

6 May 2015

To respective clients  
By email

**Re : The New Hong Kong Companies Ordinance (Cap 622) effective from 3 March 2014  
Impact on our audit engagement and / or scope of audit services**

Effective from 3 March 2014, the newly enacted Companies Ordinance (Cap. 622) (the "Ordinance") has become effective with a view to modernised legal framework for the incorporation and operation of companies in Hong Kong. It aims to achieve four main objectives, namely, to enhance corporate governance, ensure better regulation, facilitate business and modernise the law. In particular, the Part 9 of the Ordinance is respect of the "Accounts & Audit" and is the subject of this article. After a brief period of transition from the old Companies Ordinance (Cap.32) in the last 12 months, it commences to impact our client's financial accounts preparation and auditing for the financial year ended 31 March 2015 and thereafter. This article discussed the critical impacts of the new Companies Ordinance on financial statements preparers and its resulting impact on our scope of audit services.

**(A) Business Review Exemption and Reporting Exemption**

Although one of the major objectives of the amendment is to facilitate business by simplifying reporting requirements, the new Ordinance, indeed significantly uplift the reporting requirements and standards up to a level even more stringent than those reporting requirements of the current listing rules for a Hong Kong listed companies. To cater for the practicability of the Small and Medium Enterprises (the "SME") majority who are non-listed, non-regulated, privately owned and controlled, the Ordinance provided very lenient exemption measures to allow this majority of SME from compliance of the reporting requirement (the "Reporting Exemption"). However, if your company unfortunately fails to satisfy this lenient reporting exemption, you will have no alternative but to prepare the financial statements at the full Hong Kong Financial Reporting Standards plus an over detailed Director's Report which includes a Business Review according to the Schedule 5 of the Ordinance.

Below is a brief summary of the minimum requirement under Schedule 5 of the Ordinance:

- Fair review of company's business by the management of the company
- Description of principal risks and uncertainties facing the company
- Particulars of important events affecting company since year end
- Indication of likely future development in company's business
- Analysis using financial key performance indicators
- Discussion on company's environmental policies and performance, compliance with laws and regulations; and
- Key relationships with employees, customers and suppliers.
- Disclosure of information about impending developments or matters under negotiation
- Information required extends to all subsidiaries

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For most SMEs, the above information is not practically available as most of them are struggling to compete in their business arena and they have no in-house professionally trained person to prepare such information. You should be alerted that the above information even if can be written and provided by the management team of your company, the content will be subject to audit as the information will be published together with the financial statements. In case anything wrong or misleading information found, the auditor is obliged to qualify them in the auditor's report. In such a way, you can imagine the volume of work of the auditors will be significantly compounded by few folds and time to spend on auditing the Business Review will be much even more than the usual audit on the body of the financial statements itself and, thus it is unavoidable the audit fee will be increased by few folds as well, not to mention the unreasonable undue delay and costs associated on the preparation of the financial statements.

Indeed, the lawmakers are very understandable the practicability on this unnecessary onus for the SME. Therefore, the The Companies Ordinance (Cap. 622) provides the following lenient criterias for Business Review Exemption:

- if the company is a wholly owned subsidiary of another body corporate for the year
- if the company is eligible for the **Reporting Exemption** "RE" under S359
- if a Special Resolution is passed by members according to details set out in S388(3)(c) an S384

You may note the **Business Review Exemption** can be granted under the 2<sup>nd</sup> criteria if the company also qualified for the **Reporting Exemption**. Under the Reporting Exemption, the Company will be allowed to prepare the Financial Statements according to a new set of simplified standards that is termed as SME-FRF and SME-FRS, in which no Business Review required.

Recommendation:

The eligibility of the **Reporting Exemption** will vary year by year according to the "Size Test" of the Company. Therefore, if you do not qualified on 1<sup>st</sup> criteria, it is our recommendation that all clients should arrange the Special Resoluton (criteria 3) in advance to opt-out the Business Review regardless they qualify for the Reporting Exemption or not under criteria 2. In this situation, even though the company may not be allowed or they choose not to prepare the financial statements under SME-FRF and SME-FRS and must revert to the full Hong Kong Financial Reporting Standards, they are still allowed to exempt from preparing the Business Review in their director report and thus save unnecessary costs, effort and undue delay.

In order to help you to evaluate if your company is qualified for the (1) Business Review Exemption, (2) Reporting Exemption and (3) Consolidation Exemption, we have prepared a simple tool enclosed with this letter. You may base your company's unique situation, and it may point you the next action including performing the Size Test for qualifying the Reporting Exemption and / or preparing suitable resolutions or written notice to shareholders as appropriate.

## **(B) Consolidated Financial Statements Exemption**

For SMEs who are privately owned and controlled, equity financed, non-listed and non-regulated, the consolidated financial statements are always considered useless and unnecessary for management reason. It is not uncommon they were prepared in the past was only for compliance but this preparation incurred undue delay and costs out of proportion to the interest for the shareholders. More important, most SMEs do not have resources to hire in-house professionally trained personnel to prepare the Consolidated financial statements in a proper manner with proper disclosures and thus resulted in qualification or even disclaimer in the auditor's opinion. In this regard, the Hong Kong Companies Ordinance (Cap. 622) set out the ways for a holding company to be exempted from preparing Consolidated Financial Statements:

- (a) if the holding company is a wholly owned subsidiary of another body corporate; or
- (b) If the holding company is a partially owned subsidiary of another body corporate and the shareholder have been notified about, and do not object to, the proposal not to prepare consolidated financial statements (The notification must state the relevant financial year and the notice does not relates to other financial year.)
- (c) Exclusion from consolidation under SME-FRF & SME-FRS on ground of expenses and delay out of proportion to the value to members fo the Company ("**Reporting Exemption**")

### Recommendation:

SMEs who intends to take advantage of the Consolidation Exemption, it is suggested to issue notification every year to all shareholders at least 6 months before the year-end. This is subject to no objection from any single member within 3 months before the financial year-end. This is suggested regardless if the Company intends to apply for Reporting Exemption (as in criteria (c) above) or not.

The reason is the Reporting Exemption will be subject to the size test and the result would be varying from year on year. In case the Company failed to obtain Reporting Exemption or they choose not to prepare the financial statements under SME-FRF and SME-FRS and must revert to the full Hong Kong Financial Reporting Standards, they are still allowed to exempt from preparing the Consolidated Financial Statements and thus save unnecessary costs, effort and undue delays.

In combination with the Special Resolution to opt-out the Business Review under section 388(3)(c) of the Ordinance as discussed earlier, if the client also prepares the notification under section 379(3) of the Ordinance, the holding company group will be allowed to prepare the financial statements without Business Review and without Consolidation. This is regardless if the Company qualifies for Reporting Exemption or not or they choose not to prepare the financial statement under the SME-FRF and SME-FRS.

**In other words, if both the Special Resolution for section 388(3)(c) and the notification not to prepare Consolidated financial statements under section 379(3) are validly obtained and in complaint, the holding company group will be allowed to exempt from preparing both the Business Review and Consolidated Financial Statements.**

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**(C) SME-FRF and SME-FRS**

As mentioned earlier, if a company qualifies for Reporting Exemption under the Section 359 of the Companies Ordinance (Cap. 622), they may opt to prepare the Financial Statements under the SME-FRF and SME-FRS (the "SME-FRS") as prescribed by the Hong Kong Institute of Certified Public Accountants. While the SME-FRS is the most appropriate, legal and simplified accounting framework for privately owned company or group of companies on cost based accounting, the Hong Kong Financial Reporting Standards will be largely used by companies with public interest, regulated business or listed companies with fair value accounting. This is in accord with the international tendency to separate the accounting reporting into two streams with one for private companies or private group of companies and the other stream with emphasis on fair value accounting for listed companies or companies with public characters.

It is advisable that clients should carefully consider its own specific circumstances on human resources, accounting expertise, public responsibilities and their understanding the requirements on the HKFRS/ IFRS before they determine not to opt for the SME-FRS under the Reporting Exemption. For details of the SME-FRS or sample of a SME-FRS report, you are welcomed to contact our firm for further information or advisory.

In order to assess if your company qualify for SME-FRS, you may make use of the excel tools attached to this articles for understanding the requirement for eligible entities under Section 359 of the Ordinance.

**(D) Impact to our audit engagement and / or scope of audit services**

As a Small and Medium Practising accounting firm ("SMP"), our objective is to serve those SMEs or private group of companies with limited resources on statutory compliances and provide an efficient and effective platform for maintaining the statutory reportings.

***Having considered the new reporting requirements and given a serious thought on our firm's capability with related professional risk concerned, we apologies that we are prepared not to offer our statutory audit services for clients who are too big to qualify for the "Reporting Exemption" or those clients voluntarily select not to take advantage of the "Reporting Exemption" as prescribed in the Companies Ordinance (Cap. 622).***

In addition, ***clients who fail to pass a Special Resolution for "Business Review Exemption" at least 6 months before the year-end, we would not be able to provide the statutory audit services.*** In this regards, the Special Resolution requires 75% of members voted in person or by proxy and agreed not to prepare the Business Review and can include every subsequent year until being revoked by another Special Resolution.

Lastly, given the recent implementation of the HKFRS 10, 11, 12, the consolidated financial statement requires the information disclosure that are far beyond our SME clients are capable to handle by their internal accounting resources. Accordingly, ***clients who fail to arrange notification to shareholders the proposal not to prepare consolidated financial statements within 6 months before the year end and with no objection 3 months before year-end, we would also not be able to provide the statutory audit services.***

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**(E) Conclusion**

The purpose of this article is not to illustrate the reporting requirements of the new Hong Kong Companies Ordinance. Instead, having digested the lengthy legislation documents, we are trying to re-present in an organized way the various reliefs offered by the Ordinance with an objective to allow the majority of the SMEs to take advantage of the simplified reporting requirements.

Since the Ordinance on one hand aims to uphold the Hong Kong's corporate governance and on the another hand tries to find a way to relief the SMEs from reporting requirement for facilitating businesses, the stipulations have been very complicated and cross over to each other. Therefore, at the last part of the articles, we would like to summarize an action plan and provide certain template resolution or notices for action if you intend to take advantages of the simplified reporting.

**ACTION PLAN CHECKLIST**

	Issues		Action Required	Y	N
(A)	Business Review Exemption	1	Special Resolution is passed by 75% of the members voted in person or by proxy not to prepare Business Review ( <a href="#">appendix 1</a> )		
		2	Passed at least 6 months before end of year		
		3	May include every subsequent year until revoked by Special Resolution		
		4	Filing with Companies Registry required		
(B)	Consolidated Statements Exemption	1	Partially owned holding company needs to notify all the shareholders the proposal not to prepare consolidated financial statements ( <a href="#">appendix 3</a> )		
		2	The notification must state the relevant financial year and the notice does not relates to other financial year		
		3	The notification must specify which subsidiary to be excluded		
		4	The notification must state the director's reasons		
		5	Notification sent by directors to all the members at least 6 months before year end and no objection within 3 months before the year end)		
		6	All members must agree		
(C)	Reporting Exemption	1	If the Company does not have any subsidiary and is not a subsidiary of another HK Co – 100% written approval from shareholders required		
		2	If satisfy the size test, no shareholder approval is required		
		3	If fail the size test, but satisfy the large size test and be classified as Eligible Private Company/Group, at least 75% of all the members must pass a resolution at a general meeting that the company is to fall within the reporting exemption for the financial year, with none objecting either at the meeting or otherwise in writing		
		4	Resolution of (3) required to be filed with Companies Registry		

APPENDIX 1

Company No. : XXXXXXX

THE COMPANIES ORDINANCE  
(CHAPTER 622)

SPECIAL RESOLUTION

OF

**ABC LIMITED**  
(the "Company")

**PASSED ON xx<sup>th</sup> May 2015**

By a written resolution signed by all the members of the Company pursuant to section 548 of the Hong Kong Companies Ordinance (the "Ordinance"), the following Special Resolution was passed :-

"IT WAS RESOLVED that pursuant to the section 388(3)(c) of the Hong Kong Companies Ordinance, the Company is not going to prepare the Business Review as required by the Schedule 5 of the Ordinance for the financial year ending on 31<sup>st</sup> day of December 2015."

"It was further RESOLVED that the special resolution not to prepare the Business Review required by the Schedule 5 of the Ordinance remain in force for every subsequent years until being revoked by a subsequent Special Resolution to that effect."

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Mr. X  
Member

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Mr. Y  
Member

APPENDIX 2

**ABC LIMITED**  
**(the "Company")**

Board of Directors Resolution

By a written resolution signed by all the Director(s) of the Company, the following Special Resolution was duly passed :-

**Notification to members the directors' intention not to prepare consolidated statements pursuant to section 379(3)(b) of the Hong Kong Companies Ordinance (Cap. 622)**

IT WAS RESOLVED to issue notification to all the members of the Company pursuant to the section 379(3)(b) of the Companies Ordinance that the directors of the Company do not intend to prepare consolidated financial statements for the financial year from 1 January 2015 to 31 December 2015.

IT WAS FURTHER RESOLVED that Mr. X be authorized and directed, for and on behalf of the Board of Directors, to take further action and execute such notice to all members or additional documents as may deem necessary or appropriate to carry out the purposes of the above resolutions, and all of his/her actions in carrying out this resolution be, and hereby approved and ratified in all respects.

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Mr. X  
Director

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Mr. Y  
Director

APPENDIX 3

**ABC LIMITED**

(A company incorporated in Hong Kong with limited liability)

**Notification to members**

**The directors' intention not to prepare consolidated statements pursuant section 379(3)(b) of the Hong Kong Companies Ordinance (Cap. 622)**

**NOTICE IS HEREBY GIVEN** that the Board of Directors of the Company does not intend to prepare the consolidated statement for the financial year from 1 January 2015 to 31 December 2015 on the grounds that such exercise would cause expenses and delay out of proportion to the value of the members of the Company.

Pursuant to the section 379(3)(b) of the Hong Kong Companies Ordinance, the Board is required to issue such notification on this respect, at least 6 months before the end of the financial year and no members write to the Company asking for preparation of the Consolidated statements up to 3 months before the end of the financial year end.

Subsidiaries that are to be excluded in the consolidated statements include A Ltd, B Ltd and C Ltd.

Should any member wish the Company to continue preparing the consolidated statements for the financial year ended 31 December 2015, the members can do so by written request to the Company during the 3-month period from 1 October 2015 to 31 December 2015.

Yours faithfully,  
By order of the Board  
ABC Limited

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Mr. X  
Director  
Hong Kong, XX May 2015