

30 November 2018

BY HAND AND BY EMAIL

Hong Kong Exchanges and Clearing Limited
8th Floor, Two Exchange Square
8 Connaught Place
Central
Hong Kong

Dear Sirs,

Consultation Paper on Proposal relating to Listed Issuers with Disclaimer or Adverse Audit Opinion on Financial Statements

Ernst & Young is pleased to respond in this letter to the request of The Stock Exchange of Hong Kong Limited for feedback on the captioned consultation paper.

We welcome the Exchange's efforts to afford better investors' protection by safeguarding the quality and reliability of financial information published by listed issuers. In general, we agree that issuers should strengthen their risk management and internal control systems, and resolve audit issues promptly with their auditors. However, the Exchange may wish to further consider the possible consequences of delisting as well as the technical aspects of resolving the audit issues as described in paragraph 32(ii) of the consultation paper.

Set out below are our comments and observations on the proposals.

To add a specific suspension requirement

The proposed Main Board Rule 13.50A (or GEM Rule 17.49B) requires a trading suspension where an issuer has published a preliminary annual results announcement and its auditor has issued, or has indicated that it will issue, a disclaimer or adverse opinion on the relevant financial statements.

Under the delisting Rules, the Exchange may delist a Main Board issuer after its continuous suspension of 18 months (or 12 months for a GEM issuer). The Exchange considers that the remedial period would give sufficient time for issuers to resolve issues with their auditors while incentivising them to do so promptly.

However, there may be situations where the time required to resolve the audit issues may be out of the issuer's control. For example, when it involves the inability to exercise control over the assets and operations of certain subsidiaries due to a shareholder dispute or an investigation by the police or other regulatory authorities which does not involve any question on the integrity of

the directors, the issuer may be unduly penalised with the threat of delisting whilst it takes time to resolve the issues giving rise to the disclaimer or adverse opinion. In these situations, the Exchange should consider whether it should exercise its discretion to relax Main Board Rule 6.01A(1) (or GEM Rule 9.14A(1)) or the proposed Main Board Rule 13.50A (or GEM Rule 17.49B).

Criteria for trading resumption

According to paragraph 32 of the consultation paper, one of the resumption criteria is that the issuer should provide comfort from the auditor that the disclaimer or adverse opinion would be removed. Paragraph 32(ii) of the consultation paper states that this may involve a special engagement of the auditor to perform audit on a single financial statement (e.g., the statement of financial position) of the issuer or a specific element or item of a financial statement using the auditing standard HKSA 805 (Revised). In practice, HKSA 805 (Revised) is only used in limited circumstances and an auditor may feel unable to report under HKSA 805 (Revised), say, on a single financial statement, without an audit being performed on the remaining statements, in order to obtain a more complete picture of the entity's financial position, particularly where a disclaimer opinion has previously been issued. Without further clarification as to the type of circumstances when an auditor's report prepared under HKSA 805 (Revised) is appropriate, issuers and the market may expect that an audit opinion on a single financial statement or a specific element or item of a financial statement is feasible, when in fact it may not be feasible in most of the situations. Such clarification will also help to avoid undue pressure on the auditor arising from an expectations gap between the listed issuer and the auditor.

We note from Appendix I to the consultation paper that the proposed rule wording does not refer to "comfort from the auditor" which is different from the wording used in paragraph 32 of the consultation paper. Any final rule wording should not create any impression that the comfort should come from the auditor. The comfort should be from the issuer to the Exchange. In our view, the most probable supporting work for such comfort is a full audit on a complete set of financial statements.

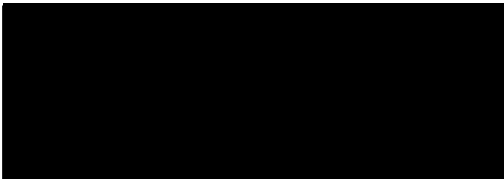
Paragraph 33 of the consultation paper states that depending on the nature of the underlying issues, the issuer may resume trading where it has addressed the issues but continues to receive a disclaimer of opinion on its financial statements, provided that the modification does not detract the auditors' assurance concerning the closing balances of the financial statements for the financial period following trading resumption. According to paragraph 34 of the consultation paper, the Exchange also considers that allowing the issuer to resume trading after the issue is addressed (whilst it may continue to receive a disclaimer of opinion) will maintain the principle that suspension should be kept to a minimum in the interest of shareholders, while at the same time protect investors through providing appropriate disclosures. Issuers that have received a disclaimer of opinion on their previous financial statements may, despite having resolved all the audit issues leading to the disclaimer opinion, continue to receive a disclaimer of opinion on their financial statements for the financial year commencing on or after 1 January 2019 (the proposed effective date of the proposals) in respect of opening balances. Based on the rationale set out

by the Exchange in the consultation paper, the Exchange would allow trading to continue for these issuers. This is not apparent from the generic wording of the proposed Main Board Rule 13.50A (or GEM Rule 17.49B). The Exchange should consider including the above situations in its Frequently Asked Questions (“FAQs”) to be issued in conjunction with the Rule amendments.

In the event that the Exchange adopts the proposals, we suggest that the Exchange liaise with the HKICPA to work out appropriate guidance materials, including the feasibility of applying HKSA 805 (Revised), as well as guidance for issuers involved in a re-issue of the financial statements etc. Such materials may take the form of Exchange FAQs or an HKICPA pronouncement, and should be effective at the same time as the Rule amendments.

Should you have any questions on the above comments, please do not hesitate to contact our Professional Practice Partner in Hong Kong, [REDACTED], on [REDACTED]

Yours faithfully,



Certified Public Accountants
Hong Kong