



Questions and answers relating to consolidated and company level financial statements prepared under Part 9 of the new CO (Cap. 622)

Topic 1 Application of section 379: which companies should prepare company level financial statements and which companies should prepare consolidated financial statements

Question 1.1: Whether consolidated financial statements are required when a holding company does not have any material subsidiaries

If a reporting entity has subsidiaries but none of its subsidiaries are material is it still necessary to prepare consolidated financial statements?

Answer: It depends. The Companies Registry's FAQ confirms that if all of the company's subsidiaries are collectively immaterial in accordance with section 381(3) then the company is not required to comply with section 379(2) (preparation of consolidated financial statements). In order for this to be the case when the holding company has more than one subsidiary, then the company's subsidiaries must be immaterial when taken together in accordance with section 381(3)(b). It is not sufficient for each subsidiary to be individually judged to be immaterial.

Question 1.2: Application of section 379 to holding companies which are wholly owned subsidiaries of another body corporate

If the reporting entity is a wholly owned subsidiary of another body corporate but chooses to prepare consolidated financial statements will this satisfy section 379 of the CO?

Answer: The requirement to prepare either company-level or consolidated financial statements is set out in section 379 of the CO. The Companies Registry's FAQ clarifies that the intention of sections 379(2) and 379(3) is as follows:

- (a) If a holding company is required to prepare consolidated financial statements then it is not required to prepare company-level financial statements; and
- (b) If a holding company is a wholly owned subsidiary of another body corporate (or a partially-owned subsidiary and its shareholders do not object to the preparation of company-level financial statements) then the company is not required to prepare consolidated financial statements.
- (c) A wholly owned subsidiary of another body corporate may prepare annual consolidated financial statements so long as the annual consolidated financial statements comply with sections 380 and 383 and in every respect with the requirements applicable to annual consolidated financial statements, in which event no company-level financial statements are required to be prepared by it.
- (d) However, if the annual consolidated financial statements do not comply in every respect with the requirements applicable to annual consolidated financial statements, then the wholly owned subsidiary should prepare company-level financial statements for the purposes of compliance with section 379(1) and should regard any additional consolidated financial statements or consolidated financial information which it chooses to prepare in respect of the full financial year as "non statutory accounts"

within the meaning of section 436. Further guidance on “non statutory accounts” can be found in Accounting Bulletin 6 issued by the HKICPA.

Question 1.3: Application of section 379 when the holding company was a wholly owned subsidiary of another body corporate for only part of the financial year

If a holding company is wholly owned at the end of the year but was not wholly owned throughout the whole of the year is it required to prepare consolidated financial statements under the CO?

Answer: The requirement to prepare consolidated financial statements set out in section 379(2) applies to companies which are holding companies as at the end of the year. The Companies Registry’s FAQ confirms that the requirements in section 379(3) similarly apply only with reference to the status of the company **as of the end of the financial year**. In practice this means that:

- (a) If the company is a wholly owned subsidiary of another body corporate at the end of the financial year then it can prepare company level financial statements to satisfy section 379(1) as per section 379(3)(a);
- (b) If the company is not a wholly owned subsidiary of another body corporate at the end of the financial year then it must prepare consolidated financial statements in order to satisfy section 379(2) unless it is a partially owned subsidiary of another body corporate at the year-end date and the requirements of section 379(3)(b) have been satisfied in respect of notifying the shareholders and none of them have objected.

So far as compliance with section 379 is concerned, it is irrelevant whether or not the company was wholly owned or partially owned at any other time in the financial year.

Question 1.4: Consequences of the directors of a partially owned subsidiary of another body corporate missing the “six months before the year-end” deadline

Section 379(3)(b) requires the directors of a partially owned subsidiary of another body corporate to notify members in writing at least 6 months before the end of the financial year if they do not intend to prepare consolidated financial statements and to allow a period for members to object.

What should the directors and members do if the directors miss this deadline but the members still wish to support the directors’ intentions not to prepare consolidated financial statements?

Answer: If the directors miss the “six months before the year-end” deadline, then they must comply with the full requirements for that financial year i.e. they must prepare consolidated financial statements or seek legal advice on the consequences of failing to comply with the relevant statutory requirements. Failure to meet the six months deadline cannot be excused by the members as this is a statutory requirement.

Failing to meet this deadline in one financial year does not preclude the directors from taking steps to meet it in good time for the next financial year. However, it should be

noted that the notification that is required under section 379(3)(b) in order to claim exemption from the preparation of consolidated financial statements can only apply to one financial year. Therefore, every year a fresh notification no later than 6 months before the end of the year is required if the directors are seeking to take advantage of section 379(3)(b).

Question 1.5: Identifying the relevant accounting standards when a holding company prepares company level financial statements in accordance with section 379(3)

As discussed in questions 1.2 to 1.4, section 379(3) of the CO states that section 379(2) (being the requirement to prepare consolidated financial statements and the exemption from preparing company level financial statements) does not apply to a holding company in the following cases:

- “(a) if the company is a wholly owned subsidiary of another body corporate in the financial year; or
- (b) if—
 - (i) the company is a partially owned subsidiary of another body corporate in the financial year;
 - (ii) at least 6 months before the end of the financial year, the directors notify the members in writing of the directors’ intention not to prepare consolidated statements for the financial year, and the notification does not relate to any other financial year; and
 - (iii) as at a date falling 3 months before the end of the financial year, no member has responded to the notification by giving the directors a written request for the preparation of consolidated statements for the financial year.”

Paragraph 4(a) of HKFRS 10 Consolidated Financial Statements also sets out exemption criteria in respect of which entities are exempt from preparing consolidated financial statements. The criteria set out in paragraphs 4(a)(i)-(iii) of HKFRS 10 are typically met by any intermediate holding company which satisfies s379(3) of the CO. However, the criteria set out in paragraph 4(a)(iv) of HKFRS 10, which are that the company’s ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with HKFRSs or IFRSs, may, or may not, be met depending on the situation of the company’s parent entity.

For example, the criteria in HKFRS 10.4(a)(iv) would not be met in the following situations:

- (a) the company is a wholly owned subsidiary of a private Hong Kong incorporated company which is not required to file its financial statements on public record; or
- (b) the company is a wholly owned subsidiary of a US parent which issues US GAAP financial statements but does not issue IFRS financial statements.

In such cases which accounting standards are the “applicable accounting standards” for the purposes of complying with s380(4)(b) of the CO if the company follows the requirements of s379(3)?

Answer: As explained in the answers to questions 1.2 and 1.3 above, section 379 of the CO is explicit on which companies should prepare company level financial statements and which should prepare consolidated financial statements and these requirements take precedence over s380. That is, s379 determines which type of financial statements need to be prepared (company level or consolidated), and s380 then contains the “general requirements for financial statements” being the requirements for the contents of those financial statements (company level or consolidated) as are required to be prepared under s379.

On this basis, the “accounting standards applicable to the financial statements” referred to in s380(4)(b) are those relevant to the type of financial statements (company level or consolidated) required by s379. This is supported by the definition of “accounting standards applicable to the financial statements” set out in s380(8)(b):

“a reference to accounting standards applicable to any financial statements is a reference to accounting standards as are, in accordance with their terms, relevant to the company’s circumstances and to the financial statements”.

In the case of a holding company preparing company level financial statements to satisfy section 379(1), the statement of compliance included in the financial statements in accordance with section 4 of Schedule 4 to the CO and paragraph 16 of HKAS 1 *Presentation of Financial Statements* should clearly state that the financial statements comply with the accounting standards applicable to the company level financial statements only. For the avoidance of doubt, it is also advisable for the statement of compliance to explain why the company is not required to prepare consolidated financial statements.

For example, the financial statements could include the following wording as the statement of compliance in the basis of preparation note (e.g. which is typically disclosed as note 1 to the financial statements):

Statement of compliance and basis of preparation

For the purposes of compliance with sections 379 and 380 of the Hong Kong Companies Ordinance (Cap. 622), these financial statements have been prepared to present a true and fair view of the financial position and financial performance of the company only. Consequently, they have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (HKFRSs, which term collectively includes Hong Kong Accounting Standards (HKASs) and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance (Cap. 622) that are relevant to the preparation of company level financial statements by an intermediate parent company.

[As the company is a wholly owned subsidiary of another body corporate, it satisfies the exemption criteria set out in section 379(3)(a) of the Hong Kong Companies Ordinance (Cap. 622), and is therefore not required to prepare consolidated financial statements.] **OR** [As the company is a partially owned subsidiary of another body corporate and has satisfied the exemption criteria set out in section 379(3)(b) of the Hong Kong Companies Ordinance (Cap. 622), it is not required to prepare consolidated financial statements].

Given the above, these financial statements are not prepared for the purposes of compliance with HKFRS 10, *Consolidated financial statements*, so far as the preparation of consolidated financial statements is concerned. As a consequence, the financial statements do not give all the information required by HKFRS 10 about the economic activities of the group of which the company is the parent.

The measurement basis used in the preparation of the financial statements is ... [continue with the normal basis of preparation note]

Note that the illustrative wording directly above is only applicable if (a) the company falls within s379(3) of the CO; and (b) the company has complied with those HKFRSs which are applicable to the preparation of company level financial statements.

It should be noted that if the company fails to prepare consolidated financial statements when required to do so under s379 and/or the financial statements that it prepares fail to comply with sections 380, 381(if applicable) or 383, then each director may be held to have committed an offence. Specifically:

- s379(4) states that a director has committed an offence and is liable to a fine of \$300,000 if the director fails to take all reasonable steps to secure compliance with these sections; and
- s379(5) states a director has committed an offence and is liable to a fine of \$300,000 and imprisonment for 12 months if the director wilfully fails to take all reasonable steps to secure compliance with these sections.

It should also be noted that the above approach to the statement of compliance is applicable only in the circumstances when the requirements of section 379 of the CO to prepare company level financial statements take precedence over the requirements of HKFRS 10.4(a). It is not expected that analogies to this guidance may be drawn to justify other departures from the requirements of HKFRS, given the requirements of section 380(4)(b) of the CO and paragraphs 15 to 24 of HKAS 1.

Implications for the auditor's report

Section 406(1) requires the auditor to state the auditor's opinion on the following matters:

- (a) whether the financial statements have been properly prepared in compliance with the CO; and
- (b) in particular, whether the financial statements –
 - (i) in the case of annual financial statements of a company that does not fall within the reporting exemption for the financial year, give a true and fair view of the financial position and financial performance of the company as required by section 380; or
 - (ii) in the case of annual consolidated financial statements of a company that does not fall within the reporting exemption for the financial year, give a true and fair view of the financial position and financial performance of the company and all the subsidiary undertakings as required by section 380.

Therefore, although there may appear to be a difference in the criteria between HKFRS 10.4(a) and s379(3) as to which entities should prepare consolidated financial statements, it follows from s406(1) that it is not necessary for the auditor to qualify the auditor's report on the financial statements of a Hong Kong incorporated company for non compliance with HKFRS 10 in this specific situation if all of the following conditions are met:

- (a) the company falls within s379(3) of the CO and is therefore not required by the CO to prepare consolidated financial statements;



- (b) the company has followed the requirements of s379(3) and has therefore prepared company level financial statements; and
- (c) those company level financial statements comply with those HKFRSs which are applicable to the preparation of company level financial statements, as well as all other requirements of the CO relating to the contents of company level financial statements as set out in sections 380 and 383.

Consistent with this approach, an example unqualified auditor's report under s405 of the CO would be as follows:

Independent auditor's report to the members of [name of company]

(incorporated in Hong Kong with limited liability)

We have audited the financial statements of [name of company] ("the company") set out on pages to, which comprise the company's statement of financial position as at [*reporting date*], the company's statement of profit or loss and other comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The directors of the company are responsible for the preparation of financial statements that give a true and fair view in accordance with applicable Hong Kong Financial Reporting Standards issued by the HKICPA that are relevant to these financial statements and the Hong Kong Companies Ordinance and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 405 of the Hong Kong Companies Ordinance (Cap. 622), and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the company as at [*reporting date*] and of its financial performance and cash flows for the year then ended in accordance with the applicable Hong Kong Financial Reporting Standards relevant to these financial statements and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

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Please refer to our [cover page](#) for background information on the Q&As