

Quality Education 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 Quality Education Fund set out on pages 4 to 23, 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 Quality Education 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 Quality Education 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 Quality Education 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 Quality Education 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 Quality Education 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 Quality Education 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

QUALITY EDUCATION 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	3	136,833	123,402
Dividend income	4	94,979	88,294
Net realised and revaluation (losses)/gains on:			
– securities		(83,240)	304,182
– derivative financial instruments		31,465	12,103
– deposits with banks and other financial institutions		(1,761)	227
		(53,536)	316,512
Other income	5	243	194
		178,519	528,402
EXPENDITURE			
Grants and awards	6	(177,530)	(151,868)
Operating expenses	7	(69,382)	(55,713)
		(246,912)	(207,581)
(DEFICIT)/SURPLUS FOR THE YEAR		(68,393)	320,821
OTHER COMPREHENSIVE INCOME		—	—
TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR		(68,393)	320,821

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

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

	Note	2019	2018
ASSETS			
Cash at bank		70,104	60,640
Deposits with banks and other financial institutions having a maturity of three months or less when placed	8	169,077	167,533
Deposits with banks and other financial institutions having a maturity of more than three months when placed	8	1,026,656	785,994
Securities	9	6,609,240	7,028,766
Derivative financial instruments	10	10,488	4,043
Receivables and other assets	11	172,030	94,809
Placement with the Exchange Fund	12	1,454,680	1,393,087
		9,512,275	9,534,872
LIABILITIES			
Derivative financial instruments	10	(5,536)	(4,767)
Payables and other liabilities	13	(81,172)	(36,145)
		(86,708)	(40,912)
NET ASSETS		9,425,567	9,493,960
Representing:			
FUND BALANCE			
Accumulated surplus		9,425,567	9,493,960

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

Permanent Secretary for Education Incorporated
Trustee of the Quality Education Fund

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

QUALITY EDUCATION 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	9,493,960	9,173,139
Total comprehensive (loss)/income for the year	<u>(68,393)</u>	<u>320,821</u>
Balance at end of year	<u>9,425,567</u>	<u>9,493,960</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 2019
(Expressed in thousands of Hong Kong dollars)

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
(Deficit)/Surplus for the year	(68,393)	320,821
Adjustments for:		
Interest income	(136,833)	(123,402)
Dividend income	(94,979)	(88,294)
(Increase)/Decrease in deposits with banks and other financial institutions having a maturity of more than three months when placed	(240,662)	69,437
Decrease/(Increase) in investments in securities	419,526	(56,839)
Increase in placement with the Exchange Fund	(61,593)	(276,209)
Change in derivative financial instruments	(5,676)	(12,209)
(Increase)/Decrease in receivables and other assets	(85,730)	27,006
Increase/(Decrease) in payables and other liabilities	45,027	(26,271)
Elimination of foreign exchange differences in reevaluation of cash and cash equivalents	717	1,187
Interest received	146,365	96,337
Dividends received	93,956	92,269
NET CASH FROM OPERATING ACTIVITIES	11,725	23,833
CASH AND CASH EQUIVALENTS		
AT BEGINNING OF YEAR	228,173	205,527
EFFECT OF EXCHANGE RATE CHANGES	(717)	(1,187)
CASH AND CASH EQUIVALENTS		
AT END OF YEAR	239,181	228,173
ANALYSIS OF CASH AND CASH EQUIVALENTS		
Deposits with banks and other financial institutions having a maturity of three months or less when placed	169,077	167,533
Cash at bank	70,104	60,640
	239,181	228,173

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

QUALITY EDUCATION FUND

Notes to the financial statements

(Amounts 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.

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 except that equity and debt securities managed by the Fund's external investment managers (note 15(a)) and derivative financial instruments are measured at fair value as explained in the accounting policies set out in note 2(d).

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 expenditure. The estimates and associated assumptions are based on 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 first effective for the current accounting period of the Fund. 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 17).

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)(vii)). 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 recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial instruments are recognised on trade date, the date on which the Fund commits to purchase or sell the instruments.

At initial recognition, financial assets and financial liabilities are measured at fair value plus or minus, in the case of a financial asset or financial liability not measured at fair value through surplus or deficit (equivalent to “fair value through profit or loss” under HKFRS 9), transaction costs that are directly attributable to the acquisition of the financial assets or the issue of the financial liabilities. Transaction costs of financial instruments measured at fair value through surplus or deficit are expensed immediately.

(ii) Classification and subsequent measurement from 1 September 2018

Financial instruments measured at fair value through surplus or deficit

These comprise equity and debt securities managed by the Fund’s external investment managers (note 15(a)), and derivative financial instruments. They are subsequently measured at fair value. Changes in fair value are recognised in surplus or deficit in the period in which they arise.

Derivative financial instruments used by the Fund to manage its risks associated with foreign currency fluctuations do not qualify for hedge accounting. They are presented as assets when the fair value is positive and as liabilities when the fair value is negative.

Financial assets measured at amortised cost

These comprise cash at bank, deposits with banks and other financial institutions, receivables and other assets, and placement with the Exchange Fund. They are held for the collection of contractual cash flows which represent solely payments of principal and interest. They are subsequently measured at amortised cost using the effective interest method. The measurement of loss allowances for these financial assets is based on the expected credit loss model as described in note 2(d)(vii).

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 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.

Financial liabilities measured at amortised cost

These comprise payables and other liabilities. They are subsequently measured at amortised cost using the effective interest method.

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

(iii) Classification and subsequent measurement before 1 September 2018

Trading financial instruments

Derivatives that did not qualify for hedge accounting were categorised as “trading” and carried at fair value. Their subsequent measurement before 1 September 2018 was the same as that from 1 September 2018 (note 2(d)(ii)).

Financial assets designated at fair value

Financial assets designated at fair value consisted of equity and debt securities that were managed and evaluated on a fair value basis in accordance with a documented risk management and investment strategy. They were carried at fair value. Their subsequent measurement before 1 September 2018 was the same as that from 1 September 2018 (note 2(d)(ii)).

Loans and receivables

Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were carried at amortised cost using the effective interest method less impairment losses, if any (note 2(d)(viii)).

Other financial liabilities

These were financial liabilities other than trading financial instruments. Their classification and subsequent measurement before 1 September 2018 were the same as those from 1 September 2018 (note 2(d)(ii)).

(iv) Fair value measurement principles

The Fund measures equity and debt securities managed by the Fund's external investment managers (note 15(a)) and derivative financial instruments at fair value at each reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either (a) in the principal market for the asset or liability, or (b) in the absence of a principal market, in the most advantageous market for the asset or liability; and the Fund has access to these markets at the measurement date.

The fair value of an asset or a liability is measured with those assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their best economic interest.

The Fund uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. The Fund measures fair values using the following fair value hierarchy that reflects the significance of inputs used in making the measurements:

Level 1 – fair values are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – fair values are determined with inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. 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).

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Fund determines whether transfers between levels in the hierarchy should be reflected in the financial statements by re-assessing categorisation (based on the level of input that is most significant and relevant to the fair value measurement as a whole) at the reporting date.

(v) 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.

(vi) 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.

(vii) 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. Financial assets measured at fair value through surplus or deficit are not subject to the expected credit loss assessment.

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.

(viii) Impairment of financial assets before 1 September 2018

The carrying amounts of loans and receivables were 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

(i) Interest income

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

(ii) Dividend income

Dividend income from equity securities is recognised in surplus or deficit when the share price is quoted ex-dividend.

(iii) Net realised and revaluation gains/losses

Realised gains or losses on financial instruments are recognised in surplus or deficit when the financial instruments are derecognised. Changes in fair value of financial instruments measured at fair value through surplus or deficit are recognised as revaluation gains or losses in surplus or deficit in the period in which they arise.

(iv) Other income

Other income is recognised in surplus or deficit on an accrual basis.

(f) 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 are only recognised as expenditure when the conditions are met.

(g) 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 closing exchange rates at the reporting date. All foreign currency translation differences are recognised as net realised and revaluation gains or losses in surplus or deficit.

(h) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include cash at bank and deposits with banks and other financial institutions having a maturity of three months or less when placed.

3. Interest income

	2019	2018
Interest income from:		
— placement with the Exchange Fund	49,504	50,627
— debt securities measured at fair value through surplus or deficit denominated in:		
— Hong Kong dollar	14,173	13,380
— other currencies	44,479	41,055
	58,652	54,435
— deposits denominated in:		
— Hong Kong dollar	879	2,695
— other currencies	27,798	15,645
	28,677	18,340
	<u>136,833</u>	<u>123,402</u>

4. Dividend income

	2019	2018
Dividend income from equity securities listed:		
— in Hong Kong	50,639	44,412
— outside Hong Kong	44,340	43,882
	<u>94,979</u>	<u>88,294</u>

5. Other income

	2019	2018
Sale of materials developed from projects	174	162
Commission recapture income	63	24
Miscellaneous	6	8
	<u>243</u>	<u>194</u>

6. Grants and awards

	2019	2018
Grants paid/due for payment	182,639	150,423
Refund of unused grants	<u>(11,935)</u>	<u>(5,549)</u>
	170,704	144,874
Awards under the teaching excellence scheme	<u>6,826</u>	<u>6,994</u>
	<u>177,530</u>	<u>151,868</u>

7. Operating expenses

	2019	2018
Dissemination and promotion costs	45,924	30,303
Fees for investment managers	16,974	18,938
Investment transaction costs	3,325	3,544
Fees for custodians	2,904	2,729
Others	<u>255</u>	<u>199</u>
	<u>69,382</u>	<u>55,713</u>

8. Deposits with banks and other financial institutions

	2019	2018
Fixed deposits denominated in:		
— Hong Kong dollar	69,000	148,200
— other currencies	1,026,656	649,294
Call deposits and balances with custodians denominated in currencies other than Hong Kong dollar	<u>100,077</u>	<u>156,033</u>
	1,195,733	953,527
Less: Deposits with banks and other financial institutions having a maturity of more than three months when placed	<u>(1,026,656)</u>	<u>(785,994)</u>
Deposits with banks and other financial institutions having a maturity of three months or less when placed	<u>169,077</u>	<u>167,533</u>

9. Securities

	2019	2018
<i>Financial assets measured at fair value through surplus or deficit</i>		
Equity securities listed:		
— in Hong Kong	1,446,338	1,521,578
— outside Hong Kong	2,521,706	3,038,131
Debt securities denominated in:		
— Hong Kong dollar	557,117	512,343
— other currencies	2,084,079	1,956,714
	<u>6,609,240</u>	<u>7,028,766</u>

10. Derivative financial instruments

	2019		2018	
	Assets	Liabilities	Assets	Liabilities
Forward currency contracts, at fair value	<u>10,488</u>	<u>5,536</u>	<u>4,043</u>	<u>4,767</u>

All these forward currency contracts would mature within one year and had a total notional amount of HK\$3,653.8 million as at 31 August 2019 (2018: HK\$3,286.7 million). The notional amounts of these contracts indicate the volume of outstanding transactions and do not represent the amounts at risk.

11. Receivables and other assets

	2019	2018
Proceeds receivable from investments sold	99,831	15,305
Accrued interest from placement with the Exchange Fund	28,085	40,174
Other interest and dividends receivable	37,517	33,937
Other receivables	6,597	5,393
	<u>172,030</u>	<u>94,809</u>

12. Placement with the Exchange Fund

The balance of the placement with the Exchange Fund amounted to HK\$1,454.7 million (2018: HK\$1,393.1 million), being the principal sums of HK\$1,360.7 million (2018: HK\$1,360.7 million) plus interest paid but not yet withdrawn at the reporting date of HK\$94.0 million (2018: HK\$32.4 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% for the calendar year 2019 and at 4.6% for the calendar year 2018.

13. Payables and other liabilities

	2019	2018
Unsettled purchases of investments	68,134	27,264
Other payables and accruals	<u>13,038</u>	<u>8,881</u>
	<u><u>81,172</u></u>	<u><u>36,145</u></u>

14. Commitments

As at 31 August 2019, grants approved but not yet due for payment (note 2(f)) amounted to HK\$291.9 million (2018: HK\$125.2 million).

15. Financial risk management

(a) Investment management and control

The Trustee may invest moneys of the Fund in accordance with section 5 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 declaration of trust, 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 meets regularly 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 investments in equity securities 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 2019, the equity securities were included in securities as shown in note 9. 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 2019, a 10% increase/decrease in the market bid prices of the equity securities, with all other variables held constant, would decrease/increase the deficit for the year by HK\$396.8 million (2018: increase/decrease the surplus for the year by HK\$456.0 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 2019, a 100 basis points increase/decrease in interest rates, with all other variables held constant, would increase/decrease the deficit for the year by HK\$163.1 million

(2018: decrease/increase the surplus for the year by HK\$149.2 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.

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

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

	2019	2018
Hong Kong dollar	4,676,733	4,649,883
US dollar	3,376,798	3,463,371
Euro	617,327	579,512
Japanese yen	340,183	336,900
Pound sterling	135,747	161,882
Others	278,779	302,412
	<u>9,425,567</u>	<u>9,493,960</u>

It was estimated that, as at 31 August 2019, with all other variables held constant:

- a 0.5% increase/decrease in the exchange rate of US dollar against Hong Kong dollar would decrease/increase the deficit for the year by HK\$16.9 million (2018: increase/decrease the surplus for the year by HK\$17.3 million); and
- a 5% increase/decrease in the exchange rates of other currencies against Hong Kong dollar would decrease/increase the deficit for the year by HK\$68.6 million (2018: increase/decrease the surplus for the year by HK\$69.0 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. Cash at bank, deposits with banks and other financial institutions, debt securities, derivative financial instruments, receivables and other assets, and placement with the Exchange Fund 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, 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 cash at bank, deposits with banks and other financial institutions, and debt securities at the reporting date, analysed by the ratings designated by Moody's or their equivalents, is shown below:

	2019	2018
Cash at bank and deposits with		
banks and other financial institutions, by		
credit rating:		
Aa1 to Aa3	650,363	457,959
A1 to A3	615,474	556,208
	<u>1,265,837</u>	<u>1,014,167</u>
Debt securities, by credit rating:		
Aaa	495,717	592,564
Aa1 to Aa3	649,784	577,219
A1 to A3	1,129,106	972,938
Baa1 to Baa3	366,589	326,336
	<u>2,641,196</u>	<u>2,469,057</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 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 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 one year or less (2018: one year 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 12). It was estimated that, as at 31 August 2019, a 50 basis points increase/decrease in the interest rate, with all other variables held constant, would decrease/increase the deficit for the year by HK\$7.3 million (2018: increase/decrease the surplus for the year by HK\$6.3 million).

16. Fair values of financial instruments

The fair value of financial instruments classified under Level 1 is based on the quoted market prices of these financial instruments at the reporting date, without any deduction for estimated future selling costs.

In the absence of such quoted prices, the fair value of financial instruments classified under Level 2 is estimated using present value or other valuation techniques which maximise the use of observable data, using inputs based on market conditions existing at the reporting date.

(a) Financial instruments measured at fair value on a recurring basis

The carrying value of financial instruments measured at fair value at the reporting date according to the fair value hierarchy is shown below:

2019	Level 1	Level 2	Total
Assets			
Financial assets measured at fair value through surplus or deficit	3,968,044	2,641,196	6,609,240
Derivative financial instruments	—	10,488	10,488
	<u>3,968,044</u>	<u>2,651,684</u>	<u>6,619,728</u>
Liabilities			
Derivative financial instruments	—	5,536	5,536
	<u>—</u>	<u>5,536</u>	<u>5,536</u>

2018	Level 1	Level 2	Total
Assets			
Financial assets measured at fair value through surplus or deficit	4,559,709	2,469,057	7,028,766
Derivative financial instruments	—	4,043	4,043
	<u>4,559,709</u>	<u>2,473,100</u>	<u>7,032,809</u>
Liabilities			
Derivative financial instruments	—	4,767	4,767
	<u>—</u>	<u>4,767</u>	<u>4,767</u>

No financial assets or liabilities were classified under Level 3. There were no transfers between Level 1 and Level 2 during the year.

(b) Financial instruments not measured at fair value on a recurring basis

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

17. 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.