

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.

Please refer to the addition pages.

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

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

- End -

Rossana Chu's response to

Stock Exchange Consultation Paper – Proposal relating to listed Issuers with Disclaimer or Adverse Audit Opinion on Financial Statements

Additional pages to Q1

Requiring trading suspension may have a deterrent effect on issuers which could have avoided the disclaimer or adverse audit opinions. However, there may well be some circumstances that disclaimer or adverse audit opinions cannot be avoided or are not avoided by the issuers. The causations of disclaimer opinions may be:

- (a) delayed engagement of the auditor so that the auditor does not have sufficient time to conduct the audit or is given limited information by the issuer;
- (b) serious and significant circumstances involving the issuer's operation and financial aspects and the management and the auditor hold different judgement on those circumstances, e.g. impairment of value in investments or asset, provisions on accounts receivable, going concern issue resulting from overdue borrowings, uncertainty resulting from significant litigations; and
- (c) Issuer's failure to provide sufficient information to the auditor, whether or not for reasons that can be controlled by the issuer.

In any event, it is a blow to the issuer's public investors if the issuer they invest in publishes an annual results announcement with a disclaimer or adverse audit opinion. It is an even harder blow to the public investors if the trading in the shares of that issuer has to be suspended since then.

While I agree with the suspension suggestion, I am of the view that that it is even more important for the issuer to keep the public more informed of the adverse and material events / circumstances that may lead to a disclaimer or adverse audit opinion. In the absence of such disclosures, the integrity of the market will be compromised as follows: If the issuer does not provide sufficient information or update on such adverse events and the public do not know how serious those events are. Only the issuer and the auditor know what is happening. Eventually the issuer publishes the financial statements with a disclaimer or adverse audit opinion – which could be a surprise to the shareholders and then trading in its shares has to be suspended. The public shareholders will become the ultimate victims as their funds will be locked up and they do not even have the opportunity to sell off their shares in the open market.

I set out my suggestions below:

- (1) The regulators should tighten enforcement of the inside information disclosure regime. Events leading to a disclaimer opinion must be significant and most are developed over a period of time, and therefore it is not reasonable for the issuer to hold up the information. The inside information disclosure regime in Part XIVA of the Securities and Futures Ordinance and the Listing Rules (e.g. Rule 13.09 and 13.10) require prompt disclosure of inside information by the issuers. Yet, enforcement of such requirements does not seem to be effective. For those 43 issuers that had disclaimer audit opinions on their 2017 financial statements, I wonder how many of them had really kept the public well updated of the events giving rise to the disclaimer opinions before the financial statements were published.
- (2) Another possibility of disclaimer opinion is that the issuer engages the auditor too late. I suggest that an issuer should announce to the public if it fails to formally engage an auditor before the year end closes. At least investors are made aware that the auditor, if engaged subsequently, will have very little time to conduct the audit. That may also be good to the accounting profession. Issuers are given pressure to engage auditors on a timely basis. Auditors will not be pressurized to rush up the audit or compromise the audit quality.

Preventing a disclaimer or adverse audit opinion is better than penalizing the issuer by suspension after a disclaimer or adverse audit opinion is given. If prevention is not possible, at least the public should be given the information of how bad things are well before the issuer makes the annual results announcement.

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