

## Preparing Financial Statements under New Companies Ordinance

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## Introduction

- Chapter 622 of HK Laws and effective from 3 March 2014
- 21 Parts, 921 Sections and 11 Schedules
- 12 Subsidiary Legislations
- Corporate insolvency, winding up, disqualification of directors, receivers, managers and prospectuses remain in old Ordinance and renamed Companies (Winding up and Miscellaneous Provisions) Ordinance
- New accounting and audit requirements applicable to FS for period beginning on or after 3 March 2014 (first set year ending 31 March 2015)

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## Useful Information

- ZHONGHUI ANDA Updates ([www.zhcpa.hk](http://www.zhcpa.hk))  
[http://www.zhcpa.hk/pdf/CO\\_Mar2014.pdf](http://www.zhcpa.hk/pdf/CO_Mar2014.pdf)  
<http://www.zhcpa.hk/pdf/SME-FRSMar2014.pdf>
- New Companies Ordinance section in the SMP and SME Resource Centre of the HKICPA's Web Site  
<http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/smp-and-sme-resource-centre/>

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## Preparation of Financial Statements

Preparation of consolidated FS not required for parent at end of year if, in the year:

- Wholly owned subsidiary; or
- Partially owned subsidiary,
  - at least 6 months before year end, directors notify members in writing not to prepare consolidated FS (notification relate to that year only); and
  - no member object 3 months before year end

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## General requirements under Section 380

- True and fair view (unless company falls within RE and use Revised SME-FRS)
- Disclosures under Part 1 of Schedule 4 (all companies):
  - outstanding loans made to eligible employees to buy company's shares
  - holding company's statement of financial position and reserve movement
  - particulars of ultimate parent undertaking
  - state whether prepared in accordance with applicable accounting standards
- Disclosure of auditor's remuneration under Part 2 of Schedule 4 (companies not falling within RE)

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## Requirements under Section 381

- Consolidated FS include all subsidiaries
- If within RE and use Revised SME-FRS, subsidiaries may be excluded (immaterial or involve expense and delay out of proportion to value to members)
- If not fall within RE, may exclude immaterial subsidiaries

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## Requirements under Section 383(1)

- FS contain, in notes:
  - directors' emoluments
  - directors' retirement benefits
  - payments or benefit for termination of directors' service
  - loans, quasi-loans etc. to directors of company or its parent; directors controlled or connected parties
  - material interests of directors in transactions, arrangements or contracts entered into by the company (not required if falls within RE)
  - consideration to third parties for directors' services
- Details prescribed by Companies (Disclosure of Information about Benefits of Directors) Regulation

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## Reporting Exemption

- Permits private companies and companies limited by guarantee to take advantage of RE
- Exemption applicable if company (or group) falls within RE, not whether in fact takes advantage of eligibility
- Following types of companies not permitted:
  - banking business under Banking Ordinance
  - regulated business under Securities and Futures Ordinance
  - accepts, by way of trade or business, loans of money, other than issue of debentures or other securities; or
  - insurance business, other than solely agent

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## Four types of eligible companies

- Previous Section 141D companies
  - no subsidiaries and not subsidiary of another company
  - written approval from all shareholders each year
- Small private company (or group of small private companies)
- Eligible private company (or group of eligible private companies)
- Small guarantee company (or group of small guarantee companies)

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## Size tests for small private company (or group)

Small private company if not exceed any 2 of following:

- Annual revenue of HK\$100 million
- Total assets of HK\$100 million at year end
- 100 employees

Group of small private companies:

- Each group company qualify as small private company; and
- Group amounts not exceed 2 out of 3 of small size tests

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## Size tests for eligible private company (or group)

Eligible private company if not exceed any 2 of following:

- Annual revenue of HK\$200 million
- Total assets of HK\$200 million at year end
- 100 employees

Group of eligible private companies:

- Each group company qualify as small private company or eligible private company; and
- Group amounts not exceed 2 out of 3 of larger size tests

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## Shareholders' approvals

- For eligible private company, at least 75% members' resolution with none objecting
- For group of eligible private companies, all group companies obtain at least 75% members' resolution (except group company that meet small private company category), with none objecting
- 75% calculated as a percentage of entire shareholding
- Resolution defeated if any member objects at the meeting or written notice given at least 6 months before year end

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## Size tests for small guarantee company (or group)

- Small guarantee company if annual revenue not exceed HK\$ 25 million

Group of small guarantee companies:

- Each group company qualify as small guarantee company; and
- Group annual revenue not exceed HK\$25 million

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## Size tests in first year

- Meet size tests in first year or last year

	Year ended 31 March	
	2014	2015
Meet size tests	Y	N
Meet RE	N/A	<u>Y</u>

	Year ended 31 March	
	2014	2015
Meet size tests	N	Y
Meet RE	N/A	<u>Y</u>

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## Size tests in subsequent years

- If previously qualified, continue to qualify
- If fail for two consecutive years, fail to qualify in third year

	Year ended 31 March			
	2014	2015	2016	2017
Meet size tests	Y	N	N	N
Meet RE	N/A	Y	Y	<u>N</u>

	Year ended 31 March			
	2014	2015	2016	2017
Meet size tests	Y	N	N	Y
Meet RE	N/A	Y	Y	<u>N</u>

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## Exception to two year grace period for losing entitlement

- Fail due to new group company, disqualify in that year immediately

	Year ended 31 March		
	2014	2015	2016
Meet size tests	Y	Y	N (new group company)
Meet RE	N/A	Y	<u>N</u>

	Year ended 31 March		
	2014	2015	2016
Meet size tests	Y	N (own size)	N (new group company)
Meet RE	N/A	Y	<u>N</u>

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- If previously disqualified, continue not qualify
- If meet size tests for two consecutive years, qualify in third year

	Year ended 31 March					
	2014	2015	2016	2017	2018	2019
Meet size tests	Y	N	N	Y	Y	N
Meet RE	N/A	Y	Y	N	N	<u>Y</u>

	Year ended 31 March					
	2014	2015	2016	2017	2018	2019
Meet size tests	Y	N	N	Y	N	Y
Meet RE	N/A	Y	Y	N	N	<u>N</u>

	Year ended 31 March							
	2014	2015	2016	2017	2018	2019	2020	2021
Meet size tests	Y	N	N	Y	N	Y	Y	N
Meet RE	N/A	Y	Y	N	N	<u>N</u>	<u>N</u>	<u>Y</u>

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## Interpretative guidance for size tests

- Figures based on relevant FS i.e. using SME-FRS
- Reporting period shorter or longer than a year, revenue pro-rata to 12 months
- Group revenue and total assets after eliminating intergroup amounts
- Single company includes amounts with other group members
- Number of employees is average number (full-time or part-time):
  - determine number of employees at each month end
  - add all monthly numbers
  - divide total by number of months

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## Directors' Reports

- Directors to prepare DR that complies with:
  - Section 390
  - Section 543(2)
  - Schedule 5
  - Companies (Directors' Report) Regulation
- If consolidated FS, consolidated DR

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## General content of DR

- Section 390
  - name of directors during year and up to date of DR
  - principal activities
  - particulars of other matter material for members' appreciation of state of affairs (directors consider not harmful to business)
- Section 391
  - approved by directors and signed by director or company secretary
  - state name of signing person

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- Section 543
  - contract by which a person undertakes management and administration of the whole or any substantial part of company's business
  - not contract of directors' service or employment
  - statement of existence and duration of contract
  - name of every director and shadow director interested, and nature and extent of interest

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## Business review required by Schedule 5

- Business review consists of:
  - fair review of company's business;
  - description of principal risks and uncertainties facing company;
  - particulars of important events affecting company since year end; and
  - indication of likely future development in company's business.
- Also include:
  - 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

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- Disclosure of information about impending developments or matters under negotiation not required if seriously prejudicial to company's interests
- Information required extends to any subsidiary if consolidated DR
- Business review not required if:
  - company falls within RE;
  - company is wholly owned subsidiary of another body corporate in the year; or
  - special resolution of private company (75% members voted in person by proxy) not to prepare
- Resolution may include every subsequent year
- Resolution passed at least 6 months before end of year and revoked by special resolution
- Accounting Bulletin 5

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## Information required by Companies (Directors' Report)

### Regulation

#### Disclosures not required if falls within RE

- Arrangements to enable directors to acquire benefits by means of acquisition of shares or debentures (company, subsidiaries, parent or fellow subsidiary is party)
- Donations of HK\$10,000 or above (not apply if wholly-owned subsidiary of another HK company)
- Reasons of director resigned or refused to stand for re-election relating to affairs of company
- Material interests of directors in transactions, arrangements or contracts entered into by subsidiaries, parent or fellow subsidiary

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#### Disclosures required for all companies

- Particulars of shares issued
- Particulars of debentures issued
- Particulars of equity-linked agreement
- Dividend recommended
- Permitted indemnity provision in force

Proposed transfer to reserves and particulars of change in fixed assets not required

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## Revised SME-FRF and FRS

- Reporting Exemption for private companies and companies limited by guarantee under Section 359 of New CO
- Revised SME-FRF and FRS effective for FS period beginning on or after 3 March 2014. Earlier application not permitted
- Non-HK company e.g. BVI company, subject to law of its place of incorporation and its constitution, qualifies for reporting under the SME-FRF when meeting same requirements of HK company
- Cover consolidated FS, business combinations and investments using equity method

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## Section 9 “Impairment of Assets”

- Impairment loss should not be reversed unless FV readily apparent or recoverable amount measured reliably without undue cost
- Minimum factors of external and internal sources of information to be considered for reversal of impairments removed
- Carrying amount on reversal of impairment not exceed carrying amount if no impairment before

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- Goodwill allocated to component benefit from goodwill
- At end of each period, assess whether any indication of impairment
- If indication of goodwill impairment, follow two-step process
- Step 1:
  - measure recoverable amount of component including goodwill
  - compare recoverable amount with carrying amount
  - recognise shortfall as impairment loss in accordance with Step 2

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- Step 2:
  - write down goodwill first
  - excess allocated to identifiable non-cash assets on basis of relative carrying amounts
- NCI case similar to HKFRSs
- Impairment loss for goodwill not reversed

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## Section 14 “Income Taxes”

New disclosures:

- Applicable tax rates and jurisdictions
- Amount of unused tax losses and expiry dates

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## Section 15 “The Effects of Changes in Foreign Exchange Rates”

- Reporting currency based on concept of functional currency in HKFRSs
- Goodwill and FV adjustments to assets and liabilities treated as assets and liabilities of foreign operation
- Expressed in reporting currency of foreign operation and translated at closing rate

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## Section 18 “Business Combinations and Goodwill”

- If business combination under common control not accounted for in accordance with this section, accounted for in accordance with one of followings:
  - Merger accounting in accordance with AG 5
  - At book values as stated in FS of acquired entity or in FS of previous parent
- All business combinations accounted for by purchase method

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- Cost is aggregate of acquisition date FV, of assets given, liabilities incurred or assumed, and equity instruments issued
- Other costs recognised as expenses
- Adjustment to contingent consideration included in cost if probable and measured reliably
- After acquisition date, changes if new information about facts and circumstances existed at acquisition date within 12 months after acquisition date or to correct an error

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- Allocate cost to acquiree's identifiable assets and liabilities at their acquisition date FV
- Difference between cost and net FV of assets and liabilities accounted for as goodwill or gain on a bargain purchase, similar to HKFRSs
- Recognise intangible asset if FV readily apparent or otherwise measured reliably without undue cost or effort
- Goodwill subsequently at cost less amortisation and impairment

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- Goodwill amortised on systematic basis with rebuttable presumption of not exceeding 5 years
- Amortisation method reflects pattern in which future economic benefits arising from goodwill expected to be consumed
- If pattern cannot be determined reliably, straight-line method
- Amortisation period and method reviewed at least at end of each year if useful life exceeds 5 years

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## Section 19 “Consolidated and Company-Level Financial Statements”

Parent at end of year required to present consolidated FS except:

- wholly-owned subsidiary of another entity; or
- partially-owned subsidiary;
  - at least 6 months before year end, directors notify members in writing not to prepare consolidated FS, and notification not relate to any other year; and
  - no member object 3 months before year end
- all subsidiaries qualify for exclusion

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- Parent exempt from preparing consolidated FS need to prepare company-level FS. Investments in subsidiaries, associates and joint ventures using cost model
- All subsidiaries consolidated except:
  - their exclusion not material; or
  - their inclusion would involve expense and delay out of proportion to the value to members of company
- Members be informed in writing and not object

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- Notification must:
  - state which year (not more than one);
  - specify subsidiaries excluded; and
  - state directors' reasons
- In case needs shareholder approval for reporting exemption, notification included together and subject to same approval and objection processes
- Notification sent before date of approval of FS and allow members no less than one month to raise objections, unless all members agree
- no member object

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- Subsidiary is entity controlled by parent
- Control is power to govern financial and operating policies so as to obtain benefits from its activities
- Consolidation procedures similar to HKFRSs
- Gain or loss on disposal of subsidiaries includes exchange differences except undue cost or effort is needed
- Carrying amount of any investment retained in former subsidiary regarded as cost of investment

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## Section 20 “Investments in Associates”

- Concept of significant influence similar to HKFRSs
- Accounting policy choice:
  - cost model
  - equity method
- Equity method similar to HKFRSs

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## Section 21 “Interests in Joint Ventures and Other Forms of Joint Arrangements”

- A joint venture is contractual arrangement through separate entity and subject to joint control
- Concept of joint control similar to HKFRSs
- Accounting policy choice:
  - cost model.
  - equity method
- Equity method similar to HKFRSs

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## Section 22 “Cash Flow Statement (optional)”

- Not required to include cash flow statement
- If voluntarily includes cash flow statement, follow requirements of this section
- Requirements similar to those in HKFRSs

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## Appendices

- Guidance on determining agent or principal and same as HKAS 18
- Illustrative example of measuring and recognising impairment allocation when NCI
- Table of non-exempt disclosure requirements in notes to FS using Revised SME-FRS
- Illustrative company-level FS amended
- New illustrative consolidated FS

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# Q&A Section

