

BRIEFING NOTE

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New Hong Kong Companies Ordinance

Briefing Note 1

What's new for full financial statements?

In 2014, an entirely new Companies Ordinance (CO) (Cap. 622) came into effect in Hong Kong. To assist with understanding the key areas of changes and implementation issues, KPMG developed a series of briefing notes, each one focusing on a particular topic relevant to financial reporting.

In this briefing note we look at what was new for companies that had been preparing full financial statements under the old CO (Cap. 32). Here, there were two main areas of change to think about:

- the new reporting exemption, which allows more non-public companies to opt out of the "true and fair" regime and instead prepare simplified financial statements; and
- for those companies which do not or cannot opt out, the changes that have been made to modernize the requirements that apply going forward, in particular giving statutory backing to HKFRSs.

These changes came into effect for the first financial reporting year beginning on or after 3 March 2014, which was the commencement date of the new CO: so the first year-ends that were impacted were those falling in 2015. For example, for those companies with a calendar year-end, these changes first impacted on the financial statements for the year ended 31 December 2015.

On 1 February 2019 the Companies (Amendment) (No. 2) Ordinance 2018 came into effect. This Amendment Ordinance, (referred to here as the 2019 Amendment Ordinance, given its effective date) aimed to clarify policy intent and remove ambiguities and inconsistencies based on experience and operational feedback from stakeholders. This briefing note has been updated to reflect those amendments to the extent that they impact on the preparation of financial statements and it is current as of April 2020. So far as financial statements are concerned, the main impacts of the 2019 Amendment Ordinance are on eligibility for the reporting exemption (see pages 2-3), obtaining approval from members in respect of exemption from preparing consolidated financial statements (see pages 11-12) and greater flexibility around choice of reporting date (see pages 12-13).

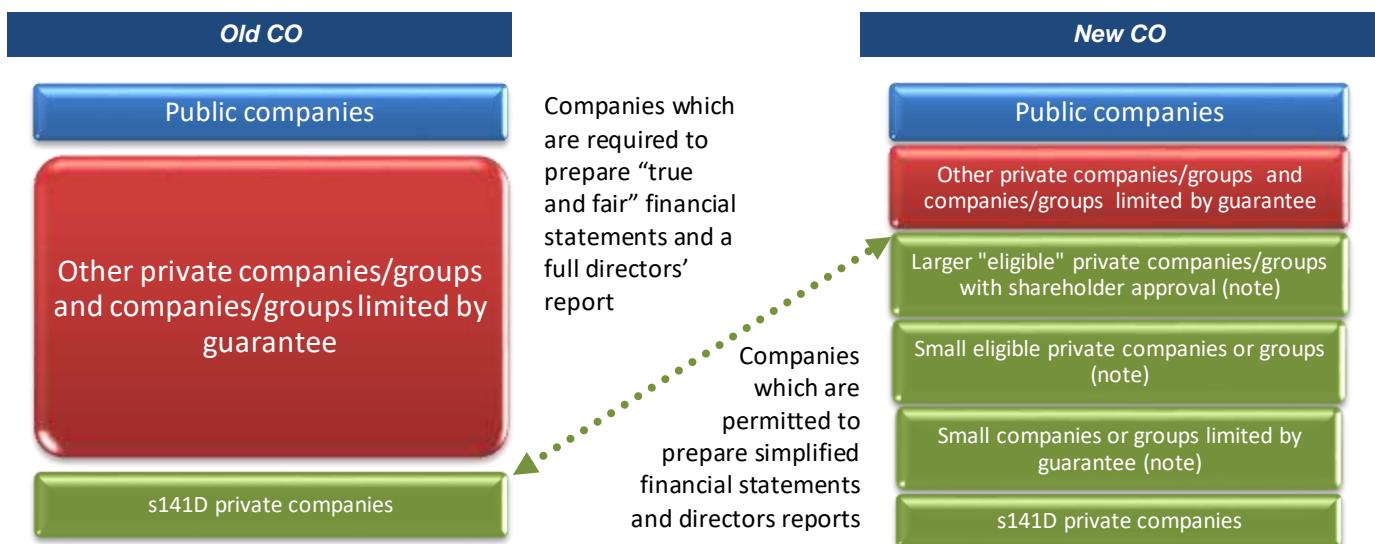
If you would like further assistance on any of the matters discussed, please feel free to talk with your usual KPMG contact.

Which companies are required to prepare full financial statements?

Full financial statements are annual financial statements which are required to give a true and fair view of the company (or group's) financial position and performance. It is generally accepted that "giving a true and fair view" requires the financial statements to comply with the most recently effective Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), as well as the disclosure requirements of the CO and, if listed, the Stock Exchange Listing Rules.

One of the key changes introduced by the new CO relates to allowing a greater number of non-public companies to opt out of the full reporting regime and prepare simplified financial statements instead. Simplified financial statements are exempt from the requirement to give a true and fair view and are prepared under the HKICPA's Simplified Financial Reporting Framework and Financial Reporting Standard (SME-FRF and SME-FRS), rather than HKFRSs. Typically these financial statements are prepared on a simplified historical cost basis and do not include any assets or liabilities at fair value, or deferred tax. The disclosure notes also contain less information on the reporting entity's affairs compared to full financial statements.

The differences between the old CO and the new CO in respect of which companies need to prepare full financial statements can be summarised as follows:



Note: As a result of amendments made by the 2019 Amendment Ordinance, it is now clear that

- (i) *eligible groups can include both Hong Kong incorporated and overseas incorporated entities; and*
- (ii) *eligible groups can consist of a mix of larger and smaller private companies and/or companies limited by guarantee, provided the group as a whole meets the relevant size tests as discussed below.*

Under the old Companies Ordinance (Cap. 32), only companies which fell within the scope of section 141D were eligible for simplified reporting. These were private companies which had no subsidiaries and were not a subsidiary of another Hong Kong incorporated company, and only if 100% of the shareholders agreed that this company could produce simplified financial statements.

The new Company Ordinance carries forward the exemption criteria in s141D as one category of exempt company. In addition, simplified reporting can be adopted by private groups, private companies which are subsidiaries of other companies, and companies/groups limited by guarantee provided that:

- they fall within the relevant size tests; and
- in the case of larger private companies, they obtain at least 75% shareholder approval, with none objecting.

The remainder of Hong Kong incorporated companies need to prepare financial statements which give a true and fair view and comply with HKFRSs.

The size tests can be summarized as follows:

	Small guarantee company /group ¹	Small private company /group ¹	Larger ("eligible") private company /group ¹
Annual revenue	≤ \$25m	≤ \$100m ²	≤ \$200m ²
Total assets	No limit	≤ \$100m ²	≤ \$200m ²
Average employees	No limit	≤ 100 ²	≤ 100 ²

¹ In groups, the size tests must be met for each company in the group and for the group as a whole. In the case of mixed groups, now permitted under the 2019 Amendment Ordinance, the relevant tests for the group as a whole depend on the nature of the holding company in that group. That is, if the holding company in that group is a private company, then the group as a whole needs to satisfy the size tests applicable to private groups, whereas if the holding company is a company limited by guarantee, then the group as a whole will need to satisfy the size test applicable to groups of companies limited by guarantee. Please refer to our briefing note 4 for further details of the eligibility tests.

² Must meet 2 out of these 3 criteria to qualify as "small" or "eligible"

Practical issues:

Do eligible companies need to adopt the simplified regime?

No: the new simplified reporting regime is optional. Furthermore, switching to the new simplified regime would require positive action on the part of the directors – so if no action is taken in this regard, then the company simply continues to be subject to the requirement to prepare full financial statements which give a true and fair view. Switching regimes is also not a decision that needed to be made in time for 2014: the company can switch regimes at a later date, provided the company is eligible at that time.

Why would an eligible company not want to switch?

The simpler regime may appeal to private companies on the basis of a saving in time and effort. However, we expect that many companies may be reluctant to change even if eligible. Reasons not to switch to the simplified regime might include one or more of the following:

- the company's financial statements are used by others (such as lenders, customers, or other stakeholders), and the company considers that HKFRSs are more widely accepted or that the "true and fair" audit opinion carries more weight than an audit opinion which only refers to the financial statements being "properly prepared";
- given the nature of the company (or group's) business, changing to the new regime would not materially simplify the financial statements;
- the company is part of a listed group that has to prepare consolidated financial statements in accordance with HKFRS or IFRS® Standards and so preparing the company's financial statements under the SME-FRS may increase the amount of time needed to track the necessary consolidation adjustments;
- the company (or group) is borderline with respect to either the size tests or the ability to secure the necessary shareholder approvals and so there is a reasonable risk that at some point in the near future that the company (or group) would need to switch back to the full reporting regime; and/or
- the company is likely in the near future to be part of an initial public offering, or of interest to private equity investors, and being able to show a track record of producing full financial statements may prove useful at that time.

It is therefore important that management carries out a full cost-benefit analysis before making a decision over whether to move the company's financial reporting onto the simplified regime.

When are the changes to the financial reporting regime effective?

All of these changes are found in Part 9 of the new CO, which contained its own commencement provisions set out in s358. In accordance with that section, these changes came into effect for the first financial reporting year beginning on or after the commencement date of the new CO. As the commencement date of the new CO was set at 3 March 2014, the first financial statements impacted were those beginning on 1 April 2014. Those companies with a calendar year-end were first impacted in the year ended 31 December 2015.

The amendments introduced by the 2019 Amendment Ordinance for mixed groups eligible for the reporting exemption are first effective for financial years beginning on or after 1 February 2019 (as per section 366A(1) and confirmed in paragraph 30A of the SME-FRF).

In the rest of this briefing note we focus on the changes relevant to those companies who must, or choose to, continue with the full financial reporting regime. At first sight the changes introduced by the new CO for these companies may look minimal. Nevertheless there were some important differences to watch out for, particularly in the first year of adoption, when new habits and understandings of what was required going forward needed to be formed.

If on the other hand you consider that the simplifications on offer could be of interest to any of the companies that you are involved with, then please take a look at our separate briefing note, number 4, where we look in-depth at this alternative regime, including a comprehensive discussion of how to gain or lose eligibility and what simplifications are on offer.

Key changes in respect of the contents of full financial statements

The changes introduced in the new CO for full financial statements were aimed at modernising the ordinance and reducing ambiguity, complexity or duplication. They can be summarised as follows:

- Providing statutory backing for HKFRSs issued by the HKICPA
- Updating terminology in the CO to follow the latest terminology used in HKFRSs
- Deleting most of the disclosure requirements in the CO which concern matters already dealt with in HKFRSs
- Moving the company-level balance sheet into the notes with significantly reduced supporting information when presenting consolidated financial statements
- Closing loopholes on disclosure of directors' emoluments
- Moving the disclosure of certain transactions with directors from the directors' report to the financial statements
- Tightening up on exemptions from preparation of consolidated financial statements
- Introducing restrictions on the extent to which a company can change its financial reporting period-end date

We discuss each of these developments in more detail below. In addition, the appendix to this briefing note gives an overview of the mandatory disclosure requirements in the new CO, including those disclosures which have been brought forward unchanged from the old CO. As mentioned above on page 3, these changes first effected financial statements for financial years which began on or after 3 March 2014.

We also recommend taking a look at our briefing notes 2 and 3 on the changes that have been made to the directors' report, and the new no-par value share capital regime, as both of these topics impact on the preparation of the annual report.

Statutory backing for HKFRSs issued by the HKICPA

As mentioned, under the old CO (Cap. 32) there was a general requirement for the financial statements to give a true and fair view and it was generally accepted that this meant the financial statements needed to comply with HKFRSs issued by the HKICPA. However, there was no specific requirement in the old CO to follow HKFRSs as such.

- *New CO aligns with accounting standards (CO s380 (4)(b), s357(1) and (4)(a)* and s4 of Part 1 of Schedule 4)*
The new CO has strengthened the status of HKFRSs, but has stopped short of identifying specific HKFRSs in the law. Instead, the new CO requires financial statements to comply with the applicable accounting standards "issued or specified by a body prescribed by the Regulation" – and the Company (Accounting Standards (Prescribed Body)) Regulation, issued in January 2013, states that the prescribed body is the HKICPA. A statement of compliance in this regard is required to be disclosed in the financial statements.
- *Companies (Accounting Standards (Prescribed Body) Regulation, section 2)*
The approach taken in the new CO allows for a degree of flexibility for the HKICPA to update the individual HKASs and HKFRSs as and when international accounting practice evolves (since the current policy of the HKICPA is that the full body of HKFRSs should be as far as possible a direct copy of the full body of IFRS Standards issued by the International Accounting Standards Board (the IASB® Board)).

* The 2019 Amendment Ordinance moved the definition of applicable accounting standards from s380(8) to s357(1) and (4)(a).

The wording of the definition remained the same.

This approach also allows a certain amount of flexibility for the Hong Kong Government to issue further regulations which may in the future give statutory backing to other standard-setting bodies in addition to the HKICPA.

Alignment of terminology with HKFRSs

The new CO uses updated terminology to be more in line with the version of HKAS 1, *Presentation of financial statements*, effective at the time of drafting the new CO. The key changes in terms are as follows:

<i>Old CO</i>		<i>New CO</i>
“accounts”		“financial statements”
“group accounts”		“consolidated financial statements”
“balance sheet”		“statement of financial position”
“profit and loss account”		“statement of comprehensive income”

- *True and fair view requirement restated (new CO s380(1),(2) compared to old CO s123(1))*

This new terminology is reflected in the updated wording of the “true and fair view” requirement:

<i>Old CO</i>		<i>New CO</i>
“true and fair view of the state of the company’s affairs and profit or loss”		“true and fair view of the company’s financial position and financial performance”

True and fair override retained

- *New CO s380(5),(6) compared to old CO s123(4)*

The new CO also gives support for the development of accounting standards by retaining the true and fair override which was introduced into the old CO in 2006. The true and fair override has two aspects:

True and fair override Companies must ...

include extra information in the financial statements IF compliance with the CO or the requirements of the accounting standards would be INSUFFICIENT to give a true and fair view (s380(5))

depart from the requirements of the CO or the requirements of the accounting standards in relation to the contents of the financial statements IF compliance with such would be INCONSISTENT with a requirement to give a true and fair view* (s380(6))

* In such cases, the company must disclose the “reasons for, and the particulars and effects of, the departure” in its financial statements

Practical issue: using the true and fair override to adopt HKFRS 10's exception for "investment entities"

Consistent with the HKICPA's policy of copying IFRS Standards, HKFRS 10, *Consolidated Financial Statements*, is an almost identical copy of IFRS 10. In 2012, IFRS 10 (and HKFRS 10) was amended to introduce an exception for "investment entities" which was intended to provide a more appropriate measurement basis for these entities' subsidiaries than full consolidation.

As defined in the amended IFRS/HKFRS 10, investment entities are broadly speaking investment vehicles, whereby they obtain funds from investors for the purposes of providing investment management services to those investors and they measure and evaluate the performance of the investments they acquire on a fair value basis.

The amendments state that such an entity shall not consolidate its subsidiaries – instead these investments must be carried at fair value through profit or loss (FVTPL), matching the basis on which these investments are evaluated by management and the ultimate investors. The only exception to this FVTPL policy is where the subsidiaries provide investment management services to the group – these service subsidiaries would still be consolidated. The amendment to IFRS/HKFRS 10 becomes effective for accounting periods beginning on or after 1 January 2014.

The practical issue for a Hong Kong incorporated investment entity is that following the above requirement in HKFRS 10 appears to be inconsistent with the requirement set out in s381(1) of the new CO. This section states that the annual consolidated financial statements for a financial year must "include all subsidiary undertakings of the company".

Also, in the case where the investment entity does not have any service subsidiaries to consolidate, then the above requirement appears to be inconsistent with s379(2). This section states that if a company is a holding company at the end of the financial year then the directors must prepare consolidated financial statements.

As a result, it appears that in order to comply with HKFRS 10, investment entities would need to invoke the true and fair override set out in s380(6). As mentioned above, under s380(6), the company would be required to disclose the "reasons for, and the particulars and effects of, the departure" in their financial statements.

Ultimately, this is a legal matter which is only relevant to those investment entities which are Hong Kong incorporated companies - if concerned about using the true and fair override in s380(6) to achieve compliance with accounting standards in this situation, then please consult a lawyer.

Deletion of disclosure requirements already dealt with in HKFRSs

- *Newly introduced Schedule 4 and compliance with accounting standards to replace the old 10th Schedule*

In the old CO, the 10th Schedule set out a long list of specific items which should be disclosed in any given set of accounts. This Schedule was in effect an early form of accounting standard, in that it covered a range of common matters pertaining to the balance sheet and profit and loss account. For example, it dealt with analysing the balance sheet into various categories of assets, liabilities, share capital and reserves, giving additional note disclosures for leasehold land and investments and any liabilities secured on the company's assets, and disclosing the methods by which inventory and turnover had been stated, and foreign currency balances had been translated into the presentation currency.

In the new CO, the 10th Schedule is replaced by Schedule 4. Instead of a long list of specific items to disclose, Schedule 4 contains only 5 items, one of which is to disclose whether the financial statements have been prepared in accordance with the applicable accounting standards (as mentioned above).

The other requirements in the new Schedule 4 are:

- three miscellaneous items which have been brought forward from the old CO*; and
- new requirements in respect of the company's balance sheet in a set of consolidated financial statements (which are looked at more closely below).

As a result, the majority of the information in the financial statements relating to the financial performance and position of the company or group is now determined by the disclosure requirements of HKFRSs and, for companies listed on the Hong Kong Stock Exchange, the requirements of the Listing Rules.

* *These 3 items are (i) name of parent undertaking, (ii) auditors' remuneration and (iii) certain loans made to employees to enable them to buy shares in the company – see the appendix to this briefing note for more details*

Practical issue: should the repeal of the old 10th Schedule result in changes to financial statements?

As companies are free to disclose more than the minimum required, in practice there is no need to review the financial statements and remove disclosures that strictly speaking are no longer required. It is also likely that some of the disclosures may continue to be common practice in Hong Kong financial statements as the information is considered useful. Examples of such information might include:

- "turnover", being the revenue arising from a company's principal activities;
- analysing leasehold interests in land into short, medium and long term interests; and
- disclosing separately the amount of tax payable to the Hong Kong tax authorities and the rate at which it is accrued.

However, the repeal of the old 10th Schedule provides an opportunity to streamline the disclosures and delete those which appeared to sit uncomfortably with the requirements of HKFRSs. Examples of such information include:

- the distinction between "fixed assets" and "assets which are neither fixed nor current" (under HKFRSs the distinction is usually between types of asset, such as investment property, property, plant and equipment held for own use and intangible assets);
- the details of dividends paid and proposed, disclosed (or referred to) on the face of the income statement (under HKFRSs such items are regarded as movements in equity, not items which relate to profit or loss); and
- analyses of interest expense between bank loans and other loans repayable within 5 years and more than five years (under HKFRSs comprehensive information on liquidity risk and interest rate risk needs to be disclosed instead).

Disclosure of the company-level balance sheet as a note to the consolidated financial statements

Under the new CO the disclosure requirements relating to the company-level balance sheet have been relaxed when a company is preparing consolidated financial statements, as follows:

Old CO	→	New CO
<ul style="list-style-type: none">• <i>New CO Schedule 4, part 1, section 2 compared to old CO s123(1), (5)</i> <p>No exemption from “true and fair view” of company-level balance sheet</p> <p>Impact in practice on group accounts:</p> <ul style="list-style-type: none">• company-level balance sheet was included in group accounts as a primary statement• a full set of supporting notes was also included, sufficient to give a true and fair view of state of affairs of the company		<p>Only limited disclosure of company-level information is required if preparing consolidated financial statements</p> <p>New requirement is to include notes to the consolidated financial statements which disclose:</p> <ul style="list-style-type: none">• the company-level statement of financial position (the new name for the balance sheet); and• the movement in the company-level reserves <p>No other company-level notes are required to support the statement of financial position.</p>

Practical issue: is it necessary for the directors to sign the company-level balance sheet now it is in the notes?

Yes. Section 387 states that a “statement of financial position that forms part of any financial statements” must be approved by the directors and signed on their behalf. There is no exemption granted in section 387 for the company’s statement of financial position presented in the notes in accordance with Schedule 4 and therefore the note containing the company’s statement of financial position should also contain the directors’ signature. This position has been confirmed by the Companies Registry in an FAQ, Q14 of the “[Accounts and Audit](#)” topic, which can be accessed via their website.

Closing loopholes on disclosure of directors’ emoluments

- *New CO s383 and Companies (Disclosure of Information about Benefits of Directors) Regulation, compared to old CO s161*

The detailed disclosure requirements relating to the disclosure of directors’ emoluments that were set out in section 161 of the old CO have been brought forward and included in a new Regulation, the Companies (Disclosure of Information about Benefits of Directors) Regulation (“C(DIBD)R”). This is referred to under section 383 of the new CO, as being information relating to directors which must be included in the notes to the annual financial statements.

In drafting the new Regulation, the opportunity was also taken to close loopholes that existed in the old wording and to improve the extent of information disclosed. These include the following changes introduced by the C(DIBD)R compared to section 161 of the old CO:

- Expanding the scope of “directors’ emoluments” to include explicitly:
 - any emoluments paid or receivable in respect of a person accepting office as a director;
 - bonuses;
 - payments to, or receivable by, a connected entity of the director*;
 - payments made to a person at the direction of the director or a connected entity of a director*; and

- payments made to a person for the benefit of the director or a connected entity of a director*.

** As more fully explained on page 10 of this briefing note, section 486 of the new CO sets out the meaning of "a connected entity of the director" - this includes individuals (e.g. close family members) as well as corporate entities*

- Introducing a new disclosure requirement to separately disclose consideration provided to or receivable by any "third party" for making available the services of a person as a director of the company or in any other capacity while a director.
- Requiring that whenever the consideration provided is a non-cash benefit, then the "nature" of that benefit should be disclosed.
- Renaming the concept of "pensions" in the old s161 as "retirement benefits" in the C(DIBD)R and defining this broadly to include "any lump sum, allowance, gratuity, periodical payment or other like benefit, any other property, or any other benefit whether in cash or otherwise" given on or after retirement or on death.

NB There are exclusions for benefits from schemes paid for by contributions during the service period and for personal injury/death benefits payable in relation to a work-related injury, but generally this can be seen as a broadening of the concept and may catch, for instance, continuing accommodation and medical or club benefits provided to retired directors.

- Extending the scope of the disclosure of termination payments to include payments made to shadow directors on termination.

Further details on the above requirements are set out in Part 2 of the C(DIBD)R and in section 383 of the new CO. In addition, Accounting Bulletin 3 (Revised) "Guidance on the disclosure of directors' remuneration" issued by the HKICPA has been updated in consultation with the Companies Registry to provide additional guidance on how to meet these requirements in practice.

Disclosure of certain directors' transactions moved from the directors' report to the financial statements

- *New CO s383(1)(e)*
- *Companies (Disclosure of Information about Benefits of Directors) Regulation, section 20-22*
- *Companies (Directors' Report) Regulation, section 10*
- *Old CO s129D(3)(j)*

Under the old CO it was necessary to disclose in the directors' report certain particulars for "contracts of significance in relation to the company's business" involving the company, its subsidiaries, its holding company or any subsidiary of its holding company, in which a director of the company has, or had during the year, a "material interest". The old CO indicated that it was for the directors to judge whether a contract was "significant" or a director's interest was "material".

The new CO retains this requirement but has modified its impact as follows:

- a) The concept of "contract of significance" has been broadened to be "a transaction, arrangement or contract" that is significant in relation to the company's business
- b) So far as public companies are concerned, a director of a public company is treated as having a material interest in a transaction, arrangement or contract entered into by that public company if a connected entity of that director has a material interest in that transaction, arrangement or contract
- c) The location of the disclosures has been split as follows:
 - If the "transaction, arrangement or contract" involves the company, then it falls under s383(1)(e) of the new CO and, in accordance with section 22 of the Companies (Disclosure of Information about Benefits of Directors) Regulation (C(DIBD)R), is required to be disclosed in the financial statements; whereas
 - if the "transaction, arrangement or contract" involves the company's parent, subsidiary or fellow subsidiary then it falls under section 10 of the Companies (Directors' Report) Regulation of the new CO and is required to be disclosed in the directors' report.

- *New CO s484-488*
- *Companies (Disclosure of Information about Benefits of Directors) Regulation, section 20-22*

What is a “connected entity”?

As mentioned above, so far as public companies are concerned, a director of a public company is treated as having a material interest if a connected entity of that director has a material interest. Section 486 of the new CO sets out the complete list of relationships which would result in an entity being regarded as being “connected” with a director, with additional explanation found in sections 484, 487-488.

This list is wide-ranging and includes individuals (e.g. close family members and business partners) as well as corporate entities with which the director is “associated”. As per section 488 a director is “associated” with a body corporate if he alone, or he and certain close family members together, are entitled to control more than 30% of the voting power, or the directors of that entity are accustomed to act in accordance with the instructions of the director or an entity connected with the director.

Particular care should be taken to become familiar with the detail of these sections if the company is a public company. For example, as a result of the definition of “family member” set out in section 487, a “connected entity” includes the parents of a director and his/her adult children – these persons do not need to be dependent on the director in order for them to fall within the definition of “connected entity”. The term “connected entity” also includes a person in a co-habitation relationship with the director and a new broad definition of such a relationship is included in section 484.

Transactions between these persons or entities and the company are discloseable in the financial statements under the C(DIBD)R, unless the directors are, after consideration, of the opinion that:

- the transaction, arrangement or contract is not significant in relation to the company’s business; and/or
- the interest that the director has in the transaction, arrangement or contract is not material.

Is there any practical impact of moving the disclosures into the financial statements?

Generally, the key difference between disclosing any information in the financial statements and disclosing it in the directors’ report is that the information disclosed in the financial statements falls within the scope of the auditors’ report and is therefore subject to audit.

In this particular case, moving this disclosure into the financial statements may not necessarily increase the amount of audit work, as significant contracts involving the company and its directors are already within the audit scope due to the requirements of HKAS 24, *Related Party Disclosures*. However, additional disclosures and associated additional audit work may arise due to either or both of the following:

- the definition of “connected entity” in the new CO is broader than the scope of HKAS 24, which may extend the disclosures to be made by public companies. For example, under HKAS 24 the director’s interest in another entity would need to be a controlling interest to fall within the definition of “related party”, which may be a higher threshold than the 30% limit specified in s488 of the new CO. Also, under HKAS 24 the definition of a “family member” may have been interpreted more narrowly than is permitted under s487 of the new CO; and/or
- the level of disclosure required under the C(DIBD)R for any discloseable transaction, arrangement or contract exceeds that required under HKAS 24. In particular, under the C(DIBD)R, specific disclosure is required of:
 - the names of the director having the material interest;
 - the nature of that interest; and
 - the names of the other parties to the transaction, arrangement or contract, including, where applicable, the names of the director’s connected entity and the nature of the connection, if the company is a public company and the transaction, arrangement or contract involves entities connected with the director.

Tightening up on exemptions from preparing consolidated financial statements

- *New CO s379 compared to old CO s124*

Under both the old CO and the new CO, if the company has subsidiaries at the end of the financial reporting period, and is not a wholly-owned subsidiary of another body corporate, then it is required to prepare consolidated financial statements unless it meets certain exemption criteria.

The new CO tightened up the exemptions, including introducing procedures by which partially-owned parents are required to seek advance approval from shareholders in the first half of the financial year if they do not wish to prepare consolidated financial statements. However, as a result of feedback from stakeholders, the 2019 Amendment Ordinance introduces an alternative way for these parents to seek approval later in the financial year, to provide further practical relief.

The new exemption criteria are considered in more detail below.

When all of the company's subsidiaries are immaterial

- *New CO s381(3) compared to old CO s124(2)*

Under both the old and the new CO, subsidiaries which are immaterial may be excluded from the consolidated financial statements. The old CO described this as being when including the subsidiary "would be of no real value to members of the company, in view of the insignificant amounts involved". In contrast, section 381 the new CO includes more explicit requirements on when a company may exclude a subsidiary on the grounds of immateriality:

- an individual subsidiary may only be excluded from consolidation if the inclusion of the subsidiary is not material for the purposes of giving a true and fair view of the financial position AND the financial performance of the group; and
- more than one subsidiary may only be excluded from consolidation if the inclusion of the subsidiaries taken together is not material for the purposes of giving a true and fair view of the financial position and the financial performance of the group.

These additional requirements are an effective way to prevent companies avoiding consolidation by carving their business up into a large number of small subsidiaries. However, if all the company's subsidiaries are genuinely immaterial when taken together, and the company wants to exclude them, then the company is in all practical respects exempt from preparing consolidated financial statements.

When the parent is a partially-owned subsidiary of another body corporate

- *New COs379(3)(b) compared to old CO s124(2)(b)*

The old CO allowed a subsidiary to be excluded from consolidation if including that subsidiary "would involve expense or delay out of proportion to the value to members". Similar to the effective exemption from consolidation if all subsidiaries are judged immaterial, this wording was referred to on occasion by partially-owned parents as a justification for not preparing group accounts, on the grounds that the shareholders did not value including any of the subsidiaries in their financial statements.

The old "expense or delay" words were not carried forward into the new CO. Instead, under the new CO as first effective in 2014, a parent with material subsidiaries which is not wholly-owned is only exempt from preparing consolidated financial statements if all of the criteria set out in section 379(3)(b) are met. These criteria are as follows:

- a) the parent must be a partially-owned subsidiary of another body corporate;
- b) at least 6 months before the end of the financial year, the directors must write to the members to notify them that they do not intend to prepare consolidated financial statements for this financial year; and
- c) 3 months before the financial year end, no member has written to the company requesting the company to prepare consolidated financial statements.

- *New COs 379(3)(c) introduced by the 2019 Amendment Ordinance*

Additional relief provided by the 2019 Amendment Ordinance

Since the new CO came into effect, the requirement to contact shareholders at least 6 months before the year end has proved a challenge in some situations, for example if there has been a change in the entity's shareholders or when an entity only became a parent in the second half of the year. To help in such cases, the 2019 Amendment Ordinance introduces an alternative method by which partially owned parents can confirm the views of their shareholders later in the year. This is in a new sub-section, s379(3)(c). In accordance with s379(3)(c), a partially owned parent will be exempt from preparing consolidated financial statements if all of its members agree in writing before the end of the financial year that consolidated financial statements will not be prepared for that financial year.

This new alternative method provides some relief for those entities whose circumstances changed during the year or who overlooked the 6 month rule, provided that all of the shareholders are willing to confirm that they are content with company-level financial statements. However, this new method still requires action to be taken during the financial year and so will not provide relief to those parents who only consider this issue at the time of preparing their annual report.

Practical issue: when to send the notification to members

Section 379(3)(b)(ii) explicitly states that the notification to members cannot relate to any other financial year. The new section 379(3)(c) introduced by the 2019 Amendment Ordinance is also clear that the written notification from members should only relate to one financial year. This means that a partially-owned parent will have to notify the members each year to gain the exemption from producing consolidated financial statements. Furthermore, the notification will have to be sent before the end of the financial year to which it relates. Thinking about this matter cannot wait until the financial year has come to an end and the company begins to draw up the annual financial statements.

One practical way to satisfy these requirements on a recurring basis would be to include each year the current year notification in the notice relating to the Annual General Meeting (AGM).

For example, if a company does not wish to prepare consolidated financial statements for the year ended 31 December 2020, it would need to notify the shareholders before 30 June 2020 if relying on s379(3)(b). This could be done by including the matter in the notice of the 2020 AGM called to approve the 2019 financial statements, provided that this notice is sent before 30 June 2020. If it waits until after this date, then it will need to obtain 100% positive confirmation from all shareholders under the new s379(3)(c) in order to gain exemption.

Other administrative matters

New restrictions on changing the period end date

- *New CO s367-371*

The new CO includes specific requirements relating to the length of a company's financial reporting period and any changes to that period from one year to the next. Previously this was only covered indirectly by reference to the frequency of annual general meetings.

The new requirements are set out in sections 367 to 371 of the new CO. These requirements were slightly relaxed by the 2019 Amendment Ordinance to cater for those companies which define their financial year as an exact 52 week period or ending on a specific day of the week, rather than a full calendar year.

In most cases, there is no practical effect of these new requirements, provided a company continues to prepare financial statements for each consecutive 12 month period.

However, if the directors of a company wish to change the company's reporting date (known in the new CO as the "accounting reference date"), it should be noted that the new CO requires a directors' resolution and imposes certain constraints. These constraints are aimed at preventing the directors using the excuse of moving to a new reporting date to effectively put-off reporting at 12 month intervals either too often, or for too long a delay.

The details of the new requirements and the 2019 amendment are as follows:

Constraints on changing the reporting date

- *New CO s371*

- A company cannot specify a new accounting period in relation to a previous accounting period if the period in which the reporting documents must be laid at the AGM or circulated to the members has already expired.
- The directors cannot specify a new accounting period if they had, within the last 5 years, already extended an earlier accounting period. The only exceptions are:
 - if the directors are specifying a new accounting period in order to ensure that the accounting period of the company coincides with the accounting period of the holding company (for example, if there has been a change in controlling shareholder); or
 - if the members approve a resolution to that effect.
- The directors cannot specify a new accounting reference date which would have the effect of extending the period to longer than 18 months.

For example: if in 2015 the directors of a company with a 31 December year end wish to change the company's reporting date to 30 September, this would need to be done by shortening the reporting period for the year of change to just 9 months – it could not be achieved by extending the reporting period which began on 1 January 2015 to 30 September 2016.

- *New CO s371(2)*

It should also be noted that if the directors of a public company or a company limited by guarantee change the reporting date of the company, then the company must deliver a notice to the Registrar in the specified form within 15 days of the directors' resolution.

- *New CO s367(1), (2)*

Relaxation introduced by the 2019 Amendment Ordinance

The new CO, as originally effective in 2014, effectively defined the reporting date as being the anniversary of the previous reporting date i.e. a date exactly one full calendar year later. Therefore, if the reporting period ended on any other day, this was regarded as a "change in the reporting date" which would be subject to the above requirements. This caused difficulties for entities that defined their reporting period as an exact 52 week period, or, for example, as ending on the last Friday in February each year.

To cater for such entities, the 2019 Amendment Ordinance amended the definition of "financial year" in sub-sections (1) and (2) of s367 to allow for the financial year end date to be any date within a period of 7 days before or after the anniversary of the previous financial year end date.

In this briefing note we started with the key question of "which companies are required to prepare full financial statements?". We then focused on the minimum content and disclosures for full financial statements, highlighting the key changes from the old requirements, and some practical issues to bear in mind, as well as flagging the changes introduced by the 2019 Amendment Ordinance.

To complete our introduction to the new CO's impact on full financial statements, the appendix to this briefing note includes a complete list of the mandatory disclosures, including those which have been brought forward unchanged from the old CO.

If you would like further assistance on any of the matters discussed, please do not hesitate to talk with your usual KPMG contact. They can also share with you our other briefing notes, in which we:

- introduce the changes for the directors' report, including the new "business review" requirement;
- consider the implications of moving to a no-par value share capital regime, a development which affected all companies incorporated in Hong Kong from the commencement date of the new CO; and
- take an in-depth look at the new simplified reporting regime, including more details on meeting the qualifying size and shareholder approval tests, the accounting simplifications on offer and things to think about before deciding whether or not it is worthwhile making the change from full financial reporting.

Appendix: Mandatory disclosures under the new CO

As explained on page 6 of this briefing note, once the relevant sections of the new CO became effective, HKFRSs and the Listing Rules became the primary source of the disclosure requirements for the majority of the information in the financial statements relating to the financial performance and position of the company or group. However, the new CO has retained the requirements to disclose certain information, primarily relating to transactions which involve directors or parties related to directors. In this appendix we give an overview of these mandatory disclosure requirements.

Mandatory disclosure requirements in new CO	Comparison to old CO
<p>S. 383</p> <p>The financial statements must contain the information prescribed by the Regulation about the following matters:</p> <ul style="list-style-type: none">(a) directors' emoluments(b) directors' retirement benefits(c) termination benefits paid to directors(d) loans, quasi-loans and other dealings in favour of directors of the company or its holding company(e) material interests of directors in transactions, arrangements or contracts entered into by the company or another company in the same group(f) consideration provided to or receivable by a third party for making available the services of a director <p>Details of the required disclosures in respect of the above are set out in the Companies (Disclosure of Information about Benefits of Directors) Regulation (C(DIBD)R).</p>	<p>Items (a)-(c) and (f) relate to the disclosure of directors' emoluments as was covered by section 161 in the old CO. As discussed on pages 8-9 of this briefing note, when bringing forward the requirements of s161 into the new C(DIBD)R, the opportunity has been taken to close some potential loopholes and improve the information disclosed.</p> <p>Item (d) relates to disclosure of loans, quasi-loans and credit transactions (guarantees) that were covered by sections 161B and 161BA of the old CO. The detailed disclosure requirements of these sections have been brought forward largely unaltered into the C(DIBD)R. However, when contemplating entering into such transactions, care should be taken to refer to the requirements of Part 11 of the new CO "Fair Dealing by Directors" (particularly sections 491 to 515) to ensure the most up-to-date relevant approval requirements have been met.</p> <p>Item (e) derives from a disclosure requirement that was in section 129D of the old CO, which set out information to be disclosed in the directors' report. Further details of this change introduced by the new CO can be found on pages 9-10 of this briefing note.</p>
<p>Sch 4 Part 1.1</p> <p>The financial statements must disclose the aggregate amount of outstanding loans made under the authority of sections 280 and 281 (these are loans made to eligible employees to enable them to buy shares in the company)</p>	<p>This disclosure requirement is brought forward from the old 10th Schedule (para 9(c))</p>

Mandatory disclosure requirements in new CO

Comparison to old CO

Sch 4 Part 1.2	<p>Schedule 4 of the new CO states that if a group produces consolidated financial statements, the following must be included in the notes to the consolidated financial statements:</p> <ul style="list-style-type: none"> • the parent's company level statement of financial position; and • a note disclosing the movement in the parent company's reserves. <p>The statement of financial position must be in the same format as if the parent company was not required to produce consolidated financial statements, but notes to the parent's company level statement of financial position are not required.</p>	<p><i>This is a new requirement. As discussed on pages 6-7 of this briefing note, this requirement replaces the requirement in s123(1) of the old CO to include a company-level balance sheet as a primary statement, which, together with notes, showed a true and fair view of the state of affairs of the company.</i></p>
Sch 4 Part 1.3	<p>If at the end of the year the company is a subsidiary of another undertaking, it must disclose the name of the parent undertaking and the parent undertaking's country of incorporation (if the parent undertaking is a body corporate) or its principal place of business (if the parent undertaking is not a body corporate)</p>	<p><i>This disclosure requirement is brought forward from s129A(1) of the old CO. Note also that the 23rd Schedule of the old CO has become Schedule 1 of the new CO. This Schedule defines the terms "parent undertaking" and "subsidiary undertaking".</i></p>
Sch 4 Part 1.4	<p>The financial statements must state whether they have been prepared in accordance with the applicable accounting standards as defined by section 357(1)* of the new CO and, if they have not been so prepared, must state the particulars of, and the reasons for, any material departure from those standards.</p> <p><i>(NB "the applicable accounting standards" for those companies which are not entitled to or do not take advantage of the reporting exemption are HKFRSs issued by the HKICPA)</i></p>	<p><i>As discussed on page 6 of this briefing note, this is a new requirement for the CO, but is consistent with existing practice due to similar requirements to disclose a statement of compliance contained in paragraph 16 of HKAS 1, Presentation of Financial Statements.</i></p>
Sch 4 Part 2.1	<p>The company's financial statements must state under a separate heading the amount of the remuneration of the auditor. For this purpose "remuneration" includes any sum paid by the company in respect of the auditor's expenses.</p>	<p><i>This disclosure requirement is brought forward from the old 10th Schedule (para 15)</i></p>

Mandatory disclosure requirements in new CO

Comparison to old CO

S. 387

The statement of financial position must be approved by the directors and must be signed by 2 directors on the directors' behalf (unless the company only has one director, in which case the sole director must sign the statement).

The names of the director(s) who signed the statement of financial position must be stated on any statement of financial position laid before the company in general meeting, sent to a member under section 430 or otherwise, circulated, published or issued by the company.

Note: In consolidated financial statements the requirement to approve and sign the statement of financial position applies to both the consolidated financial statement of financial position and the company-level statement of financial position included in the notes under Schedule 4.

This requirement is brought forward from s129B of the old CO, except that the terminology is updated from "balance sheet" to "statement of financial position".

This is a new requirement. Under the old CO this is general practice but not specifically required.

The continuing need for this statement of financial position to be signed has been confirmed in an FAQ on the new Companies Ordinance issued by the Companies Registry under the topic ["Accounts and Audit"](#).

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