

The Exchange Fund

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Report of the Director of Audit to the Financial Secretary

I have audited the statement of the accounts on pages 86 to 111 which has been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of the Monetary Authority and the Director of Audit

The directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance (Cap. 66) requires the Monetary Authority to sign the statement of the accounts. In preparing the statement of the accounts, the Monetary Authority has to select appropriate accounting policies and to apply them consistently.

It is my responsibility to form an independent opinion, based on my audit, on that statement of the accounts and to report my opinion to you.

Basis of opinion

I certify that I have audited the statement of the accounts referred to above in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance and the Audit Commission auditing standards. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the statement of the accounts. It also includes an assessment of the significant estimates and judgements made by the Monetary Authority in the preparation of the statement of the accounts, and of whether the accounting policies are appropriate to the Exchange Fund's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance as to whether the statement of the accounts is free from material misstatement. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the statement of the accounts. I believe that my audit provides a reasonable basis for my opinion.

Opinion

In my opinion the statement of the accounts gives a true and fair view of the state of affairs of the Exchange Fund as at 31 December 2002 and of its surplus and cash flows for the year then ended and has been properly prepared in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance.

Audit Commission
Hong Kong
27 March 2003

(Dominic Y T Chan)
Director of Audit

Exchange Fund - Income and Expenditure Account			
for the year ended 31 December 2002			
(Expressed in millions of Hong Kong dollars)	Notes	2002	2001
INCOME			
Interest income			
Interest income on debt securities		29,662	34,091
Other interest income		3,608	5,818
Total interest income		33,270	39,909
Dividend income from listed equity securities		3,237	3,668
Net realised and revaluation gains/(losses) on other investments in securities		(6,542)	(24,956)
Other net realised and revaluation gains/(losses)		(10,184)	1,801
Net exchange gains/(losses)		27,241	(13,059)
Bank licence fees		134	154
Others		33	26
TOTAL INCOME		47,189	7,543
EXPENDITURE			
Note and coin expenses	3(a)	273	144
Operating expenses	3(b)	1,162	1,070
Interest expense	3(c)	21,169	10,839
TOTAL EXPENDITURE		22,604	12,053
SURPLUS/(DEFICIT) FOR THE YEAR		24,585	(4,510)

Exchange Fund - Balance Sheet

as at 31 December 2002

(Expressed in millions of Hong Kong dollars)

	Notes	2002	2001
ASSETS			
Cash and money at call		15,956	13,848
Placements with banks and other financial institutions	4	35,475	85,403
Investment securities	5	300	300
Other investments in securities	6	878,838	853,898
Gold	7	179	145
Thailand financing package	8	1,058	4,149
Other assets	9	19,678	18,534
Investments in subsidiaries	10	2,145	2,145
Investment in associate	11	-	7
Fixed assets	12	1,436	717
TOTAL ASSETS	13	955,065	979,146
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness	14	118,475	107,545
Government-issued currency notes and coins in circulation	14	5,891	5,691
Balance of the banking system	15	525	671
Exchange Fund Bills and Notes	16	122,925	118,157
Placements by banks and other financial institutions	17	36,270	47,122
Placements by other Hong Kong Special Administrative Region government funds	18	301,669	380,602
Placements by Hong Kong statutory bodies		4,279	5,124
Other liabilities	19	37,857	11,645
Total liabilities		627,891	676,557
Accumulated surplus		327,174	302,589
TOTAL LIABILITIES AND FUND EQUITY		955,065	979,146

Joseph YamMonetary Authority
27 March 2003

The notes on pages 90 to 111 form part of these accounts.

Exchange Fund - Statement of Changes in Equity

for the year ended 31 December 2002

(Expressed in millions of Hong Kong dollars)

Accumulated surplus

Balance at 1 January

302,589 307,099

Surplus/(Deficit) for the year

24,585 (4,510)

Balance at 31 December

327,174 302,589

Exchange Fund - Cash Flow Statement			
for the year ended 31 December 2002			
(Expressed in millions of Hong Kong dollars)	Notes	2002	2001
Net cash from operating activities	21(a)	2,115	25,432
Cash flows from investing activities			
Purchase of fixed assets		(771)	(597)
Repayment of loan by associate		7	7
Interest received on loan to associate		-	1
Net cash used in investing activities		(764)	(589)
Net increase in cash and cash equivalents		1,351	24,843
Cash and cash equivalents at 1 January		118,153	93,608
Effect of foreign exchange rate changes		835	(298)
Cash and cash equivalents at 31 December	21(b)	120,339	118,153

The notes on pages 90 to 111 form part of these accounts.

Exchange Fund - Notes on the Accounts

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

1. PRINCIPAL ACTIVITIES

The Monetary Authority, under delegated authority from the Financial Secretary as Controller of the Exchange Fund (“the Fund”), manages the Fund in accordance with the provisions of the Exchange Fund Ordinance. The principal activities of the Fund are the safeguarding of the exchange value of the currency of Hong Kong and the maintaining of the stability and integrity of Hong Kong’s monetary and financial systems.

The principal activities of the subsidiaries are shown in Note 10.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Basis of preparation

- (i) Group accounts are not prepared in view of the insignificant amounts involved in the subsidiaries and associate.
- (ii) These accounts have been prepared using the fair value measurement basis, as modified by the use of historical cost for investment securities, other assets, investments in subsidiaries and associate, fixed assets, placements by other Hong Kong Special Administrative Region (“HKSAR”) government funds for which interest is payable at rates determined by reference to the investment income of the Fund and other liabilities, and in accordance with accounting principles generally accepted in Hong Kong, and comply with all applicable Statements of Standard Accounting Practice and Interpretations issued by the Hong Kong Society of Accountants. Fair value represents the market price of a financial instrument for which there is a published price quotation in an active securities market. Where such a market price is not available, fair value represents the valuation of a financial instrument according to a price matrix of discounted cash flows using applicable interest rates for discounting.

(b) Investments

- (i) Investments in securities

Investments in debt and equity securities, except those held as investments in subsidiaries and associate, are accounted for as follows.

Investments in securities are recognised as assets from the date on which the Fund is bound by the contract which gives rise to them. They are classified as investment securities and other investments in securities.

Investment securities

Investment securities are securities which are intended to be held on a continuing basis, and which are held for an identified long term purpose documented at the time of acquisition or change of purpose and are clearly identifiable for the documented purpose.

Investment securities are included in the balance sheet at cost less provision for any diminution in value which is other than temporary.

Other investments in securities

Other investments in securities are those which are not classified as investment securities and are stated at fair value at the balance sheet date.

Changes in fair value of these investments are recognised in the income and expenditure account in “Net realised and revaluation gains/(losses) on other investments in securities” as they arise.

Exchange Fund - Notes on the Accounts (cont.)

Gains and losses on sale of these investments are accounted for in the income and expenditure account in "Net realised and revaluation gains/(losses) on other investments in securities" in the period in which the disposal occurs as the difference between the net sales proceeds and the carrying amount of the securities.

(ii) Investments in subsidiaries and associate

Investments in subsidiaries and associate are stated at cost less provision for any diminution in value which is other than temporary as determined by management.

The results of subsidiaries and associate are accounted for by the Fund on the basis of dividends when they are declared.

(c) Placements with banks and other financial institutions

Placements with banks and other financial institutions are valued in the balance sheet according to a price matrix of discounted cash flows using applicable interest rates for discounting. Changes in value of these placements are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

(d) Exchange Fund Bills and Notes

Where Exchange Fund Bills and Notes have been issued at a premium or discount, those premiums and discounts are amortised over the period from the date of issue to the date of redemption and are included in the income and expenditure account in "Interest expense". Exchange Fund Bills and Notes are stated in the balance sheet at market value. Changes in market value of Exchange Fund Bills and Notes are recognised in the income and expenditure account in "Other net realised and revaluation gains/(losses)" as they arise.

On redemption of the Exchange Fund Bills and Notes, the resulting gains and losses, being the difference between the redemption amount and the carrying amount, are recognised in the income and expenditure account in "Other net realised and revaluation gains/(losses)" in the period in which the redemption takes place.

(e) Placements by other HKSAR government funds and other placements

Placements by other HKSAR government funds for which interest is payable at market-based rates are valued according to a price matrix of discounted cash flows using applicable interest rates for discounting. Changes in value of these placements are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)". In the balance sheet, these placements are stated at the principal amounts payable at the balance sheet date with the revaluation differences included in "Other liabilities".

Placements by other HKSAR government funds for which interest is payable at rates determined by reference to the investment income of the Fund are stated at the principal amounts payable at the balance sheet date.

Placements by banks, other financial institutions and Hong Kong statutory bodies are valued in the balance sheet according to a price matrix of discounted cash flows using applicable interest rates for discounting. Changes in value of these placements are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

Exchange Fund - Notes on the Accounts (cont.)

(f) Repurchase and resale agreements

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Placements by banks and other financial institutions". Conversely, securities purchased under analogous commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in "Placements with banks and other financial institutions". At the balance sheet date consideration received or paid under repurchase and resale agreements is valued according to a price matrix of discounted cash flows using applicable interest rates for discounting. Gains or losses arising from revaluation are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

(g) Securities lending agreements

Where securities are loaned with the receipt of cash or securities collateral, they remain on the balance sheet. Where cash collateral is received, a liability is recorded in respect of the cash received in "Placements by banks and other financial institutions". At the balance sheet date, this liability is valued according to a price matrix of discounted cash flows using applicable interest rates for discounting. Gains or losses arising from revaluation are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

(h) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date. Exchange gains and losses on foreign currency translation are included in the income and expenditure account in "Net exchange gains/(losses)".

Certificates of Indebtedness, government-issued currency notes and coins in circulation, all of which are denominated in Hong Kong dollars but are issued and redeemed in US dollars at the linked exchange rate of US\$1=HK\$7.80, are stated in the accounts at their Hong Kong dollar face value. At the balance sheet date the difference between their Hong Kong dollar face value and the market value of the US dollars required for their redemption is included in "Other assets".

Foreign currency income and expenditure are translated into Hong Kong dollars at the exchange rates prevailing at the transaction dates.

(i) Off-balance sheet financial instruments

Forward foreign exchange contracts are marked to market at the balance sheet date with the resultant revaluation gains and losses being included in the income and expenditure account in "Net exchange gains/(losses)".

Interest rate swap contracts are marked to market at the balance sheet date with the resultant revaluation gains and losses being included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

Revaluation gains or losses on forward foreign exchange contracts and interest rate swap contracts are included in the balance sheet as "Other assets" or "Other liabilities" as appropriate.

Stock index futures contracts and bond futures contracts are marked to market at the balance sheet date with their marked to market value being included in the balance sheet as "Other assets" or "Other liabilities" as appropriate. The resultant revaluation gains and losses are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

Exchange Fund - Notes on the Accounts (cont.)

(j) Fixed assets

Fixed assets, including premises, furniture, fixtures and equipment, motor vehicles, personal computers and capitalised systems development costs, are stated at cost less accumulated depreciation. Freehold land is not depreciated. All other fixed assets are depreciated on a straight-line basis over their respective estimated useful lives of between 3 and 39 years.

On disposal of fixed assets, the profit or loss is calculated as the difference between the net sales proceeds and the net carrying amount.

(k) Revenue recognition

Interest income is recognised on an accrual basis and dividend income is recognised when the share price goes ex-dividend.

Premiums and discounts on acquisition of debt securities are dealt with in the income and expenditure account in "Net realised and revaluation gains/(losses) on other investments in securities" in the process of marking to market of such securities at the balance sheet date.

Bank licence fees are fees receivable from Authorised Institutions under the Banking Ordinance and are accounted for in the period when receivable.

Other income includes income from sale of withdrawn coins and Central Moneymarkets Unit fees. Other income is accounted for in the period when receivable.

(l) Interest expense

Interest expense is recognised on an accrual basis. Discounts and premiums relating to borrowings are amortised on a straight-line basis over the respective remaining lives of the instruments. For a majority portion of the placements by other HKSAR government funds, interest is payable at rates determined by reference to the investment income of the Fund. For the rest of such placements, interest is payable at market-based rates.

(m) Related parties

For the purposes of these accounts, parties are considered to be related to the Fund if the Fund 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 Fund and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

(n) Cash and cash equivalents

Cash and cash equivalents are cash and money at call, placements with banks and other financial institutions and short-term highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value, having been within three months of maturity when placed or acquired.

(o) Staff retirement schemes

The Hong Kong Monetary Authority ("HKMA") operates two defined contribution schemes, the Provident Fund Scheme and the Mandatory Provident Fund Scheme. Under the schemes, contributions applicable each year are charged to the income and expenditure account. The assets of the staff retirement schemes are held separate from the Fund.

Exchange Fund - Notes on the Accounts (cont.)

(p) Operating leases

Leases where substantially all the rewards and risks of ownership remain with the leasing company are accounted for as operating leases. Rental payments under operating leases are charged to the income and expenditure account on a straight-line basis over the period of the relevant leases.

(q) Segment reporting

The activities of the Fund managed by the HKMA comprise four business segments. These are management of funds under the Currency Board Account, management of funds representing the general reserve assets of the Fund, banking supervision and monetary management. As the assets, revenue and overall results of banking supervision and monetary management are not significant, these two segments are combined with the segment for management of funds representing the general reserve assets of the Fund. Details on this combined segment are disclosed in Note 22 together with the Currency Board Account segment. There is no disclosure of geographic segments as the HKMA operates predominantly in one location. In line with the normal practice of central banking institutions, further breakdown of the investments by currencies or geographic markets is not disclosed.

3. EXPENDITURE

(a) **Note and coin expenses** represent reimbursements to the note-issuing banks in respect of note-issuing expenses, and expenses incurred directly by the Fund in issuing government-issued currency notes and coins.

(b) Operating expenses

	2002	2001
Staff costs		
Salaries and other staff costs	523	457
Retirement benefit costs	24	23
Premises and equipment expenses		
Depreciation charges	52	64
Operating lease charges	63	81
Other premises and equipment expenses	43	47
Other operating expenses	457	398
TOTAL	1,162	1,070

Salaries and other staff costs for 2002 include HK\$70 million (2001 - Nil) representing the recognition of accumulating annual leave entitlements in accordance with Statement of Standard Accounting Practice ("SSAP") 34 "Employee benefits" which became effective from 1 January 2002. In prior years, no accrual was made in respect of accumulating annual leave entitlements.

Exchange Fund - Notes on the Accounts (cont.)

The numbers of senior staff (Executive Directors and above) of the HKMA whose emoluments fell within the following bands were:

HK\$	2002	2001
1,000,000 or below	-	1
1,000,001 to 1,500,000	-	1
1,500,001 to 2,000,000	-	1
2,500,001 to 3,000,000	1	-
3,000,001 to 3,500,000	3	2
3,500,001 to 4,000,000	4	3
4,000,001 to 4,500,000	1	1
4,500,001 to 5,000,000	-	1
5,500,001 to 6,000,000	1	1
6,000,001 to 6,500,000	1	1
6,500,001 to 7,000,000	1	1
8,500,001 to 9,000,000	1	-
9,000,001 to 9,500,000	-	1
	13	14

The aggregate emoluments of senior staff (Executive Directors and above) were as follows:

	2002	2001
Fixed pay	48.3	46.8
Variable pay	6.4	8.0
Other benefits (A)	3.9	3.1
	58.6	57.9

(A) Other benefits include provident funds, medical and life insurance, and annual leave accrued during the year. There are no other allowances or benefits-in-kind.

(c) Interest expense

	2002	2001
Interest on placements by other HKSAR government funds:		
With interest at market-based rates	228	588
With interest at rates determined by reference to the investment income of the Fund	15,648	1,572
Other interest expense	5,293	8,679
TOTAL	21,169	10,839

Exchange Fund - Notes on the Accounts (cont.)

4. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	2002	2001
Placements with banks and other financial institutions in respect of resale agreements	4,910	42,844
Other placements with banks and other financial institutions	30,565	42,559
TOTAL	35,475	85,403

5. INVESTMENT SECURITIES

Investment securities comprise 3,000 unlisted shares of the Bank for International Settlements with a nominal value of 2,500 Swiss gold francs each (25% paid).

6. OTHER INVESTMENTS IN SECURITIES

Other investments in securities comprise debt securities and equity securities:

At fair value	2002	2001
Debt securities		
Treasury bills and commercial papers		
Listed outside Hong Kong	15,724	254
Unlisted	194,800	84,354
Certificates of deposit		
Unlisted	22,744	25,182
Other debt securities		
Listed		
In Hong Kong	4,540	6,291
Outside Hong Kong	436,103	496,417
Unlisted	90,907	120,214
Total debt securities	764,818	732,712
Equity securities		
Listed		
In Hong Kong (a)	50,891	85,864
Outside Hong Kong	63,129	35,322
Total equity securities	114,020	121,186
TOTAL	878,838	853,898

Exchange Fund - Notes on the Accounts (cont.)

(a) Equity securities listed in Hong Kong

The investment benchmark of the Fund allocates 5% of its assets to the Hong Kong equity market as a long-term investment. The disposal of the Hong Kong equity portfolio, other than the long-term investment portfolio, was conducted in an orderly manner with minimum disruption to the market. In November 1999, a disposal programme was implemented through the launching of The Tracker Fund of Hong Kong ("TraHK"), a collective investment fund designed to provide investment results that closely correspond to the performance of the Hang Seng Index. Proceeds from TraHK's initial offer were used to buy shares from the Fund. Further disposals were made through the Tap Facility which was a means for the Fund to continue passively selling more shares into TraHK in response to investor demand. Under the Tap Facility, TraHK units could be created for cash which was used to purchase Hong Kong equity shares from the Fund. In 2002, disposal of Hong Kong equity portfolio through the Tap Facility amounted to HK\$22.0 billion (2001 - HK\$35.2 billion). The disposal programme was terminated in late 2002. All the remaining Hong Kong stocks held in the disposal portfolio of the Fund were retained as part of its long-term investment portfolio.

7. GOLD

	2002	2001
Gold, at market value		
66,916 ounces (2001 - 66,916 ounces)	179	145

8. THAILAND FINANCING PACKAGE

On 21 September 1997, the HKMA participated in a financing package organised for Thailand by the International Monetary Fund ("IMF"). The financing package is in the form of a Currency Swap Agreement ("the Agreement") between the Bank of Thailand ("BOT") and a number of Asian central banks and multinational institutions, including the HKMA and the IMF. Under the Agreement, the HKMA entered into swap transactions to exchange US dollars for Thai Baht up to a maximum of US\$1 billion for a maximum period of five years. At the end of the agreed period for each swap transaction, the exchange of currencies will be reversed and the US dollars to be received by the HKMA will be equivalent to the original principal swapped plus interest at market rate. The transaction is accounted for as a US dollar loan to reflect its economic substance. Since the first drawdown made in October 1997, the HKMA has released a total of US\$862 million under the Agreement. In October 1999, the BOT gave notice that it would not draw down on the remaining US\$138 million. In April 2001, the BOT started to repay the principal of the loan in instalments in accordance with the terms and conditions of the Agreement. During the year, the BOT had made repayments totalling US\$396 million (2001 - US\$330 million). As at 31 December 2002, the total outstanding principal and accrued interest due from the BOT amounted to US\$136 million (2001 - US\$532 million) and US\$1 million (2001 - US\$4 million) respectively.

Exchange Fund - Notes on the Accounts (cont.)

9. OTHER ASSETS

	2002	2001
Staff housing loans	331	334
Revaluation gains on off-balance sheet items which are marked to market	6,798	3,347
Revaluation difference on Certificates of Indebtedness, government-issued currency notes and coins in circulation	26	30
Prepayments and receivables	12,523	14,823
TOTAL	19,678	18,534

10. INVESTMENTS IN SUBSIDIARIES

	2002	2001
Unlisted shares, at cost	2,145	2,145

The following is a list of the subsidiaries as at 31 December 2002 and 2001:

Name of company	Place of incorporation and operation	Principal activities	Issued equity capital	Exchange Fund's interest in equity capital
Hong Kong Note Printing Limited	Hong Kong	Banknotes printing	HK\$255,000,000	55%
The Hong Kong Mortgage Corporation Limited	Hong Kong	Investment in mortgages, mortgage securitisation and guarantee	HK\$2,000,000,000	100%
Exchange Fund Investment Limited	Hong Kong	Investment management	HK\$5,000,000	100%
Hong Kong Institute for Monetary Research	Hong Kong	Research	HK\$2	100%

With effect from January 2003, the management of the Fund's long-term Hong Kong equity portfolio has been transferred to the HKMA from the Exchange Fund Investment Limited, which has become inactive.

Exchange Fund - Notes on the Accounts (cont.)

Net aggregate amounts attributable to the Fund of profits less losses of the subsidiaries that are not dealt with in these accounts are as follows:

	2002	2001
For the current financial year:		
Hong Kong Note Printing Limited	33.5	25.1
The Hong Kong Mortgage Corporation Limited	260.2	255.5
Exchange Fund Investment Limited	-	-
Hong Kong Institute for Monetary Research	(0.2)	(0.5)
	293.5	280.1
For the previous financial years since acquisition:		
Hong Kong Note Printing Limited	202.5	177.4
The Hong Kong Mortgage Corporation Limited	846.0	590.5
Exchange Fund Investment Limited	-	-
Hong Kong Institute for Monetary Research	(1.5)	(1.0)
	1,047.0	766.9

Net aggregate amounts due from/(to) the subsidiaries are as follows:

	2002	2001
Hong Kong Note Printing Limited	0.3	0.7
The Hong Kong Mortgage Corporation Limited	0.3	0.3
Exchange Fund Investment Limited	(12.6)	(13.0)
Hong Kong Institute for Monetary Research	1.9	1.8
	(10.1)	(10.2)

The Hong Kong Mortgage Corporation Limited has unissued authorised share capital of HK\$1 billion (2001 - HK\$1 billion) which is callable from the Fund.

Exchange Fund - Notes on the Accounts (cont.)

11. INVESTMENT IN ASSOCIATE

Name of company	Place of incorporation and operation	Principal activities	Issued equity capital	Exchange Fund's interest in equity capital
Hong Kong Interbank Clearing Limited	Hong Kong	Interbank clearing	HK\$10,000	50%

The breakdown of the investment in associate is:

	2002	2001
Unlisted shares, at cost (HK\$5,000)	-	-
Loan to associate	-	7
TOTAL	-	7

The loan to Hong Kong Interbank Clearing Limited was unsecured and bore a fixed rate of interest at 1% over 3-month HIBOR per annum, repayable by 16 quarterly instalments starting from January 1999. The loan was fully repaid in 2002.

12. FIXED ASSETS

	Premises	Other Fixed Assets	Total
Cost			
At 1 January 2002	565	423	988
Additions	746	25	771
Disposals	-	(5)	(5)
At 31 December 2002	1,311	443	1,754
Accumulated depreciation			
At 1 January 2002	1	270	271
Charge for the year	-	52	52
Written back on disposal	-	(5)	(5)
At 31 December 2002	1	317	318
Net book value at 31 December 2002	1,310	126	1,436
Net book value at 31 December 2001	564	153	717

Additions include the deposit and partial payment for the purchase of new office premises in Hong Kong amounting to HK\$746 million (2001 - HK\$558 million). As the new office premises were under construction, no depreciation charges were made in 2002.

Exchange Fund - Notes on the Accounts (cont.)

13. TOTAL ASSETS

	2002	2001
Foreign currency assets	891,632	877,427
Hong Kong dollar assets	63,433	101,719
TOTAL	955,065	979,146

The Fund holds Hong Kong dollar and foreign currency assets. A large proportion of the Fund's foreign currency assets is held in US dollars. Apart from the US dollar assets, the Fund also holds assets denominated in fully convertible foreign currencies.

Total foreign currency assets and unsettled spot and forward foreign exchange transactions are as follows:

	2002	2001
Foreign currency assets excluding unsettled spot and forward transactions	891,632	877,427
Net unsettled spot and forward transactions	-	-
TOTAL	891,632	877,427
US\$ million equivalent	114,335	112,521

The Fund's assets are held in deposit, trustee and safe-keeping accounts with banks, central banks and custodial organisations situated in Hong Kong and other major financial centres.

14. CERTIFICATES OF INDEBTEDNESS, GOVERNMENT-ISSUED CURRENCY NOTES AND COINS IN CIRCULATION

As backing for the banknote issues, each note-issuing bank is required to hold a non-interest bearing Certificate of Indebtedness issued by the Financial Secretary. Payments for the issuance and redemption of notes against these Certificates are made in US dollars at a fixed rate of US\$1=HK\$7.80. Consistent with the requirement for backing banknote issuance with US dollars, the issuance and the withdrawal of government-issued currency notes and coins are conducted against US dollars at a fixed rate of US\$1=HK\$7.80.

Exchange Fund - Notes on the Accounts (cont.)

15. BALANCE OF THE BANKING SYSTEM

Under the interbank payment system based on Real Time Gross Settlement principles, all licensed banks maintain a Hong Kong dollar clearing account with the HKMA for the account of the Fund. The aggregate balance in these accounts represents the total level of liquidity in the interbank market. Under the Convertibility Undertaking, the HKMA undertakes to convert Hong Kong dollars in the clearing accounts maintained by licensed banks with the HKMA into US dollars at the fixed exchange rate of US\$1=HK\$7.80.

16. EXCHANGE FUND BILLS AND NOTES

	2002	2001
Exchange Fund Bills	72,152	74,608
Exchange Fund Notes	50,773	43,549
TOTAL	122,925	118,157

Exchange Fund Bills are issued by the Fund for maturities not exceeding one year. Exchange Fund Notes are issued by the Fund with 2-year, 3-year, 5-year, 7-year and 10-year maturities.

17. PLACEMENTS BY BANKS AND OTHER FINANCIAL INSTITUTIONS

	2002	2001
Placements by banks and other financial institutions in respect of repurchase agreements	34,719	42,022
Other placements by banks and other financial institutions	1,551	5,100
TOTAL	36,270	47,122

Exchange Fund - Notes on the Accounts (cont.)

18. PLACEMENTS BY OTHER HKSAR GOVERNMENT FUNDS

The breakdown of placements by other HKSAR government funds is:

	2002	2001
Placements with interest payable at market-based rates		
General Revenue Account	1,007	750
Capital Investment Fund	3,305	3,753
Loan Fund	5,937	8,419
Capital Works Reserve Fund	263	546
Innovation and Technology Fund	93	148
	10,605	13,616
Placements with interest payable at rates determined by reference to the investment income of the Fund		
General Revenue Account	22,747	85,666
Land Fund	247,334	247,227
Capital Works Reserve Fund	4,766	17,675
Civil Service Pension Reserve Fund	11,746	11,741
Disaster Relief Fund	35	31
Innovation and Technology Fund	4,436	4,646
	291,064	366,986
TOTAL	301,669	380,602

Placements by other HKSAR government funds are not permanently appropriated for the use of the Fund, but are principally repayable on demand when they are required to meet the obligations of the fiscal reserves.

19. OTHER LIABILITIES

	2002	2001
Interest payable on placements by other HKSAR government funds at rates determined by reference to the investment income of the Fund	17,109	1,572
Revaluation losses on off-balance sheet items which are marked to market	1,962	1,873
Accrued interest and other liabilities	18,786	8,200
TOTAL	37,857	11,645

Exchange Fund - Notes on the Accounts (cont.)

20. MATURITY PROFILE

	2002						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets							
Cash and money at call	15,956	-	-	-	-	-	15,956
Placements with banks and other financial institutions	-	35,475	-	-	-	-	35,475
Investment securities	-	-	-	-	-	300	300
Other investments in securities	-	193,412	133,557	245,624	192,225	114,020	878,838
Gold	-	-	-	-	-	179	179
Thailand financing package	-	366	421	271	-	-	1,058
	15,956	229,253	133,978	245,895	192,225	114,499	931,806
Liabilities							
Certificates of Indebtedness	118,475	-	-	-	-	-	118,475
Government-issued currency notes and coins in circulation	5,891	-	-	-	-	-	5,891
Balance of the banking system	525	-	-	-	-	-	525
Exchange Fund Bills and Notes	-	51,116	32,038	32,221	7,550	-	122,925
Placements by banks and other financial institutions	-	33,870	2,400	-	-	-	36,270
Placements by other HKSAR government funds	292,921	8,166	582	-	-	-	301,669
Placements by Hong Kong statutory bodies	3,269	1,010	-	-	-	-	4,279
	421,081	94,162	35,020	32,221	7,550	-	590,034

Exchange Fund - Notes on the Accounts (cont.)

	2001						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	
Assets							
Cash and money at call	13,848	-	-	-	-	-	13,848
Placements with banks and other financial institutions	-	85,403	-	-	-	-	85,403
Investment securities	-	-	-	-	-	300	300
Other investments in securities	-	117,321	94,577	292,756	228,058	121,186	853,898
Gold	-	-	-	-	-	145	145
Thailand financing package	-	230	2,860	1,059	-	-	4,149
	13,848	202,954	97,437	293,815	228,058	121,631	957,743
Liabilities							
Certificates of Indebtedness	107,545	-	-	-	-	-	107,545
Government-issued currency notes and coins in circulation	5,691	-	-	-	-	-	5,691
Balance of the banking system	671	-	-	-	-	-	671
Exchange Fund Bills and Notes	-	51,955	30,647	27,644	7,911	-	118,157
Placements by banks and other financial institutions	-	47,122	-	-	-	-	47,122
Placements by other HKSAR government funds	368,784	4,869	6,949	-	-	-	380,602
Placements by Hong Kong statutory bodies	82	2,152	2,890	-	-	-	5,124
	482,773	106,098	40,486	27,644	7,911	-	664,912

Exchange Fund - Notes on the Accounts (cont.)

21. NOTES TO THE CASH FLOW STATEMENT

(a) Reconciliation of surplus/(deficit) for the year to net cash from operating activities

	2002	2001
Surplus/(Deficit) for the year	24,585	(4,510)
Interest income	(33,270)	(39,909)
Interest expense	21,169	10,839
Dividend income	(3,237)	(3,668)
Amortisation of premiums and discounts on Exchange Fund Bills and Notes	1,339	3,031
Depreciation	52	64
Change in placements with banks and other financial institutions	-	889
Change in other investments in securities	25,066	66,913
Change in gold	(34)	(3)
Change in Thailand financing package	3,091	2,575
Change in other assets	(3,502)	(1,077)
Change in Certificates of Indebtedness, government-issued currency notes and coins in circulation	11,130	8,053
Change in balance of the banking system	(146)	2
Change in Exchange Fund Bills and Notes	3,429	5,838
Change in placements by banks and other financial institutions	(10,852)	11,733
Change in placements by other HKSAR government funds	(78,933)	(36,560)
Change in placements by Hong Kong statutory bodies	(845)	(4,536)
Change in other liabilities	10,801	(5,751)
Elimination of exchange differences	(835)	298
Interest received	35,669	39,554
Interest paid	(5,760)	(32,018)
Dividend received	3,198	3,675
Net cash from operating activities	2,115	25,432

(b) Analysis of the balances of cash and cash equivalents

	2002	2001
Cash and money at call	15,956	13,848
Treasury bills and commercial papers	62,555	18,512
Certificates of deposit	6,353	390
Placements with banks and other financial institutions	35,475	85,403
TOTAL	120,339	118,153

Exchange Fund - Notes on the Accounts (cont.)

22. SEGMENT REPORTING

The business activities of the Fund managed by the HKMA comprise:

- Management of funds under the Currency Board Account (a)
- Management of funds representing the general reserve assets of the Fund
- Banking supervision
- Monetary management

As the assets, revenue and overall results of the latter two activities are not significant, they are presented as part of the assets, revenue and results of management of funds representing the general reserve assets of the Fund.

	Currency Board Account		Reserve Management and Other Activities		Re-allocation (c)		Total of the Fund	
	2002	2001	2002	2001	2002	2001	2002	2001
Income	6,888	11,825	40,301	(4,282)	-	-	47,189	7,543
Expenditure								
Interest expense	3,985	5,631	17,184	5,208	-	-	21,169	10,839
Other expenses (b)	-	-	1,435	1,214	-	-	1,435	1,214
	3,985	5,631	18,619	6,422	-	-	22,604	12,053
Surplus/(Deficit) for the year	2,903	6,194	21,682	(10,704)	-	-	24,585	(4,510)

Exchange Fund - Notes on the Accounts (cont.)

	Currency Board Account		Reserve Management and Other Activities		Re-allocation (c)		Total of the Fund	
	2002	2001	2002	2001	2002	2001	2002	2001
Assets								
Backing Assets								
Investment in designated US dollar assets	283,936	254,200	-	-	-	-	283,936	254,200
Interest receivable on designated US dollar assets	922	2,370	-	-	-	-	922	2,370
Net accounts payable	(9,067)	- (c) (i)	-	-	9,067	-	-	-
Other investments	-	- (c) (ii)	648,957	701,171	-	375	648,957	701,546
Other assets	-	- (c)(iii)	18,931	18,445	2,319	2,585	21,250	21,030
TOTAL ASSETS	275,791	256,570 (A)	667,888	719,616	11,386	2,960	955,065	979,146
Liabilities								
Monetary Base								
Certificates of Indebtedness	118,475	107,545	-	-	-	-	118,475	107,545
Government-issued currency notes and coins in circulation	5,891	5,691	-	-	-	-	5,891	5,691
Balance of the banking system	525	671	-	-	-	-	525	671
Exchange Fund Bills and Notes	122,925	118,157	-	-	-	-	122,925	118,157
Interest payable on Exchange Fund Notes	609	624	-	-	-	-	609	624
Net accounts receivable	(2,319)	(2,947) (c)(ii) (iii)	-	-	2,319	2,960	-	13
Placements by banks and other financial institutions	-	-	36,270	47,122	-	-	36,270	47,122
Placements by other HK SAR government funds	-	-	301,669	380,602	-	-	301,669	380,602
Placements by Hong Kong statutory bodies	-	-	4,279	5,124	-	-	4,279	5,124
Other liabilities	-	- (c) (i)	28,181	11,008	9,067	-	37,248	11,008
	246,106	229,741 (B)	370,399	443,856	11,386	2,960	627,891	676,557
Accumulated surplus								
Balance brought forward	26,829	26,218	275,760	280,881	-	-	302,589	307,099
Surplus/(Deficit) for the year	2,903	6,194	21,682	(10,704)	-	-	24,585	(4,510)
Transfer from Currency Board Account to general reserves (d)	(47)	(5,583)	47	5,583	-	-	-	-
	29,685	26,829	297,489	275,760	-	-	327,174	302,589
TOTAL LIABILITIES AND FUND EQUITY	275,791	256,570	667,888	719,616	11,386	2,960	955,065	979,146
Backing Ratio[(A)/(B)]x100%	112.06%	111.68%						

Exchange Fund - Notes on the Accounts (cont.)

- (a) Starting from 1 October 1998, specific US dollar assets of the Fund have been designated to back the Monetary Base, which comprises Certificates of Indebtedness, government-issued currency notes and coins in circulation, the balance of the banking system and Exchange Fund Bills and Notes. While specific assets of the Fund have been earmarked for backing the monetary base, all the Fund assets have continued to be available for the purpose of supporting the Hong Kong dollar exchange rate under the Linked Exchange Rate system.
- (b) Other expenses have not been allocated to the Currency Board Account as the amounts involved are not material.
- (c) For the purposes of the Currency Board Account, certain assets and liabilities of the Fund's accounts need to be included in the Monetary Base and Backing Assets respectively but as negative amounts. Such presentation is necessary to allow proper computation of the backing ratio. As at 31 December 2002, these negative amounts comprised:
- (i) "Other liabilities", HK\$9,067 million (2001 - Nil) representing accounts payable included in the Backing Assets to offset the corresponding investments purchased but not yet settled;
 - (ii) "Other investments", Nil (2001 - HK\$375 million) representing advances to banks secured on Exchange Fund Bills and Notes included in the Monetary Base to offset the corresponding Exchange Fund Bills and Notes; and
 - (iii) "Other assets" of HK\$2,319 million (2001 - HK\$2,585 million) included in the Monetary Base, which consisted of three components:
 - HK\$2,110 million (2001 - HK\$2,580 million) representing accounts receivable to offset the corresponding Exchange Fund Bills and Notes issued on tender date but not yet settled;
 - HK\$5 million (2001 - HK\$1 million) representing interests receivable on Hong Kong dollar interest rate swaps used as a means to manage the cost of issuing Exchange Fund Notes; and
 - HK\$204 million (2001 - HK\$4 million) representing receivables pertaining to revaluation gains on Hong Kong dollar interest rate swaps used as a means to manage the cost of issuing Exchange Fund Notes.
- (d) In accordance with an arrangement approved by the Financial Secretary in January 2000, assets can be transferred between the backing and general reserve portfolios when the backing ratio reaches either the upper trigger point (112.5%) or the lower trigger point (105%). This arrangement allows transfer of excess assets out of the backing portfolio to maximise their earning potential while ensuring that there are sufficient liquid assets in the backing portfolio.

Exchange Fund - Notes on the Accounts (cont.)

23. COMMITMENTS**(a) Capital commitments**

Capital expenditure authorised but not provided for in these accounts amounted to:

	2002	2001
Contracted	2,455	3,198
Not contracted	183	715
TOTAL	2,638	3,913

(b) Loan to the International Monetary Fund

On 27 January 1997, the HKMA participated in the New Arrangements to Borrow ("NAB"), a standby credit facility to the IMF for coping with instability in the international monetary system. In respect of this, the HKMA undertakes to lend foreign currencies to the IMF up to HK\$3,605 million equivalent as at 31 December 2002 (2001 - HK\$3,332 million equivalent), in the form of a term loan of five year maturity bearing prevailing market interest rates. As at 31 December 2002, there was no outstanding balance due from the IMF under the NAB (2001 - Nil).

(c) Lease commitments

Total future minimum lease payments under non-cancellable operating leases at the balance sheet date are analysed as follows:

	2002	2001
Premises		
Not later than one year	56	89
Later than one year and not later than five years	19	108
Later than five years	-	-
TOTAL	75	197

Exchange Fund - Notes on the Accounts (cont.)

24. OFF-BALANCE SHEET ITEMS

	2002	2001
Spot and forward foreign exchange contracts		
Outstanding contract amount	115,761	115,737
Gross replacement costs	2,199	874
Interest rate swap contracts		
Notional principal	27,997	29,496
Gross replacement costs	4,638	2,708
Stock index futures contracts		
Notional principal	38,209	28,666
Gross replacement costs	56	189
Bond futures contracts		
Notional principal	494	176
Gross replacement costs	3	-

25. CONTINGENT LIABILITIES

The Fund has a contingent liability up to 5.6 million Swiss gold francs or HK\$140.3 million equivalent as at 31 December 2002 (2001 - 5.6 million Swiss gold francs or HK\$113.2 million equivalent), in respect of the uncalled portion of its 3,000 shares held in the Bank for International Settlements.

26. MATERIAL RELATED PARTY TRANSACTIONS

The Fund takes placements from other HKSAR government funds and a number of Hong Kong statutory bodies, as shown on the balance sheet. During the year, interest expenses on placements from other HKSAR government funds and Hong Kong statutory bodies amounted to HK\$15,876 million (2001 - HK\$2,160 million) and HK\$77 million (2001 - HK\$271 million) respectively.

Transactions with related parties are conducted at rates determined by the Monetary Authority taking into account the nature of each transaction on a case-by-case basis.

27. COMPARATIVE FIGURES

The presentation and classification of items in the financial statements have been changed in the following aspects:

- (a) a statement of changes in equity is presented as a separate component of the financial statements in order to comply with SSAP1 (revised) "Presentation of financial statements"; and
- (b) the presentation and classification of items in the cash flow statement have been revised to follow the new requirements of SSAP15 (revised) "Cash flow statements".

Comparative figures have been reclassified to conform with the current year's presentation.

28. APPROVAL OF ACCOUNTS

The accounts were approved by the Exchange Fund Advisory Committee on 27 March 2003.