

Commodity Exchange Compensation Fund (the Fund)

Report of the Futures Compensation Fund Committee (the Committee)

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2003.

1. Establishment of the Fund

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund.

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 106 to 113.

3. Members of the committee

The members of the Committee during the year and up to the date of this report were:-

Mr Mark Dickens, JP
Mrs Alexa Lam
Mr William D Grossman
Mr Mark Ho
Mr T Brian Stevenson, SBS

4. Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the year.

5. Auditors

The retiring auditors, Messrs. KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

Mark Dickens

Chairman
5 May 2003

Auditors' Report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Commodity Exchange Compensation Fund (the Fund) established under Section 77 of the Hong Kong Commodities Trading Ordinance set out on pages 106 to 113 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

Respective Responsibilities of the SFC and Auditors

The Hong Kong Commodities Trading Ordinance requires the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of Opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, have been consistently applied and are adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund at 31 March 2003 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants
Hong Kong

5 May 2003

Income and Expenditure Account

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Income			
Net investment income	4&6	6,063	7,190
Contract levy	4&7	6,987	5,959
Recoveries	4	14	27
		13,064	13,176
Expenses			
Auditors' remuneration		41	41
Bank charges		60	66
Professional fees		27	37
Sundry expenses		1	1
		129	145
Surplus for the year		12,935	13,031
Accumulated surplus brought forward	4	94,678	81,647
Accumulated surplus carried forward		107,613	94,678

The notes on pages 110 to 113 form part of these financial statements.

Balance Sheet

At 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Current assets			
Debt securities	8	75,633	111,159
Interest receivable		957	1,154
Levy receivable		772	481
Fixed and call deposits with banks		51,767	3,677
Cash at bank		136	60
		129,265	116,531
Current liabilities			
Accounts payable and accrued charges		252	253
Net current assets		129,013	116,278
Net assets			
Representing:			
Compensation fund			
Contributions from HKFE	9	21,400	21,600
Accumulated surplus		107,613	94,678
		129,013	116,278

Approved and authorised for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 5 May 2003 and signed on its behalf by

Mark Dickens
Chairman

Alexa Lam
Committee Member

T Brian Stevenson
Committee Member

The notes on pages 110 to 113 form part of these financial statements.

Statement of Recognised Gains and Losses

For the Year Ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Surplus for the year		12,935	13,031
Total recognised gains		12,935	13,031
Effect of change in accounting policy	4	52,037	46,051

The notes on pages 110 to 113 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	2003	2002 (Restated)
	\$'000	\$'000
Net cash inflow from operating activities	6,580	5,954
Returns on investments – interest received	6,818	6,095
Investing activities		
Debt securities redeemed	51,700	39,500
Debt securities bought	(16,732)	(67,261)
Net cash inflow/(outflow) from investing activities	34,968	(27,761)
Financing		
Net contribution (refunded to)/received from HKFE	(200)	300
Net cash (outflow)/inflow from financing	(200)	300
Increase/(decrease) in cash and cash equivalents	48,166	(15,412)
Cash and cash equivalents at beginning of the year	3,737	19,149
Cash and cash equivalents at end of the year	51,903	3,737

Reconciliation of surplus for the year to net cash inflow from operating activities:

	2003	2002 (Restated)
	\$'000	\$'000
Surplus for the year	12,935	13,031
Net investment income	(6,063)	(7,190)
(Increase)/decrease in levy receivable	(291)	112
(Decrease)/increase in accounts payable and accrued charges	(1)	1
Net cash inflow from operating activities	6,580	5,954

Analysis of the balance of cash and cash equivalents as shown in the balance sheet:

	2003	2002
	\$'000	\$'000
Cash at bank	136	60
Fixed and call deposits with banks	51,767	3,677
	51,903	3,737

Notes to the Financial Statements

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

1. Status change of the HKFE shareholders

On 6 March 2000, Hong Kong Futures Exchange Limited (the HKFE) became a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx). The shareholders of the HKFE ceased to be HKFE shareholders and received shares in HKEx and HKFE trading rights. Most also became exchange participants of the HKFE, who are required to continue holding of a trading right.

Pursuant to the Exchanges and Clearing Houses (Merger) Ordinance, an exchange participant means a person who may trade on or through the Exchange Company and a "trading right" means a right to be eligible to trade on or through the Exchange Company. Following the status change and related changes to the legislation, claims against the Fund must be made in relation to a default by a HKFE exchange participant (formerly a shareholder) and the HKFE must make deposits to the Fund for each holder of a trading right (formerly each shareholder in HKFE).

2. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of the HKFE. Part VIII of the Commodities Trading Ordinance governs its operation.

The HKFE receives and determines claims against the Fund. The SFC maintains and invests the money of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The Commodities Trading Ordinance limits to \$2 million the total amount that may be paid per exchange participant default. If allowed claims exceed the limit, payments are made proportionally to claimants. The HKFE with the approval of the SFC can decide to increase the limit if it considers that the assets of the Fund so permit.

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Commodities Trading Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

The Legislative Council enacted the Securities and Futures Ordinance (SFO) on 13 March 2002. The SFO and related subsidiary legislations came into effect on 1 April 2003.

The SFO also requires the SFC to form a new single investor compensation fund (ICF) to replace the Fund and the Unified Exchange Compensation Fund. After allowing a sufficient sum of money to meet claims against it and its other liabilities, the SFC will transfer the remaining balance of money in the Fund into the ICF after 1 April 2003. Claims for any defaults occurring after 31 March 2003 shall be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 89, under Section 75(1) of Schedule 10 of the SFO, Part VIII of the Commodities Trading Ordinance remain effective in respect of the operation of the Fund.

3. Money constituting the Fund

Under the Commodities Trading Ordinance, the HKFE must keep deposited with the SFC \$100,000 for each holder of HKFE trading rights before 1 April 2003. The SFC has discretion to add to the Fund the investment return earned on the deposits net of Fund expenses or pay interest to the HKFE. In practice, the SFC adds the investment return to the Fund.

Other sources of money for the Fund include a contract levy chargeable on contracts traded on the HKFE and recoveries.

4. Significant accounting policies

The Fund prepares its financial statements in accordance with the International Financial Reporting Standards (IFRSs) promulgated by International Accounting Standards Board (IASB). We set out below a summary of our significant accounting policies.

Basis of preparation of financial statements

Under the SFO, the Fund will continue in operation until all claims against it and all its liabilities have been settled. As the Fund will eventually cease operation, we have prepared these financial statements on a break-up basis with assets stated at recoverable amounts. We have not provided in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operation will cease as these are estimated to be immaterial.

Change in accounting policy

In past years, we recognised investment income in the income and expenditure account and other receipts and distributions to the Fund directly. In order to improve the comprehensibility of the financial statements to readers, this year we recognise receipts (including contract levy and recoveries) and distributions (including provision made for compensation payments) that are directly related to the principal activity of the Fund as income and expenses respectively in the Fund's income and expenditure account. The comparative information for the year ended 31 March 2002 has been restated retrospectively to conform to the new policy.

Accumulated deficit (restated)

	2003 \$'000	2002 \$'000
Accumulated surplus brought forward as previously reported	42,641	35,596
Change in accounting policy with respect to reclassification as income		
– contract levy	63,643	57,684
– recoveries	12,851	12,824
Change in accounting policy with respect to reclassification as expenses		
– compensation to claimants	(24,457)	(24,457)
Effect of change in accounting policy	52,037	46,051
Accumulated surplus brought forward as restated	94,678	81,647

The effect of the change in accounting policy for the year is to cause an increase in income of \$7,001,000 (2002: \$5,986,000) representing the recognition of contract levy and recoveries as income. These resulted in a net increase in surplus of \$7,001,000 for the year (2002: \$5,986,000).

Recognition of income

Net Investment income Net investment income comprised (i) interest income from bank deposits and debt securities, (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income on an accrual basis.

Contract levy We record contract levy as income at a fixed rate on every leviable HKFE transaction on an accrual basis.

Recoveries We record recoveries pursuant to Section 95 of the Commodities Trading Ordinance as income on a receipt basis to the Fund.

Investments

As we have prepared the financial statements on a break-up basis, we have reclassified our investments in debt securities, which were classified as held-to-maturity debt securities before the enactment of the SFO, as current assets. We state these securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

4. Significant accounting policies (cont'd)

Impairment

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

Calculation of recoverable amount

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

Reversals of impairment

We reverse an impairment loss in respect of a receivable if the circumstances and events that have led to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Other receivables

We state other receivables at their cost less impairment losses.

Provision for compensation

We make provision for compensation for known liabilities arising from claims for pecuniary losses suffered by persons as a result of defaults occurring prior to 1 April 2003 on the part of the exchange participants of the HKFE which are determined up to the date on which the financial statements are approved by the Committee. We charge such provisions as expenses through the income and expenditure account.

Other payables

We state other payables at cost.

Related parties

For the purpose of these financial statements, we consider that the following are related parties of the Fund:

- (i) parties that the Fund has the ability, directly or indirectly, to control or significantly influence in making financial and operating decisions;
- (ii) parties that have the ability, directly or indirectly, to control or significantly influence the Fund in making financial and operating decisions; and
- (iii) parties that are subject to common control or common significant influence.

Related parties may be individuals or corporate entities.

5. Taxation

Section 87 of the Hong Kong Inland Revenue Ordinance exempts the Fund from Hong Kong taxes.

6. Net investment income

	2003 \$'000	2002 \$'000
Interest income from bank deposits and debt securities	5,104	5,618
Unrealised gain on revaluation of debt securities	959	1,572
Net investment income	<u>6,063</u>	<u>7,190</u>

7. Contract levy

The Fund received a contract levy chargeable at \$0.5 per every leviable HKFE transaction except for Mini-Hang Seng Index Futures Contracts, Stock futures contracts and Options on Stock futures contracts which are chargeable at \$0.1 per transaction.

8. Debt securities

	2003 \$'000	2002 \$'000
Maturing after one year		
In the second to third years – unlisted	37,318	54,826
After three years – unlisted	3,510	3,265
	<u>40,828</u>	<u>58,091</u>
Maturing within one year		
– listed outside Hong Kong	–	5,833
– unlisted	34,805	47,235
	<u>34,805</u>	<u>53,068</u>
	<u>75,633</u>	<u>111,159</u>

9. Contributions from HKFE

	2003 \$'000	2002 \$'000
Balance brought forward	21,600	21,300
Add: Contributions received during the year	700	800
Less: Refunds to outgoing holders of trading rights	(900)	(500)
Balance carried forward	<u>21,400</u>	<u>21,600</u>

10. Related party transactions

We have related party relationship with the SFC and the HKFE. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to note 9).

11. Financial instruments

Financial assets of the Fund comprise debt securities.

(i) Credit risk

The Fund's investment policy only allows the Fund to invest in fixed rate dated securities or in bank deposits. The policy also limits the Fund's exposure to each organisation and each country to not more than 15% and 20% of the total investment respectively. During the year, the Fund complied with the above investment policy and, as a result, was not exposed to significant credit risk.

(ii) Exchange rate risk

All our debt securities are denominated in Hong Kong dollars and, as a result, the Fund was not exposed to foreign exchange risk.

(iii) Market risk

The investment activities of the Fund expose it to various types of market risks which are associated with the markets in which it invests, to the extent of the amount invested in debt securities. Such risk will be reflected in the price and the carrying value of the financial assets concerned.

12. Contingent liabilities

As at the date of this report, there is no outstanding claims against the Fund (2002: nil).