

## Client Alert

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## New trading suspension requirement – *Auditor's disclaimer or adverse opinion on issuer's financial statements*

### Summary

On 24 May 2019, The Stock Exchange of Hong Kong Limited (“**SEHK**”) published its [consultation conclusions](#) on the proposed trading suspension requirement applicable to issuers with disclaimer or adverse audit opinion on their financial statements. The new suspension requirement will apply to issuers’ **annual results announcements for financial years commencing on or after 1 September 2019**.

### New suspension requirement

SEHK will normally require suspension of trading in an issuer’s securities if it publishes an annual results announcement and the auditor has issued, or has indicated that it will issue, a disclaimer or adverse audit opinion on the issuer’s annual financial statements.

Trading will remain suspended until the issuer has addressed the issues giving rise to the disclaimer or adverse opinion, provided comfort that such disclaimer or adverse opinion would no longer be required and disclosed sufficient information for investors to make an informed assessment of its financial position.

The new suspension requirement does not apply to (a) financial statements with a qualified opinion or a clean opinion with an emphasis of matter, or (b) interim financial statements.

### Rationale

A disclaimer (or adverse) audit opinion on the financial statements indicates that the risk of misstatements could be (or the misstatements are) both material and pervasive to the financial statements, and therefore raises concerns about the reliability of the financial information. SEHK considers the current regime cannot adequately address such concerns and a relatively large number of issuers have not taken prompt and adequate actions to address audit issues, resulting in repeated disclaimer of opinions. The new suspension requirement aims to enhance investors’ protection by improving the quality and reliability of financial information published by issuers. SEHK considers it would also encourage issuers to strengthen their risk management and internal control systems, and to act promptly to resolve audit issues with their auditors.

### Exceptions to the new suspension requirement

SEHK emphasizes that a suspension decision is not automatic based solely on a disclaimer or adverse audit opinion. The new suspension requirement will not normally apply where the disclaimer or adverse opinion relates solely to going concern (and not any other issues), in which case additional disclosure (namely, details of the audit modification, the facts giving rise to the modification and the actions taken and/or to be taken to address the





modification) must be made in the annual results announcement. Further, the new suspension requirement may not apply where the issuer has addressed all the issues giving rise to the disclaimer or adverse opinion before the publication of the annual results announcement and disclosed sufficient information to enable investors to make an informed assessment of its financial position.

## Longer remedial period for circumstances outside the issuers' control

Under the current Listing Rules, SEHK may delist a Main Board issuer after a continuous suspension for 18 months (or 12 months for a GEM issuer) ("**Remedial Period**"). Where an issuer has satisfied SEHK that it has made all reasonable efforts to resolve the issues giving rise to the disclaimer or adverse opinion but, due to reason outside its control, such issues remain unresolved, SEHK would consider allowing a longer Remedial Period, with the duration of the period to be determined on a case by case basis. The issuer must demonstrate to SEHK's satisfaction that it reasonably expects to resolve all underlying audit issues within the proposed extended Remedial Period. Examples of circumstances that may be considered to be outside the issuer's control include:

1. 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;
2. A temporary suspension of business upon the request of a regulatory or government authority due to a change in the regulatory requirements; and
3. 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.

## Transitional arrangement

To allow time for issuers to review and improve their risk management and internal control systems, the Remedial Period will be extended to 24 months for both Main Board and GEM issuers that are suspended solely due to disclaimer or adverse opinions on their financial statements for the financial years commencing between 1 September 2019 and 31 August 2021, both dates inclusive.

Issuers currently with disclaimer or adverse opinions on their financial statements will not be required to suspend trading under the new suspension requirement unless the issuers continue to receive such opinions 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.



## Recommended actions

SEHK considers that issuers could avoid audit modifications by:

1. establishing and maintaining appropriate and effective risk management and internal control systems, including measures to control and manage jointly-controlled entities and associates and to keep books and records of subsidiaries properly;
2. conducting sufficient due diligence prior to investment or acquisitions or making advances to third parties;
3. obtaining an independent valuation to support the valuation of certain assets (e.g. intangible assets, property, plant and equipment, prepayments and deposits) on a timely basis;
4. taking timely actions against its debtors to assess the recoverability of bad debts;
5. actively engaging and communicating with their auditors prior to and during the audit.

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