



Language Fund

Financial statements for the year ended 31 August 2019

Report of the Director of Audit



Audit Commission

The Government of the Hong Kong Special Administrative Region

Independent Auditor's Report To the Permanent Secretary for Education Incorporated

Opinion

I certify that I have audited the financial statements of the Language Fund set out on pages 4 to 15, which comprise the statement of financial position as at 31 August 2019, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In my opinion, the financial statements give a true and fair view of the financial position of the Language Fund as at 31 August 2019, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in accordance with section 8(3) of the Permanent Secretary for Education Incorporation Ordinance (Cap. 1098).

Basis for opinion

I conducted my audit in accordance with section 8(5) of the Permanent Secretary for Education Incorporation Ordinance and the Audit Commission auditing standards. My responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of my report. I am independent of the Language Fund in accordance with those standards, and I have fulfilled my other ethical responsibilities in accordance with those standards. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of the Permanent Secretary for Education Incorporated for the financial statements

The Permanent Secretary for Education Incorporated is responsible for the preparation of the financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and section 8(3) of the Permanent Secretary for Education Incorporation Ordinance, and for such internal control as the Permanent Secretary for Education Incorporated determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Permanent Secretary for Education Incorporated is responsible for assessing the Language Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

Auditor's responsibilities for the audit of the financial statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Audit Commission auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the Audit Commission auditing standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit 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 Language Fund's internal control;

- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Permanent Secretary for Education Incorporated;
- conclude on the appropriateness of the Permanent Secretary for Education Incorporated's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Language Fund's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Language Fund to cease to continue as a going concern; and
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



Ms Hildy Chan
Assistant Director of Audit (Acting)
for Director of Audit

25 February 2020

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

LANGUAGE FUND
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 AUGUST 2019
(Expressed in thousands of Hong Kong dollars)

	Note	2019	2018
INCOME			
Interest income from placement with			
the Exchange Fund	3	207,723	230,498
Other interest income		<u>9,641</u>	<u>9,043</u>
		217,364	239,541
EXPENDITURE			
Award of grants	4	<u>(141,913)</u>	<u>(136,225)</u>
SURPLUS FOR THE YEAR		75,451	103,316
OTHER COMPREHENSIVE INCOME		<u>—</u>	<u>—</u>
TOTAL COMPREHENSIVE INCOME			
FOR THE YEAR		<u>75,451</u>	<u>103,316</u>

The accompanying notes 1 to 8 form part of these financial statements.

LANGUAGE FUND
STATEMENT OF FINANCIAL POSITION
AS AT 31 AUGUST 2019
(Expressed in thousands of Hong Kong dollars)

	Note	2019	2018
NON-CURRENT ASSETS			
Placement with the Exchange Fund	5	6,108,067	5,840,214
CURRENT ASSETS			
Accrued interest from placement with the Exchange Fund		117,928	178,058
Other interest receivable		4,097	3,957
Other receivables		5	—
Bank deposits with maturities over three months		271,000	411,485
Bank deposit with maturity within three months		26,280	22,042
Cash at bank		26,077	22,488
		445,387	638,030
CURRENT LIABILITIES			
Grants payable		(3,008)	(3,249)
NET CURRENT ASSETS		442,379	634,781
NET ASSETS		6,550,446	6,474,995
Representing:			
FUND BALANCE			
Accumulated surplus		6,550,446	6,474,995

The accompanying notes 1 to 8 form part of these financial statements.

Permanent Secretary for Education Incorporated
Trustee of the Language Fund



(Mrs Ingrid Yeung)
Permanent Secretary for Education
25 February 2020

LANGUAGE FUND
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 AUGUST 2019
(Expressed in thousands of Hong Kong dollars)

	2019	2018
ACCUMULATED SURPLUS		
Balance at beginning of year	6,474,995	6,371,679
Total comprehensive income for the year	<u>75,451</u>	<u>103,316</u>
Balance at end of year	<u><u>6,550,446</u></u>	<u><u>6,474,995</u></u>

The accompanying notes 1 to 8 form part of these financial statements.

LANGUAGE FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 AUGUST 2019
(Expressed in thousands of Hong Kong dollars)

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received from placement with the Exchange Fund	267,853	156,893
Other interest received	9,501	9,774
Grants paid	(142,159)	(135,379)
Increase in placement with the Exchange Fund	(267,853)	(236,893)
Decrease in bank deposits with maturities over three months	<u>140,485</u>	<u>236,890</u>
NET CASH FROM OPERATING ACTIVITIES	7,827	31,285
CASH AND CASH EQUIVALENTS		
AT BEGINNING OF YEAR	<u>44,530</u>	<u>13,245</u>
CASH AND CASH EQUIVALENTS		
AT END OF YEAR	<u>52,357</u>	<u>44,530</u>
ANALYSIS OF CASH AND CASH EQUIVALENTS		
Bank deposit with maturity within three months	26,280	22,042
Cash at bank	<u>26,077</u>	<u>22,488</u>
	<u>52,357</u>	<u>44,530</u>

The accompanying notes 1 to 8 form part of these financial statements.

LANGUAGE FUND

Notes to the financial statements

(Amounts expressed in thousands of Hong Kong dollars, unless otherwise stated.)

1. General

The Language Fund (the 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

The 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), which is a collective term that includes all applicable individual HKFRSs, 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 certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Fund. Note 2(c) provides information on the changes, if any, in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Fund for the current and prior accounting periods reflected in these financial statements.

(b) Basis of preparation of the financial statements

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

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised 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.

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 reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the next year.

(c) Changes in accounting policies

The HKICPA has issued certain new and revised HKFRSs that are effective for the current accounting period. None of them impact on the accounting policies of the Fund except for the adoption of HKFRS 9 "Financial Instruments" as set out below.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (note 8).

HKFRS 9 "Financial Instruments"

HKFRS 9 replaces HKAS 39 "Financial Instruments: Recognition and Measurement". It sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

The Fund has applied HKFRS 9 retrospectively to items that existed as at 1 September 2018 in accordance with the transition requirements without restating comparative information. The carrying amounts of the items as at 1 September 2018 have not been impacted by the initial application of HKFRS 9. The nature and effect of the changes to previous accounting policies are set out below.

(i) Classification of financial assets

HKFRS 9 classifies financial assets into three principal categories: measured at (i) amortised cost; (ii) fair value through other comprehensive income; and (iii) fair value through profit or loss. These supersede HKAS 39's categories of held-to-maturity investments, loans and receivables, available-for-sale financial assets and financial assets at fair value through profit or loss. The classification of financial assets under HKFRS 9 is based on the business model under which the financial asset is managed and its contractual cash flow characteristics.

The Fund's financial assets previously classified as loans and receivables (carried at amortised cost) were reclassified to financial assets measured at amortised cost (note 2(d)(ii)). The carrying amounts as at 31 August 2018 were the same as those as at 1 September 2018.

(ii) Impairment of financial assets

HKFRS 9 replaces the "incurred loss" model in HKAS 39 with the "expected credit loss" model. The expected credit loss model requires an ongoing measurement of credit risk associated with a financial asset and therefore recognises expected credit losses earlier than under the "incurred loss" accounting model in HKAS 39. The Fund applies the new expected

credit loss model to the financial assets measured at amortised cost (note 2(d)(v)). The initial application of the new impairment requirements had no impact on the carrying amounts of the financial assets as at 1 September 2018.

(d) Financial assets and financial liabilities

(i) Initial recognition and measurement

The Fund's financial assets comprise placement with the Exchange Fund, accrued interest from placement with the Exchange Fund, other interest receivable, other receivables, bank deposits and cash at bank.

The Fund's financial liabilities comprise grants payable.

The Fund recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. At initial recognition, financial assets and financial liabilities are measured at fair value plus or minus transaction costs that are directly attributable to the acquisition of the financial assets or the issue of the financial liabilities.

(ii) Classification and subsequent measurement from 1 September 2018

The Fund classifies all financial assets as subsequently measured at amortised cost using effective interest method, on the basis that they are held within a business model whose objective is to hold them for collection of contractual cash flows and the contractual cash flows represent solely payments of principal and interest. The measurement of loss allowances for financial assets is based on the expected credit loss model as described in note 2(d)(v).

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating and recognising the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial asset or financial liability to the gross carrying amount of the financial asset or to the amortised cost of the financial liability. When calculating the effective interest rate, the Fund estimates the expected cash flows by considering all contractual terms of the financial instrument but does not consider the expected credit losses. The calculation includes all fees received or paid between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

The Fund classifies all financial liabilities as subsequently measured at amortised cost using effective interest method.

The Fund reclassifies a financial asset when and only when it changes its business model for managing the asset. A financial liability is not reclassified.

(iii) Classification and subsequent measurement prior to 1 September 2018

The Fund's financial assets, which were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market and which the Fund had no intention of trading, were classified as loans and receivables and were carried at amortised cost using the effective interest method less impairment losses, if any (note 2(d)(vi)).

The classification of the Fund's financial liabilities and their subsequent measurement prior to 1 September 2018 were the same as those from 1 September 2018 (note 2(d)(ii)).

(iv) 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 when it expires.

(v) Impairment of financial assets from 1 September 2018

For financial assets measured at amortised cost, the Fund measures the expected credit losses to determine the loss allowance required to be recognised.

Expected credit losses are a probability-weighted estimate of credit losses. They are based on the difference between the contractual cash flows due in accordance with the contract and the cash flows that the Fund expects to receive, discounted at the effective interest rate. They are measured on either of the following bases:

- 12-month expected credit losses (for financial instruments for which there has not been a significant increase in credit risk since initial recognition): these are losses that are expected to result from possible default events within the 12 months after the reporting date; and
- lifetime expected credit losses (for financial instruments for which there has been a significant increase in credit risk since initial recognition): these are losses that are expected to result from all possible default events over the expected life of the financial instruments.

In assessing whether the credit risk of a financial instrument has increased significantly since initial recognition, the Fund compares the risk of default occurring on the financial instrument assessed at the reporting date with that assessed at the date of initial recognition. In making this assessment, the Fund considers that a default event occurs when (i) the borrower is unlikely to pay its credit obligations to the Fund in full; or (ii) the financial asset is

90 days past due. The Fund considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

(vi) Impairment of financial assets prior to 1 September 2018

The carrying amounts of loans and receivables was reviewed at each reporting date to determine whether there was objective evidence of impairment. If any impairment evidence existed, an impairment loss was recognised in surplus or deficit 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 decreased and the decrease could be linked objectively to an event occurring after the impairment loss had been recognised, the impairment loss was reversed through surplus or deficit. A reversal of impairment losses was limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(e) Revenue recognition

Interest income is recognised in surplus or deficit on an accrual basis, using the effective interest method.

(f) Award of grants

Grants are recognised as expenditure when they are approved by the Trustee except that in those cases where the release of grant is subject to certain conditions, such grants are only recognised as expenditure when the conditions are met.

(g) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include cash at bank and bank deposits with maturities within three months.

3. Interest income from placement with the Exchange Fund

This represents income earned from the placement with the Exchange Fund at a fixed rate determined every January (note 5).

4. Award of grants

	2019	2018
Grants paid/due for payment	147,132	142,267
Refund of unused grants	(5,219)	(6,042)
	<u>141,913</u>	<u>136,225</u>

5. Placement with the Exchange Fund

The balance of the placement with the Exchange Fund amounted to HK\$6,108 million (2018: HK\$5,840 million), being the principal sums of HK\$5,080 million (2018: HK\$5,080 million) plus interest paid but not yet withdrawn of HK\$1,028 million (2018: HK\$760 million). The term of the placement is six years from the date of placement, during which the amount of principal sums cannot be withdrawn.

Interest on the placement is payable at a fixed rate determined every January. The rate is the average annual investment return of the Exchange Fund's Investment Portfolio for the past six years or the average annual yield of three-year Government Bond for the previous year subject to a minimum of zero percent, whichever is the higher. The interest rate has been fixed at 2.9% per annum for the year 2019 and at 4.6% per annum for the year 2018.

6. Commitments

As at 31 August 2019, grants approved but not yet due for payment (note 2(f)) amounted to HK\$625 million (2018: HK\$686 million).

7. Financial risk management

(a) Investment policy

The Fund may invest moneys of the Fund in accordance with section 5(1) of the Permanent Secretary for Education Incorporation Ordinance. It is the Fund's policy that all investments in financial instruments should be principal-protected.

(b) Market risk

Market risk is the risk that changes in market variables, such as interest rates and currency exchange rates, may affect the fair value or cash flows of a financial instrument.

(i) 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 the Fund's bank deposits bear interest at fixed rates, their fair values will fall when market interest rates increase. However, as they are 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 does not have a significant exposure to cash flow interest rate risk because it has no significant floating-rate financial instruments.

(ii) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in currency 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 an issuer or a counterparty will cause a financial loss to the Fund by failing to discharge an obligation.

The Fund's credit risk is primarily attributable to placement with the Exchange Fund, accrued interest from placement with the Exchange Fund, other interest receivable, other receivables and bank balances. The Fund selects counterparty with good credit standing, strong financial strength and sizeable capital. The Fund also limits the individual exposure, in accordance with a documented risk management strategy, and monitors credit risk on a continuous basis.

While the financial assets measured at amortised cost are subject to the impairment requirements, the Fund has estimated that their expected credit losses are immaterial and considers that no loss allowance is required.

The credit quality of bank deposits and cash at bank at the reporting date, analysed by the ratings designated by Moody's or their equivalents, is shown below:

	2019	2018
Aa3 to Aa1	90,936	158,117
A3 to A1	232,421	297,898
	<u>323,357</u>	<u>456,015</u>

The maximum exposure to credit risk of the financial assets of the Fund at the reporting date is equal to their carrying amounts.

(d) Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial 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. As the Fund has a strong liquidity position, it does not have significant exposure to liquidity risk.

As at 31 August 2019, the remaining contractual maturities of all financial liabilities, based on contractual undiscounted cash flows and the earliest date on which the Fund can be required to pay, were three months or less (2018: two months or less).

(e) Other financial risk

The Fund is exposed to financial risk arising from change in the interest rate on the placement with the Exchange Fund which is determined every January (note 5). It was estimated that, as at 31 August 2019, a 50 basis point increase/decrease in the interest rate, with all other variables held constant, would increase/decrease the surplus for the year by HK\$31 million (2018: HK\$29 million).

8. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 August 2019

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 2019 and which have not been early adopted in these financial statements.

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