Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below that are raised in the Consultation Paper downloadable from the HKEX website at:
http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2018-Adverse-Audit-Opinion/Consultation-Paper/cp201809.pdf

Where there is insufficient space provided for your comments, please attach additional pages.

1. Do you agree with the proposal to add a 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?

   ☒ Yes

   ☐ No

If your answer is "No", please give reasons for your views.

Yes with qualifications.

We understand the rationale of the proposal to suspend companies whose financial statements receive a disclaimer or adverse opinion from their auditors. Such audit opinions or disclaimers indicate serious and pervasive accounting issues that need to be addressed. On the surface, suspending those companies when the issues are still outstanding seems fair because that would prevent investors from trading in the shares when the integrity of their financial statements are being questioned by their independent auditors. Outsiders have to rely on audited financial statements to form an opinion on the state of affairs of a public listed company. It is very serious when an auditor cannot express an unqualified opinion on the truthfulness and fairness of the state of affairs of a company. We however are wary of the time factor. Under the newly adopted delisting mechanism, companies suspended for over 18 months (for Main Board) and 12 months (for GEM) will be delisted. We foresee the situation where issuers might take longer time to address and resolve some genuine accounting issues completely due to their complexity and if those issues remain (while being addressed) after 18 months (or as the case maybe 12 months), then the companies have to face delisting. It will be a very harsh situation for the companies and shareholders alike.

Let's use one example in your consultation paper for illustration, Company E received a disclaimer of opinion for FY2013 but despite its success in disposing the subsidiary in question sometime in 2014, it still received another disclaimer of opinion in FY2014 due to the scope limitation in respect of the relevant balance sheet items as at 31 December 2013. This shows that some issues would take longer than 18 months to be fully resolved from the accounting point of view despite the best efforts by the company. As in this case, the problem straddled over two financial years and would have lasted over 18 months. Under the existing delisting procedures and if the proposed suspension rule were adopted, this company would face delisting even though actions have been taken to resolve the problem and the problem would eventually be resolved.

The interests of minority shareholders would be at risk under the proposal. An immediate suspension of trading in the company's stock upon issuance of a disclaimer or adverse opinion would deprive minority shareholders of any opportunity to unload and sell their shares in the open market. Their investments would be "trapped" throughout the suspension period and in the unfortunate event that the company is delisted after 18 months (or 12 months for GEM), their investments would vanish.

Our position is therefore while we agree to suspension, a more flexible approach should be adopted to allow earlier resumption of trading, for example, after full disclosure of the issues.

2. Do you agree with the proposed 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 (as described in paragraph 32 of the Consultation Paper)?

☒ Yes

☐ No

Yes with qualifications.

We agree but would suggest that trading resumption can come earlier once the company have come up with a practical and feasible plan to address the accounting issues and full disclosure has been made, but do not have to wait till the problem has been totally solved (for that might take longer than 18 months (or 12 months for GEM) as stated in our question to Q.1).

For listing to be resumed, the auditor is required to provide the comfort that if the plan is successfully implemented, disclaimer or adverse opinion would no longer be required. There should also be a timeframe indicated for such plan. The Exchange can require the company to issue announcements regarding any updates and progress of the plan. As such, the Exchange can do necessary monitoring work to ensure that actions are being taken to implement the plan and to hold the directors and management accountable. If the problem cannot be resolved at the end of the indicated time, the Exchange shall have the discretion to demand a suspension of the company's stock. All these shall be announced to shareholders and investors by way of an announcement.

For illustration, a disclaimer or adverse opinion is issued due to the inability to access financial information of a subsidiary of a company. If the company can publish a plan at the time the financial results are announced that it intends to dispose of the subsidiary within a prescribed time as a solution, suspension should be "deferred". Or if such plan is not announced at the same time as the financial results, then suspension will take place but will be lifted when the company comes up with such plan at a later stage. The directors and management are held accountable to such plan and if it does not materialise within the prescribed time, trading of the company's shares will then immediately be suspended and the directors and management will be accountable for any breach of their duties as directors. Special symbol can be assigned to the stock code of these companies to alert investors to their situation.

Our suggestion represents real improvements from the present situation for all parties concerned:

1) Companies will need to come up with a concrete plan to address and solve the problem within a prescribed time in order to have the disclaimer or adverse opinion removed, unlike now where they can do nothing and drag on for years. On the other hand, companies can have more time to address and solve the problem without the constraint of 18 months.

2) The Exchange can hold the directors and management of the companies accountable by monitoring the progress of the implementation of the plan. The Exchange has the right to penalise them under the Listing Rules if they are in breach of their duties as directors under the Listing Rules.

3) Existing shareholders can make a well informed judgement on the state of affairs of the company, the financial statements of which are qualified and have a window to unload and sell their shares, rather than being trapped immediately.

4) Investors will know by the special symbol attached to the stock codes that these companies have received a disclaimer or adverse audit opinion and trading of their shares might be suspended if the relevant remedial action plan has not been implemented as announced. With full disclosure, investors will be at their own risk in buying or selling shares of these companies, whereas under the existing Listing Rules and trading arrangement, investors may know about the disclaimer or adverse opinion if they do not read the relevant announcements or annual reports of these companies.

If your answer is “No”, please give reasons for your views.

- End -