

Financial Reporting Update Issue 80 – May 2015

Gaining exemption from the requirement to prepare a business review under the new Companies Ordinance – December year ends need to act now

21 May 2015

As you may be aware, starting from 2015 year-ends, all Hong Kong incorporated companies will be required under the new Hong Kong Companies Ordinance (CO) to include a business review as part of their directors' report, unless exempt.

We expect that most Hong Kong incorporated private companies will be concerned about this extra disclosure burden and would wish to be exempt, if this is possible under the law. This is particularly the case for the annual reports of subsidiaries within larger groups which are prepared primarily for compliance purposes and do not have a wide distribution.

This edition of Financial Reporting Update focuses on the question of how these companies can claim exemption.

If you have not already thought about this issue, now is the time to start as for many companies exemption is only possible if the directors take action to organise a resolution to be passed in the **first half** of the year, i.e. before 30 June for a December year end, and they follow up that action by filing the resolution with the Companies Registry within 15 days of it being passed.

Which companies are required to prepare a business review?

All companies incorporated in Hong Kong will be required under section 388 of the new CO to include a business review in their directors' report unless they are specifically exempt. This new requirement applies to financial years beginning on or after 3 March 2014 (the commencement date of the new Ordinance). This means that the first companies to be affected will be those with a March year end, starting from March 2015.

Under the amended Listing Rules¹, overseas incorporated companies listed on the Hong Kong Stock Exchange are also required to prepare a business review consistent with the HKEEx's level playing field principle. The HKEEx has set an effective date of years ending 31 December 2015 for these amendments. Before that date, compliance with Schedule 5 is optional for non Hong Kong incorporated issuers, creating a short transitional period when the requirements may differ depending on whether the issuer is incorporated in Hong Kong or overseas.



[Information sheet on business review exemptions](#)



[Briefing Note 2](#)



[Briefing Note 4](#)

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Which companies are exempt from preparing a business review?

According to section 388(3) of the CO, there are 3 categories of companies which are exempt from preparing a business review. These are as follows:

- 1) wholly owned subsidiaries of another body corporate;
- 2) companies which fall under the section 359 “reporting exemption”; and
- 3) private companies whose shareholders have passed a special resolution exempting the company.

Wholly owned subsidiaries of another body corporate are defined in section 357(3) – the ownership can be direct or indirect and the parent can be incorporated in or outside Hong Kong. These companies are automatically exempt.

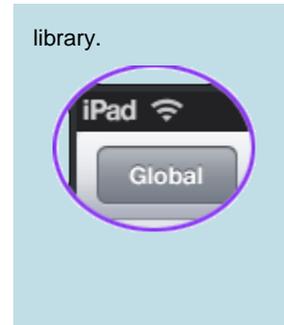
So far as the reporting exemption is concerned, a company would be exempt from preparing a business review if it can answer “yes” to any one of the following questions²:

- Does the company currently report under the simplified reporting regime and does it plan to continue to do so (“Section 141D” companies³)? or
- Is the company a company limited by guarantee (or a group of such companies) with annual revenue of not more than \$25 million (“small” guarantee companies or groups)? or
- Is the company a private company (or group of private companies) and meets at least 2 out of 3 size tests of not more than \$100 million annual revenue, \$100 million total assets and 100 employees (“small” private companies or groups)? or
- Is the company a larger “eligible” private company (or group of larger “eligible” private companies) that has decided to follow the simplified reporting regime in their financial statements for periods ending on or after 31 March 2015 and has already taken steps to meet the tough shareholder approval requirements⁴?

If a company cannot say yes to any of the above and the directors do not wish to prepare a business review, then they will need to approach the shareholders for approval under section 388(3)(c). This approval can only be given by the shareholders of a private company⁵ and it needs to be in the form of a **special resolution**.

Important points to note now about gaining exemption by passing a special resolution

Unless the private company is wholly owned by another body corporate or clearly falls within the smallest size tests of the reporting exemption, the easiest way for a private company to be sure of exemption is to pass the special resolution. Section 388(4) also helps directors by indicating that:



- the resolution can be passed for an indefinite numbers of years
i.e. it can be passed in relation to the financial year and every subsequent financial year until revoked; and
- it can only be revoked by a special resolution.

This means that once this special resolution is in place in time for the 2015 year ends, there is no need to repeat the exercise in future years.

But planning ahead is essential in this first year of implementing the new law due to the following important facts:

- 1) Under section 388(4) this particular resolution must be passed **at least 6 months before** the end of the financial year to which the directors' report relates.
- 2) Under section 622(2) the company must deliver a copy of the resolution to the Registrar of Companies **within 15 days** after it is made or passed.
- 3) As these are statutory deadlines, failure to meet them **cannot** be made good by the shareholders ratifying the directors' neglect.

So, if directors fail to organize the special resolution in time to be valid for the 2015 year end, and the company is not otherwise exempt, then the directors will need to prepare a 2015 business review for that company or seek legal advice on the consequences to them personally of failing to comply with the relevant statutory requirements.

To assist with gaining exemption we have prepared an [Information Sheet](#) which brings together all the key points mentioned above about gaining exemption, as well as further details on where to find these requirements in the law and on matters such as passing a written resolution instead of calling a meeting and notifying the auditors.

If you are interested to find out more about the impact of the new Companies Ordinance on annual reports, please visit our external website page at <http://www.kpmg.com/cn/hk-companies-ordinance>.

We would also encourage you to talk with your KPMG contact about any particular areas of interest or concern or to let them know if there are any aspects of your implementation plan where we can help. For example, your KPMG contact can provide you with copies of our worksheets which help on confirming whether or not the company is eligible for the reporting exemption, and checklists and a practical guide aimed at helping those companies which are required to, or choose to, prepare a business review.

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1. On 6 February 2015, the HKEx issued its Consultation Conclusions on the *Review of Listing Rules on Disclosure of Financial Information with reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments* to update the Listing Rules for the new Companies Ordinance disclosure requirements. Amendments to the Listing Rules were included as an appendix to the Consultation Conclusions. These amendments are mandatory for financial years ending on or after 31 December 2015.
 2. Further guidance on the reporting exemption can be found in KPMG's *New Hong Kong Companies Ordinance Briefing Note 4 – Non-public company reporting*

exemption: impacts on directors' reports and financial statements, a link to which can be found at the start of this bulletin.

3. These are private companies which have no subsidiaries and are not a subsidiary of another company, and only if 100% of the shareholders agree in writing each year that this company can produce simplified financial statements. "Section 141D" is the section in the predecessor CO (Cap. 32) which permits these companies to do simplified reporting. If they continue to meet these conditions, then they continue to be able to adopt simplified reporting by being eligible for the reporting exemption under section 359(1)(b) of the new CO.
4. Larger "eligible" companies are companies that 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 that have obtained sufficient shareholder approval from at least 75% of all the members with none objecting. This is a much tougher shareholder approval test than passing a special resolution and therefore we do not expect it to be common that private companies, other than wholly owned companies, will go down this route for the purposes of adopting simplified financial reporting, especially in time for 2015.
5. Private companies are defined in section 11 of the CO

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