



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

**Consultation Conclusions on the
Draft Securities and Futures
(Accounts and Audit) Rules**
《證券及期貨(帳目及審計)規則》
草擬本的諮詢總結

Hong Kong
July 2002

香港
2002年7月

INTRODUCTION

1. On 21 December 2001, the Securities and Futures Commission (the “Commission”) released a Consultation Document (the “Consultation Document”) on the draft Securities and Futures (Accounts and Audit) Rules (the “Rules”).
2. The Consultation Document contained details of the prescribed contents of the annual accounts as well as audit requirements and the general scope of audit opinions.
3. The consultation period lasted until 31 January 2002.
4. A summary of comments received on the draft Rules (“Summary of Comments”) is attached as Appendix 1.
5. Taking into account the submissions received and following discussions with commentators, a few revisions to the Rules were considered appropriate.
6. These revisions have been adopted by the Commission and effected in the Revised Draft Rules, which are attached as Appendix 2 (“Revised Draft Rules”). As the Revised Draft Rules remain subject to deliberation of the Legislative Council, they may not be in the final form. They are issued primarily to demonstrate how we have revised the rules in response to the market comments and not for the purpose of another round of consultation.
7. The purpose of this report is to provide interested persons with an analysis of the main comments raised during the consultation process and the rationale for the Commission’s conclusions. This report should be read in conjunction with the Securities and Futures Ordinance (the “Ordinance”), the Consultation Document, the Revised Draft Rules, and the Summary of Comments.

PUBLIC CONSULTATION

A. Background

8. The Rules prescribe the contents of the annual accounts and the auditor’s report of such accounts to be submitted by licensed corporations and associated entities to the Commission.
9. The primary changes implemented by the Rules from the existing requirements are:
 - expanding the scope of application to all licensed corporations and associated entities;
 - requiring that selected returns prescribed in the Securities and Futures (Financial Resources) Rules, as at the end of the financial period, are to be audited and submitted to the Commission;

- where applicable, requiring the auditor to confirm adequacy of systems of control of a licensed corporation or associated entity to ensure compliance with the Securities and futures (Client Money) Rules and the Securities and Futures (Client Securities) Rules; and
- requiring information about the business and risk management of licensed corporations and associated entities by means of a questionnaire.

B. Consultation Process

10. In addition to the public announcement inviting comments, the Consultation Document was distributed to all registered persons and various professional bodies. The Consultation Document was also published on the website of the Commission.
11. Sessions were held with industry participants and their legal advisers during and after the consultation period to discuss their comments.
12. 9 submissions were received from the legal, accounting and market industries including international brokerage firms, industry representative bodies, professional associations (including the Hong Kong Society of Accountants and the Law Society of Hong Kong). One of the submissions consisted of a survey of its members conducted by the Hong Kong Securities Institute.
13. The overall tone of the comments was positive. Commentators generally recognized the need for annual audited accounts. Comments primarily focused on the uncertainty of cost implications of particular new requirements and the need to develop internal control guidance or benchmarks.

CONSULTATION CONCLUSIONS

Auditor's Opinion Regarding Contravention of the FRR

14. The Rules require that the auditor also express an opinion as to whether there has been any breach of the FRR by the licensed corporation during the financial year (clause 4(1)(g)).
15. The Hong Kong Society of Accountants indicated their concern about this requirement, arguing that it expanded unduly the previous requirements with respect to an audit opinion on compliance with the FRR. In their view, it would be more appropriate only to require the auditors to state whether there "appears to the auditor" to have been a contravention of the FRR and not whether there actually has been any such breach.
16. It was not the policy intent to significantly expand the scope of the audit in this manner. Accordingly, we have revised clause 4(1)(g) to bring the requirement in line with existing standard.

Rules and Forms Specified in the draft Rules

17. Several commentators expressed concern that the annual account filings required under the Rules must also contain confirmation of compliance with requirements of various other rules that are not in final form or not available at the time of consultation. These rules include the Securities and Futures (Client Money) Rules (the “Client Money Rules”), the Securities and Futures (Client Securities) Rules (the “Client Securities Rules”), the Securities and Futures ((Financial Resources) Rules (the “FRR”), and the Securities and Futures (Keeping of Records) Rules and proforma financial statements and questionnaires. The commentators indicated that it is difficult for them to fully assess the impact of these requirements for purposes of these draft Rules.
18. As our primary objective of the consultation is to seek views and comments on the general accounting and auditing requirements for licensed corporations, associated entities and their auditors, we consider commentators would still be able to comment usefully on the general principles reflected in the Rules without certain reference documents. In any event, all the relevant rules have been released for consultation so there should be a general understanding of the sort of requirements we have in mind. In respect of the reporting requirements which are more detailed in nature, such as proforma financial statements and questionnaires, it is more appropriate not to cover these in this consultation. In fact, we have been closely working with the industry participants and professional bodies to finalize these documents.

Internal Control Guidelines are Needed

19. The Rules require that an auditor of a licensed corporation or an associated entity must express an opinion annually on whether a licensed corporation or an associated entity of an intermediary had control systems in place that adequately ensure compliance with the customer protection requirements of the Client Money Rules and the Client Securities Rules (clause 4(1)(e)).
20. Both market participants and the accounting professionals asked for more detailed guidance to aid in establishing an acceptable internal control system. Generally, we agree that guidelines are necessary and will work with market participants and professional bodies to develop applicable guidance primarily based on the existing guidelines, “Management, Supervision and Internal Control Guidelines for Persons Registered with or Licensed by the Securities and Futures Commission” issued in 1997.

Duplication of Auditor’s Opinion and Licensed Corporation’s Confirmation on Internal Control System

21. Some commentators also viewed the clause 4(1)(e) requirement for an auditor’s opinion as to the adequacy of the internal control system as duplicative of the similar confirmation required by the licensed corporations and associated entities under clause 3(1)(c) and (3)(2)(c) of the Rules.

22. The annual confirmation by licensed corporations or associated entities was intended to ensure that they have established and are satisfied with their internal controls for client money and securities. However, on reflection, such confirmation may be taken into consideration in the context of the auditor's opinion. Requiring an auditor's opinion is to obtain independent assessment of the internal control system. Therefore, in order to streamline the proposed regulatory reporting requirements, we have removed the annual confirmation requirement for licensed corporations and associated entities in the Revised Draft Rules and placed reliance on the auditor's opinion alone.

Application of the Rules

23. One commentator would like to clarify that the Rules will be applicable to an associated entity of a registered institution as defined in the Ordinance. In fact, the Rules are intended to cover an associated entity of a registered institution and we have addressed this requirement in the Revised Draft Rules.

Costs Associated with Auditor's Opinions

24. A few commentators were concerned with the possible cost implications of requiring auditors to express opinions on selected returns as at the end of the financial year, as well as the adequacy of internal control systems.
25. With respect to the additional work that will be required of auditors under these Rules, we believe that the additional related costs will be minimal and nevertheless justified on grounds of better protection for investors and given that much of what is required of the auditors is already required under current rules and their professional pronouncements.
26. Under section 4 of the Securities (Accounts and Audit) Rules, an auditor is required to opine on whether the computation of liquid capital (as at the end of the financial year) is correctly compiled from the books and records of the securities dealer. Similar requirements exist in the Commodities Trading (Accounts and Audit) Rules and the Leveraged Foreign Exchange Trading (Accounts and Audit) Rules.
27. In addition to the statutory requirements, the Industry Auditing Guideline 3.404 "The Audit of The Accounts of Dealers in Securities" issued by the Hong Kong Society of Accountants in 1986 also states that it is of great importance for the auditors to review the system of accounting and internal control of a securities dealer in order to report on the books and records kept by the dealer.

Matters Reportable by Auditors

28. We have added a new clause 5 to the Revised Draft Rules which prescribes certain sections of the Securities and Futures (Client Money) Rules, the Securities and Futures (Client Securities) Rules and the Securities and Futures (Keeping of Records) Rules as requirements for the purposes of the definition of "prescribed requirement" in section 157(3) of the SFO. Such prescribed

requirements then become matters in respect of which an auditor must report to the SFC non-compliance by a licensed corporation or associated entity he is auditing. This is similar to section 89 of the Securities Ordinance under which auditors are required to report to the Commission upon discovery of evidence of contraventions of the equivalent of these prescribed requirements in current law.

Technical Change

29. We have updated all references in the Rules to clauses in the Securities and Futures Bill to the appropriate sections under the Ordinance. These changes have no substantive effect on the Revised Draft Rules.

EFFECTIVE DATE AND TRANSITIONAL ARRANGEMENTS

30. It is intended that the Securities and Futures (Accounts and Audit) Rules will become effective on the day appointed for the commencement of Part VI of the Ordinance.

Summary of comments received on Draft Securities and Futures (Accounts and Audit) Rules (the “Rules”)

	Section reference	Details of the Rules	Respondent’s Comments	SFC’s Response
1.		General comments	<p>[HKSbA, LSHK, Linklaters] The absence of the various rules and documents creates difficulty in commenting on the draft Rules in any event, whether the draft Rules impose undue compliance burdens on licensed corporations and their associated entities, whether such persons will be able to obtain confirmations from their auditors in the form required by the draft Rules, and the likely cost increases involved.</p> <p>The other commentator also commented that they were not in the position to comment the draft Rules as the following documents were not available:-</p> <p>3(1)(b) Section 35(1), Financial Resources Rules 3(1)(b)(v) Format and source of data for the analysis 3(1)(c)(i) Section 3 to 6, Client Money Rules Section 4 to 9, Client Securities Rules 3(1)(d) Format and content of questionnaire 4(1)(f)(i) Keeping of Records Rules 4(1)(g) Financial Resources Rules</p>	<p>Our primary objective of the consultation is to seek views and comments on the general accounting and auditing requirements for licensed corporations, associated entities and their auditors. Therefore, we consider commentators would still be able to usefully comment on the general principles reflected in the draft Rules without certain reference documents.</p> <p>All the relevant Rules have been released for consultation so there should be a general understanding of the sort of requirements we have in mind. In addition, we also explained in the consultation document that proforma financial statements and questionnaires were not included in the consultation document as they tend to be detailed in nature. However, we will consult with the industry group and the HKSA before finalizing these documents.</p>

Note: Please refer to the derivation table at the end of this document for cross references to the section numbers under the Securities and Futures Ordinance as gazetted on 28 March 2002.

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
2.	2	<u>Interpretation</u> Meaning of associated entity	[HKSA] The New Policy Initiatives are set out in paragraph 11 of the Introduction of the Consultation Document. However, the commentator asked for clarification in the "Foreword" or "Introduction" of the proposed Rules that they are not applicable to an associated entity, which is an authorized financial institution by virtue of the provision in Section 156(7) of the Securities and Futures Ordinance.	The draft Rules are to be read in conjunction with the Securities and Futures Ordinance (the "Ordinance") generally. In particular, Section 156(7) of the Ordinance specifically excludes authorized financial institutions from the definition of associated entity for the purposes of section 156. Since the Rules are subordinate to the Ordinance it is not necessary to state this again.
3.	Section 156 of the Ordinance		[LSHK] Although Section 156 of the Securities and Futures Ordinance (the "Ordinance") would enable the SFC to prescribe relevant requirements in relation to the annual audited financial statements and other documents to be submitted by associated entities of registered institutions, the draft Rules do not extend to such associated entities.	The draft Rules are also intended to cover an associated entity of a registered institution. In order to clearly address this requirement, we have made relevant changes to the draft Rules accordingly.

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
4.	3(1)(b), (2)(b) and 4(1)(d)	<p><u>Reporting requirements</u></p> <p>Each licensed corporation is required to prepare the returns as specified in the Securities and Futures (Financial Resources) Rules in respect of the end of financial year or the financial year in which it ceases carrying in all of the regulated activities. In addition, auditor of a licensed corporation is also required to express opinion on whether the returns specified in Section 3(1)(b) or Section 3(2)(b) are correctly compiled from the records of the licensed corporation.</p>	<p>[HKSA, HKSI] Additional cost would be incurred as extra work will have to be performed by an auditor to express an opinion on the monthly financial returns. This creates a heavy cost burden on the licensed corporations. If auditors are required to review the financial returns as part of the annual audit, it is obvious that such review would not serve any purpose as the SFC already has a checking mechanism in place and that the use of auditors would add unnecessary costs and a further layer of complexity to the submission process.</p>	<p>We would like to clarify that the draft Rules only require a licensed corporation to submit specified returns at the end of the financial year.</p> <p>In addition, the existing Securities (Accounts and Audit) Rules already require a dealer to include specified returns in the audited financial statements.</p>
5.	3(1)(c), (2)(c) [(2)(c) deleted now], (3)(c) and (4)(c) [(4)(c) deleted now]	<p><u>Reporting on adequacy of internal controls</u></p> <p>The licensed corporation or associated entity must prepare a document in the applicable form confirming that during the financial year, it has adequate systems of control in place to ensure compliance with specified sections of the Securities and Futures (Client Money) Rules and the Securities and Futures (Client Securities) Rules (Section 3(1)(c), (2)(c), (3)(c) and (4)(c)) and to require the auditor to assess such adequacy (Section 4(1)(e)).</p>	<p>[Name of respondent withheld upon request]</p> <p>One commentator generally supported the proposed requirements for certifications that adequate control systems have been put in place. However, the commentator also asked that either the Rules should clearly spell out or SFC should issue separate guidelines to specify the grounds, standards or criteria the SFC expects adequacy of control systems to be assessed by licensed corporations, associated entities or auditors.</p>	<p>The SFC will issue further guidance on internal control to ensure compliance with the Securities and Futures (Client Money) Rules ("Client Money Rules") and the Securities and Futures (Client Securities) Rules ("Client Securities Rules") largely based on the Management, Supervision and Internal Control Guidelines for Persons Registered with or Licensed by the SFC. In fact, a working group has been formed with the HKSA to co-ordinate the development of such guidance.</p>

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
6.			<p>[HKSA] In order to facilitate the licensed corporation or the associated entity to prepare the document on internal controls pursuant to Section 3(1)(c), 3(2)(c) or 3(3)(c) of the proposed Rules, and also to facilitate the auditors' reporting thereon pursuant to Section 4(1)(e) of the proposed Rules, the SFC should establish an industry benchmark on the minimum internal controls that are required to be maintained by the licensed corporation or its associated entity. The proposed industry benchmark should be established after consulting the market well in advance of the implementation the proposed Rules so that both the licensed corporation and its associated entity and the auditors are informed of the requirements.</p>	<p>Please refer to our response to item 5.</p>

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
7.			[LSHK, Linklaters] Sections 3(1)(c), (2)(c), (3)(c) and (4)(c) of the draft Rules do not appear to accommodate the situation where the licensed corporation or associated entity concerned cannot confirm that it had systems of control in place that were adequate to ensure compliance.	We do not agree that the licensed corporation or associated entity could not confirm adequacy of internal control for client assets as under paragraph 4.3 of the Code of Conduct, registered persons are expected to have internal control procedures which can be reasonably expected to protect their operations and their clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions. In Section 4(1)(e) of the Rules, the auditor is required to opine as to whether or not systems of control were in place. If the opinion is that they were not then we would draw the appropriate conclusions about the fitness and properness of the licensed corporation involved.
8.			[HKSI] The draft Rules may not be suitable to those small to medium size licensed corporations due to small number of staff. The segregation of duties is not apparent.	Please refer to our response to item 7.
9.			[LSHK, Linklaters] There is a substantial element of duplication between the confirmations required from the licensed corporation or associated entity, and the opinions required from the auditor as prescribed in Section 4(1)(e) and (f) of the draft Rules.	In order to streamline the regulatory reporting requirements, the confirmation requirement by the licensed corporation or the associated entity has been removed from the revised draft Rules. Instead, reliance will be placed on the auditor's opinion alone.

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
10.			<p>[ISDL, HKSbA] The potential scope of the additional requirement for auditors to report on the adequacy of systems of control ensuring compliance of Securities and Futures (Client Money) Rules and Securities and Futures (Client Securities) Rules may result in correspondingly large fee charge. In view of the difficult time currently experienced by most of the registrants, this increase in expenditure is most unwelcome. The commentator urged the SFC and the HKSA to set out appropriate guidelines in limiting the scope of audit.</p>	<p>The Industry Auditing Guideline 3.404 “The Audit of The Accounts of Dealers in Securities” issued by the HKSA in 1986 recognised that it is of great importance for the auditors to review the system of accounting and internal controls of a securities dealer in order to report on whether proper books and records have been maintained by the dealer. Therefore, we do not expect that the proposed requirements will significantly increase the scope of the audit.</p> <p>In addition, we have also considered the possible cost implication that may be incurred by a licensed corporation or associated entity. The draft Rules accordingly only require auditors to give an opinion on internal controls in respect of two specific rules (namely the Client Money Rules and the Client Securities Rules).</p>
11.			<p>[HKSI] It should be clarified that for purposes of Section 11(c) of the Consultation Document, the requirement does not apply to those investment advisors whose advisory activities do not involve handling “client money” and “client securities”. Otherwise, the auditors may carry out excessive or unrelated assessments on the company’s internal control systems, which may complicate the reporting to the SFC.</p>	<p>It is not our intention to require an auditor of a licensed corporation to confirm the adequacy of internal controls to ensure compliance with the Client Money Rules and the Client Securities Rules even when the licensed corporation does not hold any client assets. We have clarified this issue in the revised draft Rules by adding “where applicable”.</p>

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
12.			[HKSI] The SFC should clarify whether client assets held by a licensed corporation which relates to its other business (say insurance premium from clients) should be covered by the draft Rules.	It has been clarified in the Client Money Rules and the Client Securities Rules that they only apply to assets received or held in the course of the conduct of regulated activity. Since the Accounts and Audit Rules cross-refer to these Rules their scope of application is similarly limited.
13.	3(1)(d) [3(1)(d) replaced by 3(1)(c) now]and 3(3)(d) [3(3)(d) replaced by 3(3)(c) now]	<p><u>Business and Risk Management Questionnaire</u></p> <p>Sections 3(1)(d)</p> <p>For the purposes of Section 156(1)(a) of the Ordinance, a licensed corporation must prepare, in respect of each financial year, a business and risk management questionnaire in the applicable form.</p> <p>Section 3(3)(d)</p> <p>For the purposes of Section 156(1)(a) of the Ordinance, an associated entity of a licensed corporation must prepare, in respect of each financial year, a business and risk management questionnaire in the applicable form.</p>	[LSHK, Linklaters] There seems to be considerable scope for overlap between the information required to be provided under the business and risk management questionnaire and the confirmations and opinions required to be provided by licensed corporations, associated entities and auditors under the Rules.	<p>In order for the SFC to better understand the overall business activity of the licensed corporation and the associated entity, the business and risk management questionnaire will ask for more detailed information in relation to their business activity, risk management and internal control.</p> <p>As set out in item 9 above, the confirmation made by the licensed corporation or the associated entity regarding adequacy of internal controls for client money and client securities has been removed from the draft Rules.</p>

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
14.	4(1)(e)	<p><u>Auditors' reporting requirements for adequacy of internal controls</u></p> <p>An auditor's report under Section 156 (1)(b) or (2)(b) of the Ordinance must contain a statement by the auditor as to whether in the auditor's opinion during the financial year, the licensed corporation or the associated entity, as the case may be, had systems of control in place that were adequate to ensure compliance with</p> <p>(i) Sections 4 to 8 of the Securities and Futures (Client Money) Rules; and</p> <p>(ii) Sections 5 to 10 of the Securities and Futures (Client Securities) Rules.</p>	<p>[LSHK, Linklaters] Concern was expressed that the opinions required under Section 4(1)(e) and (f) also may result in potential overlap.</p>	<p>Section 4(1)(f) requires auditors specifically to report on actual compliance while Section 4(1)(e) primarily focuses on the adequacy of internal controls. Therefore, we do not consider there is any duplication.</p>
15.	4(1)(f)	<p><u>Auditors' reporting requirements for statutory compliance</u></p> <p>An auditor's report under Section 156 (1)(b) or (2)(b) of the Ordinance must contain a statement by the auditor as to whether in the auditor's opinion during the financial year, the licensed corporation or the associated entity, as the case may be, has complied with :</p>	<p>[LSHK, Linklaters] The draft Rules requirement that the auditor opine on compliance with the Securities and Futures (Keeping of Records) Rules may be problematic because identifying or discovering transactions which should have been included in the records but have not been may be extremely difficult. We expect that auditors will wish to make various assumptions in giving their opinion that may largely negate the value of this opinion to the SFC.</p>	<p>We do not regard this is a new requirement for an auditor to express opinion on keeping of records and keeping of client's securities and client's money by a licensed corporation. Under Section 4 of the existing Securities (Accounts and Audit) Rules, an auditor is required to give an opinion as to whether the dealer has properly kept the records under sections 81 and 83 of the Securities Ordinance (including keeping of client's securities) and all trust accounts in accordance with section 84 of the Securities Ordinance. Similar</p>

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
		(i) Sections 3 to 8 of the Securities and Futures (Keeping of Records) Rules; (ii) Sections 4 to 8 of the Securities and Futures (Client Money) Rules (iii) Sections 5 to 10 of the Securities and Futures (Client Securities) Rules		requirements also apply under the Commodities Trading (Accounts and Audit) Rules and the Leveraged Foreign Exchange Trading (Accounts and Audit) Rules.
16.	4(1)(g)	<p><u>Auditors' reporting requirements for compliance with the Financial Resources Rules</u></p> <p>An auditor's report under Section 156 (1)(b) or (2)(b) of the Ordinance must contain a statement by the auditor as to whether in the auditor's opinion:</p> <p>“there has been any contravention of the Securities and Futures (Financial Resources) Rules (“FRR”) by the licensed corporation during the financial year.”</p>	<p>[HKSA] Under Section 4(c) of the current Securities (Accounts & Audit) Rules, the auditors are only required to include a statement in the auditors' report “whether there appears to the auditor to have been any contravention of the FRR by the dealer during the financial year” or “whether the auditors are aware of any instances during the year where the dealer has contravened the FRR”. If Section 4(1)(g) of the draft Rules is intended to be a more onerous audit reporting requirement than that in Section 4(c) of the current Securities (Accounts & Audit) Rules, this will have the effect of requiring the auditors to extend the scope of their audit to actively search for any contravention of the FRR.</p>	We have revised the draft Rules so that the auditor is only required to express whether in his opinion there “appears to have been any contravention” of the FRRs. This addresses the concerns of the commentator.

	Section reference	Details of the Rules	Respondent's Comments	SFC's Response
17.	4(2)	<p><u>Format of auditor's report</u></p> <p>A licensed corporation or an associated entity of a licensed corporation, as the case may be, may submit 2 separate auditor's reports in respect of a financial year, one containing a statement by the auditor concerning the matters referred to in Subsection (1)(a) to (c) and the other containing a statement by the auditor concerning the matters referred to in Subsection (1)(d) to (g).</p>	<p>[HKSI] It is a matter of cost, as the existing rule is fair enough to monitor securities dealers and investment advisor.</p>	<p>After considering the comments from the industry participants and professional bodies, the draft Rules reflect a balance between relevant professional development and cost. We allow flexibility for two separate auditor's reports (entirely at the discretion of the licensed corporation or associated entity) to accommodate future professional development and for licensed corporations, associated entities and auditors to determine appropriate reporting arrangements.</p>
18.			<p>[HKSA] Auditors are required to prepare two auditors' reports to satisfy the reporting requirements under the draft Rules. Under the circumstance, it is considered that Section 4 of the draft Rules should not be drafted in the current form such that Subsection (1) prescribes the contents of a "composite" auditors' report while Subsection (2) prescribes that two separate auditors' reports are allowed to be submitted. Section 4 should have been drafted in such a way that it reflects the current professional development, i.e. the preparation of two separate auditors' report.</p>	<p>Please refer to our response to item 17.</p>

List of Respondents

Date received	Respondent
23 January 2002	The Law Society of Hong Kong (LSHK)
25 January 2002	Hong Kong Bar Association (HKBA)
29 January 2002	Hong Kong Society of Accountants (HKSA)
30 January and 7 February 2002	Hong Kong Stockbrokers Association (HKSB)
30 January 2002	Institute of Securities Dealers Limited (ISDL)
31 January 2002	Linklaters and Alliance (Linklaters) representing Goldman Sachs (Asia) L.L.C. and Morgan Stanley Dean Witter Asia Limited
31 January 2002	Hong Kong Securities Institute (HKSI)
31 January 2002	Hong Kong Association of Banks (HKAB)
1 February 2002	(commentator reserved anonymity)

Derivation Table

Clause/Schedule in the Securities and Futures Bill	Section/Schedule in the Securities and Futures Ordinance
152	156
152(7)	156(7)
384	397
Part 1 Schedule 1	Part 1 Schedule 1

REVISED DRAFT

SECURITIES AND FUTURES (ACCOUNTS AND AUDIT) RULES

CONTENTS

Section		Page
1.	Commencement	1
2.	Interpretation	1
3.	Financial statements and other documents to be prepared by licensed corporations and associated entities of intermediaries	1
4.	Auditor's report	3
5.	Matters reportable by auditors under section 157 of the Ordinance	5

SECURITIES AND FUTURES (ACCOUNTS AND AUDIT) RULES

(Made by the Securities and Futures Commission under section 397(1)
of the Securities and Futures Ordinance (5 of 2002))

1. Commencement

These Rules shall come into operation on the day on which Part VI of the Securities and Futures Ordinance (5 of 2002) comes into operation.

2. Interpretation

In these Rules, unless the context otherwise requires –

“dealing in securities” (證券交易) has the meaning assigned to it by Part 2 of Schedule 5 to the Ordinance;

“margin client” (保證金客戶) means –

- (a) in relation to a corporation licensed for dealing in securities, a client to whom the corporation provides securities margin financing; or
- (b) a client of a corporation licensed for securities margin financing.

“systems of control” (監控系統), in relation to a licensed corporation or an associated entity of an intermediary, means in so far as applicable the internal controls and trading, accounting, settlement and stock holding systems it has implemented to ensure its compliance with the provisions specified in section 4(1)(e).

3. Financial statements and other documents to be prepared by licensed corporations and associated entities of intermediaries

(1) For the purposes of section 156(1)(a) of the Ordinance, the financial statements and other documents that a licensed corporation shall prepare, in respect of each financial year, are –

- (a) a set of accounts consisting of each of the following, prepared in accordance with generally accepted accounting principles –
 - (i) a profit and loss account;
 - (ii) a balance sheet; and
 - (iii) notes to the accounts;
- (b) in so far as applicable, the following returns as referred to in section 58 of the Securities and Futures (Financial Resources) Rules (L.N. of 2002), each made up to the last day of the financial year –
 - (i) a liquid capital computation;
 - (ii) a required liquid capital computation;
 - (iii) a summary of bank loans, advances, credit facilities and other financial accommodation available to it;
 - (iv) an analysis of margin clients;
 - (v) an analysis of collateral received from margin clients;
 - (vi) a rolling balance cash client analysis;
 - (vii) an analysis of client assets; and
 - (viii) a report on proprietary derivative positions; and
- (c) a business and risk management questionnaire.

(2) For the purposes of section 156(2)(a) of the Ordinance, the financial statements and other documents required to be prepared by a licensed corporation that ceases carrying on all of the regulated activities for which it is licensed are –

- (a) a set of accounts as referred to in subsection (1)(a); and

- (b) a liquid capital computation as referred to in subsection (1)(b)(i).

(3) For the purposes of section 156(1)(a) of the Ordinance, the financial statements and other documents that an associated entity of an intermediary shall prepare, in respect of each financial year, are –

- (a) a set of accounts consisting of each of the following, prepared in accordance with generally accepted accounting principles –
 - (i) a profit and loss account;
 - (ii) a balance sheet; and
 - (iii) notes to the accounts;
- (b) an analysis of client assets as at the end of the financial year; and
- (c) a business and risk management questionnaire.

(4) For the purposes of section 156(2)(a) of the Ordinance, the financial statements and other documents required to be prepared by an associated entity of an intermediary that ceases to be such an associated entity are –

- (a) a set of accounts as referred to in subsection (3)(a); and
- (b) an analysis of client assets as referred to in subsection (3)(b).

4. Auditor's report

(1) For the purposes of section 156(1)(b) or (2)(b) of the Ordinance, an auditor's report required to be submitted by a licensed corporation or an associated entity of an intermediary shall contain a statement by the auditor as to whether, in the auditor's opinion –

- (a) the profit and loss account and the balance sheet are in accordance with the records kept by the licensed corporation or the associated entity (as the case may be)

- under the Securities and Futures (Keeping of Records) Rules (L.N. of 2002) and satisfy the requirements of these Rules;
- (b) the balance sheet gives a true and fair view of the state of affairs of the licensed corporation or the associated entity (as the case may be) as at the end of the financial year to which it relates;
 - (c) the profit and loss account gives a true and fair view of the profit or loss of the licensed corporation or the associated entity (as the case may be) for the financial year to which it relates;
 - (d) in the case of a licensed corporation, each of the returns as referred to in section 3(1)(b) or (2)(b) (as the case may be) is correctly compiled from the records of the licensed corporation or, if not correctly compiled, the nature and extent of the incorrectness;
 - (e) in so far as applicable, during the financial year in question, the licensed corporation or the associated entity (as the case may be) had systems of control in place that were adequate to ensure compliance with –
 - (i) sections 4, 5, 6, 8(4), 10 and 11 of the Securities and Futures (Client Money) Rules (L.N. of 2002); and
 - (ii) sections 4(4), 5, 10(1) and 12 of the Securities and Futures (Client Securities) Rules (L.N. of 2002);
 - (f) in so far as applicable, during the financial year in question, the licensed corporation or the associated entity (as the case may be) has complied with –

- (i) sections 3, 4, 5, 6, 7 and 8 of the Securities and Futures (Keeping of Records) Rules (L.N. of 2002);
 - (ii) sections 4, 5, 6, 8(4), 10 and 11 of the Securities and Futures (Client Money) Rules (L.N. of 2002); and
 - (iii) sections 4(4), 5, 10(1) and 12 of the Securities and Futures (Client Securities) Rules (L.N. of 2002); and
- (g) in the case of a licensed corporation, there appears to have been any contravention of the Securities and Futures (Financial Resources) Rules (L.N. of 2002) by the licensed corporation during the financial year in question.

(2) A licensed corporation or an associated entity of an intermediary (as the case may be) may submit 2 separate auditor's reports in respect of a financial year, one containing a statement by the auditor concerning the matters referred to in subsection (1)(a) to (c) and the other containing a statement by the auditor concerning the matters referred to in subsection (1)(d) to (g).

5. Matters reportable by auditors under section 157 of the Ordinance

The following provisions are prescribed requirements for the purposes of the definition of "prescribed requirement" in section 157(3) of the Ordinance –

- (a) sections 3, 4, 5, 6, 7 and 8 of the Securities and Futures (Keeping of Records) Rules (L.N. of 2002).
- (b) sections 4, 5, 6, 8(4), 10 and 11 of the Securities and Futures (Client Money) Rules (L.N. of 2002);
- (c) sections 4(4), 5, 10(1) and 12 of the Securities and Futures (Client Securities) Rules (L.N. of 2002);

Chairman,
Securities and Futures Commission

2002

Explanatory Note

These Rules are made by the Securities and Futures Commission under section 397(1) of the Securities and Futures Ordinance (5 of 2002). They prescribe for the purposes of sections 156(1)(a) and (2)(a) of the Ordinance the financial statements and other documents that licensed corporations and associated entities of intermediaries shall prepare. They also prescribe the matters upon which an auditor shall make a statement in his report under sections 156(1)(b) and (2)(b) of the Ordinance on the accounts of the licensed corporation or the associated entity he is auditing. In addition, they prescribe certain provisions as requirements for the purposes of reporting by auditors under section 157 of the Ordinance.