

Consultation Document
The Draft Securities and Futures (Accounts and Audit) Rules
(the “draft Rules”)

Introduction

1. As is the position under the Securities Ordinance, the Commodities Trading Ordinance and the Leveraged Foreign Exchange Trading Ordinance, the Securities and Futures Bill does not contain detailed requirements in relation to the annual accounts to be submitted by licensed corporations or associated entities; it merely gives the Securities and Futures Commission (“the Commission”) the necessary rule-making power under clause 152 to prescribe requirements in the subsidiary legislation.
2. There are controls already built into the legislative system, whereby any rules made by the Commission must be subject to negative vetting by the Legislative Council. In addition, the Commission now releases the draft Rules (see Attachment 1) for public consultation.
3. The Commission has used the FinNet communication network to send copies of this consultation document to registered dealers that have lodged their Financial Resources Rules returns electronically with the Commission via FinNet. Copies of the consultation document are available free of charge at the Commission’s office and may also be downloaded from the Commission’s Internet website at <http://www.hksfc.org.hk>.
4. The public is invited to submit comments in writing before close of business 31 January 2002:

By mail to : SFC (Accounts and Audit Rules)
 12/F, Edinburgh Tower
 The Landmark
 15 Queen’s Road, Central
 Hong Kong

By fax to : (852) 2523 4598

By on-line submission : <http://www.hksfc.org.hk>

By e-mail to : accounts_and_audit_rules@hksfc.org.hk

5. **Please note that the names of the commentators and the contents of their submissions may be published on the SFC web site and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation document (see Attachment 2).**
6. **You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.**
7. The draft Rules should be read in conjunction with the Securities and Futures Bill itself.
8. To ensure that our regulatory thinking is in the right direction, the Commission has formulated the draft Rules after consulting selected representatives from the brokerage industry and the Hong Kong Society of Accountants. We wish to acknowledge and thank them for their invaluable input.

Background

9. In short, the draft Rules prescribe the contents of the annual accounts to be submitted by licensed corporations and associated entities to the Commission.
10. The draft Rules have drawn on the Securities (Accounts and Audit) Rules, the Commodities Trading (Accounts and Audit) Rules and the Leveraged Foreign Exchange Trading (Accounts and Audit) Rules.

New Policy Initiatives

11. We have tried to minimise changes to the existing requirements, but several policy changes have been incorporated into the draft Rules:
 - (a) to apply the Rules to all licensed corporations¹ and their associated entities;

¹ The requirement to submit annual accounts under the Securities Ordinance or the Commodities Trading Ordinance does not apply to investment advisers and commodities trading advisers. Indeed, they are required to submit annual accounts under the Annual Return, where there is no equivalent requirement for them to be submitted within 4 months of the financial year-end.

- (b) to require submission of selected parts of the monthly returns as stipulated by the Securities and Futures (Financial Resources) Rules (**section 3(1)(b)** and **(2)(b)**) and for the same to be reviewed by the auditor (**section 4(1)(d)**);

[At present, securities dealers and securities margin financiers are required to submit the liquid capital computation, particulars on credit facilities, margin clients and collateral by margin clients as part of the annual audited accounts. Under the draft Rules, all licensed corporations must also submit an analysis of client assets held by the licensed corporation and a report on proprietary derivative positions.]

- (c) to obtain confirmation from the licensed corporation or associated entity that it has adequate systems of control in place to ensure compliance with 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)**); and

[This requirement is modelled on section 63(3A) of the Banking Ordinance which requires an auditor to report, amongst other things, whether the authorized institution had in place adequate² systems of control³ to enable compliance with specified duties during the period under review.

The Commission regards systems of controls to be crucial for ensuring client asset protection and therefore proposes to incorporate similar requirements in the draft Rules.

The above notwithstanding, we are conscious of the cost implications and would like to invite comments on this particular proposal.]

- (d) to obtain further information from the licensed corporation or associated entity about its business and risk management by way of a questionnaire (**section 3(1)(d)** and **(3)(d)**).

² Under the Banking Ordinance, “adequate”, in relation to systems of control, includes operating effectively.

³ Under the Banking Ordinance, “systems of control” includes procedures.

Other Matters

12. It is worthy of note that in order to follow the International Standard on Assurance Engagements⁴, the HKSA issued Standards on Assurance Engagements ("SAE") in June 2001. We understand from the HKSA that this effectively requires HKSA Members to separately report on the truth and fairness of the financial statements and on other matters which fall under the ambit of the new SAE. As a direct consequence of this professional development, the draft Rules specifically allow for two separate auditor's reports to be submitted instead of one.

13. Also, unlike the existing accounts and audit rules, these draft Rules do not contain any proforma balance sheet, profit and loss account, notes to the accounts or the new business and risk management questionnaire. As these tend to be detailed in nature but non-controversial, no public consultation is considered necessary. The Commission shall continue to work with the working group and the Hong Kong Society of Accountants in prescribing these forms which shall be gazetted in due course as provided under clause 388(1) of the Bill (**section 3(1)(a)/(c)/(d) and (3)(a)/(c)/(d)**).

⁴ Assurance engagements are engagements where auditors evaluate or measure a subject matter that is the responsibility of another party against identified suitable criteria, and to express a conclusion that provided the intended user with a high or moderate level of assurance about that subject matter.

DRAFT

SECURITIES AND FUTURES
(ACCOUNTS AND AUDIT) RULES

SECURITIES AND FUTURES (ACCOUNTS AND AUDIT) RULES

(Made by the Securities and Futures Commission
under section 384(1) of the Securities and
Futures Ordinance (of 2001))

1. Commencement

These Rules shall come into operation on the day
appointed for the commencement of Part VI of the
Securities and Futures Ordinance (of 2001).

2. Interpretation

In these Rules, unless the context otherwise
requires -

"applicable form" () means a form specified by the
Commission under section 388(1) of the Ordinance.

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

(1) For the purposes of section 152(1)(a) of the
Ordinance, a licensed corporation must prepare, in
respect of each financial year -

- (a) a set of accounts consisting of each of the following in the applicable form and 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) where applicable, the following returns as referred to in [section 35(1)] of the Securities and Futures (Financial Resources) Rules (L.N. of 2001), in respect of the end of the financial year -
 - (i) a liquid capital computation;
 - (ii) a summary of bank loans, advances and other credit facilities;
 - (iii) an analysis of margin clients;
 - (iv) an analysis of securities collateral;
 - (v) an analysis of client assets; and

(vi) a report on proprietary
derivative positions [excluding
Table 6];

(c) a document in the applicable form
confirming that during the financial year
the licensed corporation had systems of
control in place that were adequate to
ensure compliance with -

- (i) sections 3 to 6 of the Securities
and Futures (Client Money) Rules
(L.N. of 2001); and
- (ii) sections 4 to 9 of the Securities
and Futures (Client Securities)
Rules (L.N. of 2001); and

(d) a business and risk management
questionnaire in the applicable form.

(2) For the purposes of section 152(2)(a) of the
Ordinance, a licensed corporation must prepare, in
respect of the financial year in which it ceases carrying
on all of the regulated activities for which it is
licensed -

- (a) a set of accounts as referred to in subsection (1)(a);
- (b) a liquid capital computation as referred to in subsection (1)(b)(i); and
- (c) a document regarding the adequacy of its systems of control as referred to in subsection (1)(c).

(3) For the purposes of section 152(1)(a) of the Ordinance, an associated entity of a licensed corporation must prepare, in respect of each financial year -

- (a) a set of accounts consisting of each of the following, in accordance with generally accepted accounting principles unless otherwise specified in an applicable form -
 - (i) a profit and loss account;
 - (ii) a balance sheet; and
 - (iii) notes to the accounts;

- (b) a summary of client assets in respect of the end of the financial year in the applicable form;

- (c) a document in the applicable form confirming that during the financial year the associated entity had systems of control in place that were adequate to ensure compliance with -
 - (i) sections 3 to 6 of the Securities and Futures (Client Money) Rules (L.N. of 2001); and
 - (ii) sections 4 to 9 of the Securities and Futures (Client Securities) Rules (L.N. of 2001); and

- (d) a business and risk management questionnaire in the applicable form.

(4) For the purposes of section 152(2)(a) of the Ordinance, an associated entity of a licensed corporation must prepare, in respect of the financial year in which it ceases to be an associated entity -

- (a) a set of accounts as referred to in subsection (3)(a);
- (b) a summary of client assets as referred to in subsection (3)(b); and
- (c) a document regarding the adequacy of its systems of control as referred to in subsection (3)(c).

4. Auditor's report

(1) An auditor's report under section 152(1)(b) or (2)(b) of the Ordinance must 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 2001) and comply with 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;
- (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;
- (d) 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) 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 -

(i) sections 3 to 6 of the Securities
and Futures (Client Money) Rules
(L.N. of 2001); and

(ii) sections 4 to 9 of the Securities
and Futures (Client Securities)
Rules (L.N. of 2001);

(f) during the financial year, the licensed
corporation or the associated entity, as
the case may be, has complied with -

(i) sections [x to y] of the
Securities and Futures (Keeping
of Records) Rules (L.N. of
2001);

(ii) sections 3 to 6 of the Securities
and Futures (Client Money) Rules
(L.N. of 2001); and

(iii) sections 4 to 9 of the Securities and Futures (Client Securities) Rules (L.N. of 2001); and

(g) there has been any contravention of the Securities and Futures (Financial Resources) Rules (L.N. of 2001) by the licensed corporation during the financial year.

(2) 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).

Chairman,
Securities and Futures
Commission

2001

Explanatory Note

These Rules are made by the Securities and Futures Commission under section 384(1) of the Securities and Futures Ordinance (of 2001). They prescribe for the purposes of section 152(1)(a) and (2)(a) of the Ordinance the financial statements and other documents that licensed corporations and their associated entities must prepare. They also prescribe the matters upon which an auditor must make a statement in his report under section 152(1)(b) and (2)(b) of the Ordinance on the accounts of the licensed corporation or the associated entity he is auditing.

Personal Information Collection Statement

1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data⁴ will be used following collection by the Securities and Futures Commission (“SFC”), what you are agreeing to with respect to the SFC’s use of your Personal Data and your rights under the PDPO.

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to the Consultation Document on the Draft Securities and Futures (Accounts and Audit) Rules (“the Consultation Document”) may be used by the SFC for one or more of the following purposes:
 - to administer the relevant Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
 - for the purposes of performing the SFC’s statutory functions under the relevant Ordinances
 - for research and statistical purposes
 - other purposes permitted by law

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Document. The names of persons who submit comments on the Consultation Document together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC web site and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

⁴ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Document. The SFC has the right to charge a reasonable fee for processing any data access request.

Enquiries

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Document, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer,
The Securities and Futures Commission
12/F, Edinburgh Tower, The Landmark
15 Queen's Road Central Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.