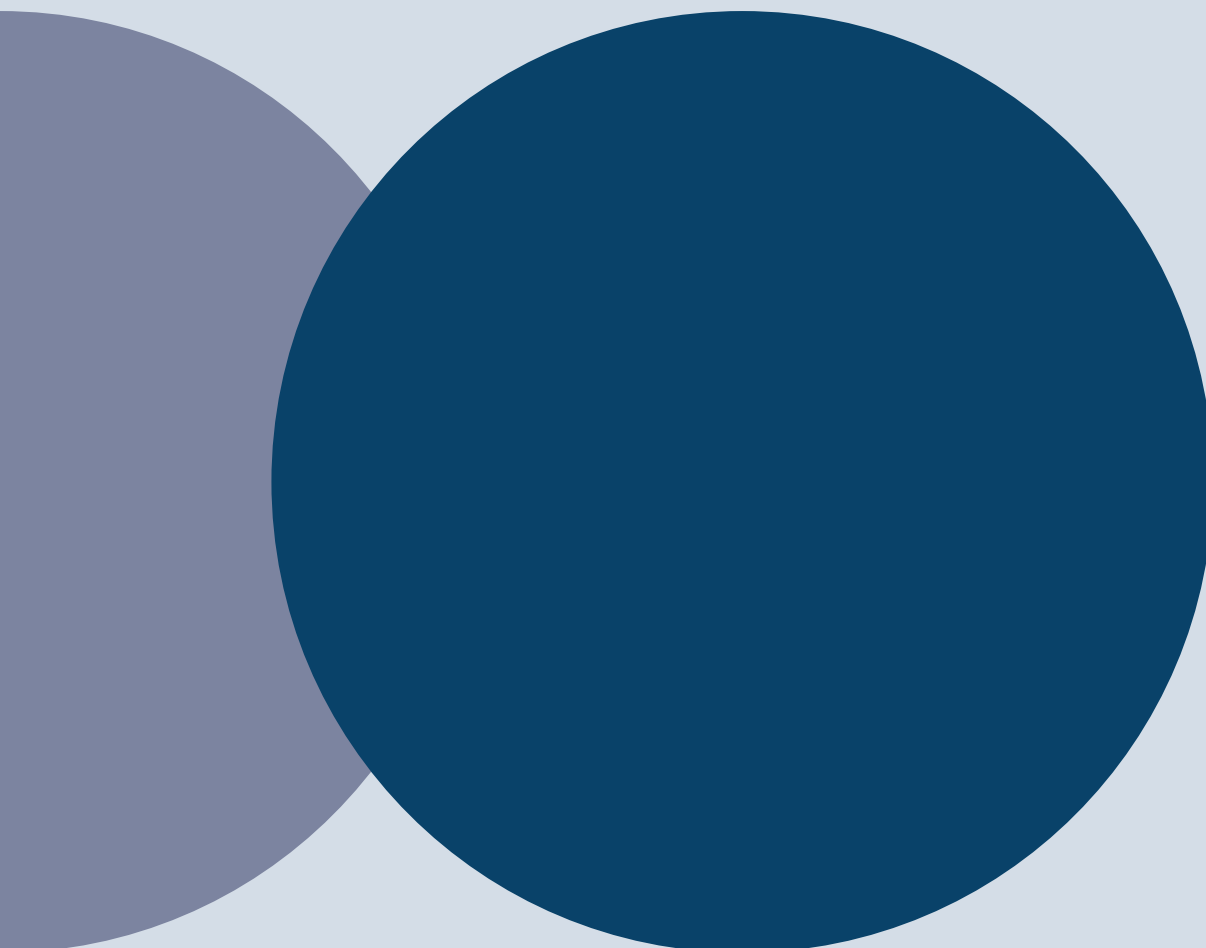


May 2019

CONSULTATION CONCLUSIONS

PROPOSAL RELATING TO LISTED ISSUERS WITH
DISCLAIMER OR ADVERSE AUDIT OPINION ON
FINANCIAL STATEMENTS



CONTENTS

	Page No.
EXECUTIVE SUMMARY	1
CHAPTER 1 : INTRODUCTION	3
CHAPTER 2 : PROPOSAL ADOPTED AND DISCUSSION ON SPECIFIC RESPONSES	5

APPENDICES

APPENDIX I : AMENDMENTS TO THE LISTING RULES	
APPENDIX II : LIST OF RESPONDENTS	

EXECUTIVE SUMMARY

1. This paper presents the results of the consultation conducted by the Exchange on the proposal to require 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 audit opinion on the financial statements.
2. We received a total of 62 responses¹ from a broad range of stakeholders. 36% of respondents fully supported the proposal, 24% of respondents (including both supporting and opposing respondents) recommended certain modifications to the proposal and the remaining 40% opposed. As these respondents have provided substantive reasons for their views and proposed modifications, we have given due consideration to their views and the merits of their alternative proposals, in particular, whether they address the concerns giving rise to our consultation.
3. After balancing respondents' comments and the rationale of our proposal, we have decided to implement the proposal with the following modifications:
 - (a) **Modified suspension requirement** - We have revised the proposed Rule 13.50A to disapply the suspension requirement where (i) the disclaimer or adverse opinion relates solely to going concern; or (ii) the underlying issue giving rise to the audit modification has been resolved before the issuer publishes the preliminary results announcement.
 - (b) **Modified remedial period** - Under the current delisting Rules, issuers may be delisted after their continuous suspension for 18 months (or 12 months for a GEM issuer). Where the resolution of issues giving rise to the disclaimer or adverse opinion is outside the issuer's control, a longer remedial period may be allowed, with the duration of the period being determined on a case by case basis.
 - (c) **Effective date** – The new Rule 13.50A will apply to issuers' preliminary annual results announcements for financial years commencing on or after 1 September 2019.

¹ Three responses were entirely identical, in content, to other responses. Responses with entirely identical content were counted as one response for the purpose of calculating the above percentages.

- (d) ***Transitional arrangement*** - As a transitional arrangement, the remedial period will be extended to 24 months for both Main Board and GEM issuers that are suspended solely due to a disclaimer or adverse opinion being issued in the first two financial years after the implementation of the new Rule 13.50A. Accordingly, the 24 months remedial period will apply to issuers suspended solely due to disclaimer or adverse opinions on their financial statements for the financial years commencing on or after 1 September 2019 and up to and including 31 August 2021. We have added a new Rule 13.50B regarding this transitional arrangement.
4. For the avoidance of doubt, issuers currently with disclaimer or adverse opinions on their financial statements will not be required to suspend trading under the new Rule 13.50A unless the issuers continue to receive such opinion on their financial statements for the financial years commencing on or after 1 September 2019 and the issues giving rise to the audit modifications remain unresolved.

CHAPTER 1 : INTRODUCTION

Background

5. On 28 September 2018, The Stock Exchange of Hong Kong Limited (**Exchange**), a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (**HKEX**), published a Consultation Paper on Proposal Relating to Listed Issuers with Disclaimer or Adverse Audit Opinion on Financial Statements (the **Consultation Paper**). The Consultation Paper sought market views on the proposal to introduce a specific suspension requirement applicable to listed issuers with disclaimer or adverse audit opinions on their financial statements.
 6. In the Consultation Paper, we proposed a new Rule 13.50A:
 - The Exchange will normally require suspension of trading in an issuer's securities if the issuer publishes a preliminary results announcement for a financial year and the auditor has issued, or has indicated that it will issue, a disclaimer or adverse opinion on the issuer's financial statements; and
 - the suspension will normally remain in force until the issuer has addressed the issues giving rise to the disclaimer or adverse opinion, provided comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required, and disclosed sufficient information to enable investors to make an informed assessment of its financial positions.
- Under the current delisting Rules, issuers may be delisted after their continuous suspension for 18 months (or 12 months for a GEM issuer).
7. A disclaimer or adverse opinion on the financial statements indicates that the risk of misstatements could be both material and pervasive, and investors may not have sufficient information to make an informed assessment of the issuer's financial position. The proposal seeks to afford better investors' protection by safeguarding the quality and reliability of financial information published by listed issuers. It would also encourage issuers to strengthen their risk management and internal control systems, and to resolve audit issues promptly with their auditors.
 8. For the avoidance of doubt, the new Rule 13.50A does not apply to financial statements with a qualified opinion or a clean opinion with an emphasis of matter.
 9. The consultation period ended on 30 November 2018.

Number of responses and nature of respondents

10. We received a total of 62 submissions from a broad range of respondents. Of these, 3 responses were entirely identical, in content, to other responses.

Category	Number of responses	Percentage of responses
Listed issuers	19	32%
HKEX participant	1	2%
Professional bodies / industry associations	9	16%
Accounting firms	6	10%
Law firms	2	3%
Corporate finance firms	2	3%
Individuals	19	32%
Other entity	1	2%
Total	59	100%

11. A list of the respondents (other than those who requested anonymity) is set out in **Appendix II**. Except for 3 respondents who requested the Exchange not to publish their submissions, the full text of all the submissions is available on the HKEX website.
https://www.hkex.com.hk/News/Market-Consultations/2016-to-Present/Responses_May_2019?sc_lang=en
12. Chapter 2 summarizes the major comments from the respondents and our responses and conclusions. This paper should be read in conjunction with the [Consultation Paper](#), which is posted on the HKEX website.
13. Unless otherwise stated, the Rules cited in this paper refer to the Main Board Listing Rules, and apply equally to the GEM Listing Rules.
14. The new Rules 13.50A and 13.50B are set out in **Appendix I** and also available on the HKEX website. It has been approved by the Board of the Exchange and the Board of the Securities and Futures Commission. The new Rules will apply for financial years commencing on or after 1 September 2019.
15. We would like to express gratitude to all the respondents for their time and effort in reviewing the Consultation Paper and sharing with us their views.

CHAPTER 2 : PROPOSAL ADOPTED AND DISCUSSION ON SPECIFIC RESPONSES

A. TO ADD A SPECIFIC SUSPENSION REQUIREMENT (Question 1)

The proposal

16. We proposed to add a new Rule 13.50A whereby the Exchange will normally require suspension of trading in an issuer's securities if the issuer publishes a preliminary results announcement for a financial year and its auditor has issued, or has indicated that it will issue, a disclaimer or adverse opinion on the issuer's financial statements.
17. We consider that the proposed suspension requirement would enhance investors' protection by improving the quality and reliability of financial information, encourage issuers to maintain appropriate and effective risk management and internal control systems, and where necessary, require them to act promptly to resolve audit issues with their auditors.

Comments received

18. We received a total of 62 responses² from a broad range of stakeholders. 36% of respondents fully supported the proposal, 24% of respondents (including both supporting and opposing respondents) recommended certain modifications to the proposal and the remaining 40% opposed. As these respondents have provided substantive reasons for their views and proposed modifications, we have given due consideration to their views and the merits of their alternative proposals, in particular, whether they address the concerns giving rise to our consultation. The discussion below sets out these respondents' views and their rationale for their positions, our feedback to the responses and our revisions to the proposal to address the respondents' comments and to achieve a balanced outcome that would also address the concerns giving rise to our consultation.
19. Respondents supporting the proposal generally agreed with the rationale set out in the Consultation Paper. Supporting respondents considered that a disclaimer or adverse opinion is a serious matter as it indicates that information in the financial statements cannot be relied upon, and as a result, investors would not have sufficient information to make an informed assessment when trading in the issuers' securities. The proposal would help protect the interests of investors and uphold the quality and reputation of the Hong Kong market.

² Three responses were entirely identical, in content, to other responses. Responses with entirely identical content were counted as one response for the purpose of calculating the above percentages.

20. Supporting respondents also considered that the proposal may inform the market of the seriousness of the matter and may act as a deterrent, resulting in fewer financial statements with disclaimer or adverse opinions. It would also encourage issuers to act and resolve audit issues promptly and incentivize them to further enhance and strengthen its continuous disclosures and risk management and internal control systems.
21. Respondents who opposed the proposal were mainly concerned that the proposed suspension may not be in the best interest of the issuer and its shareholders for the following reasons. They considered that the current disclosure based and post-vetting regime is adequate as it provides a transparent market by requiring issuers to fully and timely disclose material issues, while allowing the Exchange to suspend or cancel the listing of an issuer to protect investors and/or maintain an orderly market. Investors should be able to make their own assessment in dealing with the issuer's securities based on the disclosures it made with respect to the circumstances surrounding the disclaimer or adverse opinion.
22. A few opposing respondents suggested that instead of mandating a trading suspension, the Exchange should consider adding a suffix to the stock short name to identify issuers with disclaimer or adverse opinions. This could alert investors of the associated investment risk in trading of the issuers' securities.
23. Respondents have provided certain modifications and comments to our proposal, and reasons for their views and proposed modifications are as follows:

Suspension impact on minority shareholders

24. Some respondents considered that audit issues are often complex and issuers would generally requires a long time to fully resolve such issues with their auditors, thereby leading to prolonged trading suspension in the event of a disclaimer or adverse opinion on its financial statements. This would deprive shareholders of the ability to trade in the issuer's securities during the suspension period.
25. Some respondents stated that given suspension would take place immediately upon publication of the preliminary results announcement under the proposal, there would be no forewarning for shareholders should they wish to exit from their investments before the suspension period commences. A respondent suggested allowing trading to continue in the one-month period between the publication of the preliminary results announcement and the annual report. Other respondents noted that, in practice, the management is often aware of a possible disclaimer or adverse opinion on its financial statements well ahead of the publication of the preliminary results announcement, and accordingly, issuers should timely inform the market of this information to give shareholders an exit window before the suspension period commences.

Suspension on a case by case basis

26. Some respondents considered that where the circumstances leading to a disclaimer or adverse opinion usually do not involve any irregularities or misconduct, or the issuers' deliberate actions to destroy their books and records or audit evidence or obstruct the auditors' work, it would be unfair to penalize the issuers by suspending trading of their securities. Some commented that as there can be reasons leading to a disclaimer or adverse opinion on financial statements that are outside the issuer's control, trading suspension should not be automatic based solely on an auditor's opinion. Instead, the Exchange should have the discretion to decide whether to suspend trading having regard to the circumstances of individual issuers. In particular, one respondent suggested that the issuer and its auditor should be required to discuss with the Exchange if a disclaimer is foreseen and submit a plan for remedial actions, and the Exchange should then decide if suspension is warranted on a case by case basis.
27. In addition, certain respondents pointed out that the proposal appears to be out of line with the requirements in other markets. Two respondents pointed out that the mandatory trading suspension requirement in the PRC formerly applicable to A-share companies with modified opinions was abolished in 2018 and has now been replaced by new disclosure-based rules³. Two other respondents suggested that we should follow the practices of the UK market.

Delay commencement of the suspension period

28. Several respondents commented that issuers should be allowed a reasonable timeframe to resolve the audit issues before trading is suspended. Some respondents suggested that trading suspension should only be required if the issuer has published results announcements with a disclaimer or adverse opinion for at least two or three consecutive years. Another respondent suggested to grant a grace period (e.g. six months). These respondents believe that such mechanism could lessen the number of suspensions.

³ In the PRC, the China Securities Regulatory Commission issued the revised "Compilation Rule for Information Disclosure by Companies Offering Securities to the Public No. 14 – Modified Audit Opinions and Other Matters Involved" and removed the provision to suspend the trading of the shares of a listed company that receives a modified audit opinion due to its clear violation of accounting standards. Notwithstanding such amendment, the suspension requirements concerning listed companies which receive a disclaimer of opinion or an adverse opinion on their financial statements in all other circumstances remained unchanged in the stock exchange listing rules.

Induce financial hardship on issuers

29. A number of respondents commented that suspension may trigger events of default under bank loans, notes and bonds, and worsen the financial position of the issuers. This may be particularly problematic for financially distressed issuers with going concern issue as suspension would affect their ability to raise funds and attract investors, making it more difficult for these issuers to restructure or self-rescue. These respondents suggested that the Exchange should consider relaxing the mandatory suspension requirement under the proposal where the disclaimer or adverse opinion is solely due to a going concern issue.

Issues outside the issuers' control

30. Some respondents considered that, in many cases, the underlying audit issues giving rise to a disclaimer or adverse opinion are matters outside the issuers' control. Some examples given by the respondents include: (i) inability to provide sufficient and reliable information to assess the likelihood of the successful launch of its operations pending formal government approval to be obtained, (ii) litigation and dispute on significant asset or contract or income, (iii) funding shortage due to poor market sentiment, (iv) failure to obtain audit confirmation or evidence of recoverability of receivable debtors, (v) absence of a valuation report or (vi) deconsolidation of subsidiaries and incomplete or missing books and records due to uncooperative or uncontactable management. In these cases, the respondents suggested the Exchange should extend the remedial period given the issuers are unlikely to be able to resolve the situation within a short period of time.

Remedial period insufficient to resolve issues

31. Some respondents were concerned that the remedial period of 18 months (12 months for GEM issuers) may not be sufficient for issuers to resolve the audit issues generally due to their complexities. If the issuer is unable to resolve matters within the remedial period, its shares would be delisted. This would deprive shareholders from realizing their investments in the market.
32. A respondent suggested resuming trading once the issuer has disclosed a concrete plan to address the audit issues (rather than to wait for the resolution of the issues). If the plan does not materialized, the Exchange can request for another trading suspension. The respondent claimed that this will allow issuers to come up with a concrete plan free from the time constraint to resolve all audit issues within the remedial period.

Effects on auditor

33. Some respondents considered that the proposal may exert undue pressure on auditors to avoid issuing a disclaimer or adverse opinion and also affect auditors' independence. Further, it may also promote opinion-shopping by issuers and thus lower the quality of audits. Some accounting professionals were also concerned that the proposal would give the market the wrong impression that auditors have the responsibility to take steps to ensure that the audit issues are addressed and remedied, when the primary responsibility clearly lies with the issuers.
34. Conversely, some respondents took the view that the basis for audit modifications often involves subjective judgement of the auditors and may arise from circumstances relating to the nature or timing of the auditor's work which do not necessarily reflect the true position of the issuer. These respondents considered that the proposal may give the auditor too much bargaining power, including setting higher audit fees or promoting unnecessary compromises on disputed items in the financial statements which resulted from differences in judgment between the issuer and its auditor.

Concerns associated with the delisting regime

35. A number of respondents raised concerns related to delisting of suspended issuers, which was the subject of an earlier consultation on delisting published in September 2017, and which concluded in May 2018⁴. These include: (i) a respondent suggested the Exchange should implement a separate over-the-counter market for trading in suspended and delisted securities, or devise a special or restrictive trading arrangement to allow a restricted group of investors to trade in the securities of the suspended issuer, and for minority shareholders to dispose of their investments in a suspended issuer to those investors; (ii) one respondent was concerned about the impact on securities brokers acting as custodians of delisted shares as they may remain obligated to continue to hold these securities; (iii) some respondents commented that the eventual delisting of an issuer under the proposal may facilitate controlling shareholders with ulterior motives to squeeze out the minority shareholders; and (iv) one respondent considered that the Exchange would be perceived to have a conflict of interest in executing the proposal as it may not be in the interest of the Exchange to rehabilitate the problematic issuers as they consume a disproportionate amount of regulatory resources, and delisting of the issuers would appear to be a quick dispensation of the issues.

Other comments

36. A few respondents sought clarification on whether the proposal would apply to disclaimer or adverse conclusions expressed by auditor on the review of the interim financial information.

⁴ See [Consultation Conclusions on Delisting and Other Rule Amendments](#) published in May 2018.

Our responses and conclusion

Current regime

37. As stated in the Consultation Paper, the current Rules safeguard the reliability of annual financial statements by requiring such information to be audited by independent auditors. Where an auditor disclaims its opinion or issues an adverse opinion, it raises concerns about the reliability of the financial information.
38. In recent years, we have heightened our vetting of issuers' financial results with audit modifications and required issuers to formulate plans to timely address the audit issues. However, in our experience, a large number of issuers have not taken prompt and adequate actions to implement those plans or have not shown significant progress in removing the audit modifications, resulting in repeated disclaimers of opinions⁵. The number of issuers with disclaimer of audit opinions and the duration of the disclaimer opinions remained high, relative to other markets⁶. As stated in the Consultation Paper, 43 issuers⁷ published audited financial statements with a disclaimer of opinion for the 2017 financial year end. Of these, 19 issuers⁸ received disclaimer of opinion for three or more consecutive years, with three issuers receiving repeated disclaimer of opinions for seven years.
39. Accordingly, we consider the current regime cannot adequately address concerns on the quality and reliability of financial information. While the suspension practices in other markets vary, we consider their circumstances related to auditors' opinion differ and accordingly, we would warrant different considerations when formulating our Rules.

Modify proposed suspension requirements

40. We note the concerns expressed by respondents that suspension deprives shareholders the ability to trade in the issuer's securities, and for issuers with going concern issue, suspension may trigger events of default and worsen their financial positions.

⁵ Please refer to the Review of Disclosure in Issuer's Annual Reports to Monitor Rule Compliance – [Report 2016](#) and [Report 2017](#) and [Review of Issuer's Annual Report Disclosure – Report 2018](#) for details.

⁶ For example, based on a report published by the Chinese Institute of Certified Public Accountant titled "Analysis report on audit affairs of listed companies' 2017 annual report" and a report published by the CSRC titled "Analysis on non-standard audit report of listed companies in 2017", there were 23 disclaimer or adverse opinions issued on over 3,500 issuers listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange in the PRC for the 2017 financial year end, with the longest audit modifications being three consecutive years.

⁷ Excluding 14 long suspended companies and an issuer which had a disclaimer of opinion issued on its financial statements subsequent to the publication of its preliminary annual results announcement for the 2017 financial year end.

⁸ Of the 43 disclaimer cases, 5, 8, 5, 2, 2 and 2 issuers received repeated disclaimer of opinions for 2, 3, 4, 5, 6 and 7 consecutive years, respectively.

41. We reiterate that a suspension decision is not automatic based solely on a disclaimer or adverse opinion. Under the proposed Rule 13.50A, the Exchange *will normally* require suspension of trading upon publication of a preliminary results announcement where the auditor has issued or indicated that it will issue a disclaimer or adverse opinion on the financial statements. As explained in paragraph 30 of the Consultation Paper, suspension may not be required where the underlying issue is resolved before the issuer publishes the preliminary results announcement, provided that the audit issues would not have an ongoing effect on the issuer's financial statements for the succeeding financial years. This is despite the fact that the issuer may still receive a disclaimer or adverse audit opinion in the next year's auditors report relating to the comparative figures. Examples of such circumstances include the following:
- (i) an issuer had de-consolidated a major subsidiary in the financial year as it was unable to exercise control over the subsidiary and had no access to its books and records. The issuer had disposed of the de-consolidated subsidiary to resolve the audit issues during the same financial year. The auditor expressed a disclaimer of opinion on the financial statements as it was not provided with sufficient information to assess when the issuer had lost control of and should de-consolidate the subsidiary and the possible effects on the consolidated financial statements; or
 - (ii) an issuer had a fire accident during the financial year leading to the loss of books and records. The issuer had reconstructed its accounting records after the fire accident and before the publication of its preliminary results announcement for the financial year. The auditor issued a disclaimer of opinion on the financial statements for the financial year due to the loss of appropriate supporting documents as a result of the fire accident.

In these circumstances, the incidents would not have ongoing effect but there may be a disclaimer of opinion in the next year's auditors report relating to the comparative figures. In these examples, provided the issuers had disclosed additional information on the impact of the incident on its financial position in its preliminary results announcement, it would not require trading suspension.

42. We have added Note 2 to Rule 13.50A to clarify that suspension of trading may not be required if the underlying issues giving rise to the disclaimer or adverse opinion has been resolved before the issuer published its preliminary results announcement and the issuer has disclosed sufficient information to enable investors to make an informed assessment of its financial positions.
43. Out of the 43 disclaimer cases, we note that the underlying issues were resolved in 2017 and 2018 in 2 cases and 17 cases, respectively.

44. Some respondents noted that the issuer should timely announce to the market its knowledge of a possible disclaimer or adverse opinion on its financial statements, as this is usually well ahead of the publication of the preliminary results announcement and would provide shareholders with a window to exit from their investments. It is likely that, before the publication of the preliminary results announcement, the issuer will become aware that the auditor may issue a disclaimer or adverse audit opinion on its financial statements. The issuer should continually assess, based on the specific facts and circumstances (including the likelihood of receiving a disclaimer or adverse opinion), whether it has inside information and when such information needs to be disclosed. Disclosure of inside information may be required ahead of the publication of the preliminary results announcement, depending on the facts and circumstances of a particular case. Issuers are reminded of their obligation to disclose any inside information that comes to light in the course of the audit process in accordance with statutory requirements.
45. We have not adopted some respondents' suggestion to provide a one-month trading window before publication of the financial statements (and after publication of the preliminary results announcements), as it would not address our concern about a lack of reliable financial information during that one-month trading period. Further, the short trading window may invite volatile trading and market confusion.
46. *Issuers with going concern modification* – In paragraph 31 of our Consultation Paper, we noted that the proposal would apply to issuers with disclaimer of opinion on going concern only (**going concern issuers**), given a disclaimer of opinion indicates that the auditor cannot obtain sufficient evidence regarding the existence of plans management has put in place or the existence of other mitigating factors to support its use of the going concern basis of accounting in the preparation of the financial statements, and the risk of misstatements in their financial statements could be both material and pervasive. However, taking into consideration respondents' concerns that suspending going concern issuers could accelerate their demise and induce financial hardship on these issuers, we have revised the proposal and will not suspend an issuer where the disclaimer or adverse opinion on its financial statements relate solely to going concern.

47. On balance, we consider that the going concern issue relates mainly to differences in judgment between the auditors and the management on the basis of preparation of the financial statements (i.e. liquidation basis vs going concern basis), rather than on the accuracy of individual financial figures, and thus can be addressed by issuers making clear disclosures in their annual report. Out of the 43 disclaimer cases, 12 issuers had disclaimer of opinions due to going concern only on its 2017 financial statements⁹. We have added Note 1 to Rule 13.50A to exclude going concern issuers from the suspension requirement. The issuer must disclose in its preliminary results announcement details of the audit modification, the facts and circumstances giving rise to the modification (including the different views of the issuer and its auditor), and the actions taken and/or to be taken by the issuer to address the modification.
48. The Corporate Governance Code¹⁰ also requires an issuer to make prominent disclosures and discuss at length in its annual report material uncertainties relating to events or conditions that may cast significant doubt on the issuer's ability to continue as a going concern, such that investors would have sufficient information to understand the severity and significance of matters.

Delayed commencement of the suspension period

49. We have also carefully considered, and not adopted the respondents' suggestion to delay suspension by two to three years, or to grant a grace period after the issuance of a disclaimer or an adverse opinion. While these suggestions would allow minority shareholders and custodians to dispose of their investment, they do not address our concerns about a lack of reliable financial information.

Modified Remedial Period

50. *Issues outside the issuers' control* - Some respondents commented that disclaimer or adverse opinions may involve issues that are outside the issuers' control and it would be unfair to penalize these issuers. We acknowledge that in these circumstances, the remedial period of 18 months may be insufficient for the issuers to resolve the issues. Where the issuer has satisfied the Exchange that it has made all reasonable efforts to resolve the issues but, due to reason outside its control, such underlying issues remain unresolved, we would consider allowing a longer remedial period, with the duration of the period to be determined case by case. We will amend the guidance letter on long suspension and delisting (GL95-18) to clarify this point.

⁹ Based on a re-compilation and further analysis of issuers with disclaimer of opinions in 2017 conducted after the publication of the Consultation Paper, we note that there were 12 (instead of 13 as stated in the Consultation Paper) going concern only cases. There were two cases involving going concern issue and a disclaimer of opinion on the opening balances of the financial statements where the underlying issues had been resolved. We have included these two cases amongst the 12 going concern cases.

¹⁰ See code provision C.1.3 in the Corporate Governance Code in Appendix 14 to the Rules.

51. Examples of circumstances that may be considered to be outside the issuer's control include (i) delay in government granting a requisite approval due to change in government policies, where due applications and filings had been made by the issuer, and where it has no influence on the outcome and timing of the grant; (ii) a temporary suspension of business upon the request of a regulatory or government authority due to a change in the regulatory requirements; and (iii) the audit issue can only be fully resolved upon a court order or a final arbitral awards with respect to outstanding proceedings is obtained or granted.
52. From the 43 disclaimer cases in 2017, six cases involved matters whereby the resolution of the issues giving rise to the disclaimer or adverse opinion appeared to be outside the issuers' control.
53. *Issues within the issuers' control* - We note that most circumstances described by respondents as being outside the issuers' control (see paragraph 30) involve actions that can be taken by issuers (e.g. obtain an independent valuation to support the valuation of certain assets), or can be pre-empted by proper internal controls or risk management controls (e.g. loss of books and records of subsidiaries)¹¹.
54. The Corporate Governance Code sets out the expected standards for the maintenance of appropriate and effective risk management and internal control systems, and the board of directors is responsible for ensuring that the issuer establishes and maintains these control systems. Furthermore, the board of directors of an issuer is responsible for the management and operations of the issuer, and must be answerable to the issuer for the application or misapplication of its assets¹². As noted in our Reports on Review of Issuer's Annual Report Disclosure, repeated audit modifications raise questions whether the directors properly discharged their fiduciary duties under Rule 3.08.
55. We consider that issuers can avoid audit modifications by: (i) establishing and implementing proper internal controls and risk management measures; (ii) conducting sufficient due diligence prior to investment or acquisitions or making advances to third parties; and/or (iii) having better plan and actively engaging and communicating with its auditors prior to and during the audit. Accordingly, we will retain our proposal in these circumstances. We encourage issuers to improve governance practices.

¹¹ For example, the resolution of the relevant issues may not be regarded to be outside the issuer's control if the issues remain unresolved because the issuer has failed to timely obtain an independent valuation to support the valuation of its assets or take timely actions against its debtors to assess the recoverability of bad debts. Circumstances will also not be considered to be outside the issuer's control where the disclaimer or adverse opinion is attributed to the issuer's lack of adequate internal controls or risk management controls. These may include, for example, the issuer's failure to put in place adequate measures to control and manage its jointly-controlled entities or associates or keep the books and records of its subsidiaries.

¹² See Rule 3.08.

56. Nevertheless, having considered the respondents' concerns and to allow time for issuers to review and improve their internal controls and risk management practices, we propose a transitional arrangement to allow a longer remedial period of 24 months (for both Main Board and GEM issuers) where the issuer is initially suspended solely due to new Rule 13.50A and the continued suspension is solely subject to resolution of these audit issues giving rise to the disclaimer or adverse opinion. A 24-month period would allow issuers to release two full sets of audited financial statements.
57. The transitional arrangement will apply to the first two financial years after the implementation of the new Rule 13.50A. We have added a new Rule 13.50B regarding such transitional arrangement.

Effects on auditors

58. We noted respondents' concerns about undue pressure on, or conversely, too much bargaining power given to, auditors. Auditors must abide by the code of ethics for professional accountants and audit independence rules to uphold professional ethics, standards and integrity and impartially exercise their professional judgment when performing an audit and concluding its audit opinion.
59. Under government reform, the Financial Reporting Council (**FRC**) will become the statutory regulator of auditors in Hong Kong, with powers to conduct independent investigation into possible auditing and reporting irregularities in relation to auditors of listed issuers. The Exchange and the FRC will play their respective roles to regulate issuers and auditors, to safeguard the reliability of financial information prepared by issuers.

The delisting regime

60. Comments relating to the delisting of long suspended companies are outside the scope of this consultation and were addressed in the consultation conclusions on delisting¹³.

Other Comments

61. We clarify that the proposal would apply to an audit opinion issued on an issuer's financial statements for a financial year as the Rules require an audit opinion only on the issuers' financial statements for the financial year end. It would not apply to interim financial statements.

Conclusion

62. We will adopt the proposal with the modifications set out in paragraphs 42, 47, 50, 56 and 57.

¹³ See [Consultation Conclusions on Delisting and Other Rule Amendments](#) published in May 2018.

B. CRITERIA FOR TRADING RESUMPTION (Question 2)

The proposal

63. Under the new Rule 13.50A, suspension will normally remain in force until the issuer has addressed the issues giving rise to the disclaimer or adverse opinion, provided comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required, and disclosed sufficient information to enable investors to make an informed assessment of its financial positions.
64. We provided examples in the Consultation Paper on how issuer could provide comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required. This includes: (i) a full financial year audit or a special interim audit of the issuer's financial statements; or (ii) a special engagement of the auditor to perform audit on a single financial statement of the issuer or a specific element, account or item of a financial statement under HKSA805 (Revised).

Comments received

65. 46% of the respondents supported the proposed criteria for trading resumption, 12% of the respondents (including both supporting and opposing respondents) recommended certain modifications and clarifications and 42% opposed.
66. Respondents supported and opposed this proposal for reasons largely the same as those for the proposed suspension requirement discussed in Part 1 above. In addition, some respondents have sought our clarification and provided certain modification on this proposal. Their comments are set out in the following paragraphs.
67. Comments were received from accounting professionals on the types of audits that may be performed for the issuers to provide comfort that a disclaimer or adverse opinion would no longer be required. In particular, a number of accounting professionals considered that in practice, HKSA805 (Revised) can only be used in limited circumstances and it may not be feasible for an auditor to report under HKSA805 (Revised) on a single financial statement or a specific element or item of a financial statement without an audit being performed on the remaining statements, as the auditors would be unable to obtain a complete picture of the entity's financial position. A respondent further noted that it would unlikely be an appropriate method because a disclaimer or adverse opinion provides no assurance on the financial statements as a whole. In addition, from a practical perspective, investors would likely find it confusing and inconvenient to have to piece together the original financial statements with the subsequently published financial information audited under HKSA805 (Revised).
68. A number of respondents considered that the responsibility to provide comfort that a disclaimer or adverse opinion would no longer be required should lie with the issuer instead of the auditor.

69. A few respondents suggested that as trading may resume despite the issuer still receiving an audit modification, the Exchange should assign unique stock markers to issuers during the period commencing upon the resumption of trading and ending upon the disclaimer or adverse opinion being removed. This is to caution investors of the potential risk.

Our response and conclusion

70. We noted comments from accounting professionals on the examples given on the types of audits that may be performed for the issuers to provide comfort that a disclaimer or adverse opinion would no longer be required. These are only examples to provide guidance on the possible actions that the issuers may take, having communicated with its auditors, and must be considered case by case to fit the particular circumstances.
71. We also clarify that under the new Rule 13.50A, the issuer, not the auditor, is responsible for providing comfort that a disclaimer or adverse opinion would no longer be required. Issuers should take all necessary actions to support the provision of such comfort.
72. We do not propose to assign stock markers to the short stock names of the issuers that continue to receive disclaimer of opinions after resumption of trading, as these issuers would have already addressed the issues and disclosed information necessary for investors to assess their updated financial positions before trading resumption is allowed.
73. We will adopt the proposal set out in paragraph 63.

C. EFFECTIVE DATE

74. The new Rule 13.50A will apply to issuers' preliminary annual results announcements for financial years commencing on or after 1 September 2019. Under the new Rule 13.50B, the transitional arrangement described in paragraphs 56 and 57 will apply to issuers suspended solely due to disclaimer or adverse opinions in financial years commencing on or after 1 September 2019 and up to and including 31 August 2021.
75. In respect of issuers currently with disclaimer or adverse opinions on their financial statements, unless the issuers continue to receive such opinion on their financial statements for the financial years commencing on or after 1 September 2019 and the issues giving rise to the audit modifications remain unresolved, they will not be required to suspend trading under the new Rule 13.50A.
76. We therefore remind issuers to consult and communicate with their auditors with an aim to resolve existing audit modifications and any audit issues which may potentially give rise to audit modifications prior to the proposal becoming effective.

77. For the avoidance of doubt, the new Rule 13.50A does not apply to financial statements with a qualified opinion or a clean opinion with an emphasis of matter.

APPENDIX I : AMENDMENTS TO THE LISTING RULES

Main Board Listing Rules

Chapter 13

EQUITY SECURITIES

CONTINUING OBLIGATIONS

...

13.50A The Exchange will normally require suspension of trading in an issuer's securities if it publishes a preliminary results announcement for a financial year as required under rules 13.49(1) and (2) and the auditor has issued, or has indicated that it will issue, a disclaimer of opinion or an adverse opinion on the issuer's financial statements. The suspension will normally remain in force until the issuer has addressed the issues giving rise to the disclaimer or adverse opinion, provided comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required, and disclosed sufficient information to enable investors to make an informed assessment of its financial positions.

Notes: (1) The Exchange will not normally suspend trading in an issuer's securities under this rule where the issuer publishes a preliminary results announcement for a financial year and the auditor has issued, or has indicated that it will issue, a disclaimer of opinion on the issuer's financial statements relating to the going concern issue only (and not any other issues). The preliminary results announcement must contain details of the audit modification, the facts and circumstances giving rise to the modification (including the different views of the issuer and its auditor), and the actions taken and/or to be taken by the issuer to address the modification.

(2) If the issuer has addressed all the issues giving rise to the disclaimer of opinion or adverse opinion before the publication of the preliminary results announcement and disclosed sufficient information to enable investors to make an informed assessment of its financial position, suspension of trading may not be required under this rule.

13.50B As a transitional arrangement for issuers whose securities have been suspended from trading under rule 13.50A, the 18 month period referred to in rule 6.01A(1) is extended to 24 months if the suspension during the 18 month period is only due to a disclaimer or adverse opinion on the issuer's financial statements for the financial years commencing between 1 September 2019 and 31 August 2021, both dates inclusive.

...

Chapter 17

EQUITY SECURITIES

CONTINUING OBLIGATIONS

...

17.49B The Exchange will normally require suspension of trading in an issuer's securities if it publishes a preliminary results announcement for a financial year as required under rule 18.49 and the auditor has issued, or has indicated that it will issue, a disclaimer of opinion or an adverse opinion on the issuer's financial statements. The suspension will normally remain in force until the issuer has addressed the issues giving rise to the disclaimer or adverse opinion, provided comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required, and disclosed sufficient information to enable investors to make an informed assessment of its financial positions.

Notes: (1) The Exchange will not normally suspend trading in an issuer's securities under this rule where the issuer publishes a preliminary results announcement for a financial year and the auditor has issued, or has indicated that it will issue, a disclaimer of opinion on the issuer's financial statements relating to the going concern issue only (and not any other issues). The preliminary results announcement must contain details of the audit modification, the facts and circumstances giving rise to the modification (including the different views of the issuer and its auditor), and the actions taken and/or to be taken by the issuer to address the modification.

(2) If the issuer has addressed all the issues giving rise to the disclaimer of opinion or adverse opinion before the publication of the preliminary results announcement and disclosed sufficient information to enable investors to make an informed assessment of its financial position, suspension of trading may not be required under this rule.

17.49C As a transitional arrangement for issuers whose securities have been suspended from trading under rule 17.49B, the 12 month period referred to in rule 9.14A(1) is extended to 24 months if the suspension during the 12 month period is only due to a disclaimer or adverse opinion on the issuer's financial statements for the financial years commencing between 1 September 2019 and 31 August 2021, both dates inclusive.

...

APPENDIX II : LIST OF RESPONDENTS

Listed Issuers

1. Beijing Tong Ren Tang Chinese Medicine Company Limited
2. Cathay Pacific Airways Limited
3. Hong Kong Aircraft Engineering Company Limited
4. Kingston Financial Group Limited
5. Ping An Insurance (Group) Company of China, Ltd.
6. Swire Pacific Limited
7. Swire Properties Limited
8. to 19. 12 listed issuers requested anonymity

HKEX Participant

20. Pico Zeman Securities (HK) Limited

Professional Bodies / Industry Associations

21. ACCA Hong Kong
22. Chamber of Hong Kong Listed Companies, the
23. Hong Kong Institute of Certified Public Accountants
24. Hong Kong Institute of Chartered Secretaries, the
25. Hong Kong Institute of Directors, the
26. Hong Kong Securities Association
27. Hong Kong Securities Professionals Association
28. Hong Kong Society of Financial Analysts, the
29. Law Society of Hong Kong, the

Accounting Firms

30. Deloitte Touche Tohmatsu
31. Ernst & Young
32. KPMG
33. PricewaterhouseCoopers
34. RSM Hong Kong
35. SHINEWING Risk Services Limited

Law Firms

36. Lawrence Chan & Co.
37. 1 law firm requested anonymity.

Corporate Finance Firms

- 38. Asian Capital Limited
- 39. Kingston Corporate Finance Limited¹
- 40. SWCS Corporate Services (Hong Kong) Limited

Other Entity

- 41 Financial Reporting Council

Individuals

- 42. Chi Wai Suen, Ryan Ming-Young Chiu
- 43. Chris Maden²
- 44. Christopher Cheung Wah-fung
- 45. Christopher Ho
- 46. David M. Webb
- 47. Kar Nang Sherman Chan
- 48. Ken BH Wu
- 49. Kong Chi Wong
- 50. Ralph Neville Jones
- 51. Rossana Chu
- 52. Terence Lau
- 53. YH Lam
- 54. to 62. 9 individuals requested anonymity³

¹ Contents identical to Kingston Financial Group Limited, the holding company of Kingston Corporate Finance Limited

² Same reasons as David M. Webb

³ Two responses were entirely identical in content

Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square, 8 Connaught Place,
Central, Hong Kong

info@hkex.com.hk
電話：+852 2522 1122 傳真：+852 2295 3106
hkexgroup.com | hkex.com.hk