

HKEx LISTING DECISION
Cite as HKEx-LD44-3 (First Quarter of 2005)

[Withdrawn in April 2019]

Summary	
Name of Parties	Company A - a Main Board listing applicant and its subsidiaries (the "Group") Subsidiary A - a company incorporated in the PRC and a wholly owned subsidiary of Company A
Subject	Whether the results of Subsidiary A could be consolidated into the financial statements of the Group where the registered capital of Subsidiary A had not yet been fully paid and such consolidation would result in non-compliance with the laws of Subsidiary A's place of incorporation?
Listing Rule	Listing Rule 4.11
Decision	The Exchange determined that it was acceptable for the Group to consolidate the results of Subsidiary A into its financial statements according to the accounting principles adopted by the Group. However, the prospectus was required to provide full disclosure of any non-compliance with the applicable PRC laws and the consequences of such non-compliance.

SUMMARY OF FACTS

1. Company A was incorporated outside Hong Kong and the PRC. After the end of the Group's track record period, Subsidiary A had obtained approval from the relevant PRC authorities to enable it to increase its registered capital payable by two instalments. The payment date of the second instalment was proposed to be after the completion of Company A's IPO.
2. Company A and its predecessors had made all past contributions to Subsidiary A's registered capital in compliance with an agreed timetable. Company A intended to raise funds to pay the outstanding capital contribution partly by a combination of bank loans and the IPO proceeds. It was not the intention of Company A to accelerate the timetable in order to pay up Subsidiary A's registered capital in full before the IPO of Company A.

3. However, according to the relevant PRC laws and regulations, unless the registered capital of Subsidiary A was fully paid, Company A was not permitted to consolidate the financial results of Subsidiary A into the audited consolidated accounts of the Group.
4. The financial results of the Group were prepared in accordance with Hong Kong Financial Reporting Standards. These standards specifically required Company A to consolidate the results of Subsidiary A into the results of the Group if it had control over Subsidiary A without considering whether Subsidiary A's registered capital had been fully paid.
5. Company A's PRC legal advisers had advised that notwithstanding the applicable PRC laws prohibiting consolidation of the accounts of a subsidiary that has not paid its registered capital in full, the proposed consolidation would:
 - a. neither result in a breach of the articles of association of Subsidiary A nor a breach of the official approval documents, which authorised the further increases in registered capital by instalments;
 - b. neither affect the continuing legal existence of Subsidiary A nor the decision making power, control and ownership of Company A over Subsidiary A; and
 - c. would not result in the legal person status of Subsidiary A being revoked by the relevant authorities.
6. Each of the existing shareholders of Company A had also jointly and severally undertaken to indemnify Subsidiary A against all claims, fines, penalties or losses whatsoever which might be incurred, suffered by, made against or become payable either by Subsidiary A or by the Group as a result of the breach of the capital contribution provisions under the PRC law.

THE ISSUE RAISED FOR CONSIDERATION

7. Whether the results of Subsidiary A could be consolidated into the financial statements of the Group where the registered capital of Subsidiary A had not yet been fully paid and such consolidation would result in non-compliance with the laws of Subsidiary A's place of incorporation?

APPLICABLE LISTING RULE OR PRINCIPLE

8. Listing Rule 4.11 provides that:-

'The financial history of results and the balance sheet included in the accountants' report must normally be drawn up in conformity with:-

- (a) *Hong Kong Financial Reporting Standards; or*
- (b) *International Financial Reporting Standards...'*

THE ANALYSIS

9. When considering a new applicant's suitability for listing, the Exchange expects each applicant to comply fully with all relevant laws and regulations at its place of incorporation and at the place where it conducts their business operations.
10. In the present case, the Exchange considered that the question of consolidation raised an issue of conflicts of law. A consolidation of the results of Subsidiary A would result in a contravention of PRC regulations. On the other hand, a failure to consolidate would result in Company A failing to comply with the requirements of Hong Kong Financial Reporting Standards.
11. The Exchange determined that for companies seeking a listing in Hong Kong, it is in the interest of the public investors in Hong Kong to have accounting information presented in accordance with the requirements of the accounting standards stipulated under the Listing Rules. The Hong Kong Financial Reporting Standards being one of those acceptable standards.
12. When reaching its conclusion, the Exchange considered the following factors:-
- a. Company A and its predecessors had complied with the agreed timetable for all past contributions to Subsidiary A's registered capital and the unpaid amounts arose as a result of a subsequent increase in the registered capital approved by the relevant PRC authorities;
 - b. Subsidiary A had been in actual operation since incorporation; and
 - c. the joint and several indemnities provided by the existing shareholders of Company A.
13. Accordingly, the Exchange determined that the consolidation issue could be sufficiently addressed by proper disclosure in the prospectus. This should include disclosure of:-
- the details of the non-compliance;
 - the PRC legal opinion on the potential consequences of the non-compliance, including assessment of the seriousness and likelihood of each of the consequences;
 - the expected time by which any such non-compliance would be rectified.

THE DECISION

14. Based on the above facts and the circumstances of the case and the Exchange's analysis of the Listing Rules, the Exchange determined that it was acceptable for the Group to consolidate the results of Subsidiary A into its financial statements according to the accounting principles adopted by the Group. However, the prospectus was required to contain full disclosure of any non-compliance with the applicable PRC laws and the consequences of such non-compliance.