

Report of the Director of Audit



Audit Commission

The Government of the Hong Kong Special Administrative Region

Capital Works Reserve 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 Capital Works Reserve Fund set out on pages 26 to 35, which comprise the statement of assets and liabilities as at 31 March 2019, 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 Capital Works Reserve 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 2019 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 Capital Works Reserve Fund's internal control; and

- evaluate the appropriateness of accounting policies used by the Director of Accounting Services and the reasonableness of accounting estimates and related disclosures.

John Chu
Director of Audit

29 October 2019

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

Capital Works Reserve Fund

STATEMENT OF ASSETS AND LIABILITIES AS AT 31 MARCH 2019

(Expressed in Hong Kong dollars)

| | Note | 2019 \$'000 | 2018 \$'000 |
|------------------------------------|---------|--------------------|----------------|
| Assets | | | |
| Investments with the Exchange Fund | 3 | 148,640,017 | 184,696,141 |
| Cash and bank balances | | 2,084 | 5,292 |
| | | 148,642,101 | 184,701,433 |
| Liabilities | | | |
| Deposits | 4 | (1,950,222) | (1,947,802) |
| | | 146,691,879 | 182,753,631 |
| Representing: | | | |
| Fund Balance | | | |
| Balance at beginning of year | | 182,753,631 | 100,873,337 |
| (Deficit)/Surplus for the year | | (36,061,752) | 81,880,294 |
| Balance at end of year | 5, 6, 7 | 146,691,879 | 182,753,631 |

Notes 1 to 10 form part of these financial statements.

Charlix WONG
Director of Accounting Services
26 August 2019



Capital Works Reserve Fund

STATEMENT OF RECEIPTS AND PAYMENTS FOR THE YEAR ENDED 31 MARCH 2019

(Expressed in Hong Kong dollars)

| | Note | 2019 \$'000 | 2018 \$'000 |
|----------------------------------------------------|------|---------------------|---------------------|
| Cash and bank balances at beginning of year | | 5,292 | 1 |
| Receipts | 8 | 125,848,798 | 168,767,863 |
| Payments | 5, 9 | (161,910,550) | (86,887,569) |
| (Deficit)/Surplus for the year | | (36,061,752) | 81,880,294 |
| Other cash movements | 10 | 36,058,544 | (81,875,003) |
| Cash and bank balances at end of year | | 2,084 | 5,292 |

Notes 1 to 10 form part of these financial statements.

Charlix WONG
Director of Accounting Services
26 August 2019



Capital Works Reserve Fund

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars, unless otherwise stated)

1. Purpose and Legislation

The Capital Works Reserve Fund was set up to finance public works programmes, acquisitions of land, capital subventions and major systems and equipment items. It was initially established on 1 April 1982 by a Resolution of the Legislative Council passed on 20 January 1982 and subsequently deemed to have been established under section 29(3) of the Public Finance Ordinance (Cap. 2). Since 1 January 1998, it has been reconstituted under another Resolution passed on 17 December 1997 (hereinafter referred to as the Resolution).

2. Accounting Policies

- (i) The accounts of the Capital Works Reserve 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 fixed assets, loans, investments other than those made under paragraph (d)(iii) of the Resolution, and debtors and creditors other than those deposits referred to in Note 4 below.
- (ii) For the purposes of these financial statements, a contingent liability is defined as:
 - (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Government; or
 - (b) a present obligation that arises from past events but is not recognised because:
 - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - the amount of the obligation cannot be measured with sufficient reliability.
- (iii) 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 and deposits held under paragraph (d)(iii) of the Resolution:

| | 2019 | 2018 |
|------------------------------------------|---------------------------|--------------------|
| | \$'000 | \$'000 |
| Investments (Notes (ii) and (iii) below) | 148,590,477 | 184,651,906 |
| Deposits | 49,540 | 44,235 |
| | <u>148,640,017</u> | <u>184,696,141</u> |

- (ii) The investments represent the cost of investments together with the investment income received in the year being reported.
- (iii) The investment income is calculated, in accordance with an arrangement entered into with the Hong Kong Monetary Authority in 2007, 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 (replacing the three-year Exchange Fund Notes with effect from 1 January 2016) for the previous year subject to a minimum of zero percent, whichever is the higher. The rate of return for the calendar year 2018 was 4.6% (2017: 2.8%). The annual investment income is receivable on 31 December each year.

Capital Works Reserve Fund

4. Deposits

These are moneys received from time to time from individuals or organisations for a variety of reasons and are in due course either repayable or transferable for credit to the Fund:

| | 2019 | 2018 |
|--------------------------|-------------------------|------------------|
| | \$'000 | \$'000 |
| Contract retention money | 1,729,715 | 1,655,906 |
| Others | 220,507 | 291,896 |
| | <u>1,950,222</u> | <u>1,947,802</u> |

5. Fund Balance

The Fund Balance includes receipts from sums borrowed for the purposes of the Capital Works Reserve Fund under the Loans Ordinance (Cap. 61) that are required to be credited to the Fund under paragraph (b)(v) 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 paragraph (d)(ii) of the Resolution.

Following a resolution passed under section 3(1) of the Loans Ordinance, the Government issued in July 2004 bonds and notes totalling \$20 billion to retail and institutional investors. These include institutional notes of US\$1.25 billion denominated in United States dollars. The outstanding liabilities, not included in the Statement of Assets and Liabilities, in respect of sums borrowed are as follows:

| | 2019 | 2018 |
|----------------------------------------|-------------------------|------------------|
| | \$'000 | \$'000 |
| Outstanding government bonds and notes | <u>1,500,000</u> | <u>1,500,000</u> |

The outstanding bonds and notes were notes denominated in Hong Kong dollars and were repaid at maturity in July 2019. During the financial year, there were payments of interest of \$77 million on the notes.

6. Contingent Liabilities

As at 31 March 2019, the amount of contingent liabilities arising from legal claims, disputes and proceedings was \$2,395 million (2018: \$2,611 million).

Capital Works Reserve Fund

7. Commitments

The balances of the approved project estimates that were unspent were as follows:

| Head | | 2019 | 2018 |
|-----------------------------------------------|--------------------------------------|--------------------|---------------|
| | | \$'000 | \$'000 |
| Land acquisition | | | |
| 701 | Land acquisition | 18,395,581 | 5,649,880 |
| | Sub-total | 18,395,581 | 5,649,880 |
| Capital works – Public Works Programme | | | |
| 702 | Port and airport development | 81,880 | 125,021 |
| 703 | Buildings | 120,095,793 | 87,107,253 |
| 704 | Drainage | 21,261,840 | 15,156,426 |
| 705 | Civil engineering | 47,711,928 | 53,216,280 |
| 706 | Highways | 105,356,256 | 131,316,746 |
| 707 | New towns and urban area development | 70,380,235 | 64,997,430 |
| 709 | Waterworks | 11,911,456 | 10,817,227 |
| 711 | Housing | 10,005,924 | 9,089,744 |
| | Sub-total | 386,805,312 | 371,826,127 |
| Capital subventions | | | |
| 708 (part) | Capital subventions | 38,396,289 | 25,079,020 |
| | Sub-total | 38,396,289 | 25,079,020 |
| Systems and equipment | | | |
| 708 (part) | Major systems and equipment | 8,493,350 | 6,099,767 |
| 710 | Computerisation | 12,190,239 | 9,331,144 |
| | Sub-total | 20,683,589 | 15,430,911 |
| | | 464,280,771 | 417,985,938 |

Capital Works Reserve Fund

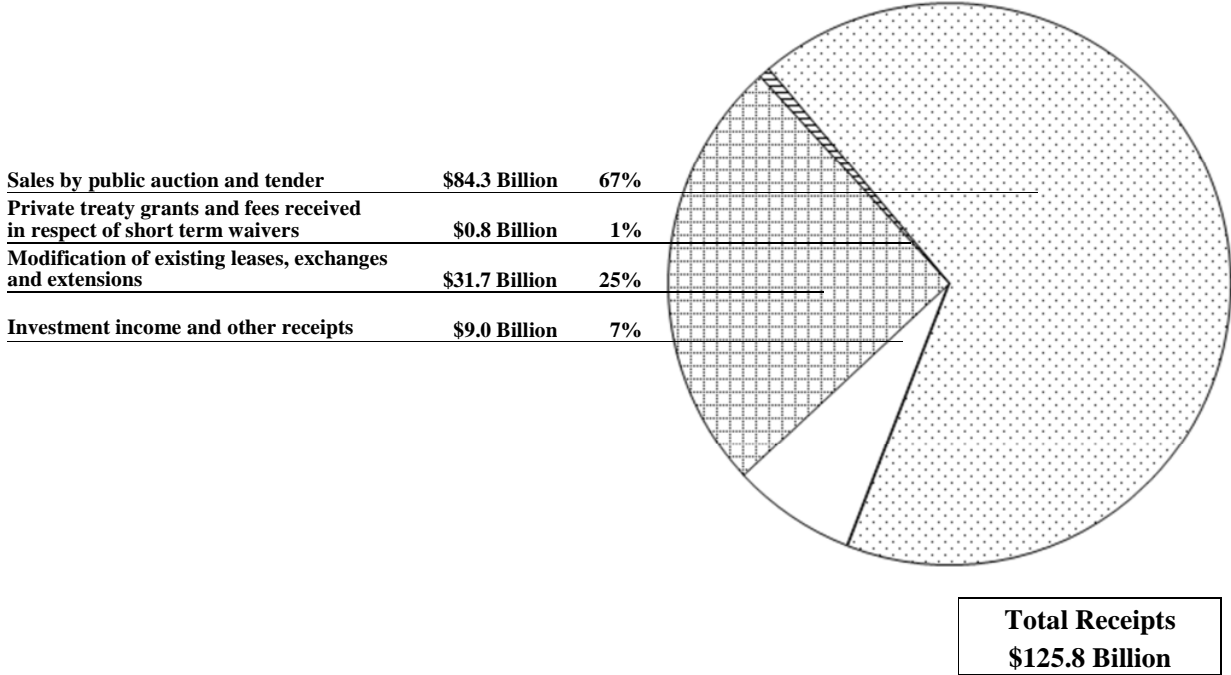
8. Receipts

| | 2019 | | 2018 |
|--------------------------------------------------------------|--------------------------------|---------------------------|--------------------|
| | Original Estimate \$'000 | Actual \$'000 | Actual \$'000 |
| Land premium | | | |
| Sales by public auction and tender | - | 84,254,576 | 114,588,712 |
| Private treaty grants | - | 64,513 | 74,187 |
| Modification of existing leases, exchanges and extensions | - | 31,733,381 | 49,318,984 |
| Fees received in respect of short term waivers | - | 808,131 | 829,413 |
| | 121,000,000 | 116,860,601 | 164,811,296 |
| Investment income | | | |
| Investments with the Exchange Fund (Note (i) below) | - | 8,928,354 | 3,830,897 |
| Others | - | 1,416 | 1,437 |
| | 8,899,000 | 8,929,770 | 3,832,334 |
| Other receipts | | | |
| Donations and contributions | 10,017 | 19,408 | 22,359 |
| Others | - | 39,019 | 101,874 |
| | 10,017 | 58,427 | 124,233 |
| | <u>129,909,017</u> | <u>125,848,798</u> | <u>168,767,863</u> |

- (i) Pursuant to the Financial Secretary's directives, the investment incomes of the Fund for the calendar years 2014 and 2015 totalling \$6.86 billion (comprising \$2.88 billion for 2014 and \$3.98 billion for 2015), along with the investment incomes on other parts of the fiscal reserves for the two years, were set aside and retained within the Exchange Fund for the Housing Reserve, and not received in the respective financial years 2014-15 and 2015-16. The Housing Reserve was established in December 2014. As explained in the 2015-16 Budget Speech, the Housing Reserve is to provide financial resources to meet the ten-year public housing supply target. The investment income retained within the Exchange Fund earns the same rate of investment return as stipulated in Note 3(iii). As announced in the 2019-20 Budget Speech, the Housing Reserve will be brought back to the Government's accounts and recorded as investment income over four financial years from 2019-20 to 2022-23. The accumulated investment return not received was \$0.93 billion up to 31 December 2018 (2017: \$0.59 billion), including the investment return for the calendar year 2018 amounting to \$0.34 billion (2017: \$0.21 billion). Together with the accumulated investment return, the sums not received as revenue of the Fund and earmarked as Housing Reserve totalled \$7.79 billion (2017: \$7.45 billion).

Capital Works Reserve Fund

Analysis of Receipts for the year ended 31 March 2019



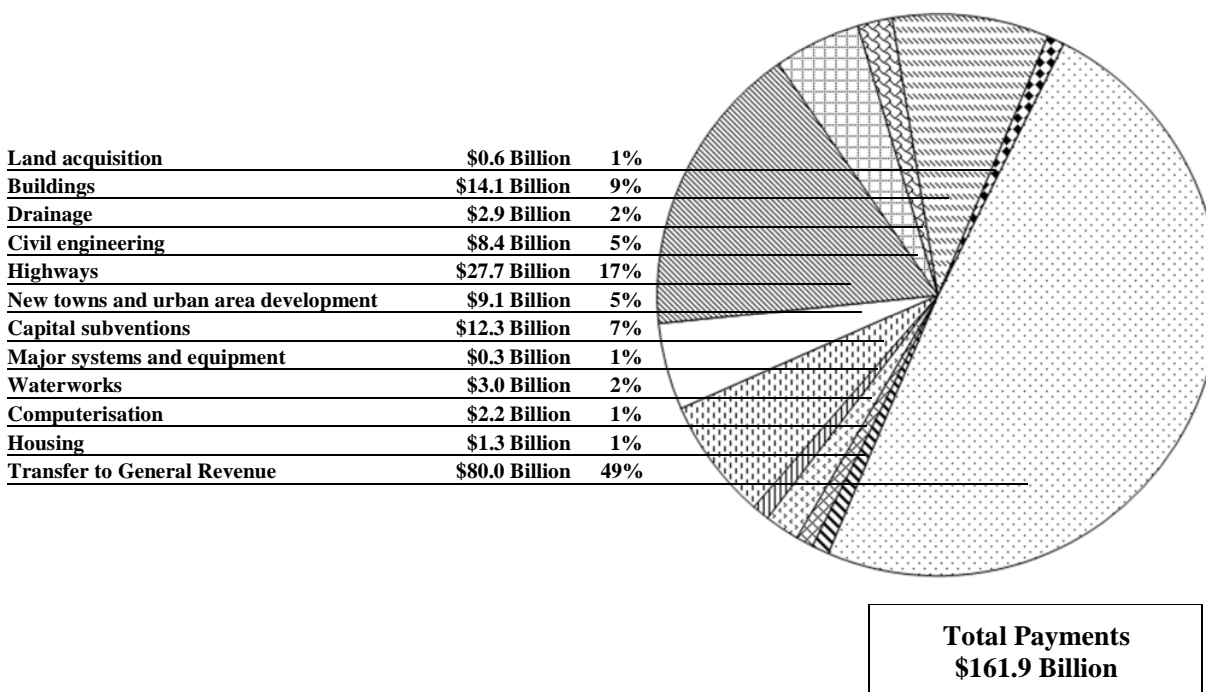
Capital Works Reserve Fund

9. Payments

| | 2019 | | 2018 |
|-----------------------------------------------------|-----------------------------|---------------------------|-------------------|
| | Original Estimate \$'000 | Actual \$'000 | Actual \$'000 |
| Land acquisition | 1,616,190 | 580,874 | 440,579 |
| Public Works Programme | | | |
| Port and airport development | 988 | 972 | 777 |
| Buildings | 14,870,255 | 14,053,765 | 11,288,836 |
| Drainage | 2,783,932 | 2,840,242 | 3,039,320 |
| Civil engineering | 9,680,927 | 8,396,699 | 7,414,564 |
| Highways | 30,880,805 | 27,662,667 | 44,097,127 |
| New towns and urban area development | 10,109,599 | 9,082,415 | 6,346,873 |
| Waterworks | 4,083,140 | 2,995,969 | 3,018,506 |
| Housing | 1,783,102 | 1,276,645 | 993,336 |
| | 74,192,748 | 66,309,374 | 76,199,339 |
| Capital subventions and major systems and equipment | | | |
| Capital subventions | 19,065,765 | 12,345,715 | 7,639,572 |
| Major systems and equipment | 813,846 | 300,111 | 516,808 |
| | 19,879,611 | 12,645,826 | 8,156,380 |
| Computerisation | 2,526,800 | 2,227,272 | 1,961,797 |
| Government bonds and notes issued in July 2004 | | | |
| Interest and other expenses | 76,881 | 76,880 | 76,880 |
| Transfer to General Revenue | 80,000,000 | 80,000,000 | - |
| Other payments | | | |
| Refund of overpayment of land premium | - | 70,324 | 52,594 |
| | <u>178,292,230</u> | <u>161,910,550</u> | <u>86,887,569</u> |

Capital Works Reserve Fund

Analysis of Payments for the year ended 31 March 2019*



* Actual payments on “Port and airport development”, “Refund of overpayment of land premium” and “Interest and other expenses on government bonds and notes” are not shown as it is less than \$0.1 billion each.

10. Other Cash Movements

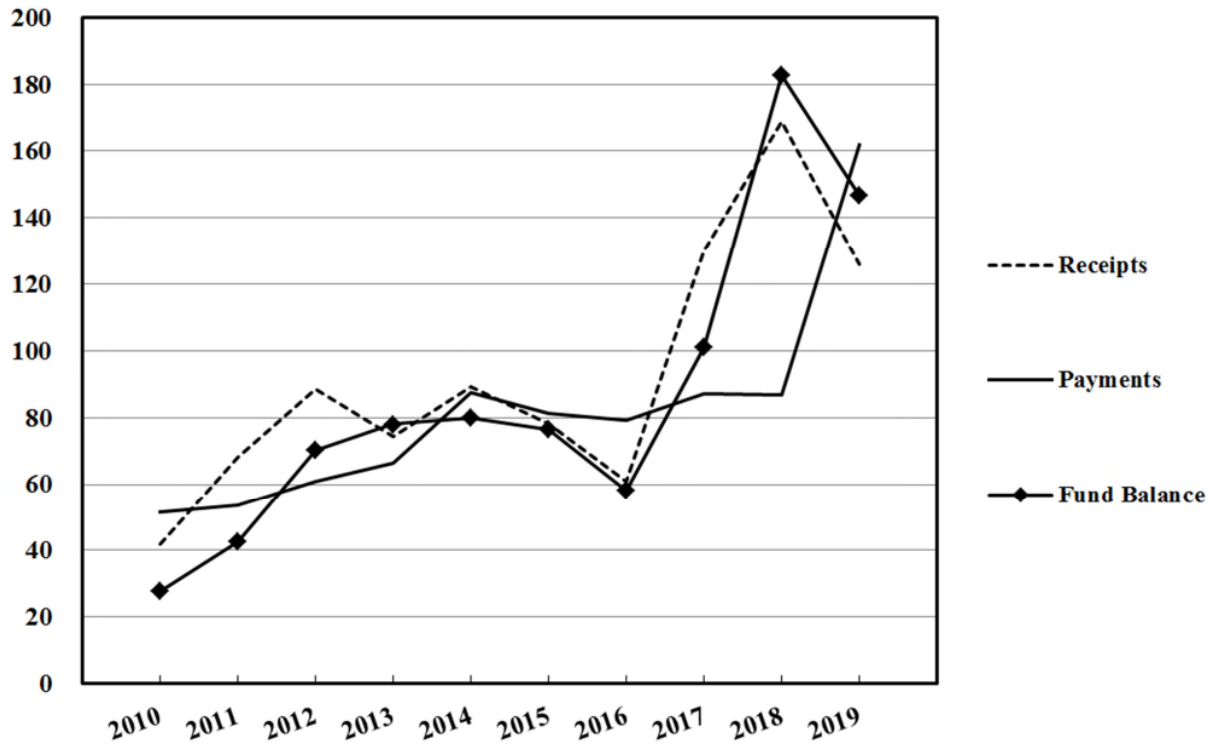
These are cash movements arising from changes in other assets and liabilities:

| | 2019 \$'000 | 2018 \$'000 |
|---------------------------------------|----------------|----------------|
| Reduction/(Increase) in Assets | | |
| Investments with the Exchange Fund | 36,056,124 | (82,043,471) |
| Increase in Liabilities | | |
| Deposits | 2,420 | 168,468 |
| | 36,058,544 | (81,875,003) |

Capital Works Reserve Fund

Receipts, Payments and Fund Balance for the years ended 31 March 2010 to 2019

\$Billion



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