

Land Fund

REPORT OF THE DIRECTOR OF AUDIT



Audit Commission

The Government of the Hong Kong Special Administrative Region

Independent Auditor's Report To the President of the Legislative Council

Opinion

I certify that I have examined and audited the financial statements of the Land Fund set out on pages 84 to 88, which comprise the statement of assets and liabilities as at 31 March 2021, and the statement of receipts and payments for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In my opinion, the financial statements of the Land Fund are prepared, in all material respects, in accordance with the Public Finance Ordinance (Cap. 2) and section 11(1) of the Audit Ordinance (Cap. 122).

Basis for opinion

I conducted my audit in accordance with section 12(1) of the Audit Ordinance and the Audit Commission auditing standards. My responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of my report. I have fulfilled the independence and other ethical responsibilities in accordance with those standards. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Other information

The Director of Accounting Services is responsible for the other information. The other information comprises all the information included in the Accounts of the Government of the Hong Kong Special Administrative Region for the year ended 31 March 2021 published by the Treasury, other than the financial statements and my auditor's report thereon.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Director of Accounting Services' responsibilities for the financial statements

In accordance with section 16(1) of the Public Finance Ordinance, the Director of Accounting Services is responsible for the compilation and supervision of the accounts of the Government of the Hong Kong Special Administrative Region, for the management of accounting operations and procedures, and for ensuring that all regulations, directions or instructions made or given under the Public Finance Ordinance relating thereto and in respect of the safe custody of public moneys and its accounting are complied with.

Auditor's responsibilities for the audit of the financial statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Audit Commission auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the Audit Commission auditing standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Land Fund's internal control; and
- evaluate the appropriateness of accounting policies used by the Director of Accounting Services.

John Chu
Director of Audit

8 September 2021

Audit Commission
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7 Gloucester Road
Wanchai, Hong Kong

Land Fund

STATEMENT OF ASSETS AND LIABILITIES AS AT 31 MARCH 2021

(Expressed in Hong Kong dollars)

	Note	2021 \$'000	2020 \$'000
Assets			
Investments with the Exchange Fund	3	200,190,794	219,729,659
Other investments	4	19,500,000	-
		<u>219,690,794</u>	<u>219,729,659</u>
Representing:			
Fund Balance			
Balance at beginning of year		219,729,659	219,729,659
(Deficit)/Surplus for the year		(38,865)	-
Balance at end of year	5	<u>219,690,794</u>	<u>219,729,659</u>

Notes 1 to 8 form part of these financial statements.

Charlix WONG
Director of Accounting Services
19 July 2021



Land Fund

STATEMENT OF RECEIPTS AND PAYMENTS FOR THE YEAR ENDED 31 MARCH 2021

(Expressed in Hong Kong dollars)

	Note	2021 \$'000	2020 \$'000
Cash and bank balances at beginning of year		-	-
Receipts	6	-	-
Payments	7	(38,865)	-
(Deficit)/Surplus for the year		(38,865)	-
Other cash movements	8	38,865	-
Cash and bank balances at end of year		-	-

Notes 1 to 8 form part of these financial statements.

Charlix WONG
Director of Accounting Services
19 July 2021



Land Fund

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars, unless otherwise stated)

1. Purpose and Legislation

The Land Fund was set up with effect from 1 July 1997 by a Resolution (hereinafter referred to as the Resolution) passed by the then Provisional Legislative Council under section 29(1) of the Public Finance Ordinance (Cap. 2) in July 1997. The Hong Kong Monetary Authority has been directed by the Financial Secretary to manage the investment of the Fund's assets. From 1 July 1997 to 31 October 1998, the assets of the Fund were managed as a separate portfolio. From 1 November 1998 to 31 December 2015, the assets of the Fund were merged into the Exchange Fund and invested in the same way as the other fiscal reserves placed with the Exchange Fund. With effect from 1 January 2016, the assets of the Fund have been held as a notional savings account within the fiscal reserves called the Future Fund for placement with the Exchange Fund for securing higher investment returns over a ten-year investment period (Note 3(iv)). In 2020-21, part of the Future Fund was allocated for investment in Cathay Pacific Airways Limited (Note 4).

2. Accounting Policy

The accounts of the Land Fund are kept on a cash basis. Transactions are recorded when moneys are received or paid. The Statement of Assets and Liabilities includes investments made under the Resolution.

3. Investments with the Exchange Fund

- (i) These are investments made under paragraph 7 of the Resolution.
- (ii) The investments represent the cost of investments together with the investment income received in the year being reported.
- (iii) Between 1 April 2007 and 31 December 2015, the investment income was 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 was the higher.
- (iv) With effect from 1 January 2016, the assets of the Land Fund have been held as a notional savings account within the fiscal reserves called the Future Fund. The Future Fund balance (other than the part mentioned in Note 4) is placed with 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 return on the Future Fund placement with the Exchange Fund is determined annually based on a composite rate (12.3% and 8.7% for the calendar years 2020 and 2019 respectively) computed on a weighted average basis with reference to the agreed rate under the Investment Portfolio (Note (iii) above) and the annual rate of return linked with the performance of the Long-Term Growth Portfolio. The Future Fund, together with investment return not received 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. In respect of the Land Fund portion of \$200.19 billion (2019: \$219.73 billion), such accumulated investment return not received as revenue amounted to \$108.16 billion as at 31 December 2020 (2019: \$71.84 billion), including the investment return for the calendar year 2020 of \$36.32 billion (2019: \$23.81 billion). As announced in the 2021-22 Budget Speech, the accumulated investment return on the Future Fund would be brought back to the Government's accounts and recorded as investment income on a progressive basis starting from 2021-22.

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4. Other investments

In June 2020, in a bid to uphold Hong Kong's status as an international aviation hub, the Financial Secretary exercised his authority under the Resolution to allocate \$27.3 billion of the Land Fund (via the Future Fund) to invest in Cathay Pacific Airways Limited. On 12 August 2020, \$19.5 billion was drawn from the assets of the Land Fund placed with the Exchange Fund for the investment in Cathay Pacific Airways Limited. The investment would remain as a part of the Future Fund (Note 3(iv)). The investment is held by Aviation 2020 Limited, a dedicated company wholly-owned by the Financial Secretary Incorporated as established under the Financial Secretary Incorporation Ordinance (Cap. 1015).

	2021 \$'000	2020 \$'000
Aviation 2020 Limited	<u>19,500,000</u>	<u>-</u>

- (i) The investment represents the cost of investment.
- (ii) The investment represents \$19.5 billion of preference shares with detachable warrants of Cathay Pacific Airways Limited.

5. Commitments

The approved investment that was unpaid was as follows:

	2021 \$'000	2020 \$'000
Aviation 2020 Limited	<u>7,800,000</u>	<u>-</u>

- (i) The commitment represents the amount earmarked for a bridge loan to Cathay Pacific Airways Limited for drawdown in accordance with a facility agreement.

6. Receipts

Pursuant to the Financial Secretary's directives, the investment incomes of the Land Fund for the calendar years 2014 and 2015 totalling \$19.99 billion (comprising \$7.91 billion for 2014 and \$12.08 billion for 2015), along with the investment incomes on other parts of the fiscal reserves for the two years, 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 3(iii). The accumulated investment return was \$4.23 billion up to 31 December 2020 (2019: \$3.36 billion), including the investment return for the calendar year 2020 amounting to \$0.87 billion (2019: \$0.65 billion). As announced in the 2019-20 Budget Speech, the Housing Reserve would be brought back to the Government's accounts and recorded as investment income over four financial years from 2019-20 to 2022-23. The rate of investment return for the calendar year 2020 was 3.7% (2019: 2.9%). At the same time, \$82.37 billion (the balance of the Housing Reserve as at 31 December 2018 which included \$22.7 billion from the Fund) was earmarked for public housing development.

During the financial year 2020-21, no amount was brought back from the Housing Reserve to the Fund. As at 31 March 2021, the investment incomes and the accumulated investment return (i.e. up to calendar year 2020) not received and recorded by the Fund and retained for the Housing Reserve totalled \$24.22 billion (2020: \$23.35 billion).

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7. Payments

	<u>2021</u>		<u>2020</u>
	Original Estimate \$'000	Actual \$'000	Actual \$'000
Operating expenses	-	38,865	-

8. Other Cash Movements

These are cash movements arising from changes in other assets and liabilities:

	2021 \$'000	2020 \$'000
Reduction/(Increase) in Assets		
Investments with the Exchange Fund	19,538,865	-
Other investments	(19,500,000)	-
	38,865	-