

AUDIT COMMITTEE REPORT

The Audit Committee

The Audit Committee (AC) is delegated with the authority from the Board to provide independent oversight of the Group's financial reporting and internal control systems, and the adequacy of the external and internal audits. The AC is provided with sufficient resources to perform its duties including support, as necessary, from the Internal Audit Department (IAD), the external auditor, legal counsel and management in examining all matters relating to the Group's adopted accounting principles and practices, and in reviewing all material financial, operational and compliance controls. The AC's terms of reference are available on the HKEX Group website [ORG](#).

The AC comprises five INEDs whose names and biographies are set out in the Board and Committees section of this Annual Report. None of the AC members are employed by or otherwise affiliated with the former or current auditors of HKEX.

The AC held four meetings in 2016. Members' attendance records are disclosed in the Corporate Governance Report contained in this Annual Report.

Summary of Work in 2016/2017

- Endorsed amendments to the AC's terms of reference
- Endorsed amendments to the Group Anti-Bribery and Anti-Corruption Policy and the Group Whistleblowing Policy and adoption of the Group Personal Account Dealing Policy and the Group Record Retention Policy
- Reviewed the Group's quarterly, half-yearly and annual financial results
- Reviewed in detail, with both management and the external auditors, the approach and methodology applied with respect to the Key Audit Matters included in the year end auditor's report
- Approved the annual internal audit plan and internal audit three year strategic plan (2017 to 2019)
- Reviewed the external auditor's statutory audit scope for 2016
- Reviewed significant findings of the IAD, external auditor and regulators, and management's response to their recommendations
- Reviewed the adequacy and effectiveness of the Group's internal control systems and its accounting, financial reporting and internal audit functions
- Reviewed the continuing connected transactions
- Reviewed and monitored the external auditor's independence and engagement to perform non-audit services
- Approved the 2016 external audit engagement letters and fees
- Reviewed changes in accounting principles and practices proposed by management

Review of Financial Results

The AC reviewed the 2016 Consolidated Financial Statements in conjunction with HKEX's external auditor. Based on this review and discussions with management, the AC was satisfied that the Consolidated Financial Statements were prepared in accordance with applicable accounting standards and fairly present the Group's financial position and results for the year ended 31 December 2016. The AC therefore recommended the Consolidated Financial Statements for the year ended 31 December 2016 be approved by the Board.

Review of Internal Control Systems

The AC reviewed the effectiveness of the Group's policies and procedures regarding internal control systems (including financial, operational, IT, risk management, information security, outsourcing, legal, compliance and those controls designed to detect material fraud) by reviewing the work of the IAD and the Group's external auditor, and regular reports from management including those on risk management, regulatory compliance and legal matters.

The AC reviewed and concurred with the management's confirmation that for the year ended 31 December 2016: (i) the Group's risk management and internal control systems were effective with reference to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework (2013) principles; (ii) the Group had adopted the necessary control mechanisms to monitor and correct non-compliance; and (iii) the Group had complied satisfactorily with the requirements of the Corporate Governance Code in respect of risk management and internal control systems. The management's confirmation was endorsed by the Risk Committee and submitted to the Board.

Review of Accounting, Financial Reporting and Internal Audit Functions

The AC reviewed and was satisfied with the adequacy of the resources, staff qualifications and experience, training programmes and budget of the Group's accounting, financial reporting and internal audit functions.

Review of Continuing Connected Transactions

During 2016, the Group entered into certain continuing connected transactions as disclosed in the Corporate Governance Report contained in this Annual Report. The AC, under the authority delegated by the Board, reviewed these continuing connected transactions pursuant to Rule 14A.55 of the Main Board Listing Rules. As a good corporate governance practice, an AC member who has an interest in the transactions abstained from reviewing them. The AC confirmed that the transactions were entered into by the Group in accordance with the conditions of the waiver granted by the SFC and the Main Board Listing Rules requirements that:

- (i) the transactions have been entered into in the Group's ordinary and usual course of business, and on normal commercial terms or on terms no more favourable than terms available to independent third parties;
- (ii) the transactions other than the Buy-in Transactions disclosed in the Corporate Governance Report have been conducted in accordance with the rules and regulations of the relevant Group company governing such transactions, and where the rules and regulations do not govern those transactions in full, in accordance with the standard terms and conditions of the relevant Group company relating to such transactions;
- (iii) the Buy-in Transactions have been conducted in accordance with the standard terms and conditions of HKSCC applicable generally to all buy-in brokers in such transactions for and on behalf of HKSCC and at the mutually agreed commission rates payable by HKSCC in respect of such Buy-in Transactions generally (there were no Buy-in Transactions by connected persons during 2016); and
- (iv) the transactions have been entered into according to the relevant agreements governing each of the continuing connected transactions on terms that were fair and reasonable and in the interests of Shareholders as a whole.

The Company's external auditor was engaged to report on the transactions in accordance with Rule 14A.56 of the Main Board Listing Rules. The AC reviewed the unqualified report issued by the external auditor.

Independence of External Auditor

The AC is mandated to monitor the independence of the Group's external auditor, PricewaterhouseCoopers (PwC), to ensure objectivity in the financial statements. All services provided by PwC must be approved by the AC. To ensure that the policy of restricting the non-audit work done by the external auditor is followed strictly by all entities within the Group, appropriate policies and procedures have been established which set out: (i) the classification of services as pre-approved, not pre-approved and prohibited; and (ii) the approval process for services that have not been pre-approved.

Before commencement of the audit of the Group's 2016 financial statements, the AC received the written confirmation from PwC of its independence and objectivity.

During the year, the AC reviewed PwC's statutory audit scope and non-audit services and approved its fees. Under the approval procedures for audit fees, all audit fees for entities within the Group were coordinated and presented by PwC Hong Kong, and all statutory audit fees for the Group companies were approved by the AC.

External Auditor's Services and Fees		
	2016 \$m	2015 \$m
Audit services	14	13
Non-audit services		
• Tax advisory and compliance	5	6
• Other services	1	2
Total	20	21

Re-appointment of External Auditor

The AC was satisfied with PwC's work, its independence, and its objectivity, and therefore recommended the re-appointment of PwC (which has indicated its willingness to continue in office) as the Group's external auditor for 2017 for Shareholders' approval at the 2017 AGM.

John Barrie HARRISON

Chairman of the Audit Committee

Hong Kong, 22 February 2017