any material respect, or the auditor has failed to obtain all the information or explanations that are necessary and material for the purpose of the audit ("the two statements"), the auditor must state that fact in the auditor's report. Section 408 of the new CO (i.e. clause 399 of the CB) imposes a criminal sanction on a person for "knowingly or recklessly" causing the omission of the two statements from the auditor's report.

13. At the FA Panel meeting held on 7 January 2013, Hon Kenneth LEUNG relayed the concerns from the accounting industry that the matters concerning an auditor's liability in respect of the audit report on the revised financial statements of a company would be prescribed in the "Companies (Revision of Financial Statements and Reports) Regulation. He was of the view that it would be more appropriate for matters involving offences of auditors be provided in the principle ordinance and further suggested that the Administration should improve the drafting of section 408 of the new CO. The Administration explained that as the principal ordinance had provided for the powers of FS to make subsidiary legislation on various matters, including those relating to the auditor's liability for revised financial statements, and the detailed requirements and arrangements concerning the revised financial statements would be prescribed in the said subsidiary legislation, it followed that the related auditor's liability should also be included in the same subsidiary legislation. The Administration was aware that there were views about room for improving the drafting of section 408 and would continue its efforts to gauge the accounting industry's views on the matter through the Hong Kong Institute of Certified Professional Accountants.

Penalty levels

14. To ensure that offences of similar nature under the new CO would be punishable with similar penalties and that the penalties involved reflected the relative seriousness of the offences, and to align the penalties for offences committed by Hong Kong companies and those by non-Hong Kong companies, the Administration had taken an exercise to align and rationalize the penalty levels for all offences under the new CO. Bills Committee members had enquired about the general rationale for setting different levels of fines for different offences in the alignment exercise. The Administration explained that the general principles were that penalty should reflect the relative seriousness of the offences and offences of similar nature or seriousness should be punishable with similar penalties. The Bills Committee had also examined the corresponding levels of daily default fines to different levels of fines for offences having regard to the need to relieve the burden on Small and Medium-sized Enterprises relating to minor offences while ensuring quick remedial actions by offenders. Bills Committee members also considered it important for CR to formulate clear policies for prosecuting offences under the CB in order to enhance consistency and transparency in the exercise of the power.

Latest development

15. The Subcommittee on Subsidiary Legislation Made under the New Companies Ordinance will commence scrutiny of the second batch of subsidiary legislation made under the new CO at the meeting on 9 April 2013.

Relevant papers

16. A list of the relevant papers on the LegCo website is in **Appendix I**.

Council Business Division 1
Legislative Council Secretariat
8 April 2013

Appendix I

List of relevant papers

Date	Event	Papers/Minutes of meeting
25 February 2011	Meeting of the Bills Committee on Companies Bill	Background brief on the Companies Bill (LC Paper No. CB(1)1406/10-11(01)) http://www.legco.gov.hk/yr10-11/english/bc/bc03/papers/bc030225cb1-1406-1-e.pdf Legislative Council Brief on Companies Bill (File Ref.: CBT/17/2C) http://www.legco.gov.hk/yr10-11/english/bills/brief/b20_brf.pdf
29 June 2011	Council meeting	Report of the Bills Committee on Companies Bill (LC Paper No. CB(1)2221/11-12)) http://www.legco.gov.hk/yr10-11/english/bc/bc03/reports/bc030627cb1-2221-e.pdf
12 July 2011	Council meeting	Companies Bill passed at the Council meeting http://www.legco.gov.hk/yr11-12/english/ord/ord028-12-e.pdf
September 2012	Public consultation on subsidiary legislation for implementation of the new Companies Ordinance (Phase One)	Phase One consultation document http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/sub_leg_new_comp_ordinance_ph1_e.pdf
November 2012	Public consultation on subsidiary legislation for implementation of the new Companies Ordinance (Phase Two)	Phase Two consultation document http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/sub_leg_new_comp_ordinance_ph2_e.pdf

Date	Event	Papers/Minutes of meeting
7 January 2013	FA Panel meeting	Administration's paper (LC Paper No. CB(1)358/12-13(04)) http://www.legco.gov.hk/yr12-13/english/panels/fa/papers/fa0107cb1-358-4-e.pdf Administration's paper (LC Paper No. CB(1)385/12-13(02)) http://www.legco.gov.hk/yr12-13/english/panels/fa/papers/fa0107cb1-385-2-e.pdf Background brief (LC Paper No. CB(1)358/12-13(05)) http://www.legco.gov.hk/yr12-13/english/panels/fa/papers/fa0107cb1-358-5-e.pdf Follow-up paper (LC Paper No. CB(1)508/12-13(01)) http://www.legco.gov.hk/yr12-13/english/panels/fa/papers/fa0107cb1-508-1-e.pdf
23 January 2013	Council meeting	Written question raised by Dr Hon Kenneth CHAN on "Policy on public access to government information" Press release http://www.info.gov.hk/gia/general/201301/23/P201301230307.htm Hansard (pages 6-10) http://www.legco.gov.hk/yr12-13/english/counmtg/hansard/cm0123-translate-e.pdf

Date	Event	Papers/Minutes of meeting
30 January 2013	Council meeting	Written question raised by Hon Ronny TONG on "Public consultation on draft bills conducted by Government". Press release http://www.info.gov.hk/gia/general/201301/30/P201301300434.htm Hansard (pages 43-49) http://www.legco.gov.hk/yr12-13/english/counmtg/hansard/cm0130-translate-e.pdf
30 January 2013	-	Legislative Council Brief on Companies Ordinance – Companies (Words and Expressions in Company Names) Order, Companies (Disclosure of Company name and Liability Status) Regulation, Companies (Accounting Standards (Prescribed Body)) Regulation, Companies (Directors' Report) Regulation and Companies (Summary Financial Reports) Regulation (CBT/7/6C) http://www.legco.gov.hk/yr12-13/english/subleg/brief/7-11_brf.pdf
8 February 2013	Meeting of the House Committee	Legal Service Division Report on Subsidiary Legislation Gazetted on 1 February 2013 (LC Paper No. LS23/12-13) http://www.legco.gov.hk/yr12-13/english/hc/papers/hc0208ls-23-e.pdf

Date	Event	Papers/Minutes of meeting
21 February 2013 to 12 March 2013	The Subcommittee on Subsidiary Legislation Made under the New Companies Ordinance ("the Subcommittee")	Background brief (LC Paper No. CB(1)579/12-13(01)) http://www.legco.gov.hk/yr12-13/english/hc/sub_leg/sc05/agenda/sc0520130221.htm First report of the Subcommittee (LC Paper No. CB(1)727/12-13) http://www.legco.gov.hk/yr12-13/english/hc/papers/hc0315cb1-727-e.pdf
21 March 2013	-	Legislative Council Brief on Companies Ordinance – Companies (Revision of Financial Statements and Reports) Regulation and Companies (Disclosure of Information about Benefits of Directors) Regulation (CBT/7/6C) (to follow)

Appendix II

A list of the 13 pieces of subsidiary legislation under the new Companies Ordinance

On company names

(a) Companies (Words and Expressions in Company Names) Order
(b) Companies (Disclosure of Company Name and Liability Status) Regulation

On company records

(c) Company Records (Inspection and Provision of Copies) Regulation
(d) Companies (Residential Addresses and Identification Numbers) Regulation

On accounts and audit

(e) Companies (Accounting Standards (Prescribed Body)) Regulation
(f) Companies (Disclosure of Information about Benefits of Directors) Regulation
(g) Companies (Directors' Report) Regulation
(h) Companies (Summary Financial Reports) Regulation
(i) Companies (Revision of Financial Statements and Reports) Regulation

On others matters

(j) Companies (Model Articles) Notice
(k) Companies (Non-Hong Kong Companies) Regulation
(l) Companies (Fees) Regulation
(m) Companies (Unfair Prejudice Petitions) Proceedings Rules

Note : (1) Items (a) to (l) will be made by the Financial Secretary and subject to the negative vetting procedures
(2) Item (m) will be made by the Chief Justice and subject to the positive vetting procedures.
(3) Refer to footnote 3 in the main paper for item (d).