

Report of the Director of Audit



Audit Commission

The Government of the Hong Kong Special Administrative Region

Quality Education Fund

Independent Audit Report

To the Permanent Secretary for Education Incorporated

I certify that I have audited the financial statements of the Quality Education Fund set out on pages 3 to 21, which comprise the statement of financial position as at 31 August 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows 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 Quality Education Fund as at 31 August 2010 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.

(LAU Sun-wo)
Assistant Director of Audit
for Director of Audit

22 February 2011

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

QUALITY EDUCATION FUND
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 AUGUST 2010
(Expressed in thousands of Hong Kong dollars)

	Note	2010	2009
INCOME/(LOSS)			
Interest income	4	116,726	139,432
Dividend income	5	41,178	51,644
Net realised and revaluation gains/(losses) on:			
- securities		169,899	(259,976)
- trading financial instruments		110,794	30,686
- cash and deposits with banks and other financial institutions		(7,211)	(2,200)
Other income	6	1,311	566
		<u>432,697</u>	<u>(39,848)</u>
EXPENDITURE			
Grants and awards	7	(99,207)	(91,645)
Operating expenses	8	(30,923)	(29,015)
		<u>(130,130)</u>	<u>(120,660)</u>
SURPLUS/(DEFICIT) FOR THE YEAR		302,567	(160,508)
OTHER COMPREHENSIVE INCOME		<u>-</u>	<u>-</u>
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		<u><u>302,567</u></u>	<u><u>(160,508)</u></u>

The accompanying notes 1 to 17 form part of these financial statements.

QUALITY EDUCATION FUND
STATEMENT OF FINANCIAL POSITION
AS AT 31 AUGUST 2010

(Expressed in thousands of Hong Kong dollars)

	Note	2010	2009
ASSETS			
Cash at bank		57,034	23,984
Investments:			
Deposits with banks and other financial institutions	9	343,435	809,761
Securities	10	6,096,715	5,244,556
Trading financial instruments	11	11,149	5,754
Receivables and other assets	12	353,493	154,756
		<u>6,861,826</u>	<u>6,238,811</u>
LIABILITIES			
Trading financial instruments	11	(3,392)	(6,466)
Payables and other liabilities	13	(435,739)	(112,217)
		<u>(439,131)</u>	<u>(118,683)</u>
NET ASSETS		<u><u>6,422,695</u></u>	<u><u>6,120,128</u></u>
Representing:			
FUND BALANCE			
Accumulated surplus		<u><u>6,422,695</u></u>	<u><u>6,120,128</u></u>

The accompanying notes 1 to 17 form part of these financial statements.

(Mrs Cherry Tse)
Permanent Secretary for Education Incorporated
Trustee of the Quality Education Fund
22 February 2011

QUALITY EDUCATION FUND
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 AUGUST 2010
(Expressed in thousands of Hong Kong dollars)

	2010	2009
ACCUMULATED SURPLUS		
Balance at beginning of year	6,120,128	6,280,636
Total comprehensive income/(loss) for the year	302,567	(160,508)
	<hr/>	<hr/>
Balance at end of year	<u><u>6,422,695</u></u>	<u><u>6,120,128</u></u>

The accompanying notes 1 to 17 form part of these financial statements.

QUALITY EDUCATION FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 AUGUST 2010
(Expressed in thousands of Hong Kong dollars)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Surplus/(Deficit) for the year	302,567	(160,508)
Adjustments for:		
Interest income	(116,726)	(139,432)
Dividend income	(41,178)	(51,644)
(Increase)/Decrease in investments in securities	(852,159)	367,140
Change in trading financial instruments	(8,469)	13,419
Increase in receivables and other assets	(195,305)	(69,390)
Increase in payables and other liabilities	323,522	57,021
Elimination of foreign exchange differences in revaluation of cash and cash equivalents	1,416	4,856
Interest received	113,411	150,156
Dividends received	41,061	52,328
NET CASH (USED IN)/FROM OPERATING ACTIVITIES	(431,860)	223,946
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	833,745	614,655
Effects of exchange rate changes on cash and cash equivalents	(1,416)	(4,856)
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>400,469</u>	<u>833,745</u>
ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS		
	2010	2009
Fixed deposits maturing within three months	228,959	755,939
Cash at bank	171,510	77,806
	<u>400,469</u>	<u>833,745</u>

The accompanying notes 1 to 17 form part of these financial statements.

QUALITY EDUCATION FUND

Notes to the financial statements

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

1. General

The Quality Education Fund (the Fund) was established by a declaration of trust made on 2 January 1998 by the Permanent Secretary for Education Incorporated (the Trustee). The Fund provides grants to fund projects that aim to raise the quality of school education, and to promote quality school education in Hong Kong.

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.

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is historical cost except that investments in securities and trading financial instruments are stated at their fair value as explained in the accounting policies set out below.

The preparation of financial statements 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 end of the reporting

period 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 classifies its financial assets and financial liabilities into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: trading financial instruments, securities, loans and receivables, and other financial liabilities.

Financial assets and financial liabilities are measured initially at fair value, which normally equals to the transaction prices, plus transaction costs for loans and receivables and other financial liabilities that are directly attributable to the acquisition of the financial asset or the issue of the financial liability. Transaction costs on trading financial instruments and securities are expensed immediately.

The Fund recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instruments. Regular purchases and sales of financial assets are accounted for at trade date.

(ii) Categorisation

Trading financial instruments

These comprise forward currency contracts used by the Fund to manage its risks associated with foreign currency fluctuations. Such derivative financial instruments do not qualify for hedge accounting and are categorised as “trading” under HKAS 39 *Financial instruments: Recognition and measurement*.

Trading financial instruments are carried at fair value, and presented as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value are included in the statement of comprehensive income in the period in which they arise.

Securities

Securities consist of equities and debt securities. Under HKAS 39, these investments are designated upon initial recognition as financial assets at fair value, based on the fact that they are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management and investment strategy.

Securities are carried at fair value under HKAS 39. Changes in the fair value are included in the statement of comprehensive income 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 and which the Fund has no intention of trading, other than those that the Fund, upon initial recognition, designates at fair value. This category includes cash at bank, deposits with banks and other financial institutions, and receivables and other assets.

Loans and receivables are carried at amortised cost using the effective interest method less impairment losses, if any (note 2(c)(vi)).

Other financial liabilities

These are financial liabilities other than trading financial instruments. They are carried at amortised cost using the effective interest method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the end of the reporting period without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments, or if the market for it is not active, the fair value of the financial asset or financial liability is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the end of the reporting period applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the end of the reporting period.

(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.

The Fund uses the weighted average method to determine realised gains and losses to be recognised in the statement of comprehensive income on derecognition.

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

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liabilities simultaneously.

(vi) Impairment of financial assets

The carrying amounts of loans and receivables are reviewed at the end of each reporting period to determine whether there is objective evidence of impairment. If any such evidence exists, an impairment loss is recognised in the statement of comprehensive income 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 statement of comprehensive income.

(d) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include cash at bank, deposits with banks and other financial institutions and short-term highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value, having been within three months of maturity when placed or acquired.

(e) Revenue and expenditure recognition

(i) Interest income

Interest income is recognised in the statement of comprehensive income on an accrual basis, using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating 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 instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Fund estimates cash flows considering all contractual terms of the financial instrument but does not consider future 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.

(ii) Dividend income

Dividend income from listed equity securities is recognised in the statement of comprehensive income when the share price is quoted ex-dividend. Dividend income from unlisted equity securities is recognised in the statement of comprehensive income when the shareholder's right to receive payment is established.

(iii) Other income

Other income is recognised in the statement of comprehensive income on an accrual basis.

(iv) Net realised and revaluation gains/losses

Realised gains or losses on financial instruments are recognised in the statement of comprehensive income when the financial instruments are derecognised.

Changes in fair value of trading financial instruments and financial assets and financial liabilities designated at fair value are recognised as revaluation gains or losses in the statement of comprehensive income in the period in which they arise.

(v) Grants recognition

Grants are payable to schools, educational bodies, institutions or individuals who are permanent residents in Hong Kong. Grants are recognised as expenditure when they are approved by the Trustee except in those cases where the release of grant is subject to certain conditions, such grants being recognised as expenditure when the grantees comply with the conditions.

(f) Foreign currency translation

Foreign currency transactions during the year are translated into Hong Kong dollars at the spot exchange rates at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the spot exchange rates at the end of the reporting period. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into Hong Kong dollars using the exchange rates at the dates when the fair value was determined. All foreign currency translation differences are recognised in the statement of comprehensive income.

3. Changes in accounting policies

The HKICPA has issued certain new and revised HKFRSs that are effective for the current accounting period. There have been no significant changes to the accounting policies applied in these financial statements for the years presented as a result of these developments. However, as a result of adopting HKAS 1 (Revised) and Amendments to HKFRS 7, there are changes to the presentation of these financial statements.

The Fund has not applied any new standard that is not yet effective for the current accounting period (note 17).

(a) HKAS 1 (Revised) *Presentation of Financial Statements*

The revised standard introduces the statement of comprehensive income and presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Fund has elected to present one statement. The standard also introduces terminology changes to titles for the financial statements. The Fund has changed the “Income and Expenditure Account” to the “Statement of Comprehensive Income”, the “Balance Sheet” to the “Statement of Financial Position” and the “Cash Flow Statement” to the “Statement of Cash Flows”.

(b) Amendments to HKFRS 7 *Financial Instruments: Disclosures* – Improving Disclosures about Financial Instruments

The amendments require enhanced disclosures about fair value measurements. The amendments introduce a three-level hierarchy (note 16(b)) for fair value measurement disclosures about financial instruments and require some specific quantitative disclosures for those instruments classified in the lowest level in the hierarchy. These disclosures will help improve comparability between entities about the effects of fair value measurements. The amendments do not require the provision of comparative figures.

4. Interest income

	2010	2009
Debt securities:		
- Hong Kong	36,808	43,673
- Overseas	78,148	89,824
	114,956	133,497
Deposits:		
- Hong Kong dollar	571	653
- Foreign currencies	1,199	5,282
	1,770	5,935
	116,726	139,432

5. Dividend income

	2010	2009
Listed equities:		
-Hong Kong	21,872	24,851
-Overseas	19,306	26,793
	<u>41,178</u>	<u>51,644</u>

6. Other income

	2010	2009
Securities lending income	744	278
Commission recapture income	245	172
Sale of materials developed from projects	281	116
Class action income	41	-
	<u>1,311</u>	<u>566</u>

7. Grants and awards

	2010	2009
Grants	102,194	104,814
Refund of unused grants	(8,635)	(15,648)
	<u>93,559</u>	<u>89,166</u>
Awards under the teaching excellence scheme	5,648	2,479
	<u>99,207</u>	<u>91,645</u>

8. Operating expenses

	2010	2009
Fees for investment managers	14,380	11,634
Fees for custodians	2,158	2,076
Investment transaction costs	7,461	9,444
Publicity costs	6,899	5,753
Others	25	108
	<u>30,923</u>	<u>29,015</u>

9. Deposits with banks and other financial institutions

	2010	2009
Hong Kong dollar fixed deposits	125,310	202,000
Foreign currency fixed deposits	103,649	553,939
Foreign currency call deposits and balances with custodians	114,476	53,822
	<u>343,435</u>	<u>809,761</u>

10. Securities

	2010	2009
Equity securities:		
Hong Kong listed equities	1,021,268	960,762
Overseas listed equities	1,631,988	1,356,360
	2,653,256	2,317,122
Debt securities:		
Hong Kong debt securities:		
- Listed	220,400	257,273
- Unlisted	573,764	768,292
Overseas debt securities:		
- Listed	1,565,651	1,262,516
- Unlisted	1,083,644	639,353
	3,443,459	2,927,434
	<u>6,096,715</u>	<u>5,244,556</u>

11. Trading financial instruments

	2010		2009	
	Assets	Liabilities	Assets	Liabilities
Forward currency contracts, at fair value	11,149	3,392	5,754	6,466

All these forward currency contracts would mature within one year and had a total notional amount of HK\$2,779.2 million as at 31 August 2010 (2009: HK\$3,301.1 million). The notional amounts of these contracts indicate the volume of outstanding transactions and do not represent the amounts at risk.

12. Receivables and other assets

	2010	2009
Proceeds from investments sold	306,218	112,074
Interest and dividends receivable	40,445	37,013
Other debtors	6,830	5,669
	<u>353,493</u>	<u>154,756</u>

13. Payables and other liabilities

	2010	2009
Cost of investments bought	421,563	102,885
Other creditors and accruals	14,176	9,332
	<u>435,739</u>	<u>112,217</u>

14. Commitments

As at 31 August 2010, approved grants to be released by the Fund when the grantees comply with the conditions and not provided for in the financial statements amounted to HK\$100.6 million (2009: HK\$85.5 million). Since inception up to 31 August 2010, grants totalling HK\$3,784.1 million for 7,848 projects (2009: HK\$3,665.7 million for 7,566 projects) were approved by the Trustee.

15. Financial risk management

(a) Investment management and control

The Trustee may invest moneys of the Fund in accordance with section 5(1) of the Permanent Secretary for Education Incorporation Ordinance. She has appointed the Director of Accounting Services to manage the investments of the Fund.

The Steering Committee, established under the Trust Deed, may advise the Trustee on policies and procedures governing the operation of the Fund and on the assessment of applications for the funding from the Fund. Members of the Steering Committee are appointed by the Secretary for Education.

The Fund's investment objective is to generate a reasonable growth in the value of the funds whilst producing recurrent income to meet regular funding requests in order to support the development of quality education in Hong Kong and to fund activities that aim to raise the quality of school education, and to promote quality school education in Hong Kong.

The investment performance of the Fund is monitored through the Investment Committee which usually meets on a quarterly basis to review investment reports prepared by the Director of Accounting Services and to interview the Fund's external investment managers. The Investment Committee also formulates guidelines on asset allocation in order to meet the investment objective. Members of the Investment Committee are appointed by the Secretary for Education.

The investment management and control of the Fund are set out in a documented risk management and investment strategy and are reviewed on a regular basis by the Investment Committee.

(b) Market risk

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

(i) Equity price risk

Equity price risk is the risk of loss arising from changes in equity prices. The Fund's equities are subject to the equity price risk inherent in all equity securities i.e. the value of holdings may fall as well as rise. As at 31 August 2010, the equities were included in securities as shown in note 10. The risk is primarily addressed through diversification of investment portfolio in accordance with a documented risk management and investment strategy, and the Fund monitors the risk on a continuous basis.

It was estimated that, as at 31 August 2010, a 10% increase/decrease in the market bid prices of the equities, with all other variables held constant, would increase/decrease the revaluation gains for the year by HK\$265.3 million (2009: HK\$231.7 million).

(ii) 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 a substantial portion of the Fund's debt securities and all of its deposits with banks and other financial institutions bear interest at fixed rates, their fair values will fall when market interest rates increase. Investments in debt securities are made in accordance with a documented risk management and investment strategy, and the Fund monitors the fair value interest rate risk on a continuous basis.

It was estimated that, as at 31 August 2010, a 100 basis points increase/50 basis points decrease in interest rates, with all other variables held constant, would decrease/increase the revaluation gains on the debt securities for the year by HK\$182.6 million/HK\$91.3 million. For the year ended 31 August 2009, a similar analysis was performed based on the assumption of an increase/decrease of 100 basis points in interest rates, which would decrease/increase the revaluation gains by HK\$180.0 million. As regards deposits with banks and other financial institutions, since 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 does not have a significant exposure to cash flow interest rate risk because only a small portion of its debt securities bear interest at rates determined by reference to market interest rates.

The Fund's exposure to interest rate risk, based on the major interest bearing assets stated at carrying amounts at the end of the reporting period and categorised by the earlier of contractual repricing dates or maturity dates, is shown below:

	Repricing period				Total
	3 months or less	More than 3 months but not more than 1 year	More than 1 year but not more than 5 years	Over 5 years	
2010					
Deposits with banks and other financial institutions	343,435	—	—	—	343,435
Debt securities	216,892	186,434	1,371,081	1,669,052	3,443,459
	<u>560,327</u>	<u>186,434</u>	<u>1,371,081</u>	<u>1,669,052</u>	<u>3,786,894</u>
2009					
Deposits with banks and other financial institutions	809,761	—	—	—	809,761
Debt securities	25,223	227,898	1,078,644	1,595,669	2,927,434
	<u>834,984</u>	<u>227,898</u>	<u>1,078,644</u>	<u>1,595,669</u>	<u>3,737,195</u>

(iii) 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's non-Hong Kong investments are exposed to currency risk. The Fund only makes investments denominated in Hong Kong dollar, US dollar and currency of a country whose foreign currency long-term debt has a high credit rating. Assets denominated in foreign currencies and the exposure to non-Hong Kong dollar are handled in accordance with a documented risk management and investment strategy, and the Fund monitors the currency risk on a continuous basis.

The net exposure to each currency at the end of the reporting period arising from recognised assets and liabilities after taking into account the effect of forward currency contracts is shown below:

	2010	2009
Hong Kong dollar	3,255,097	3,237,469
US dollar	1,841,707	1,720,270
Euro	547,740	521,110
Japanese Yen	342,169	289,792
Great British Pound	204,306	192,327
Others	<u>231,676</u>	<u>159,160</u>
	<u>6,422,695</u>	<u>6,120,128</u>

It was estimated that, as at 31 August 2010, a 50 basis points increase/decrease in the exchange rate of the US dollar against the Hong Kong dollar, with all other variables held constant, would increase/decrease the exchange gains as included in revaluation gains for the year by HK\$9.2 million (2009: HK\$8.6 million).

It was estimated that, as at 31 August 2010, a 500 basis points increase/decrease in the exchange rates of the other foreign currencies against the Hong Kong dollar, with all other variables held constant, would increase/decrease the exchange gains as included in revaluation gains for the year by HK\$66.3 million (2009: HK\$58.1 million).

(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. Investments in debt securities, trading financial instruments, and loans and receivables are potentially subject to credit risk. The Fund selects issuer or 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 and investment strategy. Hence the Fund does not have significant exposures to credit risk and monitoring is done on a continuous basis.

The Fund does not have significant concentrations of credit risk. The Fund's maximum exposure to credit risk at the end of the reporting period without taking account of collateral held or other credit enhancements, if any, is shown below:

	2010	2009
Cash at bank	57,034	23,984
Deposits with banks and other financial institutions	343,435	809,761
Debt securities	3,443,459	2,927,434
Trading financial instruments	11,149	5,754
Receivables and other assets	353,493	153,756
	<u>4,208,570</u>	<u>3,920,689</u>

The credit quality of cash at bank and deposits with banks and other financial institutions and debt securities, analysed by the ratings designated by Moody's or their equivalents, at the end of the reporting period is shown below:

	2010	2009
Cash at bank and deposits with banks and other financial institutions, by credit rating:		
Aaa	114,504	53,802
Aa3 to Aa1	93,386	340,734
A3 to A1	192,579	439,209
	<u>400,469</u>	<u>833,745</u>
Debt securities, by credit rating:		
Aaa	2,238,495	1,570,995
Aa3 to Aa1	630,238	649,171
A3 to A1	497,674	653,437
Below A3	77,052	53,831
	<u>3,443,459</u>	<u>2,927,434</u>

(d) Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. The Fund monitors the liquidity requirements on a continuous basis and maintains a level of short-term deposits and cash to pay grants and operating expenses as necessary. Hence the Fund does not have significant exposures to liquidity risk.

16. Fair values of financial instruments

(a) Fair values

The fair values of financial instruments quoted in active markets are their quoted prices at the end of the reporting period. In the absence of such quoted market prices, fair values are estimated using present value or other valuation techniques, using inputs based on market conditions existing at the end of the reporting period.

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

(b) The carrying value of financial instruments, measured at fair value as at 31 August 2010 according to three levels of fair value hierarchy, is shown below:

- Level 1: fair values of financial instruments are quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: fair values of financial instruments are determined involving inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3: fair values of financial instruments are determined with inputs that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Total
Assets			
Securities at fair value	3,447,420	2,649,295	6,096,715
Trading financial instruments	—	11,149	11,149
	<u>3,447,420</u>	<u>2,660,444</u>	<u>6,107,864</u>
Liabilities			
Trading financial instruments	—	3,392	3,392

No financial assets or liabilities were classified under Level 3.

17. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 August 2010

Up to the date of issue of the 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 2010 and which have not been early adopted in the 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 adoption. 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**

Amendments to HKFRS 7 *Financial Instruments:*

1 July 2011

Disclosures

– Disclosures - Transfers of Financial Assets

HKFRS 9 *Financial Instruments*

1 January 2013