Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email < co_rewrite@fstb.gov.hk > and by post

31 December 2012

Our Ref.: C/CB, M86522

Financial Services and the Treasury Bureau
15th Floor, Queensway Government Offices
66 Queensway
Hong Kong

Dear Sirs,

Public Consultation on Subsidiary Legislation for Implementation of the new Companies Ordinance (Phase 2)

The Hong Kong Institute of Certified Public Accountants has considered the above consultation paper and our comments on the draft subsidiary legislation are set out in the appendix to this letter.

If you have any questions on this submission or wish to discuss it further, please contact Mary Lam, the Institute's Deputy Director, Specialist Practices at tel. 2287 7086 or by email at < mary@hkicpa.org.hk >.

Yours faithfully,

Peter Tisman
Director, Specialist Practices

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Appendix

Annex 8 Companies (Trading Disclosures) Regulation

Section 3 Display of registered name at registered office, etc.

Section 3(1) of the Regulation requires that a company must display continuously its registered name in legible characters prominently on the outside of its registered office, while section 3(2) provides for displaying of the registered name of a company by electronic means and specifies in sections 3(2)(a) and 3(2)(b) how to satisfy the requirement to "display continuously", for the purpose of section 3(1).

We welcome the modernisation of the requirement to accommodate the display of registered names of companies by electronic means. However, it would be impracticable for the names to be displayed continuously, on a 24-hour, 7-day basis, through an electronic device. It would not be meaningful or environmentally friendly to keep an electronic device on for displaying the names during Sundays, public holidays, after normal office hours (the period from late evening to early morning of the following day), given also that, during such periods, access into commercial/office buildings is often restricted. In order to facilitate the use of electronic means to display registered names, we recommend that the Regulation should be revised to clarify how the requirement to "display continuously" by using electronic devices can be satisfied, taking into consideration the practicalities.

Section 3(2) requires the registered name to be displayed for at least 20 continuous seconds once in every four minutes or to be displayed within four minutes after a request to display is made. In addition to such detailed specification, we recommend that there should also be provisions in the Regulation to cater for any breakdown or malfunction of electronic devices; otherwise, in such situations, which may occur from time to time, the company and its responsible person could inadvertently commit an offence under section 7(1) of the Regulation.

In addition, there will be practical difficulties to make available an electronic device "outside" of an office or place of business. Building owners or occupiers are generally not allowed to place objects in common areas of a building under the deed of mutual covenant of the building. They may also violate fire safety rules and regulations by placing objects in common areas. A more suitable place to install an electronic device for displaying company names would be the reception area of the office. This may result in the device not being able to be made available for public access after the office is closed. It is therefore suggested that the application of the requirement for displaying a name "on the outside of" an office or place of business, under section 3(1) of the Regulation, be revised to cater for the potential practical difficulties relating to electronic displays.

Annex 9 Companies (Revision of Financial Statements and Reports) Regulation

Section 2 Interpretation

We consider that "audit report", which is defined to mean a report on revised financial statements in this Regulation, could easily be confused with "auditor's report", which has the meaning given to it by section 357(1) of the new Companies Ordinance ("CO"). These two similar terms with different meanings could easily be confused, especially in part 5 of the Regulation, where section 15 refers to both an audit report and an auditor's report. Also, the public would generally understand the term "audit report" to mean the same as "auditor's report". Therefore to improve clarify and avoid misunderstandings, we recommend that "audit report" be replaced by "auditor's report on revised financial statements".

Section 16 Offences relating to contents of an audit report

The empowering section of this Regulation is section 450 of the new CO, which provides for various matters relating to the revised financial statements, summary financial report or directors' report to be prescribed by subsidiary legislation/regulations. Section 450(3) stipulates that the regulations (i.e., subsidiary legislation) may provide for offences for failure to take all reasonable steps to secure compliance with, or for contravention of, requirements relating to financial statements, summary financial report or directors' report that have been revised; a specified provision of the regulations; or a specified provision of the new CO as having effect under the regulations. It appears, therefore, that section 450(3) does not explicitly empower the regulations to introduce an offence relating to contents of the auditor's report on revised financial statements, akin to section 408 of the new CO in relation to the auditor's report.

It is noted that there were protracted discussions and considerable differences of opinion among the stakeholders, the government and the legislators on clause 399 (section 408 of the new CO), which introduces a criminal sanction on auditors, during the passage of the Companies Bill through the Legislative Council ("LegCo"). Committee Stage Amendments were proposed to this clause, including amendments advocated by the accountancy profession to alleviate the profession's concerns and an amendment put forward by the Administration to deal with perceived drafting and implementation issues. However, ultimately, none of the Committee Stage Amendments to clause 399 was passed by LegCo and the clause was retained in its original form when the Companies Bill was passed.

The Administration acknowledges that there is "room for future improvement to the drafting of section 408 to address industry concerns and bridge potential implementation gaps" and have indicated that they will approach the Hong Kong Institute of CPAs about a review of section 408 to improve the wording, in the light of comments received from LegCo and stakeholders (paragraph 9.9 of the consultation document).

In view of the controversy surrounding this section, we have serious concerns about the proposal to introduce an equivalent criminal sanction in respect of omissions from the contents of the auditor's report on revised financial statements through subsidiary legislation. If the original offence was considered to be, and indeed was, of sufficient importance to be incorporated in primary legislation and to have to undergo the full process of scrutiny accorded to primary legislation, it would be inconsistent and objectionable to

introduce an offence of equal weight and importance through a process that ordinarily involves a lesser degree of scrutiny and opportunity for interested parties to fully air their concerns. Introducing through subsidiary legislation an offence equivalent to section 408 for omissions from auditor's report on revised financial statements would also make this provision more susceptible to future amendment, which could, for example, mean increasing the sanctions for breach of the provision. We note that some parties already proposed heavier penalities at the time clause 399 was under consideration. Given the nature of this provision, simplifying the process of amendment in this way would be inequitable.

We are also very concerned that a proposal to reproduce in very similar terms, in this regulation, a section from the new CO, which is known to have deficiencies, and which needs to be amended, is extremely difficult to justify and would set a very dubious precedent.

We consider, therefore, that the proposed Annex 9 section 16 offence should be withdrawn. If the Adminstration considers it necessary to introduce an offence in relation to the auditor's report on revised financial statements equivalent to the section 408 offence, this should be put forward as amendments to the primary legislation at an appropriate time, which would afford all stakeholders a full opportunity to have their views heard and to suggest any changes that they consider necessary or desirable.

Annex 10 Companies (Disclosure of Information about Benefits of Directors) Regulation

Section 2 Interpretation of Part 2
Section 4 Information about directors' retirement benefits

Definition of "retirement benefits"

The new wording of section 2 and section 4 of the Regulation (as compared with section 161 of the existing CO) will cause unnecessary confusion as to which amounts should be disclosed as retirement benefits payable to directors or past directors. We recommend that the wording of sections 2 and 4 be revisited to ensure that the requirements of this Regulation are clearly stated and result in an appropriate level of disclosure. Details of our concerns are as follows:

(i) Part (a)(iii) of the definition of retirement benefits effectively states that the term "includes any lump sum, gratuity, periodical payment or other like benefit, any other property, or any other benefit whether in cash or otherwise … given or to be given on, or in anticipation of, or in connection with any change in the nature of the person's service". Similarly, part (a)(iii) of the definition of retirement insurance scheme effectively states that it "means a scheme for the provision of medical, accident or life assurance coverage … on or in connection with any change in the nature of a person's service". The phrase "any change in the nature of a person's service" appears much broader than the generally accepted concept of "retirement". For example, it would seem to include an expansion in the active role of a director to include additional board committee responsibilities, such as being asked to act as chair person.

(ii) On the other hand, the requirements set out in section 4 of the Regulation concerning the information to be disclosed appear unduly narrow. That is, it appears from section 4(1)(a) that the amount discloseable is "the excess of the retirement benefits paid over the retirement benefits entitled", where the "retirement benefits paid" is defined in section 4(2)(a) as a reference to retirement benefits paid "under any retirement benefits scheme". This would appear to mean that only any amounts paid out of a scheme that exceed entitlements would be discloseable, which is a much narrower concept than the definition of "retirement benefits" set out in section 2.

Part 4 Disclosure of Directors' Material Interests in Transactions, Arrangements or Contracts (sections 16 and 17)

Part 4 of the Regulation stipulates the detailed provisions pertaining to the requirements of section 383(1)(e), which are that the notes to the financial statements should contain information relating to "material interests of directors in transactions, arrangements or contracts entered into by the company or another company in the same group of companies". It is noted that part 4 of the Regulation reproduces the disclosure requirement in section 129D(3)(j) of the existing CO, which in effect brings the disclosures of directors' interests in contracts into the financial statements and, therefore, into the audit scope, rather than being in the directors' report. As a result, part 4 of the Regulation requires the notes to the financial statements to include information relating to transactions between parties, other than those companies upon which the auditor has been appointed to report.

As stated in section 17 of the Regulation, the information required to be disclosed relates to transactions, arrangements or contracts entered into between a director of the company (or his/her connected entities) and any one of the following parties:

(a) the company;
(b) a holding company of the company;
(c) a subsidiary undertaking of the company; or
(d) a subsidiary undertaking of the holding company.

Transactions covered under category (a) and, in the case of consolidated financial statements, category (c), will be within the scope of the auditor's procedures, on the basis that the transactions, arrangements or contracts will be recorded in the relevant company's books and records that are subject to audit.

However, the transactions covered by categories (b) and (d) are between two parties neither of which are within the scope of the auditor or the company's audit procedures.

In view of the above, we consider that it would be better were disclosure of directors' material interests in transactions, arrangements or contracts to stay in the directors' report. However, since section 383(1)(e) of the new CO has already stipulated that such information is to be contained in the notes to financial statements, we propose that the subsidiary legislation narrow down the scope of this section by limiting the interpretation of the phrase "the company or another company in the same group of companies" in section 383(1)(e) to categories (a) and (c) above.

It would also be helpful if sections 17(4) and 17(5) could clarify that the "significance" of any such transaction is to be judged with reference to the company for which these financial statements are being prepared (i.e., the reporting entity). The current drafting is unclear as to whether "a company" and "the company" in sections 17(4) and 17(5) refer to the reporting entity or to whichever of the companies identified in sections 17(1)(a) to (d) is a party to the transaction in question. In other words, it is not clear whether the significance of a transaction between, for example, a director and the company's holding company (under section 17(1)(b)), should be judged with respect to the significance of that transaction to the company itself or to the holding company.

If the disclosures are considered insufficient to address the matters currently covered by section 129D(3)(j), then we recommend that the Companies (Directors' Report) Regulation, as referred to in sections 388(1)(b) and 388(2)(b) of the new CO, should be expanded to include those additional disclosures.

Annex 11 Companies (Residential Addresses and Identification Numbers) Regulation

No specific comments.

Annex 12 Companies (Unfair Prejudice Proceedings) Rules

Rule 7 Drawing up of order

Rule 7(1) requires a draft of the order to be drawn up "before the expiry of the day following the day on which an order under section 725 of the Ordinance is pronounced in the Court".

We would like to seek clarification of the following technical and administrative matters:

(a) What if the day following the day on which an order is pronounced is a holiday? Would the day that a draft of the order has to be drawn up be deferred to the first business day following the day on which an order is pronounced?

(b) Would the phrase "leave with the Registrar" a draft of the order and all other documents under rule 7(1) mean physical delivery of the documents to the office of the Companies Registry? Would it be acceptable for the documents be delivered via electronic means and, if so, would the documents be required to be saved in any specific format?

(c) Since it is required to leave with the Registrar a draft of the order and all other documents before the expiry of the relevant day, it would seem that, from a practical point of view, "before the expiry of the day" could not be at 23:59 on that day and that the relevant documents should be delivered to / received by the Registrar by a certain time specified by the Registrar.

We suggest that the above technical issues need to be clarified in the Rules.

Rule 8 Service of order, etc.

It appears that "order" in rule 8(1) would mean the order referred to in rule 7(1), i.e., an order under section 725 of the new CO, but it is not sufficiently clear. Please also clarify whether an "office copy" of the order is meant to be a sealed copy of the order and, if not, to what does it refer?

General comment

We understand that at present, practitioners just need to issue a High Court Companies (Winding-up) petition even if the primary relief they seek is one of buy-out under section 168A of the existing CO, so long as winding-up is one of the reliefs. It is not clear whether practitioners will still be able to do the same after the new Rules take effect. It appears that the new Rules anticipate that a High Court Miscellaneous Proceedings petition should be issued, even if one of the reliefs is winding-up. We would suggest that this matter be clarified and further explanation be provided as to how this will work.