CONCISE GUIDE:
COMPLIANCE AND COMPANY SECRETARIAL PRACTICE OF HONG KONG PRIVATE COMPANIES

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CONCISE GUIDE:

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Concise Guide: Compliance and Company Secretarial Practice of Hong Kong Private Companies is a **user-friendly and concise reference guide** for all company secretaries, practitioners, and business professionals in regards to the changes and up-date practice of running a privately-owned company here in Hong Kong brought about by the principle laws and rules dictated by the **(current) Companies Ordinance (Cap.622)**.

This publication does its best to illustrate company secretarial practice and compliance in an **easy-to-digest format** – analysis of charts, checklist tables, and Q&A sessions demonstrating common case scenarios.

This publication offers a clear illustration of everyday scenarios regarding company secretary practice at private companies, including:

(i) summaries of the applicable procedures in charts /diagrams;
(ii) essential points formation;
(iii) checklist tables to indicate the relevant company secretarial procedures and practice; and
(iv) Q & A sessions at the end of each chapter to demonstrate the most common case scenarios that Hong Kong private companies may come across.

Authored for both professionals and students - each can find answers regarding company secretarial procedures of private companies under the current Companies Ordinance easily and as there is no need to digest a whole passage of each chapter to locate the answers.

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A. Directors

I. Board of directors

- A company is an artificial person, therefore a human beings, an agent, is required to run and manage the company
- Previously, company should have at least 2 directors
- But nowadays, a private company can have 1 director since 13 February 2004 under the Companies (Amendment) Ordinance 2003 passed by the Legislative Council of Hong Kong Special Administrative Region on 2 July 2003
- A company (companies within a listed group, public company and company limited by guarantee) must have at least 2 directors who should not be a body corporate (ss.453(2) and 456(2) of the Companies Ordinance (Cap.622))
- Private companies must have at least one director (s.454(1) of the Companies Ordinance (Cap.622))
- Private company not within a listed group can have any number of director but it must have at least one natural person as director (s.457(2) of the Companies Ordinance (Cap.622))
- Role and functions of Director:
  - is an agent of the company, the company is the principal
  - is acting as a trustee of the company's money and property
  - acts within the scope of authority (as expressed in articles of association, his service contract with the company, Companies Ordinance (Cap.622), Securities and Futures Ordinance (Cap.571), the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (HKEx) (the Listing Rules) (for listed company) etc. or implied by common law), otherwise, may be *ultra vires*
  - Seldom act singly, should act jointly by board of directors (not applicable to the company which has only sole director) but severally and jointly liable for the act done by the board of directors
  - Any person occupying the position and task of director by whatever name called e.g. Chief Executive Officer, Manager, President
  - Exercise Top-level management functions
  - collectively responsible and accountable to the company's members and stakeholders for the long-term success of the company
  - Its powers may not be delegated unless articles of association of association authorized

II. Types of directors

- Executive or non-executive director:
  - Executive Director
    - Normally works on full-time basis
    - Enter into service contract with the company and is an employee of the company (however, term should not be more than 3 years for listed companies/companies incorporated in Hong Kong, otherwise need shareholders' approval) (s.534 of the Companies Ordinance (Cap.622); LR13.68 of the Listing Rules)

    - Hold some executive and managerial position
    - Responsible for the day-to-day operation of the company
    - Usually in public and listed companies
  - Non-Executive Director
    - Not full-time basis
    - Usually not an employee
    - Not involved in the daily management of the company
    - Should attend board meeting and committee meeting regularly especially for listed companies/public companies
    - Require specific term for appointment of listed companies (i.e. not more than 3 years)
    - Receive a small amount of fees, i.e. director's fees (董事袍金) which should be recommended by remuneration committee of the company and subject to the approval of shareholders of the company at annual general meeting
    - Provide advice in area of expertise, determine overall policies and contribute to decision-making of the board
    - Usually stand for the interest of non-controlling interest shareholders/ minority shareholders, employees and other stakeholders
    - Usually in listed companies/public companies
    - A.6.2 of Corporate Governance Code of Appendix 14 of the Listing Rules states his/her duties
  - Independent Non-Executive Director
    - Listed companies must have at least 3 independent non-executive directors (INEDs) (LR 3.10 of the Listing Rules) and at least one of INEDs must have appropriate professional qualifications or accounting or related financial management expertise and at least one-third of the board should be INEDs (LR 3.10A of the Listing Rules)
    - Purpose is to invite independent views as to balance the composition of the board
    - In assessing their independency (details referring to LR 3.13 of the Listing Rules)
      - hold less than 1% shares
      - no financial interest or interest in business with the company
      - not protect the interests of an entity other than the shareholders' interest as a whole
      - not receive any interest in any securities of the company as a gift, or by means of other financial assistance, from a connected person or the company
      - not provide any service directly to the company or an employee of the service provider to the company within 1 year before his/ her employment
      - not current or past executive of the company
      - not connected with a director, chief executive or substantial shareholder of the company within 2 years
      - not financially dependent on the company or any member of the group or core connected persons of the listed company

- Members of remuneration and nomination committees of the listed company should comprise a majority of INEDs (LR 3.25 of the Listing Rules and A.5.1 of Code Provision of Appendix 14 of the Listing Rules)
- Audit committee of the listed company must comprise a minimum of three members, all of whom are non-executive directors only (LR3.21 of the Listing Rules)

- de facto director
  - although not formerly appointed if he/she undertakes tasks that are expected of a director

- shadow director (幕後董事)
  - in relation to a body corporate, means a person in accordance with whose directions or instructions (excluding advice given in a professional capacity like lawyers, qualified accountants) the directors, or a majority of the directors, of the body corporate are accustomed to act (s.2 of Companies Ordinance)
  - *Vivendi SA and Centenary Holdings Ltd v Murray Richards and Stephen Bloch* [2013] EWHC 3006: The High Court ruled a shadow director normally owes fiduciary duties to a company where he provides instructions on which the directors are accustomed to act

- alternate director
  - official appointment of a person to act on behalf of that director when that director is unable to act at any time
  - the procedure of appointment of alternate director is as same as a director (Form ND2A - Notification of Change of Secretary and Director (Appointment/Cessation)) (Appendix 3A)
  - a director can delegate his authority to an alternate director if:
    - this is authorised by the articles of association; or
    - the authority to do so is included in the terms of appointment
    - is subject to all common law and statutory duties owed by a director (s.478(2) of the Companies Ordinance (Cap.622))
    - the appointing director is vicariously liable for torts (侵權行為) committed by his alternate (s.478(1)(b) of the Companies Ordinance (Cap.622))
      - E.g. defamation of the other director by the alternate director at the board meeting; misstatement at the meeting caused the others in loss of profit, etc., the appointing director is liable for the act done by this alternate director

- nominee director
  - major investors/principals to appoint/remove certain directors to represent his/her interests on the board of directors
  - Professional firm assigns its persons to act as nominee directors of their clients

- Reserve director (s.455 of the Companies Ordinance (Cap.622))
  - For a private company which has only one member who is also the sole director, a reserve director (at least 18 years old) can be nominated in a general meeting and act in the place of the sole director in the event of his death (Form ND5 - Notice of Change of Reserve Director (Nomination/Cessation) (ss.645(2), 645(3), and 645(4) of the Companies Ordinance (Cap.622)) (Appendix 3B); Form ND7- Notice of Change in Particulars of Reserve Director (s.645(4) of the Companies Ordinance (Cap.622)) (Appendix 3C); Form ND8 – Notice of Resignation of Reserve Director) (ss.464(3), and 464(6) of the Companies Ordinance (Cap.622)) (Appendix 3D))
  - In Hong Kong, due to traditional view, a sole director who is also the sole member seldom appoints a reserve director so as to avoid taboo

- Corporate director
  - A director is a corporation rather than an individual, usually is nominee director provided by the professional firms, like Certified Public Accountants, legal/solicitors firms
  - A body corporate cannot be a director of a listed company or of its subsidiaries (for the purpose to maintain the benefit of public shareholders/public interest since body corporate has its features of limited liability)

III. Powers of the directors

- The board of directors has the powers to direct the management of the company and delegate powers to committees or individual directors to carry out the companies' activities and daily operation
- Director's powers are collective and not individual
- Powers conferred on directors by articles of association of the company or Schedule 1 (for public company) and Schedule 2 (for private company) under Cap.622H which is the Companies (Model Articles) Notice
- Directors may exercise all such powers as they are not, by Companies Ordinance or by articles of association, required to be exercised by shareholders
- Only altering the articles by shareholders can control the exercise of the powers vested in the directors
- Limitation of director's powers in the articles
  - Transaction or act binds company despite limitation in articles under s.117 of the CO: "…the power of the company's directors to bind the company, or authorize others to do so, is to be regarded as free of any limitation under any relevant document of the company."
  - No constructive notice of matters merely because it is disclosed in: (a) the articles of a company kept by the Registrar; or (b) a return or resolution kept by the Registrar (CO s.120)

IV. *Ultra Vires* act done by directors

- Under common law, *ultra vires* means Latin for "beyond powers," and in the law of corporations, referring to acts of a corporation and/or its officers outside the powers and/or authority allowed a corporation by law *(Law.com at http://dictionary.law.com/Default.aspx?selected=2181)*
- Director exercises the authorities delegated to him/her through the company's articles of association/service contract and/or board of directors
  - Not to act beyond without authority
  - An act in excess of the authority granted constitutes a breach of duty

- Such an act is invalid unless and until ratified by members/shareholders of the company
  - Note: Under common law, shareholders/members can ratify breaches by directors of their fiduciary duties. Ratification means that the company is prohibited from instituting actions against the concerned director for damages in respect of the ratified breach (however a dissenting minority shareholder may still be able to pursue an unfair prejudice or statutory derivative claim under common law). Potential conflicts of interests may occur if a majority shareholder is also a director, or is connected to a director. However, such ratification may detriment the interest of minority shareholders. In Hong Kong, most companies are family based. The shareholders are also the directors of the company. As such, ratification can often occur.
- Otherwise, the director is personal liable for any loss incurred from such an act

V. Ratification of directors' conduct under the Companies Ordinance (Cap.622)

- The Companies Ordinance (Cap.622) s.473 imposes new rules on ratification of conduct of directors involving negligence, default, breach of duty or breach of trust ("Relevant Acts") by resolutions of members
- A member who is a director in respect of the Relevant Acts, an entity connected with that director, or holds shares in the company in trust for a director or entity shall not vote, but can attend the meeting, can be counted towards the quorum of that meeting and can take part in the proceedings

VI. Prohibiting directors being protected from liability against company

- The Companies Ordinance (Cap.622) s.468(2) provides that if a provision in a company's articles of association or contract between the company and its director purports to exempt that director from liability in relation to the company resulting from negligence, default, breach of duty of trust, the provision is void
- The Companies Ordinance (Cap.622) s.468(3) extends the prohibition to include indemnity provided by an associated company of the company

VII. Indemnification of directors against liabilities to third parties

- The Companies Ordinance (Cap.622) s.469(2) allows the indemnity provided to a director against liability to a third party if the indemnity is not provided against:
  (a) any liability of the director to pay a fine in criminal proceedings or a penalty for non-compliance with a regulatory requirement; or
  (b) any liability incurred by the director in defending criminal proceedings or civil proceedings brought by the company, its associated company, members of them in which the director is convicted or loses the civil case
- The Companies Ordinance (Cap.622) ss.470 to 472 require permitted indemnity provided to directors to be disclosed in report of directors and copies of the indemnity to be kept at the company's registered office, and shall be made available for member's inspection on request without charge

VIII. Qualification and Disqualification of directors

- Qualifications of director
  - A body corporate cannot act as director of a company unless it is a private company that is not a member of a listed group of companies
  - w.e.f. 3 March 2014, company must have at least one director who is a natural person (s.457(2) of the Companies Ordinance (Cap.622))
  - Individual aged 18 or above (s.459 of the Companies Ordinance (Cap.622))
  - Must not be bankrupted (s.480 of the Companies Ordinance (Cap.622))
- Disqualifications of director
  - under Part IVA of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32) ("CWUMPO")
    - Section 168E of CWUMPO – committed an indictable offence involving fraud or dishonesty relating to the promotion, formation, management, liquidation or management of company's property
    - Section 168F of CWUMPO – persistently in default relating to filing of any return, account or other documents with Companies Registry
    - Section 168G of CWUMPO – guilty of an offence under s.275 of CWUMPO (responsibility of directors for fraudulent trading) in the course of winding up (intent to defraud creditors)
    - Section 168L of CWUMPO – the court may make a disqualification order against the director, who is liable for all or any of the debts or other liabilities of a company, where the court makes a declaration under s.275 of CWUMPO
    - Section 168H of CWUMPO – the court will make a disqualification order against a person that: (a) he/she being a director of a company which has become insolvent; or (b) his/her conduct as a director makes him/her unfit to be concerned in the management of a company
    - Section 168I of CWUMPO – in the public interest that a disqualification order under s.168H of CWUMPO should be made either by the Financial Secretary or the Official Receiver
    - Section 168J of CWUMPO – the Financial Secretary may apply to the court for a disqualification order that it is in the public interest such an order be made against the director or shadow director of any company under s.879(6) of the CO
  - under the Model Articles of Cap.622H
    - Article 27 (Schedule 1)/Article 25 (Schedule 2), office of director shall be vacated if:
      - becomes bankrupt or makes any arrangement with creditors
      - ceases to be a director under the Companies Ordinance (Cap.622), disqualification order made under Part IVA of the CWUMPO, or is prohibited from being a director under the law
      - unsound mind
      - Resigns office by notice under s.464(5) of the the Companies Ordinance (Cap.622)
      - Absent more than 6 months without directors' permission from directors' meetings being held
      - removed by ordinary resolution

IX. Appointment of directors

- Founder member(s) to the memorandum of association often appoint the first directors (s.68(1)(c) of the Companies Ordinance (Cap.622))
  - Within 15 days after date of incorporation, Form NNC1 (Incorporation Form filed with Companies Registry for appointment of first Secretary and Directors and consent to act as a Director)(Appendix 3E)
- Subsequent appointment subject to articles of association
  - Article 22 of Model Articles (Schedule 2) provides for subsequent appointment of directors
    - Appointed by ordinary resolution; or by a decision of the directors
    - Fill a casual vacancy, or appoint an additional director provided that the total number of directors must not exceed the maximum number of directors fixed in the articles of association
    - Newly appointed director must retire from office at the next annual general meeting
    - Subsequent change of Directors/their particulars, Form ND2A (Notification of Change of Company Secretary and Director) should be submitted to Companies Registry within 15 days

- Appointment of directors by separate resolutions
  - Section 460 of the Companies Ordinance (Cap.622) provides that each appointment must be made by a single resolution (for public company and company limited by guarantee)
  - A composite resolution (i.e. a motion to appoint two or more persons as directors by a single resolution) may be made provided that a resolution that it shall be so has first been agreed to by the meeting without any vote being given against it

- Procedures for appointment of director
  - check the articles of association of the company regarding the requirement of appointment of a director
  - disclosure of interests in contracts, transactions and arrangement and any others before the board meeting, if any, by the appointed director
  - convene board meeting to approve the appointment
  - execute consent to act as director by the appointed director
  - prepare a service contract of director, if any
  - prepare the minutes to record the appointment of a director
  - submit a Form ND2A to the Companies Registry within 15 days after the appointment
  - submit a Form ND5 to the Companies Registry in case a reserve director is nominated
  - update the company's register of directors to record the appointment
  - add the new director as one of bank authorized signatories, if required
  - notify the bankers, customers and suppliers regarding the newly appointment

- Register of directors
  - Every company should keep at its registered office a register of directors and secretaries, which should be opened for inspection by any member (no charge) and other person (payment on small amount)

  - Company should notify Companies Registry the place where those registers are kept

- Long-term service contract
  - Section 534 of the Companies Ordinance (Cap.622) requires the approval of the members of a company for any contracts under which the guaranteed term of employment of a director with the company exceeds or may exceed 3 years
  - disinterested members' approval is required

- Company rules governing the re-election of directors in annual general meeting under Model Articles Samples C and B of Cap.622H
  - Company rules governing the re-election of directors in annual general meeting – Articles 23–25 (Schedule 1 Model Articles Sample C of public company limited by shares), Articles 22–23 (Schedule 2 Model Articles Sample B of private company limited by shares)
    - Model Article Sample C
      - Article 23(1)(a) and Article 23(2) (Schedule 1) – A director appointed by ordinary resolution is subject to Article 24
      - Articles 24(1), 24(2), and 24(4) (Schedule 1) – At the first annual general meeting, all directors shall retire from office. At every subsequent annual general meeting, one-third of directors for the time being, or, if their number is not 3 or a multiple of 3, then the number nearest one-third, shall retire from office
      - Article 33(2) (Schedule 1), managing director is not subject to retirement by rotation and not taking into account in determining the rotation of retirement of directors
      - Articles 24(5) and 24(6) (Schedule 1) – The directors to retire in every year shall be those who have been longest in office since their last election, but as between persons who became directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot
      - Article 25 (Schedule 1) – A retiring director shall be eligible for re-election
      - Article 24(12) (Schedule 1) – The company may from time to time by ordinary resolution increase or reduce the number of directors, and may also determine in what rotation the increased or reduced number is to retire from office
      - Articles 23(1)(b), 23(3), and 23(4) (Schedule 1) – The directors shall have power at any time, and from time to time, to appoint any person to be a director, either to fill a casual vacancy or as an additional to the existing directors, but so that the total number of directors shall not at any time exceed the number fixed in accordance with these articles. Any director so appointed shall hold office only until the next following annual general meeting, and shall then be eligible for re-election but shall not be taken into account in determining the directors who are to retire by rotation at such meeting

- Model Article Sample B
  - Articles 22(1)(a) and 22(2) (Schedule 2) – unless otherwise specified, a director appointed by ordinary resolution under Article 22(1)(a) holds office for an unlimited period of time
  - Articles 22(1)(b), 22(3), and 22(4) (Schedule 2) – a director may be appointed by a decision of the directors and under Article 22(1)(b) and may only be made to: (a) fill a casual vacancy; or (b) appoint a director as an addition to the existing directors if the total number of directors does not exceed the number fixed in accordance with these articles. A director appointed must: (a) retire from office at the next annual general meeting following the appointment; or (b) if the company has dispensed with the holding of annual general meetings or is not required to hold annual general meetings, retire from office before the end of 9 months after the end of the company's accounting reference period by reference to which the financial year in which the director was appointed is to be determined
  - Article 23 (Schedule 2) – a retiring director shall be eligible for re-election

X. Resignation of directors

- May resign his/her office any time, unless provided in the articles of association or by service contract (s.464(1) of the Companies Ordinance (Cap.622))
- Company should submit Form ND2A within 15 days of the resignation (s.464(3) of the Companies Ordinance (Cap.622))
- Section 464 of the Companies Ordinance (Cap.622) provides that the resigning director may submit to the Companies Registry a Form ND4 (Appendix 3F) to inform the Companies Registry and the public of his/her resignation
- Procedures for resignation of directors
  - check the articles of association of the company regarding the requirement of resignation of a director
  - acknowledge receipt of the resignation letter by directors
  - check outstanding matters needed to be handover by the resignation director
  - convene board meeting to approve the resignation
  - prepare the minutes to record the resignation of a director
  - submit a Form ND2A to the Companies Registry within 15 days after the resignation
  - update the company's register of directors to record the resignation
  - delete the resigned director as one of bank authorized signatories, if required
  - notify the bankers, customers and suppliers regarding the resignation in any manner, like the publication of an advertisement

XI. Removal of directors

- By ordinary resolution remove a director before his/her period of office expires (s.462(1) of the Companies Ordinance (Cap.622))
- Director of a private company who has been appointed for life on/before 31 August 1984 cannot be removed (s.462(2) of the Companies Ordinance (Cap.622))

- Director may sue the company for damages of breach of contract (s.463(6) of the Companies Ordinance (Cap.622))
- A member should send special notice to remove a director or to appoint somebody in place of the director to be removed at the general meeting to registered office (s.462(4) of the Companies Ordinance)
- Section 578 of New Companies Ordinance provides that a special notice must be given to the company at least 28 days before a general meeting at which the intended resolution is to be considered
- Company should then send a copy of the notice to the director concerned (s.463(1) of the Companies Ordinance)
- The director concerned is entitled to be heard at annual general meeting/general meeting (s.463(2) of the Companies Ordinance)
- The director concerned is entitled to make written representations to members in manner as described in ss.463(3) and 463(4) of the Companies Ordinance
- Send a copy of representations to every members or the director concerned read out at the meeting
- Procedures for removing directors
  - on receipt of a special notice of an intended ordinary resolution to remove a director, send a copy of such notice to the director concerned
  - convene and hold a board meeting to authorise the convening of a general meeting and the issue of a notice
  - Section 548(6) of the Companies Ordinance: a physical meeting must be held to consider the intended removal, so the concerned director will have right to make oral representation in the general meeting before a vote is taken
  - despatch a notice of the general meeting to those members who are entitled to attend the meeting and to the director concerned at least 14 days before the meeting
  - pass an ordinary resolution sanctioning the removal of the director concerned in the general meeting
  - submit a Form ND2A to the Companies Registry within 15 days after the passing of the ordinary resolution (Appendix 3A)
  - delete the removal director as one of bank authorized signatories, if required
  - notify the company's bankers, suppliers etc. of the removal of the director such as by publication of advertisements in newspapers
  - update the company's register of directors to record the removal

XII. Fair dealings by directors

- Remuneration of directors
  - Article 28 (Cap.622H Schedule 1)/Article 26 (Cap.622H Schedule 2) – the remuneration of directors shall be determined by company in annual general meeting/general meeting
  - Section 383 of the Companies Ordinance – emoluments fully disclosed in financial statement laid before annual general meeting/general meeting

- Compensation for loss of office
  - Section 521 of the Companies Ordinance – Unless disclosed to and approved by independent shareholders, it is not lawful to pay the director for loss of office by the company
  - Section 516(3) of the Companies Ordinance – the loss of office payment provisions are extended to include: (a) payment to an entity connected with the director; and (b) payment to a person made at the direction of or for the benefit of the director or an entity connected with the director (those may refer to "connected entity" under the Companies Ordinance)
    - Note: connected entity under s.486 of the Companies Ordinance means –
      - (a) a member of the director's or former director's family;
      - (b) a person who is in a cohabitation relationship with the director or former director;
      - (c) a minor child of a person falling within paragraph (b) who—
        - (i) is not a child of the director or former director; and
        - (ii) lives with the director or former director;
      - (d) a body corporate with which the director or former director is associated (s.488 of the Companies Ordinance: associated means the control of more than 30% of voting power in general meeting or can control the board);
      - (e) a person acting in the capacity as trustee of a specified trust other than a trust for the purpose of an employee share scheme or a pension scheme; or
      - (f) a person acting in the capacity as partner (under Partnership Ordinance (Cap.38)) of—
        - (i) the director or former director;
        - (ii) the spouse of the director or former director;
        - (iii) a minor child of the director or former director; or
        - (iv) another person who, by virtue of paragraph (e), is an entity connected with the director or former director.
  - Sections 524 and 525 of the Companies Ordinance provide for the following two exceptions, i.e. no prior members' approval is required for the following payments
    - a bona fide payment to a director to discharge an existing legal obligations; to pay damages for breach of contract or under a pension scheme
    - a payment not exceeding HK$100,000 (i.e. a de minimis exception)
  - Section 577 of the Companies Ordinance – any alteration of articles of association to provide emoluments or improved emoluments for a director be passed by general meeting after adequate explanation of the provision given in notice of the meeting is allowed
- Loans to directors
  - Sections 500 to 504 of the Companies Ordinance – generally provides that a company must not make loans, and specified companies (which mean a company which is a public company or a private company or company limited by guarantee that is a subsidiary of a public company)

must not *make quasi-loans* or enter into *credit transactions*, in favour of a director of the company or of its holding company unless with the prescribed approval of members
- Quasi-loan (s.493 of the Companies Ordinance) means
  - A person makes a quasi-loan to a director or an entity connected with a director if the person—
    - (a) *agrees to pay*, or pays otherwise than pursuant to an agreement, a sum for the director or connected entity— (i) on terms that the director or connected entity (or another person on behalf of the director or connected entity) will reimburse the person; or (ii) in circumstances giving rise to a liability on the director or connected entity to reimburse the person; or
    - (b) agrees to reimburse, or reimburses otherwise than pursuant to an agreement, expenditure incurred by another person for the director or connected entity— (i) on terms that the director or connected entity (or another person on behalf of the director or connected entity) *will reimburse the person*
  - Credit transaction (defined under s.494 of the Companies Ordinance):
    - the supply of goods under a hire-purchase agreement;
    - the sale of goods or land under a conditional sale agreement;
    - the lease or hire of goods or lease of land to a director or his connected entity in return for periodical payments; and
    - the supply of goods or services or disposal of land to a director or his connected entity on the understanding that payment is to be deferred
- Section 496 of the Companies Ordinance – defines "prescribed approval of members" as "an approval obtained by a resolution of those members:
  - (a) that is passed before the transaction or arrangement is entered into; and
  - (b) in respect of which the requirements below are met:
    - (i) for written resolution, a memorandum setting out designated relevant matters is sent to members before the resolution; or
    - (ii) for general meeting, a memorandum together with notice of the general meeting is sent to members, and the resolution is subsequently passed
- The prohibitions on loans are extended to a body corporate controlled by a director of the company or of its holding company and the prohibitions on quasi-loans and credit transactions are extended to entities connected with a director of the company or of its holding company
- Connected entity is defined in s.486 of the Companies Ordinance as quoted above
- Members unanimous consent before the transaction will be available for the company to validly enter into such transaction without breaching such prohibition

- Exceptions to the above prohibitions:
  - (i) if the aggregate of the *value of transaction does not exceed 5%* of
    - (a) value of the company's net asset, or
    - (b) the company's called-up share capital (s.505 of the Companies Ordinance);
  - (ii) the funds are used to *meet expenditure*, incurred or to be incurred by a director, *on defending proceedings or in connection with an investigation or regulatory action* (ss.507 and 508); however must be made on condition that the director concerned will repay the company if he/she is found guilty or to have committed the misconduct;
  - (iii) *home loan* (on the condition: (a) for main residential premises; (b) terms not more favourable than those granted on transactions entered into by the company in its ordinary course of business; (c) a valuation report done by a professionally qualified valuation surveyor within the preceding three months of the purchase; (d) purchase of the residential premises is secured by a legal mortgage), leasing goods and land (terms not more favourable than those offered to unconnected persons on the open market)
    - total expenses for home loan and leasing goods and land not exceeding 10% of net asset or called-up capital)(ss.509 and 510)
  - (iv) in *ordinary course of business* (the company is a money lender and loan terms not more favourable than those granted to person of the same financial standing but unconnected with the company) and intra-group transaction (ss.511 and 512)
  - (v) for the purpose of providing *funds to the directors to meet business expenditure*, e.g. expenses incurred during business trips (s.506)
- Section 513 of the Companies Ordinance – civil consequences of contravention
  - Under the Companies Ordinance, criminal sanctions no longer apply to breaches of the prohibitions in ss.500 to 504
  - If a company enters into a transaction in contravention of these prohibitions, the transaction is voidable at the company's instance unless:
    - restitution is no longer possible;
    - the company has been indemnified for loss resulting from the transaction or arrangement;
    - a third party (other than the director, his controlled body corporates or connected entities) has in good faith acquired rights for value and without actual notice of the contravention, and those rights would be affected by the avoidance; or
    - the transaction is affirmed by the shareholders of the company and/or the holding company (as applicable) within a reasonable period after it is entered into in accordance with s.514 of the Companies Ordinance
  - Whether or not the transaction has been avoided, the following persons will be liable to account to the company for any gain made

and to indemnify the company for any loss resulting from the transaction or arrangement (s.513(2)):

- a director of the company, or of a holding company of the company, for whom the company entered into the transaction or arrangement;
- a body corporate controlled by such a director, or a connected entity of such a director, for whom the company entered into the transaction or arrangement;
- the director of the company who controls such a body corporate or with whom such an entity is connected;
- the director of a holding company of the company who controls such a body corporate or with whom such an entity is connected; and
- any other director of the company who authorised the transaction or arrangement

Defences

- For a controlled body corporate or connected entity of a director
  - It is a defence if it establishes that, at the time the transaction or arrangement was entered into, it was not aware of the circumstances constituting the contravention (s.513(4)(a)).
- For the director of the company (and its holding company) who controls the body corporate or with whom the entity is connected
  - It is a defence if the director establishes that he took all reasonable steps to secure the company's compliance with the relevant provisions (s.513(4)(b)).
- For any other director of the company who authorised the transaction or arrangement
  - It is a defence if the director establishes that, at the time the transaction or arrangement was entered into, he was not aware of the circumstances constituting the contravention (s.513(4)(c))

The following summarizes the prohibition of loans and similar credit transactions which subject to certain exemptions as stated above:

	Loans including provision of securities or guarantees) and related credit transactions	**Private Companies**	**Public Companies and its subsidiaries and Companies limited by Guarantee)**
1	Loans to directors of Hong Kong company/ holding company directors or body corporates (including non-Hong Kong companies) controlled by those directors/holding company directors	prohibited unless approved by shareholders of the company/by shareholders of the company and its holding company shareholders (if holding company is a Hong Kong company)	prohibited unless approved by disinterested shareholders/by disinterested shareholders and its holding company's disinterested shareholders (if holding company is a Hong Kong company)

	Loans including provision of securities or guarantees) and related credit transactions	Private Companies	Public Companies and its subsidiaries and Companies limited by Guarantee)
2	Loans to connected entities of directors/ connected entities of holding company directors	not prohibited	Prohibited unless approved by disinterested shareholders/by disinterested shareholders and its holding company's disinterested shareholders (if holding company is a Hong Kong company)
3	Quasi-loans to directors/ holding company's directors	not prohibited	prohibited unless approved by disinterested shareholders/by disinterested shareholders and its holding company's disinterested shareholders (if holding company is a Hong Kong company)
4	Quasi-loans to connected entities of directors/ connected entities of holding company's directors	not prohibited	prohibited unless approved by disinterested shareholders and its holding company's disinterested shareholders (if holding company is a Hong Kong company)
5	Credit transactions for directors/holding company's directors	not prohibited	prohibited unless approved by disinterested shareholders/disinterested shareholders and its holding company's disinterested shareholders (if holding company is a Hong Kong company)
6	Credit transactions for connected entities of directors/connected entities of holding company's directors	not prohibited	prohibited unless approved by disinterested shareholders/disinterested shareholders and its holding company's disinterested shareholders (if holding company is a Hong Kong company)

- Ambit of disclosure of material interest by directors
  - (i) has added "transaction" and "arrangement" to "contract" and add "extend" to "nature" of interest (ss.536(1) and 536(2) of the Companies Ordinance)
  - (ii) for public companies, s.536(2) of the Companies Ordinance also requires a director to disclose material interest of entities connected with that director
  - That director who is interested in a transaction, arrangement or contract of the company should not take part in the decision-making process about the matter. That means that he/she should not be counted in the quorum and vote at the meeting which considers the transaction, arrangement or contract (Articles 15, 16 (Schedule 1)/Articles 16, 17 (Schedule 2))
  - Under s.536(1) of the Companies Ordinance, where a director is in any way directly or indirectly interested in a transaction, arrangement or contract or proposed transaction, arrangement, or contract with the company, he must declare the nature of his interest (if it is material)
    - Contract: significance in relation to the company's business
    - Timing: at the earliest meeting of the directors at which it is practicable for him to do so before the company enters into transaction (s.537 of the Companies Ordinance)
    - Method (s.538 of the Companies Ordinance):
      - A declaration of interest must be made:
        - at a directors' meeting;
        - by notice in writing sent to the other directors; or
        - by general notice
      - Where a declaration of interest is to be made by notice in writing to the directors:
        - it must be sent:
          - in hard copy form by hand or post; or
          - in electronic form if the recipient has agreed to receive it by electronic means; and
        - the making of the declaration will be regarded as forming part of the proceedings at the next directors' meeting after the notice is given
      - A general notice is a notice to the effect that the director:
        - has an interest in a body corporate or firm specified in the notice and is to be regarded as interested in any transaction, arrangement or contract that is entered into with that body corporate or firm; or
        - is connected with an individual specified in the notice and is to be regarded as interested in any transaction, arrangement or contract that is entered into with that individual
      - A general notice must state:
        - the nature and extent of the director's interest in the specified body corporate or firm; or
        - the nature of the director's connection with the specified individual

expiration of his period of office. Since the auditors and directors who are being removed have their rights either to make written representations concerning their removal for circulation to the shareholders or to make oral representations concerning their removal for presentation to the shareholders during the general meetings, it provides a good corporate governance tool and channel for the removed auditors and directors to express their grievances if any mismanagement or unfair prejudice events exist. See the New Companies Ordinance Briefing Notes on Part 12: Company Administration and Procedure (Hong Kong Companies Registry website at http://www.cr.gov.hk/en/companies_ordinance/briefingnotes_index.htm).

Dispensation with holding the annual general meeting – Companies Ordinance (Cap.622) s.613 permits a company to dispense with the requirement to hold an annual general meeting by passing a written resolution or a resolution at a general meeting of all members. However, according to s.430(3), even though the company is not required to hold an annual general meeting in accordance with s.610 in respect of a financial year, the directors' reports and financial statements for the financial year are still required to be sent to every member within the period specified in s.431. See the New Companies Ordinance Briefing Notes on Part 12: Company Administration and Procedure (Hong Kong Companies Registry website at http://www.cr.gov.hk/en/companies_ordinance/briefingnotes_index.htm).

Proxy and corporate representative - Completed proxy form must be deposited at the company's registered office not less than 48 hours before the meeting (for a poll taken more than 48 hours after it was demanded, at least 24 hours before the time appointed for taking the poll). According to s.596(3), multiple proxies are allowed and can only vote on a poll in case of a company having a share capital. Besides, a corporate representative will have speaking rights (both by show of hand or demand poll) whereas a proxy for an individual member of a company is not entitled to speak at the meeting (by show of hand, but will have speaking rights if by demand poll) unless otherwise mentioned in the articles of association of the company or allowed by the chairperson of the meeting. See the New Companies Ordinance Briefing Notes on Part 12: Company Administration and Procedure (Hong Kong Companies Registry website at http://www.cr.gov.hk/en/companies_ordinance/briefingnotes_index.htm).

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4. *Key Changes under the Companies Ordinance (Cap.622)*, Charltons Solicitors at www.charltonslaw.com
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7. Codes on Takeovers and Mergers and Share Buy-backs
8. Tutorial notes prepared by Andrew Tsang and Natalie Chan during their tutoring/lecturing (CGVB410, CGVB897) at the Open University of Hong Kong
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CHAPTER 5

SHARE CAPITAL AND LOAN CAPITAL, REGISTRATION OF CHARGES

I. Definition of 'Capital'

Merriam Webster quoted legal Definition of capital as follows:

- accumulated assets (as money) invested or available for investment as:
  (i) goods (as equipment) used to produce other goods; or
  (ii) property (as stocks) used to create income

Cambridge Dictionary defined:

- Capital means money and possessions, especially a large amount of money used for producing more wealth or for starting a new business

Business dictionary at http://www.businessdictionary.com/definition/capital.html defines capital as:

- Wealth in the form of money or assets, taken as a sign of the financial strength of an individual, organization, or nation, and assumed to be available for development or investment
- Accounting: Money invested in a business to generate income
- Economics: Factors of production that are used to create goods or services and are not themselves in the process

Farrar's Company Law (1998)

- Capital refers to both the share capital and loan capital
- Share capital refer to the funds that a company raises through the issue of shares (equity financing)
- Loan capital is borrowed money obtained by the issue of debentures (debt financing also include borrowing direct from financial institution)

II. Kinds of Capital Referred to in Companies Ordinance (Cap.622)

- nominal*/authorised capital*
- issued capital
- paid-up capital
- uncalled capital
- reserve capital/reserve liability (property revaluation reserve, share premium reserve*, translation reserve, goodwill, negative goodwill, retained profits)

*abolished on 3/3/2014

III. Transitional Arrangement

On or after 3 March 2014
Shares in company have no par value/nominal value (s.135)
For existing companies:

- At the beginning of the commencement date of s.135, any amount standing to the credit of the company's share premium account and capital redemption reserve forms part of the company's share capital (Cap.622: Schedule 11 Companies Ordinance Transitional and Saving Provisions s.37(1))
- Any amount that would be required by a continuing provision to be transferred to a company's share premium account or capital redemption reserve on or after 3 March 2014 becomes part of the company's share capital (Cap.622: Schedule 11 Companies Ordinance Transitional and Saving Provisions s.37(2))

IV. What is a Share?

- Section 2 of the Companies Ordinance (Cap.622): (a) means a share in a company's share capital; and (b) if any of the company's shares is converted into stock, includes stock;
- Interest of a shareholder in the company in money term
- If a holder of a share has paid full subscription monies, his liability is limited (limited liability concept)
- Personal property which is transferable subject to the company's articles of association (s.134 confirms the shares are personal property and are transferrable in accordance to articles)
- May be issued either for cash or in kinds (i.e. assets, services or shares of other companies)
  - e.g. a sole proprietor of a business may form a company and transfer all proprietorship's asset into that company in turn receiving the company's shares (*Salomon v Salomon & Co Ltd* [1896] UKHL 1)
- Personal property – can transfer subject to articles

V. What is a Debenture?

- Section 2 of the Companies Ordinance (Cap.622) – includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not
- A debenture is any document acknowledging indebtedness issued by a company (income stock certificate)
- The company acknowledges that it is indebted to the lender for a specified amount
- May be secured by fixed or floating charge
- It promises to pay that principal sum on a specified day or on such an earlier day
- It agrees to pay interest on specified dates at a specified rate, even out of capital, if the company makes no profit
- May be secured by fixed or floating charge
- May be with a right to exchange for shares issued by the company in future

- Within one month after the allotment of debentures (including debenture stock), a company must deliver to the Companies Registrar a return of the allotment in the specified form for registration (s.316)
- As soon as practicable, and in any event within two months after an allotment of debentures, a company must register the allotment in the register of debenture holders. This helps to protect investors in investing debentures and align the position of debenture holders with that of members (s.317)
- Trust deed will be entered into and trustee will be appointed to look after the interests of the debenture holders when a series of debentures is issued to a large number of subscribers
- If the company does not perform its obligations under the debentures or the trust deed, both the debentures and trust deeds may give the holders the power to appoint a receiver to enforce their securities, i.e. debentures

VI. Debenture Stock

- A borrowed capital - with separate bond or debenture - consolidated into one mass with a debenture stock certificate for the sake of convenience
- A portion of one large loan, can be transferable in fractional amounts
- Called debenture stock if loan secured by a mortgage or charge
- Called loan stock/unsecured loan stock

VII. Bonds vs Securities

- Bond – debenture issued under the seal (optional) of the company
  - an instrument of indebtedness of bond issuer to the holders
  - a form of loan or iou
- Securities –
  - refer to any type of right, whether by way of recourse to property or assets (legal (fixed) charge/equitable (floating) charge) or by way of recourse against another person (guarantee) which supports the basic obligation of a borrower to repay borrowings; and
  - means any type of share, stock or bond issued by a company

VIII. Share Capital

- The following concepts relating to share capital have repealed on 3 March 2014, the commencement date of the Companies Ordinance (Cap.622)
  - Nominal/Authorised capital
    - The amount of capital with which a company is registered with the Registrar of Companies. It is the maximum amount of capital which a company can raise through shares. Hence companies usually are registered with such authorised capital which is well above their current needs of financing so that the company is not necessary to raise the share capital in future, for example, the authorised capital of the company is HK$2,000,000,000 divided into 10,000,000,000 ordinary

shares, that means the par value of ordinary share is HK$0.20 each in the share capital of the company

- Share issued at a discount
  - Under common law, a company may not issue shares at a discount
    - *Ooregum Gold Mining Co of India v Roper* [1892] AC 125
      - The directors (with the shareholders' approval) approved the issue of preference shares on the basis that each new share of £1 nominal value should be automatically credit with 75p paid, leaving an actual liability of only 25p. This issue was bona fide thought to be the best way of raising further funds for the company, especially since the ordinary shares stood at a great discount to the market value. An ordinary shareholder challenged the validity of this issue
      - Held that it was beyond the power of the company to issue shares at a discount, and as a result, the preference shareholders were liable for the full nominal amount of shares
    - *Re First Technology International (HK) Ltd* (unrep., HCMP 1749/2005, 18 November 2005 (CFI))
      - A petition was made to court to seek its approval for the company to issue shares at a 60% discount. Issue of shares at a discount was the only way the company could raise further funds. Potential investors had been found but they demanded a 60% discount being an estimated market value of the shares
      - Held that the petition was granted. In the petition, the court must be given a proper explanation as to why the company proposed to raise capital by issuing shares at a discount, how the discount was arrived at and whether there would be proper protection for creditors
    - A share issued at a price below its face value. For example, a share with par of HK$1 might be issued to an investor for HK$0.7. A share usually could not be issued at a discount unless certain conditions have met
- Share Premium Account
  - A share premium account is usually found on the balance sheet, this is the account to which the amount of money paid (or promised to be paid) by a shareholder for a share is credited to, only if the shareholder paid more than the cost of the share, for example, a company issue and allot shares at a price of HK$3 per share while the value of the share (net asset value) is HK$2.5 per share, then a premium of HK$0.5 per share should be credited to the share premium account of the company

- 'No-par regime' adopted
  - The Companies Ordinance (Cap.622) adopts a mandatory system of no-par for all local companies having a share capital and retires the concept of par value for all shares. The par value of shares is the minimum price at which shares can generally be issued. Since par value does not serve its original purpose of protecting creditors and shareholders as it does not necessarily give an indication of the real value of the shares. Further, this is in line with international trends to provide companies with greater flexibility in structuring their share capital and creates an environment with greater clarity and simplicity and is more desirable for the business community generally.

  - The full proceeds of a share issue will be credited to share capital under the new regime and becomes the company's share capital. The notion of issued or paid capital will continue to be relevant even after the abolition of par value, and it would then also reflect the amount in the share premium account. It will represent the amount the company actually receives from its shareholders as capital contribution.
  - The concept of paid up capital, issued capital and partly paid shares are still relevant. But they will be related to the total consideration paid or agreed to be paid for the shares issued, and not tied to par value.
  - The illustrative example regarding application of no-par regime is as follows:
    - Effect on financial statements for accounting period ending on 31 March 2014.
      - X Limited is a Hong Kong incorporated company. Its accounting reference date is 31 March. It has issued share capital of 1000 share with par value of HK$1 each. It has a share premium account of HK$8000 and a capital redemption reserve of HK$400 arising from the redemption of some shares in previous years.
      - For the year ended 31 March 2014, there are no changes to the number of issued shares but it earns profits of HK$500. It also recorded retained earnings of HK$800 at 31 March 2013.

X Limited's Statement of Position Equity Section

	31 March	
	2014	2013
	HK$	HK$
Share capital (1000 shares issued and fully paid)	9400	1000
Shae premium	–	8000
Capital redemption reserve	–	400
Retained earnings	1300	800
Total equity	10700	10200

X Limited's Statement of Changes in Equity

	Share capital	Share premium	Capital redemption reserve	Retained earnings	Total equity
	HK$	HK$	HK$	HK$	HK$
Balance at 1 April 2013	1000	8000	400	800	10200
Transfers on 3 March 2014	8400	(8000)	(400)	–	–

(*Continued*)

X Limited's Statement of Changes in Equity *(Continued)*

	Share capital	Share premium	Capital redemption reserve	Retained earnings	Total equity
Profit for the year	–	–	–	500	500
Balance at 31 March 2014	9400	–	–	1300	10700

IX. Pre-Emption Right/Statutory Restrictions on Directors' Power to Allot Shares

- Most articles of association give the directors the power to issue shares for the purpose of raising funds
- When a company issues additional shares, it dilutes existing shareholders' proportional ownership in that company if they do not subscribe the new shares
- Pre-emption right/pre-emptive clause gives the current shareholders the right to acquire new shares before they are offered to the other investors in order to prevent their shareholdings from being diluted
- Companies Ordinance ss.140 and 141 provide that unless shareholders' approval has been obtained, the board of directors of a company must not exercise any power of the company to:
  - (i) allot shares; and
  - (ii) grant rights to subscribe for shares or to convert securities into shares
  - Such shareholders' approval is known as general mandate (一般性授權) and such mandate is usually obtained in an AGM
- Shareholders' approval/general mandate may subsequently be revoked or varied at any time by a shareholders' resolution or expired under the following circumstances:-
  - If the company is required to hold an AGM under Companies Ordinance s.610, the approval/mandate will expire on the earlier of
    - (i) the conclusion of the AGM held next after the approval was given; and
    - (ii) the expiry of the period within which the next AGM after the approval was given is required to be held
- If the company is not required to hold an AGM under Companies Ordinance s.612 (e.g. written resolution in lieu of AGM or the company has only one member), then the general mandate will expire on the date on which the requirements of s.612 are satisfied
- If the company is not required to hold an AGM for any other reason (e.g. dispense to hold AGM under s.613), the general mandate will expire on the date specified in the approval, which must not be more than 12 months after the approval was given
- Exceptions to ss.140 and 141, shareholders' approval is not required under the following circumstances:
  - - a rights issue
    - An offer by way of rights to existing holders of securities which enables those securities holders to subscribe securities in proportion to their existing holdings

  - a bonus issue
    - an issue of additional shares to shareholders instead of a dividend, in proportion to the shares already held
  - an allotment of shares to founder members of a company at the time of new incorporation
  - an allotment of shares pursuant to options and convertible securities that have already approved by shareholders
- LR13.36(1)(a) requires a listed company to obtain its shareholders' prior approval for any allotment, issue or grant by it of any shares, convertible securities or options, warrants or similar rights to subscribe for any shares or convertible securities. No shareholders' approval is required in the following circumstances:
  - Rights issue/open offer, where a company offers new shares to its existing shareholders on a pro rata basis (except increase the issued share capital or market capitalisation by more than 50% under LR7.19(6)(a) and 7.24(5));
  - General mandate, where the existing shareholders have by an ordinary resolution granted a general mandate to the directors to allot shares or grant any offers or options which would require the issue, allotment or disposal of shares during the continuance of such mandate.
    - A general mandate may only continue in force until:
      - (i) the end of the first annual general meeting after it has been granted, at which time it lapses unless renewed; or
      - (ii) it is revoked or varied by ordinary resolution in general meeting
- LR13.36(2)(b) provides that the number of securities that can be allotted under a general mandate must not exceed 20% of the existing issued share capital of the company.
  - For example, the existing issued share capital is 100,000,000 shares, then the company can issue not more than 20,000,000 shares when such general mandate is granted by the shareholders at AGM
- Besides, listed companies are allowed to issue shares (other than rights issue) that have been bought back as long as they do not exceed 10% of the company's existing issued share capital.
  - For example, the current issued shares of the company is 100,000,000 shares, then the company can buy back maximum of 10,000,000 shares when such general mandate is approved by the shareholders at the AGM
- A separate ordinary resolution to add the buy-back shares to the general mandate must be passed and the directors have the authority to issue shares up to a maximum of 20% of the issued shares including in the general mandate (which includes the reissue of the cancelled buy-back shares).
  - if the cancelled buy-back shares are 10,000,000 shares, then the maximum of 20% of the issued shares can be allotted including such 10,000,000 shares
- When the above general mandate is granted, directors of the company can issue and allot shares within such threshold to potential shareholders and investors and buy back the shares of the company and do not require a fresh approval from shareholders at a general meeting

X. Return of Allotment

- Companies Ordinance (Cap.622) s.142 – in case of:
  - any shares allotted for consideration (whether wholly or partly cash consideration or non-cash consideration), or
  - any shares allotted credited as fully paid up (whether on or without a capitalization), the following documents must be filed with Companies Registry within one month after the allotment:
    - (i) a return of allotment (specified Form NSC1) (Appendix 5A);
    - (ii) a statement of capital whether there is a change to its capital structure as at the date of allotment that complies with s.201;
    - (iii) for any shares allotted for consideration (whether wholly or partly cash consideration or non-cash consideration):-
      - (a) must state the amount paid or regarded as paid on each share and the amount (if any) remaining unpaid or regarded as remaining unpaid on each share;
      - (b) in the case of an allotment wholly or partly for non-cash consideration under an arrangement made under Division 2 of Part 13, must contain particulars of the order of the Court sanctioning the arrangement; and
      - (c) in any other case of an allotment wholly or partly for non-cash consideration, must contain particulars of the contract for sale or for services or other consideration in respect of which the shares were allotted
    - (4) for any shares allotted credited as fully paid up (whether on or without a capitalization):-
      - (a) must state the amount regarded as paid on each share; and
      - (b) must contain particulars of the resolution authorizing the capitalization or allotment

XI. Kinds of Share Capital Referred to Companies Ordinance (Cap.622)

- Issued capital 已發行股份
  - the sum equal to the consideration of shares actually in issued
  - A share is issued when the shareholder is registered (i.e. shareholders have applied for the shares of the company and the company has allotted and issued the shares to the shareholders)
- Paid-up capital 繳足股份
  - that part of issued capital that has been paid up by the shareholders
  - includes all the money/consideration paid-up on such shares
- Uncalled capital 未繳股份
  - that part of the issued capital that the shareholders have not yet been called upon to pay, which can call it up at any time according to the provisions of the articles of association or shareholders' agreement
- Issued capital can be comprised of paid-up capital and uncalled capital
  - E.g. the company has issued shares of 10000 ordinary shares in which 5000 shares have been paid up and 5000 shares are not yet paid up and would be called to pay up after the shareholders have executed application for shares and submitted the application to the company for registration
- Sometimes, issued capital can be called as outstanding capital

XII. Purposes for Having Different Classes of Share Capital

- Different investment objectives
  - Immediate requirement – daily operation
    - Assign heavy voting right of particular class of share capital to facilitate the daily operation
  - Long term development – future needs
    - Set up different classes of share capital to enlarge the shareholders' base for future development
  - One-off financing purpose – a particular transaction
    - Restructuring of the company by creating different classes of shares
  - Law requirements – maintain minimum share capital
    - Maintain the certain class of share capital at a minimum amount as stipulated in the company's articles of association
  - Incentive purpose
    - Employee share options provided to particular types of employees
- Different classes of share capital issued subject to the provisions of articles of association/shareholders' agreements

XIII. Classes of Share Capital

- Ordinary shares (most common)
  - Rights of ordinary shares are set out in articles of association
    - They carry one vote per share: vote at general meetings (able to control the company through votes on establishing corporate objectives and policy, electing directors)
    - are entitled to participate equally in dividends: vote on dividends (if the company makes a profit and declares dividends)
    - if the company is wound up, share in the proceeds of the company's assets after all the debts have been paid: entitled to repayment of their capital after the company has paid its creditors and preference shareholders when winding up (surplus asset)
- Preference shares
  - entitled to some preference or priority over other shares in the company
  - rights of preference shares are set out in articles of association, or the terms of issue of shares
    - to preferential treatment when dividends are declared
    - usual preferential/priority term is to be entitled to a fixed rate of dividend out of distributable profits (as determined by ss.290 and 291 of the Companies Ordinance (Cap.622)) of the company, to be paid in priority to other classes of shareholders

- e.g. a company issues 5% preference shares of HK$5 each has to pay preference shareholders HK$0.5 per share in the form of a dividend each year out of profits before it pays dividends to other shareholders
- have a preferential right to a fixed amount of dividend, expressed as a percentage of the value of the share, e.g. a HK$1, 7% preference share will carry a dividend of HK$0.07 each year
- It is, however, still a dividend and payable only out of profits

° preference share may be participating, in which case it participates in profits beyond the fixed dividend under some formula
° are often non-voting (or non-voting except when their dividend is in arrears)
° are sometimes redeemable
° may be given a priority on return of capital on a winding up. Often they will not be entitled to share in surplus capital

• Several classes of preference shares
– Cumulative preference shares
° *Webb v Earle* [1875] LR 20 Eq 556, it was held that all preference shares are presumed to be cumulative unless otherwise described, i.e. arrears of dividends are to be made up in subsequent years when profits are available
° if no dividend is declared in any year, the arrears are carried forward and must be paid in a subsequent year before ordinary shareholders receive any dividend
- Eg. 10% preference shares received dividends of 2% in 2014 and 3% in 2015. They would then be entitled to 25% (8+7+10) in 2016

– Participating preference shares
° The right to participate further in profits, rights issue and/or bonus issues
° If such a right is given, the preference shareholders (i.e. in addition to preferential dividends) can participate in any profit remaining after the ordinary shareholders have received their share of dividend
° In other words, articles of association may give such right to participate in surplus profits up to a given %
° The courts, when interpreting share rights, also seem to have adopted a presumption that once a special entitlement has been established in the memorandum or articles, it is prima facie exhaustive of that particular type of right
° *Will v United Lankat Plantations Co* [1914] AC 11 (HL).
- Held that if a class of preferred shares is established having rights to the prior payment of a dividend of 10% of the amount paid up on the share, that is taken to be an exhaustive statement of the dividend entitlement of the class, so that the holders of those shares are limited to 10% and do not participate further in the profits of the company

– Voting rights
° Unless otherwise articles of association provided, preference shareholders are entitled to vote only:
- Their dividends are in arrears, i.e. when they have not been paid their dividends

- there is a resolution to wind up the company, preference shares have a priority in the repayment of capital if the company is wound up
- there is a resolution which is likely to affect their class rights

– Rights on winding-up
° If a company is liquidated, its non-cash assets will be sold. The sale proceeds will then first applied in paying the cost of liquidation and creditors. The surplus will then be used in returning capital to shareholders. Anything left will be called as surplus assets
° Unless articles of associations give such a right to the preference shareholders, only ordinary shareholders are entitled to share the surplus assets, if any, in the event of liquidation
° once a preference in respect of capital repayment is stated, it is prima facie exhaustive. Certainly a preference as to dividends does not imply a preference as to capital surplus or vice versa
° The most common limitation on preference shares is that the holders of those shares are entitled only to the return of the amount paid up on such shares. This limitation leaves the common shareholders (who have probably assumed more risk in the enterprise) to reap the rewards of capital appreciation of the company's net assets
° *Scottish Insurance Corporation Ltd v Wilsons and Clyde Coal Co Ltd* [1949] AC 462
- Held that the preference shareholders were not entitled to participate in the surplus assets as "the rights inter se of preference and ordinary shareholders must depend on the terms of instrument which contains the bargain that they have made with the company and each other. The articles of association are exhaustive of the rights of the preference shareholders in a winding up

– Priority as to repayment of capital
° after the company's debts and liabilities and any arrears of preference dividends have been paid, the preference shareholders are entitled to repayment of their capital in full before the ordinary shareholders are repaid their capital
° Unless such a right is given, preference shareholders and ordinary shareholders rank equally in repayment of capital in the event of liquidation

– Right to redeem shares
° If such a rights is given, the preference shareholders will be repaid by the company their investment in the company on or before a specified date

– Right to convert shares
° entitled to convert all or part of their shares of another class during a specified period at a specific price (i.e. convertible shares)

• Redeemable shares
– Redeemable means can be bought back by the company at the option of the company or the shareholder
– May not be redeemed unless they are fully paid (s.268)

  - Section 257(2) – May be redeemed out of distributable profits of the company or out of proceeds of a fresh issue of shares made for the purposes of redemption (for both listed and non-listed companies) or out of capital (for non-listed companies only and listed companies not on a recognized stock market are redeemable) (s.257(3))

- Warrants/options
  - Warrant – a right given to its holder to subscribe for a certain number of shares at a specific price during a specified period, holder has to pay an exercise price and the price of the shares
  - A listed company may not issue warrants that would exceed 20% of the issued capital of the company
  - Life of new warrants – from 1 to 5 years

- Deferred or founders' or management shares
  - That bears a restriction that no dividends can be paid to holders unless ordinary shareholders are paid a specified rate of dividends
  - Issued to founders/vendors of a business a consideration for purchase of business
  - Entitled to a generous proportion of all profits remaining after ordinary shareholders have been paid
  - Usually carry heavy voting power
  - To save stamp duty and to facilitate the takeover of a company, existing ordinary shares may be converted into deferred shares, in that case, such deferred shares may carry no voting right and/or have no right to receive dividends
  - Not common in HK

- Non-voting ordinary shares
  - Holders of which are not entitled to vote at general meetings of the company
  - Note: Non-voting deferred shares for the floatation of company (i.e. arrangement of initial public offering, the ordinary shares being held by the founders of a business who want to go listing will have to restructure their shareholding structures, their ordinary shares will be converted to NON-VOTING DEFERRED SHARES of the company by special resolution)
  - Shares on which no dividend is paid until other classes of shares have received a minimum dividend and also have no voting right

XIV. Difference Between Shares and Debentures

Companies having a share capital may raise funds by issuing shares and debentures.

- Regulatory framework
  - The relationship between a company and its members is governed by provisions of the company's articles of association and the Companies Ordinance
  - The relationship between a company and its debenture holders is governed by the terms specified in the debenture or the debenture trust deed

- Creditors v members
  - Unless otherwise provided in the debenture or the debenture trust deed, debenture holders do not have right to attend and vote at general meetings of the company
  - Shareholders are members of the company are entitled to attend and vote in general meetings unless otherwise provided in the company's articles of association

- Debenture interest v dividends
  - Payment of debenture interests and redemption of debentures are not conditional on the company making a profit. They are payable by the company on or before the due date as stated in the debenture or debenture trust deed
  - Payment of dividends is only possible when there are distributable profits. In general, articles of association provided that the payment must be approved by the company in either directors meeting, like approval of interim dividends, or a general meeting, like approval of final dividends

- Return of investment
  - Subject to exceptions, such as share buy-back, reduction of capital, a company is not allowed to return share capital to its shareholders
  - A company however have to repay the principal to the debenture holders on or before the due date as specified in the debenture or debenture trust deed

- Tax deductibility
  - Debenture interests are chargeable against the profit and loss account, in other words, debenture interests can be deducted as an expense in the books of account, hence taxable profits can be reduced
  - Dividends constitute appropriation of profits, taxable profits cannot be reduced as a result

- Issue at a premium or at a discount
  - Debenture can be issued at a premium or at a discount and there are no statutory restrictions on the application of the debenture premium and the rate of commission payable to debenture holders
  - *Mosely v Koffyfontein Mines Ltd* [1904] 2 Ch 108
    - Held that convertible debentures cannot be issued at a discount on terms that they may be immediately exchanges for shares of the equivalent nominal value, for this would be only an indirect way of achieving an issue of shares at a discount
  - Shares can be issued at a premium. However, shares can only be issued at a discount subject to relevant restrictions of the Companies Ordinance

- Priority of payment
  - In case of liquidation, the right to receive repayment of the principal and accrued debenture interests depends on the terms of issue of the debentures or debenture trust deed

- Holder of secured debentures will rank prior to unsecured debenture holders in the return of principal and accrued interests
- Holders of the unsecured debentures will rank as unsecured creditors of the company
- After all the debts have been settled in full, the shareholders can be entitled to a return of capital at last

XV. Factors Considered to Raise Funds by Either Equity Financing or Debt Financing

- In view of the company
  - Cost of issue
    - cost of issue of debentures is lower than that of issue of shares because debenture interests are tax deductible while dividends cannot be deducted as an expense in the books of account; hence, the taxable profits of the issuing company will be higher when the company issue shares
  - consideration of the company's profitability and cash flow position
    - avoid the risk of receivership and liquidation, the issuing company must make sure that there are sufficient recurring profit and cash to pay debenture interest and to repay principal if debt financing is preferred; while equity financing is chosen because dividends are only paid out of distribution profits (if any), and must be recommended by the board of directors, hence there is no burden of maintaining sufficient cash flow and guarantee of profitability
    - High interest costs during difficult financial periods can increase the risk of insolvency
    - no obligation to repay the capital unless redeemable shares are issued, hence funds can be kept by the company
  - whether there is enough amount of assets that can be offered as security
    - the issuing company must ensure that there are assets (e.g. buildings, plant and machinery) that can be offered as security under debt financing
    - However, a charge on a company's assets may restrict the company's freedom in dealing with the asset charged
    - No security needs to be offered to subscribers of shares under equity financing
  - Gearing ratio
    - Debt financing increases gearing ratio of the company, which represents a weaker financial position of the company
    - A lower gearing ratio provides a cushion and is seen as a measure of financial strength, which gives better reputation and confidence to potential and creditors
  - Desire to maintain control of the company
    - Current shareholders, in particular the controlling shareholders are unwilling to share ownership of the company with the new investors, then debt financing should be chosen

XVI. Methods of Raising Capital

- By issue of shares
  - Private company
    - inviting existing shareholders to inject funds, borrowing funds from banks of financial institutions
  - Public company
    - official listing on the stock exchange i.e. initial public offering

XVII. Main Board Listing or Growth Enterprise Market Board Listing

- Offer for subscription vs offer for sale
  - Offer for subscription – if a company itself offers the shares/debentures to the public, any person who acquires shares/debentures directly from the company is known as subscriber
  - Offer for sale – if the offer of shares/debentures to the public is made by an existing shareholder and not by the company itself, the person who acquires the shares/debentures is known as purchaser

- Purpose of a Prospectus (招股章程)
  - The main requirement to invite public to subscribe for shares and debentures is to issue a prospectus (s.2 of Cap.32, the Companies (Winding-Up and Miscellaneous Provisions) Ordinance)
    - (a) subject to paragraph (b), means any prospectus, notice, circular, brochure, advertisement, or other document-
      - (i) offering any shares in or debentures of a company (including a company incorporated outside Hong Kong, and whether or not it has established a place of business in Hong Kong) to the public for subscription or purchase for cash or other consideration; or
      - (ii) calculated to invite offers by the public to subscribe for or purchase for cash or other consideration any shares in or debentures of a company (including a company incorporated outside Hong Kong, and whether or not it has established a place of business in Hong Kong);
    - (b) does not include any prospectus, notice, circular, brochure, advertisement, or other document-
      - (i) to the extent that it is a publication falling within s.38B(2) of Companies (Winding-Up and Miscellaneous Provisions) Ordinance); or
      - (ii) to the extent that it contains or relates to an offer specified in Part 1 of the Seventeenth Schedule as read with the other Parts of that Schedule of Companies (Winding-Up and Miscellaneous Provisions) Ordinance); (Replaced 30 of 2004 s.2)

- Content of a prospectus
  - has to contain all the information that is required to be disclosed as set out in:
    - (a) Part 1 of the Third Schedule to the Companies (Winding-Up and Miscellaneous Provisions) Ordinance) and the reports specified in Part II of that Schedule, and the provisions contained in Part III of the Schedule;
    - (b) Appendix 1 of the Main Board/Growth Enterprise Market Listing Rules (if the company wishes to have its shares traded on the Stock Exchange of Hong Kong Limited); and
    - (c) Section 342 under the Companies (Winding-Up and Miscellaneous Provisions) Ordinance)
  - Summarize information and present them to investors:
    - applicant must be suitable for listing: financial background, management experience, track records, business prospect
    - issue/marketing of securities is conducted in a fair/orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer
  - Major Contents of a prospectus
    - Risk factors
    - Corporate information
    - Industry/business overview
    - Qualification of Directors/Senior Management
    - Share Capital/Substantial shareholders
    - Financial Information – accountants' report, profit forecast, property valuation report
    - Future plans
    - Uses of proceeds
    - Structure and conditions of the offers – price payable on application, over-subscription, timetable
    - Underwriting
    - Summary of the company's articles of association or memorandum and articles of association or bye-law
    - In summary,
      - the overall financial conditions for the past 3 years (for main board) and at the latest practicable date of issuing prospectus
      - The shareholding structure before and after the offer for subscription
      - The directors and management structure of the company
      - Other information as requested by the Stock Exchange or any regulatory authority
- Registration of a prospectus
  - Before issue, prospectus must be registered: s.38D of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32)
  - The Stock Exchange of Hong Kong Limited is responsible for the vetting and authorization of prospectuses for securities to be listed on the Stock Exchange

  - If complies with Company (Winding-up and Miscellaneous Provisions) Ordinance, Stock Exchange will issue an authorization certificate together with other documents submitted by the issuer to Companies Registration for registration:
    - share application form
    - consent letter of any expert named in the prospectus, e.g. auditor, property valuer
    - certified copies of material contracts referred to in the prospectus, e.g. underwriting agreement
    - authorization certificate issued by the Stock Exchange

XVIII. Civil and Criminal Liabilities for Misstatements in Prospectus under the Companies (Winding-Up and Miscellaneous Provisions) Ordinance

- Criminal liability for misstatements
  - Section 40A of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32)
    - includes any untrue statement in prospectus, any person who authorised the issue is liable to imprisonment and a fine unless he/she proves either that the statement was immaterial, or that he/she had reasonable grounds to believe up to the time of the issue of the prospectus that the statement was true s.40A imposes a criminal liability for misstatements in relation to prospectuses issued by a company incorporated in Hong Kong.
    - Where a breach of s.40A of Companies (Winding-Up and Miscellaneous Provisions) has been proved on indictment, a fine of up to HK$700,000 and three years' imprisonment may be imposed. Where the matter is tried summarily, a fine of up to HK$150,000 and 12 months' imprisonment may be imposed.
  - Section 107 of Securities and Futures Ordinance (Cap.571) SFO
    - a person commits a criminal offence if he makes any fraudulent/reckless misrepresentation for the purpose of inducing another person (a) to enter into or offer to enter into, an agreement to acquire, dispose of, subscribe for or underwrite securities; or a regulated investment agreement; or (b) to acquire an interest in or participate in, or offer to acquire an interest in or participate in, a collective investment scheme
  - Section 277 of Securities and Futures Ordinance (Disclosure of false or misleading information inducing transactions), s.298 of Securities and Futures Ordinance (Offence of disclosure of false or misleading information inducing transactions)
    - Section 298 of Securities and Futures Ordinance is the basis for criminal sanction, and its *equivalent* civil sanction is set out in s.277 of Securities and Futures Ordinance
    - Under ss.277 and 298 of the SFO, liability arises where a person discloses, circulates or disseminates, or authorises or is concerned

in the disclosure, circulation or dissemination of false or misleading information which is likely to induce subscription, sale or purchase of securities or dealing in futures or increase, reduce, maintain or stabilize price, and the person knows that, or is reckless or negligent (for civil proceedings only) as to whether, it is false or misleading
    - SFO s.384 provides that it is an offence for any person, in purported compliance with a statutory requirement to provide the Securities and Futures Commission or the Stock Exchange of Hong Kong Limited with information that is false or misleading in a material particular.
    - This offence may be prosecuted by the Securities and Futures Commission in the Magistrates Court or by the Department of Justice on indictment. The maximum penalty on indictment is 2 years imprisonment and a fine of HK$1 million
    - The landmark case was the IPO prospectus of Hantex International Holdings Company Ltd (Hantex), which was listed on the Hong Kong Stock Exchange on Christmas Eve 2009. Hantex acknowledged that it had been reckless in allowing materially false and misleading information to be included in its prospectus. The result of which the proceeds from this IPO had to be returned by court order following Hantex' acknowledgement that it had contravened s.298 of the SFO

- Civil liability under the Companies Ordinance
  - Section 40(1) of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32)
    - where a prospectus invites persons to subscribe for shares or debentures of a company, the following persons shall be liable to pay compensation to all persons who on the faith of the prospectus subscribe for any shares or debentures and who suffer loss or damage by reason of an untrue statement included therein:
      - (a) director of the company at the time of issue of the prospectus
      - (b) who has authorised himself/herself to be named and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time
      - (c) a promoter of the company
      - (d) who has authorised the issue of prospectus
  - Section 40 of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32) shall extend to a non-Hong Kong company if it is issued, circulated or distributed in Hong Kong (s.342E) of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32)

- Defences against civil liability under s.40(1) of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32)
  - Section 40(2) of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32) – no person is liable under s.40(1) of Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32) if he or she proves any of following:
    - (a) that, having consented to become a director, he/she withdrew consent before the issue of the prospectus, and that is was issued without his/her authority or consent

    - (b) that the prospectus was issued without his/her knowledge or consent, and that on becoming aware of its issue he/she gave reasonable public notice that it was issued without his/her knowledge or consent
    - (c) that, after the issue of the prospectus and before allotment, he/she, on becoming aware of any untrue statement, withdrew consent and gave reasonable public notice of the withdrawal and of the reason for it
    - (d) that
      - (i) as regards every untrue statement, he/she had reasonable grounds to believe, and did believe up to the time of the allotment of the shares/debentures, that the statement was true;
      - (ii) as regards every untrue statement by an expert or contained in a copy of a report or valuation of an expert, it fairly represented the statement, or was a correct and fair copy of the report of valuation;
      - (iii) as regards every untrue statement by an official person, or contained in a copy of or extract from a public official document, it was a correct and fair representation of the statement or copy of or extract from the document

- Misrepresentation
  - Definition: consists in a false statement of existing or past fact made by one party (the misrepresentor) before or at the time of making the contract, which is addressed to the other party (the misrepresentee) and which induces the other party to enter into the contract
  - Requirements of liability: (i) a false statement of fact; (ii) false statement of fact must have been addressed by the representor to the party misled; that is, the representee; (iii) false statement of fact has induced the plaintiff to enter into the contract

- Fraudulent misrepresentation
  - *Derry v Peek* (1889) LR 14 App Cas 337 – Peek sued the directors in tort for deceit, but the court held that present reasons had led the directors to make the untrue statement and thus, Peek's action failed
  - Remedies – either affirm the contract and bring an action for damages for deceit or rescind the contract and sue for damages for any loss suffered

- Negligent misrepresentation
  - A person who has been induced to enter into contract as a result of a negligent (careless) misrepresentation made by other party
  - Remedies – either rescind the contract or sue for damages under the Misrepresentation Ordinance (Cap.284)

- Innocent misrepresentation
  - Neither a fraudulent nor a negligent misrepresentation
  - Remedies – misled party has no right to damages, only remedy is rescission, the court has a discretion to award damages instead of rescission under s.3(2) of the Misrepresentation Ordinance (Cap.284)

CHAPTER 8

ACCOUNTS AND AUDIT, ANNUAL AND CONTINUING COMPLIANCE

1. Accounting and Auditing Requirements

- Financial year beginning before 3 March 2014 (date of commencement of the Companies Ordinance (Cap.622) ("CO")) and ending after 3 March 2014 should follow the provisions of the predecessor Companies Ordinance on the preparation and contents of the financial statements as well as their circulation and adoption in annual general meeting (AGM).
- Financial statements for the year ending 31 March 2015 will follow the provisions of the Companies Ordinance.
- Directors should lay statement of profit or loss/income statement and statement of financial position or consolidated financial statements before AGM (ss.429 to 431 of the Companies Ordinance) according to the requirement as stipulated in s.610 unless the company is not required to hold AGM if:
  - Everything that is required to be done at the meeting is done by a written resolution and copies of documents required to be laid at the meeting are provided to each member on or before the circulation date of the written resolution. (i.e. pass a written resolution in lieu of AGM, the provision provided under the predecessor Companies Ordinance) or in accordance with s.610 of the CO under the following conditions:
    - company has only one member; or
    - all of the following are satisfied (s.613):
      - company has passed a resolution by all members to dispense with the holding of AGM
      - company has not revoked the resolution or the company has revoked the resolution but is not required to hold AGM in respect of a financial year that would be required to be held within 3 months after the resolution ceases to have effect
      - no member of the company has required the holding of the AGM under s.613(5)
- Companies may dispense with the holding of AGMs by unanimous shareholders' consent. The company is required to deliver a copy of the resolution to the Registrar of Companies within 15 days after it has been passed
- Company may revoke the resolution to dispense with holding the AGM by passing an ordinary resolution (s.614(1))

II. Timing for Companies Laying the Accounts

- Accounts should be made up not more than 6 months for listed/public company, or not more than 9 months for private company/company limited by guarantee after the end of the accounting reference period[Note 1] by reference to which the financial year is to be determined (s.610(1))
  - Note 1: An accounting reference period is the period by reference to which the company's annual financial statements are to be prepared. The first and last days of the first accounting reference period[Note 2] determine the company's first financial year under the Companies Ordinance (s.367). Every subsequent accounting reference period of a company is a period of 12 months beginning immediately after the end of the previous accounting reference period and ending on its accounting reference date, unless the accounting reference period is shortened or extended by alteration of the accounting reference date (s.368(3)).
  - In short, accounting reference period is the reporting period covered by the financial statement
  - Sections 368 and 370 of the CO require the accounting reference periods to be 12 months generally
  - Section 369(6) of the CO requires that accounting reference period of the first set audited financial statements to be within 18 months after incorporation
  - Section 371(5) of the CO stipulates that the change of accounting reference period cannot extend the accounting reference period to be longer than 18 months
  - In conclusion, the statutory audited financial statements cannot cover a period more than 18 months
    - Note 2: The first accounting reference period is determined as follows -
      - For an existing company, it begins on the day immediately following its primary accounting reference date and ends on the first anniversary of that date (s.368(1)). Examples as below:
        - On the basis that the Companies Ordinance came into operation on 3 March 2014 and the accounts of the companies have been prepared under the predecessor Companies Ordinance in the circumstances described in ss.369(1) to 369(4).

	Company X	**Company Y**	**Company Z**
End date of annual financial statements	On 31 March each year	On 30 September each year	On 31 December each year
Primary Accounting Reference Date	31 March 2014	30 September 2014	31 December 2014
First Accounting Reference Period (First Financial Year)	1 April 2014 to 31 March 2015	1 October 2014 to 30 September 2015	1 January 2015 to 31 December 2015

Date for delivery of the **first** annual return accompanied by the first financial statements under the new Companies Ordinance for registration (where the company is a public or guarantee company)	For public company: Within 42 days after 30 September 2015 For guarantee company: Within 42 days after 31 December 2015	For public company: Within 42 days after 31 March 2016 For guarantee company: Within 42 days after 30 June 2016	For public company: Within 42 days after 30 June 2016 For guarantee company: Within 42 days after 30 September 2016

Notes:

For the accounts made up to the "primary accounting reference date":

The financial reporting requirements of the Companies Ordinance (Cap.622) **do not** apply. Provisions under the predecessor Companies Ordinance should be complied with instead.

If the company is a public company or a guarantee company, the annual return accompanied by certified true copies of financial statements, directors' report and auditor's report should be delivered for registration within 42 days from the date of annual general meeting pursuant to ss.107 and 109 of the predecessor Companies Ordinance. (Schedule 11 s.121 of the CO)

For the financial statements covering the first "accounting reference period" i.e. first financial year:

They are the first financial statements required to be prepared under the Companies Ordinance.

If the company is a public company or a guarantee company, the annual return accompanied by certified true copies of financial statements, directors' report and auditor's report should be delivered for registration within 42 days after the company's return date. The return date is 6 months (for a public company) or 9 months (for a guarantee company) after the end of the company's accounting reference period.

For private companies:

For local private companies, there is no change in the requirement to deliver annual returns. A private company should deliver the annual return for registration within 42 days after the anniversary of the date of the company's incorporation.

- For a company formed and registered under the Companies Ordinance, first accounting reference period begins on its incorporation date and ends on its primary accounting reference date[3] (s.368(2))

- Note 3: "primary accounting reference date" is the end date of the accounts or financial statements by reference to which the first accounting reference period, i.e. the first financial year, of a company under the Companies Ordinance is determined (s.368)
  - Existing company
    - For an existing company, the primary accounting reference date is the date up to which the company's accounts for the financial year beginning before the commencement of the Companies Ordinance ("the relevant financial year") are made, if the accounts have been laid before the company in general meeting under s.122 of the predecessor Companies Ordinance or provided to the members under section 111(6) of the predecessor Companies Ordinance on or after the commencement date of the Companies Ordinance (ss.369(1)(a), 369(2) and 369(3)).
    - If the accounts for the relevant financial year have not been so laid or provided to members, the primary accounting reference date is determined as follows, pursuant to ss.369(1)(b), 369(2) and 369(4):
      - (a) it is the end date of the accounts for the relevant financial year that have been prepared on or before the date by which the company is required by s.111(1) of the predecessor Companies Ordinance to hold a general meeting (ss.369(1)(b)(i) and 369(2));
      - (b) if (a) does not apply, it is the first anniversary of the end date of the accounts for the financial year immediately preceding the relevant financial year that have been prepared on or before the date by which the company is required by s.111(1) of the predecessor Companies Ordinance to hold a general meeting for the financial year immediately preceding the relevant financial year (ss.369(1)(b)(ii) and 369(4)); and
      - (c) in any other case, it is the date by which the company is required by s.111(1) of the predecessor Companies Ordinance to hold a general meeting (s.369(1)(b)(iii)).
    - You can refer to the above table to find the examples of primary accounting reference dates.
  - Company registered under the Companies Ordinance
    - For a company registered under the Companies Ordinance, the primary accounting reference date is a date specified by the directors that falls within 18 months after its incorporation date, or if no date is specified by the directors, the last date of the month in which the first anniversary of the company's incorporation falls (ss.369(5) to 369(7)).
      - For example, the date of incorporation of X company is 5 June 2014 (after the commencement date of the Companies Ordinance) and if the directors specify the accounting reference date fallen within 18 months after 5 June 2014, like 31 December 2014, then this the primary accounting reference date. However, if no date is specified by the directors, then the primary accounting reference date will be 30 June 2015

- Failure of laying the financial statements before AGM, the offence:
  - Directors must lay financial statements etc. before AGM, otherwise, a fine of $300,000; wilfully fails, imprisonment for 12 months on top of the fine (s.429(4))

III. Content of Financial Statements

The annual financial statements must give a true and fair view of the financial position of the company (or the group) as at the end of the financial year; and the financial performance of the company (or the group) for the financial year. The true and fair view requirement does not apply if the company falls within the *reporting exemption* which will be detailed as below.

In general, the content of financial statements includes:

- Income Statement or Statement of Financial Performance or Profit and Loss Account or statement of comprehensive income, statement of revenue and expense
- Statement of Movements in Equity or statement of retained earnings, reports on the changes in equity of the company during the stated period
- Statement of Financial Position or Balance Sheet which reports on a company's assets, liabilities, and owners' equity
- Statement of Cash Flows which reports on a company's cash flow activities, particularly its operating, investing and financing activities
- Statement of Financial Position
- Statement of Accounting Policies
- Notes to the Financial Statements describe each item on the statement of financial position/balance sheet, income statement and cash flow statement in further detail
- Independent Auditor's Report

Schedule 4 "Accounting Disclosures" of the Companies Ordinance (Cap.622) states that financial statements must comply with:

- Part 1 of Schedule 4 if the company falls within the reporting exemption for the financial year; or
- Parts 1 and 2 of Schedule 4 if the company does not fall within the reporting exemption for the financial year
- Under Part 1 of Schedule 4, the following should be required for companies whether or not falling within the reporting exemption:
  - the aggregate amount of any outstanding loans made to eligible employees to enable them to buy shares in the company under the authority of ss.280 and 281 of the CO during the financial year
  - the annual consolidated financial statements to contain, in the notes to the statements, the holding company's statement of financial position and movement in the holding company's reserves
  - The holding company's statement of financial position is not required to contain any notes. This statement of financial position must be in the format in which this statement would have been prepared if the holding company had not been required to prepare any consolidated financial statements

- subsidiary's financial statements to contain particulars of ultimate parent undertaking in the notes to the statements, i.e. the name of the ultimate parent undertaking; its country of incorporation (if body corporate); and the address of its principal place of business (if not body corporate)
- the financial statements to state whether they have been prepared in accordance with the applicable accounting standards; and if they have not been so prepared, the particulars of, and the reasons for, any material departure from those standards

- The disclosure of auditor's remuneration under Part 2 of Schedule 4 of the CO is required for companies not falling within the reporting exemption.
  - The financial statements must comply with the applicable accounting standards issued by the Hong Kong Institute of Certified Public Accountants.
  - the financial statements must contain all additional information necessary for compliance with applicable accounting standards if it is insufficient to give a true and fair view
  - If compliance with the accounting standards would be inconsistent with a requirement to give a true and fair view, the financial statements must depart to the extent necessary for it to give a true and fair view; and have to contain the reasons for, and the particulars and effect of, the departure
  - The company can follow the requirements of the relevant accounting standards when departure from the Companies Ordinance with such statutory backing
    - E.g. the requirement not to consolidate a subsidiary in the financial statements of an investment entity parent under the requirement of HKFRS 10
- The reporting exemptions are set out in the following sections –
  - Section 380(3) of the CO: (no requirement to disclose auditor's remuneration in financial statements).
  - Section 380(7) of the CO: (no requirement for financial statements to give a "true and fair view").
  - Section 381(2) of the CO: (subsidiary undertakings may be excluded from consolidated financial statements in accordance with applicable accounting standards).
  - Section 388(3)(a) of the CO: (no requirement to include business review in directors' report).
  - Section 406(1)(b) of the CO: (no requirement for auditor to express a "true and fair view" opinion on the financial statements).

IV. Content of Directors' Report

Financial statements accompany with directors' report which is basically a report of the company's information that people may wish to know about but is not included in the accounts should also sent to the members of the company. Every copy of a directors' report laid before a company in general meeting, or sent to a member or otherwise circulated, published or issued by the company, must state the name of the person who signed the report on the directors' behalf pursuant to s.391 of the Companies Ordinance.

According to s.390 of the Companies Ordinance, the directors' report in general should disclose:

(a) the principal activities of the company;
(b) the name of every person who was a director of the company during the financial year; or during the period beginning with the end of the financial year and ending on the date of the report;
(c) matters relating to shares issued, management contracts, arrangements and other contracts involving director's interest or benefits, donations and;
(d) any other matters which are material for appreciation of the state of the company's affairs.

The information required by s.390 also extends to any of the company's subsidiary undertakings if the directors' report is prepared on a consolidated basis.

The requirements regarding the contents of a directors' report which could be referred to various provisions including ss.390, 470, 543 and Schedule 5 (on the inclusion of a business review). Section 388 of the CO requires a directors' report to contain the information and comply with other requirements prescribed by regulations made under s.452(3).

- Business Review in the directors' report
  - Under s.388, all Hong Kong companies are required to prepare a business review in the directors' report in order to comply with Schedule 5, except satisfy any one of the following criteria:
    - Company falls within the reporting exemption under s.359; or
    - Company is a wholly owned subsidiary of another body corporate in the financial year; or
    - Company does not fall within the reporting exemption but pass a special resolution at least six months before the end of the financial year to which the directors' report relates
    - Sections 359 to 366 and Schedule 3 set out the qualifying conditions for companies to prepare **simplified financial and directors' reports:**

(Sections 359(1)(a)(i), 361, Schedule 3 ss.1(1), 1(2)):	**(Sections 359(2)(a), 359(2)(b) and 359(2)(c)(i), 364, Schedule 3 ss.1(7), 1(8) and 1(9)):**
A private company is automatically qualified for simplified reporting if it is a "small private company", i.e. a private company that satisfies any two of the following conditions –	**A private company that is the holding company of a "group of small private companies" and that satisfies any two of the following conditions is automatically qualified for simplified reporting –**
• (i) total annual revenue[Note 1] of not more than HK$100 million;	• (i) aggregate total annual revenue[Note 1] of not more than HK$100 million;
• (ii) total assets[Note 1] of not more than HK$100 million;	• (ii) aggregate total assets[Note 1] of not more than HK$100 million;
• (iii) no more than 100 employees[Note 2].	• (iii) no more than 100 employees[Note 2].

Note 1: The total revenue and total assets are determined based on the relevant financial statements i.e. using the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRS). Where the reporting period is shorter or longer than a year, the amount of total revenue for a financial year is to be calculated on a pro-rata basis as if the length of the financial year were 12 months. In respect of a group, the aggregate total annual revenue and aggregate total assets are calculated after eliminating intergroup transactions and balances. If a group member records a revenue or amount due from other group members and the amount is over the size limit, the group will not be able to meet the size test even these amounts are eliminated on consolidation level.
Note 2: According to Schedule 3, the number of employees is the average number of persons employed by the company or the group during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows: (a) determine the number of employees as at the end of each calendar month; (b) add together all the monthly numbers; (c) divide the total number by the number of months in the reporting period

In order to qualify for the reporting exemption as a group of small private companies:	In order to qualify for the reporting exemption as a group of eligible private companies:
• each company in the group must qualify as a small private company; and	• each company in the group must qualify as either a small private company or an eligible private company; and
• the aggregate amounts for the group in total must not exceed 2 out of 3 of the small size tests.	• the aggregate amounts for the group in total must not exceed 2 out of 3 of the larger size tests.
(for eligible private company: Sections 359(1)(c), 360(1), 362, Schedule 3 s.1(3) and 1(4);for group of eligible private companies: Sections 359(2)(a), 359(2)(b) and 359(2)(c)(ii), 360(2), 365, Schedule 3 ss.1(10), 1(11) and 1(12)):	**(for a small guarantee company: Sections 359(1)(a)(i), 363, Schedule 3 ss.1(5) and 1(6); for a group of small guarantee companies: Sections 359(3), 366, Schedule 3 ss.1(13) and 1(14)):**
An "eligible private company" or an eligible private company that is the holding company of a "group of eligible private companies" that satisfies any two of the following conditions and has the approval of members holding at least 75% of the voting rights[Note 3] with no other members objecting, is qualified for simplified reporting –	**A "small guarantee company" or a guarantee company that is the holding company of a "group of small guarantee companies" is also automatically qualified for simplified reporting if its total annual revenue or aggregate total annual revenue (as the case may be) does not exceed HK$25 million.**

• (i) total (or aggregate total) annual revenue of not more than HK$200 million; • (ii) total (or aggregate total) assets of not more than HK$200 million; • (iii) no more than 100 employees.	
Note 3: The 75% vote is calculated as a percentage of the entire shareholding of a company, not simply as a percentage of the shareholders who attend the general meeting. The resolution is defeated if any member objects 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.	

Eligibility for simplified reporting under old and new Companies Ordinance

	Predecessor CO	**Current CO**
Companies required to prepare "true and fair" financial statements	a. Public companies b. Other private companies/groups and companies/groups limited by guarantee	a. Public companies b. Other private companies/groups and companies/groups limited by guarantee
Companies permitted to prepare simplified financial statements	Section 141D private companies	a. Larger "eligible" private companies/groups with shareholder approval b. Small "eligible" private companies or groups c. Small companies or groups limited by guarantee d. Section 141D private companies

- the review should reflect the directors' view of the business and be consistent with information which the directors use in managing the reporting entity, including the identification and management of operating segments, the strategic priorities of or within the reporting entity, the management of capital, the financial risk management strategies of the reporting entity and any KPIs monitored by the directors
- (b) The scope of the review should be consistent with the scope of the financial statements
  - should consider the company and all the subsidiaries as a whole, in order to satisfy the requirement of paragraph 4 of Schedule 5.
- (c) The review should complement as well as supplement the financial statements, in order to enhance the overall corporate disclosure
  - provides useful financial and non-financial information about the business and its performance that is not reported in financial statements but which, in the directors' judgement, may be relevant to the members' evaluation of past results and assessment of future prospects.
  - provides additional explanations of amounts recorded in the financial statements; and/or
  - explains the conditions and events that shaped the information contained in the financial statements.
- (d) The review should be understandable
  - provides members with focused and relevant information on material matters. In considering materiality, directors are expected to focus on the relevance of the information to the assessment of financial performance, position and adaptability and management's discharge of its accountability/stewardship responsibilities
  - consider the evidence underpinning the information to be included in the business review
  - should be written in a clear and readily understandable style
  - should be clear to the user how the KPI has been computed and the source of data used in that calculation
  - consider the extent to which the review is comparable with reviews prepared by other entities in the same industry or sector
- (e) The review should be balanced and neutral, dealing even-handedly with both good and bad aspects
  - retains balance and that members are not misled as a result of the excessive focus on favourable information or the omission of any significant information on unfavourable aspects
  - KPIs should be selected with due regard to their relevance to the development, performance or position of the reporting entity's business without undue focus on whether they show the business in a favourable or unfavourable light
  - The balanced and neutral presentation of a business review is increased when KPIs and other information in the review are prepared and presented consistently from one year to the next

- Cap.622D Companies (Directors' Report) Regulation
  - Particulars of shares issued (s.5)

  - Particulars of debentures issued (s.5A)
  - Particulars of equity-linked agreement (s.6)
  - Dividend recommended (s.7)
  - Permitted indemnity provision in force (s.9)
- Disclosure of directors' names
  - Section 390(1)(a) of the CO
    - must contain the name of every person who was a director of the company either during the financial year or during the period beginning with the end of the financial year and ending on the date of the directors' report
    - if the company is required to prepare a consolidated directors' report (as per s.388(2)), then s.390(3) states that s.390 has effect as if a reference to "the company" in s.390(1) or s.390(2) were a reference to "the company and the subsidiary undertakings" included in the annual consolidated financial statements for the financial year, the names of any persons who were or are directors of any company in the group included in the consolidated financial statements need to be disclosed in the holding company's consolidated directors' report
    - The names of directors of all subsidiary undertakings included in the annual consolidated financial statements may be disclosed on a consolidated basis, without further setting out specifically the directorship of each individual subsidiary undertaking
      - if a person is a director of more than one company in the group his or her name may be disclosed once in the list of names
      - If, in the opinion of the directors of the holding company, the number of names of directors of all subsidiary undertakings is of excessive length, disclosure of the names of such directors may be made by way of inclusion by reference, provided that the information on the relevant directors' names is clearly contained in the holding company's Directors' Report by making the list of such names readily available to the reader. Or this may be disclosed by providing a link to the holding company's website that contains a full list of the names
- information on equity-linked agreements 股票掛鈎協議 entered into by the company by s.6(1) of Cap.622D Companies (Directors' Report) Regulation
  - an agreement that will or may result in the company issuing shares; or
  - an agreement requiring the company to enter into the agreement specified in an agreement that will or may result in the company issuing shares; and
  - includes:
    - an option to subscribe for shares;
    - an agreement for the issue of securities that are convertible into, or entitle the holder to subscribe for, shares in the company;
    - an employee share scheme; and
    - a share option scheme; but
  - does not include:
    - an agreement to subscribe for shares in a company that is entered into pursuant to the company's offer of its shares to the public; and
    - an agreement to subscribe for shares in a company that is entered into pursuant to an offer made to the members of the company in proportion to their shareholdings

- a summary of reasons relating to the affairs of the company given by a director who has resigned or refused to stand for re-election and has given written notice to the company specifying that the resignation or refusal is due to reasons relating to the affairs of the company by s.8(1) of Cap.622D Companies (Directors' Report) Regulation
- the new disclosure requirement regarding permitted indemnity provisions of directors provided under s.470 of the Companies Ordinance such that non-compliance will constitute an offence by s.9 of Cap.622D Companies (Directors' Report) Regulation
  - permitted indemnity provision (獲准許的彌償條文), in relation to a company, means a provision that—
    - provides for indemnity against liability incurred by a director of the company to a third party; and
    - meets the requirements specified in s.469(2) of the Companies Ordinance
      - should not provide any indemnity against:
      - (a) any liability of the director to pay— (i) a fine imposed in criminal proceedings; or (ii) a sum payable by way of a penalty in respect of non-compliance with any requirement of a regulatory nature; or
      - (b) any liability incurred by the director— (i) in defending criminal proceedings in which the director is convicted; (ii) in defending civil proceedings brought by the company, or an associated company of the company, in which judgment is given against the director; (iii) in defending civil proceedings brought on behalf of the company by a member of the company or of an associated company of the company, in which judgment is given against the director; (iv) in defending civil proceedings brought on behalf of an associated company of the company by a member of the associated company or by a member of an associated company of the associated company, in which judgment is given against the director; or (v) in connection with an application for relief under s.358 of the predecessor Companies Ordinance or s.903 or s.904 of the CO in which the Court refuses to grant the director relief
- scope of directors' material interests disclosures
  - Scope widened

Predecessor CO	Current CO
Directors' report "Contracts of significance in relation to company's business"	**Directors' report** Transaction, arrangement or contract involves company's parent, subsidiary or fellow subsidiary [Note 1]
	Notes to the financial statements Transaction, arrangement or contract involves company [Note 2]

Note 1: Material interests of directors in a transaction, arrangement or contract of company or other group company that is significant to the company's business
In the case of public company – it includes individual or entity "connected" with a director
"Connected" – definition is broader than HKAS24 Related Party Transaction
Note 2: May not necessary increase the amount of audit work as already covered in the scope of HKAS24

V. Auditors' Responsibilities

Predecessor CO	Current CO
Auditors have no specific responsibility to review or auditor directors' report	If in the auditor's opinion, the directors' report is inconsistent with financial statements: • must disclose in auditor's report • may choose to bring to members' attention at general meeting For full financial statements to give a "True and Fair view" must comply with: • most recently effective HKFRS (issued by HKICPA) • disclosure requirements of CO; and • if listed, HK Stock Exchange Listing Rules
	If "True and Fair" is overrode, companies must: • include extra information in financial statements if compliance with new CO or accounting standards would be insufficient to give a true and fair view • disclose reasons for and particulars and effects of the departure from the CO or accounting standards in financial statements if compliance with such would be inconsistent with true and fair view

VI. Appointment of Auditors

- Directors may appoint the company's first auditors at any time before first AGM (s.395)
- Every company should at each AGM appoint/re-appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the company's next AGM (s.396)
- If a company is not required to hold an AGM under s.612:
  - the appointment/re-appointment of auditors is done by a written resolution
  - auditor deemed to be reappointed under s.403
- May appoint an individual, a corporate practice (limited company) or a firm (partnership) as auditor

VII. Qualifications and Disqualifications for Appointment

- Must be qualified under Professional Accountants Ordinance (Cap.50) and hold a practicing certificate usually granted to a Hong Kong resident
- Independent from the company which appoints him/her
  - not an officer or servant of the co
  - not a partner of, or an employee, or an officer/servant of the company
  - for listed company, the above restrictions extend to those in the subsidiary or holding company of that company

VIII. Protection to the Auditors

- Remuneration of an auditor appointed by the members may be fixed by shareholders in AGM/GM (s.404(1))
- Remuneration of an auditor appointed by the directors may be fixed by directors or shareholders in AGM/GM (s.404(2))
- Removal of auditor before the expiration of his/her term of office by shareholders' ordinary resolution in general meeting (s.419(1))
  - special notice is required for an ordinary resolution proposed for removing auditors (s.419(2))
  - Form NA1 Notice of Removal of Auditor (Appendix 8A) should be given to Companies Registrar within 15 days (s.419(4))
  - Auditors may attend the general meetings relating to the above

IX. Appointment and Removal of Auditor Prior to Expiration of Term of Office under the Listing Rules

- New Listing Rules 13.88 (w.e.f. 1 Jan 12) require shareholders' approval to appoint an auditor and to remove an auditor before the end of his term of office
- An issuer is required to send a circular proposing the removal of auditor to shareholders with any written representations from the auditor, not less than 10 business days before the general meeting
- An issuer must allow the auditor to attend the general meeting and make written and/or verbal representations to shareholders at the general meeting

X. Resignation of Auditors

- Section 417 – Auditor may resign from office by depositing a written notice of resignation at registered office
- The notice should contain a statement either there are or no circumstances connected with resignation that the auditor considers should be brought to the notice of the members or creditors of the company
- The notice should be signed by the resigning auditor
- The company should send the notice to members, debenture holders and all entitled to receive it if the notice contains facts that should be brought to the notice of members and the creditors
- The company must file a Form NA2 Notification of Resignation of Auditor (Appendix 8B) with the Companies Registry within 15 days
- Right to requisite a general meeting when he tenders his resignation, but wish to draw the attention of members to certain matters
- A "statement of circumstances" defined in s.392 of the Companies Ordinance to mean a statement given under s.424(a) or s.425(1)(a), i.e., a statement of the circumstances connected with the resignation or termination of appointment (including removal, resignation or retirement) of an auditor who considers that such circumstances should be brought to the attention of the company's members or creditors should be given to members of the company

- The auditor who has given the company a statement of circumstances is also required to deliver a copy of the statement to the Registrar for registration in the circumstances, and within the period, mentioned in ss.426(5) and 427(5)
- If the auditor gives a statement to the company under s.424(b) or s.425(1)(b) that there are no circumstances connected with his or her resignation or termination of appointment as an auditor that should be brought to the attention of the company's members or creditors, there is no requirement to deliver such statement to the Registrar of Companies for registration.

XI. Auditor's Report

Auditor's Report must state

- whether in his/her opinion, the company's balance sheet/statement of financial position and income statement/statement of profit or loss has been prepared in compliance with the Companies Ordinance; and
- exhibit a true and fair view of the state of the company's affairs. (s.406)

XII. Basic Elements of an Auditor's Report

- A title – Independent Auditor's Report
  - The auditor's report should have a title that clearly indicates that it is the report of an independent auditor
- Addressing to members of the Reporting Entity, place of incorporation for the reporting entity needed to be stated
- An introductory paragraph:
  - the financial statements have been audited and what accounting principles have been adopted, usually they will be generally accepted in Hong Kong, e.g. Statements of Auditing Standards issued by HKICPA and Appendix 16 of the Listing Rules (applicable to listed companies only)
- Respective responsibilities of directors and auditors
- The basis of auditor's opinion e.g. examination on a test basis
- Opinion of auditor e.g. the financial statements give a true and fair view of the state of affairs of the company and have prepared properly prepared in accordance with Companies Ordinance.
  - examples of an unqualified auditor's report are set out as below:

Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Small and Medium-Sized Entity Financial Reporting Standard.

INDEPENDENT AUDITOR'S REPORT

To the Members of SME Limited
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Financial Statements

Opinion
We have audited the financial statements of SME Limited ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and the income statement [and cash flow statement] for