



Hong Kong

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TRADING SUSPENSIONS PROPOSED BY HKEX FOR AUDITOR DISCLAIMERS AND ADVERSE OPINIONS

The Stock Exchange of Hong Kong (**HKEx**) is proposing a new Listing Rule to require suspension of trading in the securities of a listed issuer that publishes a preliminary results announcement for which the auditor issued (or indicated it will issue) a disclaimer on opinion or adverse opinion. The proposal is set out in HKEx's "Consultation Paper: Proposal Relating to Listed Issuers with Disclaimer or Adverse Audit Opinion on Financial Statements¹". The deadline for responding to this consultation is 30 November 2018.

Auditors' Opinions and Trading Suspensions in Hong Kong and in other Markets

Provision C.1 of the Exchange's Corporate Governance Code² requires the board of a listed issuer to present a balanced, clear and comprehensible assessment of its performance position and prospects in its financial reports. Provision C.2 requires the board to evaluate and determine the risks it will take to achieve the listed issuer's strategic objectives and to ensure that the listed issuer establishes and maintains appropriate and effective risk management and internal control systems.

Under Main Board Listing Rule 13.49(1) and (2)³, and GEM Listing Rule 18.49⁴, listed issuers have a continuing obligation

to publish a preliminary results announcement for the full financial year each year, not later than three months after the end of that financial year. The announcement must be based on the financial statements upon which the issuer and its auditor agreed. Where an auditor concludes that financial statements are not free from material misstatement (or is unable to obtain sufficient appropriate audit evidence to reach such a conclusion), it may issue one of three modified opinions as set out in the Hong Kong Standard of Auditing 705⁵:

- **Qualified Opinion:** the auditor obtained sufficient appropriate audit evidence and concludes that misstatements are material but not pervasive to the financial statements, or, if the auditor was unable to obtain such evidence, concludes that the possible effects of any undetected misstatements could be material but not pervasive to the financial statements;
- **Adverse Opinion:** the auditor obtained sufficient appropriate audit evidence and concludes that misstatements are both material and pervasive to the financial statements; and
- **Disclaimer of Opinion:** the auditor is unable to obtain sufficient appropriate audit evidence on which to base its opinion and concludes that the possible effects of any undetected misstatements could be both material and pervasive to the financial statements, or in rare circumstances involving multiple uncertainties (notwithstanding having obtained sufficient appropriate

1 <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2018-Adverse-Audit-Opinion/Consultation-Paper/cp201809.pdf?la=en>

2 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_3828_VER10.pdf

3 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_2472_VER20.pdf

4 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_929_VER20.pdf

5 http://www.hkicpa.org.hk/file/media/section6_standards/standards/Audit-n-assurance/referencem/203discard/hksa705cfd.pdf

audit evidence regarding each individual uncertainty), concludes that it is impossible to form an opinion on the financial statements due to the potential cumulative effect of those uncertainties.

A “pervasive” effect of a misstatement is one that: (i) is not confined to specific elements, accounts or items of the financial statements; (ii) represents or could represent a substantial portion of the financial statements even though it is confined to specific elements, accounts or items; or (iii) is fundamental to users’ understanding of the financial statements, in terms of disclosures.

According to paragraphs 2, 3 and 45 of Appendix 16 to the Main Board Listing Rules⁶, if the auditor’s report on the financial statements is likely to be modified, the listed issuer must disclose this and details of the modification in its announcement and annual report.

Main Board Listing Rule 6.01⁷ and GEM Listing Rule 9.01⁸ give the Exchange the power to suspend or cancel the listing of listed issuers to protect investors and maintain an orderly market. Main Board Listing Rule 13.50⁹ and GEM Listing Rule 17.49A¹⁰ require a suspension of trading where an auditor gives a disclaimer of opinion due to possible accounting irregularities, or if the listed issuer fails to publish its preliminary annual results announcement within three months after its financial year end. An issuer would have to resolve the issue(s) behind a suspension in order for trading in its listed securities to resume. A Main Board issuer’s securities may be delisted after 18 months of continuous suspension. A GEM issuer’s securities may be delisted after 12 months of continuous suspension.

In the United States, the Securities and Exchange Commission requires clear expressions of opinion on financial statements from auditors; disclaimers on opinions and adverse opinions are not acceptable. In the United Kingdom, the Financial Conduct Authority may suspend trading in a listed issuer’s securities if the issuer cannot assess its financial position accurately

and inform the market of its financial position; trading may be suspended where an auditor issues a disclaimer on opinion or an adverse opinion.

Proposed Listing Rule to Suspend Trading where Disclaimers or Adverse Opinions are Issued

In 2017, 43 listed issuers published audited financial statements where auditors issued disclaimers of opinion. Some of these disclaimers were due to material uncertainties related to the listed issuers’ abilities to continue as a going concern. Others were issued because sufficient appropriate audit evidence could not be obtained for a proper valuation of the issuers’ assets. 24 of those 43 listed issuers received disclaimers of opinions for two or more consecutive financial years.

The Exchange’s concern that some listed issuers may not be resolving audit issues promptly has led it to propose a new Main Board Listing Rule 13.50A and GEM Listing Rule 17.49B. These new rules would require the suspension of trading in a security when its listed issuer has published preliminary annual results for which the auditor has given (or indicated that it will give) a disclaimer or adverse opinion. The requirement would not apply if the auditor gives a qualified opinion or clean opinion with an emphasis of matter. If implemented, the requirement would apply only to preliminary annual results announcements for financial years commencing on or after 1 January 2019; listed issuers whose current financial statements have received disclaimers or adverse opinions would not be required to suspend trading unless they continue to receive such modified opinions on their financial statements for financial years commencing on or after 1 January 2019.

Listed issuers would be exempt from the trading suspension requirement if the underlying issue for the disclaimer on opinion had been addressed during the financial year, but the auditor expressed the disclaimer of opinion on the results and the closing financial position for the financial year. An incident that destroyed accounting records that were later reconstructed, for example, would result in the auditor disclaiming the results and closing financial position. However, since the issuer addressed the underlying issue by reconstructing the lost records and disclosing the impact of the incident on its financial position, no trading suspension would be required.

Resumption of Trading

Trading in the listed issuer’s securities would resume after: (i) the underlying issue behind the auditor’s disclaimer or adverse opinion has been addressed, (ii) the listed issuer has produced

6 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_3830_VER20.pdf

7 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_2233_VER10.pdf

8 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_465_VER10.pdf

9 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_2472_VER20.pdf

10 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/h/k/HKEX4476_780_VER20.pdf

financial information to reflect its updated financial position; and (iii) the auditor has provided comfort that the disclaimer or adverse opinion has been removed. This may require a full financial year audit (or a special interim audit) of the listed issuer's financial statements or a special engagement of the auditor to audit a single financial statement (or specific element, account or item of a financial statement) of the listed issuer. To maintain the principle of keeping trading suspensions to a minimum, the Exchange may allow trading resumptions when the underlying issue is addressed, even when the auditor's disclaimer has not yet been removed, provided that its modified opinion does not detract from its assurance concerning the closing balances of the listed issuer's financial statements for the financial period following the trading resumption.

Responding to the Consultation

The Exchange poses two questions for market comments:

1. Do you agree with the proposal to add a Listing Rule to require trading suspension if an issuer has published a preliminary annual results announcement and its auditor has issued, or has indicated that it will issue, a disclaimer or an adverse opinion on the issuer's financial statements? If not, why?
2. Do you agree with the proposed Main Board Listing Rule 13.50A to require the issuer to address the issues giving rise to the disclaimer or adverse opinion, provide comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required, and disclose sufficient information for investors to assess its updated financial position before trading resumption? If not, why?

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