

Notes to the financial statements

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of The Stock Exchange of Hong Kong Ltd (SEHK). Part X of the repealed Securities Ordinance governs its operation.

SEHK receives and determines claims against the Fund. The Securities and Futures Commission (SFC) maintains and invests the money of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The repealed Securities Ordinance limits the total compensation amount that may be paid per exchange participant default to \$8 million. If allowed claims exceed the limit, payments are made proportionally to claimants. SEHK, with the approval of the SFC, can decide to exceed the limit if it considers, among other things, that the assets of the Fund so permit. For eight defaults since 1998, SEHK proposed and the SFC approved exceeding the limit via payment of up to \$150,000 per claimant or, if higher, the claimant's proportional share of the \$8 million limit.

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the repealed Securities Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds are available.

After the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single Investor Compensation Fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After settlement of all claims against the Fund and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 should be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 112 of the repealed Securities Ordinance, under Section 74 of Schedule 10 of the SFO, Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Before 1 April 2003, SEHK was required to keep deposited with the SFC \$50,000 for each SEHK trading right under the repealed Securities Ordinance. When the SFC makes compensation payments out of the deposits, the SFC may require SEHK to replenish the net amount paid after the SFC has exhausted its subrogated rights against the defaulter. The SFC pays to SEHK the investment return earned on any remaining deposits net of Fund expenses. During the year, the SFC did not make such payment as the total of the compensation payments exceeded the deposits received from SEHK (2010: nil).

SEHK and the SFC have made contributions of their own money to the Fund. The SFC determines to retain investment returns earned on these contributions in the Fund.

Other sources of money for the Fund include: recoveries; SEHK replenishments detailed in note 14; special levy surplus detailed in note 10; and transaction levy received before the SFO became effective from 1 April 2003.

The Fund defines "capital" as including all elements of the Fund less contributions to the ICF and less contributions from SEHK (deposits for transferred trading rights) as disclosed on the face of the statement of financial position.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies

(a) Statement of compliance

The Fund prepares its financial statements in accordance with International Financial Reporting Standards (IFRSs) (including applicable International Accounting Standards and Interpretations) issued by the International Accounting Standards Board (IASB). A summary of the significant accounting policies adopted by the Fund is set out below.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Fund. However, none of these developments are relevant to the Fund's operations.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 15).

(b) Basis of preparation

Under the SFO, the Fund will continue in operation until all claims against it and all its liabilities have been settled. As the Fund will eventually cease operation, we have prepared these financial statements on a break-up basis with assets stated at recoverable amounts. We have not provided for potential future claims and recoveries as these cannot be reliably estimated. We have also not provided in the financial statements for all expenses expected to be incurred subsequent to the end of the reporting period and up to the date operations will cease as these are estimated to be immaterial.

We prepare the financial statements in conformity with IFRSs which requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. We make estimates and associated assumptions based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We review estimates and underlying assumptions on an ongoing basis. We recognise revisions to accounting estimates in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(c) Recognition of income

(i) Interest income

We record interest income as it accrues using the effective interest method.

(ii) Recoveries

We recognise recoveries pursuant to Section 118 of the repealed Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. We record recoveries received and re-distributed when and only when we can be virtually certain that the recoveries will be received and paid.

(iii) Replenishments by SEHK

We record replenishments from SEHK pursuant to Section 107 of the repealed Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by SEHK, we deem compensation payments up to the amount of \$8 million for each default to be charged to the contribution from SEHK.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(d) Impairment

(i) Recognition of impairment loss

We review the carrying amounts of the Fund's assets at the end of each reporting period to determine whether there is any objective evidence of impairment. If any such evidence exists, we estimate the asset's recoverable amount. We recognise in the statement of comprehensive income the difference between the asset's carrying amount and the recoverable amount as an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount.

(ii) Calculation of impairment loss

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

(iii) Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that are objectively linked to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. We reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined if we had not recognised any impairment loss.

(e) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(f) Creditors and accrued charges

We state creditors and accrued charges initially at fair value and thereafter at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(g) Contingent liabilities

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefit is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(h) Related parties

For the purpose of these financial statements, a party is considered to be related to the Fund if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Fund or exercise significant influence over the Fund in making financial and operating decisions or has joint control over the Fund;
- (ii) the Fund and the party are subject to common control;
- (iii) the party is an associate of the Fund or a joint venture in which the Fund is a venturer;
- (iv) the party is a member of key management personnel of the Fund or the Fund's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Fund or of any entity that is a related party of the Fund.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the Fund.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

4. Taxation

Section 87 of the Hong Kong Inland Revenue Ordinance exempts the Fund from Hong Kong Profits Tax.

5. Recoveries

During the year, the Fund recognised as recoveries the payments from liquidator of Lawsons Securities Company.

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised SFC that shares were allocated to the Fund under its subrogation rights, subject to paying a processing fee to the liquidators. The Fund recognised as recoveries the sale proceeds of shares allocated and the remaining shares at market value as of 31 March 2011 after deducting relevant processing fees and charges for collecting and selling the shares received.

The shares allocated to the Fund under its subrogation rights are classified as designated at fair value through profit and loss securities in accordance with the determination in IAS 39, *Financial instruments: Recognition and measurement*. According to IFRS 7, *Financial instruments: Disclosures*, these subrogated shares should be classified as level 1 financial instruments as they all have quoted market price (unadjusted) in an active market for an identical instrument. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in "Recoveries". Dividend income, if any, is also recognised in "Recoveries".

6. Creditors and accrued charges

Creditors and accrued charges comprised mainly compensation payments re-established for those cheque payments that were not cleared over six months from the cheque issuing date and accrued auditor's remuneration.

These liabilities classified as financial liabilities measured at amortised costs in accordance with the determination in IAS 39 unless the effect of discounting would be immaterial, in which case they are stated at cost, are due on demand or within one year and are unsecured.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

7. Set-off of SEHK deposits and refunds/contributions from SEHK

According to Section 104 of the repealed Securities Ordinance, SEHK contributes to the Fund in respect of each trading right at the rate of \$50,000 per trading right. In the absence of claims or other provisions as set out in Section 106 of the repealed Securities Ordinance, the SFC must refund to SEHK the deposit within six months after the relinquishment. During the year, deposits of \$1,700,000 in respect of 34 new trading rights were received from SEHK.

During the year, the SFC had refunded to SEHK of \$600,000 in respect of the deposit of 12 relinquished trading rights. As at 31 March 2011, there are 9 trading rights in total that have been relinquished but not yet refunded.

The movement of contributions from SEHK during the year was as follows:

	2011 \$'000	2010 \$'000
Balance brought forward	47,600	47,000
Add: 34 new trading rights issued (2010: 26)	1,700	1,300
Less: 12 relinquished trading rights refunded (2010: 14)	(600)	(700)
Balance carried forward	48,700	47,600

8. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund.

In relation to the default cases, any excess of recovered amounts (refer to note 5), if any, will be re-distributed to claimants. As the timing of re-distribution and amount of these potential excess amounts are uncertain at the date of this report, we disclose this as a contingent liability.

9. Excess transaction levy from SEHK

SEHK paid these amounts to the Fund from 1992 to 1994 under an agreement with the SFC and the Financial Secretary concerning SEHK's budget and its receipt of transaction levy.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

10. Special levy surplus

In November 2000, the former Financial Services Bureau of the HKSAR Government transferred to the Fund \$3,002,000 under the provisions of the Exchanges (Special Levy) Ordinance.

11. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single Investor Compensation Fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. Under Section 74(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. Total contributions paid into the ICF upto 31 March 2011 amounted to \$994,718,000 (2010: \$994,718,000).

12. Material related party transactions

We have related party relationships with the ICF and the SFC. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to note 11).

13. Financial risk management

The Fund's interest bearing assets mainly comprise deposits at banks which mature or re-price in the short term, as a result of which the Fund is subject to a limited exposure to interest rate risk due to fluctuations in the prevailing market rates. At 31 March 2011, it is estimated that a general increase/decrease of 100 basis points in the interest rates, with all other variables held constant, would increase/decrease the Fund's surplus and accumulated surplus by approximately \$716,000 (2010: \$690,000). Other components of accumulated surplus would not be affected (2010: Nil) by the changes in interest rates. The exposure to credit and liquidity risks arises in the normal course of the Fund's operation. The Fund is not exposed to any foreign exchange risk as all transactions and balances are denominated in HK dollars.

The Fund's credit risk is primarily attributable to amounts at bank. Management's policy is that bank balances are placed only with licensed banks rated P-1 or A-1 by Moody's or S&P respectively.

The Fund's policy is to regularly monitor its liquidity requirements to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

14. Replenishments from SEHK

Under Section 107 of the repealed Securities Ordinance, the SFC may require SEHK to replenish the Fund with an amount that is equal to that paid in connection with the satisfaction of the claim (limited to \$8,000,000 per each defaulted case) after the SFC has exhausted all relevant rights of action and other legal remedies against the defaulter.

Up to 31 March 2011, SEHK has replenished \$16,361,000 to the Fund. In compliance with Section 107 of the repealed Securities Ordinance, if no further recoveries were to be collected, the SFC may require SEHK to further replenish \$70,816,000 to the Fund as follows:

	2011 \$'000	2010 \$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the repealed Securities Ordinance	100,738	100,738
Less: Recoveries received for compensation paid up to \$8 million	(29,946)	(29,946)
Add: Recoveries re-distributed to claimants	16,385	16,385
Less: Replenishments from SEHK	(16,361)	(16,361)
Net amount the SFC may request SEHK for replenishment	70,816	70,816

Under Section 74(3) of Schedule 10 of the SFO, the SFC having allowed sufficient funds to meet claims, may reimburse SEHK for the deposits paid by SEHK into the Fund for each trading right. The reimbursement of these SEHK deposits may be set off against further replenishments required from SEHK.

Replenishment from SEHK are not recognised in the statement of financial position given that the Fund is not aware of any need for requesting SEHK for replenishment in the near future.

15. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 March 2011

Up to the date of issue of these financial statements, the IASB has issued a number of amendments and Interpretations and one new standard which are not yet effective for the year ended 31 March 2011 and which have not been adopted in these financial statements.

Effective for accounting periods beginning on or after

Revised IAS 24, *Related party disclosures*
IFRS 9, *Financial instruments*

1 January 2011

1 January 2013

The Fund is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.