



Response to Consultation Paper on Rewrite of the Companies Ordinance

Question

- 1 (a) Should the right of inspecting a company's accounting records be extended beyond directors to other officers of the company (such as managers and secretaries)?

Response

Statutory rights should be conferred for a purpose, for example to protect an interest which requires statutory force or to facilitate the proper discharge or performance of a legal duty. Company officers such as manager and secretaries have no statutory obligation for the contents of company accounts. Any obligations incurred by them for preparation of company accounts would be owed only to the directors. If the information given to them shall not be sufficient to prepare company accounts properly, they could ask the directors to provide. How the directors respond to such request is an internal matter for the company. Unless a good reason exists, the company law should not over legislate on internal management matters.

It is also difficult to see why managers and secretaries would want to take the initiative to seek a court order against the company for whom they work for disclosure of information. A restricted right of inspection may, however, be given to officers of the company who need to provide information to the auditors under section 141C(5) in order for them to provide the requisite information.

(b) Do you agree that the court may, on application by a director, allow a person to inspect a company's accounting records on behalf of the director on such terms and conditions as the court may think fit?

Agree. The directors take collective responsibility for the correctness of company financial statements. The power to compel the inspection of company accounts by agents or advisers appointed by a director may address concerns which a director may have over the accuracy or completeness of the financial statement and related disclosure before he gives his approval to the accounts.

2 (a) Do you agree that the CO should be amended to require each company to have a fixed accounting reference period?

Agree. The current indirect way of making such requirement in the CO is not satisfactory and should be addressed by an amendment.

IF YES, do you agree that:

For a newly incorporated company:

(i) it should be allowed to appoint a day as its accounting reference date through a directors' resolution, provided that the first accounting reference period should be (counting from its incorporation date) as mentioned in paragraph 3.8(a):

● not less than six months?

A policy objective for requiring the minimum length of 6 months is not apparent. If no cogent reason exists for fixing the minimum period, then the matter can be left to the directors.

● not more than 18 months?

Agree. This period is in line with the existing requirement to convene the first AGM within 18 months.

(ii) if there is no appointed date under (i) above, the accounting reference date should be the last day of the month of its incorporation anniversary as mentioned in paragraph 3.8(a)?

Agree but there is a consequential issue: Assuming the accounting reference dates have been fixed by statute because the directors have failed to fix those dates by appropriate resolution at the relevant time, whether the directors are permitted to override those statutory fixed dates by subsequent resolutions.

(iii) in either case, the subsequent successive accounting reference periods should be 12 months each?

Agree.

For any other company:

(iv) the accounting reference date should be the anniversary of the end-date of the company's most recent accounts laid at its AGM? Agree.

(iv) the first and subsequent successive accounting reference periods should be 12 months each? Agree.

(b) Do you agree that each company should be allowed to alter its accounting reference date through a directors' resolution? Agree.

IF YES, do you agree that:

(i) the accounting reference period should not be extended to more than 18 months? Agree.

(ii) such alteration should not occur within five years since the last extension of the accounting reference period, save for the purpose of aligning the accounting reference date with that of its holding company? Cannot see any valid reason for the 5-year restriction if the change has been approved by shareholders.

(iii) in the case of a public company, the resolution should be filed with the Registrar of Companies for public information? Agree.

(c) Do you agree that the CO should be amended to require each company to have a fixed financial year, i.e. the same as the accounting reference period, except that directors may alter the last day of the financial year by plus or minus seven days? Agree.

3 (a) Should a holding company be relieved from the obligation to prepare its own accounts, provided that it has prepared group accounts and has included its own balance sheet as a note to its group accounts? A holding company that has other operations apart from investment in subsidiaries and associated companies should still be required to prepare its own accounts.

- (b) Do you agree that the conditions under which a subsidiary is not required to prepare group accounts should be refined as proposed in paragraph 3.13? Agree.
- 4 Should companies (unless otherwise exempted as proposed in paragraphs 4.6, 7.9 and 7.11) be required to prepare a more analytical and forward-looking business review along the lines of paragraph 4.3? No. It is unreasonable to require directors to make forward looking statements. This places a considerable burden on the directors, and these statements may be too bland to have any informative value to shareholders. It is suggested that inclusion of material factual developments post balance sheet date would be more appropriate.
- 5 Do you have any suggestions on the information that should be included in the financial and non-financial key performance indicators, a generic term which is intended to refer to factors by reference to which a company's business can be measured effectively? No.
- 6 Do you have any other suggestions on matters that should be covered in the business review? No.
- 7 Should directors' reports (unless otherwise exempted) be required to include information on:
- (a) any significant difference in valuation between the market value of the company's non-current operating assets shown on the balance sheet as consist of interests in land and buildings and its book value to the extent practicable and, if so, what should be the appropriate information sources? No. Principles governing the valuation of assets can be left to the HKFRS.
- (b) equity linked agreements which subsist at the end of the financial year or which the company has entered into in the financial year, if the issue of shares under such agreements has a potential to dilute existing shareholders' interests? Yes because (i) equity linked agreements affect shareholders' interest and (ii) the cost of compliance should not be too great.
- 8 Should directors' reports contain a statement to the effect that, Yes. It is implicit in the directors' duty to prepare true and fair

so far as each director knows, there is no relevant audit information of which the auditors are unaware, and that each director has taken all the steps he should have taken to make himself aware of such information and to establish that the auditors are aware of it?

9 Do you agree that a separate directors' remuneration report should be prepared by:

(a) listed companies incorporated in Hong Kong; and

(b) unlisted companies incorporated in Hong Kong where holders of not less than 5% of the issued share capital or, in the case of a company not having a share capital, members representing not less than 5% of the total voting rights of all the members so request?

IF YES, do you agree that the remuneration report should disclose full details of various types of benefits given to the individual directors by name, including basic salary, fees, housing and other allowances, benefits in kind, pension contributions, bonuses, compensation for loss of office and long-term incentive schemes including share options?

10 We aim to revise the provisions regarding summary financial reports to make them more user-friendly from the company's as well as the members' viewpoints. Would you support amending the provisions along the lines as suggested in paragraph 5.4? Do you have any specific suggestions as to the form or contents of the summary financial reports?

accounts and to seek audit opinion confirming that statement.

This has already been regulated by the Listing Rules. Should avoid regulation by two different regimes serving the same purpose of proper corporate governance

If disclosure is not mandatory, 5% threshold is considered appropriate. Some members are of the view that any shareholder, regardless of the number of shares held in the company, should have the right to require full disclosure of remuneration packages to directors.

Agree that remuneration report should include transparent details of remuneration and various benefits given to the directors. Whether this should be on an individual named basis for listed companies should follow those regulated by the Listing Rules (which is currently a recommended best practice but not a mandatory requirement).

Agree save for the proposal to extend the definition of "entitled person" to include future shareholders. For listed companies, financial information is published on the internet. For unlisted public companies, financial reports can be obtained from the Companies Registry. In these cases, there should be no need to send such information through other modes to persons who are not shareholder. Financial reports of private companies are not public information and the rights to receive such information should not be given to persons who are not yet shareholders.

- 11 Should auditors be given qualified privileges for statements made in the course of their duties as auditors and in respect of their resignation as auditors under the CO? Yes.
- IF YES, do you agree that the proposed privileges should be extended to persons who publish any document prepared by the auditors in the course of their duties as auditors and in respect of their resignation under the CO? Agree.
- 12 Should the auditors' rights to information be enhanced so that they can require "specified persons", as mentioned in footnote 51, to provide them with information, explanations or other assistance as they think necessary for the performance of their duties as auditors? Agree.
- 13 Where a holding company has a subsidiary undertaking which is not a body corporate incorporated in Hong Kong, should the auditor have the right to require the holding company to obtain from the relevant persons or parties such information, explanations or other assistance as the auditor may reasonably require for the purposes of his duties as auditor? Agree
- 14 Should an outgoing auditor be allowed to give the incoming auditor information that he became aware of in his capacity as auditor without seeking permission of the company? Yes but there should be some limit on the scope of information that can be passed on, for example, those relevant to the proper discharge of obligation by the incoming auditor and a requirement that the information passed on is disclosed to the company
- 15 Should all outgoing auditors (i.e. auditors who cease to hold office for any reasons) be required to provide a statement of any circumstances connected with his ceasing to hold office that he considers should be brought to the attention of the members or creditors of the company or a statement of no such circumstances? Yes.

- 16 Do you agree with the proposed amendments to the auditing provisions as set out in paragraph 6.9?
- (a) requiring auditors to report on any inconsistencies between the audited accounts and financial information contained in other parts of the annual report, such as the directors' report; Agree. The auditor's confirmation will enhance the reliability of the directors' report.
- (b) requiring auditors to report on the auditable part of the directors' remuneration report if such a report is prepared; Disagree. Information contained in the directors' remuneration report are matters of fact, as opposed to opinion. No independent audit of such information should be required.
- (c) clarifying that an auditor's term of appointment ceases when a liquidator is appointed; and Agree
- (d) removing the existing requirement of fixing the auditors' remuneration by a company in a general meeting, and allowing directors to fix the auditors' remuneration. Agree
- 17 (a) Do you agree that the qualifying criteria for exemptions from certain accounting provisions for private companies under section 141D should be relaxed along the lines as suggested in paragraph 7.6? Agree but the criterion for determining whether or not an entity qualifies as "small group" should be properly considered with all relevant policy objectives addressed.
- (b) Specifically, do you agree that the size criteria set out in paragraphs 7.3 and 7.6(e), i.e. (aggregate) total annual revenue, (aggregate) total assets and number of employees are the right criteria? IF YES, do you agree with the proposed thresholds? Unable to form a view without knowing the basis for formulating the criteria.
- 18 Should section 141D be amended to require a private company applying the section to prepare a full set of accounts dealing with the state of affairs and profit or loss of the company as required under the SME-FRS and, in the case of a holding company, also to prepare a full set of group accounts? Agree. Private companies falling under section 141D are currently subject to SME-FRS. The amendment is a reflection of the reality.
- 19 Should "section 141D companies" be required to produce only Agree.

simplified directors' reports along the lines of paragraph 7.9?

20 Do you agree that guarantee companies should be allowed to take advantage of the simplified reporting and disclosure requirements similar to those proposed to be applied to section 141D private companies (including simplified accounts and simplified directors' reports) if they are able to meet certain qualifying criteria?

Agree

IF YES,

(i) do you agree that the size criteria set out in paragraphs 7.3 and 7.6(e), i.e. (aggregate) total annual revenue, (aggregate) total assets and number of employees, are the right criteria for guarantee companies?

Disagree. Guarantee companies are typically formed for non-profit making purposes. The consideration that has gone into fixing the criteria for assessing the SME status does not readily apply to non-profit making organizations. Annual revenue is not likely to be relevant in determining the suitability of the exemption. Different criteria should be formulated for guarantee companies with the relevant policy objectives taken into consideration.

(ii) should the thresholds outlined in paragraphs 7.3 and 7.6(e) be applied to guarantee companies or should they be modified?

For reason stated above, the criteria should be re-formulated.

(iii) should any additional information be required from those guarantee companies which take advantage of the simplified reporting and disclosure requirements?

No. If a guarantee company qualifies for the exemption by virtue of the re-formulated criteria, it should be placed on the same footing as a private company save that the obligation to file audited accounts at the Companies Registry should remain. The key should be getting the exemption criteria right.

21 (a) Among the three options listed in paragraph 8.2, which option do you favour? What are the reasons for your choice?

Option (3) is the preferred one for the reasons given in paragraphs 8.3 and 8.4 of the consultation paper.

(b) If Option (3) is chosen, do you also favour giving statutory recognition to the HKFRSs by requiring companies to state in their accounts as to whether the accounts have been prepared in

Yes.

accordance with applicable accounting standards, and particulars of any material departure from those standards and the reasons?

- (c) If you do not favour any of the three options, do you have any other suggestion for dealing with possible conflicts between the Tenth Schedule and accounting standards?

Not applicable.

- 22 (a) Do you agree that the Eleventh Schedule in its present form should be repealed while retaining those disclosure requirements concerning section 141D companies with a significant public interest or corporate governance dimension and which are not presently covered by the SME-FRS?

Agree

- (b) **IF YES**, do you agree that statutory recognition should be given to the SME-FRS by requiring section 141D companies to state in their accounts as to whether the accounts have been prepared in accordance with applicable accounting standards, and particulars of any material departure from those standards and the reasons?

Option (3) is the preferred one for the reasons given in paragraphs 8.3 and 8.4 of the consultation paper.

- (c) **IF NOT**, do you have any other suggestion for dealing with possible conflicts between the Eleventh Schedule and the SME-FRS?

Not applicable.

The Law Society of Hong Kong
29 June 2007
107161v2