

Impact of the New Hong Kong Companies Ordinance on Charitable Institutions

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The new Hong Kong Companies Ordinance (Cap. 622) (New CO) came into effect on March 3, 2014. The impact of this new law on registered charitable institutions incorporated as Hong Kong companies limited by guarantee (CLGs) is discussed in detail in our article “Assessing the Impact of the New Hong Kong Companies Ordinance on Charitable Institutions.” A summary of the key points of our article is provided here.

Impact on directors and other officers of CLGs

The New CO raises the bar on corporate governance requirements, especially in terms of the enforcement regime and standard of care expected of directors and other officers.

Term “responsible person” replaces concept of “officer in default”	Directors, managers, company secretaries and shadow directors (officers) may be personally liable for certain offenses (<i>e.g.</i> , failure to properly prepare and circulate audited financial statements) — liability now extends to officers who participate in, authorize or permit the breach, and also those who engage in reckless acts and intentional contraventions, failures and willful blindness
Duty of care, skill and diligence codified	Actions of a director to be judged both objectively and subjectively — essentially mandates a minimum standard of care, skill and diligence expected of directors irrespective of their corporate or management experience
Duty of disclosure to the board expanded	Directors must disclose to the board the nature and extent of any material interest he/she has in a contract, transaction or arrangement that is significant to the company
Business Review included in directors’ report	If the CLG does not qualify for simplified financial reporting, an analytical and forward-looking “business review” must be included in the directors’ report
Right to be indemnified out of company assets	Directors may be indemnified by the company assets for liabilities to third parties, subject to certain exceptions and disclosure requirements
Directors’ insurance	Acknowledges that CLGs may purchase D&O insurance

Changes to compliance obligations most relevant to CLGs

New CO seeks to clarify, streamline and modernize Hong Kong corporate law. Not all of the compliance changes are listed here — we highlight those that may specifically affect CLGs.

<p>CLG a distinct category — concept of a “private” CLG abolished</p>	<p>CLGs must have two directors; corporate directorships are prohibited — existing private CLGs may need to make immediate changes</p> <p>CLGs need to file (and therefore make publicly available) audited financial statements with their annual return</p>
<p>Accounting Reference Period (ARP)</p>	<p>Derived from the entity’s existing financial year-end (unless altered), the ARP is essential to determine key obligations under the New CO</p>
<p>Timing of AGMs, reporting documents and annual returns</p>	<p>AGM to be held within nine months from the end of the first ARP (unless AGM properly dispensed with) and annual return (with true certified copies of the audited financial statements, directors’ report and auditor’s report attached) to be filed within 42 days thereafter</p>
<p>Simplified financial reporting (<i>i.e.</i>, using “small GAAP”)</p>	<p>Historical cost-based accounting with fewer and simpler disclosures — eligible if annual revenue is not more than HK\$25m</p> <p>Auditors will opine whether accounts are “properly prepared” rather than giving a “true and fair view”</p> <p>CLGs should confirm articles permit preparation of accounts in this way</p>

Matters of procedural convenience

The New CO includes numerous procedural convenience amendments (not all listed below), and some may require the articles to be amended. The Inland Revenue Department should be notified of any changes to a CLG’s articles within one month and if the IRD rejects the amendments or was not informed of the change to the articles, the Section 88 Inland Revenue Ordinance tax-exempt status may be jeopardized.

Abolition of the memorandum of association	The key provisions in the memorandum (<i>e.g.</i> , the objects and powers clauses for a charity) are deemed to be part of the articles — there is no requirement to amend the articles for this
Dispense with holding an AGM	Optional — requires unanimous member approval and may require the articles to be amended (<i>e.g.</i> , if the articles require an AGM to be held, the New CO cannot override the articles) If dispensed with, a CLG must still prepare and circulate annual audited financial statements and reports
Dispense with using a common seal	Also optional — this will likely require an amendment to the articles, but if the seal is used infrequently the process of going through an amendment may be unwarranted

Obtaining Section 88 status in the future

The form of articles under the New CO (called the Model Rules) for a company limited by guarantee provide a good basis to use in preparing a new application to the IRD. Certain key amendments must be made to the articles based on the Model Rules to comply with the IRD requirements (*e.g.*, insert a detailed objects and powers clause, prohibit remuneration to directors, restrict distributions to members, etc.).

Looking ahead

Further commentary may be issued by the Companies Registry (in addition to the existing detailed materials) and/or the Inland Revenue Department on the impact of the New CO on CLGs. In time, the Law Reform Commission's 2013 report on reforming the law and regulatory framework relating to charities also may generate change in this area.