

# THE CHINA FUND

## NOTES TO THE FINANCIAL STATEMENTS (unaudited)

### 1. GENERAL

The Company is an investment fund, whose principal investment objective is the long term capital appreciation of its assets. The Company invests in equity and equity linked securities in China, and in companies with significant assets in, or significant earnings derived from China, including Chinese companies the securities of which either are or will be listed, either directly or indirectly, on any recognized stock exchange.

### 2. IMPACT OF NEW INTERNATIONAL ACCOUNTING STANDARD

The following new International Accounting Standard (“IAS”) has been adopted for the first time in the preparation of the current period’s financial statements.

- **IAS 39: Financial Instruments: Recognition and Measurement**

IAS 39 prescribes the principles for recognizing, measuring and disclosing information on financial instruments. As further explained in the accounting policy note below, all investments are classified as available for sale and are stated at fair value, with changes in fair value recognized in the revenue reserve. Further, on derecognition of financial assets, the realized gains and losses on investments are recognized in the revenue reserve.

Prior to the adoption of IAS 39, realized and unrealized gains and losses on investments arising from changes in the fair value, and foreign exchange gains and losses were recognized in the capital reserve. This accounting policy has been changed and the effect of adopting IAS 39 at 1st April 2001 has been reflected in the statement of movements in reserve and represents reclassification of previously reported unrealized gains and losses on investments of US\$546,679 from capital reserve to revenue reserve.

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## NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of preparation

These financial statements have been prepared in accordance with the International Accounting Standards issued by the International Accounting Standards Committee (“IASC”) and the Interpretations issued by the Standing Interpretations Committee of the IASC.

The Company’s Interim Report for the period ended 30th September 2001 has been prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting”.

For the current period, the Company has adopted International Accounting Standard 39 “Financial Instruments: Recognition and Measurement” (“IAS 39”) which is effective for accounting periods commencing on or after 1st January 2001.

#### (b) Accounting convention

These financial statements have been prepared under the historical cost convention, modified to include the revaluation of investments.

#### (c) Listed investments

At 1st April 2001 the Company adopted IAS 39 and classified its investment securities as “available for sale”.

The Fund intends to hold the investments for an indefinite period, which may be purchased or sold in response to changes in available cash resources arising from share subscriptions and redemptions. The investment manager would also buy and sell investment securities to balance the risks in the portfolio in response to changes in market conditions and to meet designated investment restrictions.

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## NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### (c) Listed investments (Cont'd)

All investments are initially recognized at cost, which includes transaction costs. Available-for-sale securities are subsequently re-measured at fair value. Fair values are based on quoted market prices on the principal stock exchange on which the listed securities are traded, subject to adjustments made in good faith by the directors. Adjustments may be made where overriding circumstances exist whereby another valuation basis gives a more accurate and reliable determination of fair value. Such adjustments may be made where there is infrequent activity in the market, the market is not well established (such as “over the counter” markets) or small volumes are traded relative to the number of units to be valued.

Unrealized gains and losses arising from changes in the fair value of securities classified as available for sale are recognized in the revenue account as they arise.

Realized gains and losses on investments are calculated on the average cost basis and are recognized in the revenue account.

For investments purchased in currencies other than United States dollars, for disclosure purposes, the original costs are translated into United States dollars at the rates ruling at the balance sheet date.

All purchases and sales of investments that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recognized on the trade date, which is the date on which the Company commits to purchase or sell the asset. In cases which are not within the frame established by regulation or market convention, such transactions are recognized on the settlement date. Any change in fair value of the asset to be received is recognized between the trade date and settlement date.

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## NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### (d) Dividends receivable

Dividends are recorded as being receivable on their ex-dividend dates. The ex-dividend dates for those dividends receivable as at 30th September 2001 and 31st March 2001 had occurred within one month and three months respectively, of the balance sheet date.

Dividends are generally paid one week after the ex-dividend date for equities quoted on the Shenzhen Stock Exchange and two to three days after the ex-dividend date for those quoted on the Shanghai Securities Exchange. There is no such general fixed period between the ex-dividend date and payment date for equities quoted on the Hong Kong Stock Exchange ("HKSE").

#### (e) Amounts due from brokers

Amounts due from brokers are carried at cost which is the fair value of the consideration to be received in the future for investments sold, net of charges to be paid for services received, whether or not they are billed to the Company.

Investments are settled according to the normal settlement period of the relevant stock exchange, which is usually within one week of the trade date. The amounts due from brokers included in the Company's balance sheet as at 31st March 2001 were settled in accordance with these trade terms.

#### (f) Accounts payable and accrued liabilities

All of the accounts payable in the Company's balance sheet as at 30th September 2001 and 31st March 2001 were incurred within two months of the balance sheet date. Accrued liabilities represent estimates of liabilities for which accounts have not yet been received.

# THE CHINA FUND

## NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### (g) Amounts due to brokers

Amounts due to brokers are carried at cost which is the fair value of the consideration to be paid in the future for investments purchased and services received, whether or not billed to the Company.

Investments are settled within normal settlement periods of the relevant stock exchanges, which are usually within one week after the trade date. The amounts due to brokers included in the Company's balance sheet as at 31st March 2001 were settled according to these trade terms.

#### (h) Revenue recognition

Bank interest income is recognized in the Revenue Account on a time proportion basis, taking into account the principal outstanding and the effective rate of interest applicable.

Dividend income is recognized in the Revenue Account when the Company's right to receive payment is established, which is the date on which equities are quoted as ex-dividend.

The Explanatory Memorandum states that any net loss in a particular year is written off against the Capital Reserve in that year and is not carried forward.

#### (i) Foreign currency transactions

The Company maintains its books and records in United States dollars. Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. All assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the revenue account.

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## NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### (j) Equalization

Equalization is the accrued income or loss included in the issue/repurchase price of shares and is dealt with in the Revenue Account following the issue/repurchase of shares.

#### (k) Cash and cash equivalents

Cash on hand and at banks and short term deposits which are held to maturity are carried at cost.

Cash and cash equivalents are defined as cash on hand, demand deposits and short term, highly liquid investments which are readily convertible into known amounts of cash and which are subject to insignificant risk of changes in value.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and deposits at banks.

#### (l) Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party, or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

# THE CHINA FUND

## NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

### 4. TAXATION

Under the current laws of the Cayman Islands, the Company is not required to pay any taxes in the Cayman Islands on either income or capital gains. The Company has received an undertaking from the Governor in Council of the Cayman Islands, pursuant to the provisions of Section 6 of the Tax Concessions Law (Revised), which exempts the Company from any such tax at least until the year 2012.

No provision has been made for taxation in the People's Republic of China as dividends and gains realized from the sale of "B" shares are not taxable.

No provision for Hong Kong profits tax has been made as the Company is exempted from taxation under Section 26A (1A) of the Inland Revenue Ordinance.

### 5. FEES

#### **Investment management fee**

Deutsche Asset Management (Asia) Limited is entitled to receive a fee calculated on the basis of the average daily Net Asset Value (before deduction of the fees of the Investment Manager, the Custodian and the Administrator) of the Company at the annual rate of 0.75%, subject to a minimum annual fee of US\$100,000.

#### **Administration fee**

The Administrator is entitled to receive a fee calculated on the Net Asset Value of the Company, subject to a minimum monthly fee of US\$4,000, at the following annual rates:

- 0.25% from US\$Nil to US\$50 million
- 0.20% from US\$50 million to US\$75 million
- 0.15% from US\$75 million to US\$100 million
- 0.10% above US\$100 million

## **THE CHINA FUND**

### **NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)**

#### **5. FEES (Cont'd)**

##### **Administration fee (Cont'd)**

Effective as at 20th July 2001, the Directors approved that the role of Administrator be assigned from Fortis Bank (Cayman) Limited to Fortis Fund Services (Cayman) Limited ("FFSCL"). Both companies are 100% owned subsidiaries of the same ultimate parent company. FFSCL is a Licensed Mutual Fund Administrator under The Mutual Funds Law (2001 Revision) of the Cayman Islands.

Fortis Fund Services (Asia) Limited, the Sub-Administrator, is entitled to a fee payable out of the Administration Fee.

##### **Custodian fee**

Fortis Bank (Nederland) N.V. does not receive any fees in its capacity as a custodian.

Citibank N.A., Hong Kong, a sub-custodian, is entitled to receive fees based on the month-end market value of the Company's investment holdings, at the annual rate of 0.06% for investments listed on the Shanghai Securities Exchange and the Shenzhen Stock Exchange, and 0.03% for the investments listed on the HKSE.

In addition, the sub-custodian is entitled to receive transaction fees amounting to US\$60 for each transaction involving shares listed on the Shanghai Securities Exchange and the Shenzhen Stock Exchange, and US\$40 for shares listed on the HKSE.

#### **6. (LOSS)/EARNINGS PER SHARE**

The calculation of basic (loss)/earnings per share is based on the net loss for the period of US\$2,534,226 (net income for the period ended 30th September, 2000: US\$384,181) and the weighted average of 1,245,006 (2000: 1,221,841) ordinary shares in issue during the period.

Diluted earnings per share has not been presented as there were no diluting events.



## THE CHINA FUND

### NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

#### 7. LISTED INVESTMENTS

	30/9/2001 US\$	31/3/2001 US\$
Listed investments, at cost	20,970,452	22,602,185
Unrealized (losses)/gains	<u>(2,549,938)</u>	<u>546,679</u>
Market value at balance sheet date	<u>18,420,514</u>	<u>23,148,864</u>

#### 8. FINANCIAL ASSETS AND LIABILITIES AND RISK MANAGEMENT POLICY OF THE COMPANY

In pursuing its objectives as set out in the Investment Manager's report, the Company holds a number of financial instruments:

1. Equities and equity related securities which are held in accordance with the Company's objectives; and
2. Cash, liquid resources and short term debtors and creditors that arise directly from the Company's operations.

Details of the investment strategy of the Investment Manager during the period are contained within their report to the Company.

The investments held by the Company are set out in the portfolio of investments. The Company has no financial liabilities other than short-term creditors. The main risks relating to investments are set out below.

##### (a) Market price risk

Market price risk arises mainly from uncertainty about future prices of the financial instruments held. It represents the potential loss the Company might suffer through holding market positions in the face of price movements.

## THE CHINA FUND

### NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

#### **8. FINANCIAL ASSETS AND LIABILITIES AND RISK MANAGEMENT POLICY OF THE COMPANY (Cont'd)**

##### **(a) Market price risk (Cont'd)**

The Company is exposed to market price risk on all of its investments.

The Company employs efficient portfolio management techniques to provide a degree of protection against market price falls. The Investment Manager's Investment Policy Committee meets on a formal basis monthly and frequently intra-monthly to discuss market developments. It also meets in response to unexpected external developments. The role of the committee is to analyze markets, to form opinions on the relative attractions of each asset class and to set asset mix targets.

The fund management team is responsible for monitoring the portfolio in accordance with the overall asset allocation parameters. It also seeks to ensure that individual stocks meet acceptable risk/reward profiles.

##### **(b) Liquidity risk**

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet commitments associated with financial assets.

Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.

The Company's exposure to liquidity risk is considered to be relatively minimal as all of the investments of the Company are publicly listed.

The Investment Manager will normally keep an allocation of cash to meet pending liabilities that may arise from time to time.

##### **(c) Credit risk**

Credit risk is the risk that one party to a financial asset will fail to discharge its obligation and cause the other party to incur a financial loss. Substantially all of the Company's cash and cash equivalents are deposited with a single reputable financial institution and as a result, it is exposed to a concentration of credit risk.

## THE CHINA FUND

### NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

#### **8. FINANCIAL ASSETS AND LIABILITIES AND RISK MANAGEMENT POLICY OF THE COMPANY (Cont'd)**

##### **(c) Credit risk (Cont'd)**

The Investment Manager buys and sells investments only through brokers which have been approved by the Deutsche Asset Management (Asia) Limited Risk Committee. These approved brokers are monitored to determine that they remain acceptable counterparties. In addition, the maximum exposure to any one broker is limited and these limits are reviewed on an ongoing basis.

##### **(d) Foreign currency risk**

Foreign currency risk is the risk that the value of financial assets or liabilities will fluctuate due to changes in foreign exchange rates. The Company is exposed to foreign currency risk from investments which are denominated in currencies other than United States dollars.

Financial assets and liabilities, other than listed investments described above, are subject to foreign currency risk and credit risk.

##### **(e) Interest rate risk**

Interest rate risk is the risk that the values of interest bearing financial instruments will fluctuate in value as a result of changes in interest rates.

Other than the call deposit held as at the balance sheet date which has an effective interest rate of 1.75% per annum, the Fund mainly invests in equity securities and as such, its exposure to interest rate risks is considered to be relatively minimal.

## THE CHINA FUND

### NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

#### 9. SHARE CAPITAL

	30/9/2001 US\$	31/3/2001 US\$
Authorized:		
90,000,000 ordinary shares of US\$0.01 each	<u>900,000</u>	<u>900,000</u>
Issued and fully paid:		
1,173,831 (31/3/01: 1,272,504) ordinary shares of US\$0.01 each	<u>11,738</u>	<u>12,725</u>

The Company repurchased 101,871 and issued 3,198 of its listed ordinary shares during the period, priced at the Net Asset Value of the shares on the respective repurchase and issue dates, adjusted for a dealing charge of 0.50%. The repurchase prices ranged from US\$14.95 to US\$23.19 per share, and the issue price was US\$18.76 per share. The Company paid US\$1,764,960 in aggregate for the shares repurchased and received US\$59,675 in aggregate for the shares issued during the period.

The Company did not buy back any of its listed ordinary shares on The Stock Exchange of Hong Kong Limited during the period.

#### 10. NET ASSET VALUE PER SHARE

The calculation of net asset value per share is based on net assets as at 30th September 2001 of US\$19,471,770 (31/3/01: US\$23,964,396) and 1,173,831 (31/3/01: 1,272,504) ordinary shares in issue at that date.

# **THE CHINA FUND**

## **NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)**

### **11. DIVIDEND**

The directors do not recommend the payment of an interim dividend for the period ended 30th September 2001 (2000: Nil).

A dividend of US\$0.24 per ordinary share totalling 296,552 was paid on 4th September 2001 to all shareholders appearing on the share register of the Company on 20th August 2001. The dividend has been reflected in the financial statements for the period ended 30th September 2001.

### **12. TRANSACTIONS WITH CONNECTED PERSONS**

Except for transactions as disclosed in notes 5 and 15, there were no other transactions with connected persons incurred during the period. All transactions with connected persons were entered into in the ordinary course of business and on normal commercial terms.

### **13. SOFT COMMISSION ARRANGEMENTS**

The Investment Manager, Deutsche Asset Management (Asia) Limited, is responsible for the selection of brokers to be used by the Company. In some instances, the Investment Manager has entered into soft commission arrangements with the brokers. Under these soft commission arrangements, the Investment Manager obtains services or benefits from third parties which are paid for by the brokers out of the commission they receive. Such services or benefits are related primarily to performance measurement, valuation and research services. The Investment Manager is satisfied that the bargains generating soft commissions comply with requirements for best execution both as to price and settlement.

### **14. RELATED PARTY TRANSACTIONS**

The Company's transactions with related parties are detailed in notes 5 and 15 to the financial statements.

## THE CHINA FUND

### NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)

#### 15. DIRECTORS' INTERESTS

As at 30th September 2001, none of the Company's directors or their associates had a direct or indirect interest in the share capital of the Company.

At no time during the period was the Company a party to any arrangement to enable the Company's directors or their associates to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Diane Seymour-Williams and Choy Peng Wah are Directors of the Investment Manager, Deutsche Asset Management (Asia) Limited. Apart from the above, there were no contracts of significance in relation to the Company's business to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, at the end of the period or at any time during the period.

No director has a service contract with the Company.

#### 16. SUBSTANTIAL SHAREHOLDERS

At 30th September 2001, the register of shareholders maintained under Section 16(1) of the Securities (Disclosure of Interests) Ordinance indicated that the following shareholders had an interest of 10% or more in the share capital of the Company:

	<b>Number of shares</b>	<b>% of share capital</b>
Citivic Nominees Limited*	781,785	66.60%
Clearstream Banking, societe anonyme	378,500	32.24%

(\*) *Citivic Nominees Limited is the depository for Euroclear.*

## **THE CHINA FUND**

### **NOTES TO THE FINANCIAL STATEMENTS (unaudited) (Cont'd)**

#### **17. CODE OF BEST PRACTICE**

In the opinion of the directors, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of The Stock Exchange of Hong Kong Limited throughout the period ended 30th September 2001, except that the independent non-executive directors of the Company are not appointed for specific terms. Independent non-executive directors are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the provisions of the Company's articles of association. The Company has established an audit committee in accordance with paragraph 14 of the Code of Best Practice.