

Report of the Director of Audit



Audit Commission

The Government of the Hong Kong Special Administrative Region

Bond Fund

Independent Auditor's Report To the President of the Legislative Council

Opinion

I certify that I have examined and audited the financial statements of the Bond Fund set out on pages 100 to 107, which comprise the statement of assets and liabilities as at 31 March 2018, and the statement of receipts and payments for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In my opinion, the financial statements of the Bond Fund are prepared, in all material respects, in accordance with the Public Finance Ordinance (Cap. 2) and section 11(1) of the Audit Ordinance (Cap. 122).

Basis for opinion

I conducted my audit in accordance with section 12(1) of the Audit 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 have fulfilled the independence and 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.

Other information

The Director of Accounting Services is responsible for the other information. The other information comprises all the information included in the Accounts of the Government of the Hong Kong Special Administrative Region for the year ended 31 March 2018 published by the Treasury, other than the financial statements and my auditor's report thereon.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Director of Accounting Services' responsibilities for the financial statements

In accordance with section 16(1) of the Public Finance Ordinance, the Director of Accounting Services is responsible for the compilation and supervision of the accounts of the Government of the Hong Kong Special Administrative Region, for the management of accounting operations and procedures, and for ensuring that all regulations, directions or instructions made or given under the Public Finance Ordinance relating thereto and in respect of the safe custody of public moneys and its accounting are complied with.

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 Bond Fund's internal control; and

- evaluate the appropriateness of accounting policies used by the Director of Accounting Services.

David Sun
Director of Audit

29 October 2018

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

Bond Fund

STATEMENT OF ASSETS AND LIABILITIES AS AT 31 MARCH 2018

(Expressed in Hong Kong dollars)

| | Note | 2018 \$'000 | 2017 \$'000 |
|------------------------------------|------|--------------------|--------------------|
| Assets | | | |
| Investments with the Exchange Fund | 3 | 138,156,390 | 141,378,989 |
| Liabilities | | | |
| Deposits | 4 | (1,247) | - |
| | | <u>138,155,143</u> | <u>141,378,989</u> |
| Representing: | | | |
| Fund Balance | | | |
| Balance at beginning of year | | 141,378,989 | 128,411,794 |
| (Deficit)/Surplus for the year | | (3,223,846) | 12,967,195 |
| Balance at end of year | 5, 6 | <u>138,155,143</u> | <u>141,378,989</u> |

Notes 1 to 9 form part of these financial statements.

Charlix WONG
Director of Accounting Services
29 August 2018



Bond Fund

STATEMENT OF RECEIPTS AND PAYMENTS FOR THE YEAR ENDED 31 MARCH 2018

(Expressed in Hong Kong dollars)

| | Note | 2018 \$'000 | 2017 \$'000 |
|--|------|--------------------|----------------|
| Cash and bank balances at beginning of year | | - | - |
| Receipts | 7 | 23,377,083 | 42,132,745 |
| Payments | 8 | (26,600,929) | (29,165,550) |
| (Deficit)/Surplus for the year | | (3,223,846) | 12,967,195 |
| Other cash movements | 9 | 3,223,846 | (12,967,195) |
| Cash and bank balances at end of year | | - | - |

Notes 1 to 9 form part of these financial statements.

Charlix WONG
Director of Accounting Services
29 August 2018



Bond Fund

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars, unless otherwise stated)

1. Purpose and Legislation

The Bond Fund was established with effect from 10 July 2009 by a Resolution (hereinafter referred to as the Resolution) passed by the Legislative Council under section 29(1) of the Public Finance Ordinance (Cap. 2) on 8 July 2009. Sums raised under the Government Bond Programme are credited to the Bond Fund. The Hong Kong Monetary Authority has been directed by the Financial Secretary to, inter alia, assist in managing the investment concerning the Bond Fund.

2. Accounting Policies

- (i) The accounts of the Bond Fund are kept on a cash basis. Transactions are recorded when moneys are received or paid. The Statement of Assets and Liabilities of the Fund excludes outstanding liabilities in respect of sums borrowed under paragraph (c)(i) of the Resolution referred to in Note 5 below, and debtors and creditors other than those deposits referred to in Note 4 below.
- (ii) Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates.

3. Investments with the Exchange Fund

- (i) These are investments made under paragraph (e)(ii) of the Resolution.
- (ii) The investments represent the cost of investments together with the investment income received in the year being reported. The investment income is calculated, in accordance with a Memorandum of Understanding entered into with the Hong Kong Monetary Authority in 2014, on the basis of 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 rate of return for the calendar year 2017 was 2.8% (2016: 3.3%). The annual investment income is receivable on 31 December each year.

4. Deposits

This represents the accrued interest received from successful bidders on reopened government bonds and is to be paid as part of bond interest on the next interest payment date of the bonds:

| | 2018 | 2017 |
|---|--------------|----------|
| | \$'000 | \$'000 |
| Accrued interest received from successful bidders | <u>1,247</u> | <u>-</u> |

5. Fund Balance

The Fund Balance includes receipts from sums borrowed for the purposes of the Bond Fund under the Loans Ordinance (Cap. 61) that are required to be credited to the Fund under paragraph (c)(i) of the Resolution. Repayments of the principal in relation to the outstanding liabilities in respect of sums borrowed are included in payments charged to the Fund under paragraphs (e)(i) and (ea)(i) of the Resolution. The liabilities totalling \$121.73 billion as at 31 March 2018 comprising the outstanding bonds with nominal value of \$98.19 billion and alternative bonds with nominal value of US\$3 billion (equivalent to \$23.54 billion as at 31 March 2018) are not included in the Statement of Assets and Liabilities (Note 6).

Bond Fund

6. Bonds Outstanding

In accordance with a resolution passed under section 3 of the Loans Ordinance in May 2013, the Government is authorized to borrow from any person from time to time for the purposes of the Bond Fund such sums not exceeding in total \$200 billion or equivalent, being the maximum amount of all borrowings made under paragraph (a) of this resolution that may be outstanding by way of principal at any time. The outstanding liabilities in respect of the sums borrowed under the Government Bond Programme are as follows:

| | 2018 \$'000 | 2017 \$'000 |
|---|----------------|----------------|
| Bonds | | |
| Balance at beginning of year | 103,078,440 | 100,500,000 |
| Issuance of bonds under | | |
| Tender to institutional investors | 16,600,000 | 16,600,000 |
| Subscription to retail investors | 3,000,000 | 13,000,000 |
| | 19,600,000 | 29,600,000 |
| Repayment of bonds issued under | | |
| Tender to institutional investors | (14,400,000) | (17,000,000) |
| Subscription to retail investors | (10,084,560) | (10,021,560) |
| | (24,484,560) | (27,021,560) |
| Balance at end of year | 98,193,880 | 103,078,440 |
| Alternative bonds (Note (i) below) | | |
| Balance at beginning of year | 23,312,250 | 15,509,000 |
| Issuance of bonds | - | 7,760,200 |
| Foreign currency translation difference | 228,750 | 43,050 |
| Balance at end of year (Note (ii) below) | 23,541,000 | 23,312,250 |
| Total outstanding bonds | 121,734,880 | 126,390,690 |

- (i) Alternative bonds are denominated in United States dollars.
- (ii) The outstanding alternative bonds are translated into Hong Kong dollars at the exchange rate ruling at the end of the reporting period.

Bond Fund

6. Bonds Outstanding (Continued)

(iii) The maturities of the outstanding bonds are as follows:

| | 2018 \$'000 | 2017 \$'000 |
|--|--------------------|----------------|
| Bonds | | |
| Within one year | 23,200,000 | 24,400,000 |
| After one year but within two years (Note (iv) below) | 32,323,730 | 23,200,000 |
| After two years but within five years (Note (v) below) | 28,770,150 | 40,378,440 |
| After five years | 13,900,000 | 15,100,000 |
| | 98,193,880 | 103,078,440 |
| Alternative bonds (Notes (i) and (ii) above) | | |
| After one year but within two years | 7,847,000 | - |
| After two years but within five years | 7,847,000 | 15,541,500 |
| After five years | 7,847,000 | 7,770,750 |
| | 23,541,000 | 23,312,250 |
| Total outstanding bonds | 121,734,880 | 126,390,690 |

(iv) The outstanding bonds included Silver Bonds with nominal value of \$2.92 billion (2017: Nil) which might be redeemed before maturity upon request from bond holders.

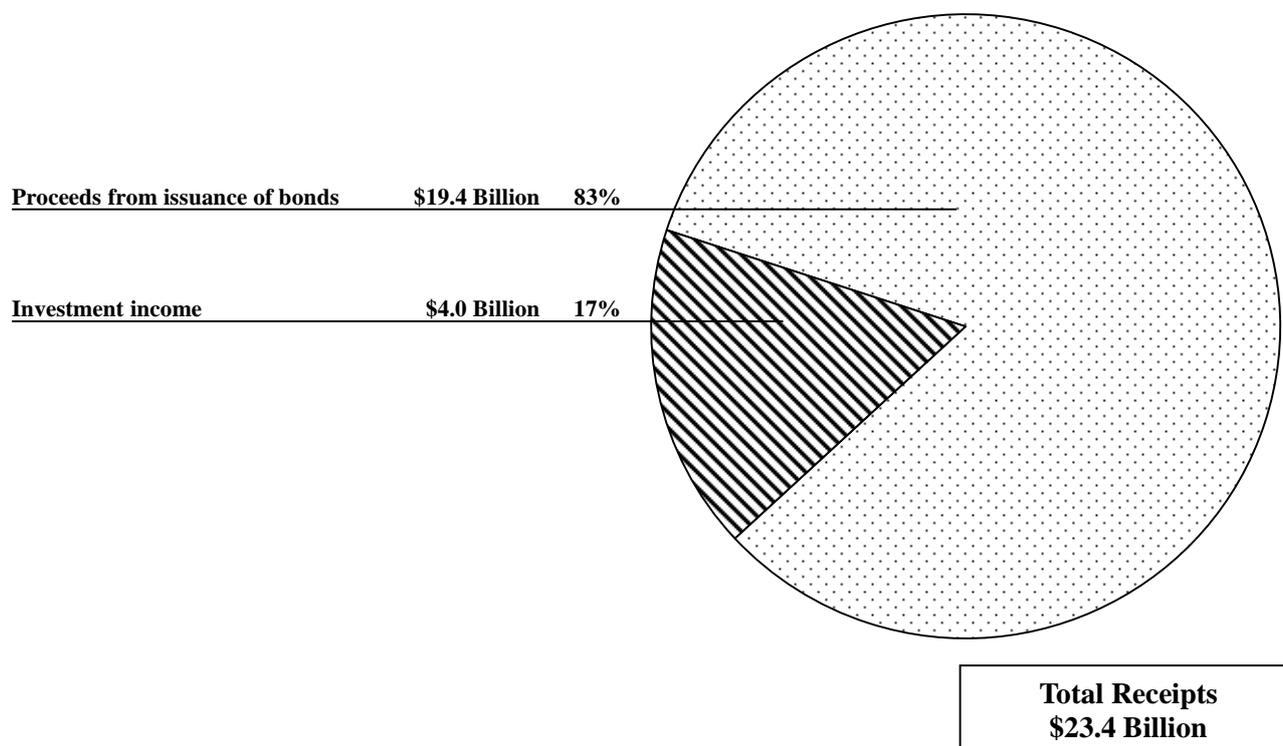
(v) The outstanding bonds included Silver Bonds with nominal value of \$2.97 billion (2017: \$2.98 billion) which might be redeemed before maturity upon request from bond holders.

7. Receipts

| | 2018 | | 2017 |
|---|--------------------------------|-------------------|------------------|
| | Original Estimate \$'000 | Actual \$'000 | Actual \$'000 |
| Proceeds from bonds issued under | | | |
| Tender or subscription | 19,600,000 | 19,429,445 | 30,039,446 |
| Switch tender | 800,000 | - | - |
| Bond swap facility | 1,000,000 | - | - |
| | 21,400,000 | 19,429,445 | 30,039,446 |
| Proceeds from issuance of alternative bonds | - | - | 7,760,200 |
| Investment income | | | |
| Investments with the Exchange Fund | - | 3,947,589 | 4,332,958 |
| Others | - | 49 | 141 |
| | 4,191,000 | 3,947,638 | 4,333,099 |
| | 25,591,000 | 23,377,083 | 42,132,745 |

Bond Fund

Analysis of Receipts for the year ended 31 March 2018

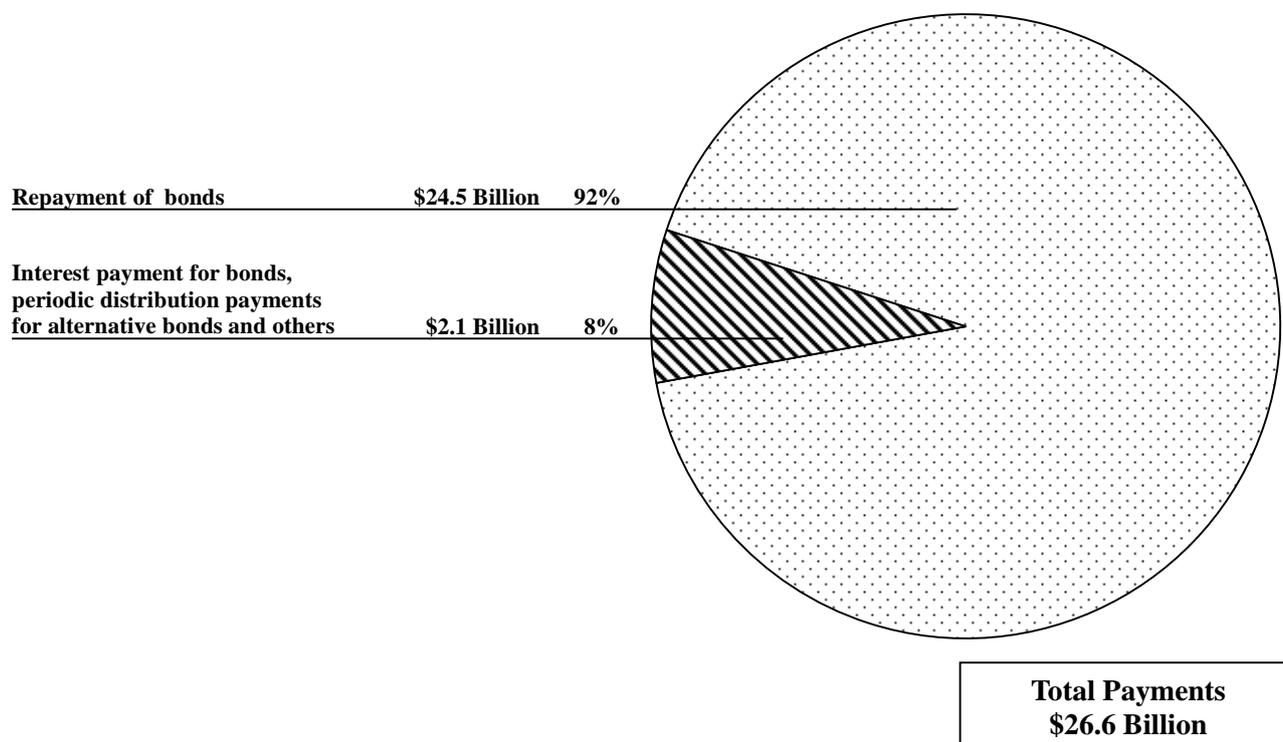


8. Payments

| | 2018 | | 2017 |
|--|-----------------------------|--------------------------|-------------------|
| | Original Estimate \$'000 | Actual \$'000 | Actual \$'000 |
| Repayment of bonds issued under | | | |
| Tender or subscription | 24,466,000 | 24,484,560 | 27,021,560 |
| Switch tender | 800,000 | - | - |
| Bond swap facility | 1,000,000 | - | - |
| | 26,266,000 | 24,484,560 | 27,021,560 |
| Interest payment for bonds | 2,072,220 | 1,546,777 | 1,805,381 |
| Periodic distribution payments for alternative bonds | 548,886 | 549,717 | 302,646 |
| Others | 20,487 | 19,875 | 35,963 |
| | <u>28,907,593</u> | <u>26,600,929</u> | <u>29,165,550</u> |

Bond Fund

Analysis of Payments for the year ended 31 March 2018



9. Other Cash Movements

These are cash movements arising from changes in other assets and liabilities:

| | 2018 \$'000 | 2017 \$'000 |
|--|------------------|---------------------|
| Reduction/(Increase) in Assets | | |
| Investments with the Exchange Fund | 3,222,599 | (12,965,619) |
| Increase/(Reduction) in Liabilities | | |
| Deposits | 1,247 | (1,576) |
| | 3,223,846 | (12,967,195) |

Bond Fund

Receipts, Payments and Fund Balance for the years ended 31 March 2010 to 2018

\$Billion

