

香港存款保障委員會
HONG KONG DEPOSIT
PROTECTION BOARD

Our Ref.: D1/1C

7 November 2007

The Chief Executive
All Scheme Members

Dear Sir/Madam,

Reviewing Returns of Relevant Deposits

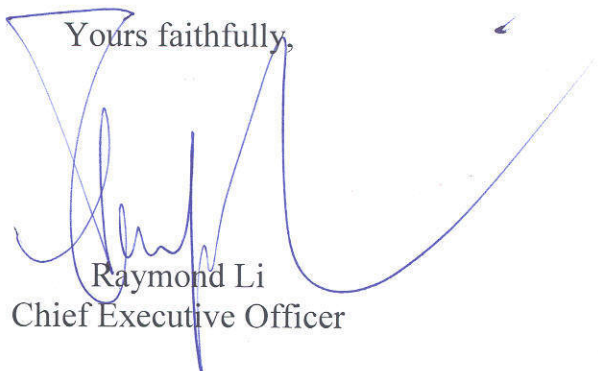
I am writing to inform you of the arrangements to be adopted by the Hong Kong Deposit Protection Board for reviewing returns of relevant deposits submitted by Scheme members.

Currently, all Scheme members are required to submit a return showing the amount of relevant deposits held with their Hong Kong offices as at 20 October every year. The amount of relevant deposits reported in the return forms the basis for the Board to determine the amount of contribution payable by a Scheme member in the following year. Starting from the returns received by the Board this year, Scheme members will be required to submit an auditor's report to certify whether the information reported in their returns is accurate. The details of the arrangement are set out in the attached information note.

In general, all Scheme members will be required to conduct regular audit reviews on their returns, albeit at different frequencies depending on the amount of relevant deposits held with them. The first batch of Scheme members to be required to submit an auditor's report will be informed shortly after the Board receives the returns for this year from Scheme members in December 2007.

If you have any questions, please do not hesitate to contact Mr Raymond Tsai at 2878 1060 or Ms Tess Leung at 2878 8280.

Yours faithfully,



Raymond Li
Chief Executive Officer

Encl.

cc Hong Kong Association of Banks

Hong Kong Deposit Protection Board

Information Note on Reviewing Returns of Relevant Deposits

PURPOSE

This information note sets out the details of the arrangement adopted by the Hong Kong Deposit Protection Board (the Board) for reviewing returns of relevant deposits submitted by Scheme members.

BACKGROUND

2. Currently, all Scheme members are required under section 48(1) and (2) of the Deposit Protection Scheme Ordinance (DPS Ordinance) to submit a return showing the amount of relevant deposits held at their Hong Kong offices as at 20 October every year. The amount of relevant deposits reported in the return forms the basis for the Board to determine the amount of contribution payable by a Scheme member in the following year. To ensure that the amount of relevant deposits reported by Scheme members in their returns and, hence, the amount of contributions collected by the Board are correct, audit reviews are required to be conducted on the returns.

REVIEW MECHANISM

3. Currently, all licensed banks in Hong Kong are under the requirements of the Banking Ordinance (BO) to conduct an annual review on a number of banking returns that they submit to the HKMA. Specifically, all licensed banks are required under section 63(3) of the BO to submit auditor's reports on the returns specified by the HKMA (e.g. Return of Capital Adequacy Ratio, Return of Large Exposures, Return of Liquidity Position and Certificate of Compliance with the Ordinance) every year. Since Scheme members as well as accounting professionals are well familiar with this review regime, a similar approach is adopted for reviewing the return of relevant deposits, i.e. all Scheme members are required to submit an auditor's report to certify whether their returns are correctly compiled.

4. Similar to section 63(3) and 63(3A) of the BO, section 48(3) and (4) of the DPS Ordinance empowers the Board to require a Scheme member to submit auditor's reports on the returns of relevant deposits and the related system of controls. In addition, the Board is empowered by section 48(1) of the DPS Ordinance to require a Scheme member to submit information for the performance of its functions.

5. The scope of work to be performed by an auditor in reviewing the return of relevant deposits is identical to the scope for reviewing a banking return (see **Annex** for more details). Nevertheless, considering the resource implications to Scheme members and having consulted the accounting profession on the availability of sufficient accounting resources in the market, Scheme members are only required to conduct a review on a rotational basis and when needed, instead of on an annual basis.

Scheme members with not more than HK\$1 bn relevant deposits

6. While it is preferable to require all Scheme members to review their returns at the same frequency, the Board recognises that it is less cost justifiable for Scheme members with a small amount of relevant deposits to conduct a review as the potential benefits brought about by the review, in terms of the impact on the amount of contribution payable, is expected to be small, if not insignificant. The Board therefore finds it acceptable to allow these Scheme members to submit an auditor's report on a less frequent basis. Balancing the need to provide a reasonable assurance of the quality of the returns of these Scheme members and to contain the cost to these Scheme members at a reasonable level, Scheme members with not more than HK\$1 bn of relevant deposits are required to submit an auditor's report once every five years.

Scheme members with more than HK\$1 bn relevant deposits

7. In the light of the potentially more significant impacts on the aggregate amount of contributions collected by the Board due to reporting errors of Scheme members with a sizeable amount of relevant deposits, the Board considers it appropriate to require these Scheme members to conduct a review on a more frequent basis. Therefore Scheme members with HK\$1 bn of relevant deposits or more are required to submit an auditor's report once every three years. In between these

regular reviews, the Board will perform annual reviews on the returns submitted by these Scheme members to screen out those with movements in the amount of relevant deposits significantly out of line with its peers to call for ad hoc reviews to be conducted by auditors.

Handling of reporting errors

8. When there is a reporting error in the return submitted by a Scheme member, whether identified by the Scheme member or by its auditor, the Board will issue a demand note to collect any shortfall or a credit note to refund any excess in the amount of contribution payable or paid by the Scheme member. The Board will also require the Scheme member to ascertain the cause of the reporting error and any remedial actions taken to prevent recurrence of similar error and inform the Board of the same.

9. If a reporting error results in a material discrepancy, the Scheme member will generally be required to submit an auditor's report on whether the revised return is correctly compiled. The Board will also require the Scheme member to ascertain whether the reporting error is an isolated instance. If not, the Scheme member will be required to review whether the returns previously submitted by it are subject to the same error and if so, submit revised returns to the Board. Since it will not be practical to require a Scheme member to review all returns submitted by it in the past, in general, Scheme members will only be required to review the returns since the last audit was conducted, or if no audit has been conducted, since 2007 when the review regime became effective. Scheme members are therefore required to maintain adequate records to prepare for conducting such retrospective reviews in case of need.

10. If reporting errors are identified repeatedly in respect of a Scheme member, the Board may require the Scheme member to submit a report prepared by an auditor as to whether or not, in the opinion of the auditor, the Scheme member has in place a system of controls that is adequate for ensuring that the return of relevant deposits is correctly compiled.

TIMING FOR THE PREPARATION OF AN AUDITOR'S REPORT

11. Considering that financial audits of Scheme members are usually conducted in the first quarter of each year, a Scheme member due for conducting a regular audit review on the return of relevant deposits for a year will be allowed to submit the auditor's report in April of the following year to avoid a clashing of the schedule of its financial audit with the audit review for the return. For auditor's reports on accuracy of returns required by the Board under other circumstances, e.g. when material discrepancies or repeated errors are noted, a period of at least 2 months from the date of issue of a formal notice by the Board will be made available to the Scheme members concerned for the preparation and submission of the auditor's reports.

Hong Kong Deposit Protection Board
November 2007

Scope and Nature of Work for Reviewing Returns of Relevant Deposits

This annex explains the scope and nature of work expected from an auditor for an auditor's report to be prepared under section 48(3) of the Deposit Protection Scheme Ordinance (DPS Ordinance) in respect of whether a return of relevant deposits submitted by a Scheme member is correctly compiled.

Scope

2. In general, the Board expects that the work an auditor performs for the purpose of reporting under section 48(3) of the DPS Ordinance on a return of relevant deposits should be in line with that applicable for an auditor's report submitted under section 63(3) of the Banking Ordinance for a banking return. Therefore, the work for an auditor reporting under section 48(3) of the DPS Ordinance should be a reasonable assurance engagement. The responsibility of correctly compiling the return of relevant deposits rests with the management of the Scheme member and the auditor's responsibility is to report on whether the Scheme member's return is correctly compiled, in all material respects, from the books and records of the Scheme member based on the procedures the auditor performed.

Nature of work

3. It should be noted that, since Scheme members are already required to maintain adequate accounting system and system of controls under the Banking Ordinance, it is sufficient for an auditor to express an opinion on the correct compilation of the return of relevant deposits from the books and records of the Scheme member. Accordingly, the work to be carried out for the purpose of reporting under section 48(3) involves agreeing amounts contained in the return of relevant deposits to appropriate records maintained by the Scheme member and checking whether the amounts have been properly compiled based on the completion instructions issued by the Board.

4. The nature of testing will however vary from one Scheme member to another as it will be dependent on the nature of the systems and processes used to produce the necessary information for the compilation of the return. There is no requirement for an auditor to provide an opinion that the books and records are correct and complete but only that the amounts in the return agree with those in the books and records.

5. The Board expects errors which are material in amount or indicative of weaknesses in the compilation process to be reported. What constitutes material will need to be judged by the auditors on a case-by-case basis but the focus is on the quality of the statistics provided rather than on minor reporting errors. As a general rule, the Board expects that an error should be considered material if it exceeds 5% of the applicable item in the return.