

For discussion
on 5 January 2018

Legislative Council Panel on Financial Affairs

The new Companies Ordinance (Cap. 622): proposed legislative amendments to improve its clarity and operation

PURPOSE

This paper briefs Members on the Administration's proposal to amend certain provisions of the new Companies Ordinance ("new CO") (Cap. 622) so as to improve the clarity and operation of the new CO and to further facilitate business in Hong Kong.

BACKGROUND

2. The new CO commenced operation in March 2014. It provides a modern statutory framework for the incorporation and operation of companies in Hong Kong. A number of measures have been introduced under the new CO to simplify statutory procedures, reduce the compliance costs of companies and cater for the needs of small and medium-sized enterprises ("SMEs"). Implementation of the new CO has been smooth and it has largely achieved our policy objectives to enhance corporate governance, ensure better regulation, facilitate business and modernise the law.

3. Based on the operational experience since the commencement of the new CO, as well as the feedbacks from various stakeholders, we have identified certain provisions of the new CO that could be amended to improve the clarity and operation of the new CO and to further facilitate business in Hong Kong.

PROPOSED LEGISLATIVE AMENDMENTS

4. The proposed legislative amendments can be broadly divided into two categories:

- (a) amendments to incorporate new developments after the commencement of the new CO; and
- (b) amendments to clarify the policy intent of certain provisions of the new CO, or to remove possible ambiguities and inconsistencies.

Amendments to incorporate new developments

5. There are two sets of proposed amendments under this category, namely (a) expanding the scope of the current regime for simplified reporting; and (b) updating the accounting-related provisions in Schedule 1 of the new CO.

Expanding the scope for simplified reporting

6. To facilitate business, the new CO allows for simplified reporting to group companies of SMEs which meet specified size criteria¹. Under this exemption, the holding company of an eligible group of companies is entitled to prepare simplified financial statements in accordance with the Small and Medium-sized Entity – Financial Reporting Standard issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), and is subject to less stringent requirements for the preparation of auditors’ report and directors’ report².

¹ A holding company of a group of companies qualifies for the reporting exemption if it satisfies the size criteria and each company (which is defined in section 2(1) as a company incorporated under the new CO or a former CO) in the group is qualified as a small private company (Schedule 3 section 1(7)) or an eligible private company (Schedule 3 Section 1(10)) or a small guarantee company (Schedule 3 section 1(13)), as the case may be. See sections 359, 360, 361, 362, 363, 364, 365, 366 and Schedule 3.

² Specific exemptions include, for example: -

- (a) more relaxed requirements for the preparation of financial statements and the auditors’ report (sections 380(7) and 406(1)(b)); and
- (b) no requirement to include a business review in the directors’ report (section 388(3)(a)).

7. In the light of operational experience and after discussing with relevant stakeholders, we consider that there is room to provide more flexibility to SMEs to reduce their compliance costs so long as the size criteria are met. We propose adding provisions to allow the holding companies of two other types of corporate groups to benefit from the reporting exemption, namely –

- (a) holding companies of groups of small private companies or guarantee companies with non-Hong Kong subsidiaries, provided that both the holding company and all of its subsidiary companies (including non-Hong Kong subsidiaries) meet the size criteria; and
- (b) holding companies of group companies comprising both private companies and guarantee companies, provided that both the holding company and all the subsidiary companies meet the size criteria.

Updating the accounting-related provisions in Schedule 1 to the new CO

8. Section 16 of the new CO provides that any reference to a parent undertaking or subsidiary undertaking is to be construed in accordance with Schedule 1 of the new CO. The definitions of “parent undertaking” and “subsidiary undertaking” are important for the purpose of establishing which subsidiaries must be included in a holding company’s consolidated financial statements. The policy intent of setting out these definitions in Schedule 1 is to provide legal certainty on the one hand and to facilitate updating on the other in case there are changes to the relevant accounting standards issued by the HKICPA.

9. In the light of the introduction of the Hong Kong Financial Reporting Standard 10 issued by the HKICPA (last updated in January 2017), we propose to amend Schedule 1 to update the definitions of “parent undertaking” and “subsidiary undertaking” to reflect the latest accounting standards. The latest accounting standards establish control as the basis for determining which entities are to be included in the consolidated financial statements and define the principle of control. The proposed amendments will avoid any possible inconsistency between the new CO and the latest accounting standards in determining whether an entity is a “subsidiary undertaking” of the “parent undertaking”.

Amendments to clarify policy intent, or to remove possible ambiguities and inconsistencies

10. The proposed amendments under this category are technical in nature. The purposes of making these proposed amendments are mainly to clarify the policy intent of the new CO, or to remove possible ambiguities and inconsistencies. The proposed amendments are set out in paragraphs 11 to 15.

Display of company name for non-Hong Kong Companies

11. The new CO and its subsidiary legislation contain detailed requirements regarding the display of the name of a company incorporated in Hong Kong³. However there are no corresponding provisions for non-Hong Kong companies. We propose to add a provision to empower the Financial Secretary to make regulations providing for the requirements on the display of company names and the disclosure of liability status of non-Hong Kong companies and to make new subsidiary legislation prescribing such requirements, so as to align the obligations of non-Hong Kong companies with those of local companies in the display of company names.

Alignment of penalty provisions relating to financial statements and reports

12. At present, the penalty level for an offence relating to the revision of financial statements and reports, which is specified in section 20 of the Companies (Revision of Financial Statements and Reports) Regulation (Cap 622F), is lower than the penalty level for a corresponding offence relating to the original financial statements and reports which is specified in the new CO.

13. During the scrutiny of the subsidiary legislation by the Legislative Council in 2013, in response to Bills Committee members' request, the Administration undertook to review and remove the inconsistency in the

³ The requirements set out in the Companies (Disclosure of Company Name and Liability Status) Regulation (Cap. 622B) include the obligation to display continuously the company name in legible characters and the company name must be so positioned that it may easily be seen by any visitor, with an option for electronic display.

penalty levels relating to financial statements and reports in the next legislative exercise to amend the new CO. The proposed amendment will align the penalty levels on conviction of the relevant offences.

Streamlining technical accounting and reporting provisions

14. In respect of financial reporting, we propose that amendments be made to the technical accounting and reporting provisions taking into account operational experience and with a view to reducing compliance costs. These include the following –

- (a) we propose to provide for an option for a holding company which is also a wholly owned subsidiary to prepare consolidated financial statements instead of its own financial statements⁴;
- (b) regarding the requirement under the new CO for a holding company to list the names of the directors of its subsidiaries in the directors' report⁵, we note that large corporate groups may find it burdensome to list the names of the directors of all of its subsidiary undertakings in the directors' report of the holding company. In order to address the practical concerns raised by relevant stakeholders, we propose to provide an alternative way of complying with the disclosure requirement, by adding an option of allowing a holding company to provide such information on its website or by keeping a list of the names of the directors of all of its subsidiaries at the holding company's registered office and making it available for inspection; and
- (c) Under the new CO, if a group of companies is not qualified as a group of small private companies because not each company in the group is qualified as a small private company, the holding company may still be eligible for the reporting exemption if members of each company in the group agree to adopt simplified reporting and no member objects⁶. After considering the views expressed by some stakeholders, we propose that the adoption of

⁴ Section 379

⁵ Section 390

⁶ Sections 360(2)(a) and (c)

simplified reporting should require a resolution by members of the holding company only.

15. Other amendments under this category are textual, most of which are for the purpose of removing possible ambiguities or ensuring consistency in the terminologies used in different provisions of the new CO. For example, section 337(6) refers to “lender”. The correct Chinese rendition should be “貸款人” instead of “借款人”. Sections 432(2) refers to “general meeting”. The correct Chinese rendition should “成員大會” instead of “周年大會”.

CONSULTATION

16. We consulted a series of stakeholders in mid-2016, including professional bodies and chambers of commerce, to gauge their views. We also consulted the Standing Committee on Company Law Reform (“SCCLR”) in November 2016. The stakeholders were generally supportive of or had no objection to the proposed amendments. The SCCLR was also supportive of the proposed amendments.

LEGISLATIVE TIMETABLE

17. We plan to introduce the amendment bill into the Legislative Council in Q2 2018.

ADVICE SOUGHT

18. Members are invited to note and offer views on the proposed legislative amendments to the new CO.

**Financial Services and the Treasury Bureau
December 2017**