

Consolidated Financial Statements

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

| | Note | 2002 \$'000 | 2001 \$'000 |
|---|-------|----------------|----------------|
| INCOME | | | |
| Trading fees, transaction levy and trading tariff | 4 | 331,729 | 351,408 |
| Stock Exchange listing fees | | 320,033 | 275,266 |
| Clearing and settlement fees | | 181,424 | 214,015 |
| Depository, custody and nominee services fees | | 211,413 | 227,970 |
| Income from sale of information | | 293,735 | 337,189 |
| Interest income | 5 | 266,612 | 451,395 |
| Interest expenses | | (5,797) | (69,445) |
| Net interest income | | 260,815 | 381,950 |
| Other income | 6 | 208,941 | 211,015 |
| | 2 | 1,808,090 | 1,998,813 |
| OPERATING EXPENSES | | | |
| Staff costs and related expenses | | 492,549 | 527,994 |
| Information technology and computer maintenance expenses | | 262,700 | 231,064 |
| Premises expenses | | 101,234 | 100,452 |
| Product marketing and promotion expenses | | 14,728 | 15,516 |
| Legal and professional fees | | 39,613 | 61,800 |
| Depreciation and amortisation | | 163,139 | 152,669 |
| Other operating expenses | | 90,694 | 86,872 |
| | | 1,164,657 | 1,176,367 |
| SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES | 2 | 6,141 | - |
| PROFIT BEFORE TAXATION | 2/7 | 649,574 | 822,446 |
| TAXATION | 11(a) | (56,606) | (82,020) |
| PROFIT ATTRIBUTABLE TO SHAREHOLDERS | 29 | 592,968 | 740,426 |
| DIVIDENDS | | 532,220 | 343,419 |
| Earnings per share | 12 | \$0.57 | \$0.71 |
| Dividends per share | | | |
| Interim dividend paid | | \$0.08 | \$0.08 |
| Final dividend declared | | \$0.43 | \$0.25 |
| | | \$0.51 | \$0.33 |
| Dividend payout ratio | | 90% | 46% |

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

| | Note | 2002 \$'000 | 2001 \$'000 |
|--|------|----------------|----------------|
| Total equity at 1 Jan | | 5,235,407 | 4,878,956 |
| Change in valuation of investment property | 26 | (1,500) | (4,200) |
| Change in valuation of other properties | 26 | (16,850) | (9,273) |
| Change in fair value of non-trading securities | 26 | 14,548 | 1,886 |
| Net deficit not recognised in the consolidated profit and loss account | | (3,802) | (11,587) |
| Profit attributable to shareholders | 29 | 592,968 | 740,426 |
| Realisation of change in fair value of non-trading securities on maturity and disposal | 26 | (6,015) | (28,969) |
| Dividends paid | 29 | (344,094) | (343,419) |
| Proceeds from issue of shares under share option scheme | 25 | 21,928 | – |
| Total equity at 31 Dec | | 5,496,392 | 5,235,407 |

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CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

| | Note | 2002 \$'000 | 2001 \$'000 |
|--|-----------|-------------------|-------------------|
| NON-CURRENT ASSETS | | | |
| Fixed assets | 13(a) | 748,108 | 786,110 |
| Investments in associated companies | 14 | 35,536 | – |
| Clearing House Funds | 15 | 980,748 | 944,154 |
| Compensation Fund Reserve Account | 16 | 35,827 | 35,146 |
| Cash and Derivatives Market Development Fund | 17 | 914 | 914 |
| Non-trading securities maturing over one year | 18 | 87,604 | 52,366 |
| | | <u>1,888,737</u> | <u>1,818,690</u> |
| CURRENT ASSETS | | | |
| Margin funds on derivatives contracts | 19 | 4,551,601 | 4,803,107 |
| Accounts receivable, prepayments and deposits | 20(a) | 3,118,199 | 2,334,767 |
| Taxation recoverable | | 1,774 | 5,857 |
| Trading securities | 21 | 3,490,046 | 3,182,527 |
| Bank balances and time deposits pledged | 36 | – | 10,000 |
| Bank balances and time deposits | | 985,114 | 1,590,062 |
| | | <u>12,146,734</u> | <u>11,926,320</u> |
| CURRENT LIABILITIES | | | |
| Bank loans | 33(b)(ii) | 49,456 | 46,453 |
| Margin deposits and securities received from | | | |
| Clearing Participants on derivatives contracts | 19 | 4,551,601 | 4,803,107 |
| Accounts payable, accruals and other liabilities | 20(b) | 3,007,392 | 2,733,306 |
| Participants' admission fees received | 22 | 3,350 | 14,550 |
| Deferred revenue | | 269,774 | 246,827 |
| Taxation payable | | 29,051 | 19,556 |
| Provisions | 23(a) | 28,863 | 25,927 |
| | | <u>7,939,487</u> | <u>7,889,726</u> |
| NET CURRENT ASSETS | | <u>4,207,247</u> | <u>4,036,594</u> |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | <u>6,095,984</u> | <u>5,855,284</u> |

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CONSOLIDATED BALANCE SHEET (continued) AT 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

| | Note | 2002 \$'000 | 2001 \$'000 |
|---|-------|-------------------------|-------------------------|
| NON-CURRENT LIABILITIES | | | |
| Participants' admission fees received | 22 | 86,800 | 91,500 |
| Participants' contributions to Clearing House Funds | 15 | 425,440 | 423,960 |
| Deferred taxation | 11(b) | 67,253 | 75,275 |
| Provisions | 23(a) | 20,099 | 29,142 |
| | | <u>599,592</u> | <u>619,877</u> |
| NET ASSETS | | <u>5,496,392</u> | <u>5,235,407</u> |
| CAPITAL AND RESERVES | | | |
| Share capital | 25 | 1,043,581 | 1,040,665 |
| Share premium | 25 | 19,012 | – |
| Revaluation reserves | 26 | 33,980 | 43,797 |
| Designated reserves | 27 | 727,811 | 692,016 |
| Retained earnings | 29 | 3,223,268 | 3,198,763 |
| Proposed and declared dividend | 29 | 448,740 | 260,166 |
| SHAREHOLDERS' FUNDS | | <u>5,496,392</u> | <u>5,235,407</u> |

Approved by the Board of Directors on 12 March 2003

LEE Yeh Kwong, Charles
Director

KWONG Ki Chi
Director

Consolidated Financial Statements

HONG KONG EXCHANGES AND CLEARING LIMITED (HKEx)

BALANCE SHEET

AT 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

| | Note | 2002 \$'000 | 2001 \$'000 |
|--|-------|------------------|------------------|
| NON-CURRENT ASSETS | | | |
| Fixed assets | 13(b) | 43,598 | 24,569 |
| Investments in subsidiaries | 24(a) | 4,145,198 | 4,145,198 |
| Other assets | | 5,729 | 3,089 |
| | | <u>4,194,525</u> | <u>4,172,856</u> |
| CURRENT ASSETS | | | |
| Accounts receivable, prepayments and deposits | 20(a) | 20,337 | 16,889 |
| Amounts due from subsidiaries | 24(b) | 489,019 | 82,603 |
| Bank balances and time deposits | | 10,139 | 81,629 |
| | | <u>519,495</u> | <u>181,121</u> |
| CURRENT LIABILITIES | | | |
| Accounts payable, accruals and other liabilities | 20(b) | 70,343 | 22,650 |
| Amounts due to subsidiaries | 24(b) | 3,111 | – |
| Provisions | 23(b) | 23,826 | 5,129 |
| | | <u>97,280</u> | <u>27,779</u> |
| NET CURRENT ASSETS | | <u>422,215</u> | <u>153,342</u> |
| NET ASSETS | | <u>4,616,740</u> | <u>4,326,198</u> |
| CAPITAL AND RESERVES | | | |
| Share capital | 25 | 1,043,581 | 1,040,665 |
| Share premium | 25 | 19,012 | – |
| Merger reserve | 28 | 2,997,115 | 2,997,115 |
| Retained earnings | 29 | 108,292 | 28,252 |
| Proposed and declared dividend | 29 | 448,740 | 260,166 |
| SHAREHOLDERS' FUNDS | | <u>4,616,740</u> | <u>4,326,198</u> |

Approved by the Board of Directors on 12 March 2003

LEE Yeh Kwong, Charles
Director

KWONG Ki Chi
Director

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CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

| | Note | 2002 \$'000 | 2001 \$'000 |
|--|-------|------------------|--------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net cash outflow from operating activities | 30(a) | <u>(126,485)</u> | <u>(2,485,688)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Payments for purchases of fixed assets | | (130,733) | (263,139) |
| Proceeds from sales of fixed assets | | 34 | 227 |
| Net (increase)/decrease in non-trading securities | | (32,305) | 785,217 |
| (Increase)/decrease in time deposits with original maturity more than three months | | (57,060) | 336,441 |
| Net cash outflow from investments in associated companies and disposal of a subsidiary | | (31,546) | – |
| Dividends received from non-trading securities | | 2,482 | 2,516 |
| Interest received from non-trading securities | | 41,671 | 226,909 |
| Net cash (outflow)/inflow from investing activities | | <u>(207,457)</u> | <u>1,088,171</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| New bank loans | | – | 46,453 |
| Proceeds from issue of shares under share option scheme | | 21,928 | – |
| Admission fees received less refunds to Participants | | (15,900) | (4,200) |
| Dividends paid | | (344,094) | (343,419) |
| Net cash outflow from financing activities | | <u>(338,066)</u> | <u>(301,166)</u> |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | | (672,008) | (1,698,683) |
| Cash and cash equivalents at the beginning of the year | | <u>1,351,964</u> | <u>3,050,647</u> |
| Cash and cash equivalents at the end of the year | 30(b) | <u>679,956</u> | <u>1,351,964</u> |

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NOTES TO THE ACCOUNTS

(Financial figures are expressed in Hong Kong dollars)

1. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

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

(b) Basis of preparation

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

(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.

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

Consolidated Financial Statements

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(c) Group accounting (continued)

(ii) Associated companies

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

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

(d) Turnover

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

(e) Revenue recognition

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

- (i) Trading fees, transaction levy and trading tariff on securities and options traded on the Stock Exchange are recognised on a trade date basis.
- (ii) Trading fees on derivatives contracts traded on the Futures Exchange are recognised on the day when the derivatives contracts are entered into.
- (iii) Settlement fees on derivatives contracts traded on the Futures Exchange are recognised on outstanding contracts at the official final settlement day.

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(e) Revenue recognition (continued)

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

(f) Interest expenses

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

(g) Employee benefit costs

(i) Employee leave entitlements

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Employee benefit costs (continued)

(ii) Equity compensation benefits

Share options under the Pre-listing Share Option Scheme have been granted to the Executive Director and employees. When the options are exercised, the proceeds received are credited to share capital (nominal value) and share premium. No costs in relation to the options are charged to the profit and loss account (note 25).

(iii) Retirement benefit costs

Contributions to the defined contribution provident funds regulated under the Occupational Retirement Schemes Ordinance (ORSO) and operated by the Group and the AIA-JF Premium MPF Scheme are expensed as incurred. Contributions to one of the two ORSO approved provident funds of the Group are offset by contributions forfeited in respect of employees who leave the provident fund before the contributions are fully vested. Forfeited contributions of another provident fund 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 funds 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.

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Fixed assets

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

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

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

| | |
|---------------------------------------|--------------|
| Leasehold land | 0.1% to 0.8% |
| Buildings | 4% |
| Leasehold improvements | 20% |
| Computer trading and clearing systems | |
| – software | 20% |
| – hardware | 33.33% |
| Other computer hardware and software | 33.33% |
| Furniture and equipment | 20% |
| Motor vehicles | 33.33% |

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Fixed assets (continued)

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

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

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

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

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

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

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(j) Investment properties

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

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

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

(k) Goodwill

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

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

(l) Impairment of assets

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

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

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

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

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

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

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

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

(o) Non-trading securities

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

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(p) Trading securities

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

(q) Repurchase transactions

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

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

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

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

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

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(s) Deferred taxation

Deferred taxation is accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset is expected to be payable or recoverable in the foreseeable future.

(t) Deferred revenue

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

(u) Provisions, contingent liabilities and contingent assets

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

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.

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(v) Translation of foreign currencies

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

(w) Forward foreign exchange contracts

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

(x) Cash and cash equivalents

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

(y) Segment reporting

Segment assets consist primarily of fixed assets, assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund and margin fund and receivables, and exclude investments in securities, corporate bank balances and time deposits, land and buildings and investment properties. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate borrowings. Capital expenditures comprise additions to fixed assets. Business segments have been used as the primary reporting format as all business activities are conducted in Hong Kong.

(z) Dividends

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

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2. SEGMENT INFORMATION

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

| | Cash Market 2002 \$'000 | Derivatives Market 2002 \$'000 | Clearing Business 2002 \$'000 | Others 2002 \$'000 | Elimination 2002 \$'000 | Group 2002 \$'000 |
|--|----------------------------------|---|--|--------------------------|-------------------------------|-------------------------|
| Income | | | | | | |
| External | 915,612 | 158,308 | 423,690 | - | - | 1,497,610 |
| Inter-segment | 6,571 | - | 137 | - | (6,708) | - |
| Net interest and other income | | | | | | |
| - segment | 22,304 | 83,005 | 26,382 | - | - | 131,691 |
| - unallocated | - | - | - | 178,789 | - | 178,789 |
| | <u>944,487</u> | <u>241,313</u> | <u>450,209</u> | <u>178,789</u> | <u>(6,708)</u> | <u>1,808,090</u> |
| Costs | <u>409,734</u> | <u>119,111</u> | <u>261,696</u> | <u>-</u> | <u>(2,833)</u> | <u>787,708</u> |
| Segment results | <u>534,753</u> | <u>122,202</u> | <u>188,513</u> | <u>178,789</u> | <u>(3,875)</u> | <u>1,020,382</u> |
| Unallocated costs | | | | | | <u>376,949</u> |
| | | | | | | <u>643,433</u> |
| Share of (losses)/ profits of associated companies | (103) | - | 6,244 | - | | <u>6,141</u> |
| Profit before taxation | | | | | | <u>649,574</u> |
| Taxation | | | | | | <u>(56,606)</u> |
| Profit attributable to shareholders | | | | | | <u>592,968</u> |
| Segment assets | 583,407 | 4,615,050 | 4,008,776 | - | | 9,207,233 |
| Unallocated assets | - | - | - | 4,828,238 | | 4,828,238 |
| Total assets | | | | | | <u>14,035,471</u> |
| Segment liabilities | 389,873 | 4,568,217 | 3,307,534 | - | | 8,265,624 |
| Unallocated liabilities | - | - | - | 273,455 | | 273,455 |
| Total liabilities | | | | | | <u>8,539,079</u> |
| Capital expenditures | 11,877 | 24,232 | 85,729 | 24,832 | | 146,670 |
| Depreciation and amortisation | 67,459 | 9,301 | 34,364 | 53,583 | | 164,707 |
| Other non-cash expenses | 6 | 326 | 1,913 | 4 | | 2,249 |

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2. SEGMENT INFORMATION (continued)

| | Cash Market 2001 \$'000 | Derivatives Market 2001 \$'000 | Clearing Business 2001 \$'000 | Others 2001 \$'000 | Elimination 2001 \$'000 | Group 2001 \$'000 |
|--|----------------------------------|---|--|--------------------------|-------------------------------|-------------------------|
| Income | | | | | | |
| External | 927,601 | 147,620 | 469,397 | - | - | 1,544,618 |
| Inter-segment | 8,287 | - | 228 | - | (8,515) | - |
| Net interest and other income | | | | | | |
| - segment | 7,786 | 123,227 | 50,678 | - | - | 181,691 |
| - unallocated | - | - | - | 272,504 | - | 272,504 |
| | <u>943,674</u> | <u>270,847</u> | <u>520,303</u> | <u>272,504</u> | <u>(8,515)</u> | <u>1,998,813</u> |
| Costs | <u>380,344</u> | <u>155,186</u> | <u>235,661</u> | <u>-</u> | <u>(2,410)</u> | <u>768,781</u> |
| Segment results | <u>563,330</u> | <u>115,661</u> | <u>284,642</u> | <u>272,504</u> | <u>(6,105)</u> | <u>1,230,032</u> |
| Unallocated costs | | | | | | <u>407,586</u> |
| Profit before taxation | | | | | | 822,446 |
| Taxation | | | | | | <u>(82,020)</u> |
| Profit attributable to shareholders | | | | | | <u>740,426</u> |
| Segment assets | 592,492 | 4,846,842 | 2,976,637 | - | | 8,415,971 |
| Unallocated assets | - | - | - | 5,329,039 | | <u>5,329,039</u> |
| Total assets | | | | | | <u>13,745,010</u> |
| Segment liabilities | 409,813 | 4,826,622 | 2,855,981 | - | | 8,092,416 |
| Unallocated liabilities | - | - | - | 417,187 | | <u>417,187</u> |
| Total liabilities | | | | | | <u>8,509,603</u> |
| Capital expenditures | 29,196 | 21,054 | 183,098 | 29,791 | | 263,139 |
| Depreciation and amortisation | 73,882 | 12,238 | 12,666 | 53,883 | | 152,669 |
| Other non-cash expenses | 2,830 | 15 | 2,321 | - | | 5,166 |

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2. 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. The major sources of income of the business are trading fees, transaction levy, trading tariff, listing fees and income from sale of information.

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

The **Clearing Business** refers mainly to the operations of HKSCC, which is responsible for clearing, settlement and custodian activities and the related risk management of cash market activities. Its income is derived primarily from the fees charged on providing clearing, settlement, depository and nominee services.

Net interest and other income under the **Others Segment** represents mainly net interest income derived from corporate funds, which is not directly attributable to any of the three business segments and is therefore not allocated to the business segments. Unallocated costs represent overheads which are not directly attributable to the above-mentioned business segments.

Inter-segment transactions are conducted at arm's length.

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3. DISPOSAL OF SUBSIDIARY

On 31 May 2002, the share registration operations of the Group's Clearing Business, Hong Kong Registrars Limited (HKRL), a wholly-owned subsidiary, were sold and merged with those of Central Registration Hong Kong Limited, which has been renamed as Computershare Hong Kong Investor Services Limited (CHIS). The Group received 18 per cent of the issued share capital of CHIS as consideration for the sale of HKRL. On the same date, the Group increased its holding in CHIS to 24 per cent by acquiring a further 6 per cent of the issued share capital of CHIS by cash.

The results of HKRL for the five months ended 31 May 2002 have been incorporated in the consolidated profit and loss account and are as follows:

| | Five months ended 31 May 2002 \$'000 | Year ended 31 Dec 2001 \$'000 |
|------------------------|---|-------------------------------------|
| Income | 14,183 | 26,466 |
| Operating expenses | (2,509) | (9,102) |
| Profit before taxation | 11,674 | 17,364 |
| Taxation | (1,064) | (3,367) |
| Profit after taxation | 10,610 | 13,997 |

The net book value of the total assets and total liabilities of HKRL at the date of disposal was \$6,926,476 (31 December 2001: \$40,276,000) and \$6,926,456 (31 December 2001: \$8,084,000) respectively.

The disposal of HKRL for a 18 per cent holding in CHIS is considered an exchange of similar assets. As a result, no gain or loss arose from the transaction.

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4. TRADING FEES, TRANSACTION LEVY AND TRADING TARIFF

| | 2002 \$'000 | 2001 \$'000 |
|---|----------------|----------------|
| Trading fees, transaction levy and trading tariff are derived from: | | |
| Securities and options traded on the Stock Exchange | 215,871 | 250,306 |
| Derivatives contracts traded on the Futures Exchange | 115,858 | 101,102 |
| | <u>331,729</u> | <u>351,408</u> |

5. INTEREST INCOME

| | 2002 \$'000 | 2001 \$'000 |
|-----------------------|----------------|----------------|
| Interest income from: | | |
| Bank deposits | 96,372 | 189,073 |
| Listed securities | 41,013 | 52,725 |
| Unlisted securities | 129,227 | 209,597 |
| | <u>266,612</u> | <u>451,395</u> |

6. OTHER INCOME

| | 2002 \$'000 | 2001 \$'000 |
|---|----------------|----------------|
| Stock Exchange network and terminal user fees | 84,158 | 59,681 |
| Participants' subscription and application fees | 40,767 | 42,436 |
| Share registration services fees | 18,500 | 25,155 |
| Income received from former clearing house | - | 15,960 |
| Non-interest investment income (note 7) | 24,169 | 32,354 |
| Miscellaneous income | 41,347 | 35,429 |
| | <u>208,941</u> | <u>211,015</u> |

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7. PROFIT BEFORE TAXATION

| | 2002 \$'000 | 2001 \$'000 |
|--|----------------|----------------|
| Profit before taxation is stated after crediting/(charging): | | |
| Staff costs, excluding retirement benefit costs and Directors' emoluments | (437,407) | (468,160) |
| Retirement benefit costs, excluding Directors' emoluments | (47,195) | (51,357) |
| Auditors' remuneration | (1,438) | (1,914) |
| Interest on bank loans and overdrafts repayable within five years | (1,736) | (812) |
| Operating lease rentals | | |
| – land and buildings | (64,716) | (66,347) |
| – computer systems and equipment | (72,275) | (76,900) |
| Non-interest investment income: | | |
| Realised and unrealised (loss)/gain on investments | | |
| – listed trading securities | (18,625) | 15,945 |
| – unlisted trading securities | 16,092 | 18,555 |
| – exchange difference | 21,725 | (4,775) |
| Dividend income | | |
| – listed securities | 4,977 | 2,516 |
| – unlisted securities | – | 113 |
| Gross rental income | 459 | 459 |
| Amortisation of goodwill (included in share of profits less losses of associated companies) | (1,568) | – |
| Depreciation | (163,139) | (152,669) |
| Interest expenses payable to Participants | (4,061) | (69,445) |
| Loss on disposal of fixed assets | (3,149) | (1) |

8. DIRECTORS' EMOLUMENTS

None of the fifteen Directors (2001: fifteen), except the Executive Director, received any emoluments during the year (2001: \$Nil). Total emoluments of the only Executive Director, excluding share option benefits, for the year amounted to \$7,947,000 (2001: \$8,477,000) of which \$7,072,000 (2001: \$7,075,000) was attributable to salaries, other allowances and benefits in kind. Employer's contribution to retirement scheme for the year amounted to \$875,000 (2001: \$875,000). No discretionary bonus was paid for 2002 (2001: \$527,000). No directors' fees were paid to any of the Directors (2001: \$Nil).

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8. DIRECTORS' EMOLUMENTS (continued)

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

9. FIVE TOP-PAID EMPLOYEES

One (2001: one) of the five top-paid employees was a Director, whose emoluments are disclosed in note 8. Details of the emoluments of the other four (2001: four) top-paid employees are as follows:

| | 2002 \$'000 | 2001 \$'000 |
|---|----------------|----------------|
| Salaries, other allowances and benefits in kind | 19,309 | 16,702 |
| Performance award | – | 843 |
| Retirement scheme contributions by employer | 2,174 | 1,816 |
| Compensation for loss of office | – | 3,727 |
| | <u>21,483</u> | <u>23,088</u> |

The emoluments of these employees are within the following bands:

| | 2002 Number of employees | 2001 Number of employees |
|---------------------------|--------------------------------|--------------------------------|
| \$4,000,001 – \$4,500,000 | 2 | – |
| \$4,500,001 – \$5,000,000 | – | 2 |
| \$5,000,001 – \$5,500,000 | – | – |
| \$5,500,001 – \$6,000,000 | 1 | 1 |
| \$7,000,001 – \$7,500,000 | 1 | – |
| \$7,500,001 – \$8,000,000 | – | 1 |
| | <u>4</u> | <u>4</u> |

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9. FIVE TOP-PAID EMPLOYEES (continued)

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.

10. RETIREMENT BENEFIT COSTS

The Group has sponsored two defined contribution provident fund schemes which are registered under ORSO and have obtained Mandatory Provident Fund (MPF) exemption. The two ORSO schemes, being the Hong Kong Exchanges and Clearing Provident Fund Scheme (the Plan) and the Hong Kong Futures Exchange Provident Scheme (the HKFE Scheme), are for all full-time permanent employees. Contributions to these two retirement schemes 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 defined contribution provident fund schemes approved by ORSO. Contributions to the MPF Scheme are in accordance with the statutory limits prescribed by the MPF Ordinance.

During the year, the HKFE Scheme's assets and liabilities were liquidated and the proceeds of \$9,742,912 were transferred to the Plan on 15 April 2002. All members have withdrawn from the HKFE Scheme and become members of the Plan. The HKFE Scheme was terminated on 15 July 2002.

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

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

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10. RETIREMENT BENEFIT COSTS (continued)

| | 2002 \$'000 | 2001 \$'000 |
|---|----------------|----------------|
| Forfeited contributions during the year and retained in the Plan | <u>2,981</u> | <u>2,154</u> |

Contributions to the HKFE Scheme were offset by contributions forfeited in respect of employees who left the HKFE Scheme before the contributions were fully vested. Forfeited contributions totalling \$40,275 were utilised during the year. Upon the termination of the HKFE Scheme, the balance of \$5,480 of forfeited contributions was reimbursed to the Futures Exchange.

11. TAXATION

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

| | 2002 \$'000 | 2001 \$'000 |
|--|----------------|----------------|
| Provision for Hong Kong Profits Tax for the year | 68,741 | 73,614 |
| Overprovision in respect of prior years | <u>(5,422)</u> | <u>(1,131)</u> |
| | 63,319 | 72,483 |
| Deferred taxation (note 11(b)) | <u>(8,022)</u> | <u>9,537</u> |
| | 55,297 | 82,020 |
| Share of taxation of associated companies | <u>1,309</u> | <u>-</u> |
| | <u>56,606</u> | <u>82,020</u> |

Hong Kong Profits Tax has been provided for at 16 per cent (2001: 16 per cent) on the estimated assessable profit for the year.

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11. TAXATION (continued)

(b) Deferred taxation in the consolidated balance sheet represents:

| | Group | |
|---|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 |
| At 1 Jan | 75,275 | 65,738 |
| Transfer (to)/from the consolidated profit and loss account (note 11(a)) | (8,022) | 9,537 |
| At 31 Dec | <u>67,253</u> | <u>75,275</u> |

The amount represents the tax effect of accelerated depreciation allowances on fixed assets.

The revaluation of investment property and land and buildings (note 13) does not constitute a timing difference for deferred taxation purposes as realisation of the revaluation surplus would not result in any tax liability.

There was no other material unprovided deferred taxation for the year.

12. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$592,968,000 (2001: \$740,426,000) and the weighted average of 1,042,665,487 shares (2001: 1,040,664,846) in issue during the year.

The share options outstanding as set out in note 25 did not have a material dilutive effect on the basic earnings per share.

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13. FIXED ASSETS

(a) Group

| | Investment property under long- term lease in Hong Kong \$'000 | Land and buildings under long- term lease in Hong Kong \$'000 | Computer trading and clearing systems \$'000 | Other computer hardware and software \$'000 | Leasehold improvements, furniture, equipment and motor vehicles \$'000 | Total \$'000 |
|---------------------------------|---|--|--|--|--|-----------------|
| Cost or valuation | | | | | | |
| At 1 Jan 2002 | 11,500 | 136,700 | 1,424,325 | 333,826 | 236,920 | 2,143,271 |
| Additions | - | - | 76,922 | 51,795 | 17,953 | 146,670 |
| Revaluation | (1,500) | (19,700) | - | - | - | (21,200) |
| Disposals | - | - | (38,881) | (4,848) | (15,672) | (59,401) |
| At 31 Dec 2002 | 10,000 | 117,000 | 1,462,366 | 380,773 | 239,201 | 2,209,340 |
| Representing | | | | | | |
| At cost | - | - | 1,462,366 | 380,773 | 239,201 | 2,082,340 |
| At valuation | | | | | | |
| - 31 Dec 2002 | 10,000 | 117,000 | - | - | - | 127,000 |
| | 10,000 | 117,000 | 1,462,366 | 380,773 | 239,201 | 2,209,340 |
| Accumulated depreciation | | | | | | |
| At 1 Jan 2002 | - | - | 949,262 | 253,931 | 153,968 | 1,357,161 |
| Charge for the year | - | 2,850 | 104,961 | 26,383 | 28,945 | 163,139 |
| Revaluation | - | (2,850) | - | - | - | (2,850) |
| Disposals | - | - | (36,089) | (4,845) | (15,284) | (56,218) |
| At 31 Dec 2002 | - | - | 1,018,134 | 275,469 | 167,629 | 1,461,232 |
| Net book value | | | | | | |
| At 31 Dec 2002 | 10,000 | 117,000 | 444,232 | 105,304 | 71,572 | 748,108 |
| At 31 Dec 2001 | 11,500 | 136,700 | 475,063 | 79,895 | 82,952 | 786,110 |

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13. FIXED ASSETS (continued)

(a) Group (continued)

The cost of investment property was \$8,229,000 (2001: \$8,229,000). The investment property was revalued as at 31 December 2002 on the basis of its open market value by Jones Lang LaSalle, an independent firm of qualified property valuers. A deficit of \$1,500,000 was charged to the investment properties revaluation reserve during 2002 (2001: deficit of \$4,200,000) (note 26).

Land and buildings were revalued as at 31 December 2002 on the basis of their open market value in existing use carried out by Jones Lang LaSalle, an independent firm of qualified property valuers. A deficit of \$16,850,000 was charged to other properties revaluation reserve during 2002 (2001: deficit of \$9,273,000) (note 26).

The total cost of land and buildings of the Group was \$101,087,000 (2001: \$101,087,000). The carrying value of these land and buildings as at 31 December 2002 would have been \$80,973,000 (2001: \$82,650,194) had they been carried at cost less accumulated depreciation.

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13. FIXED ASSETS (continued)

(b) HKEx

| | Other computer hardware and software \$'000 | Leasehold improvements, furniture, equipment and motor vehicles \$'000 | Total \$'000 |
|---------------------------------|--|--|-----------------|
| Cost | | | |
| At 1 Jan 2002 | 18,020 | 11,189 | 29,209 |
| Additions | 26,284 | 744 | 27,028 |
| Disposals | (75) | (40) | (115) |
| | <u>44,229</u> | <u>11,893</u> | <u>56,122</u> |
| | | | |
| Accumulated depreciation | | | |
| At 1 Jan 2002 | 2,616 | 2,024 | 4,640 |
| Charge for the year | 5,407 | 2,532 | 7,939 |
| Disposals | (46) | (9) | (55) |
| | <u>7,977</u> | <u>4,547</u> | <u>12,524</u> |
| | | | |
| Net book value | | | |
| At 31 Dec 2002 | <u>36,252</u> | <u>7,346</u> | <u>43,598</u> |
| At 31 Dec 2001 | <u>15,404</u> | <u>9,165</u> | <u>24,569</u> |

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14. INVESTMENTS IN ASSOCIATED COMPANIES

| | 2002 | Group 2001 |
|--|----------------------|---------------|
| | \$'000 | \$'000 |
| Share of net assets of associated companies | 8,215 | – |
| Goodwill on acquisition of shares in associated companies less amortisation (note a) | <u>25,321</u> | – |
| | 33,536 | – |
| Loan receivable from an associated company (note b) | <u>2,000</u> | – |
| | <u><u>35,536</u></u> | <u>–</u> |

(a) Goodwill

| | \$'000 |
|---|----------------------|
| Cost | |
| At 1 Jan 2002 | – |
| Addition on acquisition of shares in associated companies | <u>26,889</u> |
| At 31 Dec 2002 | <u><u>26,889</u></u> |
| Accumulated amortisation | |
| At 1 Jan 2002 | – |
| Charge for the year (note 7) | <u>1,568</u> |
| At 31 Dec 2002 | <u><u>1,568</u></u> |
| Net book value | |
| At 31 Dec 2002 | <u><u>25,321</u></u> |
| At 31 Dec 2001 | <u><u>–</u></u> |

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

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14. INVESTMENTS IN ASSOCIATED COMPANIES (continued)

(b) Loan receivable from an associated company is unsecured with interest payable semi-annually at prime rate per annum and is repayable on 31 May 2004.

(c) Details of the unlisted associated companies as at 31 December 2002 are as follows:

| Name | Place of incorporation | Principal activities | Particulars of shares held | Interest held |
|--|------------------------|---|----------------------------------|---------------|
| Computershare Hong Kong Investor Services Limited | Hong Kong | Provision of share registration services | 5,854 Class A ordinary shares | 24% |
| Wilco International Processing Services Limited | Hong Kong | Provision of transaction processing services to Stock Exchange Participants | 6 Class B ordinary shares | 30% |

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

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15. CLEARING HOUSE FUNDS

| | Group | |
|---|----------------|----------------|
| | 2002 | 2001 |
| | \$'000 | \$'000 |
| <hr/> | | |
| Net asset values of the Clearing House Funds are as follows: | | |
| HKSCC Guarantee Fund | 372,352 | 367,888 |
| SEOCH Reserve Fund | 134,185 | 128,837 |
| HKCC Reserve Fund | 474,211 | 447,429 |
| | <hr/> | <hr/> |
| | 980,748 | 944,154 |
| | <hr/> | <hr/> |
| Net assets of the Clearing House Funds are composed of: | | |
| Unlisted non-trading securities, at fair value | | |
| – debt securities | 155,688 | 340,821 |
| Contributions receivable from Broker Participants in CCASS | 31,490 | 28,390 |
| Bank balances and time deposits | 806,401 | 590,304 |
| | <hr/> | <hr/> |
| | 993,579 | 959,515 |
| Less: Other liabilities | (12,831) | (15,361) |
| | <hr/> | <hr/> |
| | 980,748 | 944,154 |
| | <hr/> | <hr/> |
| The Clearing House Funds are funded by: | | |
| Clearing Participants' contributions | 425,440 | 423,960 |
| Clearing houses' contributions | 320,200 | 320,200 |
| Accumulated investment income net of expenses attributable to: | | |
| – Clearing Participants' contributions | 176,643 | 157,975 |
| – Clearing houses' contributions | 58,465 | 42,019 |
| | <hr/> | <hr/> |
| | 980,748 | 944,154 |
| | <hr/> | <hr/> |

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15. CLEARING HOUSE FUNDS (continued)

Temporary fluctuations in fair value of investments are reflected in the assets and investment revaluation reserve of the Group. As at 31 December 2002, the aggregate cost and market value of the funds were \$980,748,000 and \$983,526,000 respectively (2001: \$944,154,000 and \$943,220,000 respectively).

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.

16. COMPENSATION FUND RESERVE ACCOUNT

The Securities and Futures Commission (SFC) is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). The Stock Exchange is required by the 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. The Stock Exchange maintains an account known as the Compensation Fund Reserve Account for all receipts and payments in relation to the Compensation Fund under the Rules of the Exchange, in particular the following:

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

The Compensation Fund is further explained in note 33(a)(i).

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17. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND

| | Group | |
|--|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 |
| Net asset value of HKCC's CDMD Fund | <u>914</u> | <u>914</u> |
| The Fund is composed of: | | |
| Unlisted non-trading securities, at fair value | | |
| – debt securities | <u>914</u> | <u>914</u> |
| The Fund represents: | | |
| Accumulated investment income net of expenses | | |
| appropriated from retained earnings | <u>914</u> | <u>914</u> |

Temporary fluctuations in fair value of investments are reflected in the assets and investment revaluation reserve of the Group. As at 31 December 2002, the aggregate cost and market value of the fund were \$914,000 and \$948,000 respectively (2001: \$914,000 and \$933,000 respectively).

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.

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18. NON-TRADING SECURITIES

| | Group | |
|--|--------|--------|
| | 2002 | 2001 |
| | \$'000 | \$'000 |
| <hr/> | | |
| Analysis of non-trading securities: | | |
| Current | – | – |
| Non-current | 87,604 | 52,366 |
| | <hr/> | <hr/> |
| | 87,604 | 52,366 |
| | <hr/> | <hr/> |
| Non-trading securities, at fair value: | | |
| Equity securities | | |
| – listed outside Hong Kong | 55,301 | 52,366 |
| – unlisted | 32,303 | – |
| | <hr/> | <hr/> |
| | 87,604 | 52,366 |
| | <hr/> | <hr/> |

19. MARGIN FUNDS ON DERIVATIVES CONTRACTS

| | Group | |
|---|-----------|-----------|
| | 2002 | 2001 |
| | \$'000 | \$'000 |
| <hr/> | | |
| The margin funds comprise: | | |
| SEOCH Clearing Participants' margin funds | 757,333 | 740,934 |
| HKCC Clearing Participants' margin funds | 3,794,268 | 4,062,173 |
| | <hr/> | <hr/> |
| | 4,551,601 | 4,803,107 |
| | <hr/> | <hr/> |
| The assets of the margin funds comprise: | | |
| Bank balances and time deposits | 2,148,753 | 2,339,051 |
| Listed securities deposited as alternatives to cash deposits, at market value | 1,119,682 | 1,312,995 |
| Margin receivable from Clearing Participants | 3,198 | – |
| Listed non-trading securities, at fair value | | |
| – debt securities | 173,907 | 68,208 |
| Unlisted non-trading securities, at fair value | | |
| – money market fund | 162,484 | 229,127 |
| – debt securities | 943,577 | 853,726 |
| | <hr/> | <hr/> |
| | 4,551,601 | 4,803,107 |
| | <hr/> | <hr/> |
| 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 | 4,551,601 | 4,803,107 |
| | <hr/> | <hr/> |

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

(a) Accounts receivable, prepayments and deposits

| | Group | | HKEx | |
|--|------------------|------------------|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 | 2002 \$'000 | 2001 \$'000 |
| Receivable from Exchange and Clearing Participants: | | | | |
| – CNS money obligations | 2,647,591 | 1,727,190 | – | – |
| – transaction levy, stamp duty and fee receivable | 94,237 | 101,440 | – | – |
| Other fees receivable | 229,094 | 210,282 | – | – |
| Interest receivable | 61,598 | 48,157 | – | – |
| Other receivables, prepayments and deposits | 85,679 | 247,698 | 20,337 | 16,889 |
| | 3,118,199 | 2,334,767 | 20,337 | 16,889 |

(b) Accounts payable, accruals and other liabilities

| | Group | | HKEx | |
|---|------------------|------------------|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 | 2002 \$'000 | 2001 \$'000 |
| Payable to Exchange and Clearing Participants: | | | | |
| – CNS money obligations | 2,647,066 | 1,669,621 | – | – |
| – cash collateral and others | 30,994 | 27,872 | – | – |
| – arising from stock option activities | 577 | 57,868 | – | – |
| Transaction levy payable to the SFC | 16,146 | 19,420 | – | – |
| Unclaimed dividends (note c) | 105,574 | 94,880 | 6,085 | – |
| Stamp duty payable | 22,817 | 30,119 | – | – |
| Deposits received | 55,590 | 96,210 | – | – |
| Other payables and accruals | 128,628 | 737,316 | 64,258 | 22,650 |
| | 3,007,392 | 2,733,306 | 70,343 | 22,650 |

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20. ACCOUNTS RECEIVABLE, PREPAYMENTS AND DEPOSITS/ ACCOUNTS PAYABLE, ACCRUALS AND OTHER LIABILITIES (continued)

- (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 85 per cent (2001: 74 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 88 per cent (2001: 61 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.

21. TRADING SECURITIES

| | Group | |
|---|------------------|------------------|
| | 2002 \$'000 | 2001 \$'000 |
| Equity securities, at fair value | | |
| – listed in Hong Kong | 40,775 | 11,547 |
| – listed outside Hong Kong | 66,251 | 94,688 |
| | <u>107,026</u> | <u>106,235</u> |
| Debt securities, at fair value | | |
| – listed in Hong Kong | 99,182 | 103,419 |
| – listed outside Hong Kong | 982,757 | 695,491 |
| | <u>1,081,939</u> | <u>798,910</u> |
| Unlisted debt securities, at fair value | 2,301,081 | 2,277,382 |
| | <u>3,490,046</u> | <u>3,182,527</u> |

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22. 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.

23. PROVISIONS

(a) Group

| | Reinstatement costs \$'000 | Employee benefit costs \$'000 | Total \$'000 |
|---|----------------------------------|-------------------------------------|-----------------|
| At 1 Jan 2002 | 31,243 | 23,826 | 55,069 |
| Provision for the year | 228 | 33,435 | 33,663 |
| Amount used during the year | – | (31,063) | (31,063) |
| Unused amount reversed during the year | (6,190) | – | (6,190) |
| Amount paid during the year | (145) | (2,372) | (2,517) |
| At 31 Dec 2002 | <u>25,136</u> | <u>23,826</u> | <u>48,962</u> |
| | | 2002 \$'000 | 2001 \$'000 |
| Analysis of provisions: | | | |
| Current | | 28,863 | 25,927 |
| Non-current | | 20,099 | 29,142 |
| | | <u>48,962</u> | <u>55,069</u> |

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23. PROVISIONS (continued)

(b) HKEx

| | Employee benefit costs \$'000 | |
|-------------------------------------|-------------------------------------|----------------|
| At 1 Jan 2002 | | 5,129 |
| Transfer from subsidiaries (note c) | | 18,697 |
| Provision for the year | | 33,435 |
| Amount used during the year | | (31,063) |
| Amount paid during the year | | (2,372) |
| | | <u>23,826</u> |
| At 31 Dec 2002 | | <u>23,826</u> |
| | 2002 \$'000 | 2001 \$'000 |
| Analysis of provisions: | | |
| Current | 23,826 | 5,129 |
| Non-current | - | - |
| | <u>23,826</u> | <u>5,129</u> |

- (c) The employment of all staff members of the Group was centralized under HKEx with effect from 1 April 2002. Consequently, all provisions for employee benefit costs were transferred from the subsidiaries to HKEx.

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

(a) Investments in subsidiaries

| | HKEx | |
|---|------------------|------------------|
| | 2002 \$'000 | 2001 \$'000 |
| Investments in unlisted shares, at cost | <u>4,145,198</u> | <u>4,145,198</u> |

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

(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

HKEEx had direct or indirect interests in the following subsidiaries as at 31 December 2002, all of which are wholly-owned private companies incorporated and operating in Hong Kong except for HKEEx (China) Limited, which operates mainly in the PRC. Details of these companies are as follows:

| Company | Issued and fully paid up share capital | Principal activities | Interest held |
|---|---|--|------------------|
| Direct subsidiaries: | | | |
| The Stock Exchange of Hong Kong Limited | A shares \$929 | Operates the single, unified stock exchange in Hong Kong for the purposes of the Stock Exchanges Unification 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% |

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

(c) Particulars of subsidiaries (continued)

| Company | Issued and fully paid up share capital | Principal activities | Interest held |
|---|--|---|------------------|
| Direct subsidiaries: (continued) | | | |
| HKEx (Singapore) Limited | Ordinary \$2 | Investment holding | 100% |
| HKEx (China) Limited | Ordinary \$2 | Promotes HKEx products and services in the PRC | 100% |
| Indirect subsidiaries: | | | |
| The SEHK Options Clearing House Limited | Ordinary \$1,000,000 | Operates a clearing house for option contracts traded on the Stock Exchange | 100% |
| HKEx Information Services Limited | Ordinary \$100 | Sale of stock market information | 100% |
| Prime View Company Limited | Ordinary \$20 | Property holding | 100% |
| The Stock Exchange Club Limited | Ordinary \$8 | Property holding | 100% |
| The Stock Exchange Nominee Limited | Ordinary \$2 | Nominee services | 100% |

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24. 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 |
|---|--|--|------------------|
| Indirect subsidiaries: (continued) | | | |
| 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% |

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25. SHARE CAPITAL AND SHARE PREMIUM

| | | 2002 \$'000 | | 2001 \$'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 and 31 Dec 2001 | 1,040,664,846 | 1,040,665 | – | 1,040,665 |
| Shares issued under share option scheme | <u>2,916,000</u> | <u>2,916</u> | <u>19,012</u> | <u>21,928</u> |
| At 31 Dec 2002 | <u>1,043,580,846</u> | <u>1,043,581</u> | <u>19,012</u> | <u>1,062,593</u> |

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

During the year, options were exercised to subscribe for 2,916,000 shares (2001: Nil) in HKEx at a consideration of \$7.52 per share, of which \$1.00 per share was credited to share capital and the balance of \$6.52 per share was credited to the share premium account.

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25. SHARE CAPITAL AND SHARE PREMIUM (continued)

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

| Number of shares issuable under the share options outstanding as at 1 Jan 2002 | Number of share options forfeited | Number of share options granted | Number of share options exercised | Number of shares issuable under the share options outstanding as at 31 Dec 2002 |
|---|--|--|--|--|
| 27,267,384 | (1,098,364) | - | (2,916,000) | 23,253,020 |

No specific accounting guidance has been issued by the Hong Kong Society of Accountants (HKSA) on the accounting for employee share options. In November 2002, the International Accounting Standards Board (IASB) published an exposure draft, ED2 – Share-based Payment, which covers the accounting treatment for employee share options. The exposure draft is expected to be finalized as an International Financial Reporting Standard (IFRS) sometime in 2003.

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

When the Pre-listing share options are exercised and new shares are issued, the share capital is increased by the nominal value of the new shares issued and the share premium account is increased by the remainder of the proceeds. HKEx has not expensed the share options to the profit and loss account as the proposed international accounting standard ED2 does not recommend expensing options which were granted before the adoption of the new standard. Had all the outstanding Pre-listing options been fully exercised on 31 December 2002, the Group would have received \$174,862,710 in proceeds. The market value of the shares issued based on the closing price of \$9.80 per share on that date was \$227,879,596, and the employees concerned would have made a gain of \$2.28 per share, or, in aggregate, \$53,016,886.

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26. REVALUATION RESERVES

| | Investment properties revaluation reserve \$'000 | Group Other properties revaluation reserve \$'000 | Investment revaluation reserve \$'000 | Total \$'000 |
|---|--|--|--|-----------------|
| At 1 Jan 2001 | 7,471 | 42,906 | 33,976 | 84,353 |
| Change in valuation of properties | (4,200) | (9,273) | – | (13,473) |
| Change in fair value of non-trading securities | – | – | 1,886 | 1,886 |
| Realisation of change in fair value of non-trading securities on maturity and disposal | – | – | (28,969) | (28,969) |
| At 31 Dec 2001 | 3,271 | 33,633 | 6,893 | 43,797 |
| Change in valuation of properties (note 13(a)) | (1,500) | (16,850) | – | (18,350) |
| Change in fair value of non-trading securities | – | – | 14,548 | 14,548 |
| Realisation of change in fair value of non-trading securities on maturity and disposal | – | – | (6,015) | (6,015) |
| At 31 Dec 2002 | 1,771 | 16,783 | 15,426 | 33,980 |

The revaluation reserves are segregated for their respective specific purposes.

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27. DESIGNATED RESERVES

| | Group | |
|--|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 |
| Clearing House Funds reserves (note a) | | |
| – HKSCC Guarantee Fund reserve | 255,912 | 254,428 |
| – SEOCH Reserve Fund reserve | 47,185 | 44,837 |
| – HKCC Reserve Fund reserve | 252,211 | 220,929 |
| | <u>555,308</u> | <u>520,194</u> |
| Compensation Fund Reserve Account reserve (note b) | 35,827 | 35,146 |
| CDMD Fund reserve (note c) | 914 | 914 |
| Development reserve (note d) | 135,762 | 135,762 |
| | <u>727,811</u> | <u>692,016</u> |

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

(a) Clearing House Funds reserves

| | HKSCC Guarantee Fund reserve \$'000 | SEOCH Reserve Fund reserve \$'000 | HKCC Reserve Fund reserve \$'000 | Total \$'000 |
|---|---|---|--|-----------------|
| At 1 Jan 2001 | 241,861 | 35,132 | 197,162 | 474,155 |
| Investment income net of expenses of Clearing House Funds transferred from retained earnings | 12,567 | 9,705 | 23,767 | 46,039 |
| At 31 Dec 2001 | 254,428 | 44,837 | 220,929 | 520,194 |
| Investment income net of expenses of Clearing House Funds transferred from retained earnings | 1,484 | 2,348 | 31,282 | 35,114 |
| At 31 Dec 2002 | <u>255,912</u> | <u>47,185</u> | <u>252,211</u> | <u>555,308</u> |

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27. DESIGNATED RESERVES (continued)

(b) Compensation Fund Reserve Account reserve

| | \$'000 |
|---|---------------|
| At 1 Jan 2001 | 31,107 |
| Investment income net of expenses of Compensation | |
| Fund Reserve Account transferred from retained earnings | <u>4,039</u> |
| At 31 Dec 2001 | 35,146 |
| Investment income net of expenses of Compensation | |
| Fund Reserve Account transferred from retained earnings | <u>681</u> |
| At 31 Dec 2002 | <u>35,827</u> |

(c) CDMD Fund reserve

There were no movements in 2001 and 2002.

(d) Development reserve

The reserve was set aside for systems development for the Stock Exchange. There were no movements in 2001 and 2002.

28. 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 29(c).

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29. RETAINED EARNINGS

| | Group | | HKEx | |
|---|----------------|----------------|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 | 2002 \$'000 | 2001 \$'000 |
| At 1 Jan | | | | |
| Retained earnings | 3,198,763 | 2,851,834 | 28,252 | (89,248) |
| Proposed and declared dividend | 260,166 | 260,166 | 260,166 | 260,166 |
| Profit for the year (note a) | 592,968 | 740,426 | 612,708 | 460,919 |
| Investment income net of expenses of Clearing House Funds transferred to Clearing House Funds reserves | (35,114) | (46,039) | - | - |
| Investment income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund Reserve Account reserve | (681) | (4,039) | - | - |
| Dividends paid: | | | | |
| Interim dividend | (83,450) | (83,253) | (83,450) | (83,253) |
| 2001/2000 final dividend | (260,166) | (260,166) | (260,166) | (260,166) |
| Dividend on shares issued for share options exercised after declaration of 2001 final dividend | (448) | - | (448) | - |
| Dividend on shares issued for share options exercised after declaration of 2002 interim dividend | (30) | - | (30) | - |
| At 31 Dec | 3,672,008 | 3,458,929 | 557,032 | 288,418 |
| Representing: | | | | |
| Retained earnings at 31 Dec | 3,223,268 | 3,198,763 | 108,292 | 28,252 |
| Proposed and declared dividend | 448,740 | 260,166 | 448,740 | 260,166 |
| At 31 Dec | 3,672,008 | 3,458,929 | 557,032 | 288,418 |

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29. RETAINED EARNINGS (continued)

- (a) Profit attributable to shareholders includes a profit of \$612,708,000 (2001: \$460,919,000) which has been dealt with in the accounts of HKEx, the holding company of the Group.
- (b) The Group's profit after taxation includes the investment income net of expenses of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$14,480,000 (2001: \$39,713,000).
- (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 28) and retained earnings of \$1,119,321,000.

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30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

| | 2002 \$'000 | 2001 \$'000 |
|---|------------------|--------------------|
| Profit before taxation | 649,574 | 822,446 |
| Adjustments for: | | |
| Net interest income | (260,815) | (381,950) |
| Dividends received from non-trading securities | (2,482) | (2,516) |
| Gain on trading securities and exchange differences on investments | (19,192) | (29,725) |
| Depreciation and amortisation | 163,139 | 152,669 |
| Changes in provisions | - | (4,185) |
| Share of profits less losses of associated companies | (6,141) | - |
| Loss on disposal of fixed assets | 3,149 | 1 |
| Operating profit before working capital changes | 527,232 | 556,740 |
| Net increase in trading securities | (290,645) | (3,152,802) |
| Settlement of amount transferred from retained earnings to Clearing House Funds and Compensation Fund Reserve Account | (35,795) | (50,078) |
| (Increase)/decrease in accounts receivable, prepayments and deposits | (765,155) | 315,248 |
| Increase/(decrease) in other current liabilities | 281,112 | (218,534) |
| Net cash outflow from operations | (283,251) | (2,549,426) |
| Interest received from banks and trading securities | 211,500 | 247,957 |
| Interest paid | (6,176) | (69,788) |
| Hong Kong Profits Tax paid | (57,877) | (114,473) |
| Refund of Hong Kong Profits Tax | 9,319 | 42 |
| Net cash outflow from operating activities | <u>(126,485)</u> | <u>(2,485,688)</u> |

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30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Analysis of cash and cash equivalents

| | 2002 \$'000 | 2001 \$'000 |
|---|----------------|------------------|
| Time deposits with original maturity within three months | 629,776 | 918,620 |
| Cash at bank and in hand | 50,180 | 433,344 |
| Cash and cash equivalents at the end of the year | <u>679,956</u> | <u>1,351,964</u> |

(c) The net assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund 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 except for the investment income net of expenses of these funds which has been accounted for as the Group's assets and profit.

(d) Following the adoption of SSAP 15 (revised), Cash Flow Statements, certain comparatives previously reported have been restated to conform to the new policy.

31. COMMITMENTS

(a) Commitments in respect of capital expenditures:

| | Group | | HKEx | |
|--------------------------------------|----------------|----------------|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 | 2002 \$'000 | 2001 \$'000 |
| Contracted but not provided for | 36,454 | 50,194 | 2,994 | 944 |
| Authorised but not contracted for | 57,170 | 267,199 | 13,222 | 83,873 |
| | <u>93,624</u> | <u>317,393</u> | <u>16,216</u> | <u>84,817</u> |

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

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31. COMMITMENTS (continued)

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

| | Group | | HKEx | |
|---|----------------|----------------|----------------|----------------|
| | 2002 \$'000 | 2001 \$'000 | 2002 \$'000 | 2001 \$'000 |
| Land and buildings, payable | | | | |
| – within one year | 73,697 | 59,128 | 74 | – |
| – in the second to fifth years | 114,493 | 181,540 | – | – |
| | <u>188,190</u> | <u>240,668</u> | <u>74</u> | <u>–</u> |
| Computer systems and equipment, payable | | | | |
| – within one year | 55,694 | 49,664 | 28,455 | – |
| – in the second to fifth years | 46,899 | 41,279 | 16,510 | – |
| – after five years | 3,357 | 10,072 | – | – |
| | <u>105,950</u> | <u>101,015</u> | <u>44,965</u> | <u>–</u> |
| | <u>294,140</u> | <u>341,683</u> | <u>45,039</u> | <u>–</u> |

As at 31 December 2002, in respect of computer systems and equipment, the majority of the leases would mature within three years and the Group did not have any purchase options.

32. FINANCIAL RISK MANAGEMENT

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts are used to hedge the currency exposures of the Group's non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 31 December 2002, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$197 million (2001: HK\$120 million). All contracts will mature within 3 months.

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33. CONTINGENT LIABILITIES

(a) Group

- (i) The Compensation Fund is a fund set up under the SO for the purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of a default of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is \$8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at \$8 million per default. As at 31 December 2002, there were outstanding claims received in respect of 14 defaulted Stock Exchange Participants (2001: 15).

Under the new compensation arrangements to be implemented on 1 April 2003 under the Securities and Futures Ordinance (SFO), a new Investor Compensation Fund would replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. The new arrangements would not require Exchange Participants to make deposits to the Investor Compensation Fund. Existing deposits would be returned to the Stock Exchange and the Futures Exchange in accordance with the provisions of the SFO. The arrangements would remove the requirement for the Stock Exchange to replenish the Investor Compensation Fund.

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33. CONTINGENT LIABILITIES (continued)

(a) Group (continued)

- (ii) The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to \$200,000 in respect of default of any one Participant. In the unlikely event that all of its 471 trading Participants as at 31 December 2002 (2001: 492) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$94 million (2001: \$98 million).
- (iii) Pursuant to Section 21 of the Exchanges and Clearing Houses (Merger) Ordinance, 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 the obligations of HKSCC in CCASS in circumstances where CCASS Participants default on their payment obligations. As at 31 December 2002 and 31 December 2001, none of these banking facilities was utilised.
- (ii) HKEx has given a guarantee to secure banking facilities of SGD12 million to HKEx (Singapore) Limited for financing its investments since 16 April 2001. As at 31 December 2002, SGD11 million (equivalent to HK\$49 million) of the facility was drawn down (2001: SGD11 million, equivalent to HK\$46 million). The loan will mature within one year and has a fixed rate of interest.

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34. MATERIAL RELATED PARTY TRANSACTIONS

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

35. OFF BALANCE SHEET RISKS

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

36. BANKING FACILITIES WITH ASSETS PLEDGED

As at 31 December 2001, the Group had a \$10 million overdraft facility with a bank in Hong Kong, which was secured by a pledge of the Group's time deposits of an equivalent amount at that bank. This overdraft facility was not utilised and was terminated during the year. The Group did not have any assets pledged as at 31 December 2002.