

# Financial Statements

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## MPFA

# AUDITORS' REPORT TO THE MANDATORY PROVIDENT FUND SCHEMES AUTHORITY ("the MPFA")

*(Established in Hong Kong  
under the Mandatory  
Provident Fund Schemes  
Ordinance)*

We have audited the financial statements on pages 74 to 90 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

## RESPECTIVE RESPONSIBILITIES OF THE MPFA AND THE AUDITORS

The Mandatory Provident Fund Schemes Ordinance ("the Ordinance") requires the MPFA to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view, it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with section 6P(2) of the Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the MPFA in the preparation of the financial statements, and of whether the accounting policies are appropriate to the MPFA's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

## OPINION

In our opinion, the financial statements give a true and fair view of the state of the MPFA's affairs as at 31 March 2006 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with accounting principles generally accepted in Hong Kong.

### **Deloitte Touche Tohmatsu**

*Certified Public Accountants*

Hong Kong

3 July 2006

## INCOME AND EXPENDITURE ACCOUNT

For the year ended  
31 March 2006

	NOTES	2006 HK\$	2005 HK\$
<b>INCOME</b>			
Fee income		8,951,241	9,470,850
Interest income on bank deposits		9,923,051	7,439,889
Net investment income	5	369,905,011	155,349,468
		<b>388,779,303</b>	172,260,207
Other income		7,247	2,221
		<b>388,786,550</b>	172,262,428
<b>EXPENDITURE</b>			
Staff costs		142,938,783	131,713,334
Depreciation		5,948,607	10,244,702
Premises expenses		20,813,651	20,661,628
Public education and publicity expenses		8,758,764	3,878,615
Investment expenses		15,159,731	10,936,463
Other operating expenses		24,401,079	21,434,435
		<b>218,020,615</b>	198,869,177
<b>SURPLUS (DEFICIT) FOR THE YEAR</b>		<b>170,765,935</b>	(26,606,749)

## BALANCE SHEET

At 31 March 2006

	NOTES	2006 HK\$	2005 HK\$
<b>NON-CURRENT ASSETS</b>			
Property and equipment	9	12,162,571	9,765,272
Projects in progress	10	83,790	507,826
		<b>12,246,361</b>	10,273,098
<b>CURRENT ASSETS</b>			
Investments designated at fair value through profit or loss	11	4,927,431,940	–
Other investments	12	–	4,748,579,197
Derivative financial instruments	13	4,268,296	4,342,788
Unsettled investment receivables	14	44,761,415	11,787,355
Debtors, deposits and prepayments	14	19,739,252	32,230,394
Interest receivables	14	34,681,380	26,117,280
Bank deposits	14	239,500,000	252,140,000
Bank balances and cash	14	500,071,756	512,007,176
		<b>5,770,454,039</b>	5,587,204,190
<b>CURRENT LIABILITIES</b>			
Derivative financial instruments	13	2,544,896	736,192
Unsettled investment payables	15	366,326,141	345,701,152
Creditors and accrued charges	15	31,331,353	38,976,017
Fees received in advance	15	3,945,698	4,277,550
		<b>404,148,088</b>	389,690,911
<b>NET ASSETS</b>		<b>5,378,552,312</b>	5,207,786,377
<b>CAPITAL AND RESERVE</b>			
Capital grant	16	5,000,000,000	5,000,000,000
Income and expenditure account		378,552,312	207,786,377
		<b>5,378,552,312</b>	5,207,786,377

The financial statements on pages 74 to 90 were approved and authorised for issue by the Mandatory Provident Fund Schemes Authority on 3 July 2006 and are signed on its behalf by:

**Diana Chan**  
Managing Director

MPFA

**STATEMENT OF  
CHANGES IN  
CAPITAL AND  
RESERVE**

*For the year ended  
31 March 2006*

	<b>Capital Grant</b>	<b>Income and Expenditure Account</b>	<b>Total</b>
	HK\$	HK\$	HK\$
At 1 April 2004	5,000,000,000	234,393,126	5,234,393,126
Deficit for the year	–	(26,606,749)	(26,606,749)
At 31 March 2005	5,000,000,000	207,786,377	5,207,786,377
Surplus for the year	–	170,765,935	170,765,935
At 31 March 2006	5,000,000,000	378,552,312	5,378,552,312

## CASH FLOW STATEMENT

For the year ended  
31 March 2006

	2006 HK\$	2005 HK\$
<b>OPERATING ACTIVITIES</b>		
Surplus (deficit) for the year	170,765,935	(26,606,749)
Adjustments for:		
Amortisation of premium on held-to-maturity securities	–	459,751
Depreciation for property and equipment	5,948,607	10,244,702
(Gain) loss on disposals of property and equipment	(24,657)	650
Interest income on bank deposits	(9,923,051)	(7,439,889)
Interest income on investments designated at fair value through profit or loss	(152,883,706)	–
Interest income on other investments	–	(116,784,188)
Dividends from investments designated at fair value through profit or loss	(27,779,938)	–
Dividends from other investments	–	(19,604,509)
Net gain on investments designated at fair value through profit or loss	(145,314,749)	–
Net gain on other investments	–	(36,912,362)
Net realised (gain) loss on derivative financial instruments	(45,809,814)	21,098,436
Net unrealised loss (gain) on derivative financial instruments	1,883,196	(3,606,596)
Operating cash flows before movements in working capital	(203,138,177)	(179,150,754)
Decrease (increase) in debtors, deposits and prepayments	12,491,142	(18,730,151)
(Decrease) increase in creditors and accrued charges	(8,148,200)	26,164,628
Decrease in fees received in advance	(331,852)	(337,850)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(199,127,087)</b>	<b>(172,054,127)</b>
<b>INVESTING ACTIVITIES</b>		
Dividends received from investments designated at fair value through profit or loss	27,389,272	–
Dividends received from other investments	–	15,577,346
Interest received on bank deposits	9,313,638	17,308,737
Interest received from investments designated at fair value through profit or loss	144,929,019	–
Interest received from other investments	–	109,138,517
Proceeds on disposals of property and equipment	24,657	–
Payment for disposals of property and equipment	–	(650)
Proceeds on disposals of investments designated at fair value through profit or loss	13,488,938,401	–
Proceeds on disposals of other investments	–	9,820,635,497
Purchase of property and equipment and projects in progress	(7,418,334)	(3,602,335)
Purchase of investments designated at fair value through profit or loss	(13,534,434,800)	–
Purchase of other investments	–	(11,237,060,681)
Decrease in bank deposits	12,640,000	1,960,368,061
Settlement of derivative financial instruments	45,809,814	(21,098,436)
Decrease (increase) in bank balances held for investment purposes	10,846,601	(489,334,484)
<b>NET CASH FROM INVESTING ACTIVITIES</b>	<b>198,038,268</b>	<b>171,931,572</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,088,819)</b>	<b>(122,555)</b>
<b>CASH AND CASH EQUIVALENTS AT 1 APRIL 2005</b>	<b>2,921,149</b>	<b>3,043,704</b>
<b>CASH AND CASH EQUIVALENTS AT 31 MARCH 2006</b>	<b>1,832,330</b>	<b>2,921,149</b>
<b>ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Bank balances and cash	500,071,756	512,007,176
Less: Bank balances held for investment purposes	(498,239,426)	(509,086,027)
	<b>1,832,330</b>	<b>2,921,149</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended  
31 March 2006

### 1. BACKGROUND AND FUNCTIONS OF THE MANDATORY PROVIDENT FUND SCHEMES AUTHORITY ("THE MPFA")

The MPFA was established under section 6 of the Hong Kong Mandatory Provident Fund Schemes Ordinance ("the Ordinance") which came into effect on 24 July 1998. The functions of the MPFA are stated under section 6E of the Ordinance. Its office address is 21/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong.

The financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the MPFA.

### 2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the MPFA has applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") that are effective for accounting periods beginning on or after 1 January 2005. The adoption of the new HKFRSs has had no material effect on how the results for the current or prior accounting years are prepared and presented. Accordingly, no prior year adjustment has been required.

#### Financial Instruments

The MPFA has applied HKAS 32 Financial Instruments: Disclosure and Presentation and HKAS 39 Financial Instruments: Recognition and Measurement. The application of HKAS 32 and HKAS 39 has had no material impact on how financial instruments of the MPFA are presented for current and prior accounting periods.

#### *Classification and measurement of financial assets and financial liabilities*

The MPFA has applied the relevant transitional provisions in HKAS 39 with respect to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

By 31 March 2005, the MPFA classified and measured its debt and equity securities in accordance with the benchmark treatment of Statement of Standard Accounting Practice 24 ("SSAP 24"). Under SSAP 24, investments in debt or equity securities are classified as "investment securities", "other investments" or "held-to-maturity investments" as appropriate. "Investment securities" are carried at cost less impairment losses (if any) while "other investments" are measured at fair value, with unrealised gains or losses included in the income and expenditure account. Held-to-maturity investments are carried at amortised cost less impairment losses (if any). From 1 April 2005 onwards, the MPFA has classified and measured its debt and equity securities in accordance with HKAS 39. Under HKAS 39, financial assets are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables", or "held-to-maturity financial assets". "Financial assets at fair value through profit or loss" and "available-for-sale financial assets" are carried at fair value, with changes in fair values recognised in the income and expenditure account and reserve respectively. Available-for-sale equity investments that do not have quoted market prices in an active market and whose fair value cannot be reliably measured are measured at cost less impairment after initial recognition. "Loans and receivables" and "held-to-maturity financial assets" are measured at amortised cost using the effective interest method after initial recognition.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### Financial Instruments (cont'd)

*Financial assets and financial liabilities other than debt and equity securities*

From 1 April 2005 onwards, the MPFA has classified and measured its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. As mentioned above, financial assets under HKAS 39 are classified as “financial assets at fair value through profit or loss”, “available-for-sale financial assets”, “loans and receivables” or “held-to-maturity financial assets”. Financial liabilities are generally classified as “financial liabilities at fair value through profit or loss” or “other financial liabilities”. Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in the income and expenditure account directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

The MPFA has not early applied the following new standards and interpretations that have been issued but are not yet effective.

HKAS 1 (Amendment)	Capital Disclosures <sup>1</sup>
HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures <sup>5</sup>
HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation <sup>5</sup>
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions <sup>5</sup>
HKAS 39 (Amendment)	The Fair Value Option <sup>5</sup>
HKAS 39 & HKFRS 4 (Amendments)	Financial Guarantee Contracts <sup>5</sup>
HKFRS 6	Exploration for and Evaluation of Mineral Resources <sup>5</sup>
HKFRS 7	Financial Instruments: Disclosures <sup>1</sup>
HKFRS-Int 4	Determining whether an Arrangement contains a Lease <sup>5</sup>
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds <sup>5</sup>
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment <sup>6</sup>
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies <sup>4</sup>
HK(IFRIC)-Int 8	Scope of HKFRS 2 <sup>3</sup>
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives <sup>2</sup>

<sup>1</sup> Effective for annual periods beginning on or after 1 January 2007

<sup>2</sup> Effective for annual periods beginning on or after 1 June 2006

<sup>3</sup> Effective for annual periods beginning on or after 1 May 2006

<sup>4</sup> Effective for annual periods beginning on or after 1 March 2006

<sup>5</sup> Effective for annual periods beginning on or after 1 January 2006

<sup>6</sup> Effective for annual periods beginning on or after 1 December 2005



## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost basis, except for certain financial instruments, which are measured at fair values, and in accordance with HKFRSs issued by the HKICPA. The principal accounting policies adopted are as follows:

#### Revenue recognition

Fee income consists of application fees and annual fees arising from the Occupational Retirement Schemes Ordinance schemes and Mandatory Provident Fund schemes and is accounted for on an accrual basis.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

#### Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when the MPFA becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in the income and expenditure account.

#### Financial assets

The MPFA's financial assets include financial assets at fair value through profit or loss and loans and receivables. All regular way purchases or sales of financial assets are recognised and derecognised on a trade-date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

##### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss have two subcategories, including financial assets held for trading and those designated at fair value through profit or loss on initial recognition. At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in the income and expenditure account in the period in which they arise.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### Financial assets (cont'd)

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables including debtors, deposits and prepayments, unsettled investment receivables, interest receivables, bank deposits and bank balances and cash are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in the income and expenditure account when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

#### Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into and the definition of a financial liability.

Financial liabilities, including creditors and accrued charges, fees received in advance and unsettled investment payables, are subsequently measured at amortised cost, using the effective interest rate method.

##### *Derivative financial instruments*

The MPFA uses derivative financial instruments (primarily foreign exchange contracts) to hedge its exposure against investments designated at fair value through profit or loss. Such derivatives are measured at fair value regardless of whether they are designated as effective hedging instruments.

##### *Derivatives that do not qualify for hedge accounting*

Derivatives that do not qualify for hedge accounting, such as foreign exchange contracts, are deemed as financial assets held for trading or financial liabilities held for trading. Changes in fair values of such derivatives are recognised directly in the income and expenditure account.

#### Property and equipment

Property and equipment are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property and equipment over their estimated useful lives and after taking into account their estimated residual value, using the straight-line method.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### Projects in progress

An internally-generated intangible asset of projects in progress arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will produce future economic benefits. The resultant asset is amortised on a straight-line basis over its useful life, and carried at cost less subsequent accumulated amortisation and any accumulated impairment losses.

#### Impairment

At each balance sheet date, the MPFA reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

#### Foreign currencies

In preparing the financial statements of the MPFA, transactions in currencies other than the functional currency of the MPFA are recorded in its functional currency (that is the currency of the primary economic environment in which the MPFA operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in the income and expenditure account in the period in which they arise. Exchange differences arising on the retranslating of non-monetary items carried at fair value are included in the income and expenditure account for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in reserve, in which cases, the exchange differences are also recognised directly in reserve.

#### Operating leases

Rentals payable under operating leases are charged to the income and expenditure account on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

#### Retirement benefit costs

Contributions to Mandatory Provident Fund schemes are charged as expenses on an accrual basis.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 4. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The MPFA's major financial instruments include bank deposits and balances and equity and debt investments. The MPFA sets its strategic investment allocation using a statistical approach. A set of Investment Guidelines approved by the Management Board is in place to lay down limits and restrictions on currency exposure, currency risk, interest rate risk, credit risk, general activities and hedging activities. The Finance Committee, one of the standing committees of the MPFA, is responsible to oversee the investments of all MPFA funds.

Permissible investments have to satisfy requirements of credit rating, minimum market capitalisation and marketability as detailed in the Investment Guidelines. A benchmark portfolio was chosen based on an expected average return that had been weighted against its expected volatility. The probabilities of achieving positive return over one year, two years and five years were then considered. Apart from bank deposits that are managed internally, three fund managers were chosen to manage three global balanced funds. Each fund manager is required to invest with prudence with the objective of protection of principal and above benchmark returns. Apart from proactive contributions in stock selection, interest rate and currency risk management, each fund manager is expected to tactically allocate between broad asset classes based on fundamentals and judgements of relative value. Deviation margins permitted for each asset class have been set using a risk budget approach based on correlation of asset returns between asset classes, volatility and expected tracking error for each asset class.

#### Currency exposure and currency risk

The Investment Guidelines require each fund manager to hold investments to maintain a currency exposure of over 85% in HK dollar and US dollar. The benchmark return for each invested asset class is in HK dollar, US dollar or a foreign currency hedged back into US dollar. As part of the invested portfolio is in global equities, there are therefore currency risks due to currency fluctuations related to those equities. The fund managers are permitted to hedge related currency risks using forward currency contracts back into HK dollar or US dollar. As at 31 March 2006, the fair value of the investments is given below:

Currency risk	2006		2005	
	HK\$	%	HK\$	%
Instruments denominated in				
HK dollar	1,797,716,580	35	1,756,082,882	36
US dollar	3,227,212,461	63	3,038,845,501	61
Other currencies	106,747,615	2	157,937,163	3
	5,131,676,656	100	4,952,865,546	100

#### Fair value interest rate risk

The invested portfolios are exposed to fair value interest rate risks due to holdings in debt securities. The fund managers may mitigate such risk by the switching out of debt securities onto either cash or equities up to a limited percentage dictated by the permitted asset class deviation margin. The fund managers may further reduce duration risk by reducing bond portfolio duration up to two years below the benchmark duration. On the contrary, the fund managers may also increase duration risk up to two years above the benchmark duration. As at 31 March 2006, the average bond portfolio duration of all three fund managers versus that of the benchmark is set out below:

	2006 Years	2005 Years
Benchmark duration	4.24	4.01
Portfolio duration	3.65	3.52

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 4. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (cont'd)

#### Credit risk

The portfolios must invest only into bonds that have a minimum credit rating of A- by Standard & Poor's Ratings Services and A3 by Moody's Investors Service, Inc. As at 31 March 2006, the credit risk profile as weighted by market value is set out below:

Credit risk	2006		2005	
	HK\$	%	HK\$	%
Credit rating of issuers				
AAA <sup>1</sup>	1,971,272,354	52	2,134,362,889	58
AA <sup>2</sup>	911,025,064	24	653,385,579	18
A <sup>3</sup>	882,926,886	24	880,848,355	24
	3,765,224,304	100	3,668,596,823	100

<sup>1</sup> AAA means AAA by S&P and/or Aaa by Moody's

<sup>2</sup> AA means between AA- and AA+ by S&P and Aa3 and Aa1 by Moody's

<sup>3</sup> A means between A- and A+ by S&P and A3 and A1 by Moody's

#### Price risk

The invested portfolios are investments designated at fair value through profit or loss and are measured at fair value at each balance sheet date. The MPFA manages this price risk exposure by maintaining a portfolio of investments with different risk profiles. The investment performance is reported to the Finance Committee every three months and to the Management Board every six months.

#### Liquidity risk

The MPFA does not have any borrowing and therefore has no repayment liability. The MPFA maintains a sufficient short-term liquidity to fund its operations and runs a bank deposit portfolio to achieve reasonable return on cash. As part of the strategic asset allocation, the bank deposit portfolio functions as an asset class to diversify and control portfolio risk.

### 5. NET INVESTMENT INCOME

	2006 HK\$	2005 HK\$
Interest income on investments designated at fair value through profit or loss	152,883,706	–
Interest income on other investments	–	116,784,188
Amortisation of premium on held-to-maturity securities	–	(459,751)
	152,883,706	116,324,437
Dividends from investments designated at fair value through profit or loss	27,779,938	–
Dividends from other investments	–	19,604,509
Net gain on investments designated at fair value through profit or loss	145,314,749	–
Net gain on other investments	–	36,912,362
Net realised gain (loss) on derivative financial instruments	45,809,814	(21,098,436)
Net unrealised (loss) gain on derivative financial instruments	(1,883,196)	3,606,596
	369,905,011	155,349,468

## MPFA

### NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

## 6. TAXATION

No provision for Hong Kong Profits Tax has been made in the financial statements as the MPFA is exempt from Hong Kong Profits Tax under section 88 of the Inland Revenue Ordinance.

## 7. DIRECTORS' EMOLUMENTS

The emoluments of all directors for the years ended 31 March 2006 and 2005 are set out below:

			2006		
	Fees	Salaries and	Contributions	Variable	Total
	HK\$	other	to MPF	pay	emoluments
	HK\$	benefits	schemes	HK\$	HK\$
<b>Executive Directors</b>					
Diana Chan Tong Chee-ching	–	4,199,966	490,200	735,240	5,425,406
Hendena Yu	–	2,923,092	327,363	375,027	3,625,482
Ernest Lee Shu-wing	–	2,312,541	264,620	350,965	2,928,126
Darren Mark McShane	–	3,264,559	380,000	569,960	4,214,519
Jimmy Woo Jack-man	–	2,518,366	278,827	293,467	3,090,660
<b>Non-Executive Directors</b>					
Charles Lee Yeh-kwong	–	–	–	–	–
Edward Chan King-sang	–	–	–	–	–
Stephen Ip Shu-kwan	–	–	–	–	–
Leo Kung Lin-cheng	–	–	–	–	–
Lee Kai-ming	–	–	–	–	–
Angelina Lee Wong Pui-ling	–	–	–	–	–
Frederick Ma Si-hang	–	–	–	–	–
David Sun Tak-kei	–	–	–	–	–
Tam Yiu-chung	–	–	–	–	–
Kenneth Ting Woo-shou	–	–	–	–	–
Wong Ting-kwong	–	–	–	–	–
Total	–	15,218,524	1,741,010	2,324,659	19,284,193

**NOTES TO THE  
FINANCIAL  
STATEMENTS (cont'd)**

For the year ended  
31 March 2006

	Fees HK\$	Salaries and other benefits HK\$	2005 Contributions to MPF schemes HK\$	Variable pay HK\$	Total emoluments HK\$
<b>Executive Directors</b>					
Diana Chan Tong Chee-ching	–	4,096,621	472,431	661,707	5,230,759
Hendena Yu	–	2,923,763	317,134	272,747	3,513,644
Ernest Lee Shu-wing	–	2,402,814	269,884	314,036	2,986,734
Darren Mark McShane	–	3,151,399	383,967	717,600	4,252,966
Jimmy Woo Jack-man <sup>1</sup>	–	419,728	48,918	73,376	542,022
<b>Non-Executive Directors</b>					
Charles Lee Yeh-kwong	–	–	–	–	–
Edward Chan King-sang	–	–	–	–	–
Stephen Ip Shu-kwan	–	–	–	–	–
Leo Kung Lin-cheng	–	–	–	–	–
Lee Kai-ming	–	–	–	–	–
Angelina Lee Wong Pui-ling	–	–	–	–	–
Frederick Ma Si-hang	–	–	–	–	–
David Sun Tak-kei	–	–	–	–	–
Tam Yiu-chung	–	–	–	–	–
Kenneth Ting Woo-shou	–	–	–	–	–
Wong Ting-kwong	–	–	–	–	–
Robert Tang Ching <sup>2</sup>	–	–	–	–	–
Eddy Fong Ching <sup>3</sup>	–	–	–	–	–
David Li Kwok-po <sup>3</sup>	–	–	–	–	–
Lui Ming-wah <sup>3</sup>	–	–	–	–	–
Anna Wu Hung-yuk <sup>3</sup>	–	–	–	–	–
Joseph Yam Chi-kwong <sup>3</sup>	–	–	–	–	–
Total	–	12,994,325	1,492,334	2,039,466	16,526,125

<sup>1</sup> appointment effective from 1 February 2005

<sup>2</sup> resigned as from 2 April 2004

<sup>3</sup> appointment term expired from 17 March 2005

**8. EMPLOYEES' EMOLUMENTS**

Of the five individuals with the highest emoluments in the MPFA (2005: 4), all were Executive Directors, whose emoluments are included in note 7 above. The emoluments of the fifth individual in 2005 were as follows:

	2005 HK\$
Salaries and other benefits	1,828,291
Contributions to the Mandatory Provident Fund schemes	193,500
Variable pay	135,000
	<u>2,156,791</u>

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 8. EMPLOYEES' EMOLUMENTS (cont'd)

The emoluments of the five highest paid individuals were within the following bands:

	2006 No. of employees	2005 No. of employees
HK\$2,000,001 to HK\$2,500,000	–	1
HK\$2,500,001 to HK\$3,000,000	1	1
HK\$3,000,001 to HK\$3,500,000	1	–
HK\$3,500,001 to HK\$4,000,000	1	1
HK\$4,000,001 to HK\$4,500,000	1	1
HK\$4,500,001 to HK\$5,000,000	–	–
HK\$5,000,001 to HK\$5,500,000	1	1
	<b>5</b>	<b>5</b>

### 9. PROPERTY AND EQUIPMENT

	Leasehold improvements HK\$	Computer equipment and software HK\$	Office equipment and furniture HK\$	Motor vehicles HK\$	Total HK\$
<b>COST</b>					
At 1 April 2004	22,252,569	61,109,547	9,014,491	802,684	93,179,291
Additions	858,607	2,970,558	129,158	–	3,958,323
Disposals	–	–	(23,594)	–	(23,594)
At 31 March 2005	23,111,176	64,080,105	9,120,055	802,684	97,114,020
Additions	2,444,878	5,517,896	383,132	–	8,345,906
Disposals	(3,312,180)	(618,646)	(351,450)	–	(4,282,276)
At 31 March 2006	22,243,874	68,979,355	9,151,737	802,684	101,177,650
<b>DEPRECIATION</b>					
At 1 April 2004	22,252,569	46,736,090	7,336,297	802,684	77,127,640
Charge for the year	18,941	9,290,174	935,587	–	10,244,702
Eliminated on disposals	–	–	(23,594)	–	(23,594)
At 31 March 2005	22,271,510	56,026,264	8,248,290	802,684	87,348,748
Charge for the year	565,049	4,925,001	458,557	–	5,948,607
Eliminated on disposals	(3,312,180)	(618,646)	(351,450)	–	(4,282,276)
At 31 March 2006	19,524,379	60,332,619	8,355,397	802,684	89,015,079
<b>CARRYING VALUES</b>					
At 31 March 2006	2,719,495	8,646,736	796,340	–	12,162,571
At 31 March 2005	839,666	8,053,841	871,765	–	9,765,272

The above items of property and equipment are depreciated on a straight-line basis as follows:

Leasehold improvements	Over the remaining terms of the leases or 4 years, whichever is shorter
Computer equipment and software	3 – 4 years
Office equipment and furniture	4 years
Motor vehicles	4 years

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income and expenditure account in the year in which the item is derecognised.



## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 10. PROJECTS IN PROGRESS

Projects in progress consist of expenditure of capital projects not completed at 31 March 2006 of HK\$83,790 (2005: HK\$507,826).

### 11. INVESTMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2006 HK\$
<b>At fair value</b>	
Equity securities:	
Listed	1,192,816,159
Unlisted	2,801,811
	<b>1,195,617,970</b>
Debt securities:	
Listed	1,234,275,229
Unlisted	2,497,538,741
	<b>3,731,813,970</b>
Total:	
Listed	2,427,091,388
Unlisted	2,500,340,552
	<b>4,927,431,940</b>

At the balance sheet date, all investments designated at fair value through profit or loss are stated at fair value. Fair values of those listed investments and unlisted investments have been determined by reference to bid prices quoted in active markets and over the counter brokers quotations respectively.

### 12. OTHER INVESTMENTS

Upon the application of HKAS 39 on 1 April 2005, other investments were reclassified to investments designated at fair value through profit or loss.

	2005 HK\$
Equity securities:	
Listed	1,105,462,643
Debt securities:	
Listed	1,310,699,961
Unlisted	2,332,416,593
	<b>3,643,116,554</b>
Total:	
Listed	2,416,162,604
Unlisted	2,332,416,593
	<b>4,748,579,197</b>
Market value of listed securities	<b>2,416,162,604</b>

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

### 13. DERIVATIVE FINANCIAL INSTRUMENTS

	2006		2005	
	Assets HK\$	Liabilities HK\$	Assets HK\$	Liabilities HK\$
Foreign currency contracts				
– forward	4,266,938	(2,543,350)	4,342,778	(735,729)
– spot	1,358	(1,546)	10	(463)
	4,268,296	(2,544,896)	4,342,788	(736,192)

The above derivatives are not under hedge accounting and are measured at fair value at each balance sheet date. Their fair values are determined based on the quoted market prices for equivalent instruments at the balance sheet date.

### 14. OTHER FINANCIAL ASSETS

The fair values of debtors, deposits, unsettled investment receivables and interest receivables, determined based on estimated cash flows discounted at the prevailing market rate at each balance sheet date, approximate to the corresponding carrying amounts. All financial assets are non-interest bearing except for bank deposits and bank balances.

### 15. OTHER FINANCIAL LIABILITIES

The fair values of creditors and accrued charges, fees received in advance and unsettled investment payables, determined based on estimated cash flows discounted at the prevailing market rate at each balance sheet date, approximate to the corresponding carrying amounts. All financial liabilities are non-interest bearing.

### 16. CAPITAL GRANT

On 3 April 1998, the Finance Committee of the Legislative Council of the Hong Kong Special Administrative Region approved a capital grant of HK\$5 billion as initial funding to cover the establishment and operating costs of the MPFA.

### 17. LOANS TO DIRECTORS AND EXECUTIVES

There were no loans to directors or executives during the year and no loans were outstanding at the balance sheet date.

### 18. CAPITAL COMMITMENTS

At the balance sheet date, the MPFA had commitments for capital expenditure in respect of the acquisition of property and equipment as follows:

	2006 HK\$	2005 HK\$
Contracted but not provided for	195,510	–
Authorised but not contracted for	1,401,948	–
	1,597,458	–

**NOTES TO THE  
FINANCIAL  
STATEMENTS (cont'd)**

*For the year ended  
31 March 2006*

**19. OPERATING LEASE COMMITMENTS**

At the balance sheet date, the MPFA had commitments for future minimum lease payments under non-cancellable operating leases in respect of rented premises (office properties and storage space) which fall due as follows:

	<b>2006 HK\$</b>	<b>2005 HK\$</b>
Within one year	<b>11,561,874</b>	10,187,886
In the second to fifth year inclusive	<b>51,743,448</b>	63,305,322
	<b>63,305,322</b>	73,493,208

Operating lease payments represent rental payable by the MPFA for its office premises and storage space. Office leases are negotiated for an average term of six years and rentals are fixed throughout the six year term.

**20. MANDATORY PROVIDENT FUND SCHEMES COMPENSATION FUND**

Section 17 of the Ordinance requires the MPFA to establish a compensation fund and the MPFA may appoint an administrator for the compensation fund or where there is no such administrator, the MPFA must administer the compensation fund. MPFA was appointed as the administrator of the compensation fund until 31 March 2007. The Mandatory Provident Fund Schemes (General) Regulation requires the compensation fund to be maintained in separate bank accounts and separate financial statements are to be prepared in respect of the fund.

## **MPF SCHEMES COMPENSATION FUND**

### **AUDITORS’ REPORT TO THE ADMINISTRATOR OF THE MANDATORY PROVIDENT FUND SCHEMES COMPENSATION FUND (“THE FUND”)**

*(Established in Hong Kong  
under the Mandatory  
Provident Fund Schemes  
Ordinance)*

We have audited the financial statements on pages 92 to 102 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

#### **RESPECTIVE RESPONSIBILITIES OF THE ADMINISTRATOR AND AUDITORS**

The Mandatory Provident Fund Schemes (General) Regulation (“the Regulation”) requires the administrator to keep proper accounting records of the Fund and to prepare financial statements of the Fund which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with section 184(3)(a) of the Regulation, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

#### **BASIS OF OPINION**

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the administrator in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund’s circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

#### **OPINION**

In our opinion, the financial statements give a true and fair view of the state of the Fund’s affairs as at 31 March 2006 and of its surplus and cash flows for the year then ended and have been properly prepared in accordance with accounting principles generally accepted in Hong Kong.

**Deloitte Touche Tohmatsu**  
Certified Public Accountants  
Hong Kong  
3 July 2006

**MPF SCHEMES  
COMPENSATION FUND**

**INCOME AND  
EXPENDITURE  
ACCOUNT**

*For the year ended  
31 March 2006*

	NOTES	2006 HK\$	2005 HK\$
<b>INCOME</b>			
Levy fee		<b>49,135,134</b>	37,366,309
Interest income on bank deposits		<b>20,143,317</b>	4,257,465
Net investment income	5	<b>10,342,527</b>	2,009,107
		<b>79,620,978</b>	43,632,881
<b>EXPENDITURE</b>			
Auditors' remuneration		<b>43,000</b>	43,000
Investment expenses		<b>57,980</b>	59,778
Other operating expenses		<b>2,450</b>	1,400
		<b>103,430</b>	104,178
<b>SURPLUS FOR THE YEAR</b>		<b>79,517,548</b>	43,528,703

**MPF SCHEMES  
COMPENSATION FUND**

**BALANCE  
SHEET**

*At 31 March 2006*

	NOTES	2006 HK\$	2005 HK\$
<b>CURRENT ASSETS</b>			
Investments designated at fair value through profit or loss	7	<b>220,711,672</b>	–
Other investments	8	–	206,312,804
Levy fee receivables	9	<b>47,990,236</b>	36,826,884
Unsettled investment receivables	9	–	39,966,398
Interest receivables	9	<b>6,854,398</b>	2,759,517
Bank deposits	9	<b>656,360,000</b>	607,360,000
Bank balances	9	<b>145,052</b>	119,572
		<b>932,061,358</b>	893,345,175
<b>CURRENT LIABILITIES</b>			
Creditors and accrued charges	10	<b>42,698</b>	47,744
Unsettled investment payables	10	–	40,796,319
		<b>42,698</b>	40,844,063
<b>NET ASSETS</b>		<b>932,018,660</b>	852,501,112
<b>CAPITAL AND RESERVE</b>			
Seed money	11	<b>600,000,000</b>	600,000,000
Income and expenditure account		<b>332,018,660</b>	252,501,112
		<b>932,018,660</b>	852,501,112

The financial statements on pages 92 to 102 were approved and authorised for issue by the Mandatory Provident Fund Schemes Authority on 3 July 2006 and signed on its behalf by:

**Diana Chan**  
Managing Director

**MPF SCHEMES  
COMPENSATION FUND**

**STATEMENT OF  
CHANGES IN  
CAPITAL AND  
RESERVE**

*For the year ended  
31 March 2006*

	<b>Compensation Fund</b>	<b>Income and Expenditure</b>	
	<b>Seed Money</b>	<b>Account</b>	<b>Total</b>
	HK\$	HK\$	HK\$
At 1 April 2004	600,000,000	208,972,409	808,972,409
Surplus for the year	–	43,528,703	43,528,703
At 31 March 2005	600,000,000	252,501,112	852,501,112
Surplus for the year	–	79,517,548	79,517,548
At 31 March 2006	600,000,000	332,018,660	932,018,660

**MPF SCHEMES  
COMPENSATION FUND**

**CASH FLOW  
STATEMENT**

*For the year ended  
31 March 2006*

	2006 HK\$	2005 HK\$
<b>OPERATING ACTIVITIES</b>		
Surplus for the year	79,517,548	43,528,703
Adjustments for:		
Interest income on bank deposits	(20,143,317)	(4,257,465)
Interest income on investments designated at fair value through profit or loss	(5,123,508)	–
Interest income on other investments	–	(4,587,929)
Dividends from investments designated at fair value through profit or loss	(1,164,500)	–
Dividends from other investments	–	(978,180)
Net gain on investments designated at fair value through profit or loss	(4,054,519)	–
Net loss on other investments	–	3,557,002
Operating cash flows before movements in working capital	49,031,704	37,262,131
Increase in levy fee receivables	(11,163,352)	(8,439,948)
Decrease in creditors and accrued charges	(5,046)	(9,318)
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>37,863,306</b>	<b>28,812,865</b>
<b>INVESTING ACTIVITIES</b>		
Dividends received from investments designated at fair value through profit or loss	1,164,500	–
Dividends received from other investments	–	978,180
Interest received on bank deposits	15,644,137	3,920,419
Interest received from investments designated at fair value through profit or loss	5,527,807	–
Interest received from other investments	–	4,948,925
Proceeds on disposals of investments designated at fair value through profit or loss	598,032,449	–
Proceeds on disposals of other investments	–	439,815,202
Purchase of investments designated at fair value through profit or loss	(609,206,719)	–
Purchase of other investments	–	(439,125,481)
Increase in bank deposits	(49,000,000)	(39,360,000)
Decrease (Increase) in bank balances held for investment purposes	3,956	(4,771)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(37,833,870)</b>	<b>(28,827,526)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>29,436</b>	<b>(14,661)</b>
<b>CASH AND CASH EQUIVALENTS AT 1 APRIL 2005</b>	<b>69,572</b>	<b>84,233</b>
<b>CASH AND CASH EQUIVALENTS AT 31 MARCH 2006</b>	<b>99,008</b>	<b>69,572</b>
<b>ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Bank balances	145,052	119,572
Less: Bank balances held for investment purposes	(46,044)	(50,000)
	<b>99,008</b>	<b>69,572</b>



## NOTES TO THE FINANCIAL STATEMENTS

For the year ended  
31 March 2006

### 1. PURPOSE AND CLAIM FOR PAYMENT

The Mandatory Provident Fund Schemes Compensation Fund (“the Fund”) is established for the purpose of compensating members of registered Mandatory Provident Fund schemes and other persons who have beneficial interests in those schemes for losses of accrued benefits that are attributable to misfeasance or illegal conduct committed by the approved trustees of those schemes or by other persons concerned with the administration of those schemes.

Application for compensation from the Fund has to be made to a court of law in accordance with the Hong Kong Mandatory Provident Fund Schemes Ordinance (“the Ordinance”). The administrator shall then make the compensation fund payment pursuant to the decisions of the court. During the year, the Mandatory Provident Fund Schemes Authority (“the MPFA”) was the administrator of the Fund. The MPFA has not charged any administration fee to the Fund during the year. The MPFA’s office address is 21/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong.

The financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the Fund.

### 2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Fund has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (“HKFRSs”), Hong Kong Accounting Standards (“HKASs”) and Interpretations (hereinafter collectively referred to as “new HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) that are effective for accounting periods beginning on or after 1 January 2005. The adoption of the new HKFRSs has had no material effect on how the results for the current or prior accounting years are prepared and presented. Accordingly, no prior year adjustment has been required.

#### Financial Instruments

The Fund has applied HKAS 32 Financial Instruments: Disclosure and Presentation and HKAS 39 Financial Instruments: Recognition and Measurement. The application of HKAS 32 and HKAS 39 has had no material impact on how financial instruments of the Fund are presented for current and prior accounting periods.

#### *Classification and measurement of financial assets and financial liabilities*

The Fund has applied the relevant transitional provisions in HKAS 39 with respect to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

NOTES TO THE  
FINANCIAL  
STATEMENTS (cont'd)

For the year ended  
31 March 2006

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS (cont'd)

**Financial Instruments (cont'd)**

*Classification and measurement of financial assets and financial liabilities (cont'd)*

By 31 March 2005, the Fund classified and measured its debt and equity securities in accordance with the benchmark treatment of Statement of Standard Accounting Practice 24 ("SSAP 24"). Under SSAP 24, investments in debt or equity securities are classified as "investment securities", "other investments" or "held-to-maturity investments" as appropriate. "Investment securities" are carried at cost less impairment losses (if any) while "other investments" are measured at fair value, with unrealised gains or losses included in the income and expenditure account. Held-to-maturity investments are carried at amortised cost less impairment losses (if any). From 1 April 2005 onwards, the Fund has classified and measured its debt and equity securities in accordance with HKAS 39. Under HKAS 39, financial assets are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables", or "held-to-maturity financial assets". "Financial assets at fair value through profit or loss" and "available-for-sale financial assets" are carried at fair value, with changes in fair values recognised in the income and expenditure account and reserve respectively. Available-for-sale equity investments that do not have quoted market prices in an active market and whose fair value cannot be reliably measured are measured at cost less impairment after initial recognition. "Loans and receivables" and "held-to-maturity financial assets" are measured at amortised cost using the effective interest method after initial recognition.

*Financial assets and financial liabilities other than debt and equity securities*

From 1 April 2005 onwards, the Fund has classified and measured its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. As mentioned above, financial assets under HKAS 39 are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables" or "held-to-maturity financial assets". Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "other financial liabilities". Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in the income and expenditure account directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

The Fund has not early applied the following new standards and interpretations that have been issued but are not yet effective.

## MPF SCHEMES COMPENSATION FUND

### NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

## 2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS (cont'd)

### Financial Instruments (cont'd)

*Financial assets and financial liabilities other than debt and equity securities (cont'd)*

HKAS 1 (Amendment)	Capital Disclosures <sup>1</sup>
HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures <sup>5</sup>
HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation <sup>5</sup>
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions <sup>5</sup>
HKAS 39 (Amendment)	The Fair Value Option <sup>5</sup>
HKAS 39 & HKFRS 4 (Amendments)	Financial Guarantee Contracts <sup>5</sup>
HKFRS 6	Exploration for and Evaluation of Mineral Resources <sup>5</sup>
HKFRS 7	Financial Instruments: Disclosures <sup>1</sup>
HKFRS-Int 4	Determining whether an Arrangement contains a Lease <sup>5</sup>
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds <sup>5</sup>
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment <sup>6</sup>
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies <sup>4</sup>
HK(IFRIC)-Int 8	Scope of HKFRS 2 <sup>3</sup>
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives <sup>2</sup>

1 Effective for annual periods beginning on or after 1 January 2007

2 Effective for annual periods beginning on or after 1 June 2006

3 Effective for annual periods beginning on or after 1 May 2006

4 Effective for annual periods beginning on or after 1 March 2006

5 Effective for annual periods beginning on or after 1 January 2006

6 Effective for annual periods beginning on or after 1 December 2005

## 3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost basis, except for certain financial instruments, which are measured at fair values, and in accordance with HKFRSs issued by the HKICPA. The principal accounting policies adopted are as follows:

### Revenue recognition

Levy fee consists of fees charged to the approved trustees of registered Mandatory Provident Fund schemes and is accounted for on an accrual basis.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

NOTES TO THE  
FINANCIAL  
STATEMENTS (cont'd)

For the year ended  
31 March 2006

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

**Financial instruments**

Financial assets and financial liabilities are recognised on the balance sheet when the Fund becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in the income and expenditure account.

**Financial assets**

The Fund's financial assets include financial assets at fair value through profit or loss and loans and receivables. All regular way purchases or sales of financial assets are recognised and derecognised on a trade-date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss have two subcategories, including financial assets held for trading and those designated at fair value through profit or loss on initial recognition. At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in the income and expenditure account in the period in which they arise.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables including levy fee receivables, unsettled investment receivables, interest receivables, bank deposits and bank balances are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in the income and expenditure account when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

## MPF SCHEMES COMPENSATION FUND

### NOTES TO THE FINANCIAL STATEMENTS (cont'd)

For the year ended  
31 March 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into and the definition of a financial liability.

Financial liabilities, including creditors and accrued charges and unsettled investment payables are subsequently measured at amortised cost, using the effective interest rate method.

## 4. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Fund's major financial instruments include bank deposits and balances, equity and debt investments. The strategic investment allocation was set using a statistical approach. A set of Investment Guidelines approved by the MPFA's Management Board is in place to lay down limits and restrictions on currency risk, interest rate risk, credit risk and general activities. The Finance Committee, one of the standing committees of the MPFA, is responsible to oversee the investment of the Fund.

Permissible debt investments have to satisfy the requirements of the credit rating specified in the Investment Guidelines. The investment portfolio is managed in-house.

### Currency risk

The Investment Guidelines permit only investments in HK dollars. There is therefore no currency risk taken by the Fund.

### Fair value interest rate risk

The invested portfolio is exposed to fair value interest rate risks due to holdings in debt securities. Such risks may be mitigated by reducing the asset weight and portfolio duration of the bond portfolio. The Fund invests mainly in short-dated HK dollar debt securities of up to two years' maturity. As at 31 March 2006, the debt securities portfolio duration is set out below:

	2006	2005
	Years	Years
Portfolio duration	0.42	0.42

### Credit risk

The portfolios must invest only into debt securities of investment grade. As at 31 March 2006, the credit risk profile as weighted by market value is set out below:

Credit risk

Credit rating of issuers	2006		2005	
	HK\$	%	HK\$	%
AA <sup>1</sup>	184,607,796	100	175,853,477	100

<sup>1</sup> AA means between AA- and AA+ by S&P and Aa3 and Aa1 by Moody's

**MPF SCHEMES  
COMPENSATION FUND**

**NOTES TO THE  
FINANCIAL  
STATEMENTS (cont'd)**

*For the year ended  
31 March 2006*

**4. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (cont'd)**

**Price risk**

The invested portfolios are investments designated at fair value through profit or loss and are measured at fair value at each balance sheet date. The Fund maintains a fairly high percentage in cash investment, i.e. HK dollar deposits. Debt securities investments are of short maturity and therefore are subject to relatively low price risk. The investment in equities accounted for less than 5% of the total investment. Equities are managed with a passive investment style and its weighting re-balanced to maintain the strategic asset allocation within a tolerance limit. The investment performance is reported to the Finance Committee every three months and to the Management Board every six months.

**5. NET INVESTMENT INCOME**

	<b>2006 HK\$</b>	<b>2005 HK\$</b>
Interest income on investments designated at fair value through profit or loss	<b>5,123,508</b>	–
Interest income on other investments	–	4,587,929
Dividends from investments designated at fair value through profit or loss	<b>1,164,500</b>	–
Dividends from other investments	–	978,180
Net gain on investments designated at fair value through profit or loss	<b>4,054,519</b>	–
Net loss on other investments	–	(3,557,002)
	<b>10,342,527</b>	2,009,107

**6. TAXATION**

No provision for Hong Kong Profits Tax has been made in the financial statements as the Fund is exempt from Hong Kong Profits Tax under section 88 of the Inland Revenue Ordinance.

**7. INVESTMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS**

	<b>2006 HK\$</b>
<b>At fair value</b>	
Equity securities:	
Listed	<b>37,264,000</b>
Debt securities:	
Listed	<b>109,702,722</b>
Unlisted	<b>73,744,950</b>
	<b>183,447,672</b>
Total:	
Listed	<b>146,966,722</b>
Unlisted	<b>73,744,950</b>
	<b>220,711,672</b>

At the balance sheet date, all investments designated at fair value through profit or loss are stated at fair value. Fair values of those listed investments and unlisted investments have been determined by reference to bid prices quoted in active markets and over the counter brokers quotations respectively.

**MPF SCHEMES  
COMPENSATION FUND**

**NOTES TO THE  
FINANCIAL  
STATEMENTS (cont'd)**

*For the year ended  
31 March 2006*

**8. OTHER INVESTMENTS**

Upon the application of HKAS 39 on 1 April 2005, other investments were reclassified to investments designated at fair value through profit or loss.

	2005 HK\$
Equity securities:	
Listed	32,023,750
Debt securities:	
Listed	55,594,100
Unlisted	118,694,954
	174,289,054
Total:	
Listed	87,617,850
Unlisted	118,694,954
	206,312,804
Market value of listed securities	87,617,850

**9. OTHER FINANCIAL ASSETS**

The fair values of levy fee receivables, unsettled investment receivables and interest receivables, determined based on estimated cash flows discounted at the prevailing market rate at each balance sheet date, approximate to the corresponding carrying amounts. All financial assets are non-interest bearing except for bank deposits.

**10. OTHER FINANCIAL LIABILITIES**

The fair values of creditors and accrued charges and unsettled investment payables, determined based on estimated cash flows discounted at the prevailing market rate at each balance sheet date, approximate to the corresponding carrying amounts. All financial liabilities are non-interest bearing.

**11. SEED MONEY**

On 12 March 1999, an amount of HK\$600 million was injected from the Government of the Hong Kong Special Administrative Region as the seed money of the Fund.