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New Hong Kong Companies Ordinance Briefing Note 2

What's new for directors' reports?

In 2014, an entirely new Companies Ordinance ("CO") (Cap. 622) came into effect in Hong Kong. So far as directors' reports are concerned, there were three main areas to think about:

- Understanding the extent to which the requirements relating to the directors' report had been brought forward unchanged from the old CO (Cap. 32) - as we explain in this briefing note, this was not as simple as it sounds;
- Understanding which companies have to prepare the new "Business Review" and what such a statement would need to contain; and
- Taking note of the other new disclosure requirements, in particular the requirement to disclose all the names of the directors in the group when preparing consolidated financial statements.

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 impacted were those falling in 2015. For example, for those companies with a calendar year-end, these changes first impacted the financial statements and directors' reports 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 directors' reports and it is current as of April 2020. So far as directors' reports are concerned, the main impacts of the 2019 Amendment Ordinance are on eligibility for the reporting exemption (see page 4) and disclosure of the names of the directors of subsidiaries (see page 9).

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

Overview of the changes

When first looking at the new CO, it can be hard to get a sense of whether the new CO has introduced significant changes for the directors' report or not. This is because the requirements of the old s129D have been split up into various new locations in the new legislation as follows:

Old CO	New CO
<p>Almost all preparation, disclosure and approval requirements relating to the minimum contents of the directors' report were located in s129D</p>	<p>Requirements relating to the directors' reports are located in:</p> <ul style="list-style-type: none"> • Sections 388-391 and 543(2) • Schedule 5 "Contents of Directors' Report: Business Review" • Companies (Directors' Report) Regulation ("C(DR)R")

For users of the CO, the new approach may seem unduly complex, compared to the simplicity of s129D. However, from the Administration's perspective, the new approach introduces flexibility, as the legislative procedures involved in amending "regulations" (a form of "subsidiary legislation") are less onerous than those required to amend the main body of an ordinance. In fact, the C(DR)R was amended only a couple of months after it was issued, during the final stages of completing the subsidiary legislation which was needed to implement the new CO.

In the appendix to this briefing note we have mapped the requirements of s129D of the old CO to the requirements of the new CO as of the time of writing. In the remainder of this briefing note, we focus on the extent to which the contents of the directors' report changed as a result of the implementation of the new CO.

These changes can be summarised as follows:

- A new "business review" section must be included in the directors' report unless the company is exempt
- The names of all the directors in the group must be disclosed in a consolidated directors' report, and the disclosure should extend to the date of approving the directors' report*
- Disclosure of significant transactions, arrangements or contracts entered into by the company, where a director has a material interest, has been moved to the financial statements and is therefore subject to audit
- New disclosure requirements have been introduced in respect of:
 - reasons for a director resigning or not seeking re-appointment, if related to the affairs of the company;
 - permitted indemnity provisions; and
 - equity-linked agreements
- Certain disclosure requirements have been dropped from the directors' report, as these are covered by the disclosures in the financial statements

- [New CO s390, as amended by the 2019 Amendment Ordinance](#)

** After concerns were expressed on the practical implementation of this requirement - particularly from such large corporate groups - the 2019 Amendment Ordinance relaxed this requirement such that the disclosure of the names of directors of subsidiaries can be made available at the company's registered office or disclosed on the company's website. Further details of this amendment are given on page 9 of this briefing note.*

- [New CO s358](#)

All of these changes are found in Part 9 of the new CO, which contains its own commencement provisions set out in s358. In accordance with that section, these

- *Companies Registry External Circular No. 2/2013 dated 1 November 2013*

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 directors' reports of those companies with a March year-end were the first impacted, as Part 9 came into effect for these companies starting from 1 April 2014. The directors' reports of those companies with a calendar year-end were first impacted in the year ended 31 December 2015.

Each of these new requirements is looked at in turn below. In addition, in the appendix to this briefing note we have included a detailed mapping from the requirements of the old CO to the requirements of the new CO. This appendix includes details of the more minor changes that have been made to tidy up the wording of the disclosure requirements, including identifying which disclosures have been dropped from the directors' report and are instead covered by disclosures in the financial statements.

Disclosure exemptions for certain companies

One of the main objectives of the new CO so far as company reporting is concerned is to reduce the reporting burden on non-public and wholly-owned companies. The approach taken to providing relief for these companies is to exempt them from certain of the disclosure requirements and, in some cases, from the requirement for the financial statements to give a true and fair view and/or for consolidated financial statements to be prepared. If no exemption is stated then a company of any size must assume that the requirement is applicable to them.

So far as the directors' report is concerned, the following exemptions are specified in the new CO for the following types of companies:

<i>Exemptions available:</i>	For companies which ...		
	fall within the "reporting exemption"	are wholly-owned subsidiaries of another body corporate at the end of the year	are private companies and have passed a special resolution
New business review	Exempt – s388(3)(a)	Exempt – s388(3)(b)	Exempt – s388(3)(c) & (4)
Arrangements to enable a director to acquire benefits from shares in or debentures of the company or any other body corporate	Exempt – C(DR)R.3(3A)	No exemption	No exemption
Donations made for charitable or other purposes	Exempt – C(DR)R.4(3)	Exempt, but only if the company's parent is incorporated in HK – C(DR)R.4(1) & (2)	No exemption
Reasons for a director resigning or not seeking re-election	Exempt – C(DR)R.8(3)	No exemption	No exemption
Material interests of a director in transactions, arrangements or contracts	Exempt – C(DR)R.10(7)(a)	No exemption	No exemption

Which companies can "fall within the reporting exemption"?

As explained in our briefing note 1, one of the main changes in the new CO so far as company reporting is concerned is the expansion of the regime for simplified reporting for private companies and companies limited by guarantee.

Under the old CO, only companies which fall within the scope of s141D were eligible for such simplified reporting. These were private companies which had no subsidiaries and were not a subsidiary of another company, and only if 100% of the shareholders agreed that this company could produce simplified financial statements.

The new CO carries forward the exemption criteria in s141D as one category of exempt company. But it also introduces three more categories of eligible companies or groups:

- *New CO s359, as amended by the 2019 Amendment Ordinance*

New categories of eligible non-public companies

- small guarantee companies and groups of small guarantee companies if their annual revenue is not more than \$25 million;
- small private companies and groups of small private companies if they meet at least 2 out of 3 size tests of not more than \$100 million annual revenue, \$100 million total assets and 100 employees; and
- larger “eligible” private companies and groups of larger “eligible” private companies if
 - (a) they meet at least 2 out of 3 size tests of not more than \$200 million annual revenue, \$200 million total assets and 100 employees; and
 - (b) they get sufficient shareholder approval from at least 75% of all the members with none objecting

As a result of amendments in the 2019 Amendment Ordinance, it is also now clear that groups including overseas incorporated subsidiaries, and mixed groups, containing both private companies and companies limited by guarantee, are eligible, provided they meet the relevant size tests.

The above is just a snapshot of the new requirements, as there is a considerable amount of detail in sections 359 to 366A of the new CO, and in a specific Schedule, Schedule 3, on how to establish eligibility. This includes detail on computing the amounts for the “two out of three” size tests for companies and groups, and a “two year waiting period” for gaining or losing eligibility which applied once the new CO came into effect. These requirements in the new CO are explained in our briefing note 4, which looks in depth at the simplified reporting regime, together with worked examples.

Practical issue – Can the directors’ report take advantage of these exemptions even if the company chooses to follow the full reporting regime for the financial statements?

Yes. Each of the disclosure exemptions in the new CO applies if the company “falls within the reporting exemption”. The minimum requirement is therefore that the company (or the group, if the company is required to prepare consolidated financial statements) is eligible for the reporting exemption, not whether in fact it takes advantage of this eligibility by preparing simplified financial statements.

As a result, non-public companies (or groups) still have some flexibility as to the contents of their directors’ reports. But if the company is not a wholly-owned subsidiary and falls outside the smallest size category, it will need to take care to get the necessary shareholder approvals in place, in order to take advantage of any of these exemptions.

Exemption from business review: What are the requirements for the “special resolution” that other private companies need in order to be exempt?

- *New CO s388(3),(4) and s564*

Only companies which are wholly-owned subsidiaries or which fall within the reporting exemption are automatically exempt from preparing the new business review without following further procedures. If the directors of any other private company do not wish to prepare a business review, then they need to ask the members of that company to pass a special resolution to that effect. The new CO defines a special resolution as a resolution that is passed by at least 75% of those who voted in person at the meeting or by proxy.

S388(4) explicitly states that the resolution must be passed at least 6 months before the end of the financial year to which the directors’ report relates. However, this resolution can be in respect of:

- a) the financial year; or
- b) the financial year and every subsequent financial year.

It can only be revoked by a special resolution.

Insight

This shareholder approval criterion should be easier to meet than the approval for the reporting exemption discussed above, as it only requires a 75% majority vote in a general meeting of the shareholders of the company. By contrast, if a private company/group fails the smallest size criteria, it will need at least 75% of all shareholders of the company approving of the move to simplified reporting, with none objecting either at the meeting or afterwards, in order to qualify for the reporting exemption.

New Business Review

- *New CO s388(1) & (2) compared to old CO s129D(3)(a)*

An important change to the CO is the requirement for companies to present a business review in the directors' report. This is an analytical and forward looking review of the company or group, which goes beyond the factual statement of the principal activities of the company and its subsidiaries (if any) required under the old CO.

- *New CO s388(3)*

As mentioned above on page 3, there are 3 categories of companies which are exempt from this new requirement. It can be seen from those exemptions, that this new business review is intended to provide useful information for shareholders of a company, particularly those shareholders of larger private or public companies that might otherwise not have access to inside information on the company's or group's activities because they are not involved in the management of the company.

Minimum contents

- *New CO Sch 5.1*

Schedule 5 of the new CO specifies the minimum contents of the business review. The core requirements are set out in paragraph 1, which states that the directors' report for a financial year must contain a business review that consists of the following 4 components:

The year under review	The risks facing the company	Events post year end	The future
<ul style="list-style-type: none"> • Give a fair review of the company's business 	<ul style="list-style-type: none"> • Describe the principal risks and uncertainties facing the company 	<ul style="list-style-type: none"> • Disclose important events affecting the company since the end of the financial year 	<ul style="list-style-type: none"> • Indicate likely future development in the company's business

- *New CO s388(2) and Sch 5*

Although paragraph 1 of Schedule 5 consistently refers to the "company", it is clear from paragraph 4 and s388(2) of the new CO, that the business review should be prepared on a consolidated basis (i.e. covering the group as a whole) when the directors' report containing this review will be attached to a set of consolidated financial statements.

According to paragraph 3 of Schedule 5, the company is not required to disclose any information about "impending developments or matters in the course of negotiation", if such disclosure would, in the directors' opinion, be "seriously prejudicial" to the company's (or group's) interests.

- *New CO Sch 5.2* The only other detail in Schedule 5 relating to the minimum contents of the business review is set out in paragraph 2. This paragraph states that the business review must include the following information “to the extent necessary for an understanding of the development, performance or position of the company’s [group’s] business”:
 - an analysis using financial key performance indicators (KPIs);
 - a discussion on:
 - the company’s (group’s) environmental policies and performance; and
 - the company’s (group’s) compliance with the relevant laws and regulations that have a significant impact on the company (or group); and
 - an account of the company’s (group’s) key relationships with its employees, customers and suppliers, and others that have a significant impact on the company (or group) and on which the company’s (group’s) success depends.

- *New CO Sch 5.5* Schedule 5 states that “key performance indicators” means factors by reference to which the development, performance or position of the company’s business can be measured effectively.

Accounting Bulletin 5 “Guidance for the preparation and presentation of a business review under the Hong Kong Companies Ordinance”

- *AB 5.1* There is no further indication in the CO as to the expected contents of the new business review. Instead, given that the requirements on the preparation of a business review are partly modelled on requirements in the UK, the Companies Registry invited the HKICPA to develop further guidance to assist Hong Kong incorporated companies, taking the lead from guidance issued by the UK Financial Reporting Council.
The Hong Kong guidance takes the form of an Accounting Bulletin, Accounting Bulletin No. 5 (AB 5), which was issued by the HKICPA in July 2014.
- *AB 5.15* AB 5 sets out the guiding principles for the preparation and presentation of a business review. These principles are that the review should:
 - analyse the business through the eyes of the board of directors;
 - have a scope consistent with the scope of the financial statements for the period under review;
 - both complement and supplement the financial statements, in order to enhance the overall corporate disclosure;
 - be understandable; and
 - be balanced and neutral, dealing even-handedly with both good and bad aspects.
- *AB 5.15-57* AB 5 discusses these principles and provides guidance on how to interpret them. For example, in respect of the understandability principle, AB 5 states that the business review should provide focused and relevant information on material matters, taking into account qualitative and quantitative factors, while it cautions against including too much information that may obscure judgements.
AB 5 then provides a more detailed framework for the disclosures to be provided by management under the 4 main categories identified above (i.e. (i) a fair review of the reporting entity’s business, (ii) a description of the principal risks and uncertainties facing the reporting entity, (iii) particulars of important events that have occurred since the end of the financial year and (iv) an indication of the likely future development in the reporting entity’s business).
- *AB 5.8, 28-57* While the Bulletin does not introduce any new requirements, it does detail particular matters that should be disclosed in order to meet the minimum requirements of Schedule 5.

- *AB 5.41-42*

For example, AB 5 gives specific guidance on the choice and disclosure of KPIs, to ensure that the disclosure is consistent with the guiding principles of seeing the business through the eyes of management and presenting understandable information which supplements and complements the financial statements. AB 5 states that to achieve this objective it may be necessary to disclose information in the business review which explains how the KPIs were calculated, how the data used in their calculation reconciles to the financial statements, and whether they have been prepared consistently one accounting period to the next.

- *AB 5.6-7, 9, 15-57 and IG1-IG23*

In addition to examples in the main body of AB 5 which elaborate on the framework, AB 5 is accompanied by implementation guidance which illustrates suggested financial KPIs, non-financial KPIs and other quantified data measures which directors may wish to include in the business review in order to enhance the usefulness of the review for members of the company and any other users.

AB 5 states that these examples are directed towards non-public companies, in particular those companies which previously have not been required to prepare a business review. However, AB 5 also stresses that the application of the guidance in the Bulletin may vary considerably, depending on whether the reporting entity is large or small and whether its business is complex or relatively simple.

Practical issue – preparing a business review for the first time

Listed companies will already be familiar with disclosing some form of management discussion and analysis (MD&A) in their annual reports. But where should an unlisted company start?

One good source of examples are the annual reports of listed companies in the same line of business. But these should not be used as a substitute for focusing on the company or group's own circumstances, particularly at an early stage of gathering information and identifying what could be relevant. Specifically, the key success factors for drafting a good business review are:

- involving the right level of business management in brain-storming the content relevant to the risks and uncertainties facing the company, how the company/group has performed during the financial year, what has happened since then and what is likely to happen in the future; and
- drafting a concise summary of the key points that are most relevant to the company's (or group's) business, including computing financial KPIs where appropriate.

Some of the information needed for this is readily to hand – this includes:

- the company-level or consolidated financial statements, which can be used as the starting point for the “fair review” of the business, the data for any “financial key performance indicators” and the source of particulars of any important events since the end of the financial year; and
- information on compliance with relevant laws and regulations that have a significant impact on the company or group.

Identifying other information may require more reflection by management:

- What are the risks and uncertainties facing the company/group? For example, are we at risk from aggressive market competitors, from our products becoming obsolete, from securing enough lines of funding to meet working capital or future expansion plans, from the economic environment of our customers or our suppliers, from increases in prices of key raw materials, from high levels of staff turnover, from significant rent hikes for our leased premises ... - which ones are the principal ones that the company or group faces at the moment?
- Does the company/group have any “environmental policies”? If so, what are they and how have we matched up to them? If the company/group has not focused on this issue in the past, are there any plans to improve in the future?

- What would be a fair description of the state of our relationships with our key employees, customers and suppliers? How do we ensure that these relationships remain strong enough to support our future success? What contingency plans do we have if the relationships start to fail? This is a broad topic that could depend on the level of recruitment, training and retention of key talent in the workforce, customer relationship and brand building and supply chain management activities.
- Taking all the above into account, where do we see the business heading in the short, medium and perhaps longer term? Are we in a stable business with steady performance or are significant changes planned for the future? Perhaps changes in product mix, geographical markets, diversification might be in the pipeline? Which of these do we feel comfortable describing as “likely future development”? Could disclosure of any of these plans be “seriously prejudicial” to the company’s (or group’s) interests?

With the possible exception of environmental policies, all of the above topics are important areas that businesses of any size need to be focusing on in their day-to-day running of the business in order to succeed. This information will then form the raw material for drafting a concise but relevant business review for the shareholders’ information.

How does the business review fit with the requirement to prepare an MD&A?

- *Appendix 16 to the Main Board Listing Rules (MBLR) or Chapter 18 of the Listing Rules for Growth Enterprise Market (GEM)*
- *In particular, paragraphs 32 and 52 of Appendix 16 to the MBLR or GEM Listing Rules 18.41 and 18.83*

Companies listed on the Hong Kong Stock Exchange are required to include in their annual reports a separate statement containing a discussion and analysis of the group’s performance during the financial year and the material factors underlying its results and financial position – commonly referred to as the “management discussion and analysis” or MD&A. Minimum contents for the MD&A are specified in paragraph 32 of Appendix 16 to the Main Board Listing Rules (MBLR), with equivalent paragraphs in the GEM Listing Rules.

Many of these minimum requirements could be said to overlap with Schedule 5 of the new CO. But, more importantly, in paragraph 52 of Appendix 16 to the MBLR (paragraph 18.83 of the GEM Listing Rules), there is a list of “recommended additional disclosures” which very closely correlates to Schedule 5. For example, this paragraph recommends disclosure of:

- a discussion of the listed issuer’s purpose, corporate strategy and principal drivers of performance;
- a discussion on business risks (including known events, uncertainties and other factors which may substantially affect future performance) and risks management policy;
- a discussion of the listed issuer’s environmental policies and performance, including compliance with relevant laws and regulations; and
- an account of the listed issuer’s key relationships with employees, customers, suppliers and others, on which its success depends.

Given this close correlation between the Listing Rules and the new Schedule 5, the actions required by listed issuers to ensure compliance with s388 of the new CO in practice may be limited to the following:

Actions steps for listed issuers

- review the extent to which the issuer’s current approach to the MD&A goes beyond the minimum requirements and also satisfies the recommendations set out in paragraph 52 of Appendix 16 for a fuller discussion;
- where there is less than full compliance with the Appendix 16 recommendations, consider expanding the MD&A to ensure that sufficient information is included to at least meet the requirements of the new Schedule 5; and
- in any event, ensure that in the annual report the MD&A is either included within the directors’ report or a cross reference is included in the directors’ report to where the MD&A may be found.

Changes in disclosures relating to directors

Extended scope for disclosure of directors' names

- *New CO s390 compared to old CO s129D(3)(i)*

The old CO required the names of any persons who were directors of the company during the financial year be disclosed in the directors' report. Under the new CO this disclosure has been extended in two ways:

- 1) It is also necessary to disclose the names of any persons who are or were directors of the company from the end of the financial year up to the date of the report.
- 2) If a parent company prepares consolidated financial statements, then s388(2) and 390(3) are explicit that the directors' report must be a **consolidated** report so far as the disclosure of the directors' names is concerned. This means that it is also necessary to disclose the names of any persons who are or were directors of any of the subsidiaries.

- *New CO s390(4) to (7) as introduced by the 2019 Amendment Ordinance*

Limited relief provided by the 2019 Amendment Ordinance

In most cases, the disclosure of information relating to directors in a directors' report relates only to the directors of the company (i.e. the directors of the parent which heads up the consolidated group). The new disclosure of directors' names on a consolidated basis was a surprising exception to this general approach, and concerns were soon expressed on the practical implementation of this requirement, particularly from large corporate groups.

The Companies Registry initially responded by publishing an FAQ on their website permitting the disclosure of the names of the directors of the subsidiaries to be omitted from the directors' report provided that the directors' report included a cross reference to an accessible location where the list of directors of the subsidiaries could be found in full (e.g. by providing a link to the relevant website location which contained a full list of the names).

This practical approach has now been reflected in the new CO by way of amendments to section 390. Specifically, as a result of new sub-sections (4) to (7), there is no need to include the list of names of the directors of the subsidiaries in the directors' report, provided the company makes this list available throughout the relevant period either:

- (a) at the company's registered office, where it is made available for inspection by the members free of charge during business hours; or
- (b) on the company's website.

Under s390(5), the list should contain the name of every person who was a director of the company's subsidiary undertakings during the financial year or during the period between the end of the financial year and the date of approval of the directors' report. According to s390(7), this list should be continually available throughout the period until the next directors' report is sent to the members.

Although there is no longer any requirement to do so, it would be best practice to continue to provide a cross-reference in the directors' report to where this list may be accessed.

Change in scope and location of directors' material interests disclosures

- *New CO s383(1)(e)*
- *Companies (Disclosure of Information about Benefits of Directors) Regulation, section 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 new CO has retained 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

** section 484-488 of the new CO set out the meaning of "an entity connected with the director" – as explained more fully in our briefing note 1, this includes individuals (e.g. close family members) as well as corporate entities with which the director is associated*

- c) The location of the disclosures has been split as follows:
 - o 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 20 of the Companies (Disclosure of Information about Benefits of Directors) Regulation (C(DIBD)R), is required to be disclosed in the financial statements; whereas
 - o if the "transaction, arrangement or contract" involves a "specified undertaking of the company", then it falls under section 10 of the Companies (Directors' Report) Regulation (C(DR)R) of the new CO and is required to be disclosed in the directors' report. A "specified undertaking of the company" is defined in section 1 of the C(DR)R as:
 - (i) a parent company of the company;
 - (ii) a subsidiary undertaking of the company; or
 - (iii) a subsidiary undertaking of the company's parent company.

The practical impact of this change in location is that under the new CO the disclosure of the significant transactions, arrangements or contracts involving the company is within the scope of the auditors' report and is therefore subject to audit. This issue is discussed further in our briefing note 1.

NB: As mentioned on page 3, C(DR)R.10(7)(a) explicitly states that a company which falls within the reporting exemption does not need to make the above disclosure. This exemption is also found in section 23(a) of the C(DIBD)R in respect of the information that would otherwise need to be disclosed in the financial statements.

New disclosure: Reasons for resignation or not seeking re-election

- *Companies (Directors' Report) Regulation, section 8*

The new CO introduces a new disclosure requirement which may apply if a director of the company has resigned or refused to seek re-election during the financial year. Specifically, the C(DR)R states that the disclosure applies if:

- a) during the financial year a director has resigned from the office or refused to stand for re-election; and
- b) the company has received a notice from the director in writing specifying that the resignation or refusal is due to reasons relating to the affairs of the company (whether or not other reasons are specified).

In this case, the directors' report must contain a summary of the reasons relating to the affairs of the company.

Insight

- As this requirement is found in the C(DR)R, it appears that it only relates to directors of the company, and not to any of the directors of other companies in the group, even if the group is preparing consolidated financial statements; and
- as mentioned on page 3, C(DR)R.8(3) explicitly states that a company which falls within the reporting exemption does not need to make the above disclosure.

New disclosure: Permitted indemnity provisions

- *New CO s470*
- *Companies (Directors' Report) Regulation, section 9*

Under the new CO, the directors' report needs to disclose if a permitted indemnity provision is, or was, in force in any of the following situations:

- If at the date that the directors approved the directors' report a permitted indemnity provision is in force for the benefit of:
 - one or more of the directors of the company (whether made by the company or otherwise); or
 - one or more directors of an associated company (if made by the company)
- If at any time during the financial year to which the directors' report relates a permitted indemnity provision is in force for the benefit of:
 - one or more of the directors of the company (whether made by the company or otherwise); or
 - one or more directors of an associated company (if made by the company)

What is a "permitted indemnity provision"?

- *New CO s467 & s469* A permitted indemnity provision is a provision that protects directors against liability incurred by them to a third party (i.e. a person other than the company or an associated company) provided the provision does not provide indemnity against any of the following liabilities of a director:
 - a liability to pay any fine imposed in criminal proceedings, or any penalty in respect of non-compliance with any regulatory requirements; or
 - a liability incurred by the director in defending criminal proceedings in which the director is convicted; or
 - a liability incurred by the director in defending civil proceedings brought by, or on behalf of, the company or by an associated company of the company in which judgement is given against the director; or
 - a liability incurred by the director in connection with an application for relief under s358 of the old CO or s903 or 904 of the new CO in which the court refuses to grant the director relief. NB these are applications to the court to grant relief in proceedings for misconduct (i.e. negligence, breach of duty or breach of trust).
- *New CO s469(2)(a)*
- *New CO s469(2)(b)(i)*
- *New CO s469(2)(b)(ii)-(iv)*
- *New CO s469(2)(b)(v)*
- *New CO s467-469* "Permitted indemnity provisions" are an exception to the general requirements in s468, under which most provisions in the company's articles or contract terms which purport to exempt a director from liability, or to provide an indemnity against any liability, that would otherwise attach to the director in connection with any negligence, default, breach of duty or breach of trust in relation to the company, are void.
- *New CO s468(4)* NB it is explicitly stated in s468(4) that the above requirements in s468 do not prevent a company from taking out and keeping in force insurance for a director or a director of an associated company.

What is an “associated company”?

- **New CO s2**

An “associated company” is defined in s2 of the new CO as being

- (i) the company’s subsidiary; or
- (ii) the company’s holding company; or
- (iii) any subsidiary of the company’s holding company (i.e. a fellow subsidiary).

New disclosure of “equity-linked agreements”

- **Companies (Directors’ Report) Regulation, sections 5-6 compared to old CO s129D(3)(g)**

The new CO has brought forward the requirement to disclose in the directors’ report the reason for issuing any shares during the year, the class of shares issued, the number of shares issued and the consideration received. It has also introduced a new disclosure requirement in respect of “equity-linked agreements”, to capture other agreements which will (or may) result in a company issuing shares.

Specifically, section 6(3) of the C(DR)R states that the definition of an equity-linked agreement includes:

- (i) an option to subscribe for shares;
- (ii) an agreement for the issue of securities that are convertible into, or entitle the holder to subscribe for, shares in the company;
- (iii) an employee share scheme; and
- (iv) a share option scheme;

but excludes agreements to subscribe for shares in a company that are entered into:

- (i) pursuant to the company’s offer of shares to the public; or
- (ii) pursuant to an offer made to members of the company in proportion to their shareholdings (i.e. a rights issue).

- **Companies (Directors’ Report) Regulation, section 6 (1) & (2)**

The information to be disclosed depends on whether the agreement was entered into during the year and/or still subsisted at the financial year-end.

Agreements entered into during the year	Agreements subsisting at the end of the year*
<ul style="list-style-type: none"> a) The reason for entering into the agreement b) The nature and terms of the agreement, including, if applicable: <ul style="list-style-type: none"> • the conditions that must be met before the company issues any shares; • the conditions that must be met before a third party may require the company to issue any shares; and • any monetary or other consideration that the company has received or will receive under the agreement c) The classes of shares issued under the agreement d) For each class of shares, the number of shares that have been issued under the agreement 	<ul style="list-style-type: none"> a) The classes of shares that may be issued under the agreement b) For each class of shares, the number of shares that may be issued under the agreement c) Any monetary or other consideration that the company has received or will receive under the agreement d) Any other conditions or terms that remain to be met before the shares are issued <p><i>* these disclosures are required for all equity-linked agreements subsisting at the end of the financial year i.e. this information would need to be repeated in all directors’ reports for subsequent years until the shares have been issued or the agreement has lapsed</i></p>

New reporting obligation for auditors

- *New CO s406(2)*

Under the old CO, the auditors had no specific responsibility to review or audit the directors' report.

Under the new CO, a new reporting obligation has been introduced, to the effect that if, in the auditor's opinion, the information in the directors' report is inconsistent with the financial statements, the auditor must disclose this fact in the auditor's report. In addition, under the new CO the auditor may choose to bring this to the attention of the members at a general meeting.

Insight

Although new to the CO, this reporting obligation is consistent with requirements already existing in Hong Kong Standards on Auditing (HKSA). Specifically HKSA 720, "*The auditor's responsibilities relating to other information in documents containing audited financial statements*", requires the auditor to read any other information contained in the annual report in order to identify material inconsistencies, if any, with the audited financial statements.


HKSA 720 sets out steps that the auditor should take if any inconsistencies are identified, which include considering whether it is the financial statements or the other information which needs amending and bringing the matter to the attention of management and the Board (if left uncorrected). Only if the inconsistency is not removed would the auditor consider modifying the audit report.


In this briefing note we have so far looked at the new disclosure requirements applicable to the directors' report. As mentioned in the introduction to this topic, when first looking at the new CO, it can be hard to get a sense of whether the new CO has introduced significant changes for the directors' report or not. This is because, although most of the requirements of the old s129D in the old CO have been brought forward, there is no single equivalent section in the new legislation. So to complete our introduction to the new CO's impact on directors' reports, the appendix to this briefing note identifies the complete list of the requirements in the old CO which related to directors' reports and maps them to the equivalent requirements in the new CO.


If you would like further assistance on any of the matters discussed, please do not hesitate to talk with your usual KPMG contact.

Appendix: Mapping the old CO to the new CO

As explained on page 2 of this briefing note, the new CO has taken a new approach to the disclosure requirements for the directors' report, by splitting the requirements between various sections in the new CO, a new Schedule 5 and a new regulation, the Companies (Directors' Report) Regulation ("C(DR)R"). The table below summarises the requirements in the old CO and maps them to the equivalent requirements in the new CO. As this text is only a summary of the new requirements, we recommend referring to the original text of the various sections, schedules and regulations if applicable to your company's circumstances.

Old CO		New CO
Section 129D General requirements		
(1) The directors must prepare a report and attach it to the statutory financial statements laid before the members	S388, S429-430	<p>S388 of the new CO serves the same purpose as the old s129D(1), by setting out the basic requirement to prepare a directors' report, while sections 429-430 deal with sending the report to members together with the financial statements.</p> <p>S388 also:</p> <ul style="list-style-type: none"> contains a general principle that if a company is a holding company and is preparing consolidated financial statements, then the directors' report should be a consolidated report; and provides an index to the location of the various requirements relating to the contents of that report, and details of which entities are exempt from the requirement to include a business review which complies with Schedule 5.
(2) The directors' report shall be approved by the board and signed on its behalf by the chairman of the meeting at which it was approved or the secretary of the company	S391	<p>The new CO requirements are broadly the same. However:</p> <ul style="list-style-type: none"> the report can be signed by any director (i.e. it need not be the chairman of the meeting at which it was approved); and the name of the person signing the report on the directors' behalf must be stated.

Old CO		New CO
Section 129D General requirements (cont'd)		
(3) The report shall:		
(3)(a) State the principal activities of the company and its subsidiaries during the year and any significant change in those activities	S390(1)(b), (3) S388(1)(a) Schedule 5	<p>The new CO requirements are broadly the same:</p> <ul style="list-style-type: none"> • S390(1)(b) requires disclosure of any principal activities of the company; • S390(3) states that if the company is a holding company and is preparing consolidated financial statements, then the reference to “company” in this disclosure requirement should be understood to mean the company and any subsidiaries included in the consolidated financial statements <p>In addition, s388(1)(a) requires the directors’ report to include a business review which complies with the requirements of Schedule 5, unless the company is exempt (see pages 3 to 4 of this briefing note).</p>
(3)(b) State the amount of any proposed dividend	C(DR)R.7	This requirement has been restated in C(DR)R.7.
(3)(c) State the amount of any proposed transfer to reserves	n/a	This requirement has not been brought forward for the directors’ report. However, movements in reserves will be disclosed in the financial statements under HKFRSs or the SME-FRS as a movement in the Statement of Changes in Equity.
(3)(d) If the company has no subsidiaries: disclose donations of \$10,000 or above <i>(does not apply if company is a wholly-owned subsidiary of another HK company)</i>	C(DR)R.4(1)	<p>This requirement, and the exemption for certain wholly-owned companies, has been restated in C(DR)R.4(1).</p> <p><i>NB C(DR)R.4(3) also explicitly states that a company which falls within the reporting exemption does not need to make the above disclosure.</i></p>
(3)(e) If the company has subsidiaries: disclose donations of \$1,000 or above made by the company or its subsidiaries <i>(does not apply if company is a wholly-owned subsidiary of another HK company)</i>	C(DR)R.4(2)	<p>This requirement, and the exemption for certain wholly-owned companies, has been restated in C(DR)R.4(2) except that the monetary de-minimus limit has been increased to \$10,000 (i.e. to be consistent with the above requirement for companies without subsidiaries).</p> <p><i>NB C(DR)R.4(3) also explicitly states that a company which falls within the reporting exemption does not need to make the above disclosure.</i></p>

Old CO		New CO
Section 129D General requirements (cont'd)		
(3)(f) Disclose particulars of any significant change in fixed assets of the company or its subsidiaries	n/a	This requirement has not been brought forward for the directors' report. However, additions and disposals of long-term assets, such as investment property, property, plant and equipment held for own use and intangible assets will be disclosed in the financial statements under HKFRSs or the SME-FRS as notes to the Statement of Financial Position.
(3)(g) If the company has issued any shares during the year, state the reason, the class of shares issued, the number of shares issued and the consideration received	C(DR)R.5 C(DR)R.6	The requirement in s129D(3)(g) has been restated in C(DR)R.5. In addition, C(DR)R.6 introduces a new requirement to disclose certain particulars relating to any equity-linked agreement entered into during the year or in existence at the end of the year. An "equity-linked agreement" is an agreement that will or may result in the company issuing shares – see page 12 of this briefing note for further details.
(3)(h) If the company has issued any debentures during the year, state the reason, the class of debentures issued, the amount issued and consideration received	C(DR)R.5A	The requirement in s129D(3)(h) has been restated in C(DR)R.5A.
(3)(i) State the names of any persons who were directors of the company at any time during the year	S390(1)(a), (3) C(DR)R.8	This requirement has been expanded as follows: a) the directors' report should also now disclose the name of any person who was a director between the end of the reporting period and the date of approval of the directors' report; and b) if the company is a holding company and is preparing consolidated financial statements, then the requirement to disclose directors' names in the directors' report extends to the names of any directors of any subsidiaries – see page 9 of this briefing note for further details. In addition, a new requirement has been included in the C(DR)R.8 to disclose a summary of the reasons for a director resigning or not seeking re-election, if this action was because of reasons relating to the affairs of the company – see page 10 of this briefing note for further details. <i>NB C(DR)R.8(3) explicitly states that a company which falls within the reporting exemption does not need to make the above disclosure relating to reasons for resigning or not seeking re-election.</i>


Old CO



New CO

**Section 129D General requirements
(cont'd)**

<p>(3)(j) Disclose 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 (other than contracts for service – s129D(6))</p>	<p>C(DR)R.10, S383(1)(e), C(DIBD)R.22</p>	<p>This disclosure requirement has been retained but the location of the information has been changed so far as contracts involving the company and the directors are concerned: this information is now required to be included in the financial statements, bringing it within the scope of the audit.</p> <p>In addition, the scope of the requirement has been extended from "contracts" to "a transaction, arrangement or contract" that is significant in relation to the company's business. See page 10 of this briefing note for further details.</p> <p><i>NB C(DR)R.10(7(a)) explicitly states that a company which falls within the reporting exemption does not need to make this disclosure.</i></p>
<p>(3)(k) Disclose certain particulars for any arrangements to which the company, its subsidiaries, its holding company or any subsidiary of its holding company is a party, whose objects is to provide benefits to directors of the company by means of the acquisition of shares in, or debentures of, the company or any other body corporate</p>	<p>C(DR)R.3</p>	<p>This requirement has been restated in C(DR)R.3 and applies if there were any such arrangements at the end of the year (C(DR)R.3(1)) or at any time during the year (C(DR)R.3(2)).</p> <p><i>NB C(DR)R.3(3A) explicitly states that a company which falls within the reporting exemption does not need to make this disclosure.</i></p>
<p>(3)(l) Disclose particulars of any other matters so far as they are material for an appreciation of the state of the company's affairs by its members, being matters the disclosure of which will not, in the opinion of the directors, be harmful to the business of the company or any of its subsidiaries</p>	<p>S390(2), (3) C(DR)R.9</p>	<p>This requirement has been restated in s390(2). It is also now clear from s390(3) that if the company is a holding company and is preparing consolidated financial statements, then the reference to "company" in this disclosure requirement should be understood to mean the company and any subsidiaries included in the consolidated financial statements.</p> <p>In addition, C(DR)R.9 introduces a specific requirement to disclose if a permitted indemnity provision was in force for the benefit of one or more directors of the company, or of its associated company, either during the financial year to which the directors' report relates, or at the time that the directors' report is approved by the directors. This new requirement is looked at more closely on pages 11-12 of this briefing note.</p>

Old CO		New CO
Section 162A Management contracts		
<p>S162A If a company enters into any contract (other than with directors or other full-time employees) whereby any individual, firm or body corporate undertakes the management and administration of the whole or any substantial part of the business of the company, then the existence and duration of the contract, and the name of any director interested in the contract, shall be disclosed in the directors' report for every period that the contract is in existence</p>	<p>S543(2)</p>	<p>This requirement has been restated in s543(2). However, it is now explicit that the requirement to disclose the names of any directors interested in the contract extends to any shadow directors.</p>

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