

# 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 94 to 125 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 and the Group'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 and of the Group as at 31 December 2004 and of their 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  
31 March 2005

**(Benjamin Tang)**  
Director of Audit

## EXCHANGE FUND – INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 December 2004

| (Expressed in millions of Hong Kong dollars)                             | Notes | Group           |          | Fund            |          |
|--|-------|-----------------|----------|-----------------|----------|
|  |       | 2004            | 2003     | 2004            | 2003     |
| <b>INCOME</b>  |       |                 |          |                 |          |
| Interest income  |       |                 |          |                 |          |
| Interest income on debt securities                                       |       | <b>21,534</b>   | 23,253   | <b>21,380</b>   | 23,103   |
| Other interest income  |       | <b>3,064</b>    | 3,271    | <b>2,194</b>    | 2,410    |
| Total interest income  |       | <b>24,598</b>   | 26,524   | <b>23,574</b>   | 25,513   |
| Dividend income from listed equity securities                            |       | <b>4,556</b>    | 3,751    | <b>4,556</b>    | 3,751    |
| Dividend income from subsidiaries  |       | -               | -        | <b>17</b>       | 140      |
| Net realised and revaluation gains<br>on other investments in securities |       | <b>19,538</b>   | 29,384   | <b>19,538</b>   | 29,384   |
| Other net realised and revaluation gains                                 |       | <b>582</b>      | 7,977    | <b>582</b>      | 7,960    |
| Net exchange gains   |       | <b>8,469</b>    | 22,886   | <b>8,474</b>    | 22,900   |
| Bank licence fees  |       | <b>129</b>      | 130      | <b>129</b>      | 130      |
| Others   |       | <b>353</b>      | 238      | <b>70</b>       | 49       |
| <b>TOTAL INCOME</b>  |       | <b>58,225</b>   | 90,890   | <b>56,940</b>   | 89,827   |
| <b>EXPENDITURE</b>   |       |                 |          |                 |          |
| Interest expense   | 3(a)  | <b>(18,066)</b> | (30,233) | <b>(17,856)</b> | (29,847) |
| Operating expenses   | 3(b)  | <b>(1,523)</b>  | (1,508)  | <b>(1,251)</b>  | (1,179)  |
| Note and coin expenses   | 3(c)  | <b>(182)</b>    | (229)    | <b>(182)</b>    | (229)    |
| <b>TOTAL EXPENDITURE</b>   |       | <b>(19,771)</b> | (31,970) | <b>(19,289)</b> | (31,255) |
| <b>SURPLUS BEFORE PREMISES</b>   |       |                 |          |                 |          |
| <b>REVALUATION AND ASSOCIATE</b>   |       |                 |          |                 |          |
| Surplus/(Deficit) on revaluation of premises                             | 12(c) | <b>876</b>      | (876)    | <b>876</b>      | (876)    |
| Share of profit of associate   |       | <b>4</b>        | 10       | -               | -        |
| <b>SURPLUS BEFORE TAXATION</b>   |       | <b>39,334</b>   | 58,054   | <b>38,527</b>   | 57,696   |
| Taxation of subsidiaries and share of<br>taxation of associate           |       | <b>(110)</b>    | (58)     | -               | -        |
| <b>SURPLUS AFTER TAXATION</b>  |       | <b>39,224</b>   | 57,996   | <b>38,527</b>   | 57,696   |
| Minority interests   |       | <b>(21)</b>     | (24)     | -               | -        |
| <b>SURPLUS FOR THE YEAR</b>  |       | <b>39,203</b>   | 57,972   | <b>38,527</b>   | 57,696   |

The notes on pages 98 to 125 form part of these accounts.

## EXCHANGE FUND – BALANCE SHEET

as at 31 December 2004

| (Expressed in millions of Hong Kong dollars)                                 | Notes | Group            |           | Fund             |           |
|--|-------|------------------|-----------|------------------|-----------|
|  |       | 2004             | 2003      | 2004             | 2003      |
| <b>ASSETS</b>  |       |                  |           |                  |           |
| Cash and money at call   |       | <b>20,759</b>    | 19,168    | <b>20,738</b>    | 19,143    |
| Placements with banks and other financial institutions                       | 4     | <b>48,178</b>    | 43,823    | <b>42,747</b>    | 41,549    |
| Investment securities  | 5     | <b>300</b>       | 300       | <b>300</b>       | 300       |
| Other investments in securities  | 6     | <b>977,746</b>   | 931,737   | <b>977,746</b>   | 931,737   |
| Held-to-maturity securities  | 7     | <b>4,130</b>     | 3,574     | -                | -         |
| Mortgage loans   |       | <b>34,938</b>    | 34,582    | -                | -         |
| Gold   | 8     | <b>228</b>       | 217       | <b>228</b>       | 217       |
| Other assets   | 9     | <b>14,510</b>    | 14,095    | <b>13,914</b>    | 13,503    |
| Investments in subsidiaries  | 10    | -                | -         | <b>2,145</b>     | 2,145     |
| Investment in associate  | 11    | <b>23</b>        | 20        | -                | -         |
| Fixed assets   | 12    | <b>4,286</b>     | 3,309     | <b>4,036</b>     | 3,051     |
| <b>TOTAL ASSETS</b>  | 13    | <b>1,105,098</b> | 1,050,825 | <b>1,061,854</b> | 1,011,645 |
| <b>LIABILITIES AND EQUITY</b>  |       |                  |           |                  |           |
| Certificates of Indebtedness   | 14    | <b>146,775</b>   | 134,215   | <b>146,775</b>   | 134,215   |
| Government-issued currency notes and coins in circulation                    | 14    | <b>6,351</b>     | 6,297     | <b>6,351</b>     | 6,297     |
| Balance of the banking system  | 15    | <b>15,789</b>    | 28,277    | <b>15,789</b>    | 28,277    |
| Exchange Fund Bills and Notes  | 16    | <b>125,860</b>   | 123,520   | <b>125,860</b>   | 123,520   |
| Other debt securities  | 17    | <b>35,495</b>    | 36,620    | -                | -         |
| Placements by banks and other financial institutions                         | 18    | <b>39,087</b>    | 44,542    | <b>39,087</b>    | 44,542    |
| Placements by other Hong Kong Special Administrative Region government funds | 19    | <b>280,091</b>   | 252,296   | <b>280,091</b>   | 252,296   |
| Placements by Hong Kong statutory bodies                                     |       | -                | 164       | -                | 164       |
| Other liabilities  | 20    | <b>29,645</b>    | 38,284    | <b>24,310</b>    | 37,455    |
| Total liabilities  |       | <b>679,093</b>   | 664,215   | <b>638,263</b>   | 626,766   |
| Minority interests   |       | <b>167</b>       | 160       | -                | -         |
| Accumulated surplus  | 21    | <b>425,644</b>   | 386,441   | <b>423,397</b>   | 384,870   |
| Premises revaluation reserve   | 21    | <b>194</b>       | 9         | <b>194</b>       | 9         |
| Total equity   |       | <b>425,838</b>   | 386,450   | <b>423,591</b>   | 384,879   |
| <b>TOTAL LIABILITIES AND EQUITY</b>  |       | <b>1,105,098</b> | 1,050,825 | <b>1,061,854</b> | 1,011,645 |

**Joseph Yam**

Monetary Authority

31 March 2005

The notes on pages 98 to 125 form part of these accounts.

**EXCHANGE FUND – STATEMENT OF CHANGES IN EQUITY**

for the year ended 31 December 2004

| (Expressed in millions of Hong Kong dollars) | Notes | Group          |         | Fund           |         |
|--|-------|----------------|---------|----------------|---------|
|  |       | 2004           | 2003    | 2004           | 2003    |
| <b>Total equity at 1 January</b>             |       | <b>386,450</b> | 328,469 | <b>384,879</b> | 327,174 |
| <b>Surplus for the year</b>                  |       | <b>39,203</b>  | 57,972  | <b>38,527</b>  | 57,696  |
| <b>Surplus on revaluation of premises</b>    | 12(c) | <b>185</b>     | 9       | <b>185</b>     | 9       |
| <b>Total equity at 31 December</b>           | 21    | <b>425,838</b> | 386,450 | <b>423,591</b> | 384,879 |

## EXCHANGE FUND – CASH FLOW STATEMENT

for the year ended 31 December 2004

| (Expressed in millions of Hong Kong dollars)                    | Notes | Group           |         | Fund           |         |
|---|-------|-----------------|---------|----------------|---------|
|   |       | 2004            | 2003    | 2004           | 2003    |
| <b>Net cash from/(used in) operating activities</b>             | 23(a) | <b>(984)</b>    | 54,449  | <b>(5,859)</b> | 60,037  |
| <b>Cash flows from investing activities</b>                     |       |                 |         |                |         |
| Purchase of fixed assets  |       | <b>(52)</b>     | (2,583) | <b>(25)</b>    | (2,544) |
| Dividends received from subsidiaries                            |       | -               | -       | <b>17</b>      | 140     |
| Purchase of held-to-maturity securities                         |       | <b>(1,762)</b>  | (1,561) | -              | -       |
| Proceeds from sale or redemption of held-to-maturity securities |       | <b>1,198</b>    | 1,407   | -              | -       |
| <b>Net cash used in investing activities</b>                    |       | <b>(616)</b>    | (2,737) | <b>(8)</b>     | (2,404) |
| <b>Cash flows from financing activities</b>                     |       |                 |         |                |         |
| Proceeds from issue of other debt securities                    |       | <b>11,408</b>   | 10,870  | -              | -       |
| Redemption of other debt securities                             |       | <b>(12,524)</b> | (2,870) | -              | -       |
| Dividends paid to minority shareholders                         |       | <b>(13)</b>     | (114)   | -              | -       |
| <b>Net cash from/(used in) financing activities</b>             |       | <b>(1,129)</b>  | 7,886   | -              | -       |
| <b>Net increase/(decrease) in cash and cash equivalents</b>     |       | <b>(2,729)</b>  | 59,598  | <b>(5,867)</b> | 57,633  |
| <b>Cash and cash equivalents at 1 January</b>                   |       | <b>180,469</b>  | 120,676 | <b>178,170</b> | 120,339 |
| <b>Effect of foreign exchange rate changes</b>                  |       | <b>1,112</b>    | 195     | <b>1,117</b>   | 198     |
| <b>Cash and cash equivalents at 31 December</b>                 | 23(b) | <b>178,852</b>  | 180,469 | <b>173,420</b> | 178,170 |

The notes on pages 98 to 125 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

These accounts have been prepared using the fair value measurement basis, as modified by the use of historical cost for investment securities, held-to-maturity securities, other assets, investments in subsidiaries and associate, fixed assets other than premises, 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 Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. Fair value of a financial instrument represents its market price where there is a published price quotation in an active securities market. Where such a market price is not available, fair value of a financial instrument represents its valuation according to a price matrix of discounted cash flows using applicable interest rates for discounting.

#### (b) Basis of consolidation

The consolidated accounts of the Group comprise the accounts of the Fund and all its subsidiaries, and also incorporate the Group's interests in an associate on the basis set out in Note 2(c)(iii). All significant intra-group balances and transactions have been eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the operating results and net assets of a subsidiary.

#### (c) 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 Group is bound by the contract which gives rise to them. They are classified as investment securities, held-to-maturity 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. They are carried at cost less provision for any diminution in value which is other than temporary.

##### Held-to-maturity securities

Held-to-maturity securities are securities which the Group has the expressed intention and ability to hold to maturity. They are carried at amortised cost less provision for any diminution in value.

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Other investments in securities

Other investments in securities are those which are not classified as investment securities and held-to-maturity securities. They 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.

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

Investments in subsidiaries are stated in the Fund’s balance sheet at cost less provision for any diminution in value which is other than temporary.

(iii) Investment in associate

Investment in an associate is stated in the Fund’s balance sheet at cost less provision for any diminution in value which is other than temporary.

In the Group’s consolidated balance sheet, the investment in the associate is stated at the Group’s share of its net assets. The Group’s consolidated income and expenditure account includes the Group’s share of the results of the associate for the year.

### (d) 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)”.

### (e) Mortgage loans

Mortgage loans are purchased by The Hong Kong Mortgage Corporation Limited (HKMC), a subsidiary of the Fund, from approved sellers.

### (f) 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 carried at market value. Revaluation gains and losses are included in the income and expenditure account in “Other net realised and revaluation gains/(losses)”.

“Revaluation gains or losses” is the difference between the market value at the end of the year and the market value at the beginning of the year as adjusted for the amortisation of premium or discount for the year. For Bills and Notes issued during the year, “Revaluation gains or losses” is the difference between the market value at the end of the year and the issue price as adjusted for the amortisation of premium or discount for the year.

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.



## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

### (g) Other debt securities

Other debt securities are issued by the HKMC for financing the purchase of mortgage loans. Premiums and discounts on issuance of other debt securities are amortised over the period from the date of issue to the date of redemption and are included in the Group's consolidated income and expenditure account in "Interest expense".

Other debt securities are stated in the Group's consolidated balance sheet at fair value. Revaluation gains and losses are included in the Group's consolidated income and expenditure account in "Other net realised and revaluation gains/(losses)". "Revaluation gains or losses" is the difference between the fair value at the end of the year and the fair value at the beginning of the year as adjusted for the amortisation of premium or discount for the year. For other debt securities issued during the year, "Revaluation gains or losses" is the difference between the fair value at the end of the year and the issue price as adjusted for the amortisation of premium or discount for the year.

Gains and losses on redemption of other debt securities, being the difference between the redemption amount and the carrying amount, are included in the Group's consolidated income and expenditure account in "Other net realised and revaluation gains/(losses)" in the period in which the redemption takes place.

### (h) 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)".

### (i) 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)".

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

### (j) 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)".

### (k) 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.

### (l) 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 the unsettled amounts of revaluation gains or losses 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)".

### (m) Fixed assets

Premises are stated at valuation less accumulated depreciation, except for freehold land which is not depreciated. Valuations are carried out by independent professionally qualified valuers with sufficient regularity to ensure that the carrying amount does not differ materially from the fair value at the balance sheet date. Surpluses arising on revaluation are credited firstly to the income and expenditure account to the extent of any deficits arising on revaluation previously charged to the income and expenditure account in respect of the same premises, and are thereafter taken to the "Premises revaluation reserve". Deficits arising on revaluation are firstly set off against any previous revaluation surpluses included in the "Premises revaluation reserve" in respect of the same premises, and are thereafter taken to the income and expenditure account. Leasehold land is depreciated on a straight-line basis over the unexpired terms of the leases. Buildings are depreciated on a straight-line basis over their estimated useful lives, or the unexpired terms of the leases, whichever the shorter.

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Other fixed assets, including plant and machinery, furniture, fixtures and equipment, motor vehicles, personal computers and capitalised systems development costs, are stated at cost less accumulated depreciation. These assets are depreciated on a straight-line basis over their respective estimated useful lives of between 2 and 15 years.

Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Group. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

Gain or loss arising from the disposal of a fixed asset is determined as the difference between the net disposal proceeds and the carrying amount of the asset and is recognised in the income and expenditure account. On disposal of premises, any related revaluation surplus included in the "Premises revaluation reserve" is transferred directly to "Accumulated surplus".

### (n) Revenue recognition

Interest income is recognised on an accrual basis.

Dividend income from listed equity securities is recognised when the share price goes ex-dividend. Dividend income from unlisted equity securities is recognised when the shareholder's right to receive payment is established.

Premiums and discounts relating to other investments in 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 Authorized Institutions under the Banking Ordinance and are accounted for in the period when receivable.

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

### (o) 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.

### (p) Related parties

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

### (q) 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.

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

### (r) Staff retirement schemes

The Group operates several defined contribution schemes, including 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 separately from those of the Group.

### (s) 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.

### (t) Segment reporting

The activities of the Fund managed by the Hong Kong Monetary Authority (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, monetary management and the subsidiaries are not significant, their activities 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 24 together with the Currency Board Account segment. There is no disclosure of geographic segments as the Group 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.

### (u) Recently issued accounting standards

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards (new HKFRSs) which are effective for accounting periods beginning on or after 1 January 2005.

The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has commenced an assessment of the impact of these new HKFRSs.

## 3. Expenditure

### (a) Interest expense

|   | Group         |        | Fund          |        |
|---|---------------|--------|---------------|--------|
|   | 2004          | 2003   | 2004          | 2003   |
| Interest on placements by other HKSAR government funds                              |               |        |               |        |
| With interest at market-based rates   | 25            | 92     | 25            | 92     |
| With interest at rates determined by reference to the investment income of the Fund | 14,533        | 25,700 | 14,533        | 25,700 |
| Other interest expense  | 3,508         | 4,441  | 3,298         | 4,055  |
| <b>TOTAL</b>  | <b>18,066</b> | 30,233 | <b>17,856</b> | 29,847 |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## (b) Operating expenses

|  | Group        |              | Fund         |              |
|--|--------------|--------------|--------------|--------------|
|  | 2004         | 2003         | 2004         | 2003         |
| Staff costs                                      |              |              |              |              |
| Salaries and other staff costs                   | 523          | 536          | 421          | 437          |
| Retirement benefit costs                         | 31           | 30           | 25           | 25           |
| Premises and equipment expenses                  |              |              |              |              |
| Depreciation charges                             | 135          | 94           | 100          | 62           |
| Operating lease charges                          | 18           | 66           | 10           | 55           |
| Other premises expenses                          | 39           | 36           | 33           | 28           |
| General operating costs                          |              |              |              |              |
| Maintenance of office and computer equipment     | 35           | 26           | 30           | 20           |
| Financial information and communication services | 31           | 30           | 27           | 26           |
| External relations                               | 15           | 10           | 13           | 9            |
| Professional and other services                  | 43           | 28           | 35           | 22           |
| Training   | 5            | 5            | 4            | 4            |
| Others   | 101          | 168          | 10           | 12           |
| Management and custodian fees                    | 547          | 479          | 543          | 479          |
| <b>TOTAL</b>                                     | <b>1,523</b> | <b>1,508</b> | <b>1,251</b> | <b>1,179</b> |

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

| HK\$                   | 2004      | 2003      |
|------------------------|-----------|-----------|
| 500,000 or below       | -         | 1         |
| 1,000,001 to 1,500,000 | 1         | -         |
| 1,500,001 to 2,000,000 | 1         | 1         |
| 2,000,001 to 2,500,000 | 1         | -         |
| 2,500,001 to 3,000,000 | -         | 1         |
| 3,000,001 to 3,500,000 | 5         | 5         |
| 3,500,001 to 4,000,000 | 2         | 1         |
| 4,000,001 to 4,500,000 | 1         | 2         |
| 5,000,001 to 5,500,000 | 1         | 1         |
| 5,500,001 to 6,000,000 | 1         | 1         |
| 8,500,001 to 9,000,000 | 1         | 1         |
|                        | <b>14</b> | <b>14</b> |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

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

|                | 2004        | 2003 |
|----------------|-------------|------|
| Fixed pay      | 42.9        | 42.8 |
| Variable pay   | 7.5         | 7.4  |
| Other benefits | 3.6         | 2.7  |
|                | <b>54.0</b> | 52.9 |

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

- (c) **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.

### 4. Placements with Banks and other Financial Institutions

|  | Group         |        | Fund          |        |
|--|---------------|--------|---------------|--------|
|  | 2004          | 2003   | 2004          | 2003   |
| Placements with banks and other financial institutions in respect of resale agreements | 4,974         | 4,770  | 4,974         | 4,770  |
| Other placements with banks and other financial institutions                           | 43,204        | 39,053 | 37,773        | 36,779 |
| <b>TOTAL</b>   | <b>48,178</b> | 43,823 | <b>42,747</b> | 41,549 |

### 5. Investment Securities

|                          | Group |      | Fund |      |
|--------------------------|-------|------|------|------|
|                          | 2004  | 2003 | 2004 | 2003 |
| Unlisted shares, at cost | 300   | 300  | 300  | 300  |

Investment securities comprise 3,000 shares of the Bank for International Settlements with a nominal value of 5,000 Special Drawing Rights (SDRs) each (25% paid).

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 6. Other Investments in Securities

| At fair value                               | Group          |                | Fund           |                |
|---|----------------|----------------|----------------|----------------|
|   | 2004           | 2003           | 2004           | 2003           |
| <b>Debt securities</b>                      |                |                |                |                |
| <b>Treasury bills and commercial papers</b> |                |                |                |                |
| Listed outside Hong Kong                    | 3,119          | 744            | 3,119          | 744            |
| Unlisted                                    | 271,847        | 243,509        | 271,847        | 243,509        |
| <b>Certificates of deposit</b>              |                |                |                |                |
| Unlisted                                    | 12,637         | 388            | 12,637         | 388            |
| <b>Other debt securities</b>                |                |                |                |                |
| Listed                                      |                |                |                |                |
| In Hong Kong                                | 1,518          | 2,630          | 1,518          | 2,630          |
| Outside Hong Kong                           | 342,179        | 369,051        | 342,179        | 369,051        |
| Unlisted                                    | 140,816        | 144,744        | 140,816        | 144,744        |
| <b>Total debt securities</b>                | <b>772,116</b> | <b>761,066</b> | <b>772,116</b> | <b>761,066</b> |
| <b>Equity securities</b>                    |                |                |                |                |
| Listed                                      |                |                |                |                |
| In Hong Kong                                | 82,417         | 71,229         | 82,417         | 71,229         |
| Outside Hong Kong                           | 123,213        | 99,442         | 123,213        | 99,442         |
| <b>Total equity securities</b>              | <b>205,630</b> | <b>170,671</b> | <b>205,630</b> | <b>170,671</b> |
| <b>TOTAL</b>                                | <b>977,746</b> | <b>931,737</b> | <b>977,746</b> | <b>931,737</b> |

## 7. Held-to-Maturity Securities

| At amortised cost      | Group        |              | Fund     |          |
|------------------------|--------------|--------------|----------|----------|
|                        | 2004         | 2003         | 2004     | 2003     |
| <b>Debt securities</b> |              |              |          |          |
| Listed                 |              |              |          |          |
| In Hong Kong           | 224          | 77           | -        | -        |
| Outside Hong Kong      | 1,424        | 1,047        | -        | -        |
| Unlisted               | 2,482        | 2,450        | -        | -        |
| <b>TOTAL</b>           | <b>4,130</b> | <b>3,574</b> | <b>-</b> | <b>-</b> |

The market value of the listed held-to-maturity securities was HK\$1,672 million at 31 December 2004 (2003 - HK\$1,148 million).

## 8. Gold

| Gold, at market value                | Group |      | Fund |      |
|--------------------------------------|-------|------|------|------|
|                                      | 2004  | 2003 | 2004 | 2003 |
| 66,798 ounces (2003 - 66,916 ounces) | 228   | 217  | 228  | 217  |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 9. Other Assets

|   | Group         |               | Fund          |               |
|---|---------------|---------------|---------------|---------------|
|   | 2004          | 2003          | 2004          | 2003          |
| Staff housing loans   | 279           | 324           | 279           | 324           |
| Revaluation gains on off-balance sheet items which are marked to market   | 1,358         | 1,471         | 1,358         | 1,471         |
| Revaluation difference on Certificates of Indebtedness, government-issued currency notes and coins in circulation | 536           | 656           | 536           | 656           |
| Prepayments, receivables and other assets   | 12,337        | 11,644        | 11,741        | 11,052        |
| <b>TOTAL</b>  | <b>14,510</b> | <b>14,095</b> | <b>13,914</b> | <b>13,503</b> |

## 10. Investments in Subsidiaries

|                          | Fund  |       |
|--------------------------|-------|-------|
|                          | 2004  | 2003  |
| Unlisted shares, at cost | 2,145 | 2,145 |

The following is a list of the subsidiaries as at 31 December 2004 and 2003:

| 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                            | Dormant  | HK\$5,000,000         | 100%                                       |
| Hong Kong Institute for Monetary Research  | Hong Kong                            | Research   | HK\$2                 | 100%                                       |

(a) All subsidiaries are held directly by the Fund.

(b) HKMC has unissued authorised share capital of HK\$1 billion (2003 - HK\$1 billion) which is callable from the Fund.



## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 11. Investment in Associate

|                          | Group     |           | Fund     |          |
|--------------------------|-----------|-----------|----------|----------|
|                          | 2004      | 2003      | 2004     | 2003     |
| Unlisted shares, at cost | -         | -         | -        | -        |
| Share of net assets      | 23        | 20        | -        | -        |
| <b>TOTAL</b>             | <b>23</b> | <b>20</b> | <b>-</b> | <b>-</b> |

Investment in associate comprises unlisted shares of Hong Kong Interbank Clearing Limited directly held by the Fund at a cost of HK\$5,000 (2003 - HK\$5,000). Details of the associate are as follows:

| 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%  |

## 12. Fixed Assets

(a)

|  | Group        |                    |              |
|--|--------------|--------------------|--------------|
|  | Premises     | Other Fixed Assets | Total        |
| <b>Cost or valuation</b>                                     |              |                    |              |
| At 1 January 2004  | 2,972        | 744                | 3,716        |
| Additions  | -            | 52                 | 52           |
| Elimination of accumulated depreciation on revalued premises | (68)         | -                  | (68)         |
| Surplus on revaluation                                       | 1,061        | -                  | 1,061        |
| Disposals  | (1)          | (15)               | (16)         |
| At 31 December 2004  | <b>3,964</b> | <b>781</b>         | <b>4,745</b> |
| <b>Accumulated depreciation</b>                              |              |                    |              |
| At 1 January 2004  | 1            | 406                | 407          |
| Charge for the year  | 68           | 67                 | 135          |
| Elimination of accumulated depreciation on revalued premises | (68)         | -                  | (68)         |
| Written back on disposal                                     | -            | (15)               | (15)         |
| At 31 December 2004  | <b>1</b>     | <b>458</b>         | <b>459</b>   |
| <b>Net book value</b>  |              |                    |              |
| <b>At 31 December 2004</b>                                   | <b>3,963</b> | <b>323</b>         | <b>4,286</b> |
| At 31 December 2003  | 2,971        | 338                | 3,309        |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

|  | Fund         |                          |              |
|--|--------------|--------------------------|--------------|
|  | Premises     | Other<br>Fixed<br>Assets | Total        |
| <b>Cost or valuation</b>                                     |              |                          |              |
| At 1 January 2004  | 2,963        | 385                      | 3,348        |
| Additions  | -            | 25                       | 25           |
| Elimination of accumulated depreciation on revalued premises | (68)         | -                        | (68)         |
| Surplus on revaluation                                       | 1,061        | -                        | 1,061        |
| Disposals  | (1)          | (1)                      | (2)          |
| At 31 December 2004  | <b>3,955</b> | <b>409</b>               | <b>4,364</b> |
| <b>Accumulated depreciation</b>                              |              |                          |              |
| At 1 January 2004  | -            | 297                      | 297          |
| Charge for the year  | 68           | 32                       | 100          |
| Elimination of accumulated depreciation on revalued premises | (68)         | -                        | (68)         |
| Written back on disposal                                     | -            | (1)                      | (1)          |
| At 31 December 2004  | -            | <b>328</b>               | <b>328</b>   |
| <b>Net book value</b>  |              |                          |              |
| <b>At 31 December 2004</b>                                   | <b>3,955</b> | <b>81</b>                | <b>4,036</b> |
| At 31 December 2003  | 2,963        | 88                       | 3,051        |

(b) The net book value of premises comprises:

|   | Group        |       | Fund         |       |
|---|--------------|-------|--------------|-------|
|   | 2004         | 2003  | 2004         | 2003  |
| Held in Hong Kong                               |              |       |              |       |
| Medium-term leasehold (between 10 and 50 years) | <b>3,928</b> | 2,938 | <b>3,920</b> | 2,930 |
| Held outside Hong Kong                          |              |       |              |       |
| Freehold  | <b>35</b>    | 33    | <b>35</b>    | 33    |
| <b>TOTAL</b>                                    | <b>3,963</b> | 2,971 | <b>3,955</b> | 2,963 |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

- (c) Premises were revalued by qualified valuers who are members of the Hong Kong Institute of Surveyors employed by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 31 December 2004. The premises of the Fund were valued on open market value basis. The value of the premises of Hong Kong Note Printing Limited situated at Tai Po Industrial Estate was determined by reference to the surrender value laid down under the lease agreement with The Hong Kong Science and Technology Parks Corporation. The surplus on revaluation of premises of HK\$1,061 million (2003 - a deficit of HK\$867 million) is analysed as follows:

|  | Group        |              | Fund         |              |
|--|--------------|--------------|--------------|--------------|
|  | 2004         | 2003         | 2004         | 2003         |
| Surplus credited/(Deficit charged) to income and expenditure account | 876          | (876)        | 876          | (876)        |
| Surplus credited to premises revaluation reserve                     | 185          | 9            | 185          | 9            |
| <b>TOTAL</b>   | <b>1,061</b> | <b>(867)</b> | <b>1,061</b> | <b>(867)</b> |

- (d) The net book value of premises would have been as follows had they all been stated at cost less accumulated depreciation:

|                               | Group |       | Fund  |       |
|-------------------------------|-------|-------|-------|-------|
|                               | 2004  | 2003  | 2004  | 2003  |
| Net book value at 31 December | 3,750 | 3,838 | 3,742 | 3,830 |

### 13. Total Assets

|                         | Group            |                  | Fund             |                  |
|-------------------------|------------------|------------------|------------------|------------------|
|                         | 2004             | 2003             | 2004             | 2003             |
| Foreign currency assets | 977,229          | 932,916          | 969,341          | 929,625          |
| Hong Kong dollar assets | 127,869          | 117,909          | 92,513           | 82,020           |
| <b>TOTAL</b>            | <b>1,105,098</b> | <b>1,050,825</b> | <b>1,061,854</b> | <b>1,011,645</b> |

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

The Group'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 the fixed exchange 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 the fixed exchange 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

|                     | Group          |         | Fund           |         |
|---------------------|----------------|---------|----------------|---------|
|                     | 2004           | 2003    | 2004           | 2003    |
| Exchange Fund Bills | <b>68,538</b>  | 68,350  | <b>68,538</b>  | 68,350  |
| Exchange Fund Notes | <b>57,322</b>  | 55,170  | <b>57,322</b>  | 55,170  |
| <b>TOTAL</b>        | <b>125,860</b> | 123,520 | <b>125,860</b> | 123,520 |

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. Other Debt Securities

|                                | Group         |        | Fund |      |
|--------------------------------|---------------|--------|------|------|
|                                | 2004          | 2003   | 2004 | 2003 |
| Notes                          | <b>32,495</b> | 33,120 | -    | -    |
| Transferable loan certificates | <b>3,000</b>  | 3,500  | -    | -    |
| <b>TOTAL</b>                   | <b>35,495</b> | 36,620 | -    | -    |

### 18. Placements by Banks and other Financial Institutions

|   | Group         |        | Fund          |        |
|---|---------------|--------|---------------|--------|
|   | 2004          | 2003   | 2004          | 2003   |
| Placements by banks and other financial institutions in respect of securities lending | -             | 893    | -             | 893    |
| Other placements by banks and other financial institutions                            | <b>39,087</b> | 43,649 | <b>39,087</b> | 43,649 |
| <b>TOTAL</b>  | <b>39,087</b> | 44,542 | <b>39,087</b> | 44,542 |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 19. Placements by other HKSAR Government Funds

|   | Group          |         | Fund           |         |
|---|----------------|---------|----------------|---------|
|   | 2004           | 2003    | 2004           | 2003    |
| <b>Placements with interest payable at market-based rates</b>   |                |         |                |         |
| General Revenue Account   | 481            | 362     | 481            | 362     |
| Capital Investment Fund   | 5,138          | 2,093   | 5,138          | 2,093   |
| Loan Fund   | 1,897          | 4,976   | 1,897          | 4,976   |
| Capital Works Reserve Fund  | 564            | 498     | 564            | 498     |
| Innovation and Technology Fund  | 64             | 68      | 64             | 68      |
| Lotteries Fund  | 213            | 170     | 213            | 170     |
|   | <b>8,357</b>   | 8,167   | <b>8,357</b>   | 8,167   |
| <b>Placements with interest payable at rates determined by reference to the investment income of the Fund</b> |                |         |                |         |
| General Revenue Account   | 90,488         | 66,447  | 90,488         | 66,447  |
| Land Fund   | 117,774        | 140,615 | 117,774        | 140,615 |
| Capital Works Reserve Fund  | 40,551         | 16,569  | 40,551         | 16,569  |
| Civil Service Pension Reserve Fund  | 14,523         | 12,376  | 14,523         | 12,376  |
| Disaster Relief Fund  | 19             | 35      | 19             | 35      |
| Innovation and Technology Fund  | 4,292          | 4,250   | 4,292          | 4,250   |
| Lotteries Fund  | 4,087          | 3,837   | 4,087          | 3,837   |
|   | <b>271,734</b> | 244,129 | <b>271,734</b> | 244,129 |
| <b>TOTAL</b>  | <b>280,091</b> | 252,296 | <b>280,091</b> | 252,296 |

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.

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

### 20. Other Liabilities

|  | Group         |        | Fund          |        |
|--|---------------|--------|---------------|--------|
|  | 2004          | 2003   | 2004          | 2003   |
| Interest payable on placements by other HKSAR government funds at rates determined by reference to the investment income of the Fund | <b>14,533</b> | 25,700 | <b>14,533</b> | 25,700 |
| Revaluation losses on off-balance sheet items which are marked to market   | <b>2,372</b>  | 3,724  | <b>2,372</b>  | 3,724  |
| Accrued interest and other liabilities   | <b>12,740</b> | 8,860  | <b>7,405</b>  | 8,031  |
| <b>TOTAL</b>   | <b>29,645</b> | 38,284 | <b>24,310</b> | 37,455 |

### 21. Equity

|   | Group          |         | Fund           |         |
|---|----------------|---------|----------------|---------|
|   | 2004           | 2003    | 2004           | 2003    |
| <b>Accumulated surplus</b>                      |                |         |                |         |
| At 1 January                                    | <b>386,441</b> | 328,469 | <b>384,870</b> | 327,174 |
| Surplus for the year                            | <b>39,203</b>  | 57,972  | <b>38,527</b>  | 57,696  |
| <b>At 31 December</b>                           | <b>425,644</b> | 386,441 | <b>423,397</b> | 384,870 |
| <b>Premises revaluation reserve</b>             |                |         |                |         |
| At 1 January                                    | <b>9</b>       | -       | <b>9</b>       | -       |
| Surplus on revaluation of premises (Note 12(c)) | <b>185</b>     | 9       | <b>185</b>     | 9       |
| <b>At 31 December</b>                           | <b>194</b>     | 9       | <b>194</b>     | 9       |
| <b>TOTAL</b>                                    | <b>425,838</b> | 386,450 | <b>423,591</b> | 384,879 |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 22. Maturity Profile

|   | Group                  |                     |   |  |                  |                | Total            |
|---|------------------------|---------------------|---|--|------------------|----------------|------------------|
|   | 2004                   |                     |   |  |                  |                |                  |
|   | Repayable<br>on demand | 3 months<br>or less | 1 year<br>or less<br>but over<br>3 months | 5 years<br>or less<br>but over<br>1 year | After<br>5 years | Undated        |                  |
| <b>Assets</b>   |                        |                     |   |  |                  |                |                  |
| Cash and money at call  | 20,759                 | -                   | -   | -  | -                | -              | 20,759           |
| Placements with<br>banks and other<br>financial institutions    | -                      | 48,159              | 19  | -  | -                | -              | 48,178           |
| Investment securities   | -                      | -                   | -   | -  | -                | 300            | 300              |
| Other investments<br>in securities                              | -                      | 249,435             | 83,116                                    | 260,001                                  | 179,564          | 205,630        | 977,746          |
| Held-to-maturity securities                                     | -                      | 1,417               | 737                                       | 1,064                                    | 912              | -              | 4,130            |
| Mortgage loans  | 19                     | 836                 | 2,594                                     | 12,379                                   | 19,106           | 4              | 34,938           |
| Gold  | -                      | -                   | -   | -  | -                | 228            | 228              |
|   | <b>20,778</b>          | <b>299,847</b>      | <b>86,466</b>                             | <b>273,444</b>                           | <b>199,582</b>   | <b>206,162</b> | <b>1,086,279</b> |
| <b>Liabilities</b>  |                        |                     |   |  |                  |                |                  |
| Certificates of<br>Indebtedness                                 | 146,775                | -                   | -   | -  | -                | -              | 146,775          |
| Government-issued<br>currency notes and<br>coins in circulation | 6,351                  | -                   | -   | -  | -                | -              | 6,351            |
| Balance of the<br>banking system                                | 15,789                 | -                   | -   | -  | -                | -              | 15,789           |
| Exchange Fund Bills<br>and Notes                                | -                      | 51,396              | 31,217                                    | 32,628                                   | 10,619           | -              | 125,860          |
| Other debt securities   | -                      | 5,027               | 5,041                                     | 21,334                                   | 4,093            | -              | 35,495           |
| Placements by<br>banks and other<br>financial institutions      | -                      | 39,087              | -   | -  | -                | -              | 39,087           |
| Placements by other<br>HKSAR government<br>funds                | 274,575                | 5,516               | -   | -  | -                | -              | 280,091          |
|   | <b>443,490</b>         | <b>101,026</b>      | <b>36,258</b>                             | <b>53,962</b>                            | <b>14,712</b>    | <b>-</b>       | <b>649,448</b>   |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

|   | Group                  |                     |   |  |                  |         | Total     |
|---|------------------------|---------------------|---|--|------------------|---------|-----------|
|   | 2003                   |                     |   |  |                  |         |           |
|   | Repayable<br>on demand | 3 months<br>or less | 1 year<br>or less<br>but over<br>3 months | 5 years<br>or less<br>but over<br>1 year | After<br>5 years | Undated |           |
| <b>Assets</b>   |                        |                     |   |  |                  |         |           |
| Cash and money at call  | 19,168                 | -                   | -   | -  | -                | -       | 19,168    |
| Placements with<br>banks and other<br>financial institutions    | -                      | 43,823              | -   | -  | -                | -       | 43,823    |
| Investment securities   | -                      | -                   | -   | -  | -                | 300     | 300       |
| Other investments<br>in securities                              | -                      | 247,486             | 72,986                                    | 264,487                                  | 176,107          | 170,671 | 931,737   |
| Held-to-maturity securities                                     | -                      | 279                 | 860                                       | 1,669                                    | 766              | -       | 3,574     |
| Mortgage loans  | 17                     | 1,012               | 2,608                                     | 12,620                                   | 18,317           | 8       | 34,582    |
| Gold  | -                      | -                   | -   | -  | -                | 217     | 217       |
|   | 19,185                 | 292,600             | 76,454                                    | 278,776                                  | 195,190          | 171,196 | 1,033,401 |
| <b>Liabilities</b>  |                        |                     |   |  |                  |         |           |
| Certificates of<br>Indebtedness                                 | 134,215                | -                   | -   | -  | -                | -       | 134,215   |
| Government-issued<br>currency notes and<br>coins in circulation | 6,297                  | -                   | -   | -  | -                | -       | 6,297     |
| Balance of the<br>banking system                                | 28,277                 | -                   | -   | -  | -                | -       | 28,277    |
| Exchange Fund Bills<br>and Notes                                | -                      | 50,569              | 31,277                                    | 33,024                                   | 8,650            | -       | 123,520   |
| Other debt securities   | -                      | 3,845               | 5,679                                     | 24,635                                   | 2,461            | -       | 36,620    |
| Placements by<br>banks and other<br>financial institutions      | -                      | 33,271              | 11,271                                    | -  | -                | -       | 44,542    |
| Placements by other<br>HKSAR government<br>funds                | 246,399                | 5,897               | -   | -  | -                | -       | 252,296   |
| Placements by<br>Hong Kong<br>statutory bodies                  | -                      | 164                 | -   | -  | -                | -       | 164       |
|   | 415,188                | 93,746              | 48,227                                    | 57,659                                   | 11,111           | -       | 625,931   |



## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

|   | Fund                   |                     |   |  |                  |         | Total     |
|---|------------------------|---------------------|---|--|------------------|---------|-----------|
|   | 2004                   |                     |   |  |                  |         |           |
|   | Repayable<br>on demand | 3 months<br>or less | 1 year<br>or less<br>but over<br>3 months | 5 years<br>or less<br>but over<br>1 year | After<br>5 years | Undated |           |
| <b>Assets</b>   |                        |                     |   |  |                  |         |           |
| Cash and money at call  | 20,738                 | -                   | -   | -  | -                | -       | 20,738    |
| Placements with<br>banks and other<br>financial institutions    | -                      | 42,747              | -   | -  | -                | -       | 42,747    |
| Investment securities   | -                      | -                   | -   | -  | -                | 300     | 300       |
| Other investments<br>in securities                              | -                      | 249,435             | 83,116                                    | 260,001                                  | 179,564          | 205,630 | 977,746   |
| Gold  | -                      | -                   | -   | -  | -                | 228     | 228       |
|   | 20,738                 | 292,182             | 83,116                                    | 260,001                                  | 179,564          | 206,158 | 1,041,759 |
| <b>Liabilities</b>  |                        |                     |   |  |                  |         |           |
| Certificates of<br>Indebtedness                                 | 146,775                | -                   | -   | -  | -                | -       | 146,775   |
| Government-issued<br>currency notes and<br>coins in circulation | 6,351                  | -                   | -   | -  | -                | -       | 6,351     |
| Balance of the<br>banking system                                | 15,789                 | -                   | -   | -  | -                | -       | 15,789    |
| Exchange Fund Bills<br>and Notes                                | -                      | 51,396              | 31,217                                    | 32,628                                   | 10,619           | -       | 125,860   |
| Placements by<br>banks and other<br>financial institutions      | -                      | 39,087              | -   | -  | -                | -       | 39,087    |
| Placements by other<br>HKSAR government<br>funds                | 274,575                | 5,516               | -   | -  | -                | -       | 280,091   |
|   | 443,490                | 95,999              | 31,217                                    | 32,628                                   | 10,619           | -       | 613,953   |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

|   | <b>Fund</b>            |                     |   |  |                  |         | Total   |
|---|------------------------|---------------------|---|--|------------------|---------|---------|
|   | 2003                   |                     |   |  |                  |         |         |
|   | Repayable<br>on demand | 3 months<br>or less | 1 year<br>or less<br>but over<br>3 months | 5 years<br>or less<br>but over<br>1 year | After<br>5 years | Undated |         |
| <b>Assets</b>   |                        |                     |   |  |                  |         |         |
| Cash and money at call  | 19,143                 | -                   | -   | -  | -                | -       | 19,143  |
| Placements with<br>banks and other<br>financial institutions    | -                      | 41,549              | -   | -  | -                | -       | 41,549  |
| Investment securities   | -                      | -                   | -   | -  | -                | 300     | 300     |
| Other investments<br>in securities                              | -                      | 247,486             | 72,986                                    | 264,487                                  | 176,107          | 170,671 | 931,737 |
| Gold  | -                      | -                   | -   | -  | -                | 217     | 217     |
|   | 19,143                 | 289,035             | 72,986                                    | 264,487                                  | 176,107          | 171,188 | 992,946 |
| <b>Liabilities</b>  |                        |                     |   |  |                  |         |         |
| Certificates of<br>Indebtedness                                 | 134,215                | -                   | -   | -  | -                | -       | 134,215 |
| Government-issued<br>currency notes and<br>coins in circulation | 6,297                  | -                   | -   | -  | -                | -       | 6,297   |
| Balance of the<br>banking system                                | 28,277                 | -                   | -   | -  | -                | -       | 28,277  |
| Exchange Fund Bills<br>and Notes                                | -                      | 50,569              | 31,277                                    | 33,024                                   | 8,650            | -       | 123,520 |
| Placements by<br>banks and other<br>financial institutions      | -                      | 33,271              | 11,271                                    | -  | -                | -       | 44,542  |
| Placements by other<br>HKSAR government<br>funds                | 246,399                | 5,897               | -   | -  | -                | -       | 252,296 |
| Placements by<br>Hong Kong<br>statutory bodies                  | -                      | 164                 | -   | -  | -                | -       | 164     |
|   | 415,188                | 89,901              | 42,548                                    | 33,024                                   | 8,650            | -       | 589,311 |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 23. Notes to the Cash Flow Statement

## (a) Reconciliation of surplus before premises revaluation and associate to net cash from/(used in) operating activities

|   | Group           |          | Fund            |          |
|---|-----------------|----------|-----------------|----------|
|   | 2004            | 2003     | 2004            | 2003     |
| <b>Surplus before premises revaluation and associate</b>  | <b>38,454</b>   | 58,920   | <b>37,651</b>   | 58,572   |
| Interest income   | <b>(24,598)</b> | (26,524) | <b>(23,574)</b> | (25,513) |
| Interest expense  | <b>18,066</b>   | 30,233   | <b>17,856</b>   | 29,847   |
| Dividend income   | <b>(4,556)</b>  | (3,751)  | <b>(4,573)</b>  | (3,891)  |
| Amortisation of premiums and discounts on Exchange Fund Bills and Notes                           | <b>55</b>       | 661      | <b>55</b>       | 661      |
| Depreciation  | <b>135</b>      | 94       | <b>100</b>      | 62       |
| Change in placements with banks and other financial institutions                                  | <b>3,995</b>    | (3,952)  | <b>4,015</b>    | (4,015)  |
| Change in other investments in securities   | <b>(57,567)</b> | (314)    | <b>(57,567)</b> | (314)    |
| Change in mortgage loans  | <b>(389)</b>    | (6,345)  | -               | -        |
| Change in gold  | <b>(11)</b>     | (38)     | <b>(11)</b>     | (38)     |
| Change in Thailand financing package  | -               | 1,058    | -               | 1,058    |
| Change in other assets  | <b>(276)</b>    | 5,659    | <b>(227)</b>    | 5,713    |
| Change in Certificates of Indebtedness, government-issued currency notes and coins in circulation | <b>12,614</b>   | 16,146   | <b>12,614</b>   | 16,146   |
| Change in balance of the banking system   | <b>(12,488)</b> | 27,752   | <b>(12,488)</b> | 27,752   |
| Change in Exchange Fund Bills and Notes   | <b>2,285</b>    | (66)     | <b>2,285</b>    | (66)     |
| Change in placements by banks and other financial institutions                                    | <b>(5,455)</b>  | 8,272    | <b>(5,455)</b>  | 8,272    |
| Change in placements by other HKSAR government funds  | <b>27,795</b>   | (49,373) | <b>27,795</b>   | (49,373) |
| Change in placements by Hong Kong statutory bodies  | <b>(164)</b>    | (4,115)  | <b>(164)</b>    | (4,115)  |
| Change in other liabilities   | <b>2,592</b>    | (8,649)  | <b>(1,913)</b>  | (8,910)  |
| Elimination of exchange differences and other non-cash items                                      | <b>(1,062)</b>  | (166)    | <b>(1,117)</b>  | (198)    |
| Interest received   | <b>24,487</b>   | 27,179   | <b>23,435</b>   | 26,218   |
| Interest paid   | <b>(29,328)</b> | (21,689) | <b>(29,088)</b> | (21,338) |
| Dividend received   | <b>4,512</b>    | 3,507    | <b>4,512</b>    | 3,507    |
| Tax paid  | <b>(80)</b>     | (50)     | -               | -        |
| <b>Net cash from/(used in) operating activities</b>   | <b>(984)</b>    | 54,449   | <b>(5,859)</b>  | 60,037   |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

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

|  | Group          |         | Fund           |         |
|--|----------------|---------|----------------|---------|
|  | 2004           | 2003    | 2004           | 2003    |
| Cash and money at call                                 | <b>20,759</b>  | 19,168  | <b>20,738</b>  | 19,143  |
| Placements with banks and other financial institutions | <b>48,158</b>  | 39,808  | <b>42,747</b>  | 37,534  |
| Treasury bills and commercial papers                   | <b>97,298</b>  | 121,105 | <b>97,298</b>  | 121,105 |
| Certificates of deposit                                | <b>12,637</b>  | 388     | <b>12,637</b>  | 388     |
| <b>TOTAL</b>   | <b>178,852</b> | 180,469 | <b>173,420</b> | 178,170 |

## 24. 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 and the subsidiaries are not significant, they are combined with the assets, revenue and results of management of funds representing the general reserve assets of the Fund.

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

|  | Group                  |       |   |        |               |        |
|--|------------------------|-------|---|--------|---------------|--------|
|  | Currency Board Account |       | Reserve Management and Other Activities |        | Total         |        |
|  | 2004                   | 2003  | 2004                                    | 2003   | 2004          | 2003   |
| <b>Income</b>  | <b>5,549</b>           | 2,924 | <b>52,676</b>                           | 87,966 | <b>58,225</b> | 90,890 |
| <b>Expenditure</b>   |                        |       |   |        |               |        |
| Interest expense   | <b>2,559</b>           | 3,218 | <b>15,507</b>                           | 27,015 | <b>18,066</b> | 30,233 |
| Other expenses(b)  | -                      | -     | <b>1,705</b>                            | 1,737  | <b>1,705</b>  | 1,737  |
|  | <b>2,559</b>           | 3,218 | <b>17,212</b>                           | 28,752 | <b>19,771</b> | 31,970 |
| <b>Surplus/(Deficit) before premises revaluation and associate</b> | <b>2,990</b>           | (294) | <b>35,464</b>                           | 59,214 | <b>38,454</b> | 58,920 |
| Surplus/(Deficit) on revaluation of premises                       | -                      | -     | <b>876</b>                              | (876)  | <b>876</b>    | (876)  |
| Share of profit of associate                                       | -                      | -     | <b>4</b>                                | 10     | <b>4</b>      | 10     |
| <b>Surplus/(Deficit) before taxation and minority interests</b>    | <b>2,990</b>           | (294) | <b>36,344</b>                           | 58,348 | <b>39,334</b> | 58,054 |
| Taxation   | -                      | -     | <b>(110)</b>                            | (58)   | <b>(110)</b>  | (58)   |
| Minority interests   | -                      | -     | <b>(21)</b>                             | (24)   | <b>(21)</b>   | (24)   |
| <b>Surplus/(Deficit) for the year</b>                              | <b>2,990</b>           | (294) | <b>36,213</b>                           | 58,266 | <b>39,203</b> | 57,972 |

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

|   | Group                  |             |   |         |                  |      |                  |           |
|---|------------------------|-------------|---|---------|------------------|------|------------------|-----------|
|   | Currency Board Account |             | Reserve Management and Other Activities |         | Re-allocation(c) |      | Total            |           |
|   | 2004                   | 2003        | 2004                                    | 2003    | 2004             | 2003 | 2004             | 2003      |
| <b>Assets</b>   |                        |             |   |         |                  |      |                  |           |
| Backing Assets  |                        |             |   |         |                  |      |                  |           |
| Investment in designated US dollar assets                       | <b>326,823</b>         | 321,467     | -                                       | -       | -                | -    | <b>326,823</b>   | 321,467   |
| Interest receivable on designated US dollar assets              | <b>453</b>             | 620         | -                                       | -       | -                | -    | <b>453</b>       | 620       |
| Other investments   | -                      | -           | <b>759,479</b>                          | 711,954 | -                | -    | <b>759,479</b>   | 711,954   |
| Other assets  | -                      | -           | <b>17,963</b>                           | 16,599  | <b>380</b>       | 185  | <b>18,343</b>    | 16,784    |
| <b>TOTAL ASSETS</b>   | <b>327,276</b>         | 322,087 (A) | <b>777,442</b>                          | 728,553 | <b>380</b>       | 185  | <b>1,105,098</b> | 1,050,825 |
| <b>Liabilities</b>  |                        |             |   |         |                  |      |                  |           |
| Monetary Base   |                        |             |   |         |                  |      |                  |           |
| Certificates of Indebtedness                                    | <b>146,775</b>         | 134,215     | -                                       | -       | -                | -    | <b>146,775</b>   | 134,215   |
| Government-issued currency notes and coins in circulation       | <b>6,351</b>           | 6,297       | -                                       | -       | -                | -    | <b>6,351</b>     | 6,297     |
| Balance of the banking system                                   | <b>15,789</b>          | 28,277      | -                                       | -       | -                | -    | <b>15,789</b>    | 28,277    |
| Exchange Fund Bills and Notes                                   | <b>125,860</b>         | 123,520     | -                                       | -       | -                | -    | <b>125,860</b>   | 123,520   |
| Interest payable on Exchange Fund Notes                         | <b>476</b>             | 548         | -                                       | -       | -                | -    | <b>476</b>       | 548       |
| Net accounts receivable   | <b>(380)</b>           | (185)(c)    | -                                       | -       | <b>380</b>       | 185  | -                | -         |
| Other debt securities   | -                      | -           | <b>35,495</b>                           | 36,620  | -                | -    | <b>35,495</b>    | 36,620    |
| Placements by banks and other financial institutions            | -                      | -           | <b>39,087</b>                           | 44,542  | -                | -    | <b>39,087</b>    | 44,542    |
| Placements by other HKSAR government funds                      | -                      | -           | <b>280,091</b>                          | 252,296 | -                | -    | <b>280,091</b>   | 252,296   |
| Placements by Hong Kong statutory bodies                        | -                      | -           | -                                       | 164     | -                | -    | -                | 164       |
| Other liabilities   | -                      | -           | <b>29,169</b>                           | 37,736  | -                | -    | <b>29,169</b>    | 37,736    |
|   | <b>294,871</b>         | 292,672 (B) | <b>383,842</b>                          | 371,358 | <b>380</b>       | 185  | <b>679,093</b>   | 664,215   |
| <b>Minority interests</b>                                       | -                      | -           | <b>167</b>                              | 160     | -                | -    | <b>167</b>       | 160       |
| <b>Accumulated surplus</b>                                      |                        |             |   |         |                  |      |                  |           |
| Balance brought forward   | <b>29,415</b>          | 29,685      | <b>357,026</b>                          | 298,784 | -                | -    | <b>386,441</b>   | 328,469   |
| Surplus/(Deficit) for the year                                  | <b>2,990</b>           | (294)       | <b>36,213</b>                           | 58,266  | -                | -    | <b>39,203</b>    | 57,972    |
| Transfer between Currency Board Account and general reserves(d) | -                      | 24          | -                                       | (24)    | -                | -    | -                | -         |
|   | <b>32,405</b>          | 29,415      | <b>393,239</b>                          | 357,026 | -                | -    | <b>425,644</b>   | 386,441   |
| <b>Premises revaluation reserve</b>                             | -                      | -           | <b>194</b>                              | 9       | -                | -    | <b>194</b>       | 9         |
| <b>TOTAL LIABILITIES AND EQUITY</b>                             | <b>327,276</b>         | 322,087     | <b>777,442</b>                          | 728,553 | <b>380</b>       | 185  | <b>1,105,098</b> | 1,050,825 |
| Backing Ratio [(A)/(B)] x 100%                                  | <b>110.99%</b>         | 110.05%     |   |         |                  |      |                  |           |

**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 2004, these negative amounts comprised "Other assets" of HK\$380 million (2003 - HK\$185 million) included in the Monetary Base, which consisted of two components:
- HK\$11 million (2003 - HK\$9 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\$369 million (2003 - HK\$176 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.)

## 25. Commitments

## (a) Capital commitments

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

|                | Group     |      | Fund      |      |
|----------------|-----------|------|-----------|------|
|                | 2004      | 2003 | 2004      | 2003 |
| Contracted     | -         | 73   | -         | 73   |
| Not contracted | 37        | 63   | 17        | 27   |
| <b>TOTAL</b>   | <b>37</b> | 136  | <b>17</b> | 100  |

## (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 International Monetary Fund (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\$4,104 million equivalent as at 31 December 2004 (2003 - HK\$3,922 million equivalent), in the form of a term loan of five-year maturity bearing prevailing market interest rates. As at 31 December 2004, there was no outstanding balance due from the IMF under the NAB (2003 - Nil).

## (c) Lease commitments

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

|   | Group    |      | Fund     |      |
|---|----------|------|----------|------|
|   | 2004     | 2003 | 2004     | 2003 |
| <b>Premises</b>                                   |          |      |          |      |
| Not later than one year                           | 3        | 19   | 3        | 8    |
| Later than one year and not later than five years | -        | 2    | -        | 2    |
| <b>TOTAL</b>                                      | <b>3</b> | 21   | <b>3</b> | 10   |



## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

## 26. Off-Balance Sheet Items

|   | Group          |         | Fund           |         |
|---|----------------|---------|----------------|---------|
|   | 2004           | 2003    | 2004           | 2003    |
| Spot and forward foreign exchange contracts |                |         |                |         |
| Outstanding contract amount                 | <b>152,854</b> | 106,736 | <b>152,854</b> | 106,736 |
| Gross replacement costs                     | <b>278</b>     | 159     | <b>278</b>     | 159     |
| Interest rate swap contracts                |                |         |                |         |
| Notional principal                          | <b>83,269</b>  | 88,149  | <b>9,400</b>   | 10,400  |
| Gross replacement costs                     | <b>2,274</b>   | 2,635   | <b>1,159</b>   | 1,290   |
| Stock index futures contracts               |                |         |                |         |
| Notional principal                          | <b>12,421</b>  | 30,298  | <b>12,421</b>  | 30,298  |
| Gross replacement costs                     | <b>75</b>      | 915     | <b>75</b>      | 915     |
| Bond futures contracts                      |                |         |                |         |
| Notional principal                          | <b>989</b>     | 1,005   | <b>989</b>     | 1,005   |
| Gross replacement costs                     | <b>1</b>       | -       | <b>1</b>       | -       |

## 27. Contingent Liabilities

- (a) The Fund has a contingent liability up to 11.25 million SDRs or HK\$136 million equivalent as at 31 December 2004 (2003 - 11.25 million SDRs or HK\$130 million equivalent), in respect of the uncalled portion of its 3,000 shares held in the Bank for International Settlements.
- (b) Under the Mortgage Insurance Programme, the HKMC offers mortgage insurance that covers approved sellers for credit loss up to 25% of the property value of a mortgage loan when the loan amount has exceeded 70% of the property value at origination. The HKMC reinsures the risk exposure with the approved reinsurers. At 31 December 2004, the total risk-in-force assumed by the HKMC was HK\$1.77 billion (2003 - HK\$1.09 billion).
- (c) Under the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme and the Bauhinia Mortgage-Backed Securitisation Programme, the HKMC sells mortgages to two Special Purpose Companies which issue mortgage-backed securities (MBS) to investors. The HKMC provides guarantee on the timely payment of principal and interest in respect of the MBS. At 31 December 2004, the aggregate security principal balance guaranteed by the HKMC under the two programmes was HK\$5.87 billion (2003 - HK\$5.26 billion).

## EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

### 28. Material Related Party Transactions

The Fund takes placements from other HKSAR government funds and Hong Kong statutory bodies, as shown on the balance sheet. During the year, interest expenses on placements from other HKSAR government funds amounted to HK\$14,558 million (2003 - HK\$25,792 million) and Nil (2003 - HK\$15 million) for Hong Kong statutory bodies.

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.

During the year, the HKMC purchased about HK\$10 billion (2003 - HK\$10.5 billion) of mortgage loans from the HKSAR Government.

### 29. Approval of Accounts

The accounts were approved by the Exchange Fund Advisory Committee on 31 March 2005.