



## Language Fund

Financial statements for the year ended 31 August 2006

# ***Report of the Director of Audit***



**Audit Commission**

**The Government of the Hong Kong Special Administrative Region**

## **Independent Audit Report**

### **To the Permanent Secretary for Education and Manpower Incorporated**

I certify that I have audited the financial statements of the Language Fund set out on pages 1 to 14, which comprise the balance sheet as at 31 August 2006, and the income and expenditure account, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### **Permanent Secretary for Education and Manpower Incorporated's responsibility for the financial statements**

The Permanent Secretary for Education and Manpower Incorporated is responsible for the preparation and the true and fair presentation of these financial statements in accordance with section 8(3) of the Permanent Secretary for Education and Manpower Incorporation Ordinance (Cap. 1098) and Hong Kong Financial Reporting Standards. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### **Auditor's responsibility**

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with section 8(5) of the Permanent Secretary for Education and Manpower Incorporation Ordinance and the Audit Commission auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Permanent Secretary for Education and Manpower Incorporated, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **Opinion**

In my opinion, the financial statements give a true and fair view of the financial position of the Language Fund as at 31 August 2006 and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with section 8(3) of the Permanent Secretary for Education and Manpower Incorporation Ordinance.



(YING Kwok-wing)  
Assistant Director of Audit  
for Director of Audit

26 February 2007

Audit Commission  
26th Floor  
Immigration Tower  
7 Gloucester Road  
Wanchai, Hong Kong

**Language Fund**  
**Income and Expenditure Account**  
**for the year ended 31 August 2006**

	<u>Note</u>	<u>2006</u> HK\$'000	<u>2005</u> HK\$'000
<b>INCOME</b>			
Government grants	4	1,100,000	500,000
Interest income		<u>57,626</u>	<u>20,404</u>
		<u>1,157,626</u>	<u>520,404</u>
<b>EXPENDITURE</b>			
Grants		70,139	57,467
Public education and publicity expenses		<u>-</u>	<u>1</u>
		<u>70,139</u>	<u>57,468</u>
<b>SURPLUS FOR THE YEAR</b>		<u><u>1,087,487</u></u>	<u><u>462,936</u></u>

The accompanying Notes 1 to 10 form part of these accounts.

**Language Fund  
Balance Sheet  
as at 31 August 2006**

	<u>Note</u>	<u>2006</u> HK\$'000	<u>2005</u> HK\$'000
<b>Non-current assets</b>			
Structured deposits	5	80,000	230,000
Bank deposits		220,013	360,013
		<u>300,013</u>	<u>590,013</u>
<b>Current assets</b>			
Interest receivable		35,451	19,566
Structured deposits	5	149,799	-
Bank deposits		1,703,503	550,046
Cash at bank		87,177	29,418
		<u>1,975,930</u>	<u>599,030</u>
<b>Current liabilities</b>			
Grants payable		<u>(1,442)</u>	<u>(1,216)</u>
<b>Net current assets</b>		<u>1,974,488</u>	<u>597,814</u>
<b>NET ASSETS</b>		<u><u>2,274,501</u></u>	<u><u>1,187,827</u></u>
Representing:			
<b>FUND BALANCE</b>			
Accumulated surplus		<u><u>2,274,501</u></u>	<u><u>1,187,827</u></u>

The accompanying Notes 1 to 10 form part of these accounts.



(Raymond H C WONG)

Permanent Secretary for Education and Manpower Incorporated  
Trustee of the Language Fund  
26 February 2007

Language Fund  
Statement of Changes in Equity  
for the year ended 31 August 2006

	<u>Note</u>	<u>2006</u> HK\$'000	<u>2005</u> HK\$'000
<b>ACCUMULATED SURPLUS</b>			
Balance at beginning of year		1,187,827	724,891
Opening balance adjustment arising from changes in accounting policies with respect to financial instruments	3(d)	(813)	-
Balance at beginning of year, as restated		<u>1,187,014</u>	<u>724,891</u>
Surplus for the year		<u>1,087,487</u>	<u>462,936</u>
Balance at end of year		<u><u>2,274,501</u></u>	<u><u>1,187,827</u></u>

The accompanying Notes 1 to 10 form part of these accounts.

Language Fund  
Cash Flow Statement  
for the year ended 31 August 2006

	<u>Note</u>	<u>2006</u> HK\$'000	<u>2005</u> HK\$'000
<b>Cash flows from operating activities</b>			
Government grants received		1,100,000	500,000
Interest received		41,129	7,653
Grants paid		(69,913)	(56,251)
Public education and publicity expenses paid		-	(1)
Increase in structured deposits and bank deposits with original maturity over three months		(763,457)	(434,583)
<b>Net cash from operating activities</b>		<u>307,759</u>	<u>16,818</u>
<b>Cash and cash equivalents at beginning of year</b>		39,418	22,600
<b>Cash and cash equivalents at end of year</b>	6	<u><u>347,177</u></u>	<u><u>39,418</u></u>

The accompanying Notes 1 to 10 form part of these accounts.

## Language Fund

### Notes to the Accounts

#### 1. General

The Language Fund was established by a declaration of trust made on 2 May 1994 by the Permanent Secretary for Education and Manpower Incorporated (the Trustee). The Fund provides grants to fund projects aimed at improving Hong Kong people's proficiency in Chinese (including Putonghua) and English.

#### 2. Significant accounting policies

##### (a) Statement of compliance

These financial statements have been prepared in accordance with section 8(3) of the Permanent Secretary for Education and Manpower Incorporation Ordinance (Cap. 1098), accounting principles generally accepted in Hong Kong and all applicable Hong Kong Financial Reporting Standards (HKFRSs), a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (HKASs) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). A summary of the significant accounting policies adopted by the Fund is set out below.

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRSs for the current and prior accounting periods reflected in these financial statements is provided in note 3.

##### (b) Basis of preparation of the financial statements

The measurement basis used in the preparation of these financial statements is historical cost.

There are no critical accounting judgements involved in the application of the Fund's accounting policies. There are also no key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the next year.



(c) Financial assets and financial liabilities

(i) Initial recognition

The Fund's financial assets and financial liabilities include cash at bank, bank deposits, structured deposits, interest receivable and grants payable. They are measured initially at fair value, which normally equals to the transaction price plus attributable transaction costs.

The Fund recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument.

(ii) Subsequent measurement

After initial recognition, financial assets are carried at amortised cost using the effective interest method less impairment losses, if any. Financial liabilities are carried at amortised cost using the effective interest method.

(iii) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

(iv) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

An embedded derivative is separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the income and expenditure account.

The derivatives embedded in the Fund's structured deposits are not separated from the deposits because the economic characteristics and risks of the embedded derivatives are closely related to those of the deposits.

(v) Impairment

The carrying amounts of financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment.

If any such evidence exists, an impairment loss is recognised in the income and expenditure account as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If in a subsequent period the amount of such impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income and expenditure account.

(d) Revenue recognition

Government grants are recognised as income in the period in which they are receivable. Interest income is recognised as it accrues using the effective interest method.

(e) Grants

Grants are recognised as expenditure when they are approved by the Trustee except in those cases when the release of grant is subject to certain conditions, such grants being recognised as expenditure when the grantees comply with the conditions.

(f) Cash equivalents

For the purpose of the cash flow statement, cash equivalents comprise short-term, highly liquid investments with original maturity of three months or less.

### 3. Changes in accounting policies

The HKICPA has issued a number of new and revised HKFRSs that are effective for accounting periods beginning on or after 1 January 2005.

The significant accounting policies of the Fund after the adoption of these new and revised HKFRSs have been summarised in note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (note 10).

#### (a) Restatement of prior period and opening balances

The following table discloses the adjustments that have been made in accordance with the transitional provisions of the respective HKFRSs to the balance sheet as at 31 August 2005 as previously reported and to the balance sheet as at 1 September 2005. No adjustments are required to be made to the income and expenditure account for the period ended 31 August 2005.

#### (i) Effect on the balance sheet as at 31 August 2005 and 1 September 2005

	31.8.2005 (as previously reported) HK\$'000	HKAS 1 (note 3(c)) HK\$'000	31.8.2005 (reclassified) HK\$'000	HKAS 39 (note 3(d)) HK\$'000	Opening balance at 1.9.2005 HK\$'000
<b>Non-current assets</b>					
Structured deposits	-	230,000	230,000	(813)	229,187
Bank deposits	590,013	(230,000)	360,013	-	360,013
	590,013	-	590,013	(813)	589,200
<b>Current assets</b>					
Interest receivable	19,566	-	19,566	-	19,566
Bank deposits	550,046	-	550,046	-	550,046
Cash at bank	29,418	-	29,418	-	29,418
	599,030	-	599,030	-	599,030
<b>Current liabilities</b>					
Grants payable	(1,216)	-	(1,216)	-	(1,216)
<b>Net current assets</b>	597,814	-	597,814	-	597,814
<b>NET ASSETS</b>	1,187,827	-	1,187,827	(813)	1,187,014
<b>FUND BALANCE</b>	1,187,827	-	1,187,827	(813)	1,187,014

- (b) Estimated effect of changes in accounting policies on the current year

The following tables provide estimates of the extent to which each of the line items in the income and expenditure account and balance sheet for the year ended 31 August 2006 is higher or lower than it would have been had the previous policies still been applied in the year.

- (i) Effect on the income and expenditure account for the year ended 31 August 2006

	Increase in income HKAS 39 (note 3(d)) HK\$'000
<b>INCOME</b>	
Interest income	612
	<u>612</u>
<b>EXPENDITURE</b>	-
	<u>-</u>
<b>SURPLUS FOR THE YEAR</b>	<u>612</u>

- (ii) Effect on the balance sheet as at 31 August 2006

	Increase/(Decrease) in assets		
	HKAS 1 (note 3(c)) HK\$'000	HKAS 39 (note 3(d)) HK\$'000	Total HK\$'000
<b>Non-current assets</b>			
Structured deposits	80,000	-	80,000
Bank deposits	(80,000)	-	(80,000)
	<u>-</u>	<u>-</u>	<u>-</u>
<b>Current assets</b>			
Structured deposits	150,000	(201)	149,799
Bank deposits	(150,000)	-	(150,000)
	<u>-</u>	<u>(201)</u>	<u>(201)</u>
<b>Current liabilities</b>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Net current assets</b>	<u>-</u>	<u>(201)</u>	<u>(201)</u>
<b>NET ASSETS</b>	<u>-</u>	<u>(201)</u>	<u>(201)</u>
<b>FUND BALANCE</b>	<u>-</u>	<u>(201)</u>	<u>(201)</u>

(c) Changes in presentation (HKAS 1, Presentation of financial statements)

With effect from 1 September 2005, structured deposits, previously included in “bank deposits”, are presented separately on the balance sheet. The change in presentation has been applied retrospectively with comparatives reclassified as shown in note 3(a)(i).

(d) Financial instruments (HKASs 32 and 39, Financial instruments)

With effect from 1 September 2005, in order to comply with HKAS 32, the Fund has provided additional disclosures of terms, conditions, accounting policies, risk and fair values of financial assets and financial liabilities throughout the notes to the accounts and in the specific note 8.

With effect from 1 September 2005, in order to comply with HKAS 39, the Fund has changed its accounting policies relating to financial assets and financial liabilities to those set out in note 2(c). In particular, while financial assets were previously carried at cost less provision for diminution in value, they are carried at amortised cost using the effective interest method less impairment losses.

In accordance with the transitional provisions in HKAS 39, the changes in accounting policies should be adopted by way of opening balance adjustments. The carrying amount of structured deposits at 1 September 2005 was restated at their amortised cost, by adjusting the opening fund balance. Comparative amounts have not been restated as this is prohibited by the transitional provisions in HKAS 39.

**4. Government grants**

During the year, the Fund obtained a government grant of HK\$1,100 million (2005: HK\$500 million) as approved by the Finance Committee of the Legislative Council.

## 5. Structured deposits

	<u>2006</u> HK\$'000	<u>2005</u> HK\$'000
Structured deposits with interest at:		
- predetermined rates	80,000	80,000
- rates determined by reference to the Hong Kong Interbank Offered Rate	149,799	150,000
	<u>229,799</u>	<u>230,000</u>
Portion classified as current assets	(149,799)	-
Non-current portion	<u>80,000</u>	<u>230,000</u>

All the structured deposits are subject to call option to be exercised at the discretion of the banks before maturity date.

## 6. Cash and cash equivalents

	<u>2006</u> HK\$'000	<u>2005</u> HK\$'000
Cash at bank	87,177	29,418
Bank deposits with original maturity within three months	260,000	10,000
Cash and cash equivalents at end of year	<u>347,177</u>	<u>39,418</u>

## 7. Commitments

As at 31 August 2006, approved grants to be released by the Fund when the grantees comply with the conditions and not provided for in the accounts amounted to approximately HK\$1,539 million (2005: HK\$634 million).

## 8. Financial instruments

### (a) Investment policy

The Fund places deposits with banks for investment under section 5(1) of the Permanent Secretary for Education and Manpower Incorporation Ordinance. These include structured deposits and fixed deposits. It is the Fund's policy that all

investments in financial instruments should be principal-protected.

(b) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Fund does not have an exposure to currency risk as all of its financial instruments are denominated in Hong Kong dollar.

(c) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

To minimise credit risks, all structured deposits and fixed deposits are placed with licensed banks in Hong Kong.

At the balance sheet date, the Fund does not have significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

(d) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due. This results from amount and maturity mismatches of assets and liabilities.

The Fund manages liquidity risk by forecasting the amount of cash required and monitoring the working capital of the Fund to ensure that all liabilities due and known funding requirements could be met.

(e) Interest rate risk

Interest rate risk refers to the risk of loss arising from changes in market interest rates. This can be further classified into fair value interest rate risk and cash flow interest rate risk.

Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market interest rates. Since all the Fund's bank deposits and some of its structured deposits bear interest at fixed rates, their fair values will fall when market interest rates increase. However, as they are all

stated at amortised cost, their carrying amounts will not be affected by changes in market interest rates.

Cash flow interest rate risk is the risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Fund is exposed to cash flow interest rate risk because some of its structured deposits bear interest at rates determined by reference to the Hong Kong Interbank Offered Rate. In addition, since all the structured deposits are callable by the banks before maturity date, changes in market interest rates may lead to the exercise of the call options and therefore affect the future cash flows of the structured deposits.

The table below sets out the Fund's exposure to interest rate risk, based on the major interest bearing assets stated at carrying amounts and categorised by maturity dates and stating the effective interest rate for each group of assets. For structured deposits, it is assumed that the call options would not be exercised by the banks before maturity date.

	Effective interest rate	Less than 3 months HK\$'000	3 months to 1 year HK\$'000	1 to 3 years HK\$'000	Total HK\$'000
<u>2006</u>					
Structured deposits	1.67%	-	149,799	80,000	229,799
Bank deposits	4.28%	260,000	1,443,503	220,013	1,923,516
		260,000	1,593,302	300,013	2,153,315
<u>2005</u>					
Structured deposits	1.67%	-	-	230,000	230,000
Bank deposits	2.67%	260,000	290,046	360,013	910,059
		260,000	290,046	590,013	1,140,059

(f) Fair values

The Fund's financial instruments are not quoted in active markets. Their fair values are estimated using present value or other valuation techniques, using inputs based on market conditions existing at the balance sheet date.

All financial instruments are stated in the balance sheet at amounts equal to or not materially different from their fair values.



## 9. Comparative figures

Certain comparative figures have been reclassified as a result of the changes in accounting policies. Further details are disclosed in note 3.

## 10. Possible impact of amendments, new standards and interpretations issued but not yet effective

Up to the date of issue of these financial statements, the HKICPA has issued the following amendment, new standard and interpretation which are applicable to the Fund's operations but not yet effective for the accounting period ended 31 August 2006 and which have not been adopted in these financial statements:

	Effective for accounting periods beginning on or after
HK(IFRIC)-Int 9, Reassessment of embedded derivatives	1 June 2006
HKFRS 7, Financial instruments: disclosures	1 January 2007
Amendment to HKAS 1, Presentation of financial statements: capital disclosures	1 January 2007

The Fund is in the process of making an assessment of the impact expected of these amendment, new standard and interpretation in the period of initial application. So far it has concluded that their adoption is unlikely to have a significant impact on the Fund's results of operations and financial position.