



香港交易所

# **Consolidated Financial Statements**

## **For the year ended 31 December 2004**

**CONSOLIDATED PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 DECEMBER 2004**

(Financial figures are expressed in Hong Kong dollars)

	Note	2004 \$'000	As restated 2003 \$'000
<b>INCOME</b>			
Trading fees and trading tariff	5	682,293	485,211
Stock Exchange listing fees	6	378,427	333,786
Clearing and settlement fees		356,274	254,907
Depository, custody and nominee services fees		251,722	211,726
Income from sale of information		307,633	264,239
Investment income	7	228,587	296,952
Other income	8	189,001	173,004
	4	<u>2,393,937</u>	<u>2,019,825</u>
<b>OPERATING EXPENSES</b>			
Staff costs and related expenses	13	545,654	528,344
Information technology and computer maintenance expenses	14	221,624	246,648
Premises expenses		78,833	84,581
Product marketing and promotion expenses		11,263	7,891
Legal and professional fees		11,083	28,873
Depreciation		183,400	181,739
Payment to SFC under dual filing regime		20,000	15,000
Other operating expenses	9	84,439	130,651
	4	<u>1,156,296</u>	<u>1,223,727</u>
<b>OPERATING PROFIT</b>	4	<u>1,237,641</u>	<u>796,098</u>
<b>SHARE OF PROFITS LESS LOSSES OF ASSOCIATES</b>	4	<u>12,884</u>	<u>8,642</u>
<b>PROFIT BEFORE TAXATION</b>	4/10	<u>1,250,525</u>	<u>804,740</u>
<b>TAXATION</b>	4/15(a)	<u>(193,641)</u>	<u>(112,054)</u>
<b>PROFIT ATTRIBUTABLE TO SHAREHOLDERS</b>	4/38	<u>1,056,884</u>	<u>692,686</u>
<b>DIVIDENDS</b>		<u>950,911</u>	<u>629,263</u>
<b>SPECIAL DIVIDEND</b>		<u>-</u>	<u>1,762,318</u>
		<u>950,911</u>	<u>2,391,581</u>
Earnings per share	16	<u>\$1.00</u>	<u>\$0.66</u>
Dividends per share			
Interim dividend paid		\$0.43	\$0.18
Final dividend proposed/declared		\$0.47	\$0.42
		<u>\$0.90</u>	<u>\$0.60</u>
Dividend payout ratio		<u>90%</u>	<u>91%</u>
Special dividend per share		<u>-</u>	<u>\$1.68</u>

# **CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2004**

(Financial figures are expressed in Hong Kong dollars)

	Share capital and share premium (note 32) \$'000	Employee share-based compensation reserve (note 33) \$'000	Revaluation reserves (note 34) \$'000	Designated reserves (note 35) \$'000	Retained earnings (note 38) \$'000	Total equity \$'000
At 31 Dec 2003, as previously reported	<b>1,103,337</b>	-	<b>46,431</b>	<b>689,657</b>	<b>3,763,838</b>	<b>5,603,263</b>
Effect of changes in accounting policies (note 2(b))	-	<b>2,771</b>	<b>(9,932)</b>	-	<b>18,023</b>	<b>10,862</b>
At 31 Dec 2003, as restated	<b>1,103,337</b>	<b>2,771</b>	<b>36,499</b>	<b>689,657</b>	<b>3,781,861</b>	<b>5,614,125</b>
Effect of initial adoption of HKAS 39 (note 2(r))	-	-	-	-	<b>28</b>	<b>28</b>
At 1 Jan 2004, as restated	<b>1,103,337</b>	<b>2,771</b>	<b>36,499</b>	<b>689,657</b>	<b>3,781,889</b>	<b>5,614,153</b>
Change in valuation of leasehold buildings	-	-	<b>36</b>	-	-	<b>36</b>
Change in fair value of available-for-sale financial assets	-	-	<b>10,535</b>	-	-	<b>10,535</b>
Realisation of change in fair value of financial assets on maturity and disposal	-	-	<b>(26,741)</b>	-	-	<b>(26,741)</b>
Deferred tax arising from change in valuation of leasehold buildings	-	-	<b>(6)</b>	-	-	<b>(6)</b>
Deferred tax arising from change in fair value of available-for-sale financial assets	-	-	<b>(1,494)</b>	-	-	<b>(1,494)</b>
Net loss recognised directly in equity	-	-	<b>(17,670)</b>	-	-	<b>(17,670)</b>
Profit attributable to shareholders	-	-	-	-	<b>1,056,884</b>	<b>1,056,884</b>
Total recognised (loss)/profit	-	-	<b>(17,670)</b>	-	<b>1,056,884</b>	<b>1,039,214</b>
2003 special and final dividends	-	-	-	-	<b>(2,218,559)</b>	<b>(2,218,559)</b>
2004 interim dividend	-	-	-	-	<b>(454,291)</b>	<b>(454,291)</b>
Proceeds from issue of shares	<b>57,336</b>	-	-	-	-	<b>57,336</b>
Employee share option benefits	-	<b>14,290</b>	-	-	-	<b>14,290</b>
Transfer of reserves (note 35)	-	-	-	<b>(8,661)</b>	<b>8,661</b>	-
At 31 Dec 2004	<b>1,160,673</b>	<b>17,061</b>	<b>18,829</b>	<b>680,996</b>	<b>2,174,584</b>	<b>4,052,143</b>

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2004 (continued)**  
(Financial figures are expressed in Hong Kong dollars)

	Share capital and share premium (note 32) \$'000	Employee share-based compensation reserve (note 33) \$'000	Revaluation reserves (note 34) \$'000	Designated reserves (note 35) \$'000	Retained earnings (note 38) \$'000	Total equity \$'000
At 1 Jan 2003, as previously reported	1,062,593	-	29,899	727,811	3,670,061	5,490,364
Effect of changes in accounting policies (note 2(b))	-	-	(13,920)	-	17,102	3,182
At 1 Jan 2003, as restated	<u>1,062,593</u>	<u>-</u>	<u>15,979</u>	<u>727,811</u>	<u>3,687,163</u>	<u>5,493,546</u>
Change in valuation of leasehold buildings	-	-	548	-	-	548
Change in fair value of non-trading securities	-	-	27,585	-	-	27,585
Realisation of change in fair value of non-trading securities on maturity and disposal	-	-	(7,392)	-	-	(7,392)
Deferred tax arising from change in valuation of leasehold buildings	-	-	(134)	-	-	(134)
Deferred tax arising from change in fair value of non-trading securities	<u>-</u>	<u>-</u>	<u>(87)</u>	<u>-</u>	<u>-</u>	<u>(87)</u>
Net profit recognised directly in equity	-	-	20,520	-	-	20,520
Profit attributable to shareholders	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>692,686</u>	<u>692,686</u>
Total recognised profit	-	-	20,520	-	692,686	713,206
2002 final dividend	-	-	-	-	(449,387)	(449,387)
2003 interim dividend	-	-	-	-	(188,683)	(188,683)
Proceeds from issue of shares	40,744	-	-	-	-	40,744
Employee share option benefits	-	2,771	-	-	-	2,771
Transfer of reserves (note 35)	-	-	-	(40,082)	40,082	-
Forfeiture of defaulted Clearing Participants' contributions	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,928</u>	<u>-</u>	<u>1,928</u>
At 31 Dec 2003, as restated	<u><u>1,103,337</u></u>	<u><u>2,771</u></u>	<u><u>36,499</u></u>	<u><u>689,657</u></u>	<u><u>3,781,861</u></u>	<u><u>5,614,125</u></u>

**CONSOLIDATED BALANCE SHEET****AT 31 DECEMBER 2004**

(Financial figures are expressed in Hong Kong dollars)

	Note	2004 \$'000	As restated 2003 \$'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	17(a)	324,300	482,927
Investment property	18	13,300	10,000
Lease premium for land	19	94,670	95,218
Investments in associates	20	38,731	36,648
Clearing House Funds	21	1,861,487	1,551,330
Compensation Fund Reserve Account	22	37,451	36,859
Cash and Derivatives Market Development Fund	23	-	925
Non-trading securities	24	-	77,258
Time deposits with maturity over one year		38,941	393,456
Deferred tax assets	37(e)	1,227	-
Other assets		13,142	4,814
		<b>2,423,249</b>	<b>2,689,435</b>
<b>CURRENT ASSETS</b>			
Accounts receivable, prepayments and deposits	26(a)	4,691,846	4,644,680
Lease premium for land	19	548	548
Taxation recoverable		91	1,558
Margin Funds on derivatives contracts	25	10,529,692	7,874,510
Financial assets at fair value through profit or loss	27	2,761,593	-
Trading securities	28	-	3,212,998
Time deposits with original maturity over three months		1,340	28,857
Cash and cash equivalents		1,035,045	1,355,390
		<b>19,020,155</b>	<b>17,118,541</b>
<b>CURRENT LIABILITIES</b>			
Bank loans	41(b)(ii)	-	50,286
Margin deposits and securities received from Clearing			
Participants on derivatives contracts	25	10,529,692	7,874,510
Accounts payable, accruals and other liabilities	26(b)	4,902,350	4,779,904
Financial liabilities at fair value through profit or loss	27	10,749	-
Participants' admission fees received	29	4,850	4,100
Deferred revenue		284,148	257,068
Taxation payable		199,678	57,370
Provisions	30(a)	23,212	25,011
		<b>15,954,679</b>	<b>13,048,249</b>
<b>NET CURRENT ASSETS</b>		<b>3,065,476</b>	<b>4,070,292</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>5,488,725</b>	<b>6,759,727</b>
<b>NON-CURRENT LIABILITIES</b>			
Participants' admission fees received	29	82,850	84,950
Participants' contributions to Clearing House Funds	21	1,298,752	984,045
Deferred tax liabilities	37(e)	30,876	53,515
Provisions	30(a)	24,104	23,092
		<b>1,436,582</b>	<b>1,145,602</b>
<b>NET ASSETS</b>		<b>4,052,143</b>	<b>5,614,125</b>

**CONSOLIDATED BALANCE SHEET (continued)****AT 31 DECEMBER 2004**

(Financial figures are expressed in Hong Kong dollars)

	Note	2004 \$'000	As restated 2003 \$'000
<b>CAPITAL AND RESERVES</b>			
Share capital	32	<b>1,056,639</b>	1,048,999
Share premium	32	<b>104,034</b>	54,338
Employee share-based compensation reserve	33	<b>17,061</b>	2,771
Revaluation reserves	34	<b>18,829</b>	36,499
Designated reserves	35	<b>680,996</b>	689,657
Retained earnings	38	<b>1,677,964</b>	1,578,963
Proposed/declared dividends	38	<b>496,620</b>	2,202,898
<b>SHAREHOLDERS' FUNDS</b>		<b><u>4,052,143</u></b>	<b><u>5,614,125</u></b>

Approved by the Board of Directors on 28 February 2005

**LEE Yeh Kwong, Charles**  
Director

**CHOW Man Yiu, Paul**  
Director

**HONG KONG EXCHANGES AND CLEARING LIMITED (HKEx)**  
**BALANCE SHEET**  
**AT 31 DECEMBER 2004**

(Financial figures are expressed in Hong Kong dollars)

	Note	2004 \$'000	As restated 2003 \$'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	17(b)	25,164	36,858
Investments in subsidiaries	31(a)	4,145,198	4,145,198
Deferred tax assets	37(e)	1,227	-
Other assets		3,545	3,088
		<u>4,175,134</u>	<u>4,185,144</u>
<b>CURRENT ASSETS</b>			
Accounts receivable, prepayments and deposits	26(a)	20,638	18,995
Amounts due from subsidiaries	31(b)	497,463	408,250
Cash and cash equivalents		26,394	13,840
		<u>544,495</u>	<u>441,085</u>
<b>CURRENT LIABILITIES</b>			
Accounts payable, accruals and other liabilities	26(b)	110,601	61,726
Amounts due to subsidiaries	31(b)	180,603	59,402
Taxation payable		5,610	128
Provisions	30(b)	23,212	23,825
		<u>320,026</u>	<u>145,081</u>
<b>NET CURRENT ASSETS</b>		<u>224,469</u>	<u>296,004</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>4,399,603</u>	<u>4,481,148</u>
<b>NON-CURRENT LIABILITIES</b>			
Deferred tax liabilities	37(e)	-	150
Provisions	30(b)	555	235
		<u>555</u>	<u>385</u>
<b>NET ASSETS</b>		<u>4,399,048</u>	<u>4,480,763</u>
<b>CAPITAL AND RESERVES</b>			
Share capital	32	1,056,639	1,048,999
Share premium	32	104,034	54,338
Employee share-based compensation reserve	33	17,061	2,771
Merger reserve	36	2,997,115	2,997,115
Accumulated losses	38	(272,421)	(1,825,358)
Proposed/declared dividends	38	496,620	2,202,898
<b>SHAREHOLDERS' FUNDS</b>		<u>4,399,048</u>	<u>4,480,763</u>

Approved by the Board of Directors on 28 February 2005

LEE Yeh Kwong, Charles  
Director

CHOW Man Yiu, Paul  
Director

# **CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2004**

(Financial figures are expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net cash inflow from operating activities	39(a)	<u>1,816,353</u>	<u>1,408,746</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Payments for purchases of fixed assets		(23,377)	(51,635)
Proceeds from sales of fixed assets		158	190
Proceeds from sales of other assets		1,175	-
Proceeds from sales of available-for-sale financial assets		75,773	-
Decrease/(increase) in time deposits with original maturity more than three months		383,100	(117,155)
Dividends received from an associate		10,801	4,800
Dividends received from non-trading securities		-	14,097
Dividends received from available-for-sale financial assets		1,070	-
Interest received from non-trading securities		-	13,644
Interest received from available-for-sale financial assets		56,693	-
Interest paid on bank loan		(827)	(827)
Repayment of loan receivable from an associate		-	2,000
Net cash inflow/(outflow) from investing activities		<u>504,566</u>	<u>(134,886)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from issue of shares under employee share option scheme		57,336	40,744
Admission fees received less refunds to Participants		(1,350)	(1,100)
Repayment of bank loan		(50,286)	-
Dividends paid		(2,672,850)	(638,070)
Net cash outflow from financing activities		<u>(2,667,150)</u>	<u>(598,426)</u>
<b>Net (decrease) / increase in cash and cash equivalents</b>		<b>(346,231)</b>	<b>675,434</b>
Cash and cash equivalents at 31 December 2003/2002		<b>1,355,390</b>	<b>679,956</b>
Effect of initial adoption of HKAS 39		<u>25,886</u>	<u>-</u>
<b>Cash and cash equivalents at 31 December 2004/2003</b>	39(b)	<u><b>1,035,045</b></u>	<u><b>1,355,390</b></u>



## NOTES TO THE ACCOUNTS

(Financial figures are expressed in Hong Kong dollars)

### 1. GENERAL INFORMATION

Hong Kong Exchanges and Clearing Limited (“HKEx”) and its subsidiaries (collectively, “the Group”) own and operate the only stock exchange and futures exchange in Hong Kong and their related clearing houses.

HKEx is a limited company incorporated and domiciled in Hong Kong. The address of its registered office is 12<sup>th</sup> Floor, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong.

These consolidated accounts have been approved for issue by the Board of Directors on 28 February 2005.

### 2. PRINCIPAL ACCOUNTING POLICIES

#### (a) Statement of compliance

The Hong Kong Institute of Certified Public Accountants (“HKICPA”, formerly the Hong Kong Society of Accountants) has undertaken to converge by 1 January 2005 all Hong Kong Financial Reporting Standards (“HKFRSs”) with International Financial Reporting Standards (“IFRSs”) issued by the International Accounting Standards Board. As a result, the HKICPA has aligned HKFRSs with the requirements of IFRSs in all material respects as at 31 December 2004. The accounts have been prepared in accordance with HKFRSs issued by the HKICPA, 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 leasehold buildings, investment properties, available-for-sale financial assets and financial assets and financial liabilities at fair value through profit or loss, 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.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group’s accounting policies. The areas involving higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated accounts are disclosed in note 3.

#### *Early adoption of HKFRSs*

In 2004, the Group has early adopted all HKFRSs issued up to 31 December 2004 pertinent to its operations. The applicable HKFRSs are set out below and the 2003 accounts have been restated in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (b) Basis of preparation (continued)

##### *Early adoption of HKFRSs (continued)*

HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 40	Investment Property
HKFRS 2	Share-based Payments
HKFRS 3	Business Combinations
HKAS-INT 15	Operating Leases - Incentives
HKAS-INT 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets

The early adoption of HKAS 1, 7, 8, 10, 12, 14, 16, 18, 19, 21, 23, 24, 27, 28, 33, 37 and HKAS-INT 15 did not result in substantial changes to the Group's accounting policies. In summary:

- HKAS 1 affects certain presentation in the consolidated balance sheet, consolidated profit and loss account and consolidated statement of changes in equity.
- HKAS 8, 16, 21 and 28 affect certain disclosure of the accounts.
- HKAS 7, 10, 12, 14, 18, 19, 23, 27, 33, 37 and HKAS INT-15 do not have any impact as the Group's accounting policies already comply with the standards.
- HKAS 24 affects the identification of related parties and the disclosure of related party transactions.

The early adoption of HKAS 17 has resulted in a change in accounting policy relating to leasehold land. Leasehold land and buildings were previously carried at valuation less accumulated depreciation. In accordance with the provisions of HKAS 17, a lease of land and building should be split into a lease of land and a lease of building in proportion to the relative fair values of the leasehold interests in the land element and the building element of the lease at the inception of the lease. The lease premium for land is stated at cost and amortised over the period of the lease whereas the leasehold building is stated at valuation less accumulated depreciation.

The early adoption of HKFRS 2 has resulted in a change in accounting policy for employee share options. Prior to this, the provision of share options to employees did not result in a charge to the profit and loss account. Following the adoption of HKFRS 2, the fair value of share options at grant date is amortised over the relevant vesting periods to the profit and loss account (note 2(g)(ii)).

The early adoption of HKFRS 3, HKAS 36 and HKAS 38 has resulted in a change in the accounting policy for goodwill. Prior to this, goodwill was:

- amortised on a straight-line basis over a period of not exceeding 20 years; and
- assessed for impairment at each balance sheet date.

In accordance with the provisions of HKFRS 3:

- the Group ceased amortisation of goodwill from 1 January 2003;
- accumulated amortisation as at 31 December 2002 has been eliminated with a corresponding decrease in the cost of goodwill;
- from the year ended 31 December 2003 onwards, goodwill is tested annually for impairment, as well as when there are indications of impairment (note 2(m)).

The early adoption of HKAS 40 has resulted in a change in the accounting policy for the Group's investment property. Changes in valuation of the investment property were previously dealt with in an investment property revaluation reserve. Following the adoption of HKAS 40, all changes in valuation of the investment property would be recognised in the profit and loss account (note 2(j)).

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (b) Basis of preparation (continued)

##### *Early adoption of HKFRSs (continued)*

The early adoption of HKAS 32 and HKAS 39 has resulted in a change in accounting policy for recognition, measurement, derecognition and disclosure of financial instruments. Until 31 December 2003, investments of the Group were classified into non-trading securities and trading securities, and were stated in the balance sheet at fair value (note 2(r)(vii)). Bank deposits with embedded derivatives for yield enhancement were treated as bank deposits and stated at cost. Non-cash collateral deposited by Participants was recorded on balance sheet at market value.

In accordance with the provisions of HKAS 39, the investments have been classified into available-for-sale financial assets, financial assets at fair value through profit or loss and loans and receivables (which include bank deposits and cash and cash equivalents). The classification depends on the purpose for which the investments were held (note 2 (r)(i)). For debt securities and bank deposits with embedded derivatives for yield enhancement, where the economic characteristics and the risks of such derivatives are not closely related to the bank deposits and debt securities, all such bank deposits, debt securities and the embedded derivatives are designated as financial assets at fair value through profit or loss with changes in fair value recognised in the profit and loss account. Interest income for financial assets at fair value through profit or loss is included as net realised and unrealised gains/(losses) and interest income of financial assets at fair value through profit or loss. Non-cash collateral deposited by Participants is no longer recognised on the balance sheet.

The early adoption of HKAS-INT 21 has resulted in a change in accounting policy relating to deferred taxation of the Group's investment property. Prior to this, deferred tax arising from the revaluation of investment property was calculated on the basis that the property was held for sale. In accordance with the provisions of HKAS-INT 21, the deferred tax arising from the revaluation of the property should be recalculated as if the investment property is held through use and charged to the profit and loss account.

All relevant changes in the accounting policies have been made in accordance with the provisions of the respective standards, which require retrospective application to prior year comparatives other than:

- HKFRS 2 – retrospective application of all equity instruments granted to employees after 7 November 2002 and not vested at 1 January 2004;
- HKFRS 3 – prospectively after 1 January 2003.
- HKAS 39:
  - recognise all derivatives at fair value in the balance sheet on 1 January 2004 and adjust the balance to retained earnings;
  - redesignate all investments into available-for-sale financial assets, financial assets through profit or loss and loans and receivables (which include bank deposits and cash and cash equivalents) on 1 January 2004;
  - remeasure those financial assets or financial liabilities that should be measured at fair value and those that should be measured at amortised cost and adjust the balance to retained earnings at 1 January 2004;
  - prospective application for the derecognition of financial assets.

# NOTES TO THE ACCOUNTS

## 2. PRINCIPAL ACCOUNTING POLICIES (continued)

### (b) Basis of preparation (continued)

*Effect of changes in the accounting policies on consolidated profit and loss account*

	Effect of adopting								Total \$'000
	HKAS 1 <sup>#</sup> \$'000	HKAS 17 <sup>#</sup> \$'000	HKFRS 2 <sup>#</sup> \$'000	HKFRS 3* HKAS 36* & HKAS 38* \$'000	HKAS 32 <sup>#</sup> & HKAS 39 <sup>Ω</sup> \$'000	HKAS 40 <sup>#</sup> \$'000	HKAS- INT 21 <sup>#</sup> \$'000	Other reclassification <sup>#</sup> \$'000	
Year 2004									
Increase / (decrease) in investment income	-	-	-	-	367	-	-	(5,133)	(4,766)
Increase in other income	-	-	-	-	-	3,300	-	5,133	8,433
Increase in staff costs and related expenses	-	-	(14,290)	-	-	-	-	-	(14,290)
Increase in premises expenses	-	(548)	-	-	-	-	-	-	(548)
Decrease in depreciation	-	2,182	-	-	-	-	-	-	2,182
Increase in other operating expenses	-	-	-	-	(661)	-	-	-	(661)
Increase / (decrease) in share of profit less losses of associates	(2,886)	-	-	2,649	-	-	-	-	(237)
Decrease / (increase) in taxation	2,886	(249)	-	-	(60)	-	(577)	-	2,000
Total increase / (decrease) in profit	-	1,385	(14,290)	2,649	(354)	3,300	(577)	-	(7,887)
Increase / (decrease) in basic earnings per share	-	0.13 cents	(1.36 cents)	0.25 cents	(0.03 cents)	0.31 cents	(0.05 cents)	-	(0.75 cents)
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Year 2003									
Decrease in investment income	-	-	-	-	-	-	-	(14,355)	(14,355)
Increase in other income	-	-	-	-	-	-	-	14,355	14,355
Increase in staff costs and related expenses	-	-	(2,771)	-	-	-	-	-	(2,771)
Increase in premises expenses	-	(548)	-	-	-	-	-	-	(548)
Decrease in depreciation	-	1,749	-	-	-	-	-	-	1,749
Increase in other operating expenses	-	-	-	(16)	-	-	-	-	(16)
Increase / (decrease) in share of profit less losses of associates	(1,684)	-	-	2,662	-	-	-	-	978
Decrease / (increase) in taxation	1,684	(128)	-	-	-	-	(27)	-	1,529
Total increase / (decrease) in profit	-	1,073	(2,771)	2,646	-	-	(27)	-	921
Increase / (decrease) in basic earnings per share	-	0.10 cents	(0.26 cents)	0.25 cents	-	-	(0.00 cents)	-	0.09 cents

\* adjustments which take effect prospectively from 1 January 2003

Ω adjustments which take effect prospectively from 1 January 2004

# adjustments which take effect retrospectively

# NOTES TO THE ACCOUNTS

## 2. PRINCIPAL ACCOUNTING POLICIES (continued)

### (b) Basis of preparation (continued)

#### *Effect of changes in accounting policies on consolidated balance sheet*

	Effect of adopting							
	HKAS 1 <sup>#</sup> \$'000	HKAS 17 <sup>#</sup> \$'000	HKFRS 2 <sup>#</sup> \$'000	HKFRS 3* HKAS 36* & HKAS 38* \$'000	HKAS 32 <sup>†</sup> & HKAS 39 <sup>Ω</sup> \$'000	HKAS 40 <sup>#</sup> \$'000	HKAS- INT 21 <sup>#</sup> \$'000	Total \$'000
<i>At 1 January 2003 (Equity only)</i>								
<u>Increase / (decrease) in equity</u>								
Revaluation reserves	-	(12,149)	-	-	-	(1,771)	-	(13,920)
Retained earnings	-	15,614	-	-	-	1,771	(283)	17,102
<i>At 31 December 2003</i>								
<u>Increase / (decrease) in assets</u>								
Fixed assets	(10,000)	(92,700)	-	-	-	-	-	(102,700)
Investment property	10,000	-	-	-	-	-	-	10,000
Lease premium for land (current and non-current)	-	95,766	-	-	-	-	-	95,766
Investment in associates	-	-	-	2,646	-	-	-	2,646
Time deposits (non- current)	393,456	-	-	-	-	-	-	393,456
Time deposits (current)	28,857	-	-	-	-	-	-	28,857
Cash and cash equivalents	1,355,390	-	-	-	-	-	-	1,355,390
Bank balances and time deposits	(1,777,703)	-	-	-	-	-	-	(1,777,703)
<u>Increase / (decrease) in liabilities / equity</u>								
Deferred tax liabilities	-	(5,460)	-	-	-	-	310	(5,150)
Employee share-based compensation reserve	-	-	2,771	-	-	-	-	2,771
Revaluation reserves	-	(8,161)	-	-	-	(1,771)	-	(9,932)
Retained earnings	-	16,687	(2,771)	2,646	-	1,771	(310)	18,023
<i>At 31 December 2004</i>								
<u>Increase / (decrease) in assets</u>								
Fixed assets	(13,300)	(170,100)	-	-	-	-	-	(183,400)
Investment property	13,300	-	-	-	-	-	-	13,300
Lease premium for land (current and non-current)	-	95,218	-	-	-	-	-	95,218
Investment in associates	-	-	-	5,295	-	-	-	5,295
Clearing House Funds	-	-	-	-	(322,724)	-	-	(322,724)
Time deposits (non-current)	38,863	-	-	-	78	-	-	38,941
Margin Funds on derivatives contracts	-	-	-	-	(1,114,605)	-	-	(1,114,605)
Accounts receivable, prepayments and deposits	-	-	-	-	(70,686)	-	-	(70,686)
Financial assets at fair value through profit or loss	-	-	-	-	2,761,593	-	-	2,761,593
Trading securities	-	-	-	-	(2,691,657)	-	-	(2,691,657)
Time deposits (current)	1,335	-	-	-	5	-	-	1,340
Cash and cash equivalents	1,034,644	-	-	-	401	-	-	1,035,045
Bank balances and time deposits	(1,074,842)	-	-	-	-	-	-	(1,074,842)
<u>Increase / (decrease) in liabilities / equity</u>								
Margin deposits and securities received from Clearing Participants on derivatives contracts	-	-	-	-	(1,114,605)	-	-	(1,114,605)
Accounts payable, accruals and other liabilities	-	-	-	-	(10,749)	-	-	(10,749)
Financial liabilities at fair value through profit or loss	-	-	-	-	10,749	-	-	10,749
Taxation payable	-	-	-	-	60	-	-	60
Participants' contributions to Clearing House Funds	-	-	-	-	(322,724)	-	-	(322,724)
Deferred tax liabilities	-	(19,139)	-	-	-	-	887	(18,252)
Employee share-based compensation reserve	-	-	17,061	-	-	-	-	17,061
Revaluation reserves	-	(73,815)	-	-	-	(5,071)	-	(78,886)
Retained earnings	-	18,072	(17,061)	5,295	(326)	5,071	(887)	10,164

\* adjustments which take effect prospectively from 1 January 2003

Ω adjustments which take effect prospectively from 1 January 2004

# adjustments which take effect retrospectively

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (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, has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights.

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

##### (ii) Associates

An associate is a company, not being a subsidiary nor an interest in a joint venture, in which the Group has significant influence generally accompanying a shareholding of between 20% and 50% of the voting rights.

Investments in associates 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 associates for the year, and the consolidated balance sheet includes the Group's share of the net assets of associates and goodwill (net of accumulated impairment loss).

#### (d) Turnover

Turnover comprises trading fees and trading tariff from securities and options traded on The Stock Exchange of Hong Kong Limited ("the Stock Exchange") and derivatives contracts traded on Hong Kong Futures Exchange Limited ("the 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

### 2. 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 and trading fees on derivatives contracts traded on the Futures Exchange are recognised on a trade date basis.
- (ii) Settlement fees on derivatives contracts traded on the Futures Exchange are recognised on outstanding contracts at the official final settlement day.
- (iii) 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, ie, on the day following the trade day, upon acceptance of the trades. Fees for other settlement transactions are recognised upon completion of the settlement.
- (iv) 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.
- (v) Initial listing fees for initial public offering (“IPO”) are recognised upon the listing of an applicant, cancellation of the application or six months after submission of the application, whichever is earlier. Income from annual listing fees is recognised on a straight-line basis over the period covered by the respective fees received in advance.
- (vi) Income from sale of information and other fees are recognised when the related services are rendered.
- (vii) Interest income represents gross interest income from bank deposits and investments and is recognised on a time apportionment basis using the effective interest method.
- (viii) Dividend income is recognised when the right to receive payment is established.
- (ix) 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. All interest expenses are charged to the profit and loss account in the year in which they are incurred.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (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.

##### (ii) Equity compensation benefits

For share options granted under the Post-Listing Share Option Scheme (“Post-Listing Scheme”), the fair value of the employee services rendered in exchange for the grant of the options is recognised as an expense and credited to an employee share-based compensation reserve under equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted at grant date. At each balance sheet date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of the original estimates, if any, in the profit and loss account, and a corresponding adjustment to the employee share-based compensation reserve over the remaining vesting period.

Share options granted under the Pre-Listing Share Option Scheme (“Pre-Listing Scheme”) are not expensed as the options were granted before 7 November 2002 and not subject to requirements of HKFRS 2.

When the options are exercised, the proceeds received are credited to share capital (nominal value) and share premium.

##### (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.



## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (i) Fixed assets

The building component of owner-occupied leasehold 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 the basis of depreciated replacement cost. Depreciated replacement cost is used as open market value cannot be reliably allocated to the building component. The Directors review the carrying value of the leasehold buildings and adjustment is made where they consider that there has been a material change. Increases in valuation are credited to the leasehold buildings 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 leasehold buildings revaluation reserve.

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

Tangible fixed assets are depreciated at rates sufficient to write off their cost net of expected residual value over their estimated useful lives on a straight-line basis. The useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. The principal annual rates are as follows:

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

During the year, the estimated useful life of the hardware of trading and clearing systems was revised from three years to five years to better reflect the useful life of the equipment. The effect of the change in accounting estimate in the current year was a decrease in depreciation charge of \$7,265,000.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the profit and loss account during the year in which they are incurred.

An asset is written down immediately to its recoverable amount if its carrying amount is higher than the asset's estimated recoverable amount (note 2(m)).

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 that are attributable to the assets 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.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (i) Fixed assets (continued)

Amortisation of the cost of capitalised software system development expenditures is provided from the dates when the systems are available for use.

Upon the disposal of leasehold buildings, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the leasehold building revaluation reserve to retained earnings.

The gain or loss on disposal of a fixed asset other than leasehold 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.

#### (j) Investment properties

Investment properties are properties held for long-term rental yields and not occupied by the Group. Investment properties are carried at fair value, representing open-market value determined annually by independent qualified valuers. Changes in fair value are recognised in the profit and loss account.

#### (k) Lease premium for land

Leasehold land premiums are up-front payments to acquire long-term interests in lessee-occupied properties. The premiums are stated at cost and are amortised over the period of the lease on a straight-line basis to the profit and loss account.

#### (l) 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. Goodwill on acquisition of associates is included in investments in associates.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

#### (m) Impairment of assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount (ie, the higher of an asset's fair value less costs to sell and value in use). 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.

In respects of assets other than goodwill, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and the circumstances and events leading to the impairment cease to exist. A reversal of impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversal of impairment losses are credited to the profit and loss account except when the asset is carried at valuation, in which case the reversal of impairment loss is treated as a revaluation movement.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (n) 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. Investment income net of expenses of the Clearing House Funds is appropriated from retained earnings to the respective designated reserves of these funds and allocated to amounts attributable to Clearing Participants’ contribution and to clearing houses’ contributions based on the ratio of their respective average contributions and accumulated allocated investment income net of expenses. 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 and available-for-sale financial assets 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 (“SEOCH”) 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. In accordance with HKAS 39, which is effective from 1 January 2004, non-cash collateral has been derecognised. Accordingly, contributions receivable from Clearing Participants fully secured by bank guarantees and the corresponding liabilities are not reflected as assets and 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.

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.

#### (o) Margin Funds on derivatives contracts/margin deposits and securities received from Clearing Participants on derivatives contracts

Margin Funds are established by cash received or receivable 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. 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. In accordance with HKAS 39, which is effective from 1 January 2004, non-cash margin collateral has been derecognised. Therefore, only cash collateral is recorded as assets of and liabilities of the Margin Funds in the balance sheet.

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 non-trading securities/available-for-sale financial assets comprising these Margin Funds are dealt with in the investment revaluation reserve. Changes in fair value of investments designated as financial assets at fair value through profit or loss are included in the profit and loss account. The Clearing Participants of SEOCH and HKCC are entitled to interest at a rate determined by SEOCH and HKCC on the margin deposits they place with SEOCH and HKCC respectively.

#### (p) Cash marks received from Participants

Cash marks received from HKSCC Participants for their open positions are recorded as assets in the balance sheet. As these funds are refundable to the Participants when they close their positions, the marks received are reflected as liabilities to the Participants in the balance sheet.

Income arising from bank deposits comprising these funds is dealt with in the profit and loss account. HKSCC Participants are entitled to interest at a rate determined by HKSCC on the marks they place with HKSCC.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (q) Derivative financial instruments

Derivatives, which include foreign exchange contracts, are initially recognised at fair value on the date on which a derivative contract is entered into and subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. Changes in fair value of the derivatives are recognised in the profit and loss account. All derivatives are classified as financial assets at fair value through profit or loss when the fair value is positive and as financial liabilities at fair value through profit or loss when the fair value is negative.

#### (r) Investments

##### (i) Classification

From 1 January 2004, investments of the Group are classified under the following categories:

##### Financial assets at fair value through profit or loss

This category comprises financial assets held for trading and those designated as fair value through profit or loss at inception. A financial asset is classified as held for trading if acquired principally for the purpose of selling in the short term. This category includes derivatives which are not qualified for hedge accounting. Debt securities and bank deposits with embedded derivatives for yield enhancement whose economic characteristics and risks are not closely related to the host securities and deposits are designated as financial assets at fair value through profit or loss.

##### Available-for-sale financial assets

This category comprises financial assets which are non-derivatives and are designated as available-for-sale financial assets or not classified under other investment categories.

##### Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, and with no intention of trading the receivables. Bank deposits are treated as loans and receivables and are disclosed as time deposits and cash equivalents.

Details of the redesignation on 1 January 2004 are included in note 2(r)(viii).

##### (ii) Recognition and initial measurement

Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments at fair value through profit or loss are initially recognised at fair value with transaction costs recognised as expenses in the profit and loss account. Investments not designated as fair value through profit or loss are initially recognised at fair value plus transaction costs.

##### (iii) Derecognition

Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially the risk and rewards of ownership.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (r) Investments (continued)

##### (iv) Gains or losses on subsequent measurement and interest income

###### Financial assets at fair value through profit or loss

- Investments under this category are carried at fair value. Unrealised gains and losses arising from changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal, the difference between the sale proceeds and the carrying value is included in the profit and loss account.
- Interest income is recognised using the effective interest method and included as net realised and unrealised gains/(losses) and interest income from these investments.

###### Available-for-sale financial assets

- Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised in investment revaluation reserve, except for monetary securities whose exchange differences resulting from changes in amortised costs are recognised in profit and loss account. When the securities are sold, the difference between the sale proceeds and the carrying value, and the accumulated fair value adjustments in the investment revaluation reserve are treated as gains or losses on disposal.
- Interest income is recognised using the effective interest method and disclosed as interest income.

###### Loans and receivables

- Loans and receivables are carried at amortised cost using the effective interest method less provision for impairment.
- Interest income is recognised using the effective interest method and disclosed as interest income.

##### (v) Fair value measurement principles

Fair values of quoted investments are based on bid prices. For unlisted securities or financial assets without an active market, the Group establishes the fair value by using valuation techniques including the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models.

##### (vi) Impairment

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on the financial asset previously recognised in the profit or loss – is removed from investment revaluation reserve and recognised in the profit and loss account.

In case of equity securities classified as available-for-sale financial assets, a significant or prolonged decline in the fair value of the securities below their cost is considered in determining whether the securities are impaired. Impairment losses recognised in the profit and loss account on equity instruments are not reversed through the profit and loss account.

A provision of impairment for loans and receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flow, discounted at the original effective interest rate. The amount of provision is recognised in the profit and loss account.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (r) Investments (continued)

- (vii) Non-trading securities and trading securities (only applicable to accounting periods ended on or before 31 December 2003)

##### (a) Non-trading securities

Securities held by the Group for the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund, Margin Funds and its investments not held for trading were stated in the balance sheet at fair value. Changes in the fair value of individual securities were credited or debited to the investment revaluation reserve until a security was sold, matured, or was 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, was dealt with in the profit and loss account.

Individual securities were reviewed at each balance sheet date to determine whether they were impaired. When a security was considered to be impaired, the cumulative loss recorded in the investment revaluation reserve was 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 were written back to the profit and loss account when the circumstances and events leading to the impairment ceased to exist.

##### (b) Trading securities

Trading securities were investments of the Group's Corporate Funds and were marked to market (ie, 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 were 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, were recognised in the profit and loss account as they arose.

## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (r) Investments (continued)

(viii) Redesignation of securities and time deposits held by the Group as at 1 January 2004

				New designation on 1 January 2004		
	As reported on 31 Dec 2003 \$'000	Effect of initial adoption of HKAS 39 \$'000	As restated on 1 Jan 2004 \$'000	Financial assets / (liabilities) at fair value through profit or loss \$'000	Available- for-sale financial assets \$'000	Loans and receivables* \$'000
Clearing House Funds						
Non-trading securities	125,643	505	126,148	-	126,148	-
Bank balances and time deposits	1,349,644	(505)	1,349,139	-	-	1,349,139
Compensation Fund						
Reserve Account						
Non-trading securities	18,318	499	18,817	-	18,817	-
Bank balances and time deposits	26,819	(499)	26,320	-	-	26,320
CDMD Fund						
Non-trading securities	925	-	925	-	925	-
Non-trading securities	77,258	-	77,258	-	77,258	-
Margin Funds						
Non-trading securities	2,169,069	19,086	2,188,155	149,050	2,039,105	-
Bank balances and time deposits	4,900,011	(19,086)	4,880,925	-	-	4,880,925
Trading securities	3,212,998	35,283 <sup>#</sup>	3,248,281	3,248,281	-	-
Bank balances and time deposits	1,777,703	26,954 <sup>#</sup>	1,804,657	115,309	-	1,689,348
Interest receivable	62,209	(62,209) <sup>#</sup>	-	-	-	-
Forward foreign exchange contracts included in accounts payable	(11,567)	-	(11,567)	(11,567)	-	-

\* Loans and receivables include time deposits and cash and cash equivalents.

# Net impact on retained earnings on 1 January 2004 of \$28,000 (note 38).

#### (s) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss are financial liabilities held for trading and those designated at fair value through profit or loss at inception. A financial liability is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management.

Liabilities under this category are initially recognised at fair value on the date on which a contract is entered into and subsequently remeasured at their fair value. Changes in fair value of the liabilities are recognised in the profit and loss account.

#### (t) 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

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

**(u) 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.

**(v) Deferred taxation**

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.

**(w) 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.

**(x) 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.

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.



## NOTES TO THE ACCOUNTS

### 2. PRINCIPAL ACCOUNTING POLICIES (continued)

#### (y) Foreign currency translation

##### (i) Functional and presentation currency

Items included in the accounts of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated accounts are presented in Hong Kong Dollars ("HKD"), which is HKEx's and the Group's functional and presentation currency.

##### (ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets (for available-for-sale financial assets, please refer to note 2(r)(iv)) and liabilities denominated in foreign currencies are recognised in the profit and loss account.

Translation differences on non-monetary items, such as equity investments held that are classified as financial assets at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items such as equity instruments classified as available-for-sale financial assets are included in the investment revaluation reserve in equity.

#### (z) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, bank balances and time deposits within three months of maturity when acquired.

#### (aa) Segment reporting

Business segment assets consist primarily of fixed assets, assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund, Margin Funds, financial assets and other assets. Business segment liabilities comprise primarily of liabilities to Participants, financial and other liabilities. Non-business segment assets and liabilities include taxation recoverable and payable, deferred tax assets and liabilities and unclaimed dividends. Capital expenditures comprise additions to fixed assets. Business segments have been used as the primary reporting format and no geographical segment analysis is presented as all business activities are conducted in Hong Kong.

#### (ab) Dividends

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

Dividends declared are recognised as liabilities in the Group's accounts in the year the dividends are approved by the shareholders.

## NOTES TO THE ACCOUNTS

### 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group makes estimates and assumptions concerning the future. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

#### (a) Estimated impairment of investments in associates

The Group assesses annually if investments in associates have suffered any impairment in accordance with the accounting policy stated in note 2(m). The recoverable amount of the investment in one of the associates, Computershare Hong Kong Investor Services Limited (“CHIS”) is determined using discounted cash flows calculations. These calculations require the use of estimated dividends and an appropriate discount rate as stated in note 20(a)(ii).

If the discount rate moves above 27 per cent, or annual dividend falls by more than 68 per cent, an impairment loss may be considered necessary.

## NOTES TO THE ACCOUNTS

### 4. 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, capital expenditures and non-cash expenses for the year by business segments is as follows:

	2004					
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Others \$'000	Group \$'000
<b>Income</b>	<b>1,058,306</b>	<b>327,430</b>	<b>698,052</b>	<b>310,149</b>	<b>-</b>	<b>2,393,937</b>
<b>Costs</b>	<b>543,972</b>	<b>145,128</b>	<b>389,288</b>	<b>77,908</b>	<b>-</b>	<b>1,156,296</b>
<b>Segment results</b>	<b>514,334</b>	<b>182,302</b>	<b>308,764</b>	<b>232,241</b>	<b>-</b>	<b>1,237,641</b>
Share of profits less losses of associates	(12)	-	12,896	-	-	12,884
Segment profits before taxation	514,322	182,302	321,660	232,241	-	1,250,525
Taxation						(193,641)
Profit attributable to shareholders						1,056,884
Segment assets	2,131,971	11,402,930	7,802,747	65,707	1,318	21,404,673
Investments in associates	1,309	-	37,422	-	-	38,731
	<u>2,133,280</u>	<u>11,402,930</u>	<u>7,840,169</u>	<u>65,707</u>	<u>1,318</u>	<u>21,443,404</u>
Segment liabilities	<u>580,410</u>	<u>10,571,605</u>	<u>5,949,260</u>	<u>33,617</u>	<u>256,369</u>	<u>17,391,261</u>
Segment capital expenditures	<u>5,445</u>	<u>2,221</u>	<u>14,225</u>	<u>3,028</u>	<u>-</u>	<u>24,919</u>
Segment depreciation and amortisation	<u>90,326</u>	<u>15,594</u>	<u>68,202</u>	<u>9,826</u>	<u>-</u>	<u>183,948</u>
Segment provision for/ (reversal of) impairment loss	<u>156</u>	<u>30</u>	<u>39</u>	<u>(1,000)</u>	<u>-</u>	<u>(775)</u>
Segment other non-cash expenses	<u>6,724</u>	<u>1,383</u>	<u>4,889</u>	<u>792</u>	<u>-</u>	<u>13,788</u>

## NOTES TO THE ACCOUNTS

### 4. SEGMENT INFORMATION (continued)

	2003 (As restated)					
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Others \$'000	Group \$'000
<b>Income</b>	847,074	317,421	589,017	266,313	-	2,019,825
<b>Costs</b>	<u>591,879</u>	<u>175,017</u>	<u>362,585</u>	<u>94,246</u>	<u>-</u>	<u>1,223,727</u>
<b>Segment results</b>	255,195	142,404	226,432	172,067	-	796,098
Share of profits less losses of associates	<u>17</u>	<u>-</u>	<u>8,625</u>	<u>-</u>	<u>-</u>	<u>8,642</u>
Segment profits before taxation	255,212	142,404	235,057	172,067	-	804,740
Taxation						<u>(112,054)</u>
Profit attributable to shareholders						<u>692,686</u>
Segment assets	2,407,960	9,179,742	8,099,835	82,233	1,558	19,771,328
Investments in associates	<u>1,321</u>	<u>-</u>	<u>35,327</u>	<u>-</u>	<u>-</u>	<u>36,648</u>
	<u>2,409,281</u>	<u>9,179,742</u>	<u>8,135,162</u>	<u>82,233</u>	<u>1,558</u>	<u>19,807,976</u>
Segment liabilities	<u>551,468</u>	<u>7,948,646</u>	<u>5,543,371</u>	<u>30,070</u>	<u>120,296</u>	<u>14,193,851</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>90,772</u>	<u>20,993</u>	<u>57,613</u>	<u>12,909</u>	<u>-</u>	<u>182,287</u>
Segment impairment loss	<u>18,322</u>	<u>15,955</u>	<u>223</u>	<u>832</u>	<u>-</u>	<u>35,332</u>
Segment other non-cash expenses	<u>5,748</u>	<u>3,191</u>	<u>3,796</u>	<u>820</u>	<u>-</u>	<u>13,555</u>

## NOTES TO THE ACCOUNTS

### 4. SEGMENT INFORMATION (continued)

The **Cash Market** business mainly 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 (“GEM”). The major sources of income of the business are trading fees, trading tariff and listing fees. Direct costs of the Listing Function are treated as segment costs under the Cash Market. Costs of the Listing Function are further explained in note 6.

The **Derivatives Market** business refers to the derivatives products traded on the Futures Exchange and stock options traded on the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity 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, SEIOCH 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** business is responsible for developing, promoting and compiling historical 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.

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.

Assets and liabilities under the **Others Segment** represent mainly taxation recoverable and payable, deferred tax assets and liabilities and unclaimed dividends.

### 5. TRADING FEES AND TRADING TARIFF

	2004 \$'000	2003 \$'000
Trading fees and trading tariff are derived from:		
Securities traded on the Cash Market	459,524	301,075
Derivatives contracts traded on the Derivatives Market	222,769	184,136
	<u>682,293</u>	<u>485,211</u>

## NOTES TO THE ACCOUNTS

### 6. STOCK EXCHANGE LISTING FEES

Stock Exchange listing fees and costs of listing function comprise the following:

2004					
	Equity			Debt & Derivatives	Total
	Main Board	GEM	Subtotal		
Income	\$'000	\$'000	\$'000	\$'000	\$'000
Annual listing fees	224,875	25,435	250,310	2,048	252,358
Initial and subsequent issue listing fees	43,932	12,654	56,586	62,882	119,468
Prospectus vetting fees	2,690	300	2,990	205	3,195
Other listing fees	2,116	1,290	3,406	-	3,406
Total income	273,613	39,679	313,292	65,135	378,427
<b>Costs of Listing Function</b>					
Staff costs and related expenses	80,806	30,223	111,029	5,464	116,493
Information technology and computer maintenance expenses	2,217	584	2,801	3	2,804
Premises expenses	5,706	2,113	7,819	381	8,200
Legal and professional fees	2,471	1,446	3,917	-	3,917
Depreciation	10,417	3,769	14,186	544	14,730
Payment to SFC under the dual filing regime	16,353	3,647	20,000	-	20,000
Other operating expenses	5,702	1,889	7,591	181	7,772
Total costs	123,672	43,671	167,343	6,573	173,916
<b>Contribution</b>	<b>149,941</b>	<b>(3,992)</b>	<b>145,949</b>	<b>58,562</b>	<b>204,511</b>

## NOTES TO THE ACCOUNTS

### 6. STOCK EXCHANGE LISTING FEES (continued)

2003 (As restated)

	Equity			Debt & Derivatives \$'000	Total \$'000
	Main Board \$'000	GEM \$'000	Subtotal \$'000		
<b>Income</b>					
Annual listing fees	212,387	22,940	235,327	3,124	238,451
Initial and subsequent issue listing fees	32,011	22,514	54,525	34,143	88,668
Prospectus vetting fees	2,095	1,065	3,160	30	3,190
Other listing fees	2,456	1,021	3,477	-	3,477
Total income	248,949	47,540	296,489	37,297	333,786
<b>Costs of Listing Function</b>					
Staff costs and related expenses	61,200	32,284	93,484	5,306	98,790
Information technology and computer maintenance expenses	1,850	616	2,466	11	2,477
Premises expenses	4,560	2,298	6,858	347	7,205
Legal and professional fees	12,393	1,721	14,114	-	14,114
Depreciation	9,432	4,662	14,094	678	14,772
Payment to SFC under the dual filing regime	12,387	2,613	15,000	-	15,000
Other operating expenses	3,634	1,889	5,523	302	5,825
Total costs	105,456	46,083	151,539	6,644	158,183
<b>Contribution</b>	143,493	1,457	144,950	30,653	175,603

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.

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 ("the SFC") under the dual filing regime. Other indirect costs, comprising costs incurred by other divisions on building the reputation of the Stock Exchange (eg 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

## 7. INVESTMENT INCOME

	2004 \$'000	As restated 2003 \$'000
Interest income (note a)		
- bank deposits	26,481	57,638
- listed trading and non-trading securities	-	40,187
- unlisted trading and non-trading securities	-	105,612
- listed available-for-sale financial assets	4,401	-
- unlisted available-for-sale financial assets	52,292	-
	<u>83,174</u>	<u>203,437</u>
Interest expenses	<u>(1,309)</u>	<u>(2,153)</u>
Net interest income	<u>81,865</u>	<u>201,284</u>
Net realised and unrealised gains on investments (note b)		
- listed trading and non-trading securities	-	43,000
- unlisted trading and non-trading securities	-	6,387
- exchange difference	-	28,167
	<u>-</u>	<u>77,554</u>
Net realised and unrealised gains and interest income on financial assets at fair value through profit or loss		
- bank deposits with embedded derivatives	3,529	-
- listed securities	76,834	-
- unlisted securities	33,465	-
- exchange difference	530	-
	<u>114,358</u>	<u>-</u>
Gains/(losses) on disposal and maturity of available-for-sale financial assets		
- listed securities (note c)	24,841	-
- unlisted securities	101	-
- exchange difference	(192)	-
	<u>24,750</u>	<u>-</u>
Dividend income		
- listed non-trading securities	-	14,096
- listed trading securities	-	4,018
- listed available-for-sale financial assets	1,070	-
- listed financial assets at fair value through profit or loss	6,378	-
	<u>7,448</u>	<u>18,114</u>
Other exchange difference	<u>166</u>	<u>-</u>
Total investment income	<u>228,587</u>	<u>296,952</u>
Total investment income is derived from:		
Corporate Funds (note d)	148,781	214,869
Margin Funds	69,313	64,377
Clearing House Funds	10,493	17,706
	<u>228,587</u>	<u>296,952</u>

- (a) Following the adoption of HKAS 32 and HKAS 39 in 2004, investments previously classified as trading securities, and deposits and non-trading securities with embedded derivatives that are not closely related to the host deposits or non-trading securities have been redesignated as financial assets at fair value through profit or loss. Accordingly, interest from such investments amounting to \$73,332,000 is no longer disclosed as interest income but included as net realised and unrealised gains and interest income in that year. As a result, interest income shown in 2004 is not directly comparable with that in 2003.
- (b) Included net realised gains on disposal of non-trading securities of Margin Funds and Clearing House Funds in 2003 of \$6,852,000, of which \$3,763,000 had been previously recognised in investment revaluation reserve. There is no such item in 2004 as all such securities have been redesignated as available-for-sale financial assets.
- (c) Relates to profit on sale of investment in Singapore Exchange Limited in July 2004.
- (d) Investment income derived from Corporate Funds includes investment income of Compensation Fund Reserve Account of \$576,000 (2003: \$714,000) and CDMD Fund of \$20,000 (2003: \$56,000).



## NOTES TO THE ACCOUNTS

### 8. OTHER INCOME

	2004 \$'000	As restated 2003 \$'000
Network, terminal user, dataline and software sub-license fees	120,261	101,491
Participants' subscription and application fees	34,341	36,227
Share registration services fees	1,828	1,600
Brokerage on direct IPO applications	17,586	11,618
Fair value gain of an investment property	3,300	-
Accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the Margin Funds	5,133	14,355
Miscellaneous income	6,552	7,713
	<u>189,001</u>	<u>173,004</u>

### 9. OTHER OPERATING EXPENSES

	2004 \$'000	As restated 2003 \$'000
Write-down of strategic investments (note a)	-	32,683
Retirement of redundant IT systems	165	10,133
(Reversal of provision for)/provision for impairment losses of trade receivables	(850)	1,789
Insurance	16,401	11,780
Financial data subscription fees	7,414	8,978
Custodian and fund management fees	7,772	8,445
Bank charges	7,889	7,135
Repair and maintenance expenses	6,984	7,373
Other miscellaneous expenses	38,664	42,335
	<u>84,439</u>	<u>130,651</u>

- (a) Write-down of strategic investments for 2003 included a 100 per cent write-down (\$32,303,000) of the Group's investment in BondsInAsia Limited following a review of the Group's business strategy and operations.

## NOTES TO THE ACCOUNTS

### 10. PROFIT BEFORE TAXATION

	<b>2004</b>	As restated
	<b>\$'000</b>	2003
		\$'000
Profit before taxation is stated after crediting/(charging):		
Amortisation of lease premium for land	<b>(548)</b>	(548)
Auditors' remuneration		
- audit fees	<b>(1,862)</b>	(1,620)
- secondment fee	<b>(1,800)</b>	(600)
- non-audit fees	<b>(1,403)</b>	(773)
Interest on bank loans and overdrafts repayable within five years	<b>(95)</b>	(827)
Operating lease rentals		
- land and buildings	<b>(43,797)</b>	(48,485)
- computer systems and equipment	<b>(9,292)</b>	(39,323)
Rental income from investment property	<b>465</b>	459
Direct operating expenses of the investment property that generates rental income	<b>(165)</b>	(164)
Depreciation	<b>(183,400)</b>	(181,739)
Impairment loss of investments in associates	<b>-</b>	(380)
Impairment loss of club debenture	<b>(75)</b>	(860)
(Loss)/gain on disposal or write-off of fixed assets		
- retirement of redundant IT systems	<b>(165)</b>	(10,133)
- others	<b>141</b>	(1,414)
Exchange differences		
- trading and non-trading securities	<b>-</b>	28,167
- financial assets (excluding those at fair value through profit or loss)	<b>(26)</b>	-
- Others	<b>(185)</b>	-

## NOTES TO THE ACCOUNTS

### 11. DIRECTORS' EMOLUMENTS

All Directors, including one Executive Director, received emoluments during the year (2003: 15 of the 20 Directors, including two Executive Directors, received emoluments). The aggregate emoluments paid and payable to the Directors during the year were as follows:

	<b>2004</b>	As restated 2003
	<b>\$'000</b>	<b>\$'000</b>
Executive Directors:		
Salaries, other allowances and benefits in kind	7,275	8,725
Employee share option benefits (note a)	2,204	1,464
Employer's contribution to provident fund	900	855
Performance bonus	900	200
	<u>11,279</u>	<u>11,244</u>
Non-executive Directors:		
Fees	<u>1,200</u>	<u>841</u>
	<u><b>12,479</b></u>	<u><b>12,085</b></u>

- (a) Employee share option benefits represent fair value at grant date of share options issued under the Post-Listing Scheme amortised to the profit and loss account during the year disregarding whether the options have been vested/exercised or not.
- (b) The emoluments, including employee share option benefits for options issued under the Post-Listing Scheme, of the Directors were within the following bands:

	<b>2004</b>	As restated 2003
	<b>Number of Directors</b>	<b>Number of Directors</b>
\$1 – \$500,000	12	13
\$4,000,001 – \$4,500,000	-	1
\$7,000,001 – \$7,500,000	-	1
\$11,000,001 – \$11,500,000	1	-
	<u>13</u>	<u>-</u>
	<u><b>13</b></u>	<u><b>15</b></u>

## NOTES TO THE ACCOUNTS

### 11. DIRECTORS' EMOLUMENTS (continued)

The emoluments including employee share option benefits of every Director, including the Chief Executive who is an ex-officio member for the years ended 31 December 2004 and 2003, are set out below:

Name of Director	2004							As restated 2003
	Fees \$	Salary \$	Performance bonus \$	Employee share option benefits \$	Other benefits \$ (note 1)	Employer's contribution to provident fund \$ (note 2)	Total \$	Total \$
Charles Y K Lee	100,000	-	-	-	-	-	100,000	74,148
John C C Chan (note 3)	-	-	-	-	-	-	-	-
Paul M Y Chow (note 4)	-	7,200,000	900,000	2,204,345	74,425	900,000	11,278,770	7,107,365
Paul C H Fan (note 3)	-	-	-	-	-	-	-	-
Henry H L Fan (note 5)	100,000	-	-	-	-	-	100,000	13,352
Fong Hup	100,000	-	-	-	-	-	100,000	74,148
Tim Freshwater	100,000	-	-	-	-	-	100,000	74,148
Bill C P Kwok	100,000	-	-	-	-	-	100,000	74,148
K C Kwong (note 3)	-	-	-	-	-	-	-	4,136,734
Dannis J H Lee	100,000	-	-	-	-	-	100,000	74,148
Vincent K H Lee	100,000	-	-	-	-	-	100,000	74,148
Leong Ka Chai	100,000	-	-	-	-	-	100,000	74,148
Liu Jinbao (note 6)	-	-	-	-	-	-	-	11,932
John G C Seto (note 3)	-	-	-	-	-	-	-	-
Lo Ka Shui	100,000	-	-	-	-	-	100,000	74,148
John E Strickland	100,000	-	-	-	-	-	100,000	74,148
Rodney G Ward (note 3)	-	-	-	-	-	-	-	-
David M Webb	100,000	-	-	-	-	-	100,000	74,148
Oscar S H Wong	100,000	-	-	-	-	-	100,000	74,148
Yue Wai Keung (note 3)	-	-	-	-	-	-	-	-

#### 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 two years of service. The rate of vested benefit increases at an annual increment of 18% thereafter reaching 100% after completion of seven 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.

## NOTES TO THE ACCOUNTS

### 12. FIVE TOP-PAID EMPLOYEES

One (2003: two) of the five top-paid employees is a Director, whose emoluments are disclosed in note 11. Details of the emoluments of the other four (2003: three) top-paid employees are as follows:

	<b>2004</b> <b>\$'000</b> <b>(four</b> <b>employees)</b>	<b>2003</b> <b>\$'000</b> <b>(three</b> <b>employees)</b>
Salaries, other allowances and benefits in kind (note a)	<b>17,287</b>	12,321
Employee share option benefits (note b)	<b>5,375</b>	-
Performance bonus	<b>2,470</b>	293
Retirement benefit costs	<b>2,135</b>	1,365
Compensation for loss of office	<b>-</b>	1,575
	<b><u>27,267</u></b>	<b><u>15,554</u></b>

- (a) The emoluments disclosed above exclude individual income tax paid or incurred by an employee of \$410,000 (2003: \$91,000) in respect of his services as the Chief Representative of the Group's representative office in the Mainland.
- (b) Employee share option benefits represent fair value at grant date of share options issued under the Post-Listing Scheme amortised to the profit and loss account during the year disregarding whether the options have been vested/exercised or not.
- (c) The emoluments of these four (2003: three) employees, including employee share option benefits for options issued under the Post-Listing Scheme, are within the following bands:

	<b>2004</b> <b>Number of</b> <b>employees</b>	<b>2003</b> <b>Number of</b> <b>Employees</b>
\$4,000,001 – \$4,500,000	-	1
\$5,500,001 – \$6,000,000	<b>1</b>	2
\$6,000,001 – \$6,500,000	<b>2</b>	-
\$9,000,001 – \$9,500,000	<b>1</b>	-
	<b><u>4</u></b>	<b><u>3</u></b>

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.

## NOTES TO THE ACCOUNTS

### 13. STAFF COSTS AND RELATED EXPENSES

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

	2004 \$'000	As restated 2003 \$'000
Salaries, other allowances and benefits	477,022	463,697
Employee share option benefits	14,290	2,771
Unutilised annual leave	2,330	4,275
Termination benefits	4,418	12,040
Employer's contribution to provident funds	47,594	45,561
	<u>545,654</u>	<u>528,344</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 are not offset by contributions forfeited in respect of employees who left the ORSO Plan before the contributions were fully vested. Instead, forfeited contributions are credited to a reserve account of the ORSO Plan for the benefit of its members.

	2004 \$'000	2003 \$'000
Forfeited contributions during the year and retained in the ORSO Plan	<u>5,847</u>	<u>8,799</u>

### 14. INFORMATION TECHNOLOGY AND COMPUTER MAINTENANCE EXPENSES

	2004 \$'000	2003 \$'000
Costs of services and goods:		
- consumed by the Group	161,142	195,434
- directly consumed by Participants	60,482	51,214
	<u>221,624</u>	<u>246,648</u>

## NOTES TO THE ACCOUNTS

### 15. TAXATION

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

	2004 \$'000	As restated 2003 \$'000
Provision for Hong Kong Profits Tax for the year (note i)	219,086	125,503
(Over)/under provision in respect of prior years	(79)	1,170
	<u>219,007</u>	<u>126,673</u>
Deferred taxation (note 37 and note ii)	(25,366)	(14,619)
Taxation charge	<u>193,641</u>	<u>112,054</u>

- (i) Hong Kong Profits Tax has been provided for at 17.5 per cent (2003: 17.5 per cent) on the estimated assessable profit for the year.
- (ii) Deferred taxation for 2003 included a one-off deferred tax charge of \$6,184,000, which arose from recomputing outstanding deferred tax liabilities carried forward from 2002 using the higher tax rate of 17.5 per cent and the adoption of Statement of Standard Accounting Practice ("SSAP") 12: Income Taxes in 2003.
- (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 (2003: 17.5 per cent) as follows:

	2004 \$'000	As restated 2003 \$'000
Profit before taxation (excluding share of profit less losses of associates)	1,237,641	796,098
Calculated at a taxation rate of 17.5 per cent (2003: 17.5 per cent)	216,587	139,317
Income not subject to taxation	(32,906)	(41,192)
Expenses not deductible for taxation purposes	6,485	11,349
Change in deferred tax arising from unrecognised tax losses	3,411	(4,974)
Adjustment of deferred tax	143	200
(Over)/under provision in respect of prior years	(79)	1,170
Increase in opening net deferred tax liabilities resulting from an increase in tax rate	-	6,184
Taxation charge	<u>193,641</u>	<u>112,054</u>

### 16. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$1,056,884,000 (2003: \$692,686,000) and the weighted average of 1,054,985,321 shares (2003: 1,046,494,819) in issue during the year.

The employee share options outstanding as set out in note 33 do not have a material dilutive effect on the basic earnings per share.

## NOTES TO THE ACCOUNTS

### 17. FIXED ASSETS

#### (a) Group

	Leasehold buildings \$'000	Computer trading and clearing systems \$'000	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Net book value at 1 Jan 2003					
- as previously reported (note ii)	117,000	444,232	105,304	71,572	738,108
- effect of adopting HKAS 17	(98,500)	-	-	-	(98,500)
- as restated (note i)	18,500	444,232	105,304	71,572	639,608
Additions	-	13,431	16,775	6,041	36,247
Disposals	-	(3,474)	(6,659)	(1,604)	(11,737)
Depreciation	(748)	(109,510)	(39,703)	(31,778)	(181,739)
Revaluation (note 34)	548	-	-	-	548
Net book value at 31 Dec 2003	18,300	344,679	75,717	44,231	482,927
At 31 Dec 2003					
At cost	-	1,345,403	347,385	231,519	1,924,307
At valuation	18,300	-	-	-	18,300
Accumulated depreciation	-	(1,000,724)	(271,668)	(187,288)	(1,459,680)
Net book value	18,300	344,679	75,717	44,231	482,927
Net book value at 1 Jan 2004					
- as previously reported (note ii)	111,000	344,679	75,717	44,231	575,627
- effect of adopting HKAS 17	(92,700)	-	-	-	(92,700)
- as restated	18,300	344,679	75,717	44,231	482,927
Additions	-	12,739	10,275	1,905	24,919
Disposals	-	(159)	(9)	(14)	(182)
Depreciation	(736)	(116,882)	(38,487)	(27,295)	(183,400)
Revaluation (note 34)	36	-	-	-	36
Net book value at 31 Dec 2004	17,600	240,377	47,496	18,827	324,300
At 31 Dec 2004					
At cost	-	1,223,047	352,106	229,674	1,804,827
At valuation	17,600	-	-	-	17,600
Accumulated depreciation	-	(982,670)	(304,610)	(210,847)	(1,498,127)
Net book value	17,600	240,377	47,496	18,827	324,300

(i) The analysis of net book value as at 1 January 2003 was as follows:

At cost	-	1,462,366	380,773	239,201	2,082,340
At valuation	18,500	-	-	-	18,500
Accumulated depreciation	-	(1,018,134)	(275,469)	(167,629)	(1,461,232)
Net book value	18,500	444,232	105,304	71,572	639,608

(ii) Amount of leasehold buildings included the land element of the leasehold properties, which is now disclosed as "Lease premium for land" (note 19).



## NOTES TO THE ACCOUNTS

### 17. FIXED ASSETS (continued)

#### (a) Group (continued)

- (iii) Leasehold buildings were revalued as at 31 December 2004 on the basis of their depreciated replacement costs calculated by Jones Lang LaSalle, an independent firm of qualified property valuers. A revaluation gain of \$36,000 was credited to leasehold building revaluation reserve during 2004 (2003: \$548,000) (note 34).
- (iv) The cost of leasehold buildings of the Group was \$26,900,000 (2003: \$26,900,000). The carrying value of these leasehold buildings as at 31 December 2004 would have been \$13,153,000 (2003: \$14,229,000) 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
Net book value at 1 Jan 2003 (note i)	36,252	7,346	43,598
Additions	8,935	4,346	13,281
Disposals	(6,316)	(8)	(6,324)
Depreciation	(9,259)	(4,438)	(13,697)
Net book value at 31 Dec 2003	<u>29,612</u>	<u>7,246</u>	<u>36,858</u>
At 31 Dec 2003			
Cost	43,278	16,226	59,504
Accumulated depreciation	<u>(13,666)</u>	<u>(8,980)</u>	<u>(22,646)</u>
Net book value	<u>29,612</u>	<u>7,246</u>	<u>36,858</u>
Net book value at 1 Jan 2004	29,612	7,246	36,858
Additions	5,178	343	5,521
Depreciation	<u>(12,728)</u>	<u>(4,487)</u>	<u>(17,215)</u>
Net book value at 31 Dec 2004	<u>22,062</u>	<u>3,102</u>	<u>25,164</u>
At 31 Dec 2004			
Cost	46,695	16,565	63,260
Accumulated depreciation	<u>(24,633)</u>	<u>(13,463)</u>	<u>(38,096)</u>
Net book value	<u>22,062</u>	<u>3,102</u>	<u>25,164</u>
(i) The analysis of net book value as at 1 January 2003 was as follows:			
At cost	44,229	11,893	56,122
Accumulated depreciation	<u>(7,977)</u>	<u>(4,547)</u>	<u>(12,524)</u>
Net book value	<u>36,252</u>	<u>7,346</u>	<u>43,598</u>

## NOTES TO THE ACCOUNTS

### 18. INVESTMENT PROPERTY

	<b>2004</b>	<b>Group</b>
	<b>\$'000</b>	<b>2003</b>
		<b>\$'000</b>
At 1 Jan	<b>10,000</b>	10,000
Fair value gain	<b>3,300</b>	-
	<hr/>	<hr/>
At 31 Dec	<b>13,300</b>	10,000
	<hr/> <hr/>	<hr/> <hr/>

The investment property is held under long-term lease and situated in Hong Kong. The cost of investment property was \$8,229,000 (2003: \$8,229,000). The investment property was revalued as at 31 December 2004 on the basis of its open market value by Jones Lang LaSalle, an independent firm of qualified property valuers. The fair value gain during the year amounted to \$3,300,000 (2003: Nil) and was credited to the profit and loss account under other income (note 8).

### 19. LEASE PREMIUM FOR LAND

	<b>2004</b>	<b>Group</b>
	<b>\$'000</b>	<b>As restated</b>
		<b>2003</b>
		<b>\$'000</b>
Net book value at 1 Jan		
- as previously reported	-	-
- effect of adopting HKAS 17	<b>95,766</b>	96,314
	<hr/>	<hr/>
- as restated	<b>95,766</b>	96,314
Amortisation	<b>(548)</b>	(548)
	<hr/>	<hr/>
Net book value at 31 Dec	<b>95,218</b>	95,766
Current portion of non-current assets	<b>(548)</b>	(548)
	<hr/>	<hr/>
Non-current portion	<b>94,670</b>	95,218
	<hr/> <hr/>	<hr/> <hr/>

The leasehold land is held under long-term lease and situated in Hong Kong.

## NOTES TO THE ACCOUNTS

### 20. INVESTMENTS IN ASSOCIATES

	<b>Group</b>	
	<b>2004</b>	As restated
	<b>\$'000</b>	2003
		<b>\$'000</b>
Share of net assets of associates	<b>13,790</b>	11,707
Goodwill (note a)	<b>24,941</b>	24,941
	<b>38,731</b>	36,648
<b>(a) Goodwill</b>		
	<b>2004</b>	As restated
	<b>\$'000</b>	2003
		<b>\$'000</b>
Net book amount at 1 Jan (note i)		
- as previously reported	<b>22,295</b>	25,321
- effect of adopting HKFRS 3, HKAS 36 and HKAS 38	<b>2,646</b>	-
	<b>24,941</b>	25,321
- as restated	-	(380)
Impairment loss (note ii)		
	<b>24,941</b>	24,941
Net book amount at 31 Dec		
Represented by:		
Opening value upon adoption of HKFRS 3	<b>25,321</b>	25,321
Accumulated impairment	<b>(380)</b>	(380)
	<b>24,941</b>	24,941

(i) Goodwill as at 1 January 2003 represented opening value upon adoption of HKFRS 3 of \$25,321,000.

(ii) Impairment tests for investments in associates

The recoverable amount of the investment in CHIS is determined using discounted cash flows calculations which represents the present value of estimated future cash flows expected to arise from dividends to be received from CHIS and its ultimate disposal. The discount rate used is the ten-year Hong Kong Government bond rate as at 31 December 2004 of 3.55% (2003: 4.39%).

The recoverable amount of the investment in ADP Wilco Processing Services Limited ("AWPS") is based on the share of the net assets of the associate, which comprise predominantly cash and bank balances.

During the year ended 31 December 2003, an impairment loss of \$380,000 arose for the goodwill of AWPS (included in Cash Market segment) as the associate did not generate any income.

## NOTES TO THE ACCOUNTS

### 20. INVESTMENTS IN ASSOCIATES (continued)

(b) Details of the unlisted associates as at 31 December 2004 were 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	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

AWPS has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end. The company is currently undergoing voluntary liquidation.

(c) The summarised financial information based on the unaudited management accounts of the associates is as follows:

	<b>2004</b> <b>\$'000</b>	2003 \$'000
Assets	<b>82,540</b>	65,269
Liabilities	<b>26,172</b>	17,595
Income	<b>209,953</b>	118,979
Profit	<b>53,708</b>	35,999

## NOTES TO THE ACCOUNTS

### 21. CLEARING HOUSE FUNDS

	Group	
	2004 \$'000	2003 \$'000
Net assets of the Clearing House Funds are as follows:		
HKSCC Guarantee Fund	339,598	371,289
SECH Reserve Fund	160,119	131,274
HKCC Reserve Fund	1,361,770	1,048,767
	<u>1,861,487</u>	<u>1,551,330</u>
Net assets of the Clearing House Funds are composed of:		
Non-trading securities, at fair value		
- unlisted debt securities	-	125,643
Available-for-sale financial assets, at fair value		
- unlisted debt securities	127,569	-
Time deposits with original maturity over three months	144,610	140,000
Cash and cash equivalents	1,604,089	1,209,644
Contributions receivable from Clearing Participants fully secured by bank guarantees (note a)	-	92,234
	<u>1,876,268</u>	<u>1,567,521</u>
Less: Other liabilities	<u>(14,781)</u>	<u>(16,191)</u>
	<u>1,861,487</u>	<u>1,551,330</u>
The Clearing House Funds are funded by:		
Clearing Participants' contributions (note b):		
- cash	1,298,752	891,811
- bank guarantees	-	92,234
Designated reserves (note 35):		
- Clearing houses' contributions	320,200	320,200
- Forfeiture of defaulted Clearing Participants' contributions	1,928	1,928
- Accumulated investment income net of expenses attributable to:		
- Clearing Participants' contributions	182,839	183,305
- Clearing houses' contributions	55,659	60,233
	<u>560,626</u>	<u>565,666</u>
Revaluation reserve (note 34(b))	<u>2,109</u>	<u>1,619</u>
	<u>1,861,487</u>	<u>1,551,330</u>

(a) In accordance with HKAS 39, non-cash collateral is no longer recognised on balance sheet. As a result, contributions receivable from Clearing Participants fully secured by bank guarantees of \$322,724,000 and the corresponding Clearing Participants' contributions by bank guarantees have been derecognised in 2004.

(b) Amount includes Participants' additional deposits of \$961,502,000 (2003: \$641,045,000).

## NOTES TO THE ACCOUNTS

### 21. CLEARING HOUSE FUNDS (continued)

- (c) The maturity profile of the net assets of the Clearing House Funds is as follows:

	2004 \$'000	2003 \$'000
Amounts maturing/to be settled after more than twelve months	157,858	265,643
Amounts maturing/to be settled within twelve months	<u>1,703,629</u>	<u>1,285,687</u>
	<u><u>1,861,487</u></u>	<u><u>1,551,330</u></u>

- (d) 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 \$5,797,000 (2003: \$2,262,000) arose. In prior years, the loss was not appropriated to the fund but included in the Group's retained earnings. Following the clarification of the clearing house rule by the SFC in December 2004, the accumulated losses of \$8,059,000 were appropriated to the fund.

## NOTES TO THE ACCOUNTS

### 22. COMPENSATION FUND RESERVE ACCOUNT

	<b>Group</b>	
	<b>2004</b>	2003
	<b>\$'000</b>	\$'000
Net assets of the Compensation Fund Reserve Account are composed of:		
Non-trading securities, at fair value		
- unlisted debt securities	-	18,318
Available-for-sale financial assets, at fair value		
- unlisted debt securities	<b>18,831</b>	-
Cash and cash equivalents	<b>29,137</b>	26,819
Other receivable	<b>100</b>	250
	<b>48,068</b>	45,387
Less: Other liabilities	<b>(10,617)</b>	(8,528)
	<b>37,451</b>	36,859
The Fund represents:		
Accumulated investment income net of expenses included in designated reserves (note 35)	<b>37,117</b>	36,541
Revaluation reserve (note 34(b))	<b>334</b>	318
	<b>37,451</b>	36,859

(a) The maturity profile of the net assets of the Compensation Fund Reserve Account is as follows:

	<b>2004</b>	2003
	<b>\$'000</b>	\$'000
Amounts maturing/to be settled after more than twelve months	<b>18,831</b>	18,318
Amounts maturing/to be settled within twelve months	<b>18,620</b>	18,541
	<b>37,451</b>	36,859

(b) The 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:

- (i) 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;
- (ii) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (iii) Amounts reserved for the replenishment to the Compensation Fund.

The Compensation Fund is further explained in note 41(a)(i).

## NOTES TO THE ACCOUNTS

### 23. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND

	<b>Group</b>	
	<b>2004</b>	2003
	<b>\$'000</b>	<b>\$'000</b>
Net assets of HKCC's CDMD Fund	<u>-</u>	<u>925</u>
The Fund is composed of:		
Non-trading securities, at fair value		
- unlisted debt securities	<u>-</u>	<u>925</u>
	<u>-</u>	<u>925</u>
The Fund represents:		
Accumulated investment income net of expenses		
appropriated from retained earnings	<u>-</u>	<u>914</u>
Revaluation reserve (note 34(b))	<u>-</u>	<u>11</u>
	<u>-</u>	<u>925</u>

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. The Fund was fully utilised in 2004.

### 24. NON-TRADING SECURITIES

	<b>Group</b>	
	<b>2004</b>	2003
	<b>\$'000</b>	<b>\$'000</b>
Analysis of non-trading securities:		
Non-current	<u>-</u>	<u>77,258</u>
	<u>-</u>	<u>77,258</u>
Non-trading securities, at fair value:		
Equity securities		
- listed outside Hong Kong	<u>-</u>	<u>77,258</u>
	<u>-</u>	<u>77,258</u>

Non-trading securities represented the Group's investment in Singapore Exchange Limited, which was designated as an available-for-sale financial asset on 1 January 2004 and disposed of during 2004.



## NOTES TO THE ACCOUNTS

### 25. MARGIN FUNDS ON DERIVATIVES CONTRACTS

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>\$'000</b>	<b>\$'000</b>
The Margin Funds comprise:		
SEOCH Clearing Participants' Margin Funds	<b>915,250</b>	1,083,679
HKCC Clearing Participants' Margin Funds	<b>9,614,442</b>	6,790,831
	<b><u>10,529,692</u></b>	<b><u>7,874,510</u></b>

The assets of the Margin Funds comprise:

Non-trading securities, at fair value		
- listed debt securities	-	102,780
- unlisted debt securities	-	2,066,289
Listed securities deposited as alternatives to cash deposits, at market value (note a)	-	805,430
Financial assets at fair value through profit or loss, on designation		
- bank deposits with embedded derivatives	<b>130,871</b>	-
Available-for-sale financial assets, at fair value		
- listed debt securities	<b>339,158</b>	-
- unlisted debt securities	<b>3,280,786</b>	-
Time deposits with original maturity over three months	<b>300,784</b>	210,000
Cash and cash equivalents	<b>6,443,406</b>	4,690,011
Margin receivable from Clearing Participants	<b>34,687</b>	-
	<b><u>10,529,692</u></b>	<b><u>7,874,510</u></b>

The Group's liabilities in respect of the Margin Funds are as follows:

Margin deposits and securities received from SEOCH and HKCC Participants on derivatives contracts	<b><u>10,529,692</u></b>	<b><u>7,874,510</u></b>
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(a) Following the adoption of HKAS 39 in 2004, non-cash collateral deposited by Participants is no longer recognised on the balance sheet. As a result, listed securities deposited as alternatives to cash deposits of \$1,114,605,000 are not included in the balance sheet in 2004.

(b) The maturity profile of the assets of Margin Funds is as follows:

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>\$'000</b>	<b>\$'000</b>
Amounts maturing/to be settled after more than twelve months	<b>2,138,362</b>	1,675,233
Amounts maturing/to be settled within twelve months	<b>8,391,330</b>	6,199,277
	<b><u>10,529,692</u></b>	<b><u>7,874,510</u></b>

## NOTES TO THE ACCOUNTS

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

#### (a) Accounts receivable, prepayments and deposits

	Group		HKEx	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Receivable from Exchange and Clearing Participants:				
- CNS money obligations	4,261,202	4,059,677	-	-
- transaction levy, stamp duty and fees receivable	215,479	215,907	-	-
- others	13,103	20,842	-	-
Other fees receivable	158,282	217,359	-	-
Interest and dividend receivable	142	62,309	-	-
Other receivables, prepayments and deposits	43,638	68,586	20,638	18,995
	<u>4,691,846</u>	<u>4,644,680</u>	<u>20,638</u>	<u>18,995</u>

The carrying amounts of accounts receivable and deposits approximate their fair value.

#### (b) Accounts payable, accruals and other liabilities

	Group		HKEx	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Payable to Exchange and Clearing Participants:				
- CNS money obligations	4,261,382	4,027,540	-	-
- cash collateral and marks arising from stock option activities	95,677	191,252	-	-
- others	-	32,287	-	-
	54,368	80,171	-	-
Transaction levy payable to the SFC	63,736	50,369	-	-
Unclaimed dividends (note c)	143,177	120,853	25,815	9,411
Stamp duty payable	70,854	118,862	-	-
Deposits received	29,376	22,188	-	-
Other payables and accruals	183,780	136,382	84,786	52,315
	<u>4,902,350</u>	<u>4,779,904</u>	<u>110,601</u>	<u>61,726</u>

The carrying amounts of accounts payable and other liabilities approximate their fair value.

- (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 91 per cent (2003: 87 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 87 per cent (2003: 84 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

### 27. FINANCIAL ASSETS/(LIABILITIES) AT FAIR VALUE THROUGH PROFIT OR LOSS

	Group	
	2004 \$'000	2003 \$'000
<b>Analysis of financial assets at fair value through profit or loss:</b>		
<u>Held for trading</u>		
Equity securities, at fair value		
- listed in Hong Kong	93,154	-
- listed outside Hong Kong	151,954	-
	<u>245,108</u>	<u>-</u>
Debt securities, at fair value		
- listed outside Hong Kong	1,278,858	-
- unlisted	1,200,195	-
	<u>2,479,053</u>	<u>-</u>
Derivative financial instruments, at fair value		
- forward foreign exchange contracts	247	-
<u>Designated as financial assets at fair value through profit or loss</u>		
- bank deposits with embedded derivatives, at fair value	37,185	-
	<u>2,761,593</u>	<u>-</u>
<b>Analysis of financial liabilities at fair value through profit or loss:</b>		
<u>Held for trading</u>		
Derivative financial instruments, at fair value		
- forward foreign exchange contracts	10,749	-

Following the adoption of HKAS 39 in 2004, certain financial assets and liabilities were redesignated as financial assets/(liabilities) through profit or loss on 1 January 2004. There was no such redesignation in 2003 as retrospective application of HKAS 39 is not permitted.

## NOTES TO THE ACCOUNTS

### 28. TRADING SECURITIES

	<b>Group</b>	
	<b>2004</b>	2003
	<b>\$'000</b>	<b>\$'000</b>
Equity securities, at fair value		
- listed in Hong Kong	-	133,745
- listed outside Hong Kong	-	147,019
	<u>-</u>	<u>280,764</u>
Debt securities, at fair value		
- listed in Hong Kong	-	96,906
- listed outside Hong Kong	-	1,016,580
	<u>-</u>	<u>1,113,486</u>
Unlisted debt securities, at fair value	<u>-</u>	<u>1,818,748</u>
	<u>-</u>	<u>3,212,998</u>

In accordance with HKAS 39, all trading securities were redesignated as financial assets at fair value through profit or loss on 1 January 2004.

### 29. 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

### 30. PROVISIONS

#### (a) Group

	<b>Reinstatement costs \$'000</b>	<b>Employee benefit costs \$'000</b>	<b>Total \$'000</b>
At 1 Jan 2004	24,578	23,525	48,103
Provision for the year	20	32,969	32,989
Amount used during the year	-	(30,478)	(30,478)
Unused amount reversed during the year	(281)	-	(281)
Amount paid during the year	(213)	(2,804)	(3,017)
At 31 Dec 2004	<u>24,104</u>	<u>23,212</u>	<u>47,316</u>
		<b>2004 \$'000</b>	<b>2003 \$'000</b>
Analysis of provisions:			
Current		<b>23,212</b>	25,011
Non-current		<b>24,104</b>	<u>23,092</u>
		<b>47,316</b>	<u>48,103</u>

#### (b) HKEx

	<b>Reinstatement costs \$'000</b>	<b>Employee benefit costs \$'000</b>	<b>Total \$'000</b>
At 1 Jan 2004	535	23,525	24,060
Provision for the year	20	32,969	32,989
Amount used during the year	-	(30,478)	(30,478)
Amount paid during the year	-	(2,804)	(2,804)
At 31 Dec 2004	<u>555</u>	<u>23,212</u>	<u>23,767</u>
		<b>2004 \$'000</b>	<b>2003 \$'000</b>
Analysis of provisions:			
Current		<b>23,212</b>	23,825
Non-current		<b>555</b>	<u>235</u>
		<b>23,767</b>	<u>24,060</u>

## NOTES TO THE ACCOUNTS

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

#### (a) Investments in subsidiaries

	HKEx	
	2004 \$'000	2003 \$'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 2004, 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
<b>Direct subsidiaries:</b>			
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

### 31. 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
<b>Direct subsidiaries: (continued)</b>			
HKEx (Singapore) Limited	Ordinary \$2	Investment holding	100%
HKEx (China) Limited	Ordinary \$2	Promotes HKEx products and services in the Mainland	100%
<b>Indirect subsidiaries:</b>			
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

### 32. SHARE CAPITAL AND SHARE PREMIUM

		2004 \$'000	2003 \$'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 2003	1,043,580,846	1,043,581	19,012
Shares issued under employee share option scheme	<u>5,418,000</u>	<u>5,418</u>	<u>35,326</u>
At 31 Dec 2003	1,048,998,846	1,048,999	54,338
Shares issued under employee share option scheme	<u>7,640,000</u>	<u>7,640</u>	<u>49,696</u>
At 31 Dec 2004	<u>1,056,638,846</u>	<u>1,056,639</u>	<u>104,034</u>

During the year, Pre-Listing employee share options were exercised to subscribe for 7,640,000 shares (2003: 5,418,000) in HKEx at a consideration of \$7.52 per share on or before 31 March 2004 and \$6.88 per share after 31 March 2004, of which \$1.00 per share was credited to share capital and the balance was credited to the share premium account.

### 33. EMPLOYEE SHARE-BASED COMPENSATION RESERVE

	2004 \$'000	As restated 2003 \$'000
<b>Employee share-based compensation reserve</b>		
At 1 Jan, as previously reported	-	-
Effect of adopting HKFRS 2	<u>2,771</u>	-
At 1 Jan, as restated	2,771	-
Employee share option benefits	<u>14,290</u>	<u>2,771</u>
At 31 Dec	<u>17,061</u>	<u>2,771</u>

- (a) Share options are granted to the Chief Executive and employees of the Group to subscribe for shares in HKEx in accordance with the terms and conditions of the Share Option Schemes approved by the shareholders of HKEx at an extraordinary general meeting held on 31 May 2000.

Under the Pre-Listing 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. Following the declaration of a special dividend and final dividend for 2003, at the annual general meeting ("AGM") held on 31 March 2004, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the outstanding options granted under the Pre-Listing Scheme. The subscription price of the shares issuable under the options granted was adjusted from \$7.52 per share to \$6.88 per share and the aggregate contract size of the options granted but not yet exercised as at 31 March 2004 was adjusted from 6,615,465 shares to 7,288,668 shares.



## NOTES TO THE ACCOUNTS

### 33. EMPLOYEE SHARE-BASED COMPENSATION RESERVE (continued)

- (a) Under the Post-Listing Scheme of HKEx, share options were granted to:
- (i) 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;
  - (ii) 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;
  - (iii) an employee on 18 August 2003 which are exercisable between 18 August 2005 and 17 August 2013 at an exercise price of \$13.65 per share;
  - (iv) an employee on 15 January 2004 which are exercisable between 15 January 2006 and 14 January 2014 at an exercise price of \$18.90 per share;
  - (v) a number of employees on 31 March 2004 which are exercisable between 31 March 2006 and 30 March 2014 at an exercise price of \$16.96 per share; and
  - (vi) an employee on 17 May 2004 which are exercisable between 17 May 2006 and 16 May 2014 at an exercise price of \$15.91 per share.

At the AGM held on 31 March 2004, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the options granted under the Post-Listing Scheme in (i) to (iv) above that were not yet exercised prior to the AGM. The adjustments made to the first four option grants under the Post-Listing Scheme are as follows:

Date of grant	Exercise price before adjustment	Exercise price after adjustment	Number of shares issuable under the options granted before adjustment	Number of shares issuable under the options granted after adjustment	Closing price immediately before the date on which the option was granted	Closing price immediately before the date on which the option was adjusted
2 May 2003	\$9.05	\$8.28	3,000,000	3,280,000	\$9.10	\$16.85
14 August 2003	\$13.60	\$12.45	1,000,000	1,094,000	\$13.95	\$16.85
18 August 2003	\$13.65	\$12.49	1,800,000	1,968,000	\$13.35	\$16.85
15 January 2004	\$18.90	\$17.30	1,000,000	1,094,000	\$19.00	\$16.85

Shares are issued when options are exercised. The Group has no legal or constructive obligation to repurchase or settle the options in cash.

- (b) Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	2004		2003	
	Average exercise price per share \$	Number of options	Average exercise price per share \$	Number of options
Pre-Listing Scheme				
Outstanding at 1 Jan	7.52	14,171,626	7.52	23,253,020
Exercised	7.50	(7,640,000)	7.52	(5,418,000)
Forfeited	7.00	(524,829)	7.52	(3,663,394)
Adjusted *	N/A	673,203	-	-
Outstanding at 31 Dec	6.88	6,680,000	7.52	14,171,626
Post-Listing Scheme				
Outstanding at 1 Jan	11.26	5,800,000	-	-
Granted	17.21	6,888,000	11.26	5,800,000
Forfeited	16.96	(106,000)	-	-
Adjusted *	N/A	636,000	-	-
Outstanding at 31 Dec	13.78	13,218,000	11.26	5,800,000
Total	11.46	19,898,000	8.61	19,971,626

\* Adjustment approved at the AGM

## NOTES TO THE ACCOUNTS

### 33. EMPLOYEE SHARE-BASED COMPENSATION RESERVE (continued)

- (c) At 31 December 2004, out of the 19,898,000 outstanding options (2003: 19,971,626), 2,093,000 options (2003: 9,355,792) were exercisable at a weighted average exercise price of \$6.88 (2003: \$7.52).

During the year, Pre-Listing employee share options were exercised to subscribe for 7,640,000 shares (2003: 5,418,000 shares) in HKEx at a weighted average exercise price of \$7.50 each (2003: \$7.52 each). The weighted average closing share price on the dates on which the options were exercised was \$18.45 (2003: \$11.59) per share.

- (d) Share options outstanding at the end of the year have the following remaining contractual lives and exercise prices:

	2004		2003	
	Remaining contractual life	Number of options	Remaining contractual life	Number of options
Exercise price				
\$6.88/(2003: \$7.52)	5.41 years	6,680,000	6.41 years	14,171,626
\$8.28/(2003: \$9.05)	8.33 years	3,280,000	9.33 years	3,000,000
\$12.45/(2003: \$13.60)	8.62 years	1,094,000	9.62 years	1,000,000
\$12.49/(2003: \$13.65)	8.63 years	1,968,000	9.63 years	1,800,000
\$17.30/(2003: \$18.90)	9.04 years	1,094,000	-	-
\$16.96	9.24 years	5,582,000	-	-
\$15.91	9.37 years	200,000	-	-
	<b>7.70 years</b>	<b>19,898,000</b>	<b>7.30 years</b>	<b>19,971,626</b>

- (e) According to the Binomial Option Pricing Model, the value and adjusted value of the options granted during the year and 2003 are as follows:

	Date of grant					
	2 May 2003	14 Aug 2003	18 Aug 2003	15 Jan 2004	31 Mar 2004	17 May 2004
<u>Option value</u>						
Before adjustment	\$8,010,000	\$4,560,000	\$8,226,000	\$6,550,000	\$32,250,960	\$1,156,000
After adjustment *	\$8,036,000	\$4,561,980	\$8,226,240	\$6,564,000	Not subject to adjustment	Not subject to adjustment
<u>Variables</u>						
Closing share price at date of grant	\$9.05	\$13.60	\$13.65	\$18.90	\$16.70	\$14.65
Risk Free Rate (being the yield of 10-year Exchange Fund Notes)	4.30% as at 30 Apr 2003	4.84% as at 14 Aug 2003	4.76% as at 18 Aug 2003	3.96% as at 15 Jan 2004	3.78% as at 31 Mar 2004	4.55% as at 17 May 2004
Expected Volatility - note (i)	36%	36%	36%	34%	35%	37%
Expiration of the option	10 years from 2 May 2003	10 years from 14 Aug 2003	10 years from 18 Aug 2003	10 years from 15 Jan 2004	10 years from 31 Mar 2004	10 years from 17 May 2004
Expected ordinary dividend	5.60% (2003 prospective dividend yield of the shares as at 2 May 2003)	4.49% (2003 prospective dividend yield of the shares as at 14 Aug 2003)	4.47% (2003 prospective dividend yield of the shares as at 18 Aug 2003)	3.23% (2004 prospective dividend yield of the shares as at 15 Jan 2004)	3.59% (2004 prospective dividend yield of the shares as at 31 Mar 2004)	3.77% (2004 prospective dividend yield of the shares as at 17 May 2004)

\* adjustment approved at the AGM

- (i) The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the one year immediately preceding the grant date.
- (ii) The above calculation is based on the assumption that there is no material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx set out above.

## NOTES TO THE ACCOUNTS

### 33. EMPLOYEE SHARE-BASED COMPENSATION RESERVE (continued)

- (f) Had all the outstanding employee share options been fully exercised on 31 December 2004, the Group would have received \$228,096,340 in proceeds. The market value of the shares issued based on the closing price of \$20.80 per share on that date would have been \$413,878,400. The employees concerned under the Pre-Listing Scheme would have made a gain of \$13.92 per share or, in aggregate, \$92,985,600. The executive Director concerned under the Post-Listing Scheme would have made a gain of \$12.52 per share or, in aggregate, \$41,065,600. The employees concerned under the Post-Listing Scheme granted on 14 August 2003, 18 August 2003, 15 January 2004, 31 March 2004 and 17 May 2004 would have made a gain of \$8.35 per share or, in aggregate, \$9,134,900, \$8.31 per share or, in aggregate, \$16,354,080, \$3.50 per share or, in aggregate, \$3,829,000, \$3.84 per share or, in aggregate, \$21,434,880, \$4.89 per share or, in aggregate, \$978,000 respectively.

# NOTES TO THE ACCOUNTS

## 34. REVALUATION RESERVES

	Group			
	Investment property revaluation reserve \$'000	Leasehold buildings revaluation reserve \$'000	Investment revaluation reserve \$'000	Total \$'000
At 1 Jan 2003, as previously reported	1,771	14,242	13,886	29,899
Effect of changes in accounting policies (note 2 (b))	(1,771)	(12,149)	-	(13,920)
At 1 Jan 2003, as restated	-	2,093	13,886	15,979
Change in valuation of leasehold buildings (note 17(a))	-	548	-	548
Change in fair value of non-trading securities	-	-	27,585	27,585
Realisation of change in fair value of non-trading securities on maturity and disposal	-	-	(7,392)	(7,392)
Deferred tax arising from change in valuation of leasehold buildings (note 37(b))	-	(134)	-	(134)
Deferred tax arising from change in fair value of non-trading securities (note 37(b))	-	-	(87)	(87)
At 31 Dec 2003, as restated	-	2,507	33,992	36,499
At 1 Jan 2004, as previously reported	1,771	10,668	33,992	46,431
Effect of changes in accounting policies (note 2 (b))	(1,771)	(8,161)	-	(9,932)
At 1 Jan 2004, as restated	-	2,507	33,992	36,499
Change in valuation of leasehold buildings (note 17(a))	-	36	-	36
Change in fair value of available-for-sale financial assets	-	-	10,535	10,535
Realisation of change in fair value of financial assets on maturity and disposal	-	-	(26,741)	(26,741)
Deferred tax arising from change in valuation of leasehold buildings (note 37(b))	-	(6)	-	(6)
Deferred tax arising from change in fair value of available-for-sale financial assets (note 37(b))	-	-	(1,494)	(1,494)
At 31 Dec 2004	-	2,537	16,292	18,829

(a) The revaluation reserves are segregated for their respective specific purposes and are stated net of applicable deferred taxes.

(b) Includes \$2,109,000, \$Nil and \$334,000 (2003: \$1,619,000, \$11,000 and \$318,000 respectively) of gross revaluation surpluses which are attributable to investments of the Clearing House Funds, the CDMD Fund and the Compensation Fund Reserve Account respectively.

## NOTES TO THE ACCOUNTS

### 35. DESIGNATED RESERVES

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

	<b>Clearing House Funds reserves (note a) \$'000</b>	<b>Compensation Fund Reserve Account reserve \$'000</b>	<b>CDMD Fund reserve \$'000</b>	<b>Development reserve (note b) \$'000</b>	<b>Total \$'000</b>
At 1 Jan 2003	555,308	35,827	914	135,762	727,811
Surplus of investment income net of expenses transferred from retained earnings	8,430	714	-	-	9,144
Transfer to retained earnings	-	-	-	(49,226)	(49,226)
Transfer from/(to) retained earnings	8,430	714	-	(49,226)	(40,082)
Forfeiture of defaulted Clearing Participants' contributions	1,928	-	-	-	1,928
At 31 Dec 2003	565,666	36,541	914	86,536	689,657
(Deficit)/surplus of investment income net of expenses transferred from retained earnings	(5,040)	576	-	-	(4,464)
Transfer to retained earnings	-	-	(914)	(3,283)	(4,197)
Transfer from/(to) retained earnings	(5,040)	576	(914)	(3,283)	(8,661)
At 31 Dec 2004	<u>560,626</u>	<u>37,117</u>	<u>-</u>	<u>83,253</u>	<u>680,996</u>

## NOTES TO THE ACCOUNTS

### 35. DESIGNATED RESERVES (continued)

#### (a) Clearing House Funds reserves

	<b>HKSCC Guarantee Fund reserve \$'000</b>	<b>SECH Reserve Fund reserve \$'000</b>	<b>HKCC Reserve Fund reserve \$'000</b>	<b>Total \$'000</b>
At 1 Jan 2003	255,912	47,185	252,211	555,308
Surplus of 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
(Deficit)/surplus of investment income net of expenses of Clearing House Funds transferred from retained earnings	(8,059)	203	2,816	(5,040)
At 31 Dec 2004	<u>247,853</u>	<u>48,774</u>	<u>263,999</u>	<u>560,626</u>

#### (b) Development reserve

The reserve was set aside for systems development for the Stock Exchange. During 2004, \$3,283,000 (2003: \$49,226,000) of the reserve was utilised and transferred to the Group's retained earnings (note 38) for funding qualifying projects completed in 2004 (2003: \$21,109,000 relates to qualifying projects completed in 2003 and \$28,117,000 in 2002).

### 36. 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 38(c).

## NOTES TO THE ACCOUNTS

### 37. 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 (2003: 17.5 per cent).

(a) The movements on the deferred tax liabilities/(assets) account are as follows:

	<b>Group</b>		<b>HKEx</b>	
	As restated			
	<b>2004</b>	2003	<b>2004</b>	2003
	<b>\$'000</b>	\$'000	<b>\$'000</b>	\$'000
At 1 Jan, as previously reported	<b>58,665</b>	73,281	<b>150</b>	219
Effect of adopting new accounting policies (note 2(b))	<b>(5,150)</b>	(5,368)	-	-
At 1 Jan, as restated	<b>53,515</b>	67,913	<b>150</b>	219
Transfer to the profit and loss account (note 15(a))	<b>(25,366)</b>	(14,619)	<b>(1,377)</b>	(69)
Transfer from shareholders' equity (note b)	<b>1,500</b>	221	-	-
At 31 Dec (note e)	<b>29,649</b>	53,515	<b>(1,227)</b>	150

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

	<b>Group</b>	
	As restated	
	<b>2004</b>	2003
	<b>\$'000</b>	\$'000
Reserves in shareholders' equity:		
- leasehold buildings revaluation reserve (note 34)	<b>6</b>	134
- investment revaluation reserve (note 34)	<b>1,494</b>	87
	<b>1,500</b>	221

(c) Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through future taxable profits is probable. The Group had unrecognised tax losses of \$208,207,000 as at 31 December 2004 (2003: \$181,769,000) carried forward for offsetting against future taxable income.

## NOTES TO THE ACCOUNTS

### 37. DEFERRED TAXATION (continued)

(d) The movements in deferred tax liabilities/(assets) during the year are as follows:

(i) The Group

	Accelerated tax depreciation		Revaluation of properties		Tax losses		Revaluation of financial assets		Employee benefits		Total	
	As restated		As restated								As restated	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
At 1 Jan, as previously reported	64,736	82,670	5,288	5,401	(8,856)	(16,330)	1,627	1,540	(4,130)	-	58,665	73,281
Effect of adopting new accounting policies (note 2(b))	(883)	(759)	(4,267)	(4,609)	-	-	-	-	-	-	(5,150)	(5,368)
At 1 Jan, as restated	63,853	81,911	1,021	792	(8,856)	(16,330)	1,627	1,540	(4,130)	-	53,515	67,913
Charged/(credited) to profit and loss account	(25,768)	(18,058)	636	95	(302)	7,474	-	-	68	(4,130)	(25,366)	(14,619)
Charged to equity	-	-	6	134	-	-	1,494	87	-	-	1,500	221
At 31 Dec	38,085	63,853	1,663	1,021	(9,158)	(8,856)	3,121	1,627	(4,062)	(4,130)	29,649	53,515

(ii) HKEx

	Accelerated tax depreciation		Tax losses		Employee benefits		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
At 1 Jan	4,825	5,955	(545)	(5,736)	(4,130)	-	150	219
Charged/(credited) to profit and loss account	(1,990)	(1,130)	545	5,191	68	(4,130)	(1,377)	(69)
At 31 Dec	2,835	4,825	-	(545)	(4,062)	(4,130)	(1,227)	150

(e) Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheet:

	Group		HKEx	
	As restated			
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Net deferred tax assets recognised on the balance sheet	(1,227)	-	(1,227)	-
Net deferred tax liabilities recognised on the balance sheet	30,876	53,515	-	150
	29,649	53,515	(1,227)	150



## NOTES TO THE ACCOUNTS

### 38. RETAINED EARNINGS (INCLUDING PROPOSED/DECLARED DIVIDENDS)

		Group	As restated	HKEx	As restated
	Note	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
At 31 Dec 2003/31 Dec 2002					
Retained earnings/(accumulated losses), as previously reported		<b>1,560,940</b>	3,221,321	<b>(1,822,587)</b>	108,073
Proposed/declared dividends		<b>2,202,898</b>	448,740	<b>2,202,898</b>	448,740
		<b>3,763,838</b>	3,670,061	<b>380,311</b>	556,813
Effect of changes in accounting policies	2(b)	<b>18,023</b>	17,102	<b>(2,771)</b>	-
At 31 Dec 2003/31 Dec 2002					
Retained earnings, as restated		<b>3,781,861</b>	3,687,163	<b>377,540</b>	556,813
Effect of initial adoption of HKAS 39	2(r)	<b>28</b>	-	-	-
At 1 Jan					
Retained earnings, as restated		<b>3,781,889</b>	3,687,163	<b>377,540</b>	556,813
Profit for the year		<b>1,056,884</b>	692,686	<b>2,519,509</b>	458,797
Deficit/(surplus) of investment income net of expenses of Clearing House					
Funds transferred to Clearing House					
Funds reserves		<b>5,040</b>	(8,430)	-	-
Investment income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund					
Reserve Account reserve		<b>(576)</b>	(714)	-	-
Transfer from CDMD Fund reserve		<b>914</b>	-	-	-
Transfer from Development reserve		<b>3,283</b>	49,226	-	-
Dividends paid:					
2003 special and final dividends/ 2002 final dividend		<b>(2,202,898)</b>	(448,740)	<b>(2,202,898)</b>	(448,740)
Dividend on shares issued for employee share options exercised after declaration of 2003 special and final dividends/2002 final dividend		<b>(15,661)</b>	(647)	<b>(15,661)</b>	(647)
		<b>(2,218,559)</b>	(449,387)	<b>(2,218,559)</b>	(449,387)
2004/2003 interim dividend		<b>(454,283)</b>	(188,452)	<b>(454,283)</b>	(188,452)
Dividend on shares issued for employee share options exercised after declaration of 2004/2003 interim dividend		<b>(8)</b>	(231)	<b>(8)</b>	(231)
		<b>(454,291)</b>	(188,683)	<b>(454,291)</b>	(188,683)
At 31 Dec		<b>2,174,584</b>	3,781,861	<b>224,199</b>	377,540
Representing:					
Retained earnings/(accumulated losses)		<b>1,677,964</b>	1,578,963	<b>(272,421)</b>	(1,825,358)
Proposed/declared dividends		<b>496,620</b>	2,202,898	<b>496,620</b>	2,202,898
At 31 Dec		<b>2,174,584</b>	3,781,861	<b>224,199</b>	377,540

- (a) Profit attributable to shareholders includes a profit of \$2,519,509,000 (2003: \$458,797,000) which has been dealt with in the accounts of HKEx, the holding company of the Group.
- (b) The Group's profit after taxation includes a net deficit attributable to the investment income net of expenses of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$2,182,000 (2003: surplus of \$6,938,000).
- (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 36) and retained earnings of \$1,119,321,000.

## NOTES TO THE ACCOUNTS

### 39. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

	2004 \$'000	As restated 2003 \$'000
Profit before taxation	1,250,525	804,740
Adjustments for:		
Net interest income	(81,865)	(201,284)
Dividends received from non-trading securities	-	(14,097)
Dividends from available-for-sale financial assets	(1,070)	-
Gain on trading securities and exchange differences on investments	-	(70,583)
Net unrealised and realised gains and interest income on financial assets at fair value through profit or loss	(114,358)	-
Gain on disposal of available-for-sale financial assets	(24,841)	-
Amortisation of lease premium for land	548	548
Fair value gain on an investment property	(3,300)	-
Depreciation	183,400	181,739
Employee share option benefits	14,290	2,771
Impairment loss of non-trading securities	-	32,303
Impairment loss of investments in associates	-	380
Impairment loss of club debenture	75	860
(Reversal of provision for)/provision for impairment losses of trade receivables	(850)	1,789
Changes in provisions	(526)	(763)
Share of profits less losses of associates	(12,884)	(8,642)
Loss on retirement of redundant IT systems	165	10,133
(Gain)/loss on disposal of other fixed assets	(141)	1,414
Operating profit before working capital changes	1,209,168	741,308
Net decrease in trading securities	-	385,709
Net decrease in financial assets and financial liabilities at fair value through profit or loss	548,516	-
Settlement of amount transferred to/(from) retained earnings for Clearing House Funds and Compensation Fund Reserve Account	4,464	(9,144)
Settlement of amount transferred from CDMD Fund to retained earnings	914	-
Increase in accounts receivable, prepayments and deposits	(108,478)	(1,535,771)
Increase in other current liabilities	135,824	1,738,705
Net cash inflow from operations	1,790,408	1,320,807
Interest received	26,481	187,569
Cash received on financial assets at fair value through profit or loss	75,877	-
Interest paid	(1,181)	(1,492)
Hong Kong Profits tax paid	(75,232)	(98,138)
Net cash inflow from operating activities	<u>1,816,353</u>	<u>1,408,746</u>

## NOTES TO THE ACCOUNTS

### 39. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Analysis of cash and cash equivalents

	2004 \$'000	2003 \$'000
Time deposits with original maturity within three months	829,879	1,134,255
Cash at bank and in hand	<u>205,166</u>	<u>221,135</u>
Cash and cash equivalents at the end of the year	<u><u>1,035,045</u></u>	<u><u>1,355,390</u></u>

- (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.

### 40. COMMITMENTS

(a) Commitments in respect of capital expenditures:

	Group		HKEx	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Contracted but not provided for	4,484	18,359	-	1,791
Authorised but not contracted for	<u>73,554</u>	<u>72,275</u>	<u>12,898</u>	<u>8,273</u>
	<u><u>78,038</u></u>	<u><u>90,634</u></u>	<u><u>12,898</u></u>	<u><u>10,064</u></u>

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

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

	Group		HKEx	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Land and buildings, payable				
- within one year	45,844	47,552	1,307	1,149
- in the second to fifth years	<u>10,060</u>	<u>49,345</u>	<u>1,278</u>	<u>2,457</u>
	<u><u>55,904</u></u>	<u><u>96,897</u></u>	<u><u>2,585</u></u>	<u><u>3,606</u></u>
Computer systems and equipment, payable				
- within one year	64,838	59,022	43,049	40,202
- in the second to fifth years	<u>39,021</u>	<u>56,458</u>	<u>17,139</u>	<u>27,499</u>
	<u><u>103,859</u></u>	<u><u>115,480</u></u>	<u><u>60,188</u></u>	<u><u>67,701</u></u>
	<u><u>159,763</u></u>	<u><u>212,377</u></u>	<u><u>62,773</u></u>	<u><u>71,307</u></u>

As at 31 December 2004, in respect of computer systems and equipment, the majority of the leases would mature within two years and the Group did not have any purchase options.

In addition to the above, the Group has a commitment to contribute additional capital of up to \$5,600,000 (2003: \$5,600,000) to an associate, ADP Wilco Processing Services Limited, when it signs up the first client or when its cash balances fall below a certain level. The company is currently undergoing voluntary liquidation.

## NOTES TO THE ACCOUNTS

### 41. CONTINGENT LIABILITIES

#### (a) Group

- (i) The Compensation Fund is a fund set up under the repealed SO for the purpose of compensating any person (other than a Stock Exchange Participant) dealing with a Stock Exchange Participant for any pecuniary losses suffered as a result of a default by 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, and with the approval of the SFC, allow an additional payment to successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it is obligated to replenish the Compensation Fund upon the SFC's request. 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 2004, there were outstanding claims received in respect of 10 defaulted Stock Exchange Participants (2003: 13).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting 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 were received in response to that notice. Claims made after the claims period are, unless the Stock Exchange otherwise determines, barred. As at 31 December 2004, no such claims had been received in response to said notice.

Following the implementation of the new compensation arrangements under the SFO, an Investor Compensation Fund has been established to replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. Pursuant to the SFO, Exchange Participants are no longer required to make deposits to the Investor Compensation Fund and the Stock Exchange is not required to replenish the Investor Compensation Fund. Hence, deposits to the Commodity Exchange Compensation Fund were 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. Similarly, deposits to the Compensation Fund would be returned to the Stock Exchange in accordance with the SFO pending completion of any determination of outstanding claims and replenishment to the 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 the default of any one Participant. In the unlikely event that all of its 434 trading Participants as at 31 December 2004 (2003: 437) defaulted, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (2003: \$87 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.

#### (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 potential obligations of HKSCC in CCASS in circumstances where CCASS Participants default on their payment obligations. None of these banking facilities had ever been utilised as at 31 December 2003. During the year, the banking facilities were not renewed and the guarantee given by HKEx expired.
- (ii) HKEx has given a guarantee to secure banking facilities of SGD 12 million to HKEx (Singapore) Limited for financing its investment since 16 April 2001. During the year, the Singapore dollar credit facility (31 December 2003: SGD 11 million or \$50 million) was fully repaid, and the guarantee given by HKEx had expired.

## NOTES TO THE ACCOUNTS

### 42. FUTURE OPERATING LEASE ARRANGEMENTS

As at 31 December 2004, the Group had future aggregate minimum lease receipts under a non-cancellable operating lease as follows:

	<b>Group</b>	
	<b>2004</b>	2003
	<b>\$'000</b>	\$'000
Land and buildings		
- within one year	<b>501</b>	402
- in the second to fifth years	<b>439</b>	-
	<b>940</b>	402

### 43. NON-CASH COLLATERAL RECEIVED FROM PARTICIPANTS

As at 31 December 2004, the following non-cash collateral had been received from Clearing Participants for covering part of their obligations:

	<b>Group</b>	
	<b>2004</b>	2003
	<b>\$'000</b>	\$'000
<u>Clearing House Funds</u>		
Bank guarantees	<b>322,724</b>	92,234
<u>Margin Funds</u>		
Equity securities, listed in Hong Kong	<b>610,318</b>	575,195
US Treasury Bills	<b>504,287</b>	230,235
	<b>1,114,605</b>	805,430
	<b>1,437,329</b>	897,664

On 31 December 2003, non-cash collateral deposited by Participants was recorded as assets and liabilities in the balance sheet. Following the adoption of HKAS 39 on 1 January 2004, non-cash collateral deposited by Participants is no longer recognised in the balance sheet and accordingly the amounts were not recorded as assets and liabilities in the balance sheet at 31 December 2004.

## NOTES TO THE ACCOUNTS

### 44. MATERIAL RELATED PARTY TRANSACTIONS

Certain Directors of HKEx are investor participants of HKSCC (“Investor Participants”) or directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (“Exchange Participants”), Clearing Participants and Investor 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, Clearing Participants and Investor Participants, fees levied on these listed companies and fees paid to these Exchange Participants for buying shares on behalf of HKSCC are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants, Clearing Participants and Investor Participants, listed companies and Exchange Participants for buying shares on behalf of HKSCC.

In addition to the above, the Group or HKEx has entered into the following transactions with related parties:

(a) An associate

	Group		HKEx	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Income received from/(expenses paid to) an associate, CHIS:				
- Dividend income	10,801	4,800	-	-
- Loan interest income	-	21	-	-
- Share registration service fees	(354)	(516)	(354)	(516)

(b) Related companies with common directors

	Group		HKEx	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Rental payments (including air conditioning and cleaning service charges) to Shine Hill Development Limited (“Shine Hill”) (note i)	4,698	4,487	-	-
Consultancy fee to Goldman Sachs (Asia) LLC (note ii)	-	862	-	862

- (i) On 5 February 2003, the Futures Exchange as the tenant entered into a tenancy agreement (“the Lease”) with Shine Hill as the landlord. The Futures Exchange is a wholly-owned subsidiary of HKEx. Shine Hill is a subsidiary of Great Eagle Holdings Limited (“Great Eagle”). Dr LO Ka Shui is an independent non-executive Director of HKEx and the deputy chairman, managing director and substantial shareholder of Great Eagle. The Lease was an arm’s length transaction entered into on normal commercial terms.
- (ii) During 2003, consultancy fee was paid to Goldman Sachs (Asia) LLC where Mr FRESHWATER, Timothy George, 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.

## NOTES TO THE ACCOUNTS

### 44. MATERIAL RELATED PARTY TRANSACTIONS (continued)

(c) Key management personnel compensation

	Group		HKEx	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Salaries and other short-term employee benefits	51,488	47,256	42,838	37,107
Termination benefits	1,569	3,475	750	3,475
Post employment benefits	396	2,314	298	1,917
Employer's contribution to provident funds	5,425	5,248	4,491	4,109
Employee share option benefits	8,439	2,771	8,137	2,771
	<u>67,317</u>	<u>61,064</u>	<u>56,514</u>	<u>49,379</u>

(d) Amounts due from/(to) related parties

	Group		HKEx	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Amounts due from:				
- Related companies with common directors	867	845	-	-
Amounts due to:				
- An associate	(55)	(10)	(55)	(10)
- Related companies with common directors	(144)	(89)	-	-
- Key management personnel	<u>(5,894)</u>	<u>(1,285)</u>	<u>(4,960)</u>	<u>(927)</u>

(e) Subsidiaries

	HKEx	
	2004	2003
	\$'000	\$'000
Transactions with subsidiaries:		
- Management fee and equipment rental fee charged to subsidiaries	246,172	231,784
- Expenses recharged to subsidiaries	<u>633,545</u>	<u>657,348</u>
	<u>879,717</u>	<u>889,132</u>
Balances with subsidiaries:		
- Amounts due from subsidiaries	497,463	408,250
- Amounts due to subsidiaries	<u>(180,603)</u>	<u>(59,402)</u>
	<u>316,860</u>	<u>348,848</u>

The transactions and balances with subsidiaries are eliminated on consolidation.

(f) Save as aforesaid, the Group and HKEx have entered into other transactions with companies where there are common directors but the amounts are immaterial.

## NOTES TO THE ACCOUNTS

### 45. BANKING FACILITIES WITH ASSETS PLEDGED

The Group did not have any assets pledged as at 31 December 2003 and 31 December 2004.

### 46. FINANCIAL RISK MANAGEMENT

The Group's investment policy is to prudently invest all funds managed by the Group in a manner which will satisfy liquidity requirements, safeguard financial assets, manage risks while optimising return on investments.

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and equity price risk), credit risk, liquidity risk, fair value interest rate risk and cash flow interest rate risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's performance.

The investment of funds comprises three main categories: Corporate Funds (mainly share capital and retained earnings of the Group), Clearing House Funds and Margin Funds received (which exclude non-cash collateral and contributions receivable from Participants).

An Investment Advisory Committee, comprised of non-executive Directors of HKEx and an external member from the financial community, advises the Board on portfolio management and monitors the risk and performance of HKEx's investments. A Treasury team in the Finance Department is dedicated to the day-to-day management and investment of the funds. Three external fund managers have also been appointed to manage part of the Corporate Funds since July 2001. The external fund managers are stable and financially strong financial institutions and each has a worldwide aggregate fund size of a minimum of US\$10 billion under management.

Investment and fund management is governed by investment policies and risk management guidelines approved by the Board. Investment restrictions and guidelines form an integral part of risk control. Fund-specific restrictions and guidelines are set according to the investment objectives of each fund. In addition, specific limits are set for each fund to control risks (eg permissible asset type, asset allocation, liquidity, credit, counterparty concentration, maturity, foreign exchange, interest rate and market risks) of the investments.

#### (a) Market risk

##### (i) Foreign exchange risk

Foreign exchange risk is the risk of loss due to adverse movements in foreign exchange rates relating to investments denominated in foreign currencies. When seeking to optimise the returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts have been used to hedge the currency exposure of the Group's non-HKD investments and liabilities to mitigate risks arising from fluctuations in exchange rates. As at 31 December 2004, the aggregate net open foreign currency positions amounted to HK\$1,996 million, of which HK\$170 million were non-USD exposures (2003: HK\$1,663 million, of which HK\$204 million were non-USD exposures), and the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$358 million (2003: HK\$322 million). All forward foreign exchange contracts mature within one month.

##### (ii) Equity and commodity price risk

The Group is exposed to equity price risk as equities are held as part of the Corporate Fund's investments. Equity price risk is capped by an asset allocation limit. The Group is not exposed to commodity price risk as investment in commodity is not permitted under the Group's Investment Policy.



## NOTES TO THE ACCOUNTS

### 46. FINANCIAL RISK MANAGEMENT (continued)

#### (a) Market risk (continued)

Risk management techniques, such as Value-at-Risk (“VaR”) and portfolio stress testing, are used to identify, measure and control market risks. VaR measures the expected maximum loss over a given time interval (a holding period of 10 trading days is used by HKEx) at a given confidence level (95 per cent confidence interval is adopted by HKEx) based on historical data (one year is used by HKEx).

#### (b) Credit risk

##### (i) Investment and accounts receivable-related risk

The Group is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Impairment provisions are made for losses that have been incurred at the balance sheet date. The Group limits its exposure to credit risk by rigorously selecting the counterparties (ie deposit-takers and issuers) and by diversification. As at 31 December 2004, all bonds held were of investment grade. Deposits are placed only with the note-issuing banks in Hong Kong and investment grade licensed banks and restricted licence banks approved by the Board from time to time. All investments are subject to maximum concentration limit predetermined by the Board. The Group mitigates its exposure to risks relating to accounts receivables from its Participants by requiring the Participants to meet the Group’s established financial requirements and criteria for admission as Participants.

##### (ii) Clearing and settlement-related off balance sheet risk

In the normal course of business, the clearing houses of the Group, HKSCC, SEIOCH 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, SEIOCH 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.

Position limits are imposed by HKCC to regulate or limit the maximum number or value of gross and net positions which can be held or controlled by the Participants based on their liquid capital. Bank guarantees may also be accepted to extend their position limits. As of 31 December 2004, bank guarantees of \$902,500,000 were accepted (2003: \$728,000,000) for such purpose.

In addition to the above, the Group has set aside \$1,500 million of retained earnings for the purpose of strengthening the risk management regime of the clearing houses and supporting their roles as central counterparties.

## NOTES TO THE ACCOUNTS

### 46. FINANCIAL RISK MANAGEMENT (continued)

#### (c) Liquidity risk

Due to the dynamic nature of the Group's underlying businesses, investments are kept sufficiently liquid to meet operating needs and possible liquidity requirements of the Clearing House Funds and Margin Funds. In addition, banking facilities have been put in place for contingency purposes. As at 31 December 2004, the Group's total available banking facilities amounted to \$1,608 million (2003: \$2,764 million), of which \$1,500 million were repurchase facilities to augment the liquidity of Margin Funds.

## NOTES TO THE ACCOUNTS

### 46. FINANCIAL RISK MANAGEMENT (continued)

#### (d) Fair value and cash flow interest rate risks

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. Cash flow interest rate risk is the risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group is exposed to both fair value and cash flow interest rate risks.

The table below summarises the Group's exposure to fair value interest rate risk. Included in the table are the Group's financial assets and financial liabilities whose interest rate is reset within the buckets as shown below (categorised by the earlier of contractual repricing or maturity dates) and their related effective interest rates.

#### 31 December 2004

	Overnight \$'000	> Overnight to 1 month \$'000	> 1 month to 1 year \$'000	> 1 year to 3 years \$'000	> 3 years \$'000	Non- interest bearing \$'000	Total \$'000	Effective interest rate of interest bearing items
<b>Non-current assets</b>								
Clearing House Funds	1,550,359	51,060	114,321	157,858	-	(12,111)	1,861,487	0.60%
Compensation Fund								
Reserve Account	400	28,737	-	18,831	-	(10,517)	37,451	1.21%
Time deposits with maturity over one year	38,941	-	-	-	-	-	38,941	N/A
Other non-interest bearing non-current assets	-	-	-	-	-	485,370	485,370	N/A
	<b>1,589,700</b>	<b>79,797</b>	<b>114,321</b>	<b>176,689</b>	<b>-</b>	<b>462,742</b>	<b>2,423,249</b>	
<b>Current assets</b>								
Accounts receivable, prepayments and deposits	-	-	-	-	-	4,691,846	4,691,846	N/A
Margin Funds on derivatives contracts	4,220,879	2,761,283	1,524,730	1,988,113	-	34,687	10,529,692	0.65%
Financial assets at fair value through profit or loss	10,031	154,413	912,981	1,002,374	436,440	245,354	2,761,593	2.80%
Time deposits with original maturity over three months	-	402	938	-	-	-	1,340	0.94%
Cash and cash equivalents	541,776	465,397	27,872	-	-	-	1,035,045	0.27%
Other non-interest bearing current assets	-	-	-	-	-	639	639	N/A
	<b>4,772,686</b>	<b>3,381,495</b>	<b>2,466,521</b>	<b>2,990,487</b>	<b>436,440</b>	<b>4,972,526</b>	<b>19,020,155</b>	
<b>Current liabilities</b>								
Margin deposits received from Clearing Participants	10,529,692	-	-	-	-	-	10,529,692	0.00%
Accounts payable, accruals and other liabilities	148,946	-	-	-	-	4,753,404	4,902,350	0.04%
Other non-interest bearing current liabilities	-	-	-	-	-	522,637	522,637	N/A
	<b>10,678,638</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,276,041</b>	<b>15,954,679</b>	
<b>Non-current liabilities</b>								
Participants' contributions to Clearing House Funds	931,427	-	-	-	-	367,325	1,298,752	0.07%
Other non-interest bearing non-current liabilities	-	-	-	-	-	137,830	137,830	N/A
	<b>931,427</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>505,155</b>	<b>1,436,582</b>	
<b>Net (liabilities) / assets</b>	<b>(5,247,679)</b>	<b>3,461,292</b>	<b>2,580,842</b>	<b>3,167,176</b>	<b>436,440</b>	<b>(345,928)</b>	<b>4,052,143</b>	

# NOTES TO THE ACCOUNTS

## 46. FINANCIAL RISK MANAGEMENT (continued)

### (d) Fair value and cash flow interest rate risks (continued)

31 December 2003

	Overnight \$'000	> Overnight to 1 month \$'000	> 1 month to 1 year \$'000	> 1 year to 3 years \$'000	> 3 years \$'000	Non- interest bearing \$'000	Total \$'000	Effective interest rate of interest bearing items
<b>Non-current assets</b>								
Clearing House Funds	1,205,514	-	-	265,643	-	80,173	1,551,330	0.64%
Compensation Fund								
Reserve Account	244	26,575	-	18,318	-	(8,278)	36,859	1.19%
CDMD Fund	-	-	-	925	-	-	925	2.70%
Non-trading securities	-	-	-	-	-	77,258	77,258	N/A
Time deposits with maturity over one year	316,456	-	-	67,000	10,000	-	393,456	2.51%
Other non-interest bearing non-current assets	-	-	-	-	-	629,607	629,607	N/A
	1,522,214	26,575	-	351,886	10,000	778,760	2,689,435	
<b>Current assets</b>								
Accounts receivable, prepayments and deposits	-	-	-	-	-	4,644,680	4,644,680	N/A
Margin Funds on derivatives contracts	4,119,550	580,100	1,042,653	1,326,777	-	805,430	7,874,510	0.64%
Trading securities	138,277	152,253	795,946	1,312,380	533,378	280,764	3,212,998	2.94%
Time deposits with original maturity over three months	-	16,194	12,663	-	-	-	28,857	0.56%
Cash and cash equivalents	1,001,917	333,655	19,818	-	-	-	1,355,390	0.11%
Other non-interest bearing current assets	-	-	-	-	-	2,106	2,106	N/A
	5,259,744	1,082,202	1,871,080	2,639,157	533,378	5,732,980	17,118,541	
<b>Current liabilities</b>								
Bank loans	-	-	50,286	-	-	-	50,286	1.62%
Margin deposits and securities received from Clearing Participants	7,874,510	-	-	-	-	-	7,874,510	0.00%
Accounts payable, accruals and other liabilities	225,595	-	-	-	-	4,554,309	4,779,904	0.02%
Other non-interest bearing current liabilities	-	-	-	-	-	343,549	343,549	N/A
	8,100,105	-	50,286	-	-	4,897,858	13,048,249	
<b>Non-current liabilities</b>								
Participants' contributions to Clearing House Funds	548,811	-	-	-	-	435,234	984,045	0.01%
Other non-interest bearing non-current liabilities	-	-	-	-	-	161,557	161,557	N/A
	548,811	-	-	-	-	596,791	1,145,602	
<b>Net (liabilities) / assets</b>	<b>(1,866,958)</b>	<b>1,108,777</b>	<b>1,820,794</b>	<b>2,991,043</b>	<b>543,378</b>	<b>1,017,091</b>	<b>5,614,125</b>	

## NOTES TO THE ACCOUNTS

### 46. FINANCIAL RISK MANAGEMENT (continued)

#### (d) Fair value and cash flow interest rate risks (continued)

The Group's exposure to cash flow interest rate risk is summarised below. Included in the table are the Group's floating rate interest bearing financial assets and financial liabilities whose cash flows vary with changes in interest rates (eg interest income and interest expenses) and their interest rate reset dates (categorised by the earlier of contractual repricing or maturity dates).

#### 31 December 2004

	Overnight \$'000	> Overnight to 1 month \$'000	> 1 month to 1 year \$'000	> 1 year to 3 years \$'000	Total \$'000
<b>Non-current assets</b>					
Clearing House Funds	1,550,359	-	-	-	1,550,359
Compensation Fund					
Reserve Account	400	-	-	-	400
Time deposits with maturity over one year	38,941	-	-	-	38,941
	<u>1,589,700</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,589,700</u>
<b>Current assets</b>					
Margin Funds on derivatives contracts	4,220,879	180,965	100,249	-	4,502,093
Financial assets at fair value through profit or loss	10,031	103,520	173,208	28,610	315,369
Cash and cash equivalents	541,776	-	-	-	541,776
	<u>4,772,686</u>	<u>284,485</u>	<u>273,457</u>	<u>28,610</u>	<u>5,359,238</u>
<b>Current liabilities</b>					
Margin deposits received from					
Clearing Participants	10,529,692	-	-	-	10,529,692
Accounts payable, accruals and other liabilities	148,946	-	-	-	148,946
	<u>10,678,638</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>10,678,638</u>
<b>Non-current liabilities</b>					
Participants' contributions to					
Clearing House Funds	931,427	-	-	-	931,427
	<u>931,427</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>931,427</u>

## NOTES TO THE ACCOUNTS

### 46. FINANCIAL RISK MANAGEMENT (continued)

#### (d) Fair value and cash flow interest rate risks (continued)

31 December 2003

	Overnight \$'000	> Overnight to 1 month \$'000	> 1 month to 1 year \$'000	> 1 year to 3 years \$'000	Total \$'000
<b>Non-current assets</b>					
Clearing House Funds	1,205,514	-	-	-	1,205,514
Compensation Fund					
Reserve Account	244	-	-	-	244
Time deposits with maturity over one year	316,456	-	-	-	316,456
	<u>1,522,214</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,522,214</u>
<b>Current assets</b>					
Margin Funds on derivatives contracts	4,119,550	50,100	426,382	-	4,596,032
Trading securities	138,277	85,692	168,890	8,433	401,292
Cash and cash equivalents	1,001,917	-	-	-	1,001,917
	<u>5,259,744</u>	<u>135,792</u>	<u>595,272</u>	<u>8,433</u>	<u>5,999,241</u>
<b>Current liabilities</b>					
Margin deposits and securities received from Clearing Participants	7,874,510	-	-	-	7,874,510
Accounts payable, accruals and other liabilities	225,595	-	-	-	225,595
	<u>8,100,105</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,100,105</u>
<b>Non-current liabilities</b>					
Participants' contributions to Clearing House Funds	548,811	-	-	-	548,811
	<u>548,811</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>548,811</u>

## NOTES TO THE ACCOUNTS

### 46. FINANCIAL RISK MANAGEMENT (continued)

#### (e) Fair values of financial assets and liabilities

The following table summaries the carrying amounts and fair values of financial assets and financial liabilities not presented on the Group's balance sheet at their fair value. The carrying amounts of short-term receivables (ie accounts receivable, deposits and cash and cash equivalents) and short-term payables (ie accounts payable and other liabilities) approximate their fair values, and accordingly no disclosure of the fair values of these items are presented.

	Carrying amount in balance sheet		Fair value	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
<b>Financial assets</b>				
Time deposits with original maturity over one year	<b>38,941</b>	393,456	<b>37,808</b>	390,559
Other financial assets included in other non-current assets (note i)	<b>9,935</b>	400	<b>9,833</b>	400
<b>Financial liabilities</b>				
Participants' admission fees received included in non-current liabilities	<b>82,850</b>	84,950	<b>82,306</b>	84,622
Participants' contributions to Clearing House Funds:				
- Minimum contributions (note i)	<b>337,250</b>	343,000	<b>335,035</b>	341,674
- Participants' additional deposits	<b>961,502</b>	641,045	<b>961,502</b>	641,045
Provisions (note i) – non-current	<b>24,104</b>	23,092	<b>23,875</b>	22,331

- (i) The fair values are based on cash flows discounted using Hong Kong Government bond rates of a tenor similar to the contractual maturity of the respective assets/liabilities, adjusted by an estimated credit spread. Assets/liabilities without a contractual maturity are assumed to mature exactly one year after the balance sheet date. The discounted rates used range from 0.66% to 1.30% in 2004 (2003: 0.39% to 2.27%).

### 47. COMPARATIVE FIGURES

- (a) The comparative figure of time deposits with maturity over one year has been reclassified to non-current assets in order to conform with the current year's presentation.
- (b) For available-for-sale financial assets sold or matured, changes in fair value during the year up to disposal or maturity are not recognised as "change in fair value of available-for-sale financial assets" during the year and accordingly not reversed in the "realisation of change in fair value of financial assets on maturity or disposal" (there is no impact on the profit and loss account). The 2003 comparatives for "change in fair value of non-trading securities" and "realisation of change in fair value of non-trading securities on maturity or disposal" in the Consolidated Statement of Changes in Equity have been amended to conform to the current year's presentation.
- (c) The comparative figure of accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the Margin Funds has been reclassified from investment income to other income in order to conform with current year's presentation.