Hong Kong Bar Association's comments on
Rewrite of the Companies Ordinance -
Consultation Paper on the Qualifying Criteria for Private Companies to Prepare Simplified Financial and Directors' Report

1. The Hong Kong Bar Association has previously commented on the proposals in the Companies Bill which affect the scope of s.141D in 2007. In gist, the Bar agreed that the qualifying criteria under s.141D should be relaxed so that (a) the holding company of a group of companies qualified as "small group" will not have to prepare its own accounts and only have to prepare group accounts which comply with s.141D; and (b) the accounts to be prepared by the intermediate holding company and the subsidiary will likewise be simplified version as prescribed by s.141D.

2. Further, the Bar agreed with the proposal to impose revenue and asset threshold for "small company", though it noted that the proposed threshold is lower than that in the UK, and the UK scheme has a separate category of "medium-sized companies" which are subject to more reporting requirements than "small companies". On that basis, the Bar observed that the Administration might want to consider whether there was a case for increasing further the qualifying threshold so that more companies in HK can benefit from simplified reporting.

3. At that time, however, the Bar's comments were made on the premise that s.141D would be retained but modified, so that there would still be some degree of shareholders control over whether an unlisted company is to opt for simplify reporting.

4. The Bar takes the view that:-

   (1) Financial reporting is important as audited financial statements provide valuable information to those shareholders (particularly minority shareholders) who do not participate in the management and affairs of the company and have no knowledge of its financial status;

   (2) For companies of substantial size, its shareholders would more likely than not have a greater interest in its financial information;

   (3) The costs of preparing audited financial statements may be disproportionately high for small companies. This is the basic rationale for the proposal to permit small companies to prepare simplify financial and directors' reports. That concern however should not be relevant in the case of larger companies. Thus the rationale for permitting simplified reporting does not apply in the case of larger companies.

5. In light of the above, the Bar is of the view that while simplified reporting should be made available to small and perhaps even medium-sized companies, there is no reason to extend that to companies of substantial size.

6. The Bar however also has some reservations as to whether HK$50 million is an appropriate threshold, taking into account the fact that such threshold (in particular the asset part) can easily be exceeded if the company in question has some real property assets. This having been said, it should be noted that under the current proposal, a small private company is defined to mean a private company that satisfies any <u>two</u> of the following conditions –

(1) total annual revenue of not more than HK$50 million;
(2) total assets of not more than HK$50 million;
(3) no more than 50 employees.

7. Accordingly the Bar would suggest as follows:-

(1) The Bar does not support Option 1 on the basis that there is scope to increase the threshold so that more small companies can benefit from the savings in costs from simplified reporting;

(2) Nor does the Bar support Option 2, which allows companies whatever its size and value to opt for simplified reporting provided at least 75% of its shareholders agree. There is no justification for exempting substantial companies from their full financial reporting obligations, and such information may be highly relevant and important to its shareholders, in particular minority shareholders;

(3) The Bar supports in principle Option 3, although the Bar is not in a position to comment on the suggested higher threshold of HK$300/500 million. The Bar is of the view that:-

(a) Given simplified reporting is "automatic" for companies worth less than HK$50 million, i.e. no shareholders approval is required, the Bar is content to maintain that threshold at a relatively low level (the Bar would not, however, object to the higher threshold of HK$100 million as proposed by the HKICPA);

(b) However the Bar also takes the view that more small to medium-size companies should be able to benefit from the exemption from full reporting, which reflects the rationale for simplified reporting. For this "middle level" of companies (the precise ambit should be decided by the Administration, perhaps by reference to the demographics of private companies in Hong Kong), they too can benefit from such provision subject to 75% shareholders approval. In this way, a balance may be struck between extending the benefit of the proposal to a larger group of companies and the need to protect the interests of the shareholders.

13th January 2012
Hong Kong Bar Association