

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
INCOME			
Trading fees and trading tariff	3	485,211	331,729
Stock Exchange listing fees	4	333,786	320,033
Clearing and settlement fees		254,907	181,424
Depository, custody and nominee services fees		211,726	211,413
Income from sale of information		264,239	293,735
Investment income	5	311,307	284,984
Other income	6	158,649	184,772
	2	<u>2,019,825</u>	<u>1,808,090</u>
OPERATING EXPENSES			
Staff costs and related expenses	11	525,573	492,549
Information technology and computer maintenance expenses		246,648	262,700
Premises expenses		84,033	101,234
Product marketing and promotion expenses		7,891	14,728
Legal and professional fees		28,873	39,613
Depreciation and amortisation		183,488	163,139
Payment to SFC under dual filing regime		15,000	-
Other operating expenses	7	130,635	90,694
	2	<u>1,222,141</u>	<u>1,164,657</u>
OPERATING PROFIT	2	797,684	643,433
SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES	2	<u>7,664</u>	<u>6,141</u>
PROFIT BEFORE TAXATION	2/8	805,348	649,574
TAXATION	2/12(a)	<u>(113,583)</u>	<u>(61,069)</u>
PROFIT ATTRIBUTABLE TO SHAREHOLDERS	2/31	<u>691,765</u>	<u>588,505</u>
DIVIDENDS		629,263	532,220
SPECIAL DIVIDEND		<u>1,762,318</u>	<u>-</u>
		<u>2,391,581</u>	<u>532,220</u>
Earnings per share	13	<u>\$0.66</u>	<u>\$0.56</u>
Dividends per share			
Interim dividend paid		\$0.18	\$0.08
Final dividend declared		<u>\$0.42</u>	<u>\$0.43</u>
		<u>\$0.60</u>	<u>\$0.51</u>
Dividend payout ratio		<u>91%</u>	<u>91%</u>
SPECIAL DIVIDEND DECLARED PER SHARE		<u>\$1.68</u>	<u>-</u>

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
Total equity at 1 Jan, as previously reported		5,496,392	5,235,407
Effect of adopting SSAP 12	1(s)	<u>(6,028)</u>	<u>(2,853)</u>
Total equity at 1 Jan, as restated		5,490,364	5,232,554
Change in valuation of investment property	27	-	(1,500)
Change in valuation of other properties	27	(3,503)	(16,850)
Change in fair value of non-trading securities	27	15,353	14,548
Deferred tax arising from change in valuation of other properties	1(s)/27	(71)	2,696
Deferred tax arising from change in fair value of non-trading securities	1(s)/27	<u>(87)</u>	<u>(1,408)</u>
Net surplus/(deficits) not recognised in the consolidated profit and loss account		11,692	(2,514)
Profit attributable to shareholders	31	691,765	588,505
Realisation of change in fair value of non-trading securities on maturity and disposal	27	4,840	(6,015)
2002/2001 final dividend	31	(448,740)	(260,166)
2003/2002 interim dividend	31	(188,452)	(83,450)
Dividend on shares issued for employee share options exercised after declaration of 2002/2001 final dividend	31	(647)	(448)
Dividend on shares issued for employee share options exercised after declaration of 2003/2002 interim dividend	31	(231)	(30)
Proceeds from issue of shares under employee share option schemes	26	40,744	21,928
Forfeiture of defaulted Clearing Participants' contributions		<u>1,928</u>	<u>-</u>
Total equity at 31 Dec		<u>5,603,263</u>	<u>5,490,364</u>

CONSOLIDATED BALANCE SHEET **AT 31 DECEMBER 2003**

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
NON-CURRENT ASSETS			
Fixed assets	14 (a)	585,627	748,108
Investments in associated companies	15	34,002	35,536
Clearing House Funds	16	1,551,330	980,748
Compensation Fund Reserve Account	17	36,859	35,827
Cash and Derivatives Market Development Fund	18	925	914
Non-trading securities	19	77,258	87,604
Other assets		4,814	-
		<u>2,290,815</u>	<u>1,888,737</u>
CURRENT ASSETS			
Margin funds on derivatives contracts	20	7,874,510	4,551,601
Accounts receivable, prepayments and deposits	21(a)	4,644,680	3,118,199
Taxation recoverable		1,558	1,774
Trading securities	22	3,212,998	3,490,046
Bank balances and time deposits		1,777,703	985,114
		<u>17,511,449</u>	<u>12,146,734</u>
CURRENT LIABILITIES			
Bank loans	35(b)(ii)	50,286	49,456
Margin deposits and securities received from Clearing			
Participants on derivatives contracts	20	7,874,510	4,551,601
Accounts payable, accruals and other liabilities	21(b)	4,779,904	3,007,392
Participants' admission fees received	23	4,100	3,350
Deferred revenue		257,068	269,774
Taxation payable		57,370	29,051
Provisions	24(a)	25,011	28,863
		<u>13,048,249</u>	<u>7,939,487</u>
NET CURRENT ASSETS		<u>4,463,200</u>	<u>4,207,247</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>6,754,015</u>	<u>6,095,984</u>
NON-CURRENT LIABILITIES			
Participants' admission fees received	23	84,950	86,800
Participants' contributions to Clearing House Funds	16	984,045	425,440
Deferred tax liabilities	30(a)	58,665	73,281
Provisions	24(a)	23,092	20,099
		<u>1,150,752</u>	<u>605,620</u>
NET ASSETS		<u>5,603,263</u>	<u>5,490,364</u>

CONSOLIDATED BALANCE SHEET (continued)
AT 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
CAPITAL AND RESERVES			
Share capital	26	1,048,999	1,043,581
Share premium	26	54,338	19,012
Revaluation reserves	27	46,431	29,899
Designated reserves	28	689,657	727,811
Retained earnings	31	1,560,940	3,221,321
Proposed and declared dividend	31	2,202,898	448,740
SHAREHOLDERS' FUNDS		<u>5,603,263</u>	<u>5,490,364</u>

Approved by the Board of Directors on 26 February 2004

LEE Yeh Kwong, Charles
Director

CHOW Man Yiu, Paul
Director

HONG KONG EXCHANGES AND CLEARING LIMITED (HKEx)
BALANCE SHEET
AT 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
NON-CURRENT ASSETS			
Fixed assets	14(b)	36,858	43,598
Investments in subsidiaries	25(a)	4,145,198	4,145,198
Other assets		3,088	5,729
		<u>4,185,144</u>	<u>4,194,525</u>
CURRENT ASSETS			
Accounts receivable, prepayments and deposits	21(a)	18,995	20,337
Amounts due from subsidiaries	25(b)	408,250	489,019
Bank balances and time deposits		13,840	10,139
		<u>441,085</u>	<u>519,495</u>
CURRENT LIABILITIES			
Accounts payable, accruals and other liabilities	21(b)	61,726	70,343
Amounts due to subsidiaries	25(b)	59,402	3,111
Taxation payable		128	-
Provisions	24(b)	23,825	23,826
		<u>145,081</u>	<u>97,280</u>
NET CURRENT ASSETS		<u>296,004</u>	<u>422,215</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>4,481,148</u>	<u>4,616,740</u>
NON-CURRENT LIABILITIES			
Deferred tax liabilities		150	219
Provisions	24(b)	235	-
		<u>385</u>	<u>219</u>
NET ASSETS		<u>4,480,763</u>	<u>4,616,521</u>
CAPITAL AND RESERVES			
Share capital	26	1,048,999	1,043,581
Share premium	26	54,338	19,012
Merger reserve	29	2,997,115	2,997,115
(Accumulated losses)/ retained earnings	31	(1,822,587)	108,073
Proposed and declared dividend	31	2,202,898	448,740
SHAREHOLDERS' FUNDS		<u>4,480,763</u>	<u>4,616,521</u>

Approved by the Board of Directors on 26 February 2004

LEE Yeh Kwong, Charles
Director

CHOW Man Yiu, Paul
Director

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash inflow/(outflow) from operating activities	32(a)	<u>1,408,746</u>	<u>(100,386)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for purchases of fixed assets		(51,635)	(130,733)
Proceeds from sales of fixed assets		190	34
Payment for purchases of non-trading securities		-	(32,305)
Increase in time deposits with original maturity more than three months		(117,155)	(57,060)
Net cash outflow from investments in associated companies and disposal of a subsidiary		-	(31,546)
Dividends received from an associated company		4,800	-
Dividends received from non-trading securities		14,097	2,482
Interest received from non-trading securities		13,644	16,623
Interest paid on bank loan		(827)	(1,051)
Repayment of loan receivable from an associated company		<u>2,000</u>	<u>-</u>
Net cash outflow from investing activities		<u>(134,886)</u>	<u>(233,556)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares under employee share option scheme		40,744	21,928
Admission fees received less refunds to Participants		(1,100)	(15,900)
Dividends paid		<u>(638,070)</u>	<u>(344,094)</u>
Net cash outflow from financing activities		<u>(598,426)</u>	<u>(338,066)</u>
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		675,434	(672,008)
Cash and cash equivalents at the beginning of the year		<u>679,956</u>	<u>1,351,964</u>
Cash and cash equivalents at the end of the year	32(b)	<u><u>1,355,390</u></u>	<u><u>679,956</u></u>

NOTES TO THE ACCOUNTS

(Financial figures are expressed in Hong Kong dollars)

1. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Society of Accountants (HKSA), requirements of the Hong Kong Companies Ordinance and applicable disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Listing Rules).

(b) Basis of preparation

The accounts have been prepared under the historical cost convention, as modified by the revaluation of certain land and buildings, investment properties and non-trading securities and the marking to market of trading securities and shares borrowed and receivable by Hong Kong Securities Clearing Company Limited (HKSCC) for the purpose of settlement under the Continuous Net Settlement (CNS) basis.

In the current year, the Group has adopted the new Hong Kong Statement of Standard Accounting Practice (SSAP) 12: Income Taxes, issued by the HKSA, which is effective for accounting periods commencing on or after 1 January 2003. The effects of adopting the new accounting standard are set out in 1(s) below.

(c) Group accounting

(i) Consolidation

The Group has adopted merger accounting in the preparation of the consolidated accounts at the time of the merger of the Group in 2000. The consolidated accounts include the accounts of HKEx and all of its subsidiaries made up to 31 December. All material intra-group transactions and balances have been eliminated on consolidation.

A subsidiary is an entity in which HKEx, directly or indirectly, controls the composition of the board of directors, controls more than half of the voting power or holds more than half of the issued share capital.

In HKEx's balance sheet, investments in subsidiaries are stated at cost less provision, if necessary, for any impairment. The results of subsidiaries are accounted for by HKEx on the basis of dividends received and receivable.

(ii) Associated companies

An associated company is a company, not being a subsidiary, in which an equity interest is held for the long-term and significant influence is exercised in its management.

Investments in associated companies are accounted for in the consolidated accounts under the equity method. The consolidated profit and loss account includes the Group's share of the post-acquisition results of associated companies for the year, and the consolidated balance sheet includes the Group's share of the net assets of associated companies and goodwill (net of accumulated amortisation) on acquisition.

(d) Turnover

Turnover comprises trading fees and trading tariff from securities and options traded on The Stock Exchange of Hong Kong Limited (Stock Exchange) and derivatives contracts traded on Hong Kong Futures Exchange Limited (Futures Exchange), Stock Exchange listing fees, clearing and settlement fees, depository, custody and nominee services fees, income from sale of information, investment income (including investment income net of interest expenses of Clearing House Funds) and other income, which are **disclosed as Income** in the consolidated profit and loss account.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(e) Revenue recognition

Income is recognised in the profit and loss account on the following basis:

- (i) Trading fees and trading tariff on securities and options traded on the Stock Exchange are recognised on a trade date basis.
- (ii) Trading fees on derivatives contracts traded on the Futures Exchange are recognised on the day when the derivatives contracts are entered into.
- (iii) Settlement fees on derivatives contracts traded on the Futures Exchange are recognised on outstanding contracts at the official final settlement day.
- (iv) Fees for clearing and settlement of broker-to-broker trades in eligible securities transacted on the Stock Exchange are recognised in full on T + 1, i.e., on the day following the trade day, upon acceptance of the trades. Fees for settlement of other trades and transactions are recognised upon completion of the settlement.
- (v) Custody fees for securities held in the Central Clearing and Settlement System (CCASS) depository are calculated and accrued on a monthly basis. Income on registration and transfer fees on nominee services are calculated and accrued on the book close dates of the relevant stocks during the financial year.
- (vi) Income from annual listing fees is recognised on a straight-line basis over the period covered by the respective fees received in advance.
- (vii) Income from sale of information and other fees are recognised when the related services are rendered.
- (viii) Interest income represents gross interest income from bank deposits and investments and is recognised on a time apportionment basis, taking into account the principal outstanding and the applicable interest rates.
- (ix) Dividend income is recognised when the right to receive payment is established.
- (x) Rental income is recognised on an accrual basis.

(f) Interest expenses

Interest expenses are recognised on a time apportionment basis, taking into account the principal outstanding and the applicable interest rates.

(g) Employee benefit costs

- (i) Employee leave entitlements

The cost of accumulating compensated absences is recognised as an expense and measured based on the additional amount that the Group expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Employee benefit costs (continued)

(ii) Equity compensation benefits

Share options under the Pre-listing and Post-listing Share Option Schemes have been granted to two Executive Directors and employees. When the options are exercised, the proceeds received are credited to share capital (nominal value) and share premium. No costs in relation to the options are charged to the profit and loss account (note 26).

(iii) Retirement benefit costs

Contributions to the defined contribution provident fund regulated under the Occupational Retirement Schemes Ordinance (ORSO) and operated by the Group and the AIA-JF Premium MPF Scheme are expensed as incurred. Forfeited contributions of the provident fund in respect of employees who leave before the contributions are fully vested are not used to offset existing contributions but are credited to a reserve account of that provident fund. Reserves of the provident fund representing forfeited employer's contributions are available for distribution to the provident fund members at the discretion of the trustees. Assets of the provident fund and the AIA-JF Premium MPF Scheme are held separately from those of the Group and are independently administered.

(h) Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases net of any incentives received from the leasing company are charged to the profit and loss account on a straight-line basis over the lease term.

(i) Fixed assets

Land and buildings, other than investment properties, are stated at valuation less accumulated depreciation. Fair value is determined by the Directors based on independent valuations which are performed periodically. The valuations are on an open market value basis related to individual properties and separate values are not attributed to land and buildings. The Directors review the carrying value of the land and buildings and adjustment is made where they consider that there has been a material change. Increases in valuation are credited to the other properties revaluation reserve. Decreases in valuation are first offset against increases on earlier valuations in respect of the same property and are thereafter charged to the profit and loss account. Any subsequent increases are credited to the profit and loss account up to the amount previously charged and thereafter to other properties revaluation reserve.

Other tangible fixed assets are stated at cost less accumulated depreciation.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Fixed assets (continued)

Leasehold land is depreciated over the period of the lease while other tangible fixed assets are depreciated at rates sufficient to write off their cost over their estimated useful lives on a straight-line basis. The principal annual rates are as follows:

Leasehold land	over the remaining life of the leases
Buildings	4%
Leasehold improvements	over the remaining life of the leases but not exceeding 5 years
Computer trading and clearing systems	
- software	20%
- hardware	33.33%
Other computer hardware and software	33.33%
Furniture and equipment	20%
Motor vehicles	33.33%

Major costs incurred in restoring fixed assets to their normal working condition are charged to the profit and loss account. Improvements are capitalised and depreciated over their expected useful lives.

The carrying amounts of fixed assets are reviewed regularly by the Group to assess whether their recoverable amounts have declined below their carrying amounts. The Group has not discounted the expected future cash flows in determining the recoverable amounts.

Qualifying software system development expenditures are capitalised and recognised as a fixed asset in the balance sheet as the software forms an integral part of the hardware on which it operates. The expenditures comprise all qualifying direct and allocated expenses attributable to the development of distinct major computer systems.

Qualifying development expenditures incurred after the roll-out of a system are added to the carrying amount of the related assets when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Group. All other subsequent expenditures are recognised as non-qualifying expenditures.

All non-qualifying expenditures and expenses incurred on other non-qualifying development activities are charged as expenses to the profit and loss account in the period in which such expenses are incurred.

Amortisation of the cost of capitalised software system development expenditures is provided from the dates when the systems become operational.

Upon the disposal of land and buildings, other than investment properties, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the other properties revaluation reserve to the profit and loss account.

The gain or loss on disposal of a fixed asset other than land and buildings is the difference between the net sale proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(j) Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are held for their investment potential with any rental income being negotiated at arm's length.

Investment properties are carried in the balance sheet at valuations determined annually by independent valuers. The valuations are on an open market value basis and are incorporated in the accounts. Increases in valuation are credited to the investment properties revaluation reserve. Decreases in valuation are first set off against increases on earlier valuations on a portfolio basis and thereafter are charged to the profit and loss account. Any subsequent increases are credited to the profit and loss account up to the amount previously charged and thereafter to investment properties revaluation reserve.

Upon the disposal of investment properties, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the investment properties revaluation reserve to the profit and loss account.

(k) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired company at the date of acquisition and is amortised on a straight-line basis over an estimated useful life not exceeding 20 years.

Where an indication of impairment exists, the carrying amount of goodwill is assessed and written down immediately to its recoverable amount.

(l) Impairment of assets

At each balance sheet date, information from both internal and external sources is considered to assess whether there is any indication that assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and, where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a decline in revaluation.

(m) Clearing House Funds/Cash and Derivatives Market Development Fund (CDMD Fund)

Income arising from bank deposits and investments comprising these funds and expenses incurred for these funds are dealt with in the profit and loss account. Annual investment income net of expenses of the Clearing House Funds is appropriated from retained earnings to the respective designated reserves of these funds. Investment income net of expenses of the CDMD Fund may be appropriated to the designated reserve of this fund at the discretion of the Board of Directors of HKFE Clearing Corporation Limited (HKCC). Changes in valuation of the non-trading securities comprising these funds are dealt with in the investment revaluation reserve.

Net assets of the Clearing House Funds, which are derived from contributions from CCASS Participants (other than investor participants), HKCC Participants and The SEHK Options Clearing House Limited (SECH) Participants (Clearing Participants) and the respective clearing houses, and the accumulated investment income net of expenses of these funds appropriated from retained earnings, are included in the balance sheet as non-current assets. Clearing Participants' contributions are treated as non-current liabilities in the balance sheet. Contributions from the respective clearing houses, the accumulated investment income net of expenses of these funds appropriated from retained earnings and forfeiture of defaulted Clearing Participants' contributions are included in the balance sheet as designated reserves.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(m) Clearing House Funds/Cash and Derivatives Market Development Fund (CDMD Fund) (continued)

Net assets of the CDMD Fund, which are derived from the accumulated investment income net of expenses of this fund appropriated from retained earnings, are included in the balance sheet as non-current assets. The accumulated investment income net of expenses of this fund appropriated from retained earnings is included in the balance sheet as a designated reserve.

(n) Margin funds on derivatives contracts/margin deposits and securities received from Clearing Participants on derivatives contracts

Margin funds are established by deposits and securities received from SEOCH and HKCC Clearing Participants for their open positions in derivatives contracts.

The funds are refundable to the Clearing Participants of SEOCH and HKCC when they close their positions in derivatives contracts. As a result, the margin deposits and securities received are reflected as liabilities to the Clearing Participants of SEOCH and HKCC. These funds are held for the SEOCH and HKCC Clearing Participants' liabilities to the respective clearing houses and are held in segregated accounts of the respective clearing houses.

Income arising from bank deposits and investments comprising these margin funds and expenses incurred for these funds are dealt with in the profit and loss account. Changes in fair value of the securities comprising these margin funds are dealt with in the investment revaluation reserve. The Clearing Participants of SEOCH and HKCC are entitled to interest at a rate determined daily by SEOCH and HKCC on the margin deposits that they place with SEOCH and HKCC respectively.

(o) Non-trading securities

Securities held by the Group for the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund, margin funds and its investments in non-trading securities are stated in the balance sheet at fair value. Changes in the fair value of individual securities are credited or debited to the investment revaluation reserve until a security is sold, matures, or is determined to be impaired. Upon disposal, the cumulative gain or loss representing the difference between the net sale proceeds and the carrying amount of the relevant security, together with any changes in fair value transferred from the investment revaluation reserve, is dealt with in the profit and loss account.

Individual securities are reviewed at each balance sheet date to determine whether they are impaired. When a security is considered to be impaired, the cumulative loss recorded in the investment revaluation reserve is taken to the profit and loss account. Cumulative losses transferred from the investment revaluation reserve to the profit and loss account as a result of impairment are written back to the profit and loss account when the circumstances and events leading to the impairment cease to exist.

(p) Trading securities

Trading securities are investments of the Group's corporate funds and are marked to market (i.e., carried at fair value). At each balance sheet date, the net unrealised gains or losses arising from the changes in fair value of trading securities are recognised in the profit and loss account. Profits or losses on disposal of trading securities, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the profit and loss account as they arise.

(q) Repurchase transactions

When securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and the consideration received is recorded as a liability.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(r) Recognition of receivables and payables from/to HKSCC Clearing Participants on Stock Exchange trades settled on the CNS basis

Upon acceptance of Stock Exchange trades for settlement in CCASS under the CNS basis, HKSCC interposes itself between the HKSCC Clearing Participants as the settlement counterparty to the trades through novation. Final acceptance of Stock Exchange trades is confirmed on T + 1 by details contained in the final clearing statement transmitted to every HKSCC Clearing Participant.

The CNS money obligations due by/to HKSCC Clearing Participants on the Stock Exchange trades are recognised as receivables and payables when they are confirmed and accepted on T + 1.

For all other trades and transactions, HKSCC merely provides a facility for settlement within CCASS and does not interpose itself between the HKSCC Clearing Participants as the settlement counterparty to the trades. The settlement of these trades does not constitute money obligations and is excluded from the consolidated accounts of the Group.

(s) Deferred taxation

Under the new SSAP 12: Income Taxes, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred tax assets and liabilities. As a result, deferred tax assets and liabilities in 2002 are computed using a tax rate of 16 per cent and deferred tax assets and liabilities in 2003 using the higher tax rate of 17.5 per cent announced in the March 2003 Hong Kong Budget. As outstanding deferred tax liabilities brought forward from 2002 have to be recomputed at the higher tax rate in 2003, the change in tax rate has resulted in an increase in deferred tax liabilities of which \$6,040,000 was absorbed as an additional deferred tax charge in 2003.

In prior year, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. The adoption of the new SSAP 12 represents a change in accounting policy, which has been applied retrospectively and the comparatives presented have been restated to conform to the changed policy. As a result, total deferred tax liabilities as at 31 December 2001 and 2002 increased by \$2,853,000 (with a corresponding reduction of \$5,369,000 in revaluation reserves and an increase of \$2,516,000 in retained earnings) and \$6,028,000 (with a corresponding reduction of \$4,081,000 in revaluation reserves and reduction of \$1,947,000 in retained earnings) respectively. Therefore, as detailed in note 31 to the accounts, opening consolidated retained earnings at 1 January 2002 and 2003 have increased by \$2,516,000 and decreased by \$1,947,000 respectively. The change has reduced the consolidated profit for the year ended 31 December 2002 by \$4,463,000 (from \$592,968,000 to \$588,505,000).

(t) Deferred revenue

Deferred revenue comprises annual listing fees received in advance, payments received in advance for services in relation to the sales of stock market information and telecommunication line rentals for trading facilities located at brokers' offices.

(u) Provisions, contingent liabilities and contingent assets

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(u) Provisions, contingent liabilities and contingent assets (continued)

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.

(v) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at rates of exchange ruling at the balance sheet date. Exchange gains and losses are dealt with in the profit and loss account.

(w) Forward foreign exchange contracts

Forward foreign exchange contracts used to hedge the currency exposures of the Group's investments are marked to market (i.e., carried at fair value). The net unrealised gains or losses arising from the changes in fair value of the contracts (i.e., estimated amounts the Group would expect to receive or pay on the termination of the contracts) are recognised in the profit and loss account.

(x) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, bank balances and time deposits within three months of maturity when acquired.

(y) Segment reporting

Business segment assets consist primarily of fixed assets, assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund and margin funds. Business segment liabilities comprise operating liabilities. Non-business segment assets and liabilities include taxation recoverable and payable, deferred tax liabilities and unclaimed dividends. Capital expenditures comprise additions to fixed assets. Business segments have been used as the primary reporting format as all business activities are conducted in Hong Kong.

(z) Dividends

Dividends disclosed in the consolidated profit and loss account represent interim dividends paid and final dividend declared (based on the issued share capital as at the balance sheet date) for the year.

NOTES TO THE ACCOUNTS

2. SEGMENT INFORMATION

The Group's income is derived solely from business activities in Hong Kong. An analysis of the Group's income, results, assets, liabilities and capital expenditures for the year by business segments is as follows:

	Cash Market 2003 \$'000	Derivatives Market 2003 \$'000	Clearing Business 2003 \$'000	Information Services 2003 \$'000	Others 2003 \$'000	Group 2003 \$'000
Income	847,074	317,421	589,017	266,313	-	2,019,825
Costs	<u>590,854</u>	<u>174,947</u>	<u>362,183</u>	<u>94,157</u>	<u>-</u>	<u>1,222,141</u>
Segment results	256,220	142,474	226,834	172,156	-	797,684
Share of profits of associated companies	<u>1</u>	<u>-</u>	<u>7,663</u>	<u>-</u>	<u>-</u>	<u>7,664</u>
Segment profits before taxation	256,221	142,474	234,497	172,156	-	805,348
Taxation						<u>(113,583)</u>
Profit attributable to shareholders						<u>691,765</u>
Segment assets	<u>2,407,862</u>	<u>9,179,156</u>	<u>8,131,719</u>	<u>81,969</u>	<u>1,558</u>	<u>19,802,264</u>
Segment liabilities	<u>551,468</u>	<u>7,948,646</u>	<u>5,543,371</u>	<u>30,070</u>	<u>125,446</u>	<u>14,199,001</u>
Segment capital expenditures	<u>13,154</u>	<u>5,493</u>	<u>12,430</u>	<u>5,170</u>	<u>-</u>	<u>36,247</u>
Segment depreciation and amortisation	<u>91,344</u>	<u>21,222</u>	<u>60,571</u>	<u>13,013</u>	<u>-</u>	<u>186,150</u>
Segment other non-cash expenses	<u>22,489</u>	<u>18,847</u>	<u>3,305</u>	<u>1,459</u>	<u>-</u>	<u>46,100</u>

NOTES TO THE ACCOUNTS

2. SEGMENT INFORMATION (continued)

	Cash Market 2002 \$'000	Derivatives Market 2002 \$'000	Clearing Business 2002 \$'000	Information Services 2002 \$'000	Others 2002 \$'000	Group 2002 \$'000
Income	721,892	269,243	520,516	296,439	-	1,808,090
Costs	<u>568,984</u>	<u>145,867</u>	<u>334,995</u>	<u>114,811</u>	<u>-</u>	<u>1,164,657</u>
Segment results	152,908	123,376	185,521	181,628	-	643,433
Share of profits/(losses) of associated companies	<u>(103)</u>	<u>-</u>	<u>6,244</u>	<u>-</u>	<u>-</u>	<u>6,141</u>
Segment profits before taxation	152,805	123,376	191,765	181,628	-	649,574
Taxation						<u>(61,069)</u>
Profit attributable to shareholders						<u>588,505</u>
Segment assets	<u>2,206,360</u>	<u>5,839,940</u>	<u>5,894,579</u>	<u>92,818</u>	<u>1,774</u>	<u>14,035,471</u>
Segment liabilities	<u>435,596</u>	<u>4,597,581</u>	<u>3,365,127</u>	<u>38,386</u>	<u>108,417</u>	<u>8,545,107</u>
Segment capital expenditures	<u>12,068</u>	<u>27,522</u>	<u>92,987</u>	<u>14,093</u>	<u>-</u>	<u>146,670</u>
Segment depreciation and amortisation	<u>89,112</u>	<u>16,401</u>	<u>49,701</u>	<u>9,493</u>	<u>-</u>	<u>164,707</u>
Segment other non-cash expenses	<u>(688)</u>	<u>234</u>	<u>1,914</u>	<u>789</u>	<u>-</u>	<u>2,249</u>

NOTES TO THE ACCOUNTS

2. SEGMENT INFORMATION (continued)

- (a) The **Cash Market** business refers to the operations of the Stock Exchange, which covers all products traded on the cash market platforms, such as equities, debt securities, unit trusts, warrants and rights. Currently, the Group operates two cash market platforms, the Main Board and the Growth Enterprise Market. The major sources of income of the business are trading fees, trading tariff and listing fees. Direct costs of the Listing Function (which were previously included under the Others Segment) are treated as segment costs under the Cash Market Segment. Comparatives for 2002 have been reclassified retrospectively to conform to this practice. Costs of the Listing Function are further explained in note 4.

The **Derivatives Market** business refers to the derivatives products traded on the Futures Exchange and the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity, currency and interest rate futures and options. Its income mainly comprises trading fees and net interest income on the margin funds received.

The **Clearing Business** refers to the operations of the three Clearing Houses, namely HKSCC, SEOCH and HKCC, which are responsible for clearing, settlement and custodian activities and the related risk management of the cash and derivatives markets operated by the Group. Its income is derived primarily from interest earned on the Clearing House Funds and fees from providing clearing, settlement, depository and nominee services.

The **Information Services Segment** is responsible for developing and promoting e-commerce products, compiling and developing index and statistical data, and sales and business development of market data. Its income comprises primarily income from sale of Cash Market and Derivatives Market information. Since Information Services activities share similar business risks as the Cash and Derivatives Market segments, results of Information Services activities were previously grouped under the two business segments based on the nature of their business risks (e.g., income from sales of Cash market information under the Cash Market). As Information Services activities generate a significant amount of income for the Group, from 2003 onwards, their results are disclosed under a separate Information Services Segment. Accordingly, comparatives for 2002 have been reclassified to conform to the new disclosure.

In addition to the above, central income (mainly investment income of corporate funds) and central costs (mainly costs of the support functions that centrally provide services to all of the business segments) are allocated to the business segments and included in the segment income and costs. Accordingly comparatives for 2002 have been reclassified to conform to this practice.

Assets and liabilities under the **Others Segment** represent mainly taxation recoverable and payable, deferred tax liabilities and unclaimed dividends. Comparatives for 2002 have been reclassified to conform to this practice.

3. TRADING FEES AND TRADING TARIFF

	2003 \$'000	2002 \$'000
Trading fees and trading tariff are derived from:		
Securities and options traded on the Stock Exchange	318,251	215,871
Derivatives contracts traded on the Futures Exchange	166,960	115,858
	<u>485,211</u>	<u>331,729</u>

NOTES TO THE ACCOUNTS

4. STOCK EXCHANGE LISTING FEES

Stock exchange listing fees
comprise the following:

Income	2003			2002		
	Equity \$'000	Debt & derivatives \$'000	Total \$'000	Equity \$'000	Debt & derivatives \$'000	Total \$'000
Annual listing fees	235,327	3,124	238,451	226,363	4,239	230,602
Initial listing fees	50,990	34,053	85,043	36,550	39,809	76,359
Prospectus vetting fees	3,190	-	3,190	4,770	-	4,770
Other listing fees	7,102	-	7,102	8,302	-	8,302
	<u>296,609</u>	<u>37,177</u>	<u>333,786</u>	<u>275,985</u>	<u>44,048</u>	<u>320,033</u>

Listing fee income is fees paid by issuers to enable them to gain access to the Stock Exchange and enjoy the privileges and facilities by being admitted, listed and traded on the Stock Exchange.

Costs of Listing Function	2003 \$'000	2002 \$'000
Staff costs and related expenses	98,312	86,289
Information technology and computer maintenance expenses	2,477	2,576
Premises expenses	7,205	8,538
Depreciation and amortisation	14,772	12,763
Legal and professional fees	14,114	12,053
Payment to SFC under the dual filing regime	15,000	-
Other expenses	<u>5,825</u>	<u>10,291</u>
	<u>157,705</u>	<u>132,510</u>

The costs listed above are regulatory in nature, which comprise direct costs of the Listing Function on vetting IPOs and enforcing the Listing Rules, disseminating information relating to listed companies, and payments to the Securities and Futures Commission under the dual filing regime. Other indirect costs, comprising costs incurred by other units on building the reputation of the Stock Exchange (e.g., marketing and promotion, brand-building, and providing an efficient market infrastructure and market access facilities) to attract issuers to list on the Stock Exchange, which contribute to the stock exchange listing fee income above, are not included as they are part and parcel of the activities of the Group and cannot be separately quantified. Moreover, the costs do not cover costs of support services and other central overheads attributable to the Listing Function.

NOTES TO THE ACCOUNTS

5. INVESTMENT INCOME

	2003 \$'000	2002 \$'000
Interest income from		
- Bank deposits and cash margin deposits	66,830	90,761
- Listed securities	40,187	41,013
- Unlisted securities	105,612	129,227
	<u>212,629</u>	<u>261,001</u>
Interest expenses	<u>(2,153)</u>	<u>(5,797)</u>
Net interest income	<u>210,476</u>	<u>255,204</u>
Accommodation income on securities deposited by Participants as alternatives to cash deposits of the margin funds	<u>5,163</u>	<u>5,611</u>
Non-interest investment income		
Net realised gain/(loss) on investments		
- listed trading and non-trading securities	9,733	(8,789)
- unlisted trading and non-trading securities	11,197	1,360
- exchange difference	13,883	(6,346)
Net unrealised gain/(loss) on investments		
- listed trading securities	33,267	(9,836)
- unlisted trading securities	(4,810)	14,732
- exchange difference	14,284	28,071
Dividend income		
- non-trading securities	14,096	2,482
- trading securities	4,018	2,495
	<u>95,668</u>	<u>24,169</u>
Total investment income	<u>311,307</u>	<u>284,984</u>
Total investment income is derived from:		
Corporate funds (note (i))	214,869	178,613
Margin funds	78,732	82,238
Clearing House Funds	17,706	24,133
	<u>311,307</u>	<u>284,984</u>

- (i) Corporate funds include investment income of Compensation Fund Reserve Account of \$714,000 (2002: \$680,070) and CDMD Fund of \$56,000 (2002: \$42,000).

6. OTHER INCOME

	2003 \$'000	2002 \$'000
Exchange network, terminal user, dataline and software sub-license fees	101,491	97,500
Participants' subscription and application fees	36,227	40,767
Share registration services fees	1,600	18,500
Brokerage on direct IPO applications	11,618	18,973
Miscellaneous income	7,713	9,032
	<u>158,649</u>	<u>184,772</u>

NOTES TO THE ACCOUNTS

7. OTHER OPERATING EXPENSES

	2003 \$'000	2002 \$'000
Write-down of strategic investments (note i)	32,667	-
Retirement of redundant IT systems	10,133	2,791
Provision for/(reversal of provision for) doubtful debts	1,789	(900)
Insurance	11,780	12,877
Financial data subscription fees	8,978	9,098
Custodian and fund management fees	8,445	8,625
Bank charges	7,135	4,102
Repair and maintenance	7,373	7,061
Other miscellaneous expenses	42,335	47,040
	130,635	90,694

- (i) Includes a 100 per cent write-down (\$32,303,000) of the Group's investment in BondsInAsia Limited under non-trading securities following a review of the Group's business strategy and operations in May 2003.

8. PROFIT BEFORE TAXATION

	2003 \$'000	2002 \$'000
Profit before taxation is stated after crediting/(charging):		
Auditors' remuneration		
- audit fees	(1,620)	(1,438)
- non-audit fees	(1,373)	(740)
Interest on bank loans and overdrafts repayable within five years	(827)	(1,736)
Operating lease rentals		
- land and buildings	(48,485)	(64,716)
- computer systems and equipment	(39,323)	(72,275)
Net rental income	295	294
Amortisation of goodwill (included in share of profits less losses of associated companies)	(2,662)	(1,568)
Impairment of investment in associated companies (included in other operating expenses)	(364)	-
Depreciation	(183,488)	(163,139)
Impairment of club debenture (included in other operating expenses)	(860)	-
Loss on disposal/write-off of fixed assets		
- retirement of redundant IT systems	(10,133)	(2,791)
- others	(1,414)	(358)

NOTES TO THE ACCOUNTS

9. DIRECTORS' EMOLUMENTS

Fifteen out of twenty Directors, including two Executive Directors, received emoluments during the year (2002: None of the fifteen Directors, except the Executive Director, received any emoluments during the year). Total emoluments of the two Executive Directors, excluding share option benefits, for the year amounted to \$9,780,557 (2002: \$7,947,000) of which \$8,725,350 (2002: \$7,072,000) was attributable to salaries, other allowances and benefits in kind. Employer's contribution to retirement scheme for the year amounted to \$855,207 (2002: \$875,000). \$200,000 of discretionary bonus was paid for 2003 (2002: \$Nil) and \$840,912 of directors' fees were accrued for thirteen Non-executive Directors (2002: \$Nil).

The emoluments of the Directors are within the following bands:

	2003 Number of Directors	2002 Number of Directors
\$1 – \$500,000	13	-
\$4,000,001 – \$4,500,000	1	-
\$5,500,001 – \$6,000,000	1	-
\$7,500,001 – \$8,000,000	-	1
	<u>15</u>	<u>1</u>

The remuneration, excluding share option benefit, of every Director, including the Chief Executive who is an ex-officio member for the year ended 31 December 2003 is set out below –

Name of Director	Fees HK\$	Salary HK\$	Bonus HK\$	Others benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Mr Charles Y K Lee	74,148	-	-	-	-	74,148
Mr John C C Chan (note 3)	-	-	-	-	-	-
Mr Paul M Y Chow (note 4)	-	4,800,000	200,000	43,823	600,000	5,643,823
Mr Paul C H Fan (note 3)	-	-	-	-	-	-
Mr Henry H L Fan (note 5)	13,352	-	-	-	-	13,352
Mr Fong Hup	74,148	-	-	-	-	74,148
Mr Tim Freshwater	74,148	-	-	-	-	74,148
Dr Bill C P Kwok	74,148	-	-	-	-	74,148
Mr K C Kwong (note 3)	-	2,041,655	-	1,839,872	255,207	4,136,734
Mr Dannis J H Lee	74,148	-	-	-	-	74,148
Mr Vincent K H Lee	74,148	-	-	-	-	74,148
Mr Leong Ka Chai	74,148	-	-	-	-	74,148
Dr Liu Jinbao (note 6)	11,932	-	-	-	-	11,932
Mr John G C Seto (note 3)	-	-	-	-	-	-
Dr Lo Ka Shui	74,148	-	-	-	-	74,148
Mr John E Strickland	74,148	-	-	-	-	74,148
Mr Rodney G Ward (note 3)	-	-	-	-	-	-
Mr David M Webb	74,148	-	-	-	-	74,148
Mr Oscar S H Wong	74,148	-	-	-	-	74,148
Mr Yue Wai Keung (note 3)	-	-	-	-	-	-

NOTES TO THE ACCOUNTS

Notes:

1. *Other benefits include leave pay, insurance premium, and club membership.*
2. *The employee who retires before normal retirement age is eligible to 18% of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18% thereafter reaching 100% after completion of 7 years of service.*
3. *Retired on 15 April 2003.*
4. *Appointed on 1 May 2003.*
5. *Appointed on 15 November 2003.*
6. *Resigned on 28 May 2003.*

In addition to the above emoluments, a Director was granted share options under HKEx's Post-Listing Share Option Scheme. Details of the options are disclosed under Directors' interests in shares and options in the Report of the Directors.

10. FIVE TOP-PAID EMPLOYEES

Two (2002: one) of the five top-paid employees were Directors, whose emoluments are disclosed in note 9. Details of the emoluments of the other three (2002: four) top-paid employees are as follows:

	2003 \$'000	2002 \$'000
Salaries, other allowances and benefits in kind	12,321	19,309
Performance award	293	-
Retirement scheme contributions by employer	1,365	2,174
Compensation for loss of office	1,575	-
	<u>15,554</u>	<u>21,483</u>

NOTES TO THE ACCOUNTS

10. FIVE TOP-PAID EMPLOYEES (continued)

The emoluments of these five employees are within the following bands:

	2003 Number of employees	2002 Number of employees
\$4,000,001 – \$4,500,000	2	2
\$5,500,001 – \$6,000,000	3	1
\$7,000,001 – \$7,500,000	-	1
\$7,500,001 – \$8,000,000	-	1
	<u>5</u>	<u>5</u>

The employees, whose emoluments are disclosed above, include senior executives who were also Directors of the subsidiaries during the years. No Directors of the subsidiaries waived any emoluments.

11. STAFF COSTS AND RELATED EXPENSES

(a) Details of staff costs and related expenses are as follows:

	2003 \$'000	2002 \$'000
Salaries, other allowances and benefits	463,697	441,629
Unutilised annual leave	4,275	2,674
Termination benefits	12,040	176
Retirement scheme contributions by employer	<u>45,561</u>	<u>48,070</u>
	<u>525,573</u>	<u>492,549</u>

(b) Retirement Benefit Costs

The Group has sponsored a defined contribution provident fund scheme, namely the Hong Kong Exchanges and Clearing Provident Fund Scheme (the ORSO Plan), which is registered under ORSO and has obtained Mandatory Provident Fund (MPF) exemption. The ORSO Plan is for all full-time permanent employees. Contributions to the ORSO Plan by the Group and employees are calculated as a percentage of employees' basic salaries. In compliance with the MPF Ordinance, HKEx has participated in a master trust MPF scheme, the AIA-JF Premium MPF Scheme (the MPF Scheme), to provide retirement benefits to full-time permanent employees who elect to join the MPF Scheme and all temporary or part-time employees who are not eligible for joining the ORSO Plan. Contributions to the MPF Scheme are in accordance with the statutory limits prescribed by the MPF Ordinance.

The retirement benefit costs charged to the consolidated profit and loss account represent contributions paid and payable by the Group to the ORSO Plan and the MPF Scheme.

For the ORSO Plan, contributions during the year were not offset by contributions forfeited in respect of employees who left the ORSO Plan before the contributions were fully vested. Instead, forfeited contributions were credited to a reserve account of the ORSO Plan for the benefit of its members.

NOTES TO THE ACCOUNTS

11. STAFF COSTS AND RELATED EXPENSES (continued)

(b) Retirement Benefit Costs (continued)

	2003 \$'000	2002 \$'000
Forfeited contributions during the year and retained in the ORSO Plan	<u>8,799</u>	<u>2,981</u>

12. TAXATION

(a) Taxation in the consolidated profit and loss account represents:

	2003 \$'000	As restated 2002 \$'000
Provision for Hong Kong Profits Tax for the year	125,503	68,741
Under/(over) provision in respect of prior years	<u>1,170</u>	<u>(5,422)</u>
	126,673	63,319
Deferred taxation (note 30 and note (ii))	<u>(14,774)</u>	<u>(3,559)</u>
	111,899	59,760
Share of taxation of associated companies	<u>1,684</u>	<u>1,309</u>
Taxation charge	<u>113,583</u>	<u>61,069</u>

- (i) Hong Kong Profits Tax has been provided for at 17.5 per cent (2002: 16 per cent) on the estimated assessable profit for the year.
- (ii) As explained in note 1(s), under the new SSAP 12, deferred tax assets and liabilities in 2002 are computed using a tax rate of 16 per cent and deferred tax assets and liabilities in 2003 using the higher tax rate of 17.5 per cent announced in the March 2003 Hong Kong Budget. Deferred taxation for 2003 includes a one-off deferred tax charge of \$6,040,000, which arose from recomputing outstanding deferred tax liabilities brought forward from 2002 using the higher tax rate of 17.5 per cent.

NOTES TO THE ACCOUNTS

12. TAXATION (continued)

- (b) The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate of 17.5 per cent (2002: 16 per cent) as follows:

	2003 \$'000	2002 \$'000
Profit before taxation (excluding share of profit of associated companies)	<u>797,684</u>	<u>643,433</u>
Calculated at a taxation rate of 17.5 per cent (2002: 16 per cent)	139,595	102,949
Income not subject to taxation	(41,121)	(47,347)
Expenses not deductible for taxation purposes	10,561	5,567
Utilisation of previously unrecognised tax losses	(4,952)	721
Deferred tax assets arising from tax losses not recognised	(22)	(423)
Adjustment of deferred tax	231	3,715
Under/(over) provision in respect of prior years	1,170	(5,422)
Increase in opening net deferred tax liabilities resulting from an increase in tax rate	6,040	-
Effect of different taxation rates in other countries	<u>397</u>	<u>-</u>
Taxation charge before share of taxation of associated companies	111,899	59,760
Share of taxation of associated companies	<u>1,684</u>	<u>1,309</u>
Taxation charge	<u><u>113,583</u></u>	<u><u>61,069</u></u>

13. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$691,765,000 (2002: \$588,505,000) and the weighted average of 1,046,494,819 shares (2002: 1,042,665,487) in issue during the year.

The employee share options outstanding as set out in note 26 did not have a material dilutive effect on the basic earnings per share.

NOTES TO THE ACCOUNTS

14. FIXED ASSETS

(a) Group

	Investment property under long- term lease in Hong Kong \$'000	Land and buildings under long- term lease in Hong Kong \$'000	Computer trading and clearing systems \$'000	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Cost or valuation						
At 1 Jan 2003	10,000	117,000	1,462,366	380,773	239,201	2,209,340
Additions	-	-	13,431	16,775	6,041	36,247
Revaluation	-	(6,000)	-	-	-	(6,000)
Disposals/write-off	-	-	(130,394)	(50,163)	(13,723)	(194,280)
At 31 Dec 2003	10,000	111,000	1,345,403	347,385	231,519	2,045,307
Representing						
At cost	-	-	1,345,403	347,385	231,519	1,924,307
At valuation - 31 Dec 2003	10,000	111,000	-	-	-	121,000
	10,000	111,000	1,345,403	347,385	231,519	2,045,307
Accumulated depreciation						
At 1 Jan 2003	-	-	1,018,134	275,469	167,629	1,461,232
Charge for the year	-	2,497	109,510	39,703	31,778	183,488
Revaluation	-	(2,497)	-	-	-	(2,497)
Disposals/write-off	-	-	(126,920)	(43,504)	(12,119)	(182,543)
At 31 Dec 2003	-	-	1,000,724	271,668	187,288	1,459,680
Net book value						
At 31 Dec 2003	10,000	111,000	344,679	75,717	44,231	585,627
At 31 Dec 2002	10,000	117,000	444,232	105,304	71,572	748,108

The cost of investment property was \$8,229,000 (2002: \$8,229,000). The investment property was revalued as at 31 December 2003 on the basis of its open market value by Jones Lang LaSalle, an independent firm of qualified property valuers. The value remained unchanged during 2003 (2002: deficit of \$1,500,000 was charged to the investment properties revaluation reserve) (note 27).

NOTES TO THE ACCOUNTS

14. FIXED ASSETS (continued)

(a) Group (Continued)

Land and buildings were revalued as at 31 December 2003 on the basis of their open market value in existing use carried out by Jones Lang LaSalle, an independent firm of qualified property valuers. A deficit of \$3,503,000 was charged to other properties revaluation reserve during 2003 (2002: deficit of \$16,850,000) (note 27).

The total cost of land and buildings of the Group was \$101,087,000 (2002: \$101,087,000). The carrying value of these land and buildings as at 31 December 2003 would have been \$79,309,000 (2002: \$80,973,000) had they been carried at cost less accumulated depreciation.

(b) HKEx

	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Cost			
At 1 Jan 2003	44,229	11,893	56,122
Additions	8,935	4,346	13,281
Disposals/write-off	(9,886)	(13)	(9,899)
At 31 Dec 2003	43,278	16,226	59,504
Accumulated depreciation			
At 1 Jan 2003	7,977	4,547	12,524
Charge for the year	9,259	4,438	13,697
Disposals/write-off	(3,570)	(5)	(3,575)
At 31 Dec 2003	13,666	8,980	22,646
Net book value			
At 31 Dec 2003	29,612	7,246	36,858
At 31 Dec 2002	36,252	7,346	43,598

NOTES TO THE ACCOUNTS

15. INVESTMENTS IN ASSOCIATED COMPANIES

	Group	
	2003	2002
	\$'000	\$'000
Share of net assets of associated companies	11,707	8,215
Goodwill on acquisition of shares in associated companies less amortisation and impairment (note a)	22,295	25,321
	34,002	33,536
Loan receivable from an associated company (note c)	-	2,000
	34,002	35,536

(a) Goodwill

\$'000

Cost

At 1 Jan 2003 and 31 Dec 2003 26,889

Accumulated amortisation and impairment

At 1 Jan 2003 1,568
 Charge for the year (note 8) 2,662
 Impairment loss (note 8) 364

At 31 Dec 2003 4,594

Net book value

At 31 Dec 2003 22,295

At 31 Dec 2002 25,321

(b) Goodwill is amortised on a straight-line basis over 10 years.

(c) The loan was unsecured with interest payable semi-annually at prime rate per annum and was repaid before its maturity date of 31 May 2004.

NOTES TO THE ACCOUNTS

15. INVESTMENTS IN ASSOCIATED COMPANIES (continued)

(d) Details of the unlisted associated companies as at 31 December 2003 are as follows:

<u>Name</u>	<u>Place of incorporation</u>	<u>Principal activities</u>	<u>Particulars of shares held</u>	<u>Interest held</u>
Computershare Hong Kong Investor Services Limited	Hong Kong	Provision of share registration services	5,854 Class A ordinary shares	24%
ADP Wilco Processing Services Limited (formerly known as Wilco International Processing Services Limited)	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

ADP Wilco Processing Services Limited has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end.

16. CLEARING HOUSE FUNDS

	Group	
	2003	2002
	\$'000	\$'000
Net asset values of the Clearing House Funds are as follows:		
HKSCC Guarantee Fund	371,289	372,352
SEIOH Reserve Fund	131,274	134,185
HKCC Reserve Fund	1,048,767	474,211
	1,551,330	980,748
Net assets of the Clearing House Funds are composed of:		
Unlisted non-trading securities, at fair value		
- debt securities	125,643	155,688
Contributions receivable from Clearing Participants fully secured by bank guarantees	92,234	31,490
Bank balances and time deposits	1,349,644	806,401
	1,567,521	993,579
Less: Other liabilities	(16,191)	(12,831)
	1,551,330	980,748
The Clearing House Funds are funded by:		
Clearing Participants' contributions:		
- cash	891,811	393,950
- bank guarantees	92,234	31,490
Clearing houses' contributions	320,200	320,200
Forfeiture of defaulted Clearing Participants' contributions	1,928	-
Accumulated investment income net of expenses included in designated reserves attributable to:		
- Clearing Participants' contributions	183,305	176,643
- Clearing houses' contributions	60,233	58,465
Revaluation reserve (note 27(b))	1,619	-
	1,551,330	980,748

NOTES TO THE ACCOUNTS

16. CLEARING HOUSE FUNDS (continued)

The HKSCC Guarantee Fund provides resources to enable HKSCC to discharge the liabilities and obligations of defaulting Broker Participants in CCASS arising from their Stock Exchange trades accepted for settlement on the CNS basis and defective securities deposited into CCASS. The SEOCH Reserve Fund and the HKCC Reserve Fund were established for the exclusive purpose of supporting SEOCH and HKCC to fulfil their counterparty obligations in the event that one or more of their Clearing Participants fail to meet their obligations to SEOCH and HKCC respectively.

For the HKSCC Guarantee Fund, investment income was insufficient to cover the fund's expenses during the year. As a result, a loss of \$2,262,000 arose and was included in the Group's retained earnings as at 31 December 2003. Future surplus investment income net of expenses of the fund will be offset against this loss before appropriation from the Group's retained earnings to the fund.

In prior years, temporary fluctuations in fair value of investments were reflected in the assets and investment revaluation reserve of the Group. As at 31 December 2002, the aggregate cost and market value of the funds were \$980,748,000 and \$983,526,000 respectively.

17. COMPENSATION FUND RESERVE ACCOUNT

The Securities and Futures Commission (SFC) is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). By virtue of Schedule 10 of the Securities and Futures Ordinance (SFO), the Stock Exchange's obligation under the repealed Securities Ordinance (SO) to deposit with the SFC and keep deposited \$50,000 in respect of each Stock Exchange Trading Right in the Compensation Fund remains. The Stock Exchange maintains an account known as the Compensation Fund Reserve Account for all receipts and payments in relation to the Compensation Fund under the Rules of the Exchange, in particular the following:

- (a) The interest received from the SFC on the statutory deposits paid in respect of each Stock Exchange Trading Right into the Compensation Fund maintained by the SFC;
- (b) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (c) Amounts reserved for the replenishment to the Compensation Fund.

The Compensation Fund is further explained in note 35(a)(i).

18. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND

	Group	
	2003	2002
	\$'000	\$'000
Net asset value of HKCC's CDMD Fund	<u>925</u>	<u>914</u>
The Fund is composed of:		
Unlisted non-trading securities, at fair value		
- debt securities	<u>925</u>	<u>914</u>
The Fund represents:		
Accumulated investment income net of expenses		
appropriated from retained earnings	914	914
Revaluation reserve (note 27(b))	<u>11</u>	<u>-</u>
	<u>925</u>	<u>914</u>

NOTES TO THE ACCOUNTS

18. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND (continued)

The CDMD Fund was established by the cash received from The Hong Kong Futures Guarantee Corporation Limited (the former clearing house of the Futures Exchange) for the purpose of providing funding for the development and betterment of the cash and derivatives markets in Hong Kong.

In prior years, temporary fluctuations in fair value of investments were reflected in the assets and investment revaluation reserve of the Group. As at 31 December 2002, the aggregate cost and market value of the fund were \$914,000 and \$948,000 respectively.

19. NON-TRADING SECURITIES

	Group	
	2003	2002
	\$'000	\$'000
Analysis of non-trading securities:		
Non-current	<u>77,258</u>	<u>87,604</u>
	<u>77,258</u>	<u>87,604</u>
Non-trading securities, at fair value:		
Equity securities		
- listed outside Hong Kong	<u>77,258</u>	<u>55,301</u>
- unlisted	<u>-</u>	<u>32,303</u>
	<u>77,258</u>	<u>87,604</u>

20. MARGIN FUNDS ON DERIVATIVES CONTRACTS

	Group	
	2003	2002
	\$'000	\$'000
The margin funds comprise:		
SECH Clearing Participants' margin funds	<u>1,083,679</u>	<u>757,333</u>
HKCC Clearing Participants' margin funds	<u>6,790,831</u>	<u>3,794,268</u>
	<u>7,874,510</u>	<u>4,551,601</u>
The assets of the margin funds comprise:		
Bank balances and time deposits	<u>4,900,011</u>	<u>2,148,753</u>
Listed securities deposited as alternatives to cash deposits, at market value	<u>805,430</u>	<u>1,119,682</u>
Margin receivable from Clearing Participants	<u>-</u>	<u>3,198</u>
Listed non-trading securities, at fair value		
- debt securities	<u>102,780</u>	<u>173,907</u>
Unlisted non-trading securities, at fair value		
- money market fund	<u>-</u>	<u>162,484</u>
- debt securities	<u>2,066,289</u>	<u>943,577</u>
	<u>7,874,510</u>	<u>4,551,601</u>
The Group's liabilities in respect of the margin funds are as follows:		
Margin deposits and securities received from SECH and HKCC Participants on derivatives contracts	<u>7,874,510</u>	<u>4,551,601</u>

NOTES TO THE ACCOUNTS

21. ACCOUNTS RECEIVABLE, PREPAYMENTS AND DEPOSITS/ ACCOUNTS PAYABLE, ACCRUALS AND OTHER LIABILITIES

(a) Accounts receivable, prepayments and deposits

	Group		HKEx	
	2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
Receivable from Exchange and Clearing Participants:				
- CNS money obligations	4,059,677	2,647,591	-	-
- transaction levy, stamp duty and fee receivable	215,907	94,237	-	-
- Others	20,842	4,239	-	-
Other fees receivable	217,359	229,094	-	-
Interest receivable	62,309	61,598	-	-
Other receivables, prepayments and deposits	68,586	81,440	18,995	20,337
	<u>4,644,680</u>	<u>3,118,199</u>	<u>18,995</u>	<u>20,337</u>

(b) Accounts payable, accruals and other liabilities

	Group		HKEx	
	2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
Payable to Exchange and Clearing Participants:				
- CNS money obligations	4,027,540	2,647,066	-	-
- cash collateral and others	191,252	30,994	-	-
- arising from stock option activities	32,287	577	-	-
- Others	80,171	37,905	-	-
Transaction levy payable to the SFC	50,369	16,146	-	-
Unclaimed dividends (note c)	120,853	105,574	9,411	6,085
Stamp duty payable	118,862	22,817	-	-
Deposits received	22,188	23,994	-	-
Other payables and accruals	136,382	122,319	52,315	64,258
	<u>4,779,904</u>	<u>3,007,392</u>	<u>61,726</u>	<u>70,343</u>

(c) Unclaimed dividends for the Group represent dividends declared by listed companies which are held by HKSCC Nominees Limited but not yet claimed by shareholders of the companies concerned, and dividends declared by HKEx but not yet claimed by its shareholders.

(d) CNS money obligations receivable represents 87 per cent (2002: 85 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 84 per cent (2002: 88 per cent) of the total accounts payable, accruals and other liabilities. CNS money obligations mature within two days as they are due for settlement two days after the trade date. The majority of the remaining accounts receivable, prepayments, deposits, accounts payable, accruals and other liabilities will mature within three months.

NOTES TO THE ACCOUNTS

22. TRADING SECURITIES

	Group	
	2003	2002
	\$'000	\$'000
Equity securities, at fair value		
- listed in Hong Kong	133,745	40,775
- listed outside Hong Kong	147,019	66,251
	280,764	107,026
Debt securities, at fair value		
- listed in Hong Kong	96,906	99,182
- listed outside Hong Kong	1,016,580	982,757
	1,113,486	1,081,939
Unlisted debt securities, at fair value	1,818,748	2,301,081
	3,212,998	3,490,046

23. PARTICIPANTS' ADMISSION FEES RECEIVED

The admission fees are non-interest bearing and may be repayable upon the expiry of seven years from the date of admission of a Participant or upon the termination of a Participant's participation in CCASS, whichever is later. HKSCC may, at its discretion, grant early refunds of admission fees to terminated Participants after six months from the date of termination of their participation in CCASS and to Broker Participants after six months from the date of sale of their Stock Exchange Trading Right.

NOTES TO THE ACCOUNTS

24. PROVISIONS

(a) Group

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2003	25,136	23,826	48,962
Provision for the year	82	31,234	31,316
Amount used during the year	-	(26,573)	(26,573)
Unused amount reversed during the year	(178)	-	(178)
Amount paid during the year	(462)	(4,962)	(5,424)
At 31 Dec 2003	<u>24,578</u>	<u>23,525</u>	<u>48,103</u>
		2003 \$'000	2002 \$'000
Analysis of provisions:			
Current		25,011	28,863
Non-current		23,092	20,099
		48,103	48,962

(b) HKEx

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2003	-	23,826	23,826
Provision for the year	535	31,234	31,769
Amount used during the year	-	(26,573)	(26,573)
Amount paid during the year	-	(4,962)	(4,962)
At 31 Dec 2003	<u>535</u>	<u>23,525</u>	<u>24,060</u>
		2003 \$'000	2002 \$'000
Analysis of provisions:			
Current		23,825	23,826
Non-current		235	-
		24,060	23,826

NOTES TO THE ACCOUNTS

25. INVESTMENTS IN AND AMOUNTS DUE FROM /(TO) SUBSIDIARIES

(a) Investments in subsidiaries

	HKEx	
	2003 \$'000	2002 \$'000
Investments in unlisted shares, at cost	<u>4,145,198</u>	<u>4,145,198</u>

(b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries are interest-free and have no fixed terms of repayment.

(c) Particulars of subsidiaries

HKEx had direct or indirect interests in the following subsidiaries as at 31 December 2003, all of which are wholly-owned private companies incorporated and operating in Hong Kong except for HKEx (China) Limited, which operates mainly in the Mainland. Details of these companies are as follows:

Company	Issued and fully paid up share capital	Principal activities	Interest held
Direct subsidiaries:			
The Stock Exchange of Hong Kong Limited	A shares \$929	Operates the single, unified stock exchange in Hong Kong for the purposes of the Securities and Futures Ordinance	100%
Hong Kong Futures Exchange Limited	Ordinary \$19,600,000 Standard \$850,000	Operates a futures and options exchange	100%
Hong Kong Securities Clearing Company Limited	Ordinary \$2	Operates CCASS and the central securities depository and provides custody and nominee services for eligible securities listed in Hong Kong	100%
HKEC Nominees Limited	Ordinary \$2	Nominee services	100%
Hong Kong Financial Markets Development Limited	Ordinary \$2	Promotes the securities, futures and financial industry	100%

NOTES TO THE ACCOUNTS

25. INVESTMENTS IN AND AMOUNTS DUE FROM /(TO) SUBSIDIARIES (continued)

(c) Particulars of subsidiaries (continued)

Company	Issued and fully paid up share capital	Principal activities	Interest held
Direct subsidiaries: (continued)			
HKEx (Singapore) Limited	Ordinary \$2	Investment holding	100%
HKEx (China) Limited	Ordinary \$2	Promotes HKEx products and services in the Mainland	100%
Indirect subsidiaries:			
The SEHK Options Clearing House Limited	Ordinary \$1,000,000	Operates a clearing house for option contracts traded on the Stock Exchange	100%
HKEx Information Services Limited	Ordinary \$100	Sale of stock market information	100%
Prime View Company Limited	Ordinary \$20	Property holding	100%
The Stock Exchange Club Limited	Ordinary \$8	Property holding	100%
The Stock Exchange Nominee Limited	Ordinary \$2	Nominee services	100%
HKFE Clearing Corporation Limited	Ordinary \$1,000,000	Operates a clearing house for derivatives contracts traded on the Futures Exchange	100%
HKFE Clearing Linkage Limited	Ordinary \$2	Dormant	100%
HKSCC Nominees Limited	Ordinary \$20	Acting as common nominee in respect of securities held in the CCASS depository	100%
Many Profit Limited	Ordinary \$2	Investment holding	100%
Freestar Corporation Limited	Ordinary \$2	Investment holding	100%
Star Prime Limited	Ordinary \$2	Investment holding	100%
HK Conversion Agency Services Limited	Ordinary \$2	Conversion agency services	100%

NOTES TO THE ACCOUNTS

26. SHARE CAPITAL AND SHARE PREMIUM

		2003 \$'000	2002 \$'000
Authorised:			
2,000,000,000 shares of \$1 each		<u>2,000,000</u>	<u>2,000,000</u>
Issued and fully paid:			
	Number of shares of \$1 each	Share capital \$'000	Share premium \$'000
			Total \$'000
At 1 Jan 2002	1,040,664,846	1,040,665	-
Shares issued under employee share option schemes	<u>2,916,000</u>	<u>2,916</u>	<u>19,012</u>
At 31 Dec 2002	1,043,580,846	1,043,581	19,012
Shares issued under employee share option schemes	<u>5,418,000</u>	<u>5,418</u>	<u>35,326</u>
At 31 Dec 2003	<u>1,048,998,846</u>	<u>1,048,999</u>	<u>54,338</u>

Under the Pre-Listing Share Option Scheme of HKEx, share options were granted to employees on 20 June 2000 which are exercisable between 6 March 2002 and 30 May 2010 at an exercise price of \$7.52 per share.

Under the Post-Listing Share Option Scheme of HKEx, share options were granted to an executive director on 2 May 2003 which are exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$9.05 per share. In addition, share options were granted to an employee on 14 August 2003 which are exercisable between 14 August 2005 and 13 August 2013 at an exercise price of \$13.60 per share. On 18 August 2003, share options were granted to another employee which are exercisable between 18 August 2005 and 17 August 2013 at an exercise price of \$13.65 per share.

During the year, Pre-Listing employee share options were exercised to subscribe for 5,418,000 shares (2002: 2,916,000) in HKEx at a consideration of \$7.52 per share, of which \$1.00 per share was credited to share capital and the balance of \$6.52 per share was credited to the share premium account.

Movements of the employee share options during the year were as follows:

	Number of shares issuable under the employee share options outstanding as at 1 Jan 2003	Number of shares issuable under the employee share options lapsed	Number of shares issuable under the employee share options granted	Number of shares issuable under the employee share options exercised	Number of shares issuable under the employee share options outstanding as at 31 Dec 2003
Pre-Listing Share Option Scheme	23,253,020	3,663,394	-	5,418,000	14,171,626
Post-Listing Share Option Scheme	<u>-</u>	<u>-</u>	<u>5,800,000</u>	<u>-</u>	<u>5,800,000</u>
	<u>23,253,020</u>	<u>3,663,394</u>	<u>5,800,000</u>	<u>5,418,000</u>	<u>19,971,626</u>

NOTES TO THE ACCOUNTS

26. SHARE CAPITAL AND SHARE PREMIUM (continued)

No specific accounting guidance has been issued by the HKSA on the accounting for employee share options. In November 2002, the International Accounting Standards Board (IASB) published an exposure draft, ED2: Share-based Payment, which covers the accounting treatment for employee share options. The exposure draft is expected to be finalised as an International Financial Reporting Standard (IFRS) in the first quarter of 2004.

In line with other countries/regions (e.g., USA, European Union, etc), Hong Kong is working towards harmonising its accounting standards with those issued by the IASB. The HKSA has announced that, following IASB's issuance of an IFRS on share-based payment, it intends to recommend the adoption of a new SSAP so that the SSAPs maintain conformity with the IASB standards.

When the employee share options are exercised and new shares are issued, the share capital is increased by the nominal value of the new shares issued and the share premium account is increased by the remainder of the proceeds. HKEx has not expensed the employee share options to the profit and loss account. Had all the outstanding employee share options been fully exercised on 31 December 2003, the Group would have received \$171,890,628 in proceeds. The market value of the shares issued based on the closing price of \$16.85 per share on that date was \$336,521,898. The employees concerned under the Pre-Listing Share Option Scheme would have made a gain of \$9.33 per share, or, in aggregate, \$132,221,271. The executive director concerned under the Post-Listing Share Option Scheme would have made a gain of \$7.80 per share, or, in aggregate, \$23,400,000. The two employees concerned under the Post-Listing Share Option Scheme would have made a gain of \$3.25 per share, or, in aggregate, \$3,250,000 and \$3.20 per share, or, in aggregate, \$5,760,000 respectively.

NOTES TO THE ACCOUNTS

27. REVALUATION RESERVES

	Investment properties revaluation reserve \$'000	Group Other properties revaluation reserve \$'000	Investment revaluation reserve \$'000	Total \$'000
At 1 Jan 2002, as previously reported	3,271	33,633	6,893	43,797
Effect of adopting SSAP 12 - provision for net deferred tax liabilities (note 1(s))	-	(5,237)	(132)	(5,369)
At 1 Jan 2002, as restated	3,271	28,396	6,761	38,428
Change in valuation of properties	(1,500)	(16,850)	-	(18,350)
Change in fair value of non-trading securities	-	-	14,548	14,548
Realisation of change in fair value of non-trading securities on maturity and disposal	-	-	(6,015)	(6,015)
Deferred tax arising from change in valuation of properties	-	2,696	-	2,696
Deferred tax arising from change in fair value of non-trading securities	-	-	(1,408)	(1,408)
At 31 Dec 2002, as restated	1,771	14,242	13,886	29,899
At 1 Jan 2003, as previously reported	1,771	16,783	15,426	33,980
Effect of adopting SSAP 12 - provision for net deferred tax liabilities (note 1(s))	-	(2,541)	(1,540)	(4,081)
As at 1 Jan 2003, as restated	1,771	14,242	13,886	29,899
Change in valuation of properties (note 14(a))	-	(3,503)	-	(3,503)
Change in fair value of non-trading securities	-	-	15,353	15,353
Realisation of change in fair value of non-trading securities on maturity and disposal	-	-	4,840	4,840
Deferred tax arising from change in valuation of properties	-	(71)	-	(71)
Deferred tax arising from change in fair value of non-trading securities	-	-	(87)	(87)
At 31 Dec 2003	1,771	10,668	33,992	46,431

(a) The revaluation reserves are segregated for their respective specific purposes.

(b) Included in investment revaluation reserve is \$1,619,000, \$11,000 and \$318,000 which are attributable to investments of the Clearing House Funds, the CDMD Fund and the Compensation Fund Reserve Account respectively (31 December 2002: \$Nil for all funds).

NOTES TO THE ACCOUNTS

28. DESIGNATED RESERVES

	Group	
	2003	2002
	\$'000	\$'000
Clearing House Funds reserves (note a)		
- HKSCC Guarantee Fund reserve	255,912	255,912
- SEOCH Reserve Fund reserve	48,571	47,185
- HKCC Reserve Fund reserve	261,183	252,211
	565,666	555,308
Compensation Fund Reserve Account reserve (note b)	36,541	35,827
CDMD Fund reserve (note c)	914	914
Development reserve (note d)	86,536	135,762
	689,657	727,811

These reserves are segregated for their respective purposes. Details of the movements on the reserves during the year are as follows:

(a) Clearing House Funds reserves

	HKSCC Guarantee Fund reserve \$'000	SEOCH Reserve Fund reserve \$'000	HKCC Reserve Fund reserve \$'000	Total \$'000
At 1 Jan 2002	254,428	44,837	220,929	520,194
Investment income net of expenses of Clearing House Funds transferred from retained earnings	1,484	2,348	31,282	35,114
At 31 Dec 2002	255,912	47,185	252,211	555,308
Investment income net of expenses of Clearing House Funds transferred from retained earnings	-	1,386	7,044	8,430
Forfeiture of defaulted Clearing Participants' contributions	-	-	1,928	1,928
At 31 Dec 2003	255,912	48,571	261,183	565,666

NOTES TO THE ACCOUNTS

28. DESIGNATED RESERVES (continued)

(b) Compensation Fund Reserve Account reserve

	\$'000
At 1 Jan 2002	35,146
Investment income net of expenses of Compensation Fund Reserve Account transferred from retained earnings	<u>681</u>
At 31 Dec 2002	35,827
Investment income net of expenses of Compensation Fund Reserve Account transferred from retained earnings	<u>714</u>
At 31 Dec 2003	<u><u>36,541</u></u>

(c) CDMD Fund reserve

There were no movements in 2002 and 2003.

(d) Development reserve

	\$'000
At 1 Jan 2002 and 31 Dec 2002	135,762
Transfer to retained earnings (note (i))	<u>(49,226)</u>
At 31 Dec 2003	<u><u>86,536</u></u>

- (i) The reserve was set aside for systems development for the Stock Exchange. Of the transfer to retained earnings, \$21,109,000 relates to qualifying projects completed in 2003 and \$28,117,000 in 2002.

29. MERGER RESERVE

The Group has taken advantage of the merger relief available under section 48C of the Hong Kong Companies Ordinance and treated the premium created by the issuance of shares on 6 March 2000, the date HKEx became the holding company of the Stock Exchange and the Futures Exchange and their subsidiaries, as a merger reserve. In the consolidated balance sheet, the full amount of the merger reserve has been used to offset against the reserve arising on consolidation as explained in note 31(c).

NOTES TO THE ACCOUNTS

30. DEFERRED TAXATION

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5 per cent (2002: 16 per cent).

(a) The movements on the deferred tax liabilities account were as follows:

	Group	
	2003	As restated
	\$'000	2002
		\$'000
At 1 Jan, as previously reported	67,253	75,275
Effect of adopting SSAP 12 (note 1(s))	6,028	2,853
At 1 Jan, as restated	73,281	78,128
Transfer to the consolidated profit and loss account (note 12(a))	(14,774)	(3,559)
Transfer from/(to) shareholders' equity (note b)	158	(1,288)
At 31 Dec	58,665	73,281

(b) The deferred taxation transfer from/(to) shareholders' equity during the year was as follows:

	Group	
	2003	As restated
	\$'000	2002
		\$'000
Fair value reserves in shareholders' equity		
- other properties revaluation reserve (note 27)	71	(2,696)
- investment revaluation reserve (note 27)	87	1,408
	158	(1,288)

(c) Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through the future taxable profits is probable. The Group has unrecognised tax losses of \$181,769,000 as at 31 December 2003 (2002: HK\$192,271,000) to carry forward against future taxable income.

NOTES TO THE ACCOUNTS

30. DEFERRED TAXATION (continued)

(d) The movement in deferred tax liabilities during the year was as follows:

Deferred tax liabilities

	Accelerated tax depreciation		Revaluation of other properties		Tax loss		Revaluation of non-trading securities		Employee benefit		Total	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
	As restated		As restated		As restated		As restated		As restated		As restated	
At 1 Jan, as previously reported	70,682	78,939	-	-	(3,429)	(3,664)	-	-	-	-	67,253	75,275
Effect of adopting SSAP 12 (note 1(s))	11,988	3,735	5,401	8,182	(12,901)	(9,196)	1,540	132	-	-	6,028	2,853
At 1 Jan, as restated	82,670	82,674	5,401	8,182	(16,330)	(12,860)	1,540	132	-	-	73,281	78,128
Charged/(credited) to profit and loss account	(17,934)	(4)	(184)	(85)	7,474	(3,470)	-	-	(4,130)	-	(14,774)	(3,559)
Charged to equity	-	-	71	(2,696)	-	-	87	1,408	-	-	158	(1,288)
At 31 Dec	64,736	82,670	5,288	5,401	(8,856)	(16,330)	1,627	1,540	(4,130)	-	58,665	73,281

NOTES TO THE ACCOUNTS

31. RETAINED EARNINGS

		Group		HKEx	
		2003	As restated 2002	2003	As restated 2002
	Note	\$'000	\$'000	\$'000	\$'000
At 1 Jan					
Retained earnings, as previously reported		3,223,268	3,198,763	108,292	28,252
Effect of adopting SSAP 12	1(s)	(1,947)	2,516	(219)	1,995
Retained earnings, as restated		3,221,321	3,201,279	108,073	30,247
Proposed and declared dividend		448,740	260,166	448,740	260,166
Profit for the year		691,765	588,505	461,568	610,494
Investment income net of expenses of Clearing House Funds transferred to Clearing House Funds reserves		(8,430)	(35,114)	-	-
Investment income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund Reserve Account reserve		(714)	(681)	-	-
Transfer from Development reserve		49,226	-	-	-
Dividends paid:					
2002/2001 final dividend		(448,740)	(260,166)	(448,740)	(260,166)
2003/2002 interim dividend		(188,452)	(83,450)	(188,452)	(83,450)
Dividend on shares issued for employee share options exercised after declaration of 2002/2001 final dividend		(647)	(448)	(647)	(448)
Dividend on shares issued for employee share options exercised after declaration of 2003/2002 interim dividend		(231)	(30)	(231)	(30)
At 31 Dec		3,763,838	3,670,061	380,311	556,813
Representing:					
Retained earnings/(accumulated losses)		1,560,940	3,221,321	(1,822,587)	108,073
Proposed and declared dividend		2,202,898	448,740	2,202,898	448,740
At 31 Dec		3,763,838	3,670,061	380,311	556,813

- (a) Profit attributable to shareholders includes a profit of \$461,568,000 (2002: \$610,494,000) which has been dealt with in the accounts of HKEx, the holding company of the Group.
- (b) The Group's profit after taxation includes the investment income net of expenses of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$6,938,000 (2002: \$14,480,000).
- (c) The reserve arising on consolidation of \$4,116,436,000, representing the difference between the cost of acquiring the subsidiaries at the time of the merger and their respective issued share capital, was offset against merger reserve of \$2,997,115,000 (note 29) and retained earnings of \$1,119,321,000.

NOTES TO THE ACCOUNTS

32. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit before taxation to net cash outflow from operating activities

	2003 \$'000	2002 \$'000
Profit before taxation	805,348	649,574
Adjustments for:		
Net interest income	(210,476)	(255,204)
Accommodation income	(5,163)	(5,611)
Dividends received from non-trading securities	(14,097)	(2,482)
Gain on trading securities and exchange differences on investments	(70,583)	(19,192)
Depreciation and amortisation	183,488	163,139
Impairment of non-trading securities	32,303	-
Impairment of investments in associated companies	364	-
Impairment of club debenture	860	-
Provisions for bad debts	1,789	(900)
Changes in provisions	(763)	-
Share of profits less losses of associated companies	(7,664)	(6,141)
Loss on retirement of redundant IT systems	10,133	2,791
Loss on disposal of other fixed assets	1,414	358
Operating profit before working capital changes	726,953	526,332
Net decrease/(increase) in trading securities	385,709	(290,645)
Settlement of amount transferred from retained earnings to Clearing House Funds and Compensation Fund Reserve Account	(9,144)	(35,795)
Increase in accounts receivable, prepayments and deposits	(1,535,771)	(763,911)
Increase in other current liabilities	1,738,705	281,112
Net cash inflow/(outflow) from operations	1,306,452	(282,907)
Interest received	196,761	230,593
Accommodation income	5,163	5,611
Interest paid	(1,492)	(5,125)
Hong Kong Profits Tax paid	(98,138)	(57,877)
Refund of Hong Kong Profits Tax	-	9,319
Net cash inflow/(outflow) from operating activities	1,408,746	(100,386)

(b) Analysis of cash and cash equivalents

	2003 \$'000	2002 \$'000
Time deposits with original maturity within three months	1,134,255	629,776
Cash at bank and in hand	221,135	50,180
Cash and cash equivalents at the end of the year	1,355,390	679,956

(c) The net assets of the Clearing House Funds, Compensation Fund Reserve Account and margin funds are held in segregated accounts for specific purposes. Movements in individual items of the net assets of the funds during the year therefore do not constitute any cash or cash equivalent transactions to the Group.

NOTES TO THE ACCOUNTS

33. COMMITMENTS

(a) Commitments in respect of capital expenditures:

	Group		HKEx	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Contracted but not provided for	18,359	36,454	1,791	2,994
Authorised but not contracted for	72,275	57,170	8,273	13,222
	<u>90,634</u>	<u>93,624</u>	<u>10,064</u>	<u>16,216</u>

The commitments in respect of capital expenditures were mainly for the development and purchases of computer systems.

(b) Commitments for the total future minimum lease payments under operating leases in respect of:

	Group		HKEx	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Land and buildings, payable				
- within one year	47,552	73,697	1,149	74
- in the second to fifth years	49,345	114,493	2,457	-
	<u>96,897</u>	<u>188,190</u>	<u>3,606</u>	<u>74</u>
Computer systems and equipment, payable				
- within one year	59,022	55,694	40,202	28,455
- in the second to fifth years	56,458	46,899	27,499	16,510
- after five years	-	3,357	-	-
	<u>115,480</u>	<u>105,950</u>	<u>67,701</u>	<u>44,965</u>
	<u>212,377</u>	<u>294,140</u>	<u>71,307</u>	<u>45,039</u>

As at 31 December 2003, in respect of computer systems and equipment, the majority of the leases would mature within three years and the Group did not have any purchase options.

In addition to the above, the Group had a commitment to contribute additional capital of up to \$5,600,000 (2002: \$5,600,000) to an associated company, ADP Wilco Processing Services Limited, when it signs up the first client or when its cash balances fall below a certain level.

34. FINANCIAL RISK MANAGEMENT

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts are used to hedge the currency exposures of the Group's non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 31 December 2003, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$322 million (2002: HK\$197 million). All contracts will mature within three months.

NOTES TO THE ACCOUNTS

35. CONTINGENT LIABILITIES

(a) Group

- (i) The Compensation Fund is a fund set up under the repealed SO for the purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of a default of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is \$8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at \$8 million per default. As at 31 December 2003, there were outstanding claims received in respect of 13 defaulted Stock Exchange Participants (2002: 14).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting for claims against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims had been received in response to that notice. Claims made after the claims period shall, unless the Stock Exchange otherwise determines, be barred. As at 31 December 2003, no such claims had been received.

Under the new compensation arrangements implemented under the SFO, a new Investor Compensation Fund has replaced the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. The new arrangements would not require Exchange Participants to make deposits to the Investor Compensation Fund. In accordance with the provisions of the SFO, deposits to the Commodity Exchange Compensation Fund had been returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Existing deposits to the Unified Exchange Compensation Fund would be returned to the Stock Exchange in accordance with the provisions of the SFO. There is no requirement for the Stock Exchange to replenish the Investor Compensation Fund.

- (ii) The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to \$200,000 in respect of default of any one Participant. In the unlikely event that all of its 437 trading Participants as at 31 December 2003 (2002: 471) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (2002: \$94 million).
- (iii) HKEx gave an undertaking on 6 March 2000 in favour of HKSCC to contribute an amount not exceeding \$50 million in the event of HKSCC being wound up while it is a wholly-owned subsidiary of HKEx or within one year after HKSCC ceases to be a wholly-owned subsidiary of HKEx, for payment of the debts and liabilities of HKSCC contracted before HKSCC ceases to be a wholly-owned subsidiary of HKEx, and for the costs, charges and expenses of winding up.

NOTES TO THE ACCOUNTS

35. CONTINGENT LIABILITIES (continued)

(b) HKEx

- (i) Apart from the matter mentioned in (a)(iii) above, HKEx has given a guarantee to secure banking facilities granted to HKSCC since 13 December 2000. These facilities, on a committed basis of an aggregate amount of \$1.1 billion, were granted to HKSCC by five banks to provide stand-by liquidity to meet the obligations of HKSCC in CCASS in circumstances where CCASS Participants default on their payment obligations. As at 31 December 2003 and 31 December 2002, none of these banking facilities was utilised.
- (ii) HKEx has given a guarantee to secure banking facilities of SGD12 million to HKEx (Singapore) Limited for financing its investments since 16 April 2001. As at 31 December 2003, SGD 11million (equivalent to HK\$50 million) of the facility was drawn down (2002: SGD11 million, equivalent to HK\$49 million). The loan will mature within one year and has a fixed rate of interest.

36. MATERIAL RELATED PARTY TRANSACTIONS

Certain Directors of HKEx are directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (Exchange Participants) and Clearing Participants; (ii) companies listed on the Stock Exchange; and (iii) Exchange Participants for buying shares on behalf of HKSCC. Securities and derivatives contracts traded by, and fees levied on, these Exchange Participants and Clearing Participants, fees levied on these listed companies and fees paid to these Exchange Participants for buying shares on behalf of HKSCC and are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants and Clearing Participants, listed companies and Exchange Participants for buying shares on behalf of HKSCC.

In addition to the transactions mentioned above, \$862,285 (2002: \$2,521,807) of consultancy fee was paid during the year to Goldman Sachs (Asia) LLC where Mr Tim Freshwater, an independent non-executive director of HKEx is a director. The transaction was carried out in the ordinary course of business on normal commercial terms.

During the year, one of the subsidiaries, the Futures Exchange, has entered into a lease agreement with Shine Hill Development Limited, a subsidiary of Great Eagle Holdings Limited whose group managing director, Dr K S Lo is an independent non-executive director of HKEx, to lease office space for a period of two years commencing 1 January 2003. The rental payment for the year amounted to \$3,785,169 (2002: \$7,650,904) and the lease was entered into on normal commercial terms. In addition, \$647,313 (2002: \$910,616) was paid during the year for air conditioning services and \$54,950 (2002: \$67,274) for premises cleaning services to The Great Eagle Properties Management Co Limited (formerly known as Selex Properties Management Ltd) and Sun Fook Kong Housing Services Ltd respectively of which Dr K S Lo was a director.

During the year, bank charges of \$3,332,119 (2002: \$2,612,905), \$346,561 (2002: \$338,253) and \$268,843 (2002: \$428,253) were paid to The Hongkong & Shanghai Banking Corporation Limited, Bank of China (Hong Kong) Limited, and Hang Seng Bank Limited where Dr K S Lo, Dr Liu Jinbao (resigned from HKEx Board on 28 May 2003) and Mr John C C Chan (retired from HKEx Board on 15 April 2003) were directors of the aforesaid banks respectively. Dr K S Lo and Mr John C C Chan are non-executive directors of The Hongkong & Shanghai Banking Corporation Limited and Hang Seng Bank Limited respectively.

In May 2002, two loans amounted to \$12,500,000 were made to an associated company, Computershare Hong Kong Investor Services Limited (CHIS). \$5,000,000 was unsecured, interest free and was fully repaid before 30 September 2002. The remaining \$7,500,000 was unsecured with interest payable semi-annually at prime rate per annum and was fully repaid in March 2003. Total dividend and interest received in 2003 were \$4,800,280 and \$20,653 respectively (2002: \$Nil and \$183,723 respectively). In addition, share registration service fees amounted to \$516,127 (2002: \$120,547) were paid to CHIS during the year.

NOTES TO THE ACCOUNTS

37. OFF BALANCE SHEET RISKS

In the normal course of business, the clearing houses of the Group, HKSCC, SEOH and HKCC, act as the counterparties to eligible trades concluded on the Stock Exchange and the Futures Exchange through the novation of the obligations of the buyers and sellers. HKSCC is also responsible for the good title to the securities deposited and accepted in the CCASS depository. As a result, the Group has considerable market risk and credit risk since the Participants' ability to honour their obligations in respect of their trades and securities deposited may be adversely impacted by economic conditions affecting the cash and derivatives markets. If the Participants default on their obligations on settlement or there are defects in the title of securities deposited and accepted in the CCASS depository, the Group could be exposed to potential risks not otherwise accounted for in these accounts.

The Group mitigates its exposure to risks described above by requiring the Participants to meet the Group's established financial requirements and criteria for admission as Participants, monitoring compliance with risk management measures such as position limits established by the Group and requiring Clearing Participants to contribute to the Clearing House Funds set up by HKSCC, SEOH and HKCC. HKSCC also retains recourse against those Participants whose securities are deposited and accepted in the CCASS depository. Moreover, insurance has been taken out by the Group to cover the risks.

38. BANKING FACILITIES WITH ASSETS PLEDGED

The Group did not have any assets pledged as at 31 December 2002 and 31 December 2003.