

**1. PRINCIPAL ACCOUNTING POLICIES****(a) Valuation of assets and liabilities**

Financial assets and liabilities (defined as interest bearing monetary obligations due to and from the Exchange Fund) are valued in the accounts at market value at the Balance Sheet date determined on the bases set out below. The consequential change in value of the asset or liability is reflected in the carrying value of the relevant asset or liability in the Balance Sheet except in the case of balances due to the Fiscal Reserves Account which are stated in the Balance Sheet at the original amounts with the differences between the market values and the original amounts included in other liabilities.

Realised and unrealised gains and losses are included in the Income and Expenditure Account.

Fixed deposits, certificates of deposit, Fiscal Reserves Account, placements by other statutory bodies and other borrowings are valued according to a price matrix of discounted cash flows using year end interest rates for discounting.

Treasury bills, debt securities and Exchange Fund Bills and Notes are valued at the closing mid-market prices of the last business day of the year quoted on the respective securities markets.

Equities are valued at the closing market prices on the last business day of the year quoted on the respective stock exchanges.

Gold is valued at the morning fix market price on the last business day of the year as quoted by the London Bullion Market.

**(b) Foreign currency translation**

Assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the middle market rates at the close of business on the last business day of the year. Realised and unrealised gains and losses on foreign currency assets and liabilities are included in the Income and Expenditure Account.

Certificates of Indebtedness 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 average exchange rates for each month.

**(c) Off-balance sheet financial instruments**

Forward foreign currency contracts are valued at prevailing market rates on the last business day of the year. Realised and unrealised gains and losses are included in the Income and Expenditure Account.

\* All amounts are in Hong Kong dollars, unless otherwise stated.

Interest rate swap contracts and futures contracts are marked to market on the last business day of the year with the resultant unrealised gains and losses being included in the Income and Expenditure Account. Interest income and expenses arising from the interest rate swap contracts and realised gains and losses on futures contracts are included in the Income and Expenditure Account.

**(d) Fixed assets**

Fixed assets, including furniture, fixtures and equipment, personal computers and capitalised systems development costs, are stated at cost less accumulated depreciation and are depreciated on a straight line basis over their respective estimated useful lives of 3 to 5 years. Fixed assets costing less than \$10,000 are not capitalised but are charged to the Income and Expenditure Account.

**(e) Revenue recognition**

Interest income is recognised on an accruals basis and dividend income is recognised when the dividends are declared.

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**2. CHANGES IN ACCOUNTING POLICIES**

In order to give a more appropriate presentation of the results and financial position of the Exchange Fund, a number of changes in accounting policies have been implemented in 1995:

- (a) Fixed assets, which were not capitalised in prior years, are now capitalised and depreciated as described in Note 1(d) above. For practical reasons, the 1994 accounts have not been restated. Only fixed assets purchased from 1 January 1995 are capitalised.
- (b) Recognising that in practice the market exchange rate for the Hong Kong dollar does deviate, albeit marginally, from the linked exchange rate of US\$1=\$7.80, US dollar assets and liabilities, which in prior years were translated into Hong Kong dollars at the linked exchange rate, are now translated into Hong Kong dollars at the middle market rate at the close of business on the last business day of the year in accordance with normal accounting practice. The cumulative impact of the change is a reduction of \$2,622 mn in respect of net assets held as at the end of 1994. ( 1993: \$2,616 mn )
- (c) Foreign currency income and expenditure, which in prior years were translated into Hong Kong dollars at market exchange rates at the close of business on the last business day of the immediately preceding year, are now translated at the average exchange rates for each month. As this change has no impact on the surplus for 1994, no restatement is made.
- (d) In prior years, interest rate swap contracts were accounted for by accruing interest up to the Balance Sheet date. In 1995, in addition to this, they have been marked to market by discounting the future net cash flows to present value using market rates. The impact of the change is a reduction of \$214 mn in the value of net assets held as at the end of 1994. (1993: addition of \$4 mn )



### 3. PRIOR YEAR ADJUSTMENTS

To reflect the changes in accounting policy in the translation of foreign currency assets and liabilities and in valuing interest rate swap contracts as detailed in notes 2(b) and 2(d) above, the 1994 accounts have been restated as follows:

<i>HK\$mn</i>	REVISED	AS PREVIOUSLY PUBLISHED	CHANGE
Assets	405,850	408,485	-2,635
Liabilities	280,076	279,875	-201
Net assets	125,774	128,610	-2,836

### 4. INCOME

#### (a) Investment income

<i>HK\$mn</i>	1995	1994
Interest income	22,373	18,092
Dividend income	371	349
Net exchange gains	3,100	3,188
Net investment gains (losses)	20,890	(12,716)
<b>TOTAL</b>	<b>46,734</b>	<b>8,913</b>

(b) **Licence fees** are fees paid by authorised institutions under the Banking Ordinance.

(c) **Others** include income from sale of withdrawn coins, Central Moneymarkets Unit fees and reversal of provision for contingencies.

## 5. EXPENDITURE

(a) **Note and coin expenses** represent reimbursements to the note issuing banks in respect of note issue expenses, and expenses incurred directly by the Exchange Fund in issuing coins.

### (b) Operating expenses

<i>HK\$mn</i>	1995	1994
Staff costs	250	196
Premises and equipment expenses	65	66
Depreciation charges	1	—
Other operating expenses	124	92
<b>TOTAL</b>	<b>440</b>	<b>354</b>

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

<b>HK\$</b>	1995	1994
1,000,000 to 1,500,000	1	1
1,500,001 to 2,000,000	1	—
2,000,001 to 2,500,000	—	1
2,500,001 to 3,000,000	3	3
3,000,001 to 3,500,000	1	1
3,500,001 to 4,000,000	1	—
4,000,001 to 4,500,000	—	2
4,500,001 to 5,000,000	2	—
5,500,001 to 6,000,000	—	1
6,500,001 to 7,000,000	1	—
	<b>10</b>	<b>9</b>

(c) **Interest** comprises the interest cost of Exchange Fund Bills and Notes, balances due to the Fiscal Reserves Account and placements by other institutions.

## 6. CASH AND SHORT-TERM FUNDS

<i>HK\$mn</i>	1995	1994
Cash and balances with banks	394	661
Money at call and short notice	11,696	14,708
Treasury bills	82,953	45,589
Others	5,300	1,505
<b>TOTAL</b>	<b>100,343</b>	<b>62,463</b>

## 7. INVESTMENTS

<i>HK\$mn</i>	1995	1994
Debt securities	233,416	200,617
Equities	17,085	12,380
Gold	201	200
<b>TOTAL</b>	<b>250,702</b>	<b>213,197</b>

## 8. CURRENCY DISTRIBUTION OF ASSETS

The Exchange Fund holds Hong Kong dollar and foreign currency assets. A large proportion of the Fund's foreign currency assets is held in US dollars. Apart from the US dollar, the Fund also holds assets denominated in other foreign currencies, including the Australian dollar, Belgian franc, Canadian dollar, Danish krone, Deutschemark, Dutch guilder, the ECU, French franc, Japanese yen, pound sterling and Swiss franc.

## 9. LOCATION OF ASSETS

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



## 10. FIXED ASSETS

<i>HK\$mn</i>	
<u>Cost</u>	
Purchased in the year	59
<u>Accumulated depreciation</u>	
Charge for the year	(1)
<u>Net book value</u>	
At 31 December 1995	58

## 11. OTHER ASSETS

<i>HK\$mn</i>	<b>1995</b>	1994
Investment in associated company	–	–
Loan to associated company	<b>35</b>	–
Staff housing loans	<b>56</b>	55
Others	<b>9,053</b>	6,571
<b>TOTAL OTHER ASSETS</b>	<b>9,144</b>	6,626

**Investment in associated company** comprises 5,000 common shares of Hong Kong Interbank Clearing Limited (HKICL), which represent 50% of the company's outstanding shares. The investment, at cost, amounted to \$5,000 as at 31 December 1995 (1994 - nil). HKICL was incorporated in Hong Kong in May 1995 to facilitate the implementation of the Real Time Gross Settlement System and ultimately to be the operator of the clearing house under this system.

**Loan to associated company**, HKICL, amounted to \$34.6 mn as at 31 December 1995 (1994 - nil). The loan is not repayable within one year.

**Staff housing loans** amounted to \$55.8 mn as at 31 December 1995 (1994 - \$55.2 mn). The portion of the loans repayable within one year amounts to \$1.8 mn (1994 - \$1.5 mn).

**Others** comprise interest receivable, prepaid expenses and the difference between the Hong Kong dollar face value of the Certificates of Indebtedness and the market value of the US dollars required for their redemption.

## 12. TOTAL ASSETS

<i>HK\$mn</i>	1995	1994
Foreign currency assets	428,547	381,233
Hong Kong dollar assets	32,187	24,617
<b>TOTAL</b>	<b>460,734</b>	405,850

Quarterly statistics on total foreign currency assets and forward foreign exchange transactions of the Exchange Fund are published. The information for 31 December 1995 is shown below, with comparative figures for 1994:

<i>HK\$mn</i>	1995	1994
Exchange Fund foreign currency assets excluding forward transactions	428,547	381,233
Net forward transactions	13,507	13,886
Including forward transactions	442,054	395,119
US\$ equivalent at market rate	US\$57,171 mn	US\$51,069 mn

## 13. CERTIFICATES OF INDEBTEDNESS

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

## 14. BALANCE OF BANKING SYSTEM

In accordance with the Accounting Arrangements introduced in July 1988, The Hongkong and Shanghai Banking Corporation Limited, as the Management Bank of the Clearing House of The Hong Kong Association of Banks, is required to maintain a Clearing Account with the Exchange Fund. The balance in the Account, which represents the level of liquidity in the interbank market, is determined by the Monetary Authority. The Accounting Arrangements enable the Monetary Authority to maintain exchange rate stability more effectively by influencing the level of interbank liquidity through money market operations.

## 15. EXCHANGE FUND BILLS AND NOTES

Exchange Fund Bills are issued for maturities not exceeding one year. Exchange Fund Notes are broken down below according to their remaining term to maturity.

<i>HK\$mn</i>	1995	1994
Exchange Fund Bills	40,576	39,041
Exchange Fund Notes		
Maturing within 1 year	2,645	1,529
Maturing after 1 year but within 5 years	9,579	5,570
Maturing after 5 years	511	—
<b>TOTAL EXCHANGE FUND BILLS AND NOTES</b>	<b>53,311</b>	<b>46,140</b>

## 16. FISCAL RESERVES ACCOUNT

These represent balances due to the Fiscal Reserves Account bearing interest at competitive market rates and comprise:

<i>HK\$mn</i>	1995	1994
General Revenue Account	72,046	85,363
Capital Investment Fund	4,868	14,575
Loan Fund	2,928	925
Capital Works Reserve Fund Works Account	25,204	18,074
Capital Works Reserve Fund Reserve Account	13,705	12,284
Civil Service Pension Reserve Fund	7,138	—
Disaster Relief Fund	27	19
<b>TOTAL</b>	<b>125,916</b>	<b>131,240</b>



## 17. PLACEMENTS BY OTHER INSTITUTIONS

<i>HK\$mn</i>	1995	1994
Placements by other statutory bodies	25,747	16,602
Borrowings under Liquidity Adjustment Facility	681	4,748
Others	7,874	1,609
<b>TOTAL</b>	<b>34,302</b>	22,959

## 18. OTHER LIABILITIES

Other liabilities comprise expenses accrued at the year end, which include interest payable on the balances due to the Fiscal Reserves Account and the differences between the market values and the original amounts of the Fiscal Reserves Account.

## 19. STAFF RETIREMENT SCHEME

The Monetary Authority operates a defined contribution scheme, under which contributions applicable to each year are charged to the Income and Expenditure Account. Contributions from the Monetary Authority to this staff retirement scheme amounted to \$15.1 million in 1995 (1994 - \$13.2 million which included a non-recurring contribution of \$4.8 million). The assets of the staff retirement scheme are held separately from the Exchange Fund.

## 20. CAPITAL COMMITMENTS

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

<i>HK\$mn</i>	1995	1994
Contracted	64	—
Not contracted	90	—
<b>TOTAL CAPITAL COMMITMENTS</b>	<b>154</b>	—

## **21. OFF-BALANCE SHEET ITEMS**

Outstanding forward foreign exchange contracts and gross replacement costs as at 31 December 1995 amounted to \$104,774 mn (1994 - \$51,535 mn) and \$1,650 mn (1994 - \$465 mn) respectively. These contracts are entered into for hedging purposes.

Notional principals and gross replacement costs of interest rate swap contracts as at 31 December 1995 amounted to \$23,860 mn (1994 - \$11,660 mn) and \$517 mn (1994 - \$0.1 mn) respectively. These contracts are entered into for hedging purposes.

Notional principals and gross replacement costs of outstanding futures contracts as at 31 December 1995 amounted to \$78.8 mn (1994 - \$531.1 mn) and \$0.5 mn (1994 - \$2.9 mn) respectively. These contracts are entered into for hedging purposes.

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## **22. COMPARATIVE FIGURES**

Certain comparative figures for 1994 have been reclassified to conform with the current year's presentation.