

Language Fund

Financial statements for the year ended 31 August 2014

Report of the Director of Audit



Audit Commission
The Government of the Hong Kong Special Administrative Region

Language Fund

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 12, which comprise the statement of financial position as at 31 August 2014, 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 information.

Permanent Secretary for Education Incorporated's Responsibility for the Financial Statements

The Permanent Secretary for Education Incorporated is responsible for the preparation of financial statements that give a true and fair view in accordance with section 8(3) of the Permanent Secretary for Education Incorporation Ordinance (Cap. 1098) and Hong Kong Financial Reporting Standards, 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.

Auditor's Responsibility

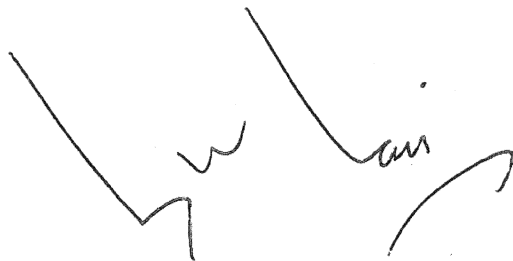
My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with section 8(5) of the Permanent Secretary for Education Incorporation Ordinance and the Audit Commission auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 of financial statements that give a true and fair view 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 2014, 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

25 February 2015

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

LANGUAGE FUND
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 AUGUST 2014
(Expressed in thousands of Hong Kong dollars)

| | Note | 2014 | 2013 |
|--|------|------------------|-----------|
| INCOME | | | |
| Government grant | 3 | 5,000,000 | — |
| Interest income from placement with the Exchange Fund | 4 | 81,370 | — |
| Other interest income | | 11,384 | 13,074 |
| | | 5,092,754 | 13,074 |
| EXPENDITURE | | | |
| Award of grants | 5 | (18,943) | (156,653) |
| SURPLUS/(DEFICIT) FOR THE YEAR | | 5,073,811 | (143,579) |
| OTHER COMPREHENSIVE INCOME | | — | — |
| TOTAL COMPREHENSIVE INCOME /(LOSS) FOR THE YEAR | | 5,073,811 | (143,579) |

The accompanying notes 1 to 9 form part of these financial statements.

LANGUAGE FUND
STATEMENT OF FINANCIAL POSITION
AS AT 31 AUGUST 2014

(Expressed in thousands of Hong Kong dollars)

| | Note | 2014 | 2013 |
|---|------|------------------|---------|
| NON-CURRENT ASSETS | | | |
| Placement with the Exchange Fund | 6 | 5,000,000 | — |
| CURRENT ASSETS | | | |
| Accrued interest from placement with the Exchange Fund | | 81,370 | — |
| Other interest receivable | | 5,843 | 4,351 |
| Other receivables | | 23,167 | 3,987 |
| Bank deposits with original maturity over three months | | 759,000 | 829,000 |
| Cash at bank | | 63,674 | 24,533 |
| | | 933,054 | 861,871 |
| CURRENT LIABILITIES | | | |
| Grants payable | | (671) | (3,299) |
| NET CURRENT ASSETS | | | |
| | | 932,383 | 858,572 |
| NET ASSETS | | | |
| | | 5,932,383 | 858,572 |
| Representing: | | | |
| FUND BALANCE | | | |
| Accumulated surplus | | 5,932,383 | 858,572 |

The accompanying notes 1 to 9 form part of these financial statements.

Permanent Secretary for Education Incorporated
Trustee of the Language Fund

(Mrs Marion Lai)
Permanent Secretary for Education
25 February 2015

LANGUAGE FUND
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 AUGUST 2014
(Expressed in thousands of Hong Kong dollars)

| | 2014 | 2013 |
|--|------------------|-----------|
| ACCUMULATED SURPLUS | | |
| Balance at beginning of year | 858,572 | 1,002,151 |
| Total comprehensive income/(loss) for the year | 5,073,811 | (143,579) |
| Balance at end of year | 5,932,383 | 858,572 |

The accompanying notes 1 to 9 form part of these financial statements.

LANGUAGE FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 AUGUST 2014
(Expressed in thousands of Hong Kong dollars)

| | Note | 2014 | 2013 |
|---|------|-------------|-----------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Government grant received | 3 | 5,000,000 | — |
| Interest received | | 9,892 | 15,741 |
| Award of grants | | (40,751) | (158,715) |
| Increase in placement with the Exchange Fund | | (5,000,000) | — |
| Decrease in bank deposits with original maturity over three months | | 70,000 | 134,000 |
| | | 39,141 | (8,974) |
| NET CASH FROM/(USED IN) OPERATING ACTIVITIES | | | |
| | | 39,141 | (8,974) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | | | |
| | | 24,533 | 33,507 |
| | | 63,674 | 24,533 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | | | |
| | | 63,674 | 24,533 |
| ANALYSIS OF CASH AND CASH EQUIVALENTS | | | |
| Cash at bank | | 63,674 | 24,533 |

The accompanying notes 1 to 9 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.

(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 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: loans and receivables and other financial liabilities.

Financial assets and financial liabilities are measured initially at fair value plus transaction costs that are directly attributable to the acquisition of the financial assets or the issue of the financial liabilities.

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

(ii) Categorisation and subsequent measurement

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. This category includes placement with the Exchange Fund, cash at bank, bank deposits, interest and other receivables.

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

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.

Other financial liabilities

This category includes grants payable. They 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 when it expires.

(iv) 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.

(v) 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 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 decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through surplus or deficit. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(d) Revenue recognition

Government grants are recognised as income in the period in which they are receivable. Interest income is recognised in surplus or deficit on an accrual basis, using the effective interest method.

(e) 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.

(f) 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 original maturity within three months.

(g) Impact of new and revised HKFRSs

The HKICPA has issued a number of 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.

The Fund has not applied any new standard that is not yet effective for the current accounting period (note 9).

3. Government grant

During the year, the Fund received a government grant of HK\$5,000 million (2013: Nil).

4. 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 6).

5. Award of grants

| | 2014 | 2013 |
|-----------------------------|---------------|----------------|
| Grants paid/due for payment | 71,164 | 177,929 |
| Refund of unused grants | (52,221) | (21,276) |
| | <u>18,943</u> | <u>156,653</u> |

6. Placement with the Exchange Fund

The balance represents the principal sum of HK\$5,000 million placement with the Exchange Fund. The term of the placement is six years from the date of placement, during which the amount of original placement 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 Exchange Fund Notes for the previous year subject to a minimum of zero percent, whichever is the higher. The interest rate has been fixed at 3.6% per annum for the year 2014.

7. Commitments

As at 31 August 2014, grants approved but not yet due for payment (note 2(e)) amounted to HK\$747 million (2013: HK\$667 million).

8. 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. Loans and receivables are potentially subject to credit risk. 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.

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

| | 2014 | 2013 |
|---|----------------|----------------|
| Cash at bank and bank deposits, by credit rating: | | |
| Aa3 to Aa1 | 219,674 | 248,533 |
| A3 to A1 | 358,000 | 341,000 |
| Baa2 | 245,000 | 264,000 |
| | 822,674 | 853,533 |

For the placement with the Exchange Fund, the credit risk is considered to be low.

The maximum exposure to credit risk of the financial assets of the Fund is equal

to their carrying amounts at the end of the reporting period.

(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 2014, 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 (2013: three 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 6). It was estimated that, as at 31 August 2014, a 50 basis point increase/decrease in the interest rate, with all other variables held constant, would increase/decrease the surplus for the year and accumulated surplus by HK\$11.3 million (2013: Nil).

9. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 August 2014

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 2014 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 development may result in new or amended disclosures in future financial statements:

**Effective for accounting
periods beginning on or after**

HKFRS 9, *Financial Instruments*

1 January 2018