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Hong Kong Capital Markets Update

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SEHK's consultation on the proposal relating to listed issuers with disclaimer or adverse audit opinion on financial statements

On 28 September 2018, the Stock Exchange of Hong Kong Limited (the Exchange) published a consultation paper (Consultation) seeking market views on its proposal to introduce a specific suspension requirement applicable to listed issuers with disclaimer or adverse audit opinion on their financial statements. The deadline for submissions is 30 November 2018.

Highlights

- The Exchange proposes the suspension of trading if a listed issuer publishes financial statements with a disclaimer of opinion by the auditor or an adverse opinion ("disclaimer or adverse opinion")
- The suspension will remain in force until the listed issuer has addressed the issues giving rise to the disclaimer or adverse opinion
- The proposed new rule is intended to apply to preliminary announcements of listed issuers for financial years commencing on or after 1 January 2019.

Background

As part of the Exchange's holistic review of the continuing obligations of listed issuers, it identified that there are market concerns around listed issuers with disclaimer or adverse opinion on their financial statements as these auditors' reports indicate the risk of misstatements could be both material and pervasive. To address this issue, the Exchange published the Consultation proposing a specific suspension requirement to provide better investor protection by safeguarding the quality and reliability of financial information published by listed issuers.

Key proposals

Specific suspension requirement

According to the Exchange's proposal, trading suspension is required where a listed 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[1] on the relevant financial statements. This trading suspension requirement would not be applicable to a listed issuer with a qualified opinion or a clean opinion with an emphasis of matter on its financial statements.

Trading suspension is also not required in exceptional cases where the underlying issue was addressed during the financial year but the auditor expressed a disclaimer of opinion on the results and the closing financial position for the financial year. For example, a listed issuer may have reconstructed its accounting records after a fire accident and its auditors disclaimed the results and closing financial position due to inherent limitations caused by the loss of primary evidence. In this case, trading suspension is not required because the incident would not have an ongoing effect. In addition, the listed issuer had taken actions to

[1] To facilitate reader's understanding of the types of audit opinions expressed by the auditor under different circumstances, a high-level summary is prepared and set out in Appendix I.

address the underlying issue before the publication of the financial results, and disclosed additional information on the impact of the incident on its financial position.

Criteria for trading resumption

To resume trading, the listed issuer must resolve the issues giving rise to a disclaimer or adverse audit opinion, produce financial information to reflect their updated financial position, and provide comfort that the disclaimer or adverse opinion would be removed. This can be achieved by:

- A full financial year audit or a special interim audit of the listed issuer's financial statements; or
- A special engagement of the auditor to perform an audit on a single financial statement of the listed issuer (e.g. the statement of financial position) or a specific element, account or item of a financial statement. The type of engagement to be performed and the appropriateness of comfort from each of the above options would largely depend on the circumstances which give rise to the modification.

The listed issuer may resume trading where it has addressed the issue but continues to receive a disclaimer of opinion on its financial statements. This is provided that the modification does not detract the auditors' assurance concerning the closing balances of the financial statements for the financial period following the trading resumption.

Under the Listing Rules, the Exchange may delist a Main Board issuer after a continuous suspension of 18 months (or 12 months for a GEM issuer) (the remedial period), which means that the listed issuer is required to act promptly to remedy the issues giving rise to the trading suspension within the remedial period.

Proposed effective date

The Exchange proposes to apply the suspension requirement to issuers' preliminary annual results announcements for the financial years commencing on or after 1 January 2019.

With respect to listed issuers currently with disclaimer or adverse opinion on their financial statements, unless the listed issuers continue to receive such opinion on their financial statements for the financial years commencing on or after 1 January 2019, they will not be required to suspend trading under the proposed new rule.

If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners and directors.

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Appendix I – Type of audit opinion

The following table sets out different types of audit opinions which the auditor may express in the auditor's report, and other disclosures in accordance with the Hong Kong Standard of Auditing (HKSA).

Type of opinion		**Circumstances where the auditor would express such opinion**
Unmodified	Key audit matters	Audit reports of listed entities are required to describe key audit matters (KAMs) in a separate section of the auditor's report under the heading "Key Audit Matters". KAMs are matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.
	Emphasis of matter	An "Emphasis of Matter" paragraph is included in the auditor's report when the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that is fundamental to users' understanding of the financial statements.
	Material uncertainty related to going concern	In assessing the entity's going concern, the auditor considers a material uncertainty exists when the magnitude of the potential impact of the events or conditions and the likelihood of occurrence is such that appropriate disclosure is necessary to achieve fair presentation (for fair presentation frameworks) or for the financial statements not to be misleading (for compliance frameworks). If the use of going concern basis of accounting is appropriate but a material uncertainty exists and adequate disclosure about the material uncertainty is made in the financial statements, a separate section, "Material Uncertainty Related to Going Concern", will be included to draw users' attention to those events or conditions indicating a material uncertainty.[3]
Modified[2]	Qualified	The auditor would express a qualified opinion when: i) having obtained sufficient appropriate audit evidence, it concludes that misstatements, individually or in aggregate, are material but not pervasive; or ii) it is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.
	Adverse[4]	The auditor would express an adverse opinion if having obtained sufficient appropriate audit evidence, it concludes that misstatements, individually or in aggregate, are both material and pervasive to the financial statements.
	Disclaimer of opinion[4]	The auditor would disclaim an opinion when: i) it is unable to obtain sufficient appropriate audit evidence on which to base the opinion; and ii) the possible effect on the financial statements of undetected misstatements, if any, could be both material and pervasive.

[2] Under HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor's Report", the decision regarding which type of modification is appropriate depends on the auditor's judgment about the nature of matter giving rise to the modification, and the pervasiveness of its effect or possible effects on the financial statements.

[3] If adequate disclosure about the material uncertainty is not made, the auditor may issue a qualified or adverse opinion depending on whether the inadequate disclosure/omission is material and/or pervasive to the financial statements.

[4] Trading suspension is required under the HKEX proposal.