



Language Fund

Financial statements for the year ended 31 August 2007

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 Incorporated

I certify that I have audited the financial statements of the Language Fund set out on pages 3 to 13, which comprise the balance sheet as at 31 August 2007, 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 Incorporated's responsibility for the financial statements

The Permanent Secretary for Education 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 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

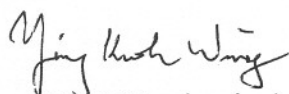
My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with section 8(5) of the Permanent Secretary for Education Incorporation Ordinance and the Audit Commission auditing standards. Those standards require that I comply with ethical 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 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 2007 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 Incorporation Ordinance.



(YING Kwok-wing)

Assistant Director of Audit
for Director of Audit

22 February 2008

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

Language Fund
Income and Expenditure Account
for the year ended 31 August 2007

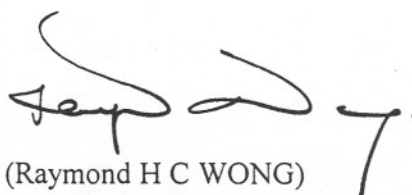
	<u>Note</u>	<u>2007</u> HK\$'000	<u>2006</u> HK\$'000
INCOME			
Government grants	3	-	1,100,000
Interest income from structured deposits and bank deposits		<u>88,066</u>	<u>57,626</u>
		88,066	1,157,626
EXPENDITURE			
Grants		<u>(255,663)</u>	<u>(70,139)</u>
(DEFICIT)/SURPLUS FOR THE YEAR		<u><u>(167,597)</u></u>	<u><u>1,087,487</u></u>

The accompanying Notes 1 to 8 form part of these accounts.

Language Fund
Balance Sheet
as at 31 August 2007

	<u>Note</u>	<u>2007</u> HK\$'000	<u>2006</u> HK\$'000
Non-current assets			
Structured deposits	4	-	80,000
Bank deposits		-	220,013
		<u>-</u>	<u>300,013</u>
Current assets			
Interest receivable		37,799	35,451
Structured deposits	4	80,000	149,799
Bank deposits		1,810,734	1,703,503
Cash at bank		183,719	87,177
		<u>2,112,252</u>	<u>1,975,930</u>
Current liabilities			
Grants payable		<u>(5,348)</u>	<u>(1,442)</u>
Net current assets		<u>2,106,904</u>	<u>1,974,488</u>
NET ASSETS		<u><u>2,106,904</u></u>	<u><u>2,274,501</u></u>
 Representing:			
FUND BALANCE			
Accumulated surplus		<u><u>2,106,904</u></u>	<u><u>2,274,501</u></u>

The accompanying Notes 1 to 8 form part of these accounts.



(Raymond H C WONG)
Permanent Secretary for Education Incorporated
Trustee of the Language Fund
22 February 2008

Language Fund
Statement of Changes in Equity
for the year ended 31 August 2007

	<u>2007</u> HK\$'000	<u>2006</u> HK\$'000
ACCUMULATED SURPLUS		
Balance at beginning of year	2,274,501	1,187,014
(Deficit)/Surplus for the year	(167,597)	1,087,487
Balance at end of year	<u>2,106,904</u>	<u>2,274,501</u>

The accompanying Notes 1 to 8 form part of these accounts.

Language Fund
Cash Flow Statement
for the year ended 31 August 2007

	<u>Note</u>	<u>2007</u> HK\$'000	<u>2006</u> HK\$'000
Cash flows from operating activities			
Government grants received		-	1,100,000
Interest received		85,518	41,129
Grants paid		(251,757)	(69,913)
Decrease/(Increase) in structured deposits and bank deposits with original maturity over three months		2,781	(763,457)
		<hr/>	<hr/>
Net cash (used in)/from operating activities		(163,458)	307,759
Cash and cash equivalents at beginning of year		347,177	39,418
		<hr/>	<hr/>
Cash and cash equivalents at end of year	5	<u><u>183,719</u></u>	<u><u>347,177</u></u>

The accompanying Notes 1 to 8 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 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 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.

(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. Government grants

During the year, the Fund did not obtain any government grants. In the prior year, the Fund obtained a government grant of HK\$1,100 million as approved by the Finance Committee of the Legislative Council.

4. Structured deposits

	<u>2007</u> HK\$'000	<u>2006</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
	<u>80,000</u>	<u>229,799</u>
Portion classified as current assets	<u>(80,000)</u>	<u>(149,799)</u>
Non-current portion	<u>-</u>	<u>80,000</u>

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

5. Cash and cash equivalents

	<u>2007</u> HK\$'000	<u>2006</u> HK\$'000
Cash at bank	183,719	87,177
Bank deposits with original maturity within three months	-	260,000
Cash and cash equivalents at end of year	<u>183,719</u>	<u>347,177</u>

6. Commitments

As at 31 August 2007, 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\$1,587 million (2006: HK\$1,539 million).

7. Financial instruments

(a) Investment policy

The Fund places deposits with banks for investment under section 5(1) of the Permanent Secretary for Education 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 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. 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>2007</u>					
Structured deposits	3.55%	-	80,000	-	80,000
Bank deposits	4.17%	321,721	1,489,013	-	1,810,734
		321,721	1,569,013	-	1,890,734
<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

(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.

8. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 August 2007

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year

ended 31 August 2007 and which have not been early adopted in these financial statements.

The Fund is in the process of making an assessment of what the impact of these amendments, new standards and interpretations 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.

The following developments may result in new or amended disclosures in future financial statements:

	Effective for accounting periods beginning on or after
HKFRS 7, Financial instruments: disclosures	1 January 2007
HKAS 1 (Revised), Presentation of financial statements	1 January 2009