

### Auditors' Report To the Securities and Futures Commission (SFC)

(Established in Hong Kong under the Securities and Futures Commission Ordinance)

We have audited the financial statements on pages 67 to 75 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

#### Respective Responsibilities of Directors and Auditors

The Securities and Futures Commission Ordinance (the Ordinance) requires the SFC to prepare financial statements and 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 judgments 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 judgments made by the SFC in the preparation of the financial statements, and of whether the accounting policies are appropriate to the SFC'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 misstatements. 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, in all material respects, of the state of the SFC's financial affairs at 31 March 1999 and of its deficit and cash flows for the year then ended, and have been properly prepared in accordance with accounting principles generally accepted in Hong Kong.

#### KPMG

Certified Public Accountants  
Hong Kong

17 May 1999

## Income and Expenditure Account

For the year ended 31 March 1999 (Expressed in HK\$'000)

	Note	1999	1998
<b>Income</b>			
Levies	2a	\$ 134,014	\$ 478,511
Fees and charges	2c	92,308	115,265
Investment income		68,811	59,551
Others		5,502	2,888
		<u>\$ 300,635</u>	<u>\$ 656,215</u>
<b>Expenditure</b>			
Personnel	5	\$ 248,455	\$ 219,384
Premises			
– rental charges under operating leases		38,864	36,253
– other		7,961	7,504
Other expenses	6	65,121	71,926
		<u>\$ 360,401</u>	<u>\$ 335,067</u>
Depreciation		12,325	9,263
		<u>\$ 372,726</u>	<u>\$ 344,330</u>
<b>(Deficit) / Surplus for the Year</b>		<b>\$ (72,091)</b>	<b>\$ 311,885</b>
<b>Balance Brought Forward</b>		<u>922,061</u>	<u>610,176</u>
		<b>\$ 849,970</b>	<b>\$ 922,061</b>
<b>Contribution to Compensation Fund</b>	14b	<u>(150,000)</u>	<u>–</u>
<b>Balance Carried Forward</b>		<u><u>\$ 699,970</u></u>	<u><u>\$ 922,061</u></u>

The notes on pages 70 to 75 form part of these financial statements.

## Balance Sheet

At 31 March 1999 (Expressed in HK\$'000)

	Note	1999	1998
<b>Fixed Assets</b>	7	\$ 20,864	\$ 15,389
<b>Investments</b>	8	\$ 511,422	\$ 763,354
<b>Current Assets</b>			
Investments	8	\$ 276,431	\$ 168,351
Bank deposits		133,875	52,967
Debtors, deposits and prepayments	9	23,088	34,979
Cash at bank and in hand		464	708
		<u>\$ 433,858</u>	<u>\$ 257,005</u>
<b>Current Liabilities</b>			
Provision for contribution to compensation fund	14b	\$ 150,000	\$ –
Deferred income	3	27,356	25,966
Creditors and accrued charges		45,978	44,881
		<u>\$ 223,334</u>	<u>\$ 70,847</u>
<b>Net Current Assets</b>		<u>\$ 210,524</u>	<u>\$ 186,158</u>
<b>Net Assets</b>		<u>\$ 742,810</u>	<u>\$ 964,901</u>
Representing :			
<b>Initial Funding by Government</b>	10	\$ 42,840	\$ 42,840
<b>Income and Expenditure Account</b>		699,970	922,061
		<u>\$ 742,810</u>	<u>\$ 964,901</u>

Approved by the Commission on  
17 May 1999 and signed on its behalf by

**Andrew L T Sheng**  
Chairman

**Brian Stevenson**  
Non-executive Director

The notes on pages 70 to 75 form part of these financial statements.

## Cash Flow Statement

For the year ended 31 March 1999 (Expressed in HK\$'000)

	Note	1999	1998
Net cash inflow from operating activities	a	\$ 34,596	\$ 267,913
Returns on investments and servicing of finance			
Interest received		\$ 70,653	\$ 56,975
Investing activities			
Payments to acquire dated securities		\$ (106,629)	\$ (537,898)
Receipts from redemption of dated securities		168,500	245,000
Receipts from disposal of dated securities		81,273	–
Payments to acquire fixed assets		(17,808)	(15,655)
Receipts from disposal of fixed assets		79	93
Contribution to compensation fund		(150,000)	–
Net cash outflow from investing activities		\$ (24,585)	\$ (308,460)
Increase in cash and cash equivalents		\$ 80,664	\$ 16,428
Cash and cash equivalents at beginning of the year		53,675	37,247
Cash and cash equivalents at end of the year	b	\$ 134,339	\$ 53,675

(a) Reconciliation of (deficit) / surplus of income over expenditure to net cash inflow from operating activities:

	1999	1998
(Deficit) / surplus of income over expenditure for the year	\$ (72,091)	\$ 311,885
Interest income	(69,519)	(60,439)
Premium on investments	1,427	1,355
Discount on investments	(854)	(467)
Depreciation charges	12,325	9,263
Profit on disposal of fixed assets	(71)	(81)
Loss on disposal of dated securities	135	–
Decrease in debtors, deposits and prepayments	10,757	3,076
Increase in provision, creditors and accrued charges	151,097	885
Increase in deferred income	1,390	2,436
Net cash inflow from operating activities	\$ 34,596	\$ 267,913

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

Bank deposits	\$ 133,875	\$ 52,967
Cash at bank and in hand	464	708
	\$ 134,339	\$ 53,675

## Notes to the Financial Statements

(Expressed in HK\$'000)

### 1. Status of the SFC

The SFC was established under and is governed by the Ordinance.

### 2. Income

Details of the funding of the SFC are set out in S.52 to 54 of the Ordinance. In particular,

- a The SFC receives a share of the levies collected by The Stock Exchange of Hong Kong Limited (SEHK) and Hong Kong Futures Exchange Limited (HKFE) on transactions recorded on the Exchanges at rates specified by the Chief Executive in Council.
- b In each financial year, the SFC shall be paid out of general revenue such moneys as shall be appropriated by the Legislative Council. At the request of the SFC, no appropriation has been made since the financial year ended 31 March 1994.
- c Subsidiary legislation provides for the payment to the SFC of fees or other charges in relation to the functions and services performed by the SFC.

### 3. Significant Accounting Policies

These accounts have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies is set out below.

#### *a Recognition of Income*

##### (i) Levies

Levies from the two Exchanges are credited to the income and expenditure account on an accruals basis.

##### (ii) Fees and Charges

Annual fees from registered persons and in respect of authorised investment arrangements are credited to the income and expenditure account on a straight line basis over the periods to which they relate. Other fees and charges are credited to the income and expenditure account when receivable.

##### (iii) Investment Income

Investment income is credited to the income and expenditure account on an accruals basis. It comprises interest earned on bank deposits and dated securities and the premium or discount on purchase of dated securities amortised or accreted on a straight line basis over the periods to redemption.

#### *b Operating Leases*

Rental payable under operating leases is accounted for on a straight line basis over the period to the next rent review date.

### 3. Significant Accounting Policies (cont'd)

#### c Fixed Assets and Depreciation

Fixed assets are stated at cost less accumulated depreciation, which is calculated to write off their cost over their anticipated useful lives on a straight line basis. The useful lives used are as follows :

Leasehold improvements	– over the shorter of the period of the respective leases and 3 years
Furniture and fixtures	– 3 years
Office equipment	– 5 years
Personal computers and software	– 3 years
Mainframe computers and application systems	– 4 years
Motor vehicles	– 4 years

#### d Investments

Investments, representing dated securities which are intended to be held to maturity, are stated at cost adjusted for the amortisation of premiums and accretion of discounts on purchase over the periods to redemption. Provisions are made where there has been a permanent diminution in value.

#### e Related Parties

For the purpose of these financial statements, parties are considered to be related to the SFC if the SFC has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the SFC and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

### 4. Taxation

In accordance with S.3(3) of the Ordinance, the receipts of the SFC are not subject to Hong Kong taxation under the Inland Revenue Ordinance.

### 5. Personnel Expenses

#### a Personnel expenses comprise:

	1999	1998
Directors' fees	\$ 1,229	\$ 1,170
Directors' salaries, allowances and gratuities	26,761	23,188
Directors' bonuses	447	785
Staff salaries, allowances and gratuities	209,507	184,715
Retirement benefits	3,277	2,930
Medical and life insurance	6,131	5,510
Overtime pay	1,103	1,086
	<u>\$ 248,455</u>	<u>\$ 219,384</u>

## Notes to the Financial Statements

(Expressed in HK\$'000)

### 5. Personnel Expenses (cont'd)

b The number of directors whose emoluments fell within the following bands were :

	1999 No. of Directors	1998 No. of Directors
Emolument Ranges		
\$0 to \$1,000	9	7
\$1,000 to \$1,500	1	–
\$3,500 to \$4,000	–	2
\$4,000 to \$4,500	3	1
\$4,500 to \$5,000	1	1
\$5,000 to \$5,500	2	–
\$6,000 to \$6,500	–	1
	<u>16</u>	<u>12</u>

c The five highest paid individuals during the year were all directors of the SFC, the aggregate remuneration of whom has been included in 5a and 5b above.

d Retirement benefits are provided to certain categories of staff through a defined contribution scheme. The SFC makes monthly contributions equal to 12% of the basic pay of such staff. Forfeited contributions in respect of staff who leave the SFC prior to qualifying for 100% disbursement of the contributions are reinvested into the total pool of contributions and shared by the existing members in the scheme at the end of the scheme year. The amount so reinvested during the year was \$238 (1998: \$346).

### 6. Other Expenses

Other expenses comprise :

	1999	1998
Training and development	\$ 7,230	\$ 8,875
Legal and professional services	36,468	30,164
Legal claims and costs awarded	770	400
Information and systems services	9,408	8,171
Auditors' remuneration	148	140
General office and insurance	4,597	14,176
Funding for the Investment Resources Centre	3,500	–
Funding for the Hong Kong Securities Institute	3,000	10,000
	<u>\$ 65,121</u>	<u>\$ 71,926</u>

## 7. Fixed Assets

	Furniture, Fixtures and Leasehold Improvements	Office Equipment	Mainframe Computers and Application Systems	Personal Computers and Software	Motor Vehicles	Total
<b>Cost</b>						
At 1 April 1998	\$ 21,332	\$ 6,278	\$ 19,771	\$ 15,791	\$ 1,400	\$ 64,572
Additions during the year	3,604	743	10,159	2,825	477	17,808
Disposals during the year	(63)	(48)	(516)	(1,510)	(421)	(2,558)
At 31 March 1999	<u>\$ 24,873</u>	<u>\$ 6,973</u>	<u>\$ 29,414</u>	<u>\$ 17,106</u>	<u>\$ 1,456</u>	<u>\$ 79,822</u>
<b>Depreciation</b>						
At 1 April 1998	\$ 15,424	\$ 3,695	\$ 15,997	\$ 13,402	\$ 665	\$ 49,183
Charge for the year	4,258	1,083	4,069	2,551	364	12,325
Written back on disposals	(63)	(48)	(511)	(1,507)	(421)	(2,550)
At 31 March 1999	<u>\$ 19,619</u>	<u>\$ 4,730</u>	<u>\$ 19,555</u>	<u>\$ 14,446</u>	<u>\$ 608</u>	<u>\$ 58,958</u>
<b>Net book value</b>						
At 31 March 1999	<u>\$ 5,254</u>	<u>\$ 2,243</u>	<u>\$ 9,859</u>	<u>\$ 2,660</u>	<u>\$ 848</u>	<u>\$ 20,864</u>
<b>Net book value</b>						
At 31 March 1998	<u>\$ 5,908</u>	<u>\$ 2,583</u>	<u>\$ 3,774</u>	<u>\$ 2,389</u>	<u>\$ 735</u>	<u>\$ 15,389</u>

## 8. Investments

		1999	1998
<b>Dated securities</b>			
Maturing after one year	– unlisted	\$ 505,503	\$ 710,829
	– listed in Hong Kong	5,919	52,525
		<u>\$ 511,422</u>	<u>\$ 763,354</u>
Maturing within one year	– unlisted	\$ 236,406	\$ 141,847
	– listed in Hong Kong	40,025	11,487
	– listed outside Hong Kong	–	15,017
		<u>\$ 276,431</u>	<u>\$ 168,351</u>
		<u>\$ 787,853</u>	<u>\$ 931,705</u>
<b>Market value at 31 March</b>			
– unlisted	– unlisted	\$ 742,513	\$ 833,103
	– listed in Hong Kong	46,031	62,973
	– listed outside Hong Kong	–	14,864
		<u>\$ 788,544</u>	<u>\$ 910,940</u>

## Notes to the Financial Statements

(Expressed in HK\$'000)

### 9. Loans to Directors and Executives

There were no outstanding loans to directors or executives at the balance sheet date (1998: nil). The maximum balance of outstanding loans to directors during the year was nil (1998: \$333).

### 10. Initial Funding by Government

This represents funds provided by Government to pay for the SFC's non-recurrent and capital expenditure when it was established. These funds are not repayable to Government.

### 11. Capital Commitments

Capital commitments outstanding at 31 March 1999 not provided for in the financial statements were as follows :

	1999	1998
Contracted for	<u>\$ 5,270</u>	<u>\$ 4,622</u>
Authorised but not contracted for	<u>\$ 24,220</u>	<u>\$ 18,159</u>

### 12. Operating Lease Commitments

At 31 March 1999 the SFC had commitments under an operating lease in respect of its premises to make payments in the next year as follows :

	1999	1998
Lease expiring over 5 years	<u>\$ 31,436</u>	<u>\$ 36,850</u>

The above analysis comprises the rental presently payable under an operating lease in respect of premises only up to the date when it will be reviewed, being 31 December 1999.

### 13. Funds Held in Escrow

At 31 March 1999 the SFC held \$139,811 in escrow (1998: \$132,476). These funds are not included in the financial statements as they are not beneficially owned by the SFC.

### 14. Related Party Transactions

- a During the year the SFC purchased dated securities at a book cost of \$16,020 from the Unified Exchange Compensation Fund (the Fund) which is established and maintained by the SFC.

**14. Related Party Transactions (cont'd)**

- b As a result of the turmoil in the Asian markets in late 1997, and the subsequent failure of certain institutions connected with the securities markets, the Government, the SFC and the SEHK announced on 26 January 1998 that they would review the statutory limit of the Fund in the case of C.A. Pacific Securities Limited (CA Pacific). On 10 June 1998, the SEHK and the SFC announced that compensation to each claimant of CA Pacific would be allowed up to the higher of \$0.15 million or the pro rata share of the statutory limit of \$8 million. In this connection, the SEHK and the SFC announced that they would make a contribution of \$150 million each initially and if necessary, another \$150 million each, to the Fund. The legislative amendments for such arrangements were enacted on 20 November 1998.

During the year the SFC made a provision of \$150 million for the initial contribution to the Fund and, as disclosed in note 15 to the accounts, agreed to contribute a further \$150 million to the Fund if necessary.

**15. Commitments and Contingencies**

The SFC in conjunction with the SEHK, has agreed to contribute a further \$150 million each to the Fund, if necessary, in addition to the \$150 million each already provided.