

CIRCULAR TO:

FULL MEMBERS
ASSOCIATE MEMBERS
CLEARING MEMBERS

No. 36/00

STATEMENTS OF FINANCIAL POSITION

PRACTICE NOTE

Attached is a revised Practice Note 25 in relation to the Statements of Financial Position required to be submitted to the Exchange on a monthly, quarterly and annual basis.

The purpose of this revised Practice Note is to provide additional explanation and guidance for the completion of the Monthly and Quarterly Statement of Financial Position (the Return) which is required to be lodged with the Exchange. The Practice Note has been prepared to remind Members of their reporting obligations and to assist with any concerns that are encountered.

It is important to note that there has been no change to the format of the Monthly or Quarterly Returns.

Members with Compliance Manuals should insert the Practice Note as new Practice Note 25.

Should Members have any questions or comments regarding the above, please contact either the undersigned on (02) 9256 0498 or Michelle Wagner, Manager – Compliance on (02) 9256 0580.

JEREMY DANON
FINANCIAL ANALYST

18 FEBRUARY 2000

PRACTICE NOTE**SUBJECT:** STATEMENTS OF FINANCIAL POSITION

- (i) Monthly Return
- (ii) Quarterly Return
- (iii) Annual Return

RELEVANT LAW/BUSINESS RULE:Full Members

Article 3.6(3)(a) and Article 3.6(3)(b)

Associate Members (includes Full Associates, Public Dealers and Introducing Broker Members)

Article 4.6(4)(b) and Article 4.6(4)(c)

Commodity Trading Advisor Associate Members

Article 4.7A

SFE Clearing House Members

SFE Clearing House General By-Law 8

ISSUED:

12 January 1989

25 September 1989 (Revised)

9 April 1992 (Revised)

29 July 1997 (Revised)

18 February 2000 (Revised)

PRACTICE NOTE NO:

25

The purpose of this revised Practice Note is to provide additional explanation and guidance in completing the Monthly and Quarterly Statement of Financial Position (the Return) which is required to be lodged with the Exchange. It is important to note that there has been no change to the format of the Monthly or Quarterly Returns.

Returns are required to be completed by all Clearing Members, Full Members (previously referred to as Floor Members), Full Associate Members (Dealing), Public Dealer Associate Members, Introducing Broker Associate Members and Commodity Trading Advisor Associate Members, unless they have a specific exemption from doing so.

Article 4.20 states that an Associate Permit Holder, designated as an Associate Permit (Public Dealer), an Associate Permit (Introducing Broker) or an Associate Permit (Commodity Trading Advisor) shall have the same rights and obligations under the Business Rules as a Public Dealer Associate Member, an Introducing Broker Associate Member or a Commodity Trading Advisor Associate Member respectively.

Pro forma Monthly and Quarterly Statements of Financial Position are available upon request.

1. **REQUIREMENTS FOR ALL MEMBERS**

- All Members are required to lodge their Returns by no later than the last trading day of the following month. To clarify this point further, should the last day of the month fall on a weekend, then the last day for lodging Returns would be on the preceding Friday. If a Member is unable to meet this deadline, it must request an extension from the Compliance Department in writing before the due date. The request must also disclose the reason why such an extension is required as well as the required date of the extension.
- The Directors' Statement must be signed by the nominated authorised signatories. As such, it is the responsibility of each Member to notify the Compliance Department and lodge a specimen signature, should there be an appointment of a new director or an officer authorised to sign the Returns on behalf of the Member.
- If there is a movement in the level of NTA in excess of 20%, an explanation must be provided in the Monthly Return (page 3) or the Quarterly Return (Note 6, page 12).
- Note 6 requires profits derived from Futures operations to be disclosed separately from those profits derived from other operations. Any movement of greater than 20% requires a specific explanation.
- An explanation must also be provided where the balance of clients' funds (both total and/or external) has moved in excess of 20% (Attachment E, page 19).
- Part (d) of paragraph 4 of the Directors' Statement must disclose specific details of net liquid assets or lines of credit available to the Member.
- A debtors' aging analysis is required to be completed on Attachment A of the Quarterly Return. Members must provide an explanation as to the recoverability of those amounts which are outstanding for more than 30 days.
- Intangible assets include such assets which are regarded in current accounting practice as intangible, for example, future income tax benefits, goodwill, patents and trademarks. In addition, for the purposes of the Exchange's definition of net tangible assets, certain other assets are excluded as follows:
 - The value of Membership of the Exchange;
 - A Clearing Commitment provided in accordance with the Clearing By-Laws or any asset used to secure that commitment;
 - Any debt owed to the Member which is disputed or may otherwise be regarded as doubtful; and
 - The value of any asset which is not capable of being realised within 12 months on a going concern basis. This definition includes unlisted securities as well as shares in associated companies not capable of being realised within 12 months on a going concern basis.

All intangible assets must be disclosed in Note 3(f) (page 9) of the Quarterly Return and excluded from NTA calculations.

- If a Member's NTA falls below 150% of the minimum required NTA, the Member is required to lodge a Quarterly Format Return each month. A Member will only be able to return to Monthly format when three successive months have passed during which time the Member's NTA has at all times been in excess of that 150% amount.
- The Quarterly Return requires all Members to complete a Statement of Net Liquid Assets. Definitions of liquid assets and liquid liabilities are provided in section 4 of this Practice Note, however, as a guide, the following items are required to be:

Included in the Statement

- Cash
- Bank overdraft
- Liquid securities
- Member and related company funds and
- Deposits or loans at call.

Excluded from the Statement

- External futures clients' monies
 - Creditors
 - Clients' Segregated Account at Bank
 - Provisions and accruals
 - Debtors or receivables
 - Prepayments
 - Fixed assets and
 - Intangible assets.
- The Quarterly Return requires all Members to complete Attachment D, where the Balance Sheet includes related or associated company receivables. Any amounts disclosed here must be supported by evidence of recoverability – for example a copy of the most recent audited financial statements of the related party. Such audited statements need only be lodged once a year. The underlying net tangible assets of the related entity must be sufficient to cover the debt to the Member should the Member's NTA decrease to a level where the minimum required level of NTA might be compromised.
 - Members must disclose all off-balance sheet items on the Statement of Net Tangible Assets, for example, contingent liabilities, lease and capital commitments, standby credit facilities and foreign exchange exposure.
 - Members are to ensure that when disclosing off-balance sheet items in the Monthly and Quarterly Returns, the true and fair value of these amounts are reported. Members must also ensure that they are consistent with those amounts which are reported in the Annual Audited Financial Statements. If there is a difference of a material nature, the Member is required to advise the Compliance Department and lodge a revised Monthly or Quarterly Return.

- Annual Returns are due for lodgement 3 months after the Member's financial year end. The following documents are required to be submitted to the Exchange unless a Member has a specific exemption from doing so:
 - Eighth Schedule Auditor's Certificate;
 - Copy of the Annual Audited Financial Statements;
 - ASIC Form 803 – Annual Statement by a Licensee;
 - ASIC Form 806 – Profit and Loss Account and Balance Sheet of a Futures Broker that is a Body Corporate; and
 - ASIC Form 807A – Auditor's report relating to Dealer's Account.

- Where a Member has disclosed an amount pertaining to Listed Securities, a basis of valuation must be noted - that is, the lower of cost and market value. The amount is deemed material if the Member is unable to meet minimum NTA requirements as a result of excluding the balance of Listed Securities from NTA calculations. If this is the case, the Member must provide a complete breakdown of the securities (together with evidence of the valuation, if requested) in order to verify the reported balance.

- Where a Member has disclosed an amount pertaining to Directors' Loans, the amount is deemed material if the Member is unable to meet minimum NTA requirements as a result of excluding the balance of Directors' Loans from NTA calculations. If this is the case, the Member must advise the Exchange the nature of the loans as well as provide evidence of their recoverability.

2. **REQUIREMENTS FOR EACH CLASS OF MEMBER**

(a) **Full Members**

Full Members, unless they have a specific exemption from doing so, must lodge the following:

Monthly Returns

- (i) Statement by Directors to support the Monthly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Reserve and NTA Movements; and
- (iv) Statement of Client Funds.

Quarterly Returns

- (i) Statement by Directors to support the Quarterly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Net Liquid Assets;
- (iv) Statement of Secured Creditors; and
- (v) Supporting Notes and Attachments to the Statement of Net Tangible Assets.

Article 3.6(3)(a)(i) requires Full Members to maintain minimum Net Tangible Assets (NTA) of \$1 million. It is this Article reference which needs to be quoted in the third paragraph of the Directors' Statement.

Full Members that hold clients' funds, are required to disclose these amounts as balance sheet items. Futures clients' fund liabilities must be disclosed in Note 2(a) of the Quarterly Return, and classified as either external funds or related and associated funds. Clients' funds deposits must be disclosed in Note 1(b), [Clients' Segregated Account at Bank] or Note 1(c), [Deposits with the SFE Clearing House, SFE or SFE Clearing House Member, Overseas Broker or deposits with authorised institutions pursuant to Section 1209(5) of the Corporations Law].

(b) Full Associate Members and Public Dealers Associate Members

Full Associate and Public Dealers Associate Members, unless they have a specific exemption from doing so, must lodge the following:

Monthly Returns

- (i) Statement by Directors to support the Monthly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Reserve and NTA Movements; and
- (iv) Statement of Client Funds.

Quarterly Returns

- (i) Statement by Directors to support the Quarterly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Net Liquid Assets;
- (iv) Statement of Secured Creditors; and
- (v) Supporting Notes and Attachments to the Statement of Net Tangible Assets.

Article 4.6(4)(b)(i) requires Full Associate Members and Public Dealer Associate Members to maintain minimum Net Tangible Assets of \$250,000. It is this Article reference which needs to be quoted in the third paragraph of the Directors' Statement.

Full Associate and Public Dealers Associate Members that hold clients' funds, are required to disclose these amounts as balance sheet items. Futures clients' fund liabilities must be disclosed in Note 2(a) of the Quarterly Return, and classified as either external funds or related and associated funds. Clients' funds deposits must be disclosed in Note 1(b), [Clients' Segregated Account at Bank] or Note 1(c), [Deposits with the SFE Clearing House, SFE or SFE Clearing House Member, Overseas Broker or deposits with authorised institutions governed under Section 1209(5) of the Corporations Law].

(c) Introducing Broker Associate Members

Introducing Broker Associate Members, unless they have a specific exemption from doing so, must lodge the following:

Monthly Returns

- (i) Statement by Directors to support the Monthly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Reserve and NTA Movements; and
- (iv) Statement of Client Funds.

Quarterly Returns

- (i) Statement by Directors to support the Quarterly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Net Liquid Assets;
- (iv) Statement of Secured Creditors;
- (v) Supporting Notes and Attachments to the Statement of Net Tangible Assets; and
- (vi) Statement of Futures Client Activity.

Article 4.6(4)(b)(ii) requires Introducing Broker Associate Members to maintain minimum Net Tangible Assets of \$50,000. It is this Article reference which needs to be quoted in the third paragraph of the Directors' Statement.

Introducing Broker Associate Members are not permitted to hold clients' funds, but must lodge a Statement of Futures Client Activity disclosing the number of clients' total funds under management at the end of the period.

(d) Commodity Trading Advisor Associate Members

Commodity Trading Advisor Associate Members, unless they have a specific exemption from doing so, must lodge the following:

Quarterly Returns

- (i) Statement by Directors to support the Quarterly Return;
- (ii) Statement of Net Tangible Assets;
- (iii) Statement of Net Liquid Assets;
- (iv) Statement of Secured Creditors;
- (v) Supporting Notes and Attachments to the Statement of Net Tangible Assets; and
- (vi) Statement of Futures Client Activity.

Article 4.7A(e) requires Commodity Trading Advisor Associate Members to maintain minimum Net Tangible Assets of \$20,000. It is this Article reference which needs to be quoted in the third paragraph of the Directors' Statement.

Commodity Trading Advisor Associate Members are only required to lodge a Quarterly Return each quarter. The Member must be aware that in the Return, the current quarterly figures are compared to the prior quarterly amounts, not the prior month. This is because the Quarterly Return is a standard form for all classes of Membership, and all other Members must lodge Returns on a monthly basis.

Commodity Trading Advisor Associate Members are not permitted to hold clients' funds, but must lodge a Statement of Futures Client Activity disclosing the number of clients' total funds under management at the end of the period. This refers to both the actual and notional amounts of funds under management.

(e) Market Associate Members

The Exchange does not require Market Associate Members to lodge Financial Returns, unless they are also Clearing Members, in which case they must lodge a statement of financial position within one calendar month after the end of each month, pursuant to Clearing By-Law 8.4.

3. CLIENTS' FUNDS

Those Full Members, Full Associate Members and Public Dealer Associate Members who hold clients' funds must ensure that the Statement of Client Funds in the Monthly Return is correctly completed. It is important to note that the amounts must correspond with the notes disclosed in the Quarterly Return.

Members are reminded that in disclosing the liability, that is, for external or related futures clients' creditors, the total ledger balance amount, or "total position", must be grossed up to account for any debit balances. The total of these debit balances must be classified as Debtors - Futures Clients.

The balance from a Member's Integrated Risk Report (or any similarly named report), must be disclosed as a deposit – either in a clients' segregated account or with a third party, (as discussed below) and segregated in respect of external futures client monies or in respect of Member (house funds) and related company funds.

Quarterly Return:

External Futures Client Monies – Note 2(a) of the Quarterly Return

This refers to money belonging to clients, as defined below in Part 3. It is important to note that house or proprietary funds and Related/Associated Company Monies and Director/Employee Monies are excluded from this balance.

Related/Associated Companies Monies and Director/Employee Monies – Note 2(a)

This refers to the funds which have been provided to a Member by a related or associated company, or a director or employee, for the purpose of trading futures and options contracts.

Members must note that any related company funds, in which the ultimate underlying beneficiary is a client, are to be excluded from this amount and instead be classified as External Futures Client Monies.

Total Futures Client Monies

The sum of External Futures Client Monies and Related/Associated Companies Monies and Director/Employee Monies.

It is incorrect for Members to use the total balance from the Integrated Risk Report. This is because the balance must be grossed up to exclude any debit balances from the individual accounts that comprise the report and also to ensure that all house funds are excluded from the balance.

Clients' Segregated Account at Bank - Note 1(b)

Article 43 of the Exchange's Business Rules and Section 1209 of the Law specifically relate to brokers requiring to segregate clients' money or property. The amount(s) disclosed in the Return must be reconciled with the balance(s) shown in the bank statement(s) where the segregated account(s) is/are held.

Deposits with SFECH Client Account – Note 1(c)

This represents client monies, held by a Member of the SFE Clearing House, which have been deposited into the Member's Client Account, that is held with the SFE Clearing House. Those Clearing Members who have Client Accounts must ensure that the balances reconcile to the Clearing House's Financial Status Advice at the Member's reporting date.

Deposits with SFECH House Account – Note 1(c)

This represents proprietary funds and funds attributable to Related/Associated Companies and Director/Employee, held by a Member of the SFE Clearing House, which have been deposited into the Member's House Account, that is held with the SFE Clearing House. Those Clearing Members who have House Accounts must ensure that the balances reconcile to the Clearing House's Financial Status Advice at the Member's reporting date.

Deposits with an SFECH Member* – Note 1(c)

This represents client monies which have been deposited with a Member of the SFE Clearing House.

Deposits with an SFECH Member** – Note 1(c)

This represents the Member's proprietary funds as well as related/associated companies' monies and director/employee monies, which have been deposited with a Member of the SFE Clearing House.

Deposits with an SFE Member* – Note 1(c)

This represents client monies which have been deposited with another Member of the Exchange that is not a Clearing Member of the SFE Clearing House.

Deposits with an SFE Member** – Note 1(c)

This represents the Member's proprietary funds as well as related/associated companies' monies and director/employee monies, which have been deposited with another Member of the Exchange that is not a Clearing Member of the SFE Clearing House.

Deposits with an Overseas Broker* – Note 1(c)

This represents client monies which have been deposited with an overseas broker for the purpose of trading futures and options on a recognised overseas Exchange. The amount disclosed in the Return must be reconciled with the balance shown on the Overseas Broker's Statement.

Deposits with an Overseas Broker** – Note 1(c)

This represents the Member's proprietary funds as well as related/associated companies' monies and director/employee monies, which have been deposited with an overseas broker for the purpose of trading futures and options on a recognised overseas Exchange. The amount disclosed in the Return must be reconciled with the balance shown on the Overseas Broker's Statement.

Deposits with Authorised Institutions - Futures Client Monies*** – Note 1(c)

This represents client monies which have been invested in accordance with the specific provisions of Section 1209(5)(d) – for example, deposits with an eligible money market dealer and Australian banks or in the purchase of cash management trust interests.

Deposits with Authorised Institutions - Other – Note 1(c)

This represents funds, other than client monies, which have been deposited with authorised institutions – for example deposits with an eligible money market dealer and Australian banks or in the purchase of cash management trust interests.

Debtors - Futures Clients – Note 1(a)

This is the total of the debit balances relating to clients' funds in the Member's Integrated Risk Report and any outstanding debtors in relation to the Member's futures operation.

It is important to note that in Note 1(c) of the Quarterly Return, total futures monies are divided into two groups. Those deposits which represent External Futures Client Monies (denoted by *) and those relating to Related/Associated Companies Monies and Director/Employee Monies as well as funds belonging to the Member - that is, house or proprietary funds (denoted by **).

Monthly Return:

The Statement of Client Funds in the Monthly Return is divided into "Client Monies"(liabilities) and "Location" (assets).

"Client Monies" are divided into the following categories and are treated as per the above discussion:

- External Futures Client Monies – (Note 2(a) of the Quarterly Return);
- Director/Employee Monies – (Note 2(a) of the Quarterly Return);
- Related/Associated Companies Monies – (Note 2(a) of the Quarterly Return); and
- Total Futures Client Monies – The sum of External Futures Client Monies and Related/Associated Companies Monies and Director/Employee Monies. It is incorrect for Members to use the total balance from the Integrated Risk Report. This is because the balance must be grossed up to exclude any debit balances from the individual accounts in the report and also to ensure that all house funds are excluded from the balance.

"Location" is divided into the following categories and are treated as per the above discussion. It is important to note that these assets represent deposits for client or external futures client monies only:

- Clients' Segregated Account at Bank - (Note 1(b) of the Quarterly Return);
- Deposits with SFECH Client Account – (Note 1(c) of the Quarterly Return);
- Deposits with an SFECH Member – (Note 1(c) of the Quarterly Return);
- Deposits with an SFE Member – (Note 1(c) of the Quarterly Return);
- Deposits with an Overseas Broker – (Note 1(c) of the Quarterly Return); and
- Funds invested in accordance with Section 1209(5) of the Corporations Law – (Note 1(c) of the Quarterly Return); – This is the same account as 'Deposits with Authorised Institutions - Futures Client Monies***' which is discussed above.

Difference

This amount refers to the difference between the sum of deposits (those identified above) and External Futures Client Monies, *not* Total Futures Client Monies. If the amount is negative (ie, a deficit of funds), the Member must provide an explanation as to the circumstances and advise the Exchange of the action taken to rectify the situation.

Example of correct methodology to account for client funds

A broker has an Integrated Risk Report with a balance of its total position being \$480,000. Five of the client accounts have a debit balance in total of \$20,000, whilst the remaining credit balances total \$500,000. Out of this total, house funds total \$30,000, related company funds total \$60,000 and the remaining \$410,000 is in respect of external futures client monies.

The Statement of Client Funds would be represented as follows:

CLIENT MONIES

	\$
Total Futures Client Monies	470,000 ¹
<u>Less:</u> Related/Associated Companies Monies	60,000
Director/Employee Monies	
External Futures Client Monies	410,000

LOCATION

Clients' Segregated Account at Bank (for example) 390,000 ²

DIFFERENCE (20,000) ³

¹ \$470,000 – The grossed up total less house funds. (\$500,000 - \$30,000)

² \$390,000 – The netted value of total less house funds less related/associated funds. It is assumed for the purpose of this example that the entire amount is deposited in a Clients' Segregated Account at Bank.

³ The \$20,000 deficit is comprised of debtors – futures clients, and may represent a timing difference in receipt/deposit of funds. NB: If this amount has been outstanding for greater than five (5) business days, the Member is obliged to “top up” the Clients' Segregated Account in accordance with Article 43.2.

4. **DEFINITIONS**

Net Tangible Assets:

The sum of the values of the assets (both fixed and current) owned by the Member or Prospective Member as the case may be (such value being the lower of cost or market) less the sum of any liabilities (secured and unsecured) attaching to those assets or to the Member or Prospective Member generally (and in the case of a partnership then attaching to the partners). The value of assets for the purpose of this definition shall not include the value attributed to any future income tax benefits, goodwill, patent, trademark, Membership of the Exchange, a Commitment provided in accordance with the Clearing By-Laws or any asset used to secure that Commitment, preliminary expense or other items of a like nature which in the opinion of the auditors of the Exchange are regarded in current accounting practice as intangible or the value attributed to any debt owed to the Member which is disputed or may otherwise be regarded as doubtful or the value of any asset which is not capable of being realised within twelve months on a going concern basis. Liabilities shall include provision for estimated liability for income tax, long service leave and any other contingency for which in the opinion of the auditors of the Exchange provision is properly made in current accounting practice. Liabilities may, if the Committee for Inspection and Audit so approves, having regard to all the circumstances, exclude Approved Subordinated Debt, or as otherwise prescribed by the Board and set out in the Schedules.

Client:

In relation to a futures broker, any person, firm or corporation behalf of whom the broker trades, or on whose behalf the broker proposes to trade or from whom the broker accepts instructions to trade, in futures or options contract.

This definition specifically excludes:

- The broker;
- If the broker is a body corporate – a director or an officer of the broker;
- An employee of the broker;
- If the broker is a body corporate – a body corporate that is related to the broker;
- A person who is associated with, or who is a partner of the broker; or
- A body corporate in which the broker has, or the broker or partners of the broker together have, a controlling interest.

Current Assets:

Assets that would or could, in the ordinary course of events be realised within 12 months after the end of the period to which the statement relates.

Current Liabilities:

Liabilities that would or could, in the ordinary course of events, be payable within 12 months after the end of the period to which the statement relates.

Liquid Assets:

Assets that would or could, in the ordinary course of events, be realised within 24 hours after the end of the period to which the statement relates.

