

Audit Committee Report

AUDIT COMMITTEE

The Audit Committee (“AC”) comprises five INEDs appointed by the Board who have extensive experience in financial matters. Messrs Marvin K T Cheung, Fong Hup and Vincent K H Lee are certified public accountants but none of them were employed by or otherwise affiliated with the former or existing auditors of HKEx.

The AC assists the Board by providing an independent review and supervision of financial reporting, and satisfying themselves as to the effectiveness of the Group’s internal controls and the adequacy of the external and internal audits. In performing its duties, the AC examines all matters relating to the Group’s adopted accounting principles and practices and reviews the Group’s information systems. External auditors, the Chief Executive and senior executives are invited to attend the meetings, as and when necessary. The terms of reference (“TOR”) of the AC setting out its role and the responsibilities are posted on HKEx’s corporate website.

The AC is provided with sufficient resources to discharge its responsibilities and is supported by the Internal Audit Department (“IA”). The AC is accountable to the Board and the minutes of all its meetings are circulated to the Board for information.

The AC holds regular meetings at least four times a year and additional meetings are organised if and when necessary. In 2005, a total of six meetings were convened and the attendance was 100 per cent. The following is a summary of the work of the AC during 2005:

- review of the 2004 Internal Audit activities and approval of the 2005 Internal Audit Plan;
- review of the financial reports for the year ended 31 December 2004, for the six months ended 30 June 2005, and for the quarters ended 31 March 2005 and 30 September 2005;
- review of the findings and recommendations of the IA on the performance of various Divisions/Departments and HKEx’s services and products;
- follow-up on the implementation of recommendations made by the IA;
- review of the effectiveness of the internal control system;
- review of the external auditors’ statutory audit plan and the letters of representation;
- consideration and approval of the 2005 audit fees;
- review of the whistle-blowing policy and procedures;
- review of the grievance procedures;
- review of the 2005 frauds detection report;
- review of the revisions to the TOR of the AC to conform to the CG Code; and
- review of the “Continuing Connected Transactions” set forth on page 89.

INTERNAL CONTROL

In mid-2005, the AC considered alternative approaches to formalise the annual review framework and decided to use the globally recognised internal control framework-based questionnaire to facilitate its review of the effectiveness of HKEx’s internal control system. Based on the result of this review, the AC considered that the HKEx’s internal control system is effective and that HKEx has adopted the necessary control mechanisms to monitor and correct non-compliance.

On 12 August 2005, the AC endorsed the whistle-blowing policy and procedures which provide, inter alia, that malpractices could be reported directly to the chairman of the AC.

Upon review of the reports on ad hoc investigations and reports from management and internal/external auditors, the AC was of the view that no suspected fraud or irregularities, internal control deficiencies, or suspected infringement of laws, rules or regulations had been found, and concluded at the meeting held on 19 January 2006 that the system of internal controls was adequate and effective.

At the same meeting, the AC considered and approved the 2006 Internal Audit Plan and authorised the IA to conduct ad hoc audits if and when the situation deems appropriate.

REVIEW OF 2005 CONSOLIDATED FINANCIAL STATEMENTS

On 3 March 2006, the AC reviewed the 2005 consolidated financial statements, including the Groups' adopted accounting principles and practices, in conjunction with HKEx's external and internal auditors. Based on this review and discussions with the management, internal auditors and external auditors, the AC endorsed the accounting treatment adopted by HKEx and had to the best of its ability assured itself that the disclosure of the financial information in this report complies with the applicable accounting standards and Appendix 16 of the Main Board Listing Rules. The AC therefore recommended the Board to approve the consolidated financial statements for the year ended 31 December 2005 for public release.

RE-APPOINTMENT OF EXTERNAL AUDITORS

The AC's recommendation on the re-appointment of PricewaterhouseCoopers as the Group's external auditors for 2005 was approved by the Shareholders at the 2005 AGM. Starting from 2005, the engagement partner of the external auditors will be subject to rotation every five years.

The AC acknowledges the delegation of responsibilities from the Board to oversee the effectiveness of the system of internal controls, including financial and operational. In view of the above measures, the AC has fully complied with and fulfilled its responsibilities as stated under the Code Provisions C.2 on Internal Controls and C.3 on Audit Committee of the CG Code.

Members of the Audit Committee

STRICKLAND, John Estmond (*Chairman*)

FONG Hup (*Deputy Chairman*)

CHEUNG Kin Tung, Marvin

FAN Hung Ling, Henry

LEE Kwan Ho, Vincent Marshall

Hong Kong, 8 March 2006