

COMPANIES BILL

CONSULTATION PAPER

**ON THE QUALIFYING CRITERIA FOR PRIVATE
COMPANIES TO PREPARE SIMPLIFIED
FINANCIAL AND DIRECTORS' REPORTS**

FINANCIAL SERVICES AND THE TREASURY BUREAU
COMPANIES REGISTRY

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ABOUT THIS DOCUMENT

This paper is published by the Financial Services and the Treasury Bureau (“FSTB”) and Companies Registry to consult the public on the proposal in the Companies Bill (“CB”) in relation to the qualifying criteria for private companies to prepare simplified financial and directors’ reports. The CB was introduced into the Legislative Council (“LegCo”) in January 2011 and is now being scrutinized by a Bills Committee. We seek to have the CB enacted before the end of the current LegCo term in July 2012.

ii. After considering the views received, we will revert to the LegCo Bills Committee in the first quarter of 2012 on whether, and if so, how the relevant provisions in the CB should be amended.

iii. Please send your comments to us on or before **16 January 2012**, by one of the following means:

By mail to: Companies Bill Team
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
Hong Kong

By fax to: (852) 2869 4195

By email to: co_rewrite@fstb.gov.hk

iv. Any questions about this document may be addressed to Mr Arsene YIU, Assistant Secretary for Financial Services and the Treasury (Financial Services), who can be reached at (852) 2528 9077 (phone), (852) 2869 4195 (fax), or co_rewrite@fstb.gov.hk.

v. This consultation paper is also available on the FSTB’s website <http://www.fstb.gov.hk/fsb> and the Companies Registry’s website <http://www.cr.gov.hk>.

vi. Submissions will be received on the basis that we may freely

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INTRODUCTION

Since the launch of the Companies Ordinance (“CO”) Rewrite exercise in 2006, we have consulted the public on the major proposals of the Rewrite through a series of public consultations. In particular, on the accounting and auditing provisions, we conducted a topical consultation in 2007¹. Subsequently, we prepared the draft CB for further consultation in two phases in 2009 and 2010. The accounting and auditing provisions were contained in Part 9 of the draft CB and were covered in the second phase consultation held between May to August 2010².

2. Taking into account the public views received, we have revised the draft CB and introduced the CB into LegCo in January 2011. The CB is now being scrutinized by a Bills Committee.

3. Among the various legislative proposals, we propose in Part 9 (Accounts and Audit) of the CB to allow private companies and holding companies of groups of private companies³ meeting certain size criteria to be automatically qualified for the preparation of simplified financial and directors’ reports. The relevant provisions in the CB are clauses 358 to 362 and schedule 3⁴. At the Bills Committee, some Members suggested that the criteria for private companies should be further relaxed. In view of Members’ concerns, the Bills Committee invited submissions from the public on the issue in July 2011⁵.

4. At the Bills Committee meeting on 25 November 2011, Members requested the Administration to conduct further consultation, particularly on whether large private companies with members’ approval should be given the flexibility to adopt simplified reporting. In response

¹ Consultation papers and conclusions are available at FSTB’s website - http://www.fstb.gov.hk/fsb/co_rewrite.

² See footnote 1.

³ In the CB, apart from private companies, we also propose that small guarantee companies and groups of small guarantee companies should automatically be qualified for simplified reporting.

⁴ The relevant clauses can be found at FSTB’s website - http://www.fstb.gov.hk/fsb/co_rewrite/eng/companiesbill/companiesbill.htm.

⁵ The submissions are available at LegCo’s website - http://www.legco.gov.hk/yr10-11/english/bc/bc03/papers/bc03_d.htm

to the Bills Committee's request, we would like to invite further views on the issue through this paper. We would carefully consider all the views received before taking a final view on the issue.

BACKGROUND

Position in the Existing Companies Ordinance ("CO")

5. Section 141D of the CO provides that a private company (except for a banking/deposit-taking company, an insurance company, a stock-broking company, or a company which is engaged in the carriage of cargo between Hong Kong and places outside Hong Kong) 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. Section 141D and the current SME-FRF are not applicable to groups of companies.

Proposal in the CB

6. Our policy intention is to save compliance costs of private companies, while at the same time maintain an appropriate level of transparency of companies' business through financial reporting. Taking into account the views received in previous consultations, we proposed in Part 9 of the CB (clauses 358 to 362 and schedule 3) that two types of private companies will automatically be qualified for simplified reporting⁶. They are set out in (a) and (b) below –

Type (a)

A private company (except for a banking/deposit-taking company, an insurance company or a stock-broking company) which is a "small private company", i.e. a private company that

⁶ i.e., section 141D of the CO is not restated in the CB.

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.

Type (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 –

- (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.

7. The simplified reporting requirements enjoyed by these private companies are summarized in **Appendix**.

LEGCO CONCERNS

8. At the Bills Committee, there are concerns that the revenue and asset criteria mentioned above are too restrictive. Some Members suggest that the relevant criteria for automatic qualification for simplified reporting should be increased. Further, they are of the view that there is very little, if any, public interest at stake in the financial reporting of private companies. They therefore suggest that private companies and private companies which are holding companies of groups of private companies not meeting the size criteria (“large private companies/groups”) should also be allowed to adopt simplified reporting provided that most of their members so resolve.

RELEVANT FACTORS FOR CONSIDERATION

Size Criteria

9. The qualifying criteria for reporting exemption in the CB is intended to be aligned with the size criteria in the SME-FRF issued by the HKICPA, which were adopted in 2005. In view of the concerns raised at the Bills Committee, we have invited the HKICPA to review the criteria in the SME-FRF. The HKICPA issued a consultation paper⁷ on 6 December 2011 proposing a relaxation to the current size criteria in the SME-FRF⁸. We will take into account the conclusions drawn by the HKICPA from the consultation in considering how the size criteria in the CB should be adjusted.

Large Private Companies/Groups

10. Regarding LegCo's concerns as to whether large private companies/groups with members' approval should be allowed to adopt simplified reporting, we have considered three options. These options are set out below.

Option 1: Large private companies/groups should not be allowed to adopt simplified reporting (i.e. no change to the proposal in the CB)

11. During the consultation on accounting and auditing provisions in 2007⁹, there was general support for the proposal to allow small private companies/groups to automatically qualify for simplified reporting, and to allow large private companies/groups to enjoy the same provided that they have members' approval. However, during the consultation on the draft CB in 2010, HKICPA and most major accounting firms expressed reservations about the proposal to extend the use of SME-FRS to private companies/groups of any size. Their reservations mainly stemmed from

⁷ Please refer to HKICPA's website – www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts

⁸ It is proposed in the HKICPA's consultation paper that the relevant financial limits on revenue and assets should be increased from HK\$50 million to HK\$100 million while the relevant numbers of employees from 50 to 100.

⁹ See footnote 1.

the fact that SME-FRS was developed essentially for SMEs as an alternative to the full Hong Kong Financial Reporting Standard (“HKFRS”) and generally has simpler accounting requirements. They were of the view that 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 accounts¹⁰.

12. As a matter of fact, the majority of private companies in Hong Kong are SMEs¹¹ and would already be automatically qualified for simplified reporting under the size criteria in the CB. For the large private companies/groups, they still have the option to prepare financial reports in accordance with the Hong Kong Financial Reporting Standard for Private Entities (“HKFRS for PE”), which is simpler and less onerous than the full HKFRS.

13. It is noted that in comparable jurisdictions like the UK and Singapore, their regimes are similar to the CB, with different accounting and reporting requirements for large and small companies. There is no mechanism for large companies to opt for the financial reporting requirements applied to smaller companies.

Option 2: Allowing large private companies/groups with members’ approval to adopt simplified reporting

14. There is a view that, for private companies, the financial reports are primarily addressed to the members of the companies. If the majority of members agree and no member objects, it is not necessary to force a company to adopt the full HKFRS (including the HKFRS for PE) even if it is relatively large in size. A company would prepare financial reports in accordance with the full HKFRS on a voluntary basis as necessary (e.g. if they need to obtain external funds).

¹⁰ Please refer to the paragraphs 43 to 46 of the consultation conclusions on the Second Phase Consultation on the Draft Companies Bill, which is available on FSTB’s website - http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/ccsp_conclusion_e.pdf

¹¹ According to the Annual Survey of Economic Activities conducted by the Census and Statistics Department, among the sectors covered, 97.2% of establishments had business receipts of less than HK\$100 million and 99.2% had engaged less than 100 persons in 2009. 97% of establishments had both business receipts not exceeding HK\$100 million and number of persons engaged not exceeding 100. For details of the survey, please refer to the Census and Statistics Department’s website (www.censtatd.gov.hk).

15. As a matter of fact, under section 141D of the existing CO, a private company with members' approval, irrespective of its size, is already allowed to prepare simplified reports (see paragraph 5 above). It does not appear that the current regime has created problems. There is therefore a case for allowing large private companies/groups with members' approval to adopt simplified reporting.

16. Based on the proposal set out in the previous consultation exercise¹², option 2 is to allow large private companies to elect for simplified reporting if members holding at least 75% of the voting rights so resolve and no other member objects. For large groups, it is necessary to have the approval of members holding at least 75% of the voting rights (with no member objecting) in the holding company or in the non-small private companies, depending on the circumstances¹³.

Option 3: Allowing large private companies/groups with members' approval to adopt simplified reporting, subject to certain size criteria being met

17. Under this option, apart from the thresholds for automatic qualification for simplified reporting, there would be an additional higher threshold on the revenue and assets criteria. Large private companies/groups of size not exceeding this higher threshold can choose to adopt simplified reporting with the approval of members holding at least 75% of the voting rights and no objection from other member.

18. The applicable criteria could be a few times the relevant limits for automatic qualification. If, for example, the threshold for automatic qualification is as proposed by the HKICPA in its consultation paper (see paragraph 9 above), i.e. a private company that satisfies any two of the following conditions –

¹² See footnote 1.

¹³ If all members of the group are small private companies but the group cannot meet the aggregate size criteria, it is necessary to have the approval of the members of the holding company. If there are non-small private companies in the group, it is necessary to have the approval of the members of all non-small private companies in the group. Approval of members of the holding company would also be required for the preparation of simplified consolidation financial statement if the aggregate size criteria exceed the threshold.

- (i) total annual revenue of not more than HK\$100 million;
- (ii) total assets of not more than HK\$100 million;
- (iii) no more than 100 employees;

then the higher threshold (say, three/five times the revenue and assets criteria) would mean –

- (i) total annual revenue of not more than HK\$300/500 million;
- (ii) total assets of not more than HK\$300/500 million;
- (iii) no more than 100 employees (no change).

19. In this regard, we note that for a company to be listed on the Main Board of the Stock Exchange of Hong Kong, where the criterion on annual revenue is applicable, the current limit is minimum HK\$500 million. This may be a reference point when determining the higher threshold.

20. This option seeks to strike a balance in addressing the concerns about options 1 and 2. On the one hand, it would provide flexibility to the vast majority of private companies/groups in Hong Kong. On the other hand, it would address the concern that the SME-FRF and SME-FRS may not be able to reflect the complexity of the accounts of very large companies.

21. The higher threshold under this option would depend on that for automatic qualification, which is being reviewed by HKICPA (see paragraph 9 above). Respondents are welcome to provide views on how the higher threshold should be set under this option.

VIEWS SOUGHT

22. We invite your views on the options set out in paragraphs 11 to 21 above, i.e. which of the following options should be adopted –

Option 1 (paragraphs 11 to 13)

Private companies/the holding companies of groups meeting the size criteria can automatically qualify for simplified reporting. Large private companies/groups cannot opt in.

Option 2 (paragraphs 14 to 16)

Private companies/the holding companies of groups meeting the size criteria can automatically qualify for simplified reporting. Large private companies/groups can opt in if members holding at least 75% of the voting rights so resolve and no other member objects.

Option 3 (paragraphs 17 to 21)

Private companies/the holding companies of groups meeting the size criteria can automatically qualify for simplified reporting. Large private companies/groups can opt in if members holding at least 75% of the voting rights so resolve and no other member objects, subject to their size not exceeding a higher threshold. Views are also sought on the higher threshold.

23. After considering the views received, we will revert to the LegCo Bills Committee in the first quarter of 2012 on whether, and if so, how the relevant provisions in the CB should be amended.

**Financial Services and the Treasury Bureau
Companies Registry
6 December 2011**

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

Reporting Requirements	Clauses in the Bill
Preparation of financial statements in compliance with the applicable accounting standards i.e. SME-FRF&FRS, which are less onerous than HKFRSs.	376(4)(b) and 8(a) 377(2) Paragraph 4 of Part 1 of Schedule 4
Exemption from disclosure of auditor's remuneration in the financial statements.	376(3)(a) Part 1 of Schedule 4
Exemption from preparing a business review and from disclosure of other information ¹⁴ in a directors' report.	380(3)(a)
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)

¹⁴ 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).