

BRIEFING NOTE

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New Hong Kong Companies Ordinance Briefing Note 4

Non-Public Company Reporting Exemption: impact on directors' reports and financial statements

One of the key changes introduced by the new HK Companies Ordinance (Cap. 622) was to significantly relax the restrictions on which non-public companies are permitted to prepare simplified financial statements under the Small and Medium-sized Entities Financial Reporting Standard (SME-FRS).

This change 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: this means that 2015 was the first year that December year-end companies were able to take advantage of the relaxation.

The simplified reporting regime is optional – that is companies can continue to prepare financial statements which show a true and fair view in accordance with the full reporting regime if they wish. They can also choose to switch to the simplified regime at any time in the future, provided they are still eligible – there was no need to decide in time for the implementation of the new CO in 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. So far as the simplified reporting regime is concerned, these amendments included three important changes for groups:

- (a) Explicitly acknowledging that groups which include non-Hong Kong incorporated subsidiaries can qualify for the reporting exemption provided these entities are not involved in ineligible activities (such as banking etc.);
- (b) Permitting "mixed groups", being groups which include both private companies and companies limited by guarantee, to take advantage of the reporting exemption if they meet the relevant size criteria; and
- (c) Relaxing the shareholder approval requirements for groups which include larger "eligible" private companies as subsidiaries, such that the holding company only needs approval from its own shareholders and not from the non-controlling shareholders of its subsidiaries.

This briefing note has been updated to reflect these amendments and is current as of April 2020.

In this briefing note, we start with an overview of the new regime, followed by a closer look at the simplifications on offer, in particular the differences between the SME-FRS and full HKFRS.

In Appendices 1 and 2 we take a closer look at establishing and losing eligibility, with a focus on helping you avoid likely pitfalls and misunderstandings. We also include further examples which illustrate the practical impact of the two-year grace period for gaining or losing SME status.

For your further reference, in Appendix 3 we have listed those disclosures which need to be included in directors' reports and financial statements regardless of whether the company opts for the simplified regime or not.

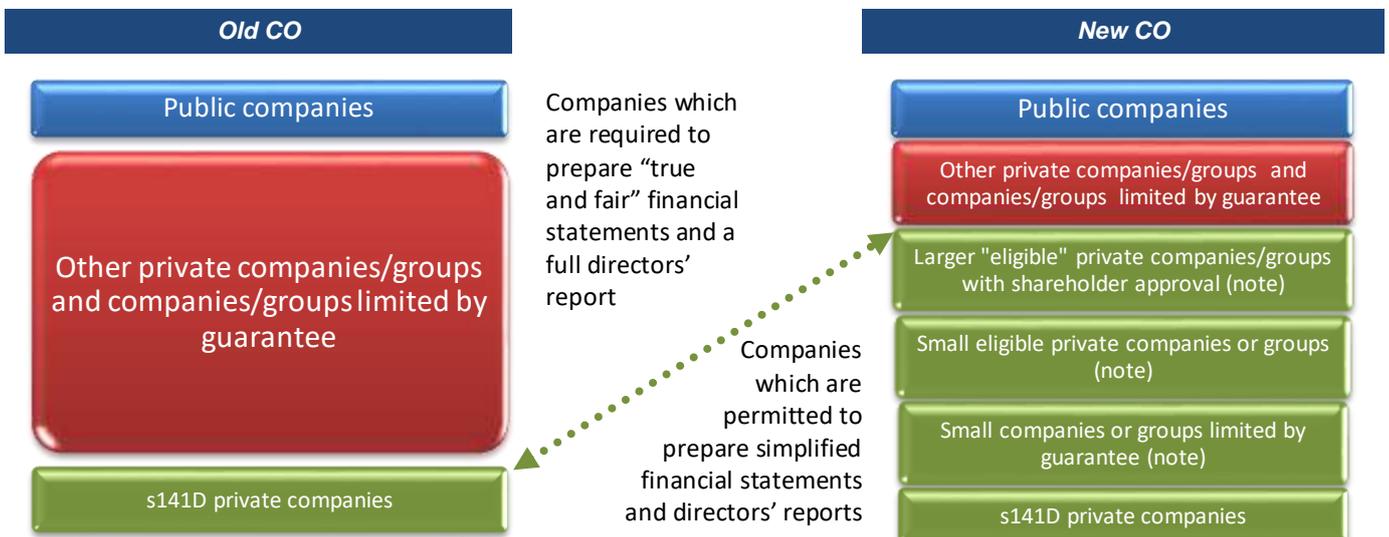
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Overview of the new regime

Which companies are eligible for the simplified reporting exemption?

Allowing a greater number of non-public companies to prepare simplified directors' reports and financial statements is one of the key changes introduced by the new CO. The simplifications take the form of exemptions from making certain disclosures and an exemption from the requirement for the financial statements to give a true and fair view.

The differences between the old and new CO in respect of which companies can choose not to prepare full directors' reports and 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 its 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 from the old section 141D as one category of exempt company. But it also introduces three more categories of eligible companies or groups:

- *New CO s359*

New categories of eligible non-public companies

- small guarantee companies and groups headed by a small guarantee company if their annual revenue is not more than \$25 million;
- small private companies and groups headed by a small private company 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 headed by a larger “eligible” private company 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

As a result of the amendments by the 2019 Amendment Ordinance, these groups can be “mixed groups” i.e. they can contain both companies limited by guarantee and private companies limited by shares, provided that these companies meet the relevant size tests. For example, the revenue of any company limited by guarantee is limited to \$25 million, regardless of whether that company is in a group of companies limited by guarantee or is in a mixed group headed by a private company. Similarly, private companies must fall within the “2 out of 3” size tests for private companies, even if in a mixed group headed by a company limited by guarantee. Further details can be found in Appendix 1 to this Briefing Note.

Ineligible activities, regardless of size of company

- *New CO s359(4), (5)*

As in the old s141D, companies carrying out certain types of public-interest business (banking, regulated activities under the Securities and Futures Ordinance or those that accept loans of money), cannot take advantage of these simplifications.

These companies also prevent any group of which they are a member from taking advantage of the simplifications. As a result of the 2019 Amendment Ordinance, it is now clear that this prohibition extends to any subsidiaries incorporated outside Hong Kong who engage in equivalent public-interest activities.

Obtaining shareholder approval for larger “eligible” private companies or groups

- *New CO s360*

As mentioned above, as well as not exceeding the size limits, a larger “eligible” private company, including the holding company of a group of larger “eligible” private companies, needs to obtain approval from its shareholders.

Specifically, to gain exemption for a larger “eligible” private company, the members holding at least 75% of the voting rights must pass a resolution at a general meeting that the company is to fall within the reporting exemption for the financial year, with none objecting.

This is an area to consider carefully as the rules are quite complex and demanding:

- the 75% vote is calculated as a percentage of all the voting rights held by the company’s shareholders, not simply as a percentage of the shareholders who attend and vote at the general meeting; and
- the vote is defeated if any shareholder votes against the resolution either at the meeting or at any time by giving notice in writing to the company, provided that the

written notice of objection is given at least 6 months before the end of the financial year to which the objection relates.

This shareholder approval test sets a high hurdle designed to ensure that larger private companies are only given relief from providing full statutory information to their shareholders if none of their shareholders consider it useful¹.

Applying these criteria to groups which contain companies incorporated outside Hong Kong

- *New CO s357(1), s359(2)(b), s359(3)(b), s359(3A)(b), s359(5)*

Prior to the 2019 Amendment Ordinance there was no explicit statement in the CO relating to how to apply the eligibility criteria to groups which include one or more subsidiaries incorporated outside Hong Kong, where the holding company is required to prepare consolidated financial statements. This led to some diversity in views as to how to approach this topic, ranging at one extreme to the view that these overseas companies can simply be ignored when testing the group or, at the other extreme, holding the view that their presence in the group effectively prevents the group from satisfying the criteria set out in Schedule 3, regardless of their size.

The 2019 Amendment Ordinance removed this uncertainty by introducing new sections which explicitly refer to a “non Hong Kong body corporate” to make clear that the same restrictions apply whether the companies in the group are incorporated in Hong Kong or elsewhere. Specifically, if the subsidiary is incorporated outside Hong Kong, then the requirements are that

- the subsidiary would not have fallen within the meaning of public company in section 12 had it been incorporated under the Hong Kong Companies Ordinance. This clarification was added by the 2019 Amendment Ordinance in a new section, s359(5)(c);
- the subsidiary does not carry on activities that are equivalent to those that are on the restricted list for Hong Kong incorporated companies, for example, any business that, had it been carried on in Hong Kong, would be required to be carried on under a valid banking license granted under the Banking Ordinance or a licence under Part V of the Securities and Futures Ordinance. This clarification was added by the 2019 Amendment Ordinance in a new section, s359(5)(a) and (b); and
- in all other respects, the subsidiary is assessed against the relevant size tests in the same way as Hong Kong incorporated companies.

These amendments serve to create a level playing field for Hong Kong incorporated holding companies, regardless of the country of incorporation of their subsidiaries.

In Appendices 1 and 2 to this briefing note we take you step-by-step through these exemption criteria and include a number of examples that illustrate them in action. These examples are particularly relevant for those companies which need to prepare consolidated financial statements and/or are borderline cases for meeting the criteria.

¹ As mentioned in the Introduction to this Briefing Note, the 2019 Amendment Ordinance simplified the approval process for groups, such that going forward it is only necessary for the holding company to obtain approval from its own shareholders and not from the non-controlling shareholders of any of its larger “eligible” subsidiaries. However, it should be noted that the holding company’s group assessment is solely for the purposes of determining whether the holding company can take advantage of the simplified reporting regime when preparing its own consolidated annual report. Regardless of what the holding company decides, each Hong Kong incorporated company within the group will be required to make its own decision as to which reporting regime to follow and, if a subsidiary wishes to use the simplified reporting regime for its own annual report, then it may still need to obtain its own shareholder approvals.

For example, a group consists of holding company H and two subsidiaries A and B. H assesses its consolidated situation against the ‘2 out of 3’ size tests and concludes that it can prepare consolidated financial statements using the SME-FRF and SME-FRS issued by the HKICPA, provided it obtains its own shareholder approval. Subsidiary A is small and also decides to follow the SME-FRF and SME-FRS when preparing its own company-level financial statements. However, subsidiary B exceeds the small-size tests of HK\$100 million annual revenue, HK\$100 million total assets and 100 average employees, as explained in Appendix 1 to this Briefing Note. Subsidiary B therefore either needs to obtain approval from its own shareholders (i.e. from H and from its non-controlling shareholders) or needs to prepare financial statements using the full HKFRS issued by the HKICPA. As a result of the amendments made by the 2019 Amendment Ordinance, this decision by B and B’s shareholders does not impact on H’s entitlement under the CO to take advantage of the simplified reporting regime. However, in practice if subsidiary B decides to prepare financial statements using full HKFRS, then holding company H may need to make adjustments on consolidation (for example to reverse any fair value adjustments) to ensure that the consolidated amounts which it reports comply with the requirements of the SME-FRS.

What is the impact of adopting simplified reporting?

Companies that decide to take advantage of the reporting exemption in the new CO will still need to prepare a directors' report and annual financial statements, and will still need to have those financial statements audited. However, the contents of that directors' report and those audited financial statements will be simpler in the following ways, compared to those following the full regime:

Directors' report	Financial statements	Audit report
<ul style="list-style-type: none">• Exempt from preparing a business review• Also exempt from disclosing:<ul style="list-style-type: none">• certain arrangements and transactions involving directors• reasons for directors resigning or not seeking re-election• donations	<ul style="list-style-type: none">• The financial statements can follow the SME-FRF and SME-FRS:<ul style="list-style-type: none">• historical cost accounting• fewer disclosures• greater alignment with concept of "realised profit"• Also exempt from disclosing certain transactions involving the directors and the company	<ul style="list-style-type: none">• The auditor will report on whether the financial statements have been "properly prepared"• The auditor will not express an opinion on whether the financial statements "give a true and fair view"

These impacts are explored in more detail in the section below starting from page 6 where we take a closer look at the simplifications on offer.

Is action needed by companies that may be eligible?

The new simplified reporting regime is optional – that is, companies can continue to prepare their financial statements which show a true and fair view in accordance with the full reporting regime if they wish. They can also choose to switch to the regime at any time in the future, provided they are still eligible.

Companies need to weigh up the pros and cons carefully before deciding if it makes sense for them to change to the simpler regime.

Key questions to consider include:

- Who uses the company's financial statements? What would they think about the change?
- How much time or other resources could be saved by switching to the simplified regime?
- How many years is the company likely to stay eligible and benefit from the change?

For some private companies, answering these questions will show that the benefits clearly outweigh any downside: perhaps the company is owner-managed and no one else other than the tax authorities will see their financial statements, switching to the new regime will cut out the complexity of keeping up with full HKFRS for many years to come, and the effort taken to become eligible is minimal as the company falls within the smallest size tests.

But as we discussed in our briefing note 1 on full financial statements, for other companies switching to the simplified regime may not be such an obvious choice. Reasons not to switch to the simplified regime, even if eligible, 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 a "properly prepared" audit opinion;
- 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 under 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.

As mentioned, there is no need to rush this decision: a company can switch to the new simplified regime in any year of their choosing going forward, provided that the company is eligible and has planned ahead to make the change, if shareholder or other stakeholder approval is needed.

A closer look at the simplifications on offer

In this part of the briefing note, we take a closer look at what simplifications might be achievable by a company or group switching to the simpler regime i.e. in what ways would their financial statements and directors' report be simpler than if the company or group followed the full requirements.

Remember: this part of the briefing note is only focusing on the reliefs available if a company or group opts to take advantage of the new CO's "reporting exemption" – it is not a complete picture of the contents of the annual report for these entities as there are other disclosures that will need to be made, regardless of whether the company (or group) opts for the simple regime. These unavoidable requirements (such as directors' emoluments), are listed in Appendix 3 to this briefing note for reference.

Directors' report: exemption from preparing a "business review"

- *New CO s388(1),(2),(3)* An important change introduced by the new CO is that companies must include a "business review" in their directors' report, unless the company:
 - falls within the reporting exemption for the year; or
 - is a wholly owned subsidiary of a "body corporate" at the end of the financial year; or
 - is a private company that does not fall within the reporting exemption but opts out of preparing a business review by special resolution (i.e. a 75% vote of shareholders who voted in a general meeting) obtained at least 6 months before the end of the financial year to which that directors' report relates.
- *New CO Sch5, s388(1),(2)* If a company is required to include a business review, the contents should follow Schedule 5 of the new CO. Schedule 5 requires the business review to include forward looking information, including descriptions of the principal risks facing the company and an analytical review of the company's business.

If the company has prepared consolidated financial statements, then its business review should also be on a consolidated basis. Therefore preparing such a review may require a considerable amount of management time and attention by the board.

For more details on the contents of a business review, please see our briefing note 2.

Practical issue – Can the directors' report exclude the business review even if the company chooses to follow the full reporting regime for the financial statements?

- *New CO s388*

Yes. The new CO states that if a company or group "falls within the reporting exemption" it does not have to include a business review in the directors' report for the year. The minimum requirement is therefore that the company (or group) is eligible for the reporting exemption, not whether in fact it takes advantage of this eligibility by preparing simplified financial statements.

As a result, private companies (or groups) still have some flexibility as to the contents of their directors' reports. But if the company is not wholly owned and falls outside the smallest size category, it will need to make sure it gets the necessary shareholder approvals.

(See Appendix 1 to this briefing note for more details on the size tests and shareholder approval requirements.)

Financial statements: permission to adopt the SME financial reporting standard

Exemption from giving a true and fair view

- *New CO s380(7), s380(4), s357(1) and (4)(a)**
 - *Company (Accounting Standards (Prescribed Body)) Regulation (para 2)*
- * *The 2019 Amendment Ordinance moved the definition of applicable accounting standards from s380(8) to s357(1) and (4)(a).*
- The key to the simplified financial reporting regime is the exemption from the requirement for the financial statements to give a true and fair view. Instead, companies are required to comply with the applicable accounting standards "issued or specified by a body prescribed by the Regulation". This "body" is the Hong Kong Institute of Certified Public Accountants (HKICPA), as stated in the Company (Accounting Standards (Prescribed Body)) Regulation, issued in January 2013.
- Due to the exemption from the requirement to give a true and fair view, the applicable HKICPA standards in this case are the "Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard" (the "SME-FRF" and "SME-FRS").

- *SME-FRF 17,18, SME-FRS 2.1*

The SME-FRF and SME-FRS are a much briefer and simpler set of accounting requirements and disclosures compared to full HKFRS. In essence, this is an accruals-concept framework which does not permit the use of fair value for re-measuring assets or liabilities. The disclosure requirements focus on basic financial information and there are no requirements, for example, to disclose financial risk management strategies.

The package is also self-contained: if the SME-FRS does not cover an event or transaction undertaken by the entity, management should use its judgment to develop an accounting policy which is consistent with the historical cost convention. There is no requirement to fall back to full HKFRS, and policies which are acceptable under full HKFRS may not be adopted under the SME-FRF and FRS if they are inconsistent with the historical cost convention.

The SME-FRF and FRS were first issued in 2005 and provided a reference point when entities were taking advantage of section 141D of the old CO. It was revised by the HKICPA to respond to the new CO in time for its commencement date of 3 March 2014. Changes introduced at that time, compared to the previous standard, included:

- updating the “qualifying entity” criteria to align with the new CO;
- expansion of the accounting requirements to cover the preparation of consolidated financial statements, including guidance on accounting for business combinations, goodwill and equity method investees;
- new guidance on the preparation of cash flow statements, which should be followed if a company chooses to prepare a cash flow statement;
- updating the definitions included in the SME-FRS to align more closely with recent changes in full HKFRS;
- reducing the amortisation period for intangible assets from 20 years to 10 years, unless the presumption is rebutted;
- new guidance on the specific disclosures to be made in the first year that a company transitions from e.g. full HKFRS to the SME-FRS; and
- new guidance on the concept of realized profits and losses under the CO and how this correlates to the recognition requirements of the SME-FRS.

In February 2019 the SME-FRF and SME-FRS were updated to reflect the changes introduced by the Amendment Ordinance to the eligibility tests and in March 2020 in respect of a number of minor accounting and disclosure requirements.

What do SME-FRS financial statements include?

- **SME-FRS 1.1**

A complete set of financial statements under the SME-FRS includes:

- a statement of financial position;
- an income statement; and
- accounting policies and explanatory notes – but these are much simpler than those required under full HKFRS.

Companies are not required to include a cash flow statement. However, if a company includes a cash flow statement then it should be prepared in accordance with the requirements of section 22 of the SME-FRS.

The SME-FRS states that the financial statements should be the consolidated financial statements, unless the entity is exempt from producing consolidated accounts or unless it has no subsidiaries. We outline the rules on exemption from producing consolidated financial statements on pages 18-19 of this briefing note.

What are the key differences in the accounting policy requirements of the SME-FRS compared to full HKFRS?

The table below summarises some of the key differences between full HKFRS and SME-FRS. This analysis is up to date as of April 2020.

	Relevant standard in full HKFRS	Simpler requirements in SME-FRS	
Property, plant and equipment: after initial recognition	HKAS 16 - cost or revaluation measurement basis allowed	Only one model allowed: carry at cost less accumulated depreciation and impairment losses	3.10
Investment properties	HKAS 40 - measure at cost or revaluation, with revaluation gains and losses to P&L	No separate requirements for investment property: treat IP the same as other property held for the long-term i.e. carry at cost less accumulated depreciation and impairment	3.1, 3.10
Intangible assets	HKAS 38 - intangible assets may have indefinite or finite lives	Intangibles are amortised under a rebuttable presumption that the useful life of any intangible asset will not exceed 10 years from when first available for use	4.14
	Any intangible assets acquired in a business combination which are separable or arise from contractual or legal rights should be recognised at fair value	Intangible assets acquired in a business combination only need to be recognised if their fair value is readily apparent or can be measured without undue cost or effort	4.2

(continued)	Relevant standard in full HKFRS	Simpler requirements in SME-FRS	
Impairment of assets	HKAS 36 - detailed requirements on identifying indicators of impairment, identifying cash-generating units, allocating goodwill and computing recoverable amounts. Also requirement to check for indicators of reversal of impairment loss	Simplified guidance on identifying “components” of a business and allocating goodwill	9.9
		Discounting of cash flows is permitted but not required	9.8
		Impairment losses need not be reversed unless the asset’s fair value is readily apparent or the recoverable amount can be measured reliably without undue cost or effort	9.5
Financial instruments (including: investments in subsidiaries, joint ventures and associates in company-level financial statements)	HKFRS 7 and 9 - detailed requirements for financial assets, financial liabilities and equity instruments, including derivatives and compound instruments HKAS 27 – in the company level financial statements there is an accounting policy choice to account for investments in subsidiaries, joint ventures and associates either at cost, per HKFRS 9 (fair value) or the equity method as described in HKAS 28	So far as investments are concerned, only investments in securities are covered. These should all be carried at historical cost (less impairment, if any)	6.1-6.13
		So far as derivatives are concerned, only forward foreign exchange contracts are specifically mentioned in the SME-FRS and the treatment depends on whether the contract is speculative or non-speculative No specific requirements for financial liabilities beyond the accruals concept and the section on borrowing costs	15.10-15.12
Borrowing costs	HKAS 23 - borrowing costs on “qualifying assets” must be capitalised	Allowed to choose a policy of expensing all borrowing costs to profit and loss <i>(capitalisation into the cost of qualifying assets is allowed as an alternative policy choice)</i>	13.1-13.4
Income tax	HKAS 12 - detailed requirements cover both current tax and deferred tax accounting	Tax accounting is limited to current tax liabilities and losses that can be carried back to previous periods Deferred tax liabilities and assets should not be recognised	14.4
Leases	HKFRS 16 - detailed requirements for lessees and lessors, including recognising right-of-use assets and lease liabilities for all leases entered into by lessees unless eligible for the short-term or low value exemptions	The SME-FRS continues to distinguish between operating leases and finance leases for lessees based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Rentals under operating leases are recognised by the lessee over the term of the lease	5.1-5.15
Share-based payments	HKFRS 2 - detailed requirements on equity-settled and cash-settled share based payment arrangements	No specific requirements	

<i>(continued)</i>	Relevant standard in full HKFRS	Simpler requirements in SME-FRS	
Employee benefits	HKAS 19 - detailed requirements on employee benefits, including post-retirement benefits and termination benefits	No specific requirements	
Business Combinations	HKFRS 3 – detailed requirements on identifying and measuring the cost of the acquisition and the assets and liabilities acquired, including measurement of contingent consideration	<p><i>Re the cost of the acquisition:</i></p> <ul style="list-style-type: none"> Contingent consideration: <ul style="list-style-type: none"> recognised only if probable (i.e. more likely than not) 	18.10
	Transaction costs and other contracts unrelated to gaining control have to be separated and dealt with according to other HKFRSs	<p><i>Re the identifiable assets and liabilities acquired:</i></p> <ul style="list-style-type: none"> Simpler measurement and recognition requirements 	18.12
	Step acquisitions have to be treated as a disposal and buy-back at fair value until control is obtained	<ul style="list-style-type: none"> In particular, intangible assets only need to be recognised if their fair value is readily apparent or can be measured without undue cost or effort <p><i>No specific requirements on step acquisitions or how to separate contracts unrelated to gaining control</i></p>	18.13
Consolidation	HKFRS 10 – detailed requirements on determining control and preparation of consolidated financial statements	<p>Simpler model to determine control: control is presumed if a parent owns more than half the votes of an entity (either directly or indirectly)</p> <p>Individual subsidiaries may be excluded from consolidation if their inclusion would involve expense or delay out of proportion to the value to the members of the company, provided the shareholders are informed and do not object</p>	19.4-19.5 19.1-19.3 19.16(g)
	Goodwill is not amortised and is instead subject to an annual impairment test together with the cash generating unit(s) to which it relates	<p>Goodwill is carried at cost less accumulated amortisation and impairment losses (if any)</p> <p>Rebuttable presumption that the useful life of the acquired goodwill will not exceed 5 years. No requirement to test for impairment unless there is an indication that impairment exists</p>	18.7-18.21 9.9

<i>(continued)</i>	Relevant standard in full HKFRS	Simpler requirements in SME-FRS	
Associates and joint ventures in the consolidated financial statements	HKAS 28 – in most cases must use equity method to account for associates and joint ventures in the consolidated financial statements	Allowed to choose a policy of accounting for associates and/or joint ventures at cost for both the consolidated and the company-level financial statements	20.4
		<i>(equity method is allowed as an alternative policy choice for the consolidated financial statements, but if equity accounting is used then goodwill needs to be amortised)</i>	20.5

Transitioning from a different GAAP to SME-FRF and SME-FRS

- SME-FRF 44** If a company changes from following full HKFRS (or another GAAP) to adopting the SME-FRF and SME-FRS, it must follow the transition requirements set out in the SME-FRF, which require any differences to be treated as a change in accounting policy.

This applies to:

 - all items recognised under full HKFRS (the previous GAAP), which do not meet the recognition criteria under the SME-FRS;
 - all items not recognised under the previous GAAP, which are recognised under the SME-FRS; and
 - all items recognised under both the previous GAAP and the SME-FRS but which were previously measured on a basis that was inconsistent with the SME-FRF and the SME-FRS.
- SME-FRS 2.7, 2.8** The SME-FRS states that such changes in accounting policy should be applied retrospectively, unless it is impracticable to determine the cumulative effect of the change. The reserves for the earliest period presented and the comparatives should be presented as if the new policy had always been followed. However, comparatives need not be restated if this would involve undue cost or effort.
- SME-FRF 45** When an entity transitions to SME-FRS, specific disclosures are required to reconcile the opening balances if they have been restated on transition.

Practical issue – Typical adjustments that might be needed on transition

It can be seen from the table above that there are a number of key measurement differences between full HKFRS and SME-FRS. Typical adjustments that would need to be made on transition would include the following:

- eliminate all deferred tax balances;
- eliminate any goodwill which arose more than 5 years ago (unless the presumption of a 5 year useful life is rebutted) and compute the cumulative amortisation to be eliminated for any goodwill acquired since then; and
- if any investments are carried at a value higher than depreciated cost less impairment loss, then eliminate the unrealised revaluation surplus*; and
- identify a best estimate of a useful life for any intangibles with indefinite useful lives, using the rebuttable presumption of not more than 10 years, and compute the cumulative amortisation to be eliminated.

** this adjustment is no longer necessary for property, plant, equipment (including investment property) or intangible assets as a result of an amendment to the SME-FRF in March 2020. Instead, for each class of property, plant, equipment or intangible assets, entities are allowed to consistently use previous GAAP carrying amount or fair value as deemed cost on transition for all items in that class (paragraph 44 of SME-FRF and related definition as amended in March 2020).*

In addition, an entity might want to take this opportunity to simplify their accounting policies by taking one or other of the policy choices on offer of:

- expensing all borrowing costs; and/or
- using the cost method in the consolidated financial statements for investments in associates and joint ventures instead of the equity method.

Such changes would move the entity's financial statements further away from being comparable with full HKFRS, but, depending on the entity's circumstances, the benefits of the simplification may outweigh this disadvantage.

Other disclosure exemptions for the directors' report and financial statements

- *New CO Companies (Directors' Report) Regulation*
- *New CO Companies (Disclosure of Information about Benefits of Directors) Regulation*

Detailed disclosure requirements affecting the annual reports can be found in two pieces of new subsidiary legislation called Regulations. Specifically, these are:

- the Companies (Directors' Report) Regulation ("C(DR)R"), which covers the detailed contents of the Directors' Report (other than the Business Review); and
- the Companies (Disclosure of Information about Benefits of Directors) Regulation ("C(DIBD)R"), which sets out the detailed disclosure requirements for the financial statements relating to:
 - directors' emoluments, retirement and termination benefits and consideration provided to or receivable by a third party for making available the services of a director;
 - loans, quasi-loans and other dealings in favour of directors; and
 - material interests of directors in transactions, arrangements or other contracts entered into by the company.

Both of these regulations contain exemptions from certain disclosure requirements for companies that are eligible for simplified reporting. These are as follows:

<i>Exemptions relating to the directors' report:</i>	
C(DR)R.3(3A)	• Arrangements to enable a director to acquire benefits from shares in or debentures of the company or any other body corporate
C(DR)R.4(3)	• Donations made for charitable or other purposes
C(DR)R.8(3)	• Reasons for a director resigning or not seeking re-election
<i>Exemptions relating to directors' report and financial statements:</i>	
C(DR)R.10(7)(a) C(DIBD)R.23(a)	Material interests of a director in transactions, arrangements or contracts entered into by the company or another company in the same group

- *New CO Sch 4 Part 2.1*

In addition to the above, companies eligible for simplified reporting are exempt from disclosing the auditors' remuneration in the financial statements. This exemption can be found in Schedule 4 to the new CO, which sets out accounting disclosures to be included in the financial statements under section 380(3) of the new CO.

If a specific exemption is not stated in the new CO, relevant Schedules or Regulations, then companies have to comply with the requirements, irrespective of whether they are otherwise preparing simplified annual reports. Appendix 3 to this briefing note gives more details in this regard and further information can be found in our briefing notes 1 and 2 on financial statements prepared under the full reporting regime and directors' reports.

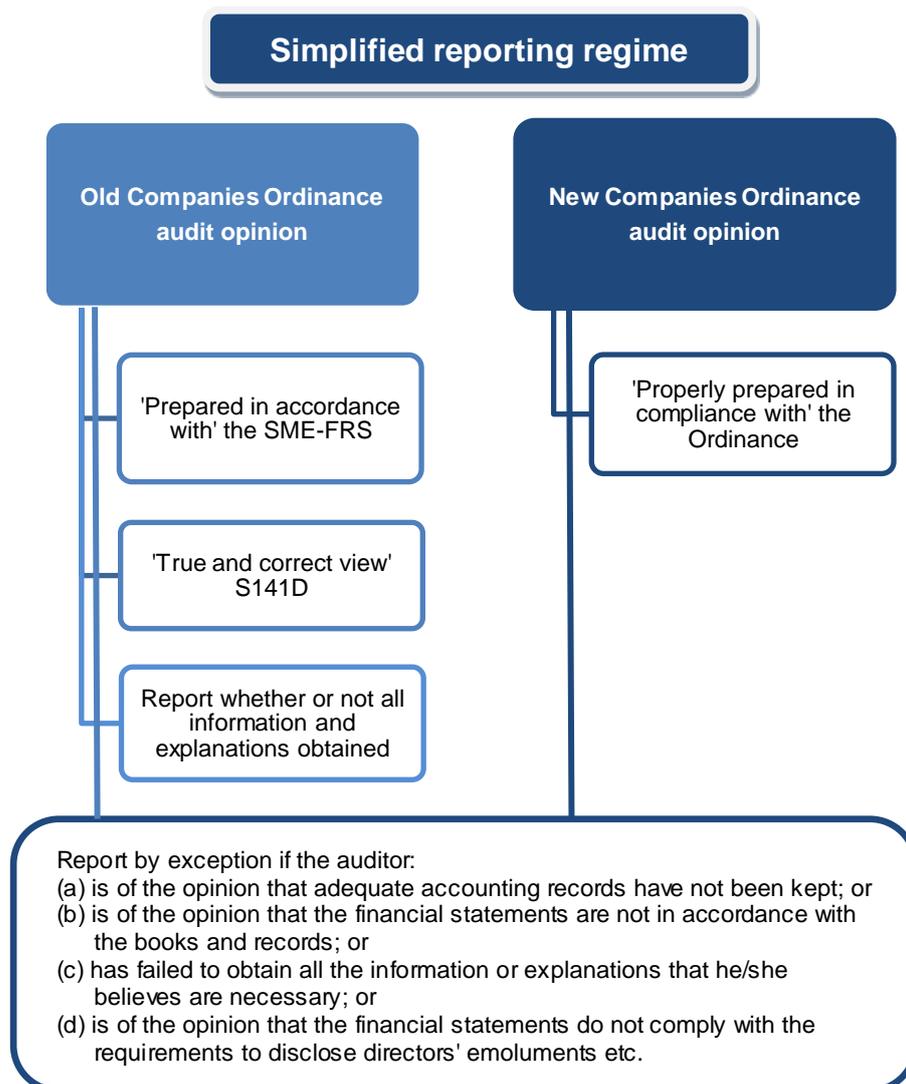
Audit report: potential reduction in procedures

- *HKICPA Practice Note 900, para 7*
- *New CO s406(1)(a),407(3)*

The new CO requires the auditors to express an opinion as to whether the financial statements have been properly prepared in accordance with the relevant reporting requirements. This is a "positive assurance" opinion. Consequently, auditors need to carry out a full scope audit following auditing standards and cannot, for example, only carry out a limited review.

There is therefore no difference in principle in the scope of the audit of simplified financial statements, compared to the audit of financial statements prepared under the full regime. However, in practice the extent of work required may be less, depending on the company's (or group's) facts and circumstances – for example, if the company owns investment properties and adopts the simplified reporting regime, it will not be necessary for the auditor to examine the work of an expert valuer, unless an impairment provision needs to be recognised against the cost of that property.

In terms of the actual wording of the audit report, minor changes have been made as follows which make the report more consistent with that required under the full reporting regime:



In this briefing note so far we have looked at the impact of the new reporting exemption on directors' reports and financial statements. If you consider that the simplifications on offer could be of interest to any companies that you are involved with, then please read on into Appendices 1 and 2 where we take a closer look at establishing and losing eligibility, with a focus on helping you avoid likely pitfalls and misunderstandings. We also include further examples which illustrate the practical impact of the two-year grace period for gaining or losing SME status. Finally, appendix 3 includes for your reference those disclosure requirements in the new CO which need to be complied with, even if eligible for the reporting exemption.

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

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Date of first publication: September 2013. Latest version: April 2020

Appendix 1: Establishing eligibility for simplified reporting

Cutting through the complexity ...

Most of the specific text in the new CO on the subject of the “reporting exemption” relates to determining which entities are eligible for the reporting exemption. This can be found in sections 359 to 366A of the new CO, with further detail in Schedule 3.

At least in the initial years of working within the new CO, such lengthy material provides its own challenges, as it may be hard for any company to find which sections are relevant to the company’s own particular circumstances and which sections may be ignored. There are also new approaches to become familiar with such as the “two out of three” size tests, the “two year waiting period” for gaining or losing eligibility, and the “75% of all members with none objecting” shareholder approval requirement.

In this appendix we take you step-by-step through

- the types of companies and groups that could be eligible; and
- the basics of the eligibility tests.

We then take a closer look at:

- the shareholder approval requirements; and
- how the size tests amounts are calculated.

These discussions include examples to illustrate them in action. These are particularly relevant for those companies which need to prepare consolidated financial statements and/or are borderline cases for meeting the criteria, whether due to size or difficulties in obtaining sufficient shareholder support. Additional examples on gaining or losing eligibility in later years can be found in Appendix 2 to this briefing note. However, please also note that establishing eligibility is primarily a legal matter – if in doubt about any of the matters discussed in these appendices then legal advice should be sought.

Which types of companies and groups could be eligible?

Ineligible lines of business

- *New CO s359(4) and (5) as referred to in s359(1), (2) and (3)*

The reporting exemption is generally available to any private companies and companies limited by guarantee that meet the size tests and, in the case of larger private companies, obtain shareholder approval. But before we look at the detailed criteria, it is worth noting that companies that carry out certain lines of business are not allowed to adopt simplified reporting, even if they are private companies.

Specifically, the new CO states that a company would not be eligible for the reporting exemption if at any time during the financial year it:

- a) carried out any banking business and held a valid banking licence granted under the Banking Ordinance (Cap. 155);
- b) was licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on a regulated business; or
- c) (i) carried on any insurance business, other than solely as an agent; or
(ii) accepted, by way of trade or business (other than banking business), loans of money at interest or repayable at a premium, other than on terms involving the issue of debentures or other securities.

This is very similar to the approach that was taken in section 141D of the old CO.

These companies are not eligible for the reporting exemption in their company-level financial statements. They also prevent any group of which they are a member from preparing simplified consolidated financial statements. Instead these companies or groups must prepare financial statements which show a “true and fair view” under the full reporting regime.

The 2019 Amendment Ordinance introduced new sections which explicitly refer to a “non-Hong Kong body corporate” to make clear that the same restrictions apply whether the companies in the group are incorporated in Hong Kong or elsewhere. Specifically, if the subsidiary is incorporated outside Hong Kong, then the requirements are that the subsidiary does not carry on activities that are equivalent to those that are on the restricted list for Hong Kong incorporated companies, for example, any business that, had it been carried on in Hong Kong, would be required to be carried on under a valid banking license granted under the Banking Ordinance or a licence under Part V of the Securities and Futures Ordinance. This clarification was added by the 2019 Amendment Ordinance in a new section, s359(5)(a) and (b).

These amendments serve to create a level playing field for Hong Kong incorporated holding companies, regardless of the country of incorporation of their subsidiaries.

Types of non-public companies that could be eligible

The new CO includes four different categories of non-public companies (and groups) that may be eligible to take the reporting exemption, provided that they are not involved in the ineligible lines of business discussed above:

- small guarantee companies (and groups of small guarantee companies);
- small private companies (and groups of small private companies);
- larger “eligible”* private companies (and groups of larger “eligible” private companies); and
- private companies that would have been eligible under s141D of the previous legislation.

The 2019 Amendment Ordinance introduced a 5th category of “mixed groups” i.e. groups which include both small guarantee companies and private companies. The eligibility criteria for each of these categories are looked at in turn below.

** The new CO simply refers to this category as “eligible” private companies – however, to distinguish this category from other categories which qualify for the exemption, we refer to this category as the “larger “eligible” private companies”*

What are “companies limited by guarantee” and “private companies”?

The definitions of “companies limited by guarantee” and “private companies” are essentially unchanged in the new legislation:

- *New CO s2*
- *New CO s9*
- *New CO s11*

A “company” is a company formed and registered under the new CO or a former CO.

A company is “limited by guarantee” under the new CO if:

- it does not have a share capital; and
- its articles limit the liability of its members to the amount its members undertake to contribute to the assets of the company if it is wound up.

The new CO states that a company is a “private company” if it is not a company limited by guarantee and its articles:

- restrict a member’s right to transfer shares; and
- limit the number of its members to 50; and
- prohibit any invitation to the public to subscribe for any shares or debentures of the company.

The new CO clarifies that the term “*member*” above excludes employees of the company and former employees, who became members whilst they were employees of the company and who continue to be members. Also, if two or more people own shares in a company jointly they are regarded as one single member.

- *New CO s382 & s389*

It is important to note, however, that if at any time during the financial year a private company breaches any of the above criteria, it is required to prepare its directors’ report and financial statements as if it were a public company i.e. it will no longer qualify for the reporting exemption unless the Court allows otherwise. This is explicitly stated in s382 and s389.

- *New CO s12*

The new CO clarifies that a company is a “public company” if it is not a private company or a company limited by guarantee. Public companies are not eligible for the reporting exemption, irrespective of their size

How do these definitions apply to non Hong Kong incorporated companies?

- *New CO s359(5)(c), s366A(2)-(3), and s7, 10, and 12A of Sch. 3*

As mentioned above, the 2019 Amendment Ordinance introduced the definition of a “non-Hong Kong body corporate” to allow for groups which include such companies to take advantage of the reporting exemption. A non-Hong Kong body corporate is defined in section 357(1) as a body corporate incorporated outside Hong Kong.

To ensure a level playing field, a holding company with non Hong Kong subsidiaries is only eligible for the reporting exemption if these companies are equivalent to private companies or companies limited by guarantee. Specifically, the amended Ordinance requires that:

- the subsidiary would not have fallen within the meaning of public company in section 12 had it been incorporated under the Hong Kong Companies Ordinance. This clarification was added by the 2019 Amendment Ordinance in a new section, s359(5)(c); and
- the subsidiary would have been qualified as a small or larger “eligible” private company, or a small guarantee company, had it been incorporated under the Hong Kong Companies Ordinance. This clarification was added by the 2019 Amendment Ordinance in a new section, s366A and in amendments to the sections in Schedule 3, which set out the various eligibility tests.

Parent companies: when is it necessary to qualify as a group?

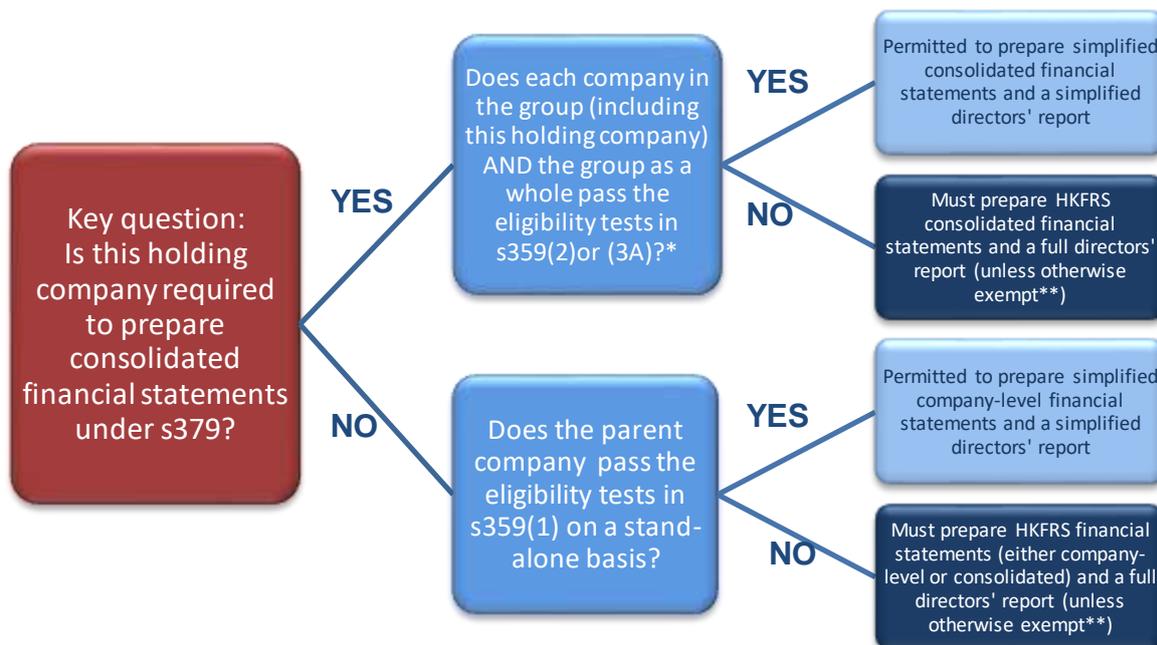
- *New CO s359*

Section 359(1) of the new CO sets out criteria which, if met by a company, entitles that company to take advantage of the reporting exemption. Section 359(2) states that a company “also” falls within the reporting exemption if it is a holding company and the group of companies qualifies as a group.

There is no clear link stated in the new CO between these requirements and section 379, which sets out which holding companies must prepare consolidated financial statements. However, it would seem reasonable to assume that a correlation is intended² i.e. that if a holding company is required to prepare consolidated financial statements, then the group needs to qualify for the exemption under section 359(2) before it can prepare simplified consolidated financial statements; whereas if the holding company does not need to prepare consolidated financial statements, then it may qualify for the simplified reporting as a stand-alone company under section 359(1).

This assumed correlation can be summarised in the following decision tree:

² This position has been confirmed by the HKICPA in question D6 of its [FAQs on financial reporting issues relating to the new Companies Ordinance \(Cap. 622\) \(“new CO”\) \(other than those relating to transition from the predecessor Ordinance \(Cap. 32\)\)](#) which is found on its webpage.



* The answer to this question primarily depends on the size of the companies, and, in the case of larger “eligible” companies, obtaining sufficient shareholder approval. But regardless of their size, the answer to this question would always be “no” if the group contains ANY of the following:

- i. public companies as defined in s12; or
- ii. companies which engage in types of business set out in s359(4) or (5).

** Even if the company is not eligible for the reporting exemption, it may still be exempt from preparing a business review under s388(3)(b) or (c). See page 7 of this Briefing Note for further details

- **New CO s379(2)** The rules on exemption from producing consolidated financial statements in the new CO are the same for holding companies whether or not they opt for simplified reporting. The rules are that a parent must prepare consolidated financial statements unless the parent is:
- **New CO s379(3)(a)**
 - a wholly owned subsidiary of another body corporate (this exemption is carried forward from the old CO); or
- **New CO s379(3)(b) and (c)**
 - a partially owned subsidiary of a body corporate which has obtained either negative or positive consent from its shareholders in a way that satisfies either s379(3)(b) or s379(3)(c):
 - negative consent is sufficient if at least 6 months before the end of the financial year, the directors write to the members to notify them that they do not intend to prepare consolidated financial statements for this financial year and up until 3 months before the end of the financial year, no member has written to the company asking the company to prepare consolidated financial statements;
 - positive consent is sufficient if it is given in writing by all shareholders before the end of the financial year. This second method of obtaining consent was introduced by the 2019 Amendment Ordinance and provides relief if the directors missed the 6 month deadline for negative consent.

Planning ahead by a partially owned subsidiary that does not want to produce consolidated accounts

Section 379(3) is explicit that a partially owned holding company will have to obtain the negative or positive consent from the members each year to gain the exemption from producing consolidated financial statements. It cannot put in place a notification intended to cover multiple years or “until further notice”.

Furthermore, 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), provided that this notice is sent out in the first half of the year.

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. 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.

Eligibility tests: the basics

- *New CO s359*

After a company has determined whether or not it will have to produce consolidated financial statements, the next step is to consider if the company, or the group (if preparing consolidated financial statements), is eligible for simplified reporting.

The following table summarises the tests for the four categories – we then look more closely at each of these in turn, followed by more detail on how the amounts should be calculated and for which years the tests must be satisfied. The examples take as a given that none of the companies in the groups illustrated are involved in the ineligible public interest activities listed in s359(4) or (5).

	Small guarantee company /group ¹	Small private company /group ¹	Larger (“eligible”) private company /group ¹	Private companies that would have been eligible under s141D ³
Annual revenue	≤ \$25m	≤ \$100m ²	≤ \$200m ²	No limit
Total assets	No limit	≤ \$100m ²	≤ \$200m ²	No limit
Average employees	No limit	≤ 100 ²	≤ 100 ²	No limit
Shareholder approval	Not required	Not required	At least 75% of members approve and none object	100% of members approve

¹ In groups, the tests must be met for each company in the group and for the group as a whole. See below for further details.

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

³ “Private companies that would have been eligible under s141D”: these are private companies that do not have subsidiaries and are not a subsidiary of another company

Small guarantee company (or a group whose holding company is a small guarantee company)

- *New CO Sch 3.1(5),(6)* The only monetary test that a guarantee company has to pass is that total annual revenue in the company's annual financial statements must not exceed \$25 million.
- *New CO Sch 3.1(7), (12A), (13),(14)* If the company limited by guarantee is required to prepare consolidated financial statements then it may pass this test either as a group of small guarantee companies or as a "mixed group" under the new sections 359(3A) and 366A introduced by the 2019 Amendment Ordinance. Specifically, to qualify as a group:
 - the holding company must qualify as a small guarantee company on a stand-alone basis;
 - each subsidiary in the group must qualify either as a small guarantee company or, if the subsidiary is a private company, then it must qualify as a small private company or a larger "eligible" company under the tests applicable to private companies; and
 - the aggregate annual revenue of the group as a whole must not exceed \$25 million.

If a small guarantee company (or group) meets the revenue test it does not need shareholder approval to adopt simplified reporting.

Small private company (or a group whose holding company is a small private company)

- *New CO Sch 3.1(1),(2)* To be eligible for simplified reporting, a small private company must not exceed 2 out of the 3 tests of: annual revenue (\$100 million), total assets (\$100 million) and average employees (100).
- *New CO Sch 3.1(7),(8),(9)* If the private company is required to prepare consolidated financial statements then it may pass this test either as a group of small private companies, or as a "mixed group" under the new sections 359(3A) and 366A introduced by the 2019 Amendment Ordinance. Specifically, to qualify for simplified reporting as a group:
 - the holding company must qualify as a small private company on a stand-alone basis
 - each subsidiary in the group must qualify as a small private company or as a small guarantee company; and
 - the aggregate amounts for the group in total must not exceed 2 out of 3 of the small size tests.

If a small private company (or group) meets at least 2 out of 3 of the tests it does not need shareholder approval to adopt simplified reporting.

Larger "eligible" private company (or group whose parent is a larger "eligible" private company)

If a private company does not meet the small private company tests, it may still be eligible for simplified reporting as a larger "eligible" private companies, provided it meets the larger size criteria and has also obtained sufficient shareholder approval.

- *New CO Sch 3.1(3),(4)* Specifically, larger "eligible" private companies must not exceed 2 out of the 3 tests of: annual revenue (\$200 million), total assets (\$200 million) and average employees (100) to be eligible for simplified reporting.
- *New CO Sch 3.1(10),(11),(12)* If the private company is required to prepare consolidated financial statements then it may pass this test either as a group of larger "eligible" private companies, or as a "mixed group"

under the new sections 359(3A) and 366A introduced by the 2019 Amendment Ordinance. Specifically, to qualify for simplified reporting as a group:

- the holding company must qualify as either a small private company or a larger “eligible” private company
- each subsidiary in the group must qualify as either a small private company, a larger “eligible” private company or a small guarantee company; and
- the aggregate amounts for the group in total must not exceed 2 out of 3 of the larger “eligible” tests.

In terms of shareholder approval, the rules for this exemption are complex and may cause practical problems. We discuss them in more detail below.

Private companies that would have been eligible under s141D of the previous legislation

- *New CO s359(1)(b)*

The new CO brings forward the rules in the previous ordinance which allowed a private company of any size to adopt simplified reporting if:

- it does not have a subsidiary and is not a subsidiary of another Hong Kong incorporated company; and
- 100% of the members agree in writing that the company will adopt simplified reporting for that financial year.

Practical issue – private companies that would have been eligible under s141D

The requirements on shareholder approval for this exemption are more demanding than those for shareholder approval for the larger “eligible” category. So in practice, we would expect that only a company which exceeded the size tests for a larger “eligible” private company would try to take this exemption.

A closer look at “shareholder approval”

Shareholder approval for a larger “eligible” private company or a larger “eligible” group

- *New CO s360*

As mentioned above, as well as not exceeding the size limits, a larger “eligible” private company, including the holding company of a larger “eligible” group needs to obtain shareholder approval to gain exemption. Specifically, to gain exemption for a larger “eligible” private company, the members holding at least 75% of the voting rights must pass a resolution at a general meeting that the company is to fall within the reporting exemption for the financial year, with none objecting.

This is an area to consider carefully as the rules are quite complex and demanding:

- The 75% vote is calculated as a percentage of all the voting rights held by the company’s shareholders, not simply as a percentage of the shareholders who attend and vote at the general meeting.
- The vote is defeated if any shareholder votes against the resolution either at the meeting or at any time by giving notice in writing to the company, provided that the written notice is given at least 6 months before the end of the financial year to which the objection relates.

The example below illustrates the Schedule 3 size tests and the shareholder approval requirements applicable when a large “eligible” private group wishes to adopt simplified reporting.

Example 1 – Which shareholders need to approve before a larger “eligible” group can adopt simplified reporting?

P Ltd has 2 subsidiaries, X Ltd and Y Ltd. All companies in the group are private companies. P Ltd owns 80% of X Ltd and 70% of Y Ltd.

P Ltd has determined that it will need to prepare consolidated financial statements and is testing to determine whether the group meets the criteria for simplified reporting.

The relevant amounts for each group company (on a stand-alone basis) and for the consolidated P Ltd Group (after excluding revenue, unrealized profits and receivables arising from intra-group transactions) are as follows:

	P Ltd	X Ltd	Y Ltd	Consolidated P Group
Annual revenue	\$90m	\$110m	\$30m	\$210m
Total assets	\$60m	\$140m	\$10m	\$150
Average employees	40	10	10	60

Analysis of the above data:

Do the revenue, assets and employees of each company (and the group in aggregate) fall within the small private company limits?

	P Ltd	X Ltd	Y Ltd	Consolidated P Group
Annual revenue	√	x	√	x
Total assets	√	x	√	x
Average employees	√	√	√	√

On the basis of the above, does each company (and the group) pass 2 out of 3 of the small company tests and qualify as a small private company (or group)?

	P Ltd	X Ltd	Y Ltd	Consolidated P Group
Within the small tests?	Yes	No	Yes	No

As X Ltd and the P group do not pass the small tests, the next step is to see if they pass 2 out of 3 of the larger “eligible” tests:

	P Ltd	X Ltd	Y Ltd	Consolidated P Group
Within the larger tests?	-	Yes	-	Yes

As P Group only qualifies under the larger “eligible” size tests, at least 75% of all the shareholders of P Ltd must approve P Ltd adopting simplified reporting in its consolidated accounts at a general meeting (with none objecting) before P Ltd can prepare simplified consolidated financial statements.

NB As a result of the 2019 Amendment Ordinance, it is no longer necessary for P Ltd to ensure that the shareholders of X Ltd also pass a resolution, for the purposes of P Ltd’s own reporting. However, if X Ltd wishes to prepare a simplified annual report to satisfy its own reporting obligations then it will still need to obtain approval from its own shareholders i.e. from P Ltd and any of its non-controlling shareholders.

Practical issues to consider if a company wishes to take the larger “eligible” private company / group exemption:

It is clear that for some companies obtaining shareholder approval may be quite challenging.

Expanding small companies or groups may need to prepare for a shareholder vote

A company, which thinks it or its group is likely to exceed the small company limits in the near future, should start to consider the implications if it wants to continue adopting the simplified regime as a larger “eligible” company (or group). This would include making preparations for a shareholder meeting and vote. We discuss how long it would take to lose small company (or group) status in appendix 2 to this briefing note.

“Special notice”

Special notice is required for the resolutions above. The requirements in the new CO concerning “special notice” are as follows:

- anyone wishing to move a resolution requiring special notice must give the company at least 28 days’ notice;
- if practicable, the company should give its members notice of the resolution at the same time as it gives notice of the meeting; or
- if not practicable, the company must give its members at least 14 days’ notice before the meeting.

Time limits for votes and shareholder opposition

There does not appear to be a time limit specifically set for obtaining the shareholder resolution in respect of any given year. However, the resolution will fail at a general meeting if any shareholder votes against the resolution to adopt simplified reporting. Also, even if the resolution is passed at a general meeting, it will still not be valid if any shareholder objects in writing at least 6 months before the end of the financial year.

This means that a larger “eligible” company will not have certainty about their ability to adopt the SME reporting exemption until the later of a successful shareholder vote and a date 6 months before the end of the financial year in question. It follows that if a larger “eligible” company (or group) attempts to pass a resolution to adopt simplified reporting for more than one year, it needs to be aware that the objection period will remain open for future years.

Shareholder apathy

To obtain the exemptions, the vote must be passed by 75% of **all** shareholders, not just the shareholders attending the meeting. So if less than 75% of shareholder votes are cast at the general meeting, the resolution will fail.

- *New CO s360(5), 578*

- *New CO s360(1)(b), (2)(a)(ii), (b)(ii), (c)(ii)*

Shareholder notification for excluding a subsidiary under the SME-FRS

- *SME-FRS 19.3*

Paragraph 19.3 of the SME-FRS sets out procedures that must be followed when the directors wish to exclude a subsidiary from consolidation on the grounds of expense and delay out of proportion to the value to the members of the company. These relate to notifying the members about the directors’ proposal and giving the members an opportunity to object.

These procedures are aligned with the new CO requirements in respect of obtaining shareholder approval. Specifically:

- If an entity needs to obtain shareholder approval as a larger “eligible” company, then the notification from the directors must be included as part of the notice to obtain the necessary shareholder approvals required to qualify for the reporting exemption and must be subject to the same approval and objection processes as apply to that approval.
- In all other cases (i.e. for the smaller private companies) the notification needs to be sent before the date of approval of the financial statements and the members must be

allowed at least one month to object, unless all the members confirm that such a period is not necessary.

Shareholder approval for a private company that would have been eligible under s141D

- **New CO s359(1)(b)(iii)** As in the previous Ordinance, to meet the requirements for this category, 100% of the members of the company must agree, in writing, that the company will follow simplified reporting for the financial year. Section 359(1)(b)(iii) explicitly states that the members can give their approval for one year only, which means that a company must obtain the written approval from 100% members for **each year** that they wish to take the exemption under this category.

How are the size test amounts calculated?

Which accounting standard should be followed?

- **New CO Sch 3.1** When deciding if a company (or group) meets the SME limits in Schedule 3, total revenue and total assets generally must be calculated assuming the company (or group) qualifies for simplified reporting. This means that accounting policies and requirements of the SME-FRS should be used rather than full HKFRS. This approach of using the SME-FRS numbers also appears to apply when testing whether a company (or group) has lost SME status as the figures should be calculated “*as reflected in the company’s annual financial statements*” which would have been prepared under the SME-FRS.

Practical issues – when testing whether a company (or group) has gained SME status

Although the CO requires the tests to be carried out with reference to the SME-FRS requirements, in practice a short-cut would be to consider whether the current HKFRS numbers would fall within the size tests. This is because generally the only impact on the tests of adopting the SME-FRS policies, if any, will be to reduce the amounts of total assets. For example:

- under the SME-FRS, PPE, investment properties and financial instruments would be measured at cost (less impairment) whereas under HKFRS they may be carried at a higher fair value; and
- under the SME-FRS deferred tax assets must be removed from the statement of financial position.

Only if the company (or group) fails to meet the total assets size test using the existing HKFRS numbers, would it be necessary for that entity to consider whether it could pass the test by re-stating any assets at a lower amount under the SME-FRS.

Further details on the key differences between HKFRS and SME-FRS accounting policies are summarised on pages 9-12.

How are total revenue and total assets calculated for a company within a group and for the group in aggregate?

- **New CO Sch 3.1** When deciding if a group meets the size tests, Schedule 3 states that:
 - (a) each company in a group must be tested using the amounts in its stand-alone company annual financial statements (i.e. before eliminating any inter-group transactions); but
 - (b) when testing the group as a whole, the amount of the group’s total revenue and total assets is calculated on the basis that all set-offs and other adjustments for transactions between group companies have been made.
- **New CO Sch 3.2(2)**

This is illustrated in Example 1 on page 23.

Practical issues

Impact of using stand-alone company annual financial statement figures for testing an individual company in the group

If there are significant trading or other transactions between the companies in the group, the individual company figures may include sizable amounts of revenue, unrealized profits and inter-company receivables that would be eliminated on consolidation.

This raises the possibility that an individual group company may exceed the limits on revenue or total assets due to intra-group transactions, and thereby prevent the group from adopting the simplified reporting exemption, even though the group in total (based on the consolidated figures) would have passed the size tests.

Ways to avoid such a pitfall might include using a branch structure, rather than separate legal entities, structuring intra-group transactions on an agency basis and/or settling significant intra-group balances prior to the year end. However, a careful analysis of potential real-world consequences would be advisable before deciding whether to adopt such strategies, including considering tax implications such as transfer pricing issues and regulatory requirements. Making such changes simply in order to be eligible for simplified financial reporting may not be worth the effort or potential downsides.

What if the directors plan to exclude a subsidiary from consolidation on the grounds of “undue expense and delay” under paragraph 19.3 of the SME-FRS? How does this affect the size tests?

The Companies Registry has confirmed in its published guidance that all subsidiaries should be taken into account when testing a group’s eligibility for the reporting exemption, irrespective of whether the directors believe they will satisfy the requirements of paragraph 19.3 of the SME-FRS in respect of excluding one or more of them from the consolidation. This means that, when assessing the eligibility of the group for the reporting exemption, all of the group’s subsidiaries’ external revenue, total assets and employees should be included in the group totals for the purposes of the relevant size tests.

This guidance can be found on the Companies Registry’s website, in the “[Accounts and Audit](#)” section of its frequently asked questions on the Companies Ordinance and is currently question 10.

Accounting periods shorter or longer than one year

- *New CO Sch 3.2(1)*

Schedule 3 states that if a reporting period is shorter or longer than a year, total annual revenue for the purposes of the size tests is calculated on a pro-rata basis.

Examples	Company A	Company B
<i>Length of financial period</i>	11 months	15 months
<i>Revenue in that period</i>	\$95 million	\$120 million
<i>Pro rata for size test</i>	$12/11 \times \$95\text{m} = \103.64m	$12/15 \times \$120 = \96m

Average number of employees

- *New CO Sch 3.2(5)*

Schedule 3 states that the average number of company employees for the size test must be calculated on a monthly basis:

$$\text{Average number of employees for testing} = \frac{\text{Aggregate of number of employees at the end of each month during the financial year}}{\text{Number of months in the financial year}}$$

How are part-time employees counted in the test?

Schedule 3 does not provide for any pro-rata calculations to take part-time employees into account. It must therefore be assumed that the above is a simple headcount test, and not a “full-time equivalent” test.

Example

Company C has 85 full-time equivalent employees, made up as follows:

- 50 employees who work full-time
- 70 employees who work half-time.

For the new CO size tests of “no more than 100 employees”, this would simply count as 120 employees, causing Company C to fail that test. It would not be acceptable to view this workforce as being 85 employees.

New companies (and groups) formed under the new CO

- *New companies and groups:*

- *small private (New CO s361(1), 364(1))*
- *larger “eligible” private (New CO s362(1), 365(1))*
- *small guarantee (New CO s363(1), 366(1))*

A new company formed and registered under the new CO which does not exceed the relevant company limits in Schedule 3 in its first financial year, will qualify as small private, larger “eligible” private or small guarantee company, as appropriate, in its first financial year (subject to obtaining the necessary shareholder approval).

A group of companies, whose holding company is formed and registered under the new CO, will qualify for simplified reporting in its first financial year if:

- all companies in the group; **and**
- the group as a whole

do not exceed the relevant limits in Schedule 3 in the group’s first financial year.

In the following years the general requirements discussed in Appendix 2 on how long a company (or group) can continue to qualify as small private, larger “eligible” private or small guarantee company (or group) will apply.

Appendix 2: Changes in SME status in later years

The new CO includes rules to determine whether and when a company (or group) can take advantage of simplified reporting in subsequent years after the first year of operation of the new CO, if it starts to meet, or ceases to meet, the SME limits in Schedule 3.

In this appendix we consider the specific rules and the practical issues for companies (and groups), including when they need to start obtaining shareholder approval, for each of the scenarios below:

- **Gaining SME status by getting smaller**
 - from using full HKFRS to gaining larger “eligible” private company (and/or group) status (Example 3)
 - gaining small private company (and/or group) status by getting even smaller (Example 4)
- **Losing SME status by getting larger**
 - losing small status and becoming a larger “eligible” private company (and/or group)(Example 5)
 - losing larger “eligible” status and moving to full HKFRS (Example 6)

These specific rules apply equally to the new category of “mixed group” introduced by the 2019 Amendment Ordinance. For example, same as for other groups, a mixed group will cease to be eligible for the simplified reporting regime if a new company joins the group during the year and the new company causes the group as a whole to fail the relevant size or activity tests. This is stated in a new section, s366A(6). In all other cases, a mixed group will cease to be eligible if it fails the tests in two consecutive years, as per the new s366A(5). Therefore mixed groups are not treated as a separate category in this appendix.

Gaining SME status by getting smaller

- **Companies and groups:**
 - *small private (New CO s361(3), 364(3))* A company or group which previously did not pass the SME Schedule 3 tests may satisfy the criteria in later years. The issue is “how many years must they satisfy the tests before they will qualify for simplified reporting?”
 - *larger “eligible” private (New CO s362(3), 365(3))* The new CO states that when gaining exemption, 2 out of 3 of the Schedule 3 limits must be met for two consecutive years. The entity will then qualify in the immediately following financial year.
 - *small guarantee (New CO s363(3), 366(3))* The company and group tests apply separately. Even if a holding company would qualify as a large “eligible” or small company for its own stand-alone financial statements, the consolidated financial statements for the group cannot take advantage of the reporting exemption unless the group as a whole meets the limits for 2 consecutive years.
 - *mixed groups (New CO s366A(5))*

Example 3 – Gaining larger “eligible” private company status in later years (company and group) by getting smaller

M Ltd did not adopt simplified reporting when the new CO first took effect, as it exceeded the Schedule 3 limits. However, in 2019, M Ltd disposed of its manufacturing division which meant that it passed the size tests for a larger “eligible” company (and group) for the first time.

M Ltd is now determining when it would first be able to adopt simplified reporting.

Analysis

M Ltd will be able to adopt simplified reporting in its financial statements to 31 December 2021, which is the first year after it has met the larger “eligible” criteria for 2 consecutive years, (see diagram below), provided M Ltd does not grow in the meantime and if it obtains the necessary approvals from its shareholders in 2021.

(continued)

Larger “eligible” private:

- *company*: 2 out of 3 Schedule 3 size tests;
- *group*: 2 out of 3 Schedule 3 size tests for **each** company in the group individually **and** 2 out of 3 for the group in aggregate

	Years ending				
	Dec 2017	Dec 2018	Dec 2019	Dec 2020	Dec 2021
Does M Ltd pass the tests in new CO Schedule 3?	No	No	Yes	Yes	
Does this mean M Ltd qualifies for simplified reporting?	No (too large)	No (too large)	No (too soon)	No (too soon)	Yes (if shareholder approval is obtained)

M Ltd qualifies to use simplified reporting for the first time in 2021 after 2 consecutive years of meeting the size test

Practical issues in later years – gaining larger “eligible” status

The example above looks at a situation where a substantial private company (or group) reduces in size and so falls within the size tests applicable to larger “eligible” companies (or groups) for the first time.

As explained on pages 22-24, if a company (or group) obtains larger “eligible” status, it will need to obtain the shareholders’ approval before it can adopt simplified reporting. However, irrespective of how far ahead that M Ltd plans for this vote, M Ltd also needs to work with the shareholders to eliminate the risk that a single shareholder may lodge an objection in writing. Otherwise, M Ltd will have no certainty that it can adopt simplified reporting until 1 July 2021 (i.e. until the period for shareholder objection expires, being 6 months before the year-end).

Losing larger “eligible” status by getting even smaller: when is shareholder approval no longer required?

- **Companies and groups:**
 - *small private (New CO s361(3), 364(3))* The new CO requirements on passing the size tests in Schedule 3 apply separately to gaining the status of a larger “eligible” private company (or group) and to gaining the status of a small private company (or group).
 - *larger “eligible” private (New CO s362(3), 365(3))* If a company (or group), which previously only met the larger “eligible” tests under new CO, becomes smaller and passes the small company tests, it will need to consider when it will no longer need to obtain shareholder approval to adopt simplified reporting.
 - *mixed group (New CO s366A(5))*

Example 4 – Losing larger “eligible” status in later years by getting even smaller

T Ltd passed the larger “eligible” company (and group) tests in 2015, when the new CO first took effect, and adopted simplified reporting for its consolidated financial statements.

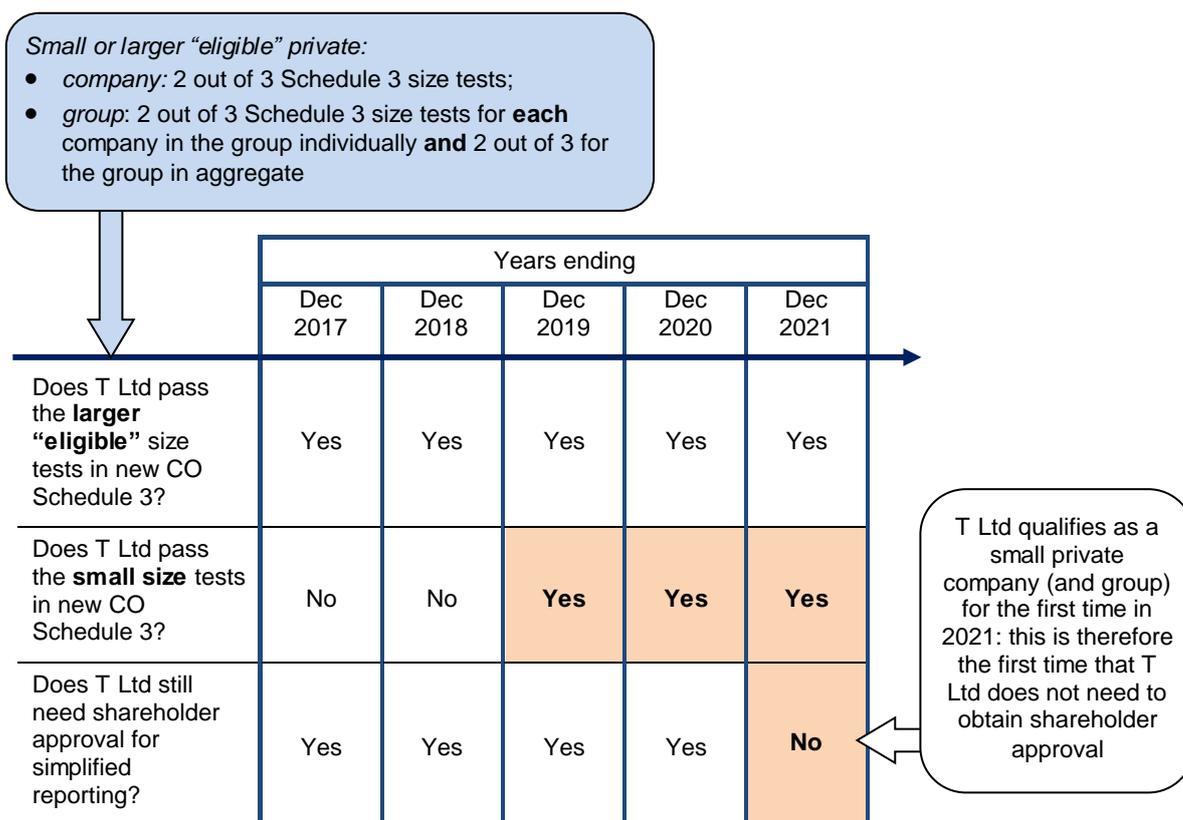
In 2019, it disposes of its retail division, which means that it passes the size tests for a small company (and group) for the first time.

It is now determining when it can first adopt simplified reporting as a small entity, without obtaining shareholder approval.

Analysis

Assuming that T Ltd and its subsidiaries remain small, T Ltd will first qualify as a small company (and group) in 2021, which is the first year after it has met the small criteria for 2 consecutive years (see diagram below). Despite its smaller size, it will have the status of a larger “eligible” group in 2019 and 2020, so it would still need to obtain shareholder approval if it wishes to take the reporting exemption for those years.

This means that if a non-controlling shareholder objects to T Ltd adopting simplified reporting, T Ltd would have to wait until 2021 to be able to adopt it without their consent.



Losing SME status by getting larger

- **Companies and groups:**

- *small private (New CO s361(4), 364(4)-(5))*
- *larger “eligible” private (New CO s362(4), 365(4)-(5))*
- *small guarantee (New CO s363(4), 366(4)-(5))*
- *mixed group (New CO s366A(6)-(8))*

A company or group, which previously qualified for simplified reporting, may fail to satisfy the criteria in later years because they do not meet the Schedule 3 limits. The issue is “in which year will they become disqualified for simplified reporting?”

For a company or group that was previously eligible, if they fail to meet the Schedule 3 limits for two consecutive years, the entity will be disqualified in the immediately following financial year.

However, when considering whether groups have lost SME status, the new CO imposes stricter conditions if a new company joins the group. If a new company joins the group such that the group in aggregate or any company in the group fails to meet the Schedule 3 limits in that financial year, the group will be disqualified in that same year. This applies both to losing status as a small group and losing status as a larger “eligible” group as shown in examples 5 and 6 below.

Losing small company (or group) status but staying within the larger “eligible” size limits: when is shareholder approval required to continue with the reporting exemption?

An expanding company (or group), which previously met the small company tests may fail the tests in the current period but still fall within the larger “eligible” company (or group) limits. In this situation, it will need to consider when it will need to start obtaining shareholder approval as a larger “eligible” entity if it wishes to continue adopting simplified reporting.

Example 5 – Losing small status (company and/or group) in later years and becoming a larger “eligible” company (or group)

J Ltd has subsidiaries and is not exempt from producing consolidated financial statements (see pages 18-19).

J Ltd passed the small company (and group) tests in 2015, when the new CO first took effect and adopted simplified reporting for its consolidated financial statements.

We will now look at different ways J Ltd may lose small status and the impact this will have on when it will need to obtain shareholder approval to continue to use simplified reporting:

Example 5A – Organic growth

In 2019, J Ltd exceeds the small company limits (and therefore also fails to meet the small group tests) due to organic growth.

Analysis

J Ltd will continue to qualify for simplified reporting as a smaller company (and group) in 2019 and 2020. If it continues at this size, in 2021, it will cease to qualify for SME-FRS as a small company and group, as this is the first year immediately following 2 consecutive years in which it does not pass the tests (see diagram below).

J Ltd will therefore need to obtain shareholder approval in 2021 to be able to continue using SME-FRS as a larger “eligible” private company or group in 2021.

J Ltd cannot take advantage of the exemption available to private companies brought forward from s141D of the previous legislation, as J Ltd has subsidiaries and this exemption is only possible for companies with no subsidiaries.

Example 5B – Acquisition of a subsidiary

In February 2019, J Ltd acquires a significant new subsidiary. For the year to 31 December 2019:

- J Ltd passes the small tests at the company level; but
- the group headed by J Ltd exceeds the small group limits due to the acquisition of the new subsidiary (though it is still within the larger “eligible” limits).

Analysis

As the J Group fails to pass the small tests in 2019 because it acquires a new subsidiary, it cannot qualify for simplified reporting as a small group in 2019.

However, as the J Group qualifies as a larger “eligible” group in 2019, it can continue to follow the SME-FRS, provided it obtains shareholder approval in 2019 (see the diagram below)

Small private or larger “eligible”:

- *company:* 2 out of 3 Schedule 3 size tests;
- *group:* 2 out of 3 Schedule 3 size tests for **each** company in the group individually **and** 2 out of 3 for the group in aggregate

	Years ending				
	Dec 2017	Dec 2018	Dec 2019	Dec 2020	Dec 2021
Does the group headed by J Ltd pass the small tests in new CO Schedule 3?	Yes	Yes	No	No	No
Does the group headed by J Ltd pass the larger “eligible” tests in new CO Schedule 3?	Yes	Yes	Yes	Yes	Yes
Does the group need to obtain shareholder approval for simplified reporting?	No	No	?	?	?

Example 5A:

If the group headed by J Ltd ceases to pass the Schedule 3 tests (but meets the larger “eligible” tests) from 2019 due to organic growth, the group will lose its small status and need shareholder approval to use SME-FRS in 2021 as a larger “eligible” group

Example 5B: If the group headed by J Ltd does not pass the small company tests in 2019 (but still passes the larger “eligible” tests) because **a new company joins the group in 2019** then the group will lose its small status in 2019 and must obtain shareholder approval in 2019 to continue using the SME-FRS as a larger “eligible” group

Practical issues to consider – if a group may lose small status in the next few years

If a small company (or group), which adopts simplified reporting, thinks that it may not pass the small tests in future but may still qualify as a larger “eligible” company (or group), it will need to start planning a meeting to obtain shareholder approval.

This is particularly important for a group which expects to acquire a new subsidiary, which is large enough such that it may make it exceed the small group limits. If it fails the group test because a new subsidiary joins the small group, it will need to obtain shareholder approval in the year the new subsidiary joins the group.

Example 6 – Losing larger “eligible” status (company and/or group) in later years by getting larger

W Ltd is a company with subsidiaries and is not exempt from producing consolidated financial statements (see pages 18-19).

W Ltd passed the larger “eligible” company (and group) tests in 2015 when the new CO first took effect and, after obtaining the necessary shareholder approvals, adopted simplified reporting for both its company and consolidated financial statements.

Using the above fact pattern, we will now look at different ways the group headed by W Ltd may lose SME status in later years and the impact this will have on when it ceases to be eligible for simplified reporting:

Example 6A – Organic growth

In 2019, due to an unexpected increase in demand for its products, W Ltd exceeds the larger “eligible” company limits (and therefore also fails to meet the group tests).

W Ltd is now determining how long it can continue to adopt simplified reporting as a larger “eligible” company and group.

Analysis

W Ltd (and its group) will continue to qualify as a larger “eligible” company (and group) in 2019 and 2020. In 2021, it will cease to be eligible for simplified reporting both as a larger “eligible” company and group, as this is the year immediately following 2 consecutive years in which it does not pass the tests (see diagram below). When it reverts to full HKFRS in its company and consolidated financial statements to 31 December 2021, it will need to apply HKFRS 1, *First-time adoption of HKFRSs*, in the year of transition.

W Ltd cannot take advantage of the exemption available to private companies brought forward from s141D of the previous legislation, as W Ltd has subsidiaries and this exemption is only possible for companies with no subsidiaries.

Example 6B – Acquisition of a subsidiary

In March 2019, W Ltd acquires a significant new subsidiary. For the year to 31 December 2019:

- W Ltd passes the larger “eligible” tests at the company level; but
- the group headed by W Ltd now exceeds the larger “eligible” group limits due to the acquisition of the new subsidiary.

Analysis

As the W Group has failed to pass the larger “eligible” tests in 2019 because it acquired a new subsidiary, it would cease to qualify for simplified reporting in 2019. W Ltd will therefore have to follow full HKFRS in its consolidated financial statements for the year to 31 December 2019 (see the diagram below).

Larger “eligible” private:

- **company:** 2 out of 3 Schedule 3 size tests; and
- **group:** 2 out of 3 Schedule 3 size tests for **each** company in the group individually **and** 2 out of 3 for the group in aggregate

	Years ending				
	Dec 2017	Dec 2018	Dec 2019	Dec 2020	Dec 2021
Does the group headed by W Ltd pass the larger “eligible” tests in new CO Schedule 3?	Yes	Yes	No	No	No
Does the group headed by W Ltd qualify for simplified reporting?	Yes	Yes	?	?	?

Example 6A:
If the group headed by W Ltd fails to pass the size tests from 2019 onwards due to organic growth, the group will lose its SME status and have to use full HKFRS in 2021

Example 6B: If the group headed by W Ltd does not pass the size tests in 2019 because **a new company joins the group in 2019** then the group will lose its SME status in 2019 and will have to use full HKFRS

Practical issues to consider – if a group may lose larger “eligible” status in the next few years by getting even larger

If at any time a company (or group), which adopts simplified reporting, thinks that it may not pass the larger “eligible” tests in future, it will need to start planning for the move to full HKFRS. This is particularly important in a group situation, if the group expects to acquire new subsidiaries and thinks that this will cause it not to pass the group tests. This is because if the test is failed because of a new subsidiary, the group will not be able to follow simplified reporting in that year of acquisition and will instead have to look to HKFRS 1, *First time adoption of HKFRSs*, for the requirements on how to transition to full HKFRS.

Appendix 3: Mandatory disclosures in the new CO

In the main body of this briefing note we introduced the exemptions that are on offer for entities that qualify for the simplified regime, to assist companies in deciding whether to take this option. In this appendix we have listed for reference the disclosure requirements in the CO that all Hong Kong incorporated companies need to comply with, regardless of whether they opt for the simplified regime.

Mandatory disclosure requirements in new CO

Comparison to old CO

S. 388-391 &
543(2)

Contents of the directors' report

Companies
(Directors'
Report)
Regulation
("C(DR)R")

Most of the requirements for the directors' report have been brought forward from s129D(3) of the old CO. However, the requirements of the old s129D(3) have been split up into various new locations in the new legislation. This new approach introduces flexibility for the Administration, as the legislative procedures involved in amending "regulations" (a form of "subsidiary legislation") and "schedules" are less onerous than those required to amend "sections" of the main body of an ordinance.

The main exception to the above is the business review, which is new compared to the old CO. However, companies which are eligible for simplified reporting are exempt (as highlighted on page 5 of this briefing note).

The specific details of what information is now required to be disclosed in the directors' report can be found in our briefing note 2.

Since companies eligible for the reporting exemption are exempt from preparing the new business review, few changes were expected to directors' reports of private companies eligible for the reporting exemption on transition to the new CO.

S. 383

Transactions involving directors

The financial statements must contain the information prescribed by the Regulation about the following matters:

- (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) []*
- (f) consideration provided to or receivable by a third party for making available the services of a director

The relevant Regulation is the Companies (Disclosure of Information about Benefits of Directors) Regulation (C(DIBD)R) made under sections 451 and 452(2) for the purposes of section 383. Further details can be found in our briefing note 1.

* As highlighted on page 12 of this briefing note, C(DIBD)R.23(a) exempts a company which falls within the reporting exemption from compliance with the part of the Regulation that relates to item (e). Item (e) relates to material interests of directors in transactions, arrangements or contracts entered into by the company or another company in the same group.

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 briefing note 1, 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.

Item (d) relates to disclosures 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 were 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.

Other disclosures in the financial statements

Sch 4 Part 1.1	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)	<i>This disclosure requirement is brought forward from the old 10th Schedule (para 9(c)) with reference to section 47C of the old CO.</i>
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>	<i>This is a new requirement. It replaces the requirement in s123(1) of the old CO to include a company-level statement of financial position as a primary statement, which, together with notes, showed a true and fair view of the state of affairs of the company.</i>
Sch 4 Part 1.3	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)	<i>This disclosure requirement is brought forward from s129A(1) of the old CO</i>
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 this purpose are the SME-FRF and SME-FRS for those companies which are entitled to and do take advantage of the reporting exemption)</i></p>	<i>This is a new requirement for the CO, but is consistent with existing practice due to similar requirements in paragraph 16 of HKAS 1, Presentation of financial statements, and paragraph 1.3 of the SME-FRS</i>
S. 387	<p>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 of financial position).</p> <p>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.</p> <p><i>Note: In consolidated financial statements the requirement to approve and sign the statement of financial position applies to both the consolidated financial statement and the company-level statement of financial position included in the notes under Schedule 4.</i></p>	<p><i>This requirement is brought forward from s129B of the old CO.</i></p> <p><i>This is a new requirement. Under the old CO this is general practice but not specifically required.</i></p>