

Unified Exchange Compensation Fund (the Fund)

Report of the Securities 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 2007.

1. Establishment of the Fund

Part X of the repealed Securities Ordinance (Chapter 333) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single Investor Compensation Fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 74 of Schedule 10 of the SFO.

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 94 to 103.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2007 and up to the date of this report were:

Mr. Keith Lui (Chairman)	[appointed on 19 September 2006]
Mr. Gerald Greiner	
Mrs. Alexa Lam	
Mr. Kenneth H W Kwok, BBS, SC	[appointed on 16 January 2007]
Mr. Eric Yip	[appointed on 1 April 2007]
Mr. Roger Lee	[appointed on 1 April 2006 and resigned on 1 April 2007]
Mr. Eddy C Fong, SBS, JP	[resigned on 15 January 2007]
Mr. Martin Wheatley	[resigned on 18 September 2006]

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

KPMG were first appointed as auditors of the Fund in 1996. KPMG retire and being eligible, offer themselves for re-appointment.

On behalf of the Committee

Keith Lui
Chairman

27 April 2007

Unified Exchange Compensation Fund

Independent Auditor's Report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the repealed Hong Kong Securities Ordinance set out on pages 94 to 103 which comprise the balance sheet as at 31 March 2007 and the income and expenditure account, the statement of changes in equity and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The SFC's responsibility for the financial statements

The repealed Hong Kong Securities Ordinance (Chapter 333) requires the directors of 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 and in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund as at 31 March 2007 and of its result and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

27 April 2007

Unified Exchange Compensation Fund

Income and Expenditure Account

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Income			
Interest income	3	2,584	1,792
Recoveries	3&5	8,754	2,384
Replenishments from the SEHK		–	1
		11,338	4,177
Expenses			
Compensation expenses		1,667	2,005
Auditor's remuneration		33	30
Professional fees		11	10
Sundry expenses		1	3
		1,712	2,048
Surplus for the year		9,626	2,129
Accumulated surplus brought forward		9,584	7,455
Accumulated surplus carried forward		19,210	9,584

We have not prepared a separate statement of changes in equity as the surplus for the year would be the only component of such a statement.

The notes on pages 97 to 103 form part of these financial statements.

Unified Exchange Compensation Fund

Balance Sheet

At 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Current assets			
Equity securities received under subrogation	5	560	721
Interest receivable		113	91
Fixed and call deposits with banks		66,324	57,236
Cash at bank		13	14
		67,010	58,062
Current liabilities			
Accounts payable and accrued charges	6	4,306	4,254
Provision for compensation	3&8	1,823	2,553
		6,129	6,807
Net current assets		60,881	51,255
Net assets		60,881	51,255
Representing:			
<u>Compensation fund</u>			
Contributions from the SEHK	9	46,100	46,100
Excess transaction levy from the SEHK	10	353,787	353,787
Special contribution		3,500	3,500
Additional contribution from the SEHK		300,000	300,000
Additional contribution from the SFC		330,000	330,000
Special levy surplus	11	3,002	3,002
Accumulated surplus		19,210	9,584
		1,055,599	1,045,973
Contributions to Investor Compensation Fund	12	(994,718)	(994,718)
		60,881	51,255

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 27 April 2007 and signed on its behalf by

Keith Lui
Chairman

Alexa Lam
Committee Member

Gerald Greiner
Committee Member

The notes on pages 97 to 103 form part of these financial statements.

Unified Exchange Compensation Fund

Cash Flow Statement

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	2007 \$'000	2006 \$'000
Cash flows from operating activities		
Surplus for the year	9,626	2,129
Net investment income	(2,584)	(1,792)
Decrease in equity securities received under subrogation	161	7,072
(Decrease)/increase in provision for compensation	(730)	1,061
Increase/(decrease) in accounts payable and accrued charges	52	(37)
Net cash from operating activities	<u>6,525</u>	<u>8,433</u>
Cash flows from investing activities		
Interest received	2,562	1,737
Net cash from investing activities	<u>2,562</u>	<u>1,737</u>
Net increase in cash and cash equivalents	<u>9,087</u>	<u>10,170</u>
Cash and cash equivalents at beginning of the year	<u>57,250</u>	<u>47,080</u>
Cash and cash equivalents at end of the year	<u>66,337</u>	<u>57,250</u>

Analysis of the balance of cash and cash equivalents:

	2007 \$'000	2006 \$'000
Fixed and call deposits with banks	66,324	57,236
Cash at bank	13	14
	<u>66,337</u>	<u>57,250</u>

Unified Exchange Compensation Fund

Notes to the Financial Statements

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

1. 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 Stock Exchange of Hong Kong Limited (SEHK). Part X of the repealed Securities Ordinance governs its operation.

The SEHK 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 repealed Securities Ordinance limits to \$8 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 SEHK, with the approval of the SFC, can decide to increase the limit if it considers, among other things, that the assets of the Fund so permit. For eight defaults since 1998, the SEHK proposed and the SFC approved increases in the limit via payment of up to \$150,000 per claimant or, if higher, the claimant's proportional share of the \$8 million limit.

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 repealed Securities Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

After the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After allowing a sufficient sum of money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 should 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 112 of the repealed Securities Ordinance, under Section 74 of Schedule 10 of the SFO, Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Before 1 April 2003, the SEHK was required to keep deposited with the SFC \$50,000 for each SEHK trading right under the repealed Securities Ordinance. When the SFC makes compensation payments out of the deposits, the SFC may require the SEHK to replenish the net amount paid after the SFC has exhausted its subrogated rights against the defaulter. The SFC pays to the SEHK the investment return earned on any remaining deposits net of Fund expenses. During the year, the SFC did not make such payment as the total of the compensation payments exceeded the deposits received from the SEHK (2006: nil).

The SEHK and the SFC have made contributions of their own money to the Fund. The SFC determines to retain investment returns earned on these contributions in the Fund.

Other sources of money for the Fund include: recoveries; SEHK replenishments detailed in note 15; special levy surplus detailed in note 11; and transaction levy received before the SFO became effective from 1 April 2003.

Unified Exchange Compensation Fund

3. Significant accounting policies

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

Basis of preparation

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 for potential future claims and recoveries as these cannot be reliably estimated. We have also not provided in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operations will cease as these are estimated to be immaterial.

We prepare the financial statements in conformity with IFRSs which requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. We make estimates and associated assumptions based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We review estimates and underlying assumptions on an ongoing basis. We recognise revisions to accounting estimates in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Recognition of income

Interest income We record interest income from bank deposits on accrual basis.

Recoveries We recognise recoveries pursuant to Section 118 of the repealed Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. We record recoveries received and re-distributed when and only when we can virtually certain that the recoveries will be received and paid.

Replenishments by the SEHK We record replenishments from the SEHK pursuant to Section 107 of the repealed Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by the SEHK, we deem compensation payments up to the amount of \$8,000,000 for each default to be charged to the contribution from the SEHK.

Unified Exchange Compensation Fund

3. Significant accounting policies (cont'd)

Impairment

(i) *Recognition of impairment loss*

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any objective evidence of impairment. If any such evidence exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account the difference between the asset's carrying amount and the recoverable amount as an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount.

(ii) *Calculation of impairment loss*

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.

(iii) *Reversals of impairment loss*

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that have objectively linked 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. We reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined if we had not recognised any impairment loss.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

Provision for compensation

We make provision for liabilities arising from claims resulting from defaults occurring before 1 April 2003 for which the SEHK has published a notice calling for claims pursuant to either Section 112 of the repealed Securities Ordinance or Section 74(4) of Schedule 10 of the SFO. The provision covers all such claims received up to the date on which the financial statements are approved by the Committee.

As a result of the enactment of the amendments to Section 113 of the repealed Securities Ordinance in November 1998, the maximum liability of the Fund to claims for each default case can exceed the normal \$8,000,000 limit.

Accounts payable and accrued charges

We state accounts payable and accrued charges initially at fair value and thereafter state them at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

Unified Exchange Compensation Fund

3. Significant accounting policies (cont'd)

Contingent liabilities

Unless the probability of outflow of economic benefits is remote, we disclose obligations as contingent liabilities where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably. We also disclose possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events unless the probability of outflow of economic benefits is remote.

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 to significantly influence in making financial and operating decisions;
- (ii) parties that have the ability, directly or indirectly, to control or to 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 (being members of key management personnel, and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Fund where those parties are individuals.

4. Taxation

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

5. Equity securities and recoveries

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised SFC that shares were allocated to the Fund under its subrogation rights, subject to paying a processing fee to the liquidators. The Fund arranged to liquidate the shares as far as possible. The Fund recognised as recoveries the sale proceeds and the remaining shares at market value as of 31 March 2007 after deducting relevant processing fees and charges for collecting and selling the securities received.

According to the repealed Securities Ordinance, the Fund is under an obligation to refund any excess amount representing the excess of the sale proceeds of recovered assets over the compensation amount to the claimants. We will proceed to make the refund once the verification process is completed.

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6. Accounts payable and accrued charges

Accounts payable and accrued charges comprised mainly compensation payments re-established for those cheque payments that were not cleared over six months from the cheque issuing date and accrued auditor's remuneration.

7. Set-off of SEHK deposits and refunds

When a trading right is transferred, the SEHK must make a \$50,000 deposit with the SFC within one month of the transfer in respect of the new holder. In the absence of claims or other provisions as set out in Section 106 of the repealed Securities Ordinance, the SFC must refund to the SEHK the deposit of the former holder within six months of the transfer. In practice, the SFC sets these amounts off against one another and does not include in these financial statements any liability of the SEHK to make a deposit during the six-month period.

The SEHK advised the SFC of 13 trading rights having been transferred during the six months to 31 March 2007 (2006: 8 trading rights had been transferred during the six months to 31 March 2006).

The SEHK also advised the SFC of four trading rights in total having been relinquished in December 2006 and March 2007. The SFC should refund to the SEHK the deposit of \$50,000 in respect of each trading right at the end of a six-month period after the relinquishment took effect.

8. Provision for compensation

	2007	2006
	\$'000	\$'000
Balance brought forward	2,553	1,492
Less: Amount paid during the year	(2,397)	(944)
Add: Net provision made	1,667	2,005
Balance carried forward	1,823	2,553

We maintain provision for claims in respect of one SEHK exchange participant for which the SEHK has published a notice calling for claims.

9. Contributions from the SEHK

According to Section 104 of the repealed Securities Ordinance, the SEHK contributes to the Fund in respect of each trading right at the rate of \$50,000 per trading right.

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10. Excess transaction levy from the SEHK

The SEHK paid these amounts to the Fund from 1992 to 1994 under an agreement with the SFC and the Financial Secretary concerning the SEHK's budget and its receipt of transaction levy.

11. Special levy surplus

In November 2000, the Financial Services Bureau of the HKSAR Government transferred to the Fund \$3,002,000 under the provisions of the Exchanges (Special Levy) Ordinance.

12. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. Under Section 74(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. Total contributions paid into the ICF upto 31 March 2007 amounted to \$994,718,000.

13. Related party transactions

We have related party relationships with the ICF, the SFC and the SEHK. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 7, 10, 12 and 15).

14. Financial instruments

Exposure to credit and liquidity risks arises in the normal course of the Fund's operation. The Fund is not exposed to any foreign exchange risk as all transactions and balances are denominated in HKD.

The Fund's credit risk is primarily attributable to cash at bank. Management's policy is that cash balances are placed only with licensed banks in Hong Kong.

The Fund's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2007 and 2006.

15. Replenishments from the SEHK

Under Section 107 of the repealed Securities Ordinance, the SFC may require the SEHK to replenish the Fund with an amount that is equal to that paid in connection with the satisfaction of the claim (limited to \$8,000,000 per each defaulted case) after the SFC has exhausted all relevant rights of action and other legal remedies against the defaulter.

Unified Exchange Compensation Fund

15. Replenishments from the SEHK (cont'd)

Up to 31 March 2007, the SEHK has replenished \$16,361,000 to the Fund. In compliance with Section 107 of the repealed Securities Ordinance, if no further recoveries were to be collected, the SFC may require the SEHK to further replenish \$69,608,000 to the Fund as follows:

	2007 \$'000	2006 \$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the repealed Securities Ordinance	99,091	99,091
Less: Recoveries received for compensation paid up to \$8 million	(29,507)	(29,019)
Add: Recoveries re-distributed to claimants	16,385	16,385
Less: Replenishments from the SEHK	(16,361)	(16,361)
Net amount the SFC may request the SEHK for replenishment	<u>69,608</u>	<u>70,096</u>

Under Section 74(3) of Schedule 10 of the SFO, the SFC having allowed sufficient funds to meet claims, may reimburse the SEHK for the deposits paid by the SEHK into the Fund for each trading right. The reimbursement of these SEHK deposits may be set off against further replenishments required from the SEHK.

Replenishments from the SEHK are not recognised in the balance sheet given that the Fund is not aware of any need for requesting the SEHK for replenishment in the near future.

16. Contingent liabilities

As at the date of this report, the validity of outstanding claims received against two exchange participants is still under investigation by the SEHK. They are subject to the normal \$8 million ceiling pursuant to Section 109 of the repealed Securities Ordinance. We have not made any provision in these financial statements for any of these claims. Under these circumstances, the maximum contingent liability of the Fund to these claims is \$16 million (2006: \$24 million).

17. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2007

Up to the date of issue of these financial statements, the IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 March 2007 and which have not been adopted in these financial statements.

Of these developments, the following relate to matters that may be relevant to the Fund's operations and financial statements:

	Effective for accounting periods beginning on or after
IFRS 7, Financial instruments: disclosures	1 January 2007
Amendments to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007

The Fund is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.