HOLDING AGMS AND TABLING OF ACCOUNTS – WHAT DO I NEED TO KNOW?

It is not uncommon for Hong Kong companies to overlook certain procedural requirements regarding the holding of annual general meetings (**AGMs**) and the tabling of audited accounts at those meetings. This may happen where, e.g., the company is a pure holding company – so such matters are not at the forefront of the minds of the managers of the business – or where the directors and shareholders are the same people. In that case, the directors may overlook compliance with certain procedural formalities as they, the director shareholders, are familiar with the company's financial situation.

Failure to hold an AGM within a certain timeframe and/or to table audited accounts (**accounts**) at an AGM are, however, offences under the Hong Kong Companies Ordinance, and the Hong Kong High Court's (**Court**) view of these offences has recently changed.

DO ALL HONG KONG COMPANIES NEED TO HOLD AN AGM?

Under the Companies Ordinance (**CO**), a Hong Kong incorporated company must hold an AGM in respect of each financial year (instead of in each calendar year as was the case under the old Companies Ordinance) (section 610) and, by reference to its accounting reference period (**ARP**):

- for a private company which is not a subsidiary of a public company, the AGM must be held within 9 months after the end of its ARP; or
- for a public company and its subsidiaries, the AGM of each company must be held within 6 months after the end of its ARP.

Under the CO, a company is not required to hold an AGM if:

- it is a dormant company and passes a special resolution to this effect;
- it effects the relevant business by a written shareholders' resolution instead;
- it is a single member company; or
- a written shareholders' resolution or general meeting resolution is passed which dispenses with holding an AGM in respect of a particular financial year or subsequent financial years.

DO ALL HONG KONG COMPANIES NEED TO PREPARE AND/OR FILE ACCOUNTS AND/OR TABLE ACCOUNTS BEFORE SHAREHOLDERS?

All Hong Kong companies, unless they are dormant, must prepare annual accounts.

A company's directors must lay before the AGM the company's financial statements, directors' report and auditors' report in respect of each financial year, within the same time frame as for the holding of AGMs (sections 429 and 431).

Save for small corporations (as defined by the Inland Revenue Department (**IRD**) and dormant companies, a company must file its accounts with the IRD for assessment of profit tax. There is not, however, a requirement to file the accounts with the Companies Registry.

WHAT IF MY COMPANY IS IN BREACH?

The offences

If default is made in holding AGMs within the required time period, the company and every officer of the company who is in default, is liable to prosecution and, if convicted, a fine of up to HK$50,000 (section 610).

If a director of a company fails to take all reasonable steps to comply with the requirement to lay accounts before the company's AGM, he is liable to prosecution and, if convicted, a fine of up to HK$300,000. If he willfully fails to take all reasonable steps to secure compliance, he is also liable to imprisonment for up to 12 months (section 429).

If a company's accounts are late in being prepared, it is not uncommon for the company to call an AGM within the requisite time frame, and then to adjourn. If the reconvened AGM, where the accounts are tabled, is held outside of the required time period though, the company will still be in breach of the CO. So, whilst this procedure may show a willingness by the company to comply with the CO, it does not, in fact, constitute formal compliance.

Rectification

The CO provides that the Court can grant relief by allowing the accounts to be laid at such GM as the Court decides (i.e., effectively extending the period allowed for holding an AGM and tabling accounts). Until recently, the Court readily granted relief where an applicant demonstrated three factors, namely: (1) the shareholders were conversant with the financial position of the company and so were not prejudiced by the non-compliance; (2) the default was inadvertent; and (3) the company would comply with its obligations in the future. Recent cases, however, indicate that the Court's stance has changed; it will no longer grant relief without there being discernible legitimate reasons for doing so. Jeopardising a proposed listing and rectifying time-barred breaches (see below) may well not be accepted as legitimate reasons. Conversely, a recent case suggests that new managers and owners of a company wishing to regulate the company's affairs properly and rectify past breaches is a scenario where the Court may exercise its discretion to grant relief. In conclusion, where breaches are technical or go back a number of years, or where there is no realistic possibility of prosecution and refusal to grant relief would not have adverse consequences, the Court may well not grant relief.

Other saving provisions?

Section 900 of the CO provides that certain breaches of the CO must be tried within three years after commission of the offence. This section applies to failure to hold an AGM on time and failure to table accounts before an AGM. The effect of this is that initiating proceedings for breaches which took place more than three years ago are time-barred.

WILL I BE LIABLE AS A DIRECTOR?

Directors at the time of breach of sections 429 or 610 will be liable. Future directors will also potentially be liable; as seen above, section 429 is broadly worded and refers to "*directors*" (rather than, for example, directors at the relevant time). As such, it is possible that anyone who becomes a director after the breach occurs (if it remains ongoing when he joins the board) (**"Incoming Director"**) may be held liable.

Section 429(4) provides, however, that a director will not be sentenced to imprisonment unless, in the opinion of the court, the offence was committed "*willfully*". The word 'willfully' suggests something done intentionally and appears to be a high threshold. Having said that, it is hard to argue that knowing about something and not actioning it is not willful behavior. So if current – or Incoming – directors know that there are breaches and choose to do nothing, it is possible that this seemingly high threshold could be met.

So if an Incoming Director has a full understanding of the breach (e.g., by conducting due diligence and recording it with a visible paper trail) he should seek to take remedial actions as soon as he joins the board (see 'practical tips' below), so that the chances of the Court entertaining a prosecution of the Incoming Director will be reduced, especially given that 'willfulness' may not be easy to establish.

Furthermore, it is worth noting that the Court has a general power of relief from liability (including criminal liability) (under section 903 of the CO) if a director/officer has acted honestly and reasonably and ought fairly to be excused of misconduct having regard to all circumstances of the case.

PRACTICAL TIPS

There are some straightforward steps that any company can take to avoid future breaches of sections 429 or 610 and to protect its directors. Further, if your company has already breached the CO, there are some steps which it might take to lessen its liability profile. These are as follows:

- diarise AGMs;
- engage a responsible and competent company secretary and accountant; and
- if permissible, put in place insurance or a deed of indemnity pursuant to which the company indemnifies its directors in respect of any losses (e.g. fines) incurred by them arising from possible breaches.

If a breach has come to light:

- hold an AGM as soon as possible and lay the relevant accounts;
- obtain written confirmation from the company's shareholders that they have not been prejudiced by the breaches and have always been aware of the financial position of the company; and
- if the breach was less than three years ago, consider applying to court for rectification.

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