

# Hong Kong Capital Markets Update

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

On 24 May 2019, the Stock Exchange of Hong Kong Limited (the Exchange) published the [conclusions of its consultation](#) on the proposal relating to listed issuers with a disclaimer or adverse audit opinion on their financial statements (Conclusions), which is summarised below:

### Highlights

- The Exchange will adopt the proposal to require trading suspension for a listed issuer which publishes financial statements with a disclaimer of opinion by the auditor or an adverse opinion ("disclaimer or adverse opinion"), with modifications to exclude going concern issuers from trading suspension.
- Trading suspension is not required for issuers with a disclaimer or adverse opinion if the underlying issue has been resolved before the publication of the preliminary results announcement.
- A longer remedial period may be allowed if the resolution of issues is outside the issuer's control.
- The suspension will remain in force until the listed issuer has addressed the issues giving rise to the disclaimer or adverse opinion.
- The new Listing Rule will apply to issuers' preliminary annual results announcements for financial years commencing on or after 1 September 2019, with a transitional arrangement to extend the remedial period to 24 months for 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 Listing Rule.

### Background

On 28 September 2018, the Exchange published a consultation paper (Consultation) to seek market feedback on the proposal to require trading suspension 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<sup>1</sup> on their financial statements. The Exchange, after considering the comments from the respondents, decided to adopt the proposal in the Consultation, with certain modifications detailed below.

### Key amendments

#### *Modified suspension requirement*

One of the major modifications is to exclude cases where the disclaimer or adverse opinion relates solely to a going concern from trading suspension, to address respondents' concerns that suspending going concern issuers could accelerate their demise and induce financial hardship on these issuers. As the going concern issue relates mainly to differences in judgement between the auditors and the management on the basis of preparation of the financial statements, rather than on the accuracy of individual financial figures, the Exchange considers the issue can be addressed by issuers making clear disclosures in their preliminary results announcement, including details of the audit modifications, the facts and circumstances giving rise to the modifications and the actions taken and/or to be taken by the issuer to address the modification.

<sup>1</sup> To facilitate the 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.

Trading suspension is also not required if the underlying issue giving rise to the disclaimer or adverse opinion has been resolved before the issuer publishes its preliminary results announcement, provided that the issue would not have an ongoing effect on the issuer's financial statements for the succeeding financial years. A typical example is that a listed issuer has 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. Although the issuer may still receive a disclaimer of opinion in the next year's auditor report relating to the opening financial position, trading suspension is not required because the incident would not have an ongoing effect. Alternatively, the issuer is required to disclose sufficient information to enable investors to make an informed assessment of its financial position.

### ***Modified remedial period***

Under the current delisting Rules, the Exchange may delist a Main Board issuer after a continuous suspension of 18 months (or 12 months for a GEM issuer). This is known as the remedial period. The Exchange acknowledges the fact that the current remedial period may be insufficient for the issuers to resolve issues that are outside of their control. These may include litigation and disputes over significant assets, contracts or income; and funding shortages due to poor market sentiment (for more examples, see the Conclusions). As such, the Exchange would allow, at its sole discretion, a longer remedial period if it is satisfied that the issuer has made all reasonable efforts to resolve the issues but, due to reasons outside its control, such underlying issues remain unresolved. The duration of the remedial period will be determined on a case by case basis.

### ***Criteria for trading resumption***

To resume trading, the listed issuer must resolve the issues that gave 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. The type of engagement to be performed by the auditor for the issuers to provide such comfort would largely depend on the circumstances which give rise to the modification and must be considered case by case.

### ***Effective date***

The Exchange will apply the suspension requirement to issuers' preliminary annual results announcements for the financial years commencing on or after 1 September 2019. 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 on their financial statements for financial years commencing on or after 1 September 2019 and up to and including 31 August 2021.

With respect to listed issuers currently with a disclaimer or adverse opinion on their financial statements, trading suspension is not required unless the listed issuers continue to receive such opinion on their financial statements for the financial years commencing on or after 1 September 2019.

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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
<b>Unmodified</b>	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 <sup>4</sup>	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. <sup>3</sup>
<b>Modified<sup>2</sup></b>	Qualified <sup>4</sup>	The auditor would express a qualified opinion when: <ul style="list-style-type: none"> <li>i) having obtained sufficient appropriate audit evidence, it concludes that misstatements, individually or in aggregate, are material but not pervasive; or</li> <li>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.</li> </ul>
	Adverse <sup>5</sup>	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 <sup>5</sup>	The auditor would disclaim an opinion when: <ul style="list-style-type: none"> <li>i) it is unable to obtain sufficient appropriate audit evidence on which to base the opinion; and</li> <li>ii) the possible effect on the financial statements of undetected misstatements, if any, could be both material and pervasive.</li> </ul>

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> Trading suspension is required for disclaimer or adverse audit opinion, except that 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.