

Alert

Updates on financial reporting and auditing



Issue 19 (September 2014)

Dear members,

Reminder on the timing for opting for reporting exemption and on consolidation matters under SME-FRF & SME-FRS (Revised)

The requirements under Part 9 of the new Companies Ordinance (Cap. 622) relating to financial statements and directors' reports will come into operation for the accounting year beginning on or after 3 March 2014. For those companies with a March-year end, the requirements will first affect the financial statements and directors' report for the year ending 31 March 2015.

Members may need to plan ahead in light of the new ordinance, in particular, companies may need to obtain necessary approval in advance to qualify for certain important exemptions under the new ordinance and the new [SME-FRF & SME-FRS \(Revised\)](#). The following sets out an overview of these requirements for members' information:

Business review: exemption available for private companies which pass a special resolution

Section 388(3)(c) exempts a private company from preparing a business review if a special resolution is passed by members of that company in accordance with the details set out in that section and section 388(4).

This resolution has to be passed at least six months before the end of the financial year to which it relates i.e. on or before 30 September 2014 if the company's financial year ends on 31 March. Action therefore needs to be taken in good time if the directors do not wish to prepare a business review and the company is not otherwise exempt* under section 388(3).

* *Other ways that the company could be exempt under section 388(3) (and therefore would not need this resolution) are:*

- (a) *if the company is eligible for the reporting exemption (see below); or*
- (b) *if the company is a wholly owned subsidiary of another body corporate.*

Please refer to the [Institute's correspondence](#) on 5 August for the reminder on the timing for opting out the preparation of business review requirement through special resolution.

Reporting exemption: obtaining sufficient shareholder support for the exemption if the company fails the smallest size criteria

Companies which meet the criteria set out under section 359 of the new ordinance are eligible to prepare financial statements under the SME-FRF & SME-FRS (Revised) for financial years beginning on or after 3 March 2014 and are not required to include a business review in their directors' reports. This simplified reporting regime is referred to as "the reporting exemption" in the ordinance.

Non-excluded¹ private companies and companies limited by guarantee which fall within the smallest size tests set out in the ordinance² are eligible for this reporting exemption without taking any further action.

However, if the company (or the group of which it is the holding company) fails those smallest size tests, then it can only be eligible for the reporting exemption if it falls into one of the following two categories:

- 1) the company is an "eligible" private company (or a group of eligible private companies) by virtue of falling within the larger size tests of HK\$200 million total annual revenue, HK\$200 million total assets and 100 employees³ and gaining sufficient shareholder support (section 359(1)(c) and section 359(2)(c)(ii)); or
- 2) the company is a private company which does not have any subsidiaries and is not a subsidiary of another Hong Kong incorporated company and has full shareholder support (section 359(1)(b)).

Specifically, the extent of shareholder support required for the above is as follows:

Category 1: A resolution has to be passed by at least 75% of all shareholders (i.e. not merely the shareholders attending the meeting). The resolution will fail if any shareholder votes against the resolution at a general meeting or if any shareholder objects in writing at least six months before the end of the financial year (section 360).

Category 2: All the members of the company have to agree in writing that the company is to fall within the reporting exemption for the financial year (section 359(1)(b)).

¹ Companies which operate in certain types of business as listed in section 359(4) are not eligible for the reporting exemption irrespective of their size.

² The smallest size tests for private companies are that they need to be below at least two out of three of the following limits: (i) not exceeding HK\$100 million total annual revenue, (ii) not exceeding HK\$100 million total assets and (iii) not exceeding 100 employees. The smallest (and only) size test for companies limited by guarantee is not exceeding HK\$25 million total annual revenue. If the company is required to prepare consolidated financial statements then these measures should be computed on a consolidated basis. More detail on these tests are set out in Schedule 3 to the ordinance.

³ These larger size tests are computed on the same basis as the smaller size tests described in the previous footnote, except that the monetary amounts are increased to HK\$200 million rather than HK\$100 million.

There is no time limit set for obtaining these approvals during the financial year. However, the ability of any shareholder to object means that if the directors wish to have certainty about whether the company can take advantage of the reporting exemption when preparing its financial statements and directors' report, then they should approach the shareholders sooner rather than later and, in the case of category 1, at least six months before the end of the financial year.

Note: These shareholder approval requirements under sections 360 or 359(1)(b) are harder to meet than the special resolution for the business review exemption mentioned above. The approvals for the reporting exemption also have to be obtained each year. Therefore, if a private company which fails the smallest size tests wishes to be exempt from preparing the business review, but intends to continue preparing full financial statements under HKFRS, then it will generally be easier to approach the shareholders for a special resolution vote under section 388(3)(c), than to try to obtain the above shareholder approvals under sections 360 or 359(1)(b).

Exemption from preparing consolidated financial statements: notifying shareholders if the company is a partially owned subsidiary of another body corporate

Section 379(3) sets out two ways in which a holding company can be exempt from preparing consolidated financial statements:

- 1) if the holding company is a wholly owned subsidiary of another body corporate; or
- 2) if the holding company is a partially owned subsidiary of another body corporate and the shareholders have been notified about, and do not object to, the proposal not to prepare consolidated financial statements.

In respect of holding companies which are wholly owned subsidiaries, no shareholder approval or notification is required.

In respect of holding companies which are partially owned subsidiaries, the requirement in section 379(3)(b) is that at least six months before the end of the financial year the directors must write to the members to notify them of their intention not to prepare consolidated financial statements for that financial year. The company's eligibility for not preparing consolidated financial statements is then confirmed if three months before the financial year end no member has written to the company requesting the company to prepare consolidated financial statements.

Exclusion of certain subsidiaries from consolidation under SME-FRF & SME-FRS (Revised) on the grounds of expense and delay out of proportion to the value to members of the company

Under SME-FRF & SME-FRS (Revised) a parent can exclude a subsidiary from consolidation on the grounds of expense and delay out of proportion to the value to members of the company only if members of the company have been informed in writing about, and do not object to, such exclusion. Paragraph 19.3 of the standard contains requirements on when the company needs to notify members. These are as follows:



If the company needs to obtain shareholder approval in order to qualify for the reporting exemption (i.e. if the entity fails the smallest size criteria)

The notification to the members must be included as part of the notice to obtain the necessary shareholder approvals required in order to qualify for the reporting exemption and it must be subject to the same approval and objection processes as applicable to that approval (as discussed above).

For all other companies which qualify for SME-FRF & SME-FRS (Revised)

The notification must be sent to the members before the date of approval of the financial statements and must allow the members of the company a period of no less than one month to raise objections, unless all members of the company confirm that such a period is not necessary.

Please refer to paragraphs 19.2-19.3 of the SME-FRS for further details. Please also be reminded that under paragraph 19.16(g) the parent needs to provide additional extensive disclosures in financial statements on any excluded subsidiaries.

The above information is only an overview of the relevant requirements and that reference should be made to the new ordinance and the SME-FRF & SME-FRS (Revised) for the full requirements if applicable.

Sincere regards,

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