

**HKEX LISTING DECISION**  
**HKEX-LD114-2017 (published in October 2017) (Updated in August 2018**  
**and for audit terminology in March 2019)**

<b>Party</b>	Company A – a Main Board issuer
<b>Issue</b>	Whether Company A was no longer suitable for listing
<b>Listing Rules</b>	Main Board Rules 2.03, 2.06, 6.01, 6.04 and 6.10
<b>Decision</b>	The Exchange considered Company A to be no longer suitable for listing, and decided to serve a delisting notice on Company A. Under the notice, Company A had six months to remedy the matters, failing which the Exchange would proceed with cancellation of its listing.

**FACTS**

1. Trading in Company A's shares was suspended pending release of an announcement about a very substantial acquisition. The acquisition was terminated subsequently but trading remained suspended due to Company A's failure to publish audited annual results.
2. Company A's auditors questioned the recognition of sales and trade receivables, the reasonableness of expenses relating to a distribution channel restructuring plan, and the rationale for providing guarantees to certain parties.
3. As resumption conditions, the Exchange required Company A to conduct a forensic investigation into the audit issues, publish all outstanding financial results and address any auditors' modifications/qualifications, and inform the market of all material information. (Updated in March 2019)
4. The forensic investigation found that:
  - (a) Company A had not issued value added tax invoices for most of its domestic sales under PRC tax rules, casting doubts on whether the recognized sales were in fact made.
  - (b) Company A had paid substantial cash rebates to four distributors, allegedly under the distribution channel restructuring plan agreed with the distributors. However, it was found not to have monitored whether the distributors used the rebates in accordance with the requirements set out in the plan. Without a plausible explanation, Company A was also found to have paid substantial cash rebates to

entities which were not parties to the plan. The forensic accountants questioned the rationale and justification for the cash rebates.

- (c) Absent any internal controls or procedures, Company A had guaranteed loans granted to related parties by banks. The loans were subsequently in default and Company A had paid and made a full provision for the guaranteed debts.
5. The forensic accountants encountered significant limitations that prevented it from conducting a proper investigation. As a result, they were unable to form a view on the audit issues.
  6. This gave rise to the following regulatory issues:
    - (a) that Company A's financial statements and/or records were not accurate and complete in material respects or were materially misleading;
    - (b) that investors had not been given the necessary information to make an informed assessment of Company A;
    - (c) the integrity of Company A's management; and
    - (d) the lack of adequate internal controls to safeguard Company A's assets and protect shareholders' interests.
  7. More than two years had lapsed since the trading suspension. Company A had yet to (i) resolve the audit issues or the forensic findings that resulted in its continued failure to publish financial results and the continued trading suspension; and (ii) fully comply with the resumption conditions.
  8. Given the above, the Exchange advised Company A of its (i) concern about the latter's suitability for continued listing and (ii) intention to commence procedures to cancel its listing.
  9. In response, Company A's special investigation committee (comprising of all the independent non-executive directors) confirmed that the management of the company had not taken or proposed any action to address the forensic findings and considered that the management was unable to resolve the relevant issues. As an attempt to resolve the issues, the committee then appointed a firm of legal advisers to understand the audit issues and the forensic findings and consider possible remedial measures.

## APPLICABLE LISTING RULES AND GUIDANCE

### *Cancellation of listing*

10. Rule 6.01 states that:

*“Listing is always granted subject to the condition that where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also do so where:— ...*

*...*

- (4) the Exchange considers that the issuer or its business is no longer suitable for listing.”*

11. Rule 6.04 states that:

*“Where dealings have been halted or suspended, the procedure for lifting the trading halt or suspension will depend on the circumstances and the Exchange reserves the right to impose such conditions as it considers appropriate. The issuer will normally be required to announce the reason for the trading halt or suspension and, where appropriate, the anticipated timing of the lifting of the trading halt or suspension...The continuation of a suspension for a prolonged period without the issuer taking adequate action to obtain restoration of listing may lead to the Exchange cancelling the listing.”*

12. Rule 6.10 states that:

*“... Where the Exchange considers that any circumstances set out in rule 6.01 arise, it may:*

- (1) publish an announcement naming the issuer and specifying the period within which the issuer must have remedied those matters which have given rise to such circumstances. Where appropriate the Exchange will suspend dealings in the issuer’s securities. If the issuer fails to remedy those matters within the specified period, the Exchange will cancel the listing. The Exchange may treat any proposal to remedy those matters as if they were an application for listing from a new applicant for all purposes, in which case, the issuer must comply with the requirements for new listing applications as set out in the Listing Rules; or*

- (2) *cancel the listing of the issuers' securities following the Exchange's publication of an announcement notifying the cancellation of the listing.*" (Updated in August 2018)

*Suitability for listing*

13. Rule 2.03 states that:

*"The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and in particular that:*

- (1) *applicants are suitable for listing;*
- (2) *the issue and marketing of securities is conducted in a fair and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer...;*
- (3) *investors and the public are kept fully informed by listed issuers...of material factors which might affect their interests;*
- (4) *all holders of listed securities are treated fairly and equally;*
- (5) *directors of a listed issuer act in the interest of shareholders as a whole, particularly where the public represents only a minority of the shareholders; and*
- (6) *all new issues of equity securities by a listed issuer are first offered to the existing shareholders by way of rights unless they have agreed otherwise."*

14. Rule 2.06 states that:

*"Suitability for listing depends on many factors. Applicants for listing should appreciate that compliance with the Exchange Listing Rules may not of itself ensure an applicant's suitability for listing. The Exchange retains a discretion to accept or reject applications and in reaching their decision will pay particular regard to the general principles outlined in rule 2.03. ..."*

15. Guidance Letter GL68-13 sets out factors that the Exchange may consider when assessing whether an applicant or its business is suitable for listing. The Exchange may also take them into account when considering a listed issuer's suitability for continued listing.

## **ANALYSIS**

16. Rule 6.01 provides that where the Exchange considers it necessary for the protection of investors or the maintenance of an orderly market, it may suspend trading or cancel the listing of any securities. The Rule also specifies certain circumstances under which the Exchange may suspend trading or cancel a listing, which include where the Exchange considers an issuer or its business to be no longer suitable for listing.
17. Suitability for listing, as set out in Rule 2.06, depends on many factors. The Exchange has a broad discretion to interpret and apply the concept of suitability case by case for the purpose of maintaining market confidence with reference to the currently acceptable standards in the market place. It takes account of its underlying regulatory objectives to, as far as reasonably practicable, ensure an orderly, informed and fair market for the trading of securities listed on it and to act in the interest of the public, having particular regard to the interest of the investing public.
18. The existence of issuers which are unsuitable for listing would undermine the quality of the market and bring it into disrepute. Rule 6.10 sets out the delisting procedures applicable to an issuer or its business which is no longer suitable for listing.
19. In this case,
  - (a) The audit issues and the forensic findings raised a serious question about the accuracy and credibility of Company A's financial statements or records in material respects, the integrity of its management, and the lack of adequate internal controls or procedures to safeguard its assets and protect shareholders' interests.
  - (b) As the management failed to take actions to address the audit issues or the forensic findings, Company A was not able to properly comply with its financial reporting obligations under the Rules despite a prolonged period of suspension. This deprived shareholders and investors of the financial information necessary for appraising its position.

20. The above issues were detrimental to maintaining confidence in the market and were not in the interest of the investing public. In these circumstances, there was a serious issue about Company A's suitability for continued listing.
21. Having considered the facts and circumstances of this case and the special investigation committee's actions as described in paragraph 9, the Exchange commenced the delisting process and gave Company A six months to remedy the matters rendering it no longer suitable for listing.

## **CONCLUSION**

22. The Exchange served a notice on Company A to commence the delisting process under Rule 6.01(4) on the ground that Company A was no longer suitable for listing. If Company A failed to remedy the matters within six months, the Exchange would proceed with cancellation of Company A's listing.