

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars, unless otherwise stated)

1. Basis of preparation

These consolidated financial statements are prepared on an accrual basis of accounting, except where stated otherwise, to present the overall financial performance and position of the Government of the Hong Kong Special Administrative Region (the Government) and to demonstrate the resources held by the Government in the delivery of public services.

2. Reporting entities and basis of consolidation

2.1 Reporting entities

The entities included in these consolidated financial statements are as follows:

- (a) General Revenue Account (GRA);
- (b) Funds established under section 29 of the Public Finance Ordinance (Cap. 2) (Note 34(a)(i));
- (c) other Funds established by the Government for specific purposes with their funding mainly from the Government and the Government being responsible for their use (Note 34(a)(ii));
- (d) Hong Kong Housing Authority (HKHA);
- (e) Hong Kong Sukuk 2014 Limited;
- (f) Hong Kong Sukuk 2015 Limited;
- (g) Hong Kong Sukuk 2017 Limited;
- (h) Exchange Fund; and
- (i) government business enterprises in which the Government has an investment holding of not less than 20 percent and of which the Government shares the net earnings (Note 34(b)(ii)).

2.2 Other non-departmental public bodies

Entities whose resource consumption has been accounted for in these consolidated financial statements as grants and subventions, thereby reflecting the relationship between the Government and these entities as the purchaser and provider of services, are not consolidated.

2.3 Basis of consolidation

Entities in Notes 2.1(a) to (g) are consolidated on a line-by-line basis whereby similar items of revenue, expenses, assets and liabilities are combined to give an overall view of the Government's financial performance and position as if they were a single entity. Significant transactions and balances of indebtedness between these entities are eliminated, and adjustments are made to reflect the financial performance and position as at 31 March for entities with a different reporting date.

Entities in Notes 2.1(h) and (i) are consolidated on an equity basis whereby the Government's share of their current year's net operating results are separately disclosed in the Consolidated Statement of Financial Performance, and the Government's share of their net assets, less any impairment losses recognised, are included in the investments reported in the Consolidated Statement of Financial Position.

2.4 Consolidated entities with financial year-end dates other than 31 March

For entities consolidated on a line-by-line basis and with a financial year-end date other than 31 March, consolidation is based on their unaudited accounts covering the twelve-month period to 31 March.

For entities consolidated on an equity basis and with a reporting date other than 31 March, consolidation is based on their audited accounts available for the latest financial year, with the exception of the Exchange Fund, of which the financial year ends on 31 December and for which adjustments are made to cover a twelve-month period to 31 March.

3. Principal accounting policies

(a) Revenue

For GRA and the funds established under the Public Finance Ordinance (Cap. 2), accruals are made for major revenue items (including taxes and duties, Government rent and rates, utilities, land premia and interest and investment income). Other revenue items are recognised when received.

For other consolidated entities, revenue is recognised when it is probable that the economic benefits will flow to the entities concerned and can be measured reliably.

(b) Expenses

For GRA and the funds established under the Public Finance Ordinance (Cap. 2), accruals are made for major expense items (including salaries, pensions, untaken leave, contract gratuities, recurrent subventions, social security payments, other operating expenses and interest expenses). Other expense items are recognised when paid.

For other consolidated entities, expenses are recognised when a decrease in future economic benefits relating to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

(c) Cash and cash equivalents

Cash and cash equivalents are cash, placements with banks and other financial institutions with an original period to maturity of not more than three months.

(d) Investments

Investments with the Exchange Fund

These are funds of the Government (Note 17(b)) placed with the Exchange Fund for investment purposes, and are stated at cost less any impairment losses recognised.

Investments in government business enterprises

For investments in those government business enterprises in which the Government has an investment holding of not less than 20 percent and of which the Government shares the net earnings (refer to Note 34(b)(ii) for a list of the entities), their values are stated at the Government's share of the net assets of the entities concerned, less any impairment losses recognised. For investments in other government business enterprises, their values are stated at cost. Gains or losses arising from disposal or recognition / reversal of impairment losses are dealt with in the Consolidated Statement of Financial Performance.

Other investments

Other investments (Note 21) are stated at cost or fair value at the end of the financial year. Changes in the fair value of investments as well as gains or losses arising from disposal or recognition / reversal of impairment losses are dealt with in the Consolidated Statement of Financial Performance.

(e) Loans and Advances

Loans and advances are stated at the principal amounts outstanding or amortised cost less provision for doubtful debts. It is reviewed at the end of the financial year to determine whether there is any concrete act or information revealing that any amount may not be fully recoverable. Gains or losses arising from recognition / reversal of provision for doubtful debts are dealt with in the Consolidated Statement of Financial Performance.

(f) Accounts receivable

Accounts receivable is stated at cost or fair value less provision for doubtful debts. It is reviewed at the end of the financial year to determine whether there is any objective evidence that an impairment loss has been incurred. Gains or losses arising from recognition / reversal of provision for doubtful debts are dealt with in the Consolidated Statement of Financial Performance.

(g) *Stocks in hand*

Stocks in hand comprise stores, parts and consumables for own consumption or sale in the course of the Government's operations. They are reported in the Consolidated Statement of Financial Position using the weighted average cost method to the extent that they are material. Stocks in hand are reported as expenses when they are used.

(h) *Home Ownership Scheme (domestic) premises*

Stock of re-purchased flats and unsold new flats are stated at the lower of cost and net realisable value. Properties under development are stated at cost.

(i) *Fixed assets*

Except for land, some infrastructure assets (mainly roads and drains) and heritage assets, the Government's fixed assets and those of the HKHA (which has been consolidated on a line-by-line basis in these financial statements) are reported in these accrual-based financial statements.

Fixed assets are stated at cost less accumulated depreciation. Cost comprises expenditure incurred in acquiring or bringing a fixed asset to its condition and location intended at the time of acquisition, construction or development. Subsequent expenditure relating to an existing fixed asset is added to the carrying amount of the fixed asset if it is probable that future economic benefits in excess of the originally assessed standard of performance of the asset will be obtained.

For those buildings whose costs cannot be ascertained reliably, their costs are based on valuation (as at 31 March 2004) made by independent qualified valuers on a depreciated replacement cost basis.

Infrastructure assets reported in these financial statements comprise water supplies, sewage services, cruise and ferry terminals, toll-tunnels (including assets under Build-Operate-Transfer (BOT) arrangements), the Lantau Link, landfills and other environmental protection facilities.

In a BOT arrangement, the Government enters into an agreement with a private sector company under which the company agrees to finance, design and build a facility at its own cost, and is given a concession, usually for a fixed period, to operate that facility and collect revenue from its operation before transferring the facility to the Government at the end of the concession period. The asset constructed by the private sector under BOT arrangement is reported as asset in the Government's Consolidated Statement of Financial Position. At the same time, a liability of the same value as the asset under BOT arrangement is also recognised and amortised as revenue over the concession period on a straight line basis.

Depreciation is provided on a straight line basis to amortise the costs or valuations of fixed assets over their estimated useful lives as follows:

– Infrastructure assets	mainly 50 years
– Buildings	10 - 50 years
– Computer software and hardware	5 - 10 years
– Civil engineering works	30 - 50 years
– Boats and vessels	4 - 20 years
– Lighting and ventilation	20 years
– Other plant and equipment	5 - 15 years

No depreciation is provided for capital works / projects in progress.

The gain or loss on retirement or disposal of a fixed asset is determined as the difference between the net disposal proceeds (if any) and its net book value, and is recognised in the Consolidated Statement of Financial Performance in the year of retirement or disposal.

(j) *Employee benefits*

Retirement benefits

For employees participating in the Mandatory Provident Fund Schemes as required under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) and the Civil Service Provident Fund Scheme, the Government's contributions to the schemes are accrued.

The Government operates a number of pension schemes which are defined benefit schemes (Note 24). For the purpose of accrual-based accounting, the present value of pension obligations under these pension schemes are determined at periodical intervals by an independent qualified actuary using the Projected Unit Credit Method. The pension benefits included in the Consolidated Statement of Financial Performance comprise the following expense items, all of which are accounted for on the accrual basis except otherwise indicated:

- (i) *current service cost* – represents the increase in the present value of pension obligations arising from service in the financial year being reported on;
- (ii) *interest cost* – represents the increase in the present value of pension obligations which arises because the pension benefits are one year closer to settlement;
- (iii) *actuarial gain / loss* – represents the decrease (for actuarial gain) or increase (for actuarial loss) in the present value of pension obligations arising from:
 - experience adjustments (i.e. the effect of differences between the previous actuarial assumptions and what has actually occurred); and
 - the effect of changes in actuarial assumptions.

Actuarial gain / loss is recognised in full as identified; and

- (iv) *curtailment loss* – represents the increase in the present value of pension obligations arising from the payment of pension benefits to participants of the voluntary retirement schemes earlier than would otherwise be the case. Curtailment loss is recognised in full as identified.

Other employee benefits

Contract gratuities and untaken leave for civil servants and non-civil service contract staff are accrued while other benefits such as housing, medical and education are recognised when they are paid.

(k) *Commitments*

Commitments comprise the outstanding balances of capital and non-recurrent funding approvals that may result in future cash outflows. Outstanding commitments (if any) are disclosed in Note 31 and classified by:

- Capital works projects, property, plant and equipment, and capital subventions;
- Non-recurrent expenditure;
- Investments; and
- Loans and non-recurrent grants.

(l) *Contingent liabilities*

Contingent liabilities are defined as:

- (i) possible obligations that arise from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Government; or
- (ii) present obligations that arise from past events, but are not recognised because:
 - it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; or
 - the amount of the obligations cannot be measured with sufficient reliability.

(m) *Foreign currency translation*

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at 31 March. Exchange gains and losses on foreign currency translation are dealt with in the Consolidated Statement of Financial Performance.

(n) *Change in accounting policy*

In previous financial statements, assets under BOT arrangements were reported as assets in the Consolidated Statement of Financial Position only when the arrangements expired. To better reflect the Government's financial performance and position, assets constructed by the private sector under BOT arrangements (Note 28) have been recognised in the consolidated financial statements starting from the financial year 2016-17 (Note 3(i)). The comparative figures for the financial year 2015-16 are restated to conform to the change in accounting policy.

The overall net effects of the change in accounting policy are an increase amounting to \$434 million in net surplus (2016: \$471 million decrease in net deficit) reported in the Consolidated Statement of Financial Performance and an increase amounting to \$8,377 million (2016: \$9,404 million) in net assets reported in the Consolidated Statement of Financial Position.

4. Taxes, rates and duties

	2017 \$ million	2016 \$ million
Internal revenue		
Profits tax	133,842	137,106
Stamp duties	61,870	62,726
Salaries tax	59,291	58,567
Betting duty	21,119	20,127
Other internal revenue	11,305	10,456
	<u>287,427</u>	<u>288,982</u>
General rates	20,892	21,608
Duties	10,236	10,709
Motor vehicle taxes	7,814	9,311
	<u>326,369</u>	<u>330,610</u>

5. Rental income

	2017 \$ million	2016 \$ million
Rents from HKHA's properties	16,976	15,591
Government rents charged at 3% of rateable values	10,523	10,008
Rents from government properties	2,613	2,507
Government land licences	2,388	2,285
	<u>32,500</u>	<u>30,391</u>

6. Fees and charges

	2017 \$ million	2016 \$ million
Infrastructure	5,085	4,936
Economic	3,773	6,423
Security	1,238	1,151
Environment and food	991	1,084
Community and external affairs	848	788
Support	532	521
Others	196	190
	<u>12,663</u>	<u>15,093</u>

7. Royalties and concessions

	2017 \$ million	2016 \$ million
Spectrum utilisation fees	7,881	853
Bridges and tunnels	2,026	1,545
Parking	434	419
Quarries and mining	112	33
Others	270	104
	<u>10,723</u>	<u>2,954</u>

8. Utilities	2017 \$ million	2016 \$ million
Waterworks	2,693	2,659
Sewage services	1,334	1,217
Marine ferry terminals	202	205
	<u>4,229</u>	<u>4,081</u>
	<u><u>4,229</u></u>	<u><u>4,081</u></u>
9. Other operating revenue	2017 \$ million	2016 (as restated) \$ million
Gain on disposal of fixed assets	9,652	587
Recovery of salaries and staff on-costs	1,497	1,513
Fines, forfeitures and penalties	1,496	1,409
Mark Six Lottery	1,276	1,219
Recovery of overpayments and losses	881	1,073
Amortised income of BOT arrangements (Note 3(i))	593	643
Others	950	1,836
	<u>16,345</u>	<u>8,280</u>
	<u><u>16,345</u></u>	<u><u>8,280</u></u>
10. Salaries, allowances and other employee benefits	2017 \$ million	2016 \$ million
Salaries and allowances	80,008	75,503
Pension current service cost (Note 24)	18,554	18,227
Other employee benefits	5,238	4,557
	<u>103,800</u>	<u>98,287</u>
	<u><u>103,800</u></u>	<u><u>98,287</u></u>
11. Other operating expenses	2017 \$ million	2016 \$ million
Hire of services and professional fees	20,554	19,184
Grants	12,019	10,844
Maintenance	8,204	7,771
General other non-recurrent	7,833	20,808
Miscellaneous	6,691	5,450
Purchase of water	4,570	4,296
Light and power	3,639	3,639
Specialist supplies, stores and equipment	3,166	2,761
Operation of waste facilities	2,932	2,477
Administration expenses	2,039	1,933
Publicity and cultural activities	1,250	1,041
Rents and property related expenses (other than quarters)	1,067	1,059
Data processing	652	625
	<u>74,616</u>	<u>81,888</u>
	<u><u>74,616</u></u>	<u><u>81,888</u></u>

12. Recurrent subventions

	2017 \$ million	2016 \$ million
Education	62,449	59,449
Health	52,971	51,133
Social welfare	15,439	14,913
Economic	2,474	2,302
Others	3,136	2,962
	<u>136,469</u>	<u>130,759</u>

13. Social security payments

	2017 \$ million	2016 \$ million
Social security allowance scheme	20,975	18,597
Comprehensive social security assistance	20,524	20,037
Other payments	51	42
	<u>41,550</u>	<u>38,676</u>

14. Operating expenses classified by function

	2017 \$ million	2016 (as restated) \$ million
Education	79,040	75,063
Social welfare	68,880	65,504
Health	59,911	67,430
Security	48,756	45,716
Infrastructure	28,626	27,245
Support	19,303	17,849
Environment and food	18,842	18,458
Economic	16,485	15,463
Community and external affairs	16,198	15,504
Housing	15,719	15,020
	<u>371,760</u>	<u>363,252</u>

15. Land premia

	2017 \$ million	2016 \$ million
Sales by public auction and tender	109,465	43,308
Modification of existing leases, exchanges and extensions	22,080	19,197
Private treaty grants	2,255	73
Fees received in respect of short-term waivers	837	755
	<u>134,637</u>	<u>63,333</u>

16. Net revenue from home ownership assistance schemes

	2017 \$ million	2016 \$ million
Income	2,729	2,595
Operating costs	(1,041)	(501)
Decrease in provisions	2	9
	<u>1,690</u>	<u>2,103</u>

Details of the flats sold were as follows:

	2017		2016	
	No. of Flats	Area (m ²)	No. of Flats	Area (m ²)
Tenants Purchase Scheme (TPS)	2,191	75,959	3,059	108,521
Home Ownership Scheme (HOS)	222	9,003	-	-

17. (a) Interest and investment income

	2017 \$ million	2016 \$ million
Investment income from the Exchange Fund (Note 17(b))	33,481	43,180
Interest on loans and investment income	11,453	10,088
	44,934	53,268
	44,934	53,268

(b) Investments with the Exchange Fund

These Government's funds comprise the investments (Notes (i) and (ii)) and deposits held by the General Revenue Account and the Funds established under section 29 of the Public Finance Ordinance (Cap. 2) except Bond Fund (Note 34(a)(i)), and are stated at cost.

- (i) Pursuant to the directive of the Financial Secretary in the 2015-16 Budget, the Future Fund was established on 1 January 2016 with an initial endowment of \$219.73 billion from the balance of the Land Fund as a notional savings account within the fiscal reserves. As from 1 July 2016, the Future Fund also includes \$4.8 billion held against the General Revenue Account, representing about one-third of the actual consolidated surplus in the 2015-16 cash-based Consolidated Account as top-up. The Future Fund placement is held in the Exchange Fund for securing higher investment returns over a ten-year investment period in accordance with an arrangement entered into with the Hong Kong Monetary Authority in December 2015. Investment income on the Future Fund placement is determined annually based on a composite rate (4.5% for the calendar year 2016) computed on a weighted average basis with reference to the agreed rate under the Investment Portfolio (Note 17(b)(ii)) and the annual rate of return linked with the performance of the Long-Term Growth Portfolio. The Future Fund (\$224.53 billion), together with investment income (\$13.11 billion up to 31 March 2017) accrued and compounded on an annual basis, is retained within the Exchange Fund until 31 December 2025 or upon decision of the Financial Secretary for withdrawal, whichever is the earlier.
- (ii) The part of the fiscal reserves outside the Future Fund (Note 17(b)(i)) is referred to as Operating and Capital Reserves in the cash-based Consolidated Account. Investment income on the Operating and Capital Reserves placement with the Exchange Fund is calculated, in accordance with an arrangement entered into with the Hong Kong Monetary Authority in 2007, on the basis of the average annual investment return of the Exchange Fund's Investment Portfolio for the past six years or the average annual yield of three-year Exchange Fund Notes (replaced by three-year government bond with effect from 1 January 2016) for the previous year subject to a minimum of zero percent, whichever is the higher. The rate of return for the calendar year 2016 was 3.3% (2015: 5.5%). The annual investment income is receivable on 31 December each year.

18. Capital expenses

	2017 \$ million	2016 \$ million
Highways	40,616	40,541
Capital subventions	8,325	6,795
Civil engineering works	6,367	4,691
New towns and urban area developments	4,660	2,654
Buildings, plant, vehicles, equipment and minor works	3,500	1,874
Drainage	1,013	893
Housing	463	548
Land acquisition	289	656
Others	205	131
	65,438	58,783
	65,438	58,783

19. Interest expenses

	2017 \$ million	2016 \$ million
Interest cost on pension liabilities (Note 24)	34,107	33,827
Interest on bonds and notes issued (Note 25)	1,875	1,927
Periodic distribution payments for alternative bonds (Note 25)	323	277
	36,305	36,031
	36,305	36,031

20. Investments in and loans to government business enterprises

	2017 \$ million	2016 \$ million
Cost of equity holdings and other capital investments	147,329	137,853
Share of undistributed reserves (Note (a))		
Balance at beginning of the year	199,879	175,235
Share of profits and losses for the year	23,591	36,011
Share of distributions for the year	(37,327)	(10,305)
Share of other reserve movements (Note 29)	(259)	(1,062)
Balance at end of the year	185,884	199,879
Balance of investments (Note (b))	333,213	337,732
Loans outstanding	1,546	918
	334,759	338,650

Note:

(a) Refer to Note 34(b)(ii) for a list of the government business enterprises consolidated on an equity basis.

(b) Included \$133.72 billion (2016: \$140.68 billion) being the Government's share of net assets of the MTR Corporation Limited (as at end of the company's financial year). The corresponding market value of the Government's investment in the company, which is listed in Hong Kong, was \$166.96 billion (2016: \$169.84 billion).

21. Other investments

	2017 \$ million	2016 \$ million
Investments made by Bond Fund	141,379	128,412
Investments made by other funds	89,547	85,583
Investments made by HKHA	45,519	49,389
Asian Development Bank	232	232
New Hong Kong Tunnel Company Limited	56	56
	276,733	263,672
	276,733	263,672

22. Loans and advances

	2017 \$ million	2016 \$ million
Education loans	17,224	16,648
Advances (Note (a))	3,028	3,074
Loan to the Guangdong Provincial People's Government for water quality improvement project	709	827
Civil servants housing loans (Note (b))	228	182
Home Purchase / Assistance Loans provided by HKHA	39	73
Other loans	5,666	3,390
	26,894	24,194

Note:

- (a) Included in the advances above is a sum of \$1,162 million (2016: \$1,162 million) being the outstanding balance of expenditure on Vietnamese migrants recoverable from the United Nations High Commissioner for Refugees (UNHCR). The last repayment, amounting to \$4 million, was received in February 1998. In January 1998, the High Commissioner for Refugees informed the Government of the Hong Kong Special Administrative Region (HKSAR) that in the absence of further funding prospects, the repayment in February 1998 was the last reimbursement that the UNHCR could realistically foresee. If the UNHCR defaults on repayment of the outstanding advances, the Government of the HKSAR will not be able to enforce repayment through legal means as the UNHCR is immune from suit under the International Organisations and Diplomatic Privileges Ordinance (Cap. 190). Consequently, the full recovery of the amount due is doubtful.

During the financial year 2016-17, the Government of the HKSAR continued to pursue the repayment of the outstanding advances from the UNHCR and to urge it to make renewed efforts to look for donations with a view to settling the amount. So far, the Government of the HKSAR has not received any further repayments. Efforts to press the UNHCR for early settlement of the outstanding advances will continue.

- (b) After deducting the sums received from sale of civil servants housing loans of \$170 million (2016: \$209 million).
- (c) The balances of loans and advances are arrived after netting off provision for doubtful debts totalling \$397 million (2016: \$389 million).

23. Other assets

	2017 \$ million	2016 \$ million
Investment income receivable from the Exchange Fund		
Housing Reserve (Note (a))	77,137	74,764
Future Fund (Note 17(b)(i))	13,107	2,299
Others	6,752	7,255
	96,996	84,318
Accounts receivable (Note (b))	39,738	33,523
HOS (domestic) premises (Note (c))	9,096	5,424
Balance of proceeds receivable from sale of housing loans	4,292	4,263
Prepayments	2,576	2,424
Stocks in hand	1,897	1,991
Issue discounts and expenses on bonds and notes (Note 25)	537	637
	155,132	132,580

Note:

- (a) Pursuant to the Financial Secretary's directives, the investment incomes for the calendar years 2014 and 2015 totalling \$72.64 billion (comprising \$27.49 billion for 2014 and \$45.15 billion for 2015) were set aside and retained within the Exchange Fund for the Housing Reserve, and not received in the respective financial years 2014-15 and 2015-16. The Housing Reserve was established in December 2014. As explained in the 2015-16 Budget Speech, the Housing Reserve is to provide financial resources to meet the ten-year public housing supply target. The investment income retained within the Exchange Fund earns the same rate of investment return as stipulated in Note 17(b)(ii) and shall be received on a date as determined by the Financial Secretary.
- (b) The balance is arrived after netting off provision for doubtful debts totalling \$25.74 million (2016: \$17.69 million).
- (c) Representing properties under development and re-purchased / unsold new HOS / Private Sector Participation Scheme (PSPS) flats.

24. Provision for pensions

The Government operates four major types of pension schemes:

- (a) *Civil Service Pension Scheme* – refers to the pension benefits governed by Pensions Ordinance (Cap. 89), Pension Benefits Ordinance (Cap. 99), Pensions (Increase) Ordinance (Cap. 305), Pensions (Special Provisions) (Hospital Authority) Ordinance (Cap. 80), Pensions (Special Provisions) (Hong Kong Polytechnic) Ordinance (Cap. 90), Pensions (Special Provisions) (Vocational Training Council) Ordinance (Cap. 387) and Pensions (Special Provisions) (The Hong Kong Institute of Education) Ordinance (Cap. 477);
- (b) *Judicial Service Pension Scheme* – refers to the pension benefits governed by Pension Benefits (Judicial Officers) Ordinance (Cap. 401) and Pensions (Increase) Ordinance (Cap. 305);
- (c) *Widows and Orphans Pension Scheme* – refers to the pension benefits governed by Widows and Orphans Pension Ordinance (Cap. 94) and Widows and Orphans Pension (Increase) Ordinance (Cap. 205); and
- (d) *Surviving Spouses' and Children's Pensions Scheme* – refers to the pension benefits governed by Surviving Spouses' and Children's Pensions Ordinance (Cap. 79) and Pensions (Increase) Ordinance (Cap. 305).

All the pension schemes above are defined benefit schemes with the civil and judicial service pension schemes being non-contributory and the other two schemes being contributory (either at a fixed amount or as a percentage on salaries). The Civil Service Pension Scheme and the dependant pension schemes are closed schemes. Civil servants offered appointment on or after 1 June 2000 are not eligible to join. The operation and funding of the pension schemes are governed by the relevant pension legislation. For the purpose of accrual-based accounting, the Government's financial liabilities under these schemes as at 31 March 2017 as well as the current service cost for the financial year 2016-17 were assessed by an independent qualified actuary using the Projected Unit Credit Method and the following principal actuarial assumptions:

	<u>2017</u>	<u>2016</u>
Discount rate	3.75% p.a.	4% p.a.
Expected rate of return on the assets of the pension schemes	Not applicable (Note (a))	
Future salary increases:		
– Price inflation and real wage growth		
<u>Civil servants</u>		
2017-18 (Note (b))	1.88% – 2.94%	3.5%
2018-19 and thereafter	3.5% p.a.	3.5% p.a.
<u>Judges and judicial officers</u>		
2017-18 (Note (b))	2.95%	3.5%
2018-19 and thereafter	3.5% p.a.	3.5% p.a.
– Promotion and annual increments (based on a set of service-related rates)	0% – 2.5% p.a.	0% – 2.5% p.a.

Note:

- (a) The Government's pension obligations are basically unfunded and hence there is no expected rate of return on the assets of the pension schemes. The pension legislation provides that payments of all pension benefits should be charged to the General Revenue. Accordingly, funds are set aside every year from the General Revenue Account for pension payments. To meet payments of civil service pensions in the most unlikely event that the Government cannot meet such liabilities from the General Revenue, the Government has since 1995 maintained a Civil Service Pension Reserve Fund which could cover the estimated pension payment for one year. The balance of this Fund was \$31,899 million as at 31 March 2017 (2016: \$27,129 million).
- (b) The assumed increase of 3.5% used in previous actuarial assessment has been updated to take into account the 2017-18 pay adjustments for civil service (a pay increase of 1.88% for civil servants in the directorate and upper salary bands; and a pay increase of 2.94% for those in the middle and lower salary bands) and the proposed 2017-18 pay adjustment for judicial service (a pay increase of 2.95% for judges and judicial officers).

Movements in the liabilities recognised in the Consolidated Statement of Financial Position:

	2017 \$ million	2016 \$ million
Present value of pension obligations at beginning of the year	874,746	815,832
Expenses recognised in the Consolidated Statement of Financial Performance	75,941	87,833
Benefits paid	<u>(31,490)</u>	<u>(28,919)</u>
Present value of pension obligations at end of the year	<u><u>919,197</u></u>	<u><u>874,746</u></u>

Expenses recognised in the Consolidated Statement of Financial Performance:

	2017 \$ million	2016 \$ million
Interest cost (Note 19)	34,107	33,827
Current service cost (Note 10)	18,554	18,227
Actuarial loss (Note 3(j)(iii))	<u>23,280</u>	<u>35,779</u>
	<u><u>75,941</u></u>	<u><u>87,833</u></u>

25. Bonds and notes issued

	Principal Amount Outstanding at 31 March 2017 \$ million	Principal Amount Outstanding at 31 March 2016 \$ million
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Government bonds and notes (Note (a)) with maturity as follows:

After two years but within five years	<u>1,500</u>	<u>1,500</u>
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Government bonds issued under the Government Bond Programme with maturity as follows:

Bonds (Note (b))		
Within one year	24,400	27,000
After one year but within two years	23,200	24,400
After two years but within five years (Note (c))	40,378	33,600
After five years	15,100	15,500
	103,078	100,500

Alternative bonds (Note (d))

After two years but within five years	15,542	15,509
After five years	7,771	-
	<u>23,313</u>	<u>15,509</u>
	<u>126,391</u>	<u>116,009</u>
	<u><u>127,891</u></u>	<u><u>117,509</u></u>

Note:

- (a) In July 2004, the Government issued bonds and notes totalling \$20 billion to retail and institutional investors. These include institutional notes of US\$1.25 billion denominated in United States dollars. The outstanding bonds and notes are denominated in Hong Kong dollars with maturity in July 2019. During the financial year, there were payments of interest of \$77 million on the notes but no repayment of principal.
- (b) During the financial year, bonds with nominal value totalling \$16.6 billion were issued to institutional investors through tender, and bonds with nominal value totalling \$13 billion were issued to retail investors through subscription. Bonds with nominal value totalling \$17 billion issued through tender and bonds with nominal value totalling \$10.02 billion issued through subscription were repaid during the financial year.
- (c) The outstanding bonds included Silver Bonds with nominal value of \$2.98 billion (2016: Nil) which might be redeemed before maturity upon request from bond holders.
- (d) Alternative bonds are denominated in United States dollars. During the financial year, alternative bonds with nominal value of US\$1 billion were issued to institutional investors under section 2A of the Loans Ordinance (Cap. 61).

26. Other liabilities

	2017 \$ million	2016 (as restated) \$ million
Provisions		
Untaken leave (Note)	27,232	26,883
Contract gratuities	693	628
Others	1,678	1,679
	<hr/> 29,603	<hr/> 29,190
Deposits	19,551	17,717
Accounts payable	9,192	9,542
Deferred income of assets under BOT arrangements (Note 3(i))	3,735	4,328
Others	764	423
	<hr/> 62,845	<hr/> 61,200
	<hr/> <hr/>	<hr/> <hr/>

Note:

The provision for 'untaken leave' gives an indication of the overall amount of leave earned but not yet taken by serving officers calculated at their current salary levels. As and when officers clear their untaken leave balance, such liability is expected to decrease. In case officers have untaken leave when leaving the Government, the liability for untaken leave will be absorbed within the salary provisions for the departments concerned. It should be noted that both leave earning rates and leave accumulation limits have been substantially reduced for civil servants offered appointment on or after 1 June 2000. To illustrate, the average leave earning rate of these civil servants is about 20 days per annum and the average accumulation limit is about 40 days. As such, it is expected that the Government's liability for untaken leave will decline in the long run.

27. Exchange Fund Reserve

The Monetary Authority, under delegated authority from the Financial Secretary as Controller of the Exchange Fund, manages the Exchange Fund in accordance with the provisions of the Exchange Fund Ordinance (Cap. 66). The net assets of the Exchange Fund reported in the Consolidated Statement of Financial Position are represented by the Exchange Fund Reserve. The movements of the Exchange Fund Reserve during the years ended 31 March 2017 and 31 March 2016 were as follows:

	2017 \$ million	2016 \$ million
Balance at beginning of the year	556,407	627,036
Transfer from / (to) General Reserve (Note 29)	35,124	(70,629)
Balance at end of the year	<u>591,531</u>	<u>556,407</u>

The Exchange Fund's abridged Balance Sheets (unaudited) as at 31 March 2017 and 31 March 2016 were as follows:

	2017 \$ million	2016 \$ million
Assets		
Foreign currency assets	3,512,245	3,336,055
Hong Kong dollar assets	252,570	168,853
	3,764,815	3,504,908
Liabilities		
Placements by Fiscal Reserves	(964,736)	(853,155)
Certificates of Indebtedness	(412,741)	(368,819)
Exchange Fund Bills and Notes issued	(963,149)	(856,862)
Placements by banks and other financial institutions	(56,136)	(60,664)
Government-issued currency notes and coins in circulation	(12,019)	(11,661)
Balance of the banking system	(259,519)	(363,390)
Placements by Hong Kong Special Administrative Region government funds and statutory bodies	(313,596)	(288,234)
Other liabilities	(191,388)	(145,716)
	(3,173,284)	(2,948,501)
Net assets	<u>591,531</u>	<u>556,407</u>

28. Fixed assets

	Buildings \$ million	Infrastructure Assets (Note) \$ million	Computer Assets \$ million	Other Plant and Equipment \$ million	Capital Works / Projects in Progress \$ million	Total \$ million
<u>At cost</u>						
At 1 April 2016	302,312	156,857	17,859	34,962	80,506	592,496
Effect of change in accounting policy (Note 3(n))	-	17,337	-	-	-	17,337
At 1 April 2016 (as restated)	302,312	174,194	17,859	34,962	80,506	609,833
Additions	4,041	475	676	1,475	36,614	43,281
Transfers	20,511	18,084	1,407	2,503	(42,505)	-
Retirements or disposals	(864)	(318)	(291)	(519)	(6)	(1,998)
At 31 March 2017	326,000	192,435	19,651	38,421	74,609	651,116
<u>Accumulated depreciation</u>						
At 1 April 2016	89,264	52,091	13,500	19,738	-	174,593
Effect of change in accounting policy (Note 3(n))	-	3,605	-	-	-	3,605
At 1 April 2016 (as restated)	89,264	55,696	13,500	19,738	-	178,198
Charge for the year	6,104	4,531	2,417	2,273	-	15,325
Written back	(555)	(141)	(289)	(454)	-	(1,439)
At 31 March 2017	94,813	60,086	15,628	21,557	-	192,084
<u>Net book value</u>						
At 31 March 2017	<u>231,187</u>	<u>132,349</u>	<u>4,023</u>	<u>16,864</u>	<u>74,609</u>	<u>459,032</u>
At 31 March 2016 (as restated)	<u>213,048</u>	<u>118,498</u>	<u>4,359</u>	<u>15,224</u>	<u>80,506</u>	<u>431,635</u>

Note:

Including assets under BOT arrangements as at 31 March 2017. Their names, concession periods and related Ordinances are as follows:

<u>Assets under BOT arrangements</u>	<u>Concession periods</u>	<u>Ordinances</u>
(a) Tate's Cairn Tunnel	July 1988 - July 2018	Tate's Cairn Tunnel Ordinance (Cap. 393)
(b) Western Harbour Crossing	August 1993 - August 2023	Western Harbour Crossing Ordinance (Cap. 436)
(c) Tai Lam Tunnel and Yuen Long Approach Road	May 1995 - May 2025	Tai Lam Tunnel and Yuen Long Approach Road Ordinance (Cap. 474)

According to the respective Ordinances, the private sector companies shall make available the assets during the concession periods for use for the passage of motor vehicles upon payments of the tolls.

The BOT arrangements for Cross-Harbour Tunnel (concession period: September 1969 - August 1999) and Eastern Harbour Crossing (concession period: August 1986 - August 2016) have expired as at 31 March 2017.

29. General Reserve

The net financial assets reported in the Consolidated Statement of Financial Position are represented by the General Reserve. The movements of the General Reserve during the years ended 31 March 2017 and 31 March 2016 were as follows:

	2017 \$ million	2016 (as restated) \$ million
Balance at beginning of the year (as previously reported)	578,807	553,672
Effect of change in accounting policy (Note 3(n))	(4,328)	(4,971)
Balance at beginning of the year (as restated)	<u>574,479</u>	<u>548,701</u>
Net surplus / (deficit) for the year	146,022	(18,350)
Share of other reserve movements in government business enterprises (Note 20)	(259)	(1,062)
Transfer (to) / from Exchange Fund Reserve (Note 27)	(35,124)	70,629
Transfer to Capital Expenditure Reserve (being net increase in fixed assets) (Note 30)	(27,397)	(25,439)
Balance at end of the year	<u><u>657,721</u></u>	<u><u>574,479</u></u>

30. Capital Expenditure Reserve

The total net book value of fixed assets reported in the Consolidated Statement of Financial Position (Note 28) is represented by the Capital Expenditure Reserve. The movements of the Capital Expenditure Reserve during the years ended 31 March 2017 and 31 March 2016 were as follows:

	2017 \$ million	2016 (as restated) \$ million
Balance at beginning of the year (as previously reported)	417,903	392,292
Effect of change in accounting policy (Note 3(n))	13,732	13,904
Balance at beginning of the year (as restated)	<u>431,635</u>	<u>406,196</u>
Transfer from General Reserve (Note 29)	<u>27,397</u>	<u>25,439</u>
Balance at end of the year	<u><u>459,032</u></u>	<u><u>431,635</u></u>

31. Commitments

Outstanding commitments as at 31 March 2017 and 31 March 2016 not provided for in the consolidated financial statements were as follows:

	2017 \$ million	2016 \$ million
(i) Capital works projects, property, plant and equipment, and capital subventions	<u>420,364</u>	<u>436,055</u>
(ii) Non-recurrent expenditure	<u><u>30,952</u></u>	<u><u>30,508</u></u>
(iii) Loans and non-recurrent grants	<u><u>33,121</u></u>	<u><u>32,778</u></u>

32. Contingent liabilities

As at 31 March 2017, the Government had the following contingent liabilities:

- (a) financial exposure on the default guarantees of \$36,836 million (2016: \$37,049 million) provided for mortgage loans of flats sold under HOS, PSPS and TPS of HKHA amounting to \$284 million (2016: \$183 million);
- (b) guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance amounting to \$36,799 million (2016: \$33,453 million);
- (c) legal claims, disputes and proceedings amounting to \$29,324 million (2016: \$12,053 million);
- (d) guarantees provided under the SME Financing Guarantee Scheme - Special Concessionary Measures amounting to \$20,811 million (2016: \$24,079 million);
- (e) possible capital subscriptions to the Asian Development Bank amounting to \$5,804 million (2016: \$5,990 million);
- (f) guarantees provided under the SME Loan Guarantee Scheme amounting to \$4,544 million (2016: \$5,253 million);
- (g) guarantees provided under a commercial loan of the Hong Kong Science and Technology Parks Corporation amounting to \$1,957 million (2016: \$2,002 million);
- (h) guarantees provided under the Special Loan Guarantee Scheme amounting to \$899 million (2016: \$3,504 million); and
- (i) financial exposure on Structural Safety Guarantee covering 25,194 units (2016: 27,450 units) of HOS and PSPS flats the amount of which could not be reasonably ascertained.

33. Events after the reporting period

After 31 March 2017, the Legislative Council and its Finance Committee have approved laws and proposals which have a financial effect on Government revenue and expenditure. These laws and proposals can be accessed at the Legislative Council website – www.legco.gov.hk.

34. Entities consolidated in these financial statements

(a) Entities consolidated on a line-by-line basis

(i) Core Government – comprising the General Revenue Account and the Funds established under section 29 of the Public Finance Ordinance (Cap. 2):

1. Capital Works Reserve Fund
2. Capital Investment Fund
3. Civil Service Pension Reserve Fund
4. Disaster Relief Fund
5. Innovation and Technology Fund
6. Land Fund
7. Loan Fund
8. Lotteries Fund
9. Bond Fund

(ii) Funds established by the Government for specific purposes with their funding mainly from the Government and the Government being responsible for their use:

1. AIDS Trust Fund
2. Beat Drugs Fund Association
3. Community Care Fund
4. Consumer Legal Action Fund
5. Education Development Fund †
6. Elder Academy Development Foundation
7. Elite Athletes Development Fund
8. Emergency Relief Fund
9. Environment and Conservation Fund
10. Gifted Education Fund † φ
11. Health Care and Promotion Fund Δ
12. HKSAR Government Scholarship Fund †
13. Hong Kong Paralympians Fund
14. Language Fund †
15. New Technology Training Fund
16. Pneumoconiosis Ex Gratia Fund
17. Qualifications Framework Fund †
18. Quality Education Fund †
19. Queen Elizabeth Foundation for the Mentally Handicapped
20. Research Endowment Fund †
21. Self-financing Post-secondary Education Fund †
22. Sir David Trench Fund for Recreation
23. Social Innovation and Entrepreneurship Development Fund
24. Supplementary Legal Aid Fund †
25. Trust Fund for Severe Acute Respiratory Syndrome
26. Trust Fund in Support of Reconstruction in the Sichuan Earthquake Stricken Areas

(iii) Hong Kong Housing Authority

(iv) Hong Kong Sukuk 2014 Limited

(v) Hong Kong Sukuk 2015 Limited

(vi) Hong Kong Sukuk 2017 Limited φ

(b) Entities consolidated on an equity basis

(i) Exchange Fund †

(ii) Government business enterprises in which the Government has an investment holding of not less than 20 percent and of which the Government shares the net earnings:

	% owned
1. Airport Authority	100%
2. Companies Registry Trading Fund	100%
3. Electrical and Mechanical Services Trading Fund	100%
4. Hong Kong Cyberport Development Holdings Limited	100%
5. Hongkong International Theme Parks Limited †	53.0%
6. Hong Kong Science and Technology Parks Corporation	100%
7. Hong Kong IEC Limited	74.9%
8. Kowloon-Canton Railway Corporation †	100%
9. Land Registry Trading Fund	100%
10. MTR Corporation Limited †	75.1%
11. Office of the Communications Authority Trading Fund	100%
12. Post Office Trading Fund	100%
13. Urban Renewal Authority	100%
14. West Rail Property Development Limited † ✧	100%

† Financial year-end date not coterminous with that of the Government.

∅ Included in the consolidated financial statements starting from the financial year 2016-17.

△ Renamed as Health Care and Promotion Scheme on 28 April 2017.

✧ The Government owns 49% of the company directly and the rest through the Kowloon-Canton Railway Corporation.

35. Comparative figures

Certain comparative figures have been re-classified to conform with the presentation of the current year.