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Financial Reporting Amidst the Coronavirus Outbreak

On 4 February, the Securities and Futures Commission and the Stock Exchange of Hong Kong issued a Joint Statement in relation to results announcements in light of travel restrictions related to the severe respiratory disease associated with a novel infectious agent.

The coronavirus outbreak will likely affect some issuers' plan and progress in preparing financial information for their results announcements. Many of our fellow directors are facing a difficult situation.

HKIoD had the opportunity to have an in-depth joint discussion with teams from the SFC (led by Mr Brian Ho, Executive Director, Corporate Finance), the Stock Exchange (led by Ms. Bonnie Y Chan, Head of Listing) and the Financial Reporting Council (led by Dr. Kelvin Wong, Chairman). From the discussion, HKIoD gained some insights and has some comfort and assurance to bring to our fellow directors.

The very purpose of the Joint Statement is to keep as much as possible the orderly and continuous running of the Hong Kong financial market. A blanket delay for financial reporting can have serious detrimental effect on the credibility of the Hong Kong market.

Under the Joint Statement, an issuer's board may have to release financial information before the auditor can perform work. Based on our understanding, however, the regulators are fully mindful that this is a difficult situation affecting many. Directors need not become too worried so long as they have faithfully performed and discharged their duties.

We have the following guidance and advice for directors.

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Results available but for the lack of agreement with the auditor

The Joint Statement by its wording would require issuers to publish preliminary results by the deadline date if such results are available but for the lack of agreement with the auditor.

To publish without agreement with the auditor would mean publishing information when the auditing team has not completed its work. The issuer's board may have missed or misunderstood the latest changes in accounting standards. The auditor may have a valid challenge to the treatment of certain assets or liabilities. The lack of agreement with auditor could be significant. Directors have reasons to be worried.

Based on our understanding, if the issuer's board has been diligent and reasonable in their treatment of the accounts and the interpretation of applicable standards, that the auditor may later disagree would not subsequently attract regulator actions unless there is evident fraud or other serious wrongdoing.

Other cases

In all other cases, the Joint Statement would require issuers to consult with the Exchange on what information is available, and to describe uncertainties and state how they may affect the numbers so the SFC and the Exchange can assess whether the information available is “accurate and complete in all material respects” and, if so published, would facilitate an informed investment decision.

The nature and scope of the uncertainties that may be present could well be material and will involve much value judgment. The audit process is a means to provide assurance on the validity and credibility of the information eventually published. Without audit, an issuer’s board may steer conservative and, out of liability reasons, become inclined to put out many disclaiming and qualifying statements as to reduce the utility of the information published.

Based on our understanding, the regulators indeed do not want a flood of cautionary statements as to make disclosure not useful. The regulators are more interested in knowing whether the board has put in a good faith effort to understand the issuer’s financial information available, the key audit matters that would more likely involve judgment (and, in normal times, actual discussions with auditor), how the board has come down to the position taken as to these key audit matters and then succinctly inform investors the rationale. Based on our understanding, a good faith effort to have gone through this deliberation process would not subsequently attract regulator actions unless there is evident fraud or other serious wrongdoing.

Ultimate responsibility rests with the whole board

The Joint Statement says the SFC and the Exchange will consider the views of the issuer’s audit committee on the unaudited financial information available to the issuer.

Audit committee members are likely to be more familiar with the issuer’s financial reporting matters. And by operation of the Corporate Governance Code, an issuer’s audit committee would have a majority of independent non-executive directors. The views of the independent members on the audit committee are a valuable check on management, we agree.

But the buck does not stop at the audit committee. The views of other independent directors not on the audit committee are also important. Although the audit committee has an important role to play in financial reporting, the whole board remains ultimately responsible for an issuer’s external financial reporting.

Advice to boards

HKIoD has some advice to board members.

- For all board members, executives and non-executives, and not just those on the audit committee, they should remember that the whole board is collectively responsible.
- For all board members, they should pay attention to key issues that would affect the issuer’s financial position. Often, such would involve the valuation of assets, the recognition of revenue, the classification of liabilities in relation to loan covenants, etc. The issuer’s cash flows situation is another area not to be missed.
- For the non-executive directors especially, they should have obtained adequate assurance in writing from the appropriate executive members (the CFO and CEO, may be other executives depending on circumstances) that there has been no failures in

internal control, no material inconsistency in financial record keeping, etc. and that there has been no unusual event or occurrence at relevant times that could affect the scope, accuracy and reliability of the financial information. To the extent possible, they should maintain close contact with key members of the audit team to try to get help with identifying the areas to focus on.

- For the non-executive directors especially, they should be proactive in audit committee and board proceedings to question and check on the information, assumptions and assurances given by management. Non-executive directors who are not audit committee members may consider sitting in audit committee sessions to help their understanding.
- For the non-executive directors (perhaps even executive directors) who may be prevented from travelling to a committee or board meeting, they need to assess if they are thereby prevented from fully grasping the picture in order to form an opinion on the subject matter. Although video-conferencing technology could enable committee and board meetings to take place, this meeting mode could mean they are less able to spot and detect nuances in a dialogue and exchange than they otherwise could in an in-person meeting. To the extent a director feels this impedes their ability to explain a matter or to raise a query, the director should voice out and not feel pressed into going along.
- Each board member should ensure that the audit committee and board deliberations are well recorded in a way that demonstrates they have made the necessary inquiry and met their duty of care.
- For all board members, they should bear in mind that continuous disclosure obligations remain. Under prevailing rules, and as highlighted in the Joint Statement, events or occurrences whether due to the coronavirus outbreak which could have a material impact on share price will need to be disclosed by way of an announcement.

Contact the regulators in case of real difficulty

All in all, a board member should not feel pressed to assent to release of financial information just to make the deadline. But each board member should put in a good faith effort to keep the financial reporting process going. The Joint Statement does invite issuers who will have difficulty in publishing financial information on time to contact the Exchange as soon as possible to discuss the situation.

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