



集友銀行

Chiyu Banking Corporation Ltd.

中國銀行（香港）有限公司附屬機構
A SUBSIDIARY OF BANK OF CHINA (HONG KONG) LIMITED

2005

Annual Report



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Report of the Directors

The Directors are pleased to present their report together with the audited consolidated accounts of Chiyu Banking Corporation Limited (hereinafter referred to as the “Bank”) and its subsidiaries (together with the Bank hereinafter referred to as the “Group”) for the year ended 31 December 2005.

Principal Activities

The principal activities of the Group are the provision of banking and related financial services. An analysis of the Group’s performance for the year by business segments is set out in Note 44 to the accounts.

Results and Appropriations

The results of the Group for the year are set out in the consolidated profit and loss account on page 8.

The Board declared a first interim dividend of HK\$56 per ordinary share, totaling HK\$168,000,000 on 28 June 2005.

The Board declared a second interim dividend of HK\$69 per ordinary share, totaling HK\$207,000,000 on 23 November 2005.

Reserves

Details of movements in the reserves of the Group and the Bank are set out in the consolidated statement of changes in equity and statement of changes in equity on page 11 and page 12 respectively.

Fixed Assets

Details of movements in fixed assets of the Group and the Bank are set out in Note 33 to the accounts.

Directors

The directors during the year and up to date of this report are:

Chairman	He Guangbei #
Vice Chairman	Ng Leung Sing #
	Ng Man Kung
Directors	Chen Yiao Zhong # (resigned on 18 March 2005)
	Chiu Ming Wah #
	Liu Yanfen #
	Mao Xiaowei #
	Ouyang Jian# (appointed on 18 March 2005)
	Tan Wan Chye #
	To Chi Wing #
	Zhang Qi Hua #
	Woo Chia Wei *
	Yu Kwok Chun *
	Chan Yiu Fai

Non-executive directors

* Independent non-executive directors



Report of the Directors (continued)

Directors (continued)

In accordance with Article 99 of the Bank's Articles of Association, Mr. Ng Leung Sing and Ms. Liu Yanfen retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Directors' Interests in Contracts of Significance

No contracts of significance, in relation to the Group's business to which the Bank, its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Management Contracts

No contracts concerning the management or administration of the whole or any substantial part of the business of the Group were entered into or existed during the year.

Directors' Interests in Equity or Debt securities

Pursuant to written resolutions of all the shareholders of the Bank's intermediate holding company, BOC Hong Kong (Holdings) Limited ("BOCHKHL"), passed on 10 July 2002, BOCHKHL has approved and adopted two share option schemes, namely, the Share Option Scheme and the Sharesave Plan. No options have been granted by BOCHKHL pursuant to the 2002 Share Option Scheme or the 2002 Sharesave Plan during the year. On 5 July 2002, Mr. He Guangbei, Mr. Ng Leung Sing, Mr. Ng Man Kung, Mr. Chiu Ming Wah, Mr. Mao Xiaowei, Mr. Chan Yiu Fai and Mr. To Chi Wing were granted option by BOC Hong Kong (BVI) Limited ("BOC (BVI)"), the immediate holding company of BOCHKHL, pursuant to a Pre-listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 3,652,800 existing issued shares of the BOCHKHL at a price of HK\$8.5 per share. These options have a vesting period of four years from 25 July 2002 with a valid exercise period of ten years. Twenty five percent of the shares subject to such options will be vested at the end of the year. Messrs. Ng Man Kung, Mao Xiaowei, Chiu Ming Wah, Ng Leung Sing and Chan Yiu Fai exercised some of their options to purchase an aggregate of 553,000 shares of BOCHKHL during the year.

Compliance with the Guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions"

The accounts for the year ended 31 December 2005 fully comply with the requirements set out in the guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority ("HKMA").

Auditors

The accounts have been audited by PricewaterhouseCoopers. A resolution for their re-appointment as auditors for the ensuing year will be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

HE Guangbei

Chairman

Hong Kong, 22 March 2006



Review and Prospects by Management

In the year of 2005, local economy has resumed its sustainable high growth since last year. Various economic sectors have recorded expansion, including exports trade, private consumption, and capital investment. Along with improvement of unemployment rate and mild inflation, local consumption and property investment are stimulated. However, continuous rise in interest rate has exerted uncertainties and pressures on the property market.

Favoured by the economic growth, business environment has continued to improve, yet the competitions remain intense in each sector. Banking industry is under continuing rise in interest rate, which put forth significant pressure on wealth management business. Together with the abundance of market capitals, this has exerted difficulty in enhancing net interest income.

In 2005, the Group has put efforts on expanding customer base and upgrading customer relationship management. We have adopted customer segmentation strategies, in order to provide better products and services to our customers. We also enriched our series of wealth management products, renovated and reallocated our services center.

The Group offered customized loans and trade finance products to match with the needs of Small and Medium Enterprises (SMEs). We also took the advantage of our network in Fuzhou and Xiamen to develop local customer services in the Mainland and provide cross border banking services. At the end of 2005, loans to customers and trade bills businesses recorded a noticeable increment of 20.40% compared with last year. Through our customer-oriented professional service teams with tailor-made wealth management products, the Group focused on expanding personal wealth management services to local and oversea Chinese customers.

In 2005, the Group achieved a profit attributable to shareholders of HK\$ 494,167,000, represented an increase in 0.21% compared with 2004. Return on average shareholders' funds and return on average assets were 13.62% and 1.59% respectively.

Net interest income in 2005 was HK\$556,685,000, recorded an increase of 4.14% compared with 2004. Net interest margin has increased by 1 basis point to 1.85%. Besides, the decline of securities brokerage and loan commission incomes led to a decrease in other operating income by 7.63% to HK\$ 205,054,000.

During the year, more resources have been devoted to enrich value-added services variety, which lead to an increase in operating expenses. The cost-to-income ratio has increased slightly by 1.02% to 28.80%. The operating expense was HK\$219,360,000, represented an increase of 4.38% as compared with 2004.

The Group has continued to improve asset quality and enhance credit risk management. The classified loans dropped from 2.97% to 1.01% compared with the end of 2004. The reversal of loan impairment allowances was HK\$29,871,000, as compared with the charge for bad and doubtful debt HK\$2,098,000 in 2004.

The Group reported an increase in the consolidated asset by HK\$306,067,000 to HK\$ 31,233,146,000. Loans and advances to customers were increased by 11.94% to HK\$10,154,351,000. Deposits from customers rose by 2.88% to HK\$25,476,311,000.

Looking forward to 2006, US and Mainland China economic growth tend to slow down. Hong Kong economy is expected to grow at slower pace subjected to the uncertain effect of rising interest rate and structural change of the economy. The competition of banking industry is expected to remain intense.

In 2006, the Group will continue to improve our products and service networks. We will place strong emphasis on expanding local and Mainland corporate customer bases. We will also expand wealth management and internet banking services through wider product variety and better service quality. The Group will continue to suit customers' needs for their business development and establish closer partnership with them. Besides, we will put more resources in improving our risk management and internal control in order to enhance corporate governance.



Corporate Governance

The Group has made reference to the HKMA's guidelines set out in the Supervisory Policy Manual "Corporate Governance of Locally Incorporated Authorized Institutions".

In order to focus on the strategic and material issues that have significant impact on the Group's operation, financial performance, risk management and long-term development, three committees have been established under the Board of Directors to oversee the major areas of the Group. The details of the committees are given below.

Executive Committee

The Executive Committee has been delegated with authorities from the Board to handle matters which require the Board's review, but arise between board meetings. Its responsibilities include:

- approving policies, implementation plans and management measures to effect the group-wise development strategies and business plans approved by the Board;
- reviewing the implementation progress of the strategies and business plans;
- recommending strategic proposals to the Board for its consideration and approval; and
- approving the Group's rules and regulations according to the policies imposed by the supervisory authorities and the holding companies.

The members of Executive Committee are Mr. Ng Man Kung (Chairman), Mr. Chan Yiu Fai and Mr. To Chi Wing. All are directors of the Bank.

Audit Committee

The Audit Committee assists the Board in overseeing the auditing activities of the Group and monitoring compliance with approved policies and procedures, so that the effectiveness of financial reporting process and internal control systems of the Group can be assured. Its responsibilities include:

- reviewing and monitoring the effectiveness of the internal control systems, the controls over financial risks and the procedures of financial reporting and auditing;
- assessing independently the effectiveness and efficiency of financial reporting system and its controlling mechanism, and the sufficiency of operating policies and system; and
- monitoring the operation of the Group to ensure the Group is running in compliance with the relevant rules and regulations.

The members of Audit Committee are Mr. Chiu Ming Wah (Chairman), Ms. Liu Yanfen, Mr. Tan Wan Chye and Mr. Woo Chia Wei. All are non-executive directors of the Bank.

Risk Management Committee

The Risk Management Committee assists the Board in overseeing the risk management of the Group, formulating the Group's risk management strategies, policies and procedures, and monitoring the implementation of those strategies, policies and procedures. Its responsibilities include:

- assisting the Board to measure and monitor the risk exposures of the Group;
- recommending appropriate risk management strategies to the Board; and
- formulating risk management related policies such as risk management policies and authorities and duties delegation policies in accordance with the requirements set by the Board.

The members of the Risk Management Committee are Mr. Mao Xiaowei (Chairman), Mr. Ng Leung Sing, Mr. Ng Man Kung, Mr. To Chi Wing and Mr. Yu Kwok Chun. All are directors of the Bank.



Report of the Auditors

AUDITORS' REPORT TO THE SHAREHOLDERS OF CHIYU BANKING CORPORATION LIMITED (incorporated in Hong Kong with limited liability)

We have audited the accounts on pages 8 to 90 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Hong Kong Companies Ordinance requires the directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the Bank and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31 December 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 22 March 2006



Consolidated Profit and Loss Account

For the year ended 31 December

	Notes	2005 HK\$'000	2004 HK\$'000
Interest income		1,017,790	702,579
Interest expense		(461,105)	(168,020)
Net interest income	6	556,685	534,559
Fees and commission income		194,689	213,928
Fees and commission expenses		(30,312)	(33,762)
Net fees and commission income	7	164,377	180,166
Net trading income	8	37,448	38,252
Other operating income	9	3,229	3,562
Operating income		761,739	756,539
Operating expenses	10	(219,360)	(210,155)
Operating profit before impairment/provisions on advances		542,379	546,384
Reversal of loan impairment allowances on advances	11	29,871	-
Charge for bad and doubtful debts	12	-	(2,908)
Operating profit		572,250	543,476
Net gain from disposal/revaluation of fixed assets	13	5,440	21,542
Net gain from fair value adjustments on investment properties	14	8,250	-
Reversal of impairment losses on investment securities		-	740
Net gain on disposal of subsidiary		4,853	-
Profit before taxation		590,793	565,758
Taxation	15	(96,626)	(72,608)
Profit for the year		494,167	493,150
Dividends	17	375,000	339,000



Consolidated Balance Sheet

As at 31 December	Notes	2005 HK\$'000	2004 HK\$'000
ASSETS			
Cash and short-term funds	21	7,029,325	9,434,661
Placements with banks and other financial institutions maturing between one and twelve months		4,136,382	3,798,731
Trade bills		788,624	103,647
Other financial assets at fair value through profit or loss	22	814,966	-
Derivative financial instruments	23	179,443	-
Certificates of deposit held	24	1,933,646	2,047,188
Advances and other accounts	25	10,102,145	8,822,697
Investment in securities			
- Available-for-sale securities	28	26,952	-
- Held-to-maturity securities	29	4,859,354	5,571,797
- Loans and receivables	30	316,647	-
- Investment securities	31	-	21,677
Fixed assets	33	548,573	498,120
Investment properties	34	53,940	20,690
Deferred tax assets	37	117	71
Other assets		443,032	607,800
Total assets		31,233,146	30,927,079
LIABILITIES			
Deposits and balances of banks and other financial institutions		633,800	1,045,819
Other financial liabilities at fair value through profit or loss	36	2,616,209	-
Derivative financial instruments	23	104,536	-
Deposits from customers	35	22,860,102	24,764,174
Certificates of deposit issued			
- at fair value through profit or loss	36	360,848	-
- at amortised cost		-	369,291
Deferred tax liabilities	37	62,719	18,319
Other accounts and provisions	38	803,756	1,262,179
Total liabilities		27,441,970	27,459,782
CAPITAL RESOURCES			
Share capital	39	300,000	300,000
Reserves	40	3,491,176	3,167,297
Shareholders' funds		3,791,176	3,467,297
Total liabilities and capital resources		31,233,146	30,927,079

Approved by the Board of Directors on 22 March 2006 and signed on behalf of the Board by:

Director: HE Guangbei

Director: NG Man Kung

Director: CHIU Ming Wah

Secretary: PO Yuen Fung



Balance Sheet

As at 31 December	Notes	2005 HK\$'000	2004 HK\$'000
ASSETS			
Cash and short-term funds	21	7,029,325	9,434,661
Placements with banks and other financial institutions maturing between one and twelve months		4,136,382	3,798,731
Trade bills		788,624	103,647
Other financial assets at fair value through profit or loss	22	814,966	-
Derivative financial instruments	23	179,443	-
Certificates of deposit held	24	1,933,646	2,047,188
Advances and other accounts	25	10,102,424	8,823,434
Investment in securities			
- Available-for-sale securities	28	6,703	-
- Held-to-maturity securities	29	4,859,354	5,571,797
- Loans and receivables	30	316,647	-
- Investment securities	31	-	1,428
Investments in subsidiaries	32	3,913	3,913
Amount due from subsidiaries	32	54,123	53,573
Fixed assets	33	535,003	463,571
Investment properties	34	53,940	20,690
Other assets		421,677	604,544
Total assets		31,236,170	30,927,177
LIABILITIES			
Deposits and balances of banks and other financial institutions		633,800	1,045,819
Other financial liabilities at fair value through profit or loss	36	2,616,209	-
Derivative financial instruments	23	104,536	-
Deposits from customers	35	22,895,039	24,810,289
Certificates of deposit issued			
- at fair value through profit or loss	36	360,848	-
- at amortised cost		-	369,291
Deferred tax liabilities	37	62,719	18,319
Other accounts and provisions	38	803,897	1,244,274
Amount due to subsidiaries	32	20,518	20,523
Total liabilities		27,497,566	27,508,515
CAPITAL RESOURCES			
Share capital	39	300,000	300,000
Reserves	40	3,438,604	3,118,662
Shareholders' funds		3,738,604	3,418,662
Total liabilities and capital resources		31,236,170	30,927,177

Approved by the Board of Directors on 22 March 2006 and signed on behalf of the Board by:

Director: HE Guangbei

Director: NG Man Kung

Director: CHIU Ming Wah

Secretary: PO Yuen Fung



Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Group							Total
	Share capital	Premises revaluation reserve	Investment properties revaluation reserve	Translation reserve	Reserve for fair value changes of available-for-sale securities	Regulatory reserve*	Retained earnings	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
At 1 January 2004	300,000	110,738	5,690	408	-	-	2,808,672	3,225,508
Net profit for the year	-	-	-	-	-	-	493,150	493,150
Currency translation difference	-	-	-	(54)	-	-	-	(54)
2004 first interim dividend paid	-	-	-	-	-	-	(150,000)	(150,000)
2004 second interim dividend paid	-	-	-	-	-	-	(189,000)	(189,000)
Revaluation of properties	-	102,028	3,310	-	-	-	-	105,338
Release from deferred tax liabilities	-	(17,645)	-	-	-	-	-	(17,645)
At 31 December 2004	<u>300,000</u>	<u>195,121</u>	<u>9,000</u>	<u>354</u>	<u>-</u>	<u>-</u>	<u>2,962,822</u>	<u>3,467,297</u>
Bank and subsidiaries	<u>300,000</u>	<u>195,121</u>	<u>9,000</u>	<u>354</u>	<u>-</u>	<u>-</u>	<u>2,962,822</u>	<u>3,467,297</u>
At 1 January 2005								
As previously reported	300,000	195,121	9,000	354	-	-	2,962,822	3,467,297
Opening adjustments (Note 4)	-	-	(9,000)	-	-	140,148	(6,971)	124,177
Balance after opening adjustments	<u>300,000</u>	<u>195,121</u>	<u>-</u>	<u>354</u>	<u>-</u>	<u>140,148</u>	<u>2,955,851</u>	<u>3,591,474</u>
Net profit for the year	-	-	-	-	-	-	494,167	494,167
2005 first interim dividend paid	-	-	-	-	-	-	(168,000)	(168,000)
2005 second interim dividend paid	-	-	-	-	-	-	(207,000)	(207,000)
Revaluation of premises	-	96,645	-	-	-	-	-	96,645
Change in fair value of available-for-sale securities taken to equity	-	-	-	-	885	-	-	885
Release to deferred tax liabilities	-	(16,498)	-	-	(143)	-	-	(16,641)
Transfer on disposal of property	-	-	-	(354)	-	-	-	(354)
Transfer from retained earnings	-	-	-	-	-	13,659	(13,659)	-
At 31 December 2005	<u>300,000</u>	<u>275,268</u>	<u>-</u>	<u>-</u>	<u>742</u>	<u>153,807</u>	<u>3,061,359</u>	<u>3,791,176</u>
Bank and subsidiaries	<u>300,000</u>	<u>275,268</u>	<u>-</u>	<u>-</u>	<u>742</u>	<u>153,807</u>	<u>3,061,359</u>	<u>3,791,176</u>

*In accordance with the requirements of HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances on advances recognised under HKAS 39.



Statement of Changes in Equity

	Attributable to equity holders of the Bank						Total HK\$'000
	Share capital HK\$'000	Premises revaluation reserve HK\$'000	Investment properties revaluation reserve HK\$'000	Reserve for fair value changes of available-for- sale securities HK\$'000	Regulatory reserve HK\$'000	Retained earnings HK\$'000	
At 1 January 2004	300,000	110,738	5,690	-	-	2,761,843	3,178,271
Net profit for the year	-	-	-	-	-	491,698	491,698
2004 first interim dividend	-	-	-	-	-	(150,000)	(150,000)
2004 second interim dividend	-	-	-	-	-	(189,000)	(189,000)
Revaluation of properties	-	102,028	3,310	-	-	-	105,338
Release from deferred tax liabilities	-	(17,645)	-	-	-	-	(17,645)
At 31 December 2004	300,000	195,121	9,000	-	-	2,914,541	3,418,662
At 1 January 2005							
As previously reported	300,000	195,121	9,000	-	-	2,914,541	3,418,662
Opening adjustments (Note 4)	-	-	(9,000)	-	140,148	(6,971)	124,177
Balance after opening adjustments	300,000	195,121	-	-	140,148	2,907,570	3,542,839
Net profit for the year	-	-	-	-	-	489,876	489,876
2005 first interim dividend paid	-	-	-	-	-	(168,000)	(168,000)
2005 second interim dividend paid	-	-	-	-	-	(207,000)	(207,000)
Revaluation of premises	-	96,645	-	-	-	-	96,645
Change in fair value of available-for-sale securities taken to equity	-	-	-	885	-	-	885
Release to deferred tax liabilities	-	(16,498)	-	(143)	-	-	(16,641)
Transfer from retained earnings	-	-	-	-	13,659	(13,659)	-
At 31 December 2005	300,000	275,268	-	742	153,807	3,008,787	3,738,604



Consolidated Cash Flow Statement

For the year ended 31 December	Notes	2005 HK\$'000	2004 HK\$'000
Cash flows from operating activities			
Operating cash (outflow)/inflow before taxation	41(a)	(1,116,631)	222,858
Hong Kong profits tax paid		(85,701)	(64,228)
Overseas profits tax paid		(4,754)	(2,859)
Net cash (outflow)/inflow from operating activities		(1,207,086)	155,771
Cash flows from investing activities			
Dividends received from investments in securities		1,094	1,107
Purchase of fixed assets		(9,931)	(5,058)
Proceeds from disposal of fixed assets		184	1
Proceeds from disposal of bank premises		3,139	-
Proceeds from disposal of subsidiaries	41(c)	35,579	-
Net cash inflow/(outflow) from investing activities		30,065	(3,950)
Cash flows from financing activities			
Dividends paid on ordinary shares		(564,000)	(336,000)
Net cash outflow from financing activities		(564,000)	(336,000)
Decrease in cash and cash equivalents		(1,741,021)	(184,179)
Cash and cash equivalents at 1 January		10,865,480	11,049,659
Cash and cash equivalents at 31 December	41(b)	9,124,459	10,865,480



Notes to the Accounts

1. Principal activities

The Group is principally engaged in the provision of banking and related financial services in Hong Kong.

The Bank is a limited liability company incorporated in Hong Kong. The address of its registered office is No.78 Des Voeux Road, Central, Hong Kong.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated accounts are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated accounts of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (HKFRSs which is a collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Statements of Standard Accounting Practice and Interpretations) issued by Hong Kong Institute of Certified Public Accountants (HKICPA), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the requirements set out in the guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions" under the Supervisory Policy Manual issued by Hong Kong Monetary Authority ("HKMA").

The consolidated accounts have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale securities, financial instruments (including derivative financial instruments) at fair value through profit or loss, investment properties are carried at open market value and premises which are carried at open market value.

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



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

The adoption of new/revised HKFRS

In 2005, the Group adopted the new/revised HKFRSs as set out below, which are relevant to its operations. Certain 2004 comparatives have been amended other than those where retrospective application is prohibited or prospective application is allowed in the transitional provision of respective standards.

HKAS 1	Presentation of Financial Statements
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial instruments: Recognition and Measurement
HKAS 40	Investment Property
HKAS-Int 21	Income Taxes – Recovery of Revalued Non-Depreciated Assets
HKFRS 5	Non-current assets held for sale and discontinued operations

The adoption of new/revised HKASs 7, 8, 10, 16, 27, 30, 36 did not result in substantial changes to the Group's accounting policies.

In summary:

HKAS 1

HKAS 1 has affected the presentation of minority interest and other disclosures.

HKAS17

The adoption of revised HKAS 17 has resulted in a change in the accounting policy relating to the reclassification of leasehold land from fixed assets to operating leases if the land element can be split reliably. The up-front prepayments made for the leasehold land will then be expensed in the profit and loss account on a straight-line basis over the period of the lease. In prior years, the leasehold land was accounted for at fair value less subsequent depreciation. It is determined that the values of the land and building elements of the Group's leasehold properties cannot be split reliably, the treatment of the leasehold properties is consistent with prior years.

HKAS 21

In HKAS 21, the functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard. All the Group entities except those located outside Hong Kong have the same functional currency as the presentation currency for respective entities accounts.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

HKAS 24

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party, or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control. Related parties may be individuals or entities.

The adoption of HKAS 24 "Related Party Disclosures" has affected the identification of related parties and some other related-party disclosures. This HKAS requires the disclosure of the compensation of key management personnel. In addition, it requires the Group to disclose related party transactions with state-controlled entities as these profit-oriented state-controlled entities are no longer exempted from disclosure.

HKAS 32 and HKAS 39

The adoption of HKAS 32 has resulted in providing additional disclosures of terms, conditions, accounting policies, risk and fair values of financial instruments throughout the notes to the accounts.

The adoption of HKAS 39 has resulted in changes in the accounting policies relating to the recognition and measurement of financial instruments with details set out in notes 2.5, 2.8 to 2.11 and 2.12.

HKAS 40

The adoption of revised HKAS 40 has resulted in a change in the accounting policy of investment properties as changes in fair values are now recorded in the profit and loss account. In prior years, the increases in fair value were credited to the investment properties revaluation reserve. Decreases in fair value were first set off against increases on earlier valuations on a portfolio basis and thereafter were expensed in the profit and loss account.

HKAS-Int 21

The adoption of revised HKAS-Int 21 has resulted in a change in the accounting policy relating to the measurement of deferred tax liability arising from the revaluation of investment properties. Such deferred income tax liability is measured on the basis of tax consequences that would follow from recovery of the carrying amount of that asset through use. In prior years, the carrying amount of that asset was expected to be recovered through sale and no deferred tax liability was recognised.

Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.1 Basic of preparation (continued)

HKFRS 5

The adoption of HKFRS 5 has resulted in a change in accounting policy for repossessed collateral assets. Repossessed collateral assets are reported as "Repossessed assets" under "Other assets" and the relevant loans and impairment allowances are derecognised. The repossessed collateral assets are measured at lower of carrying amount of derecognised loans and net realisable value of the repossessed collateral.

In prior years, loans and advances where assets had been repossessed continued to be reported as "Advances to customers" on the balance sheet and the carrying value was adjusted down to net realisable value of the repossessed assets.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards.

All standards adopted by the Group require retrospective application other than:

- HKAS 39 – does not permit recognition, derecognition and measurement of financial instruments in accordance with these standards on a retrospective basis. The Group continued to apply the previous standard, SSAP 24 "Accounting for investments in securities", to investments in securities and also to hedge relationships for the 2004 comparative information. The adjustments required for the accounting differences between SSAP 24 and HKAS 39 are determined and recognised at 1 January 2005.
- HKAS 40 does not require the Group to restate the comparative information, any adjustment should be made to the retained earnings as at 1 January 2005, including the reclassification of any amount held in revaluation surplus for investment property.
- HKAS-Int 21 – deferred income tax is provided on revaluation surplus of investment properties in accordance with HKAS-Int 21. As the retrospective effect is immaterial, no restatement of prior year comparatives figures has been made.
- HKFRS 5 – applied prospectively after the adoption date.

The HKICPA has issued a number of new and revised HKFRSs which are effective for accounting period beginning on or after 1 January 2006. The Group has not early adopted any of the following new Standards Amendments, or Interpretations which are relevant to the Group:

HKAS 1 (Amendment)	Capital Disclosures
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKFRS 7	Financial Instruments: Disclosures
HKFRS-Int 4	Determining whether an Arrangement contains a Lease

The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

Notes to the Accounts (continued)



2. Summary of significant accounting policies (continued)

2.2 Consolidation

The consolidated accounts include the accounts of the Bank and its subsidiaries made up to 31 December.

Subsidiaries

Subsidiaries are those entities in which the Group, directly or indirectly, controls the composition of the Board of Directors, controls more than half of the voting power or holds more than half of the issued share capital that entitle the Group to govern the financial and operating policies of the entities. The existence and effect of any potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for any acquisition of subsidiary by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values as of the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the profit and loss account.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets transferred. Where necessary, accounting policies of subsidiaries is changed to ensure consistency with the policies adopted by the Group.

In the Bank's balance sheet the investments in subsidiaries are stated at cost less allowance for impairment losses. The results of subsidiaries are accounted for by the Bank on the basis of dividend received and receivable.

The gain or loss on the disposal of a subsidiary represents the difference between: a) the proceeds of the sale and, b) the Group's share of its net assets including goodwill on acquisition net of any accumulated impairment loss and any related accumulated foreign currency translation difference.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.3 Segmental reporting

A business segment is a group of assets and operations engaged in providing products and services that are subject to risks and returns different from those of other business segments. A geographical segment is engaged in providing products and services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments.

2.4 Foreign currency translation

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

Foreign currency transactions are translated into the functional currency using average exchange rates or the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions are recognised directly in the profit and loss account. Assets and liabilities denominated in foreign currencies are translated at the closing rate at the balance sheet date. The differences arising from translation are recognised in the profit and loss account except for translation differences on non-monetary items such as equity classified as available-for-sale financial instruments are included in the fair value change reserve in equity.

The results and financial position of all Group entities that have a functional currency different from Hong Kong dollars are translated into Hong Kong dollars as follows:

- assets and liabilities are translated at the closing rate at the balance sheet date;
- income and expenses are translated at average exchange rates; and
- all resulting exchange differences are recognised in the currency translation reserve in equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the profit and loss account, as part of the gain or loss on sale.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting

From 1 January 2004 to 31 December 2004

Off-balance sheet financial instruments included derivatives, such as forwards, swaps, options and other transactions undertaken by the Group in the foreign exchange, interest rate, equity and other markets. The accounting for these derivatives was dependent on whether the transactions were undertaken for dealing or hedging purposes when the Group entered into a derivative contract.

Derivative financial instruments other than those transacted to hedge risk were deemed to be held for dealing purposes. Transactions undertaken for dealing purposes were marked to market at fair value. For exchange traded contracts, fair value is based on quoted market prices. For non-exchange traded contracts, fair value is based on dealers' quotes, pricing models or quoted prices for instruments with similar characteristics. The gain or loss arising from changes in fair value was recognised in the profit and loss account as "Net gain/(loss) from foreign exchange activities" or "Net gain/(loss) from other dealing activities".

Unrealised gains/losses on transactions which were marked to market were included in "Other assets" or "Other accounts and provisions".

Transactions undertaken for hedging purposes were designated at inception and the hedging instrument was required to be highly effective in accomplishing the objective of offsetting the risk being hedged throughout the life of the hedge. Hedging instruments were valued on an equivalent basis to the assets, liabilities or net positions that they were hedging. Any profit or loss was recognised in the profit and loss account on the same basis as that arising from the related assets, liabilities or net positions.

If the derivative transaction no longer met the criteria for a hedge set out above, the derivative was deemed to be held for dealing purposes and was accounted for as set out above.

From 1 January 2005 onwards

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and through the use of valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative and are categorised as held for trading under fair value through profit or loss unless they are designated as hedges and are effective hedging instruments, then they are subject to measurement under the hedge accounting requirements.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group may recognise profits on the date of transaction.

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the profit and loss account.

The Group designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way.

The Group documents at inception the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items. These criteria should be met before a hedging can be qualified to be accounted for under hedge accounting.

Changes in the fair value of derivatives that are designated and qualified as effective fair value hedges are recorded in the profit and loss account, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedge item for which the effective interest method is used is amortised to profit or loss over the period to maturity. The adjustment to the carrying amount of a hedged equity security remains in retained earnings until the disposal of the equity security.

For derivative instruments held for trading and those that do not qualify for hedge accounting, changes in their fair value are recognised immediately in the profit and loss account.

2.6 Offsetting financial instruments

Financial instruments are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.7 Interest income and expense and fees and commission income

From 1 January 2004 to 31 December 2004

Interest income and expense was recognised in the profit and loss account as it accrued, except in the case of doubtful debts, where interest was credited to a suspense account which was netted in the balance sheet against the relevant balances. Fees and commission income were recognised in the period when earned unless they related to transactions involving an interest rate risk or other risks which extended beyond the then current period, in which case they were amortised over the period of the transaction as commission. Premiums or discounts of debt securities held, or debt instruments in issue, were amortised over the period from the date of purchase or issue to the date of maturity, as part of interest income or interest expense.

From 1 January 2005 onwards

Interest income and expense are recognised in the profit and loss account for all assets/liabilities measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial instrument and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or, when appropriate, a shorter period to the net carrying amount of the financial instrument. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees, premiums or discounts and basis points paid or received between parties to the contract and directly attributable origination fees and costs which represent an integral part of the effective yield are amortised over the expected life of the financial instruments.

Once a financial instrument or a group of similar financial instruments has been written down as a result of an impairment loss, interest income is recognised on the written down value using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Subsequent unwinding of the discount allowance is recognised as interest income.

Income and amortisation derived using the effective interest method for available-for-sale securities and financial instruments at fair value through profit or loss continue to be recognised as interest income or interest expense in the profit and loss account.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.7 Interest income and expense and fees and commission income (continued)

From 1 January 2005 onwards (continued)

Fee and commission income related to credit commitments are generally amortised on a straight-line basis over the commitment period. Loan syndication fees are recognised as revenue when the related syndication arrangement has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as that of other participants.

2.8 Financial assets

From 1 January 2004 to 31 December 2004

All financial assets were carried at cost less amortisation and impairment allowances, except for “Other investment in securities” and derivative assets held for dealing which were measured at fair value. Gains and losses from changes in fair value were recognised in the profit and loss account.

The fair values of quoted investments in active markets were based on current market mid prices or closing prices as at the balance sheet date.

From 1 January 2005 onwards

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments and available-for-sale financial assets. Management determines the classification of its investment at initial recognition. The classification depends on the purpose for which the financial assets were held. All financial assets are classified at inception or date of transition to the new HKFRS and are recognised initially at fair value. Except for financial assets carried at fair value through profit or loss, all transaction costs of financial assets are included in their amortised costs.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

From 1 January 2005 onwards (continued)

(1) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated as at fair value through profit or loss at inception or date of transition to the new HKFRS. A financial asset is classified as held for trading if it is acquired principally for the purpose of selling in the short term. A financial asset is typically designated as at fair value through profit or loss if it meets the following criteria:

- it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring financial instruments or recognising the gain and losses on them on different bases; or
- a group of financial instruments is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and this is the basis on which information about these assets and liabilities is provided internally to the management.

Financial assets at fair value through profit or loss are subsequently measured at fair value. Transaction costs of financial assets so designated are taken directly to the profit and loss account. Changes in fair value of financial assets in this category are recognised in the profit and loss account as they arise.

(2) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, including placements with banks and other financial institutions, investment debt securities without active market and loans and advances to customers. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. Loans and receivables are measured at amortised cost using the effective interest method.

(3) Held-to-maturity

Financial assets classified as held-to-maturity are those traded in active markets, with fixed or determinable payments and fixed maturities that the Group's management has both the positive intention and the ability to hold to maturity. Held-to-maturity investments are carried at amortised cost using the effective interest method. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

From 1 January 2005 onwards (continued)

(4) Available-for-sale

Financial assets classified as available-for-sale are those that are either designated as such or are not classified in any of the other categories. They are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Available-for-sale financial assets are measured at fair value. The difference between fair value and amortised cost are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is then transferred to the profit and loss account.

Interest derived from available-for-sale financial instrument is recognised using the effective interest method in the profit and loss account. Dividends on equity instruments classified as available-for-sale are recognised in the profit and loss account when the Group's right to receive payment is established.

2.9 Financial liabilities

From 1 January 2004 to 31 December 2004

All financial liabilities except short positions in trading securities and derivative liabilities held for dealing were carried at cost or amortised cost. Short positions in trading securities and derivative liabilities held for dealing were carried at fair value and any gains and losses from changes in fair value were recognised in the profit and loss account.

From 1 January 2005 onwards

The Group classifies its financial liabilities under the following categories: trading liabilities, financial liabilities designated as at fair value through profit or loss, deposits, debt securities in issue and other liabilities. All financial liabilities are classified at inception and recognised initially at fair value.

(1) Trading liabilities

A financial liability is classified as held for trading if it is incurred principally for the purpose of repurchasing in the short term. It is measured at fair value and any gains and losses from changes in fair value are recognised in the profit and loss account.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.9 Financial liabilities (continued)

From 1 January 2005 onwards (continued)

(2) Financial liabilities designated as at fair value through profit or loss

A financial liability can be designated as at fair value through profit or loss if it is so designated at inception or the date of transition to the new HKFRS. Financial liabilities so designated include certain certificates of deposits issued and certain deposits received from customers that are embedded with certain derivatives. A financial liability is so typically designated if it meets the following criteria:

- it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring financial instruments or recognition the gains and losses on them on different bases: or
- a group of financial instruments is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and this is the basis on which information about these assets and liabilities is provided internally to the management.

Financial liabilities designated at fair value through profit or loss are carried at fair value and any gains and losses from changes in fair value are recognised in the profit and loss account.

(3) Deposits, debt securities in issue and other liabilities

Deposits and debt securities in issue, other than those classified as trading liabilities or designated as at fair value through profit or loss, together with and other financial liabilities are carried at amortised cost.

2.10 Valuation of securities and derivatives

From 1 January 2004 to 31 December 2004

The fair values of quoted investments and financial liabilities in active markets were based on current market mid prices or closing prices as at the balance sheet date.

From 1 January 2005 onwards

The fair values of financial instruments that are quoted in active markets are based on current bid prices and current ask prices respectively. If the market for a financial instrument is not active (including unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.11 Recognition and derecognition of financial instruments

Purchases and sales of financial instruments at fair value through profit or loss, available-for-sale and held-to-maturity are recognised on the trade date, the date on which the Group purchases or sells the asset. Loans and receivables (except investment securities) are recognised when cash is advanced to the borrowers. Financial instruments are initially recognised at fair value plus transaction costs for all financial instruments not measured at fair value through profit or loss. Financial instruments are derecognised when the rights to receive cash flows from the financial instruments have expired or where the Group has transferred substantially all risks and rewards of ownership.

2.12 Impairment of financial instruments

From 1 January 2004 to 31 December 2004

Provisions were made against specific loans and advances as and when there were doubt on the ultimate recoverability of principal and interest in full on an individually assessed basis. Specific provision was made to reduce the carrying value of the assets to their recoverable amount. Where it was not possible to reliably estimate the loss, the Group applied pre-determined provisioning levels to the unsecured portion of loans and advances based on the Group's loan classification procedures. In addition, amounts were set aside as a general provision for performing loans on pre-determined provisioning levels. Provisions were charged to the profit and loss account when provided.

Financial instruments other than loans and advances were reviewed on each balance sheet date to determine whether there was any indication of impairment. If the recoverable amount of the asset was estimated to be less than its carrying amount, the carrying amount of the asset was reduced to its recoverable amount and the impairment loss was recognised in the profit and loss account.

From 1 January 2005 onwards

(1) Assets carried at amortised cost

The Group assesses as of each balance sheet date whether there is objective evidence that a financial instrument or group of financial instruments is impaired. A financial instrument or a group of financial instruments is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial instrument or group of financial instruments that can be reliably estimated. Objective evidence that a financial instrument or group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.12 Impairment of financial instruments (continued)

From 1 January 2005 onwards (continued)

(1) Assets carried at amortised cost (continued)

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial instrument because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial instruments since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial instruments in the group, including:
 - adverse changes in the payment status of borrowers in the group; or
 - national or local economic conditions that correlate with defaults on the assets in the group.

The Group first assesses whether objective evidence of impairment exists individually for financial instruments that are individually significant, and collectively for financial instruments that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial instrument, it includes the asset in a group of financial instruments with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit and loss account. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial instruments reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.12 Impairment of financial instruments (continued)

(1) Assets carried at amortised cost (continued)

For the purpose of a collective evaluation of impairment, financial instruments are grouped on the basis of similar and relevant credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial instruments that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group.

When a loan is uncollectible, it is written off against the related allowance for impairment losses. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses in the profit and loss account.

If, in a subsequent period, the amount of allowance for impairment losses decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit and loss account. Impairment losses recognised in the profit and loss account for equity investments measured at amortised cost shall not be reversed.

Impairment losses recognised in the profit and loss account for equity investments carried at amortised cost shall not be reversed.

(2) Assets carried at fair value

The Group assesses as of each balance sheet date whether there is objective evidence that a financial instrument or a group of financial instruments is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial instruments, the cumulative losses, measured as the difference between the acquisition cost or amortised cost and the current fair value, less any impairment loss on that financial instrument previously recognised in the profit and loss, is removed from equity and recognised in the profit and loss account. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the profit and loss account, the impairment loss is reversed through the profit and loss account. With respect to equity instruments, such reversals are made through the available-for-sale reserve within equity.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.13 Intangible assets

Intangible assets principally comprise computer software. Intangible assets are stated in the financial statements at cost less accumulated amortisation and impairment. Amortisation for intangible assets is calculated on a straight-line basis from the month of acquisition or operation over the shorter of their estimated beneficial lives or effective useful periods (normally not exceeding five years) and is recognised in the profit and loss account.

When the estimated recoverable amount of a specific intangible asset is lower than its carrying amount as a result of the progress of new technology, an impairment loss is recognised in the profit and loss account.

2.14 Fixed assets

(1) Premises, equipment, fixtures and fittings

Premises mainly comprised of branches and offices. Premises are shown at open market value, based on periodic, but at least triennial, valuations by external independent valuers, less subsequent depreciation. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. In the intervening years, the directors review the carrying value of premises, by reference to the open market value of similar properties, and adjustments is made when there has been a material change. All equipments, fixtures and fittings are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition and installation of the items.

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

Increases in the carrying amount arising on revaluation of premises are credited to the premises revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same individual asset are charged against premises revaluation reserve directly in equity; all other decreases are expensed in the profit and loss account. Any subsequent increases are credited to the profit and loss account up to the amount previously debited, and then to the premises revaluation reserve. Upon disposal of premises, the relevant portion of the premises revaluation reserve realised in respect of previous valuation is released and transferred from the premises revaluation reserve to retained earnings.

Depreciation is calculated on the straight-line method to write down the cost or revalued amounts of such assets to their residual values over their estimated useful lives as follows:

-	Premises	Over the remaining period of lease
-	Equipment, fixtures and fittings	3-15 years

The assets' useful lives are reviewed, and adjusted if appropriate, as of each balance sheet date.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.14 Fixed assets (continued)

At each balance sheet date, both internal and external sources of information are considered to determine whether there is any indication that premises, equipment, fixtures and fittings 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 loss is 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 revaluation decrease. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Impairment loss is reversed through the revaluation reserve or profit and loss account as appropriate.

Gains and losses on disposals are determined by comparing net sales proceeds with carrying amount. These are included in the profit and loss account.

(2) Property under development

Property under development represents assets under construction or installation and is stated at cost less impairment losses. Cost comprises equipment cost, cost of development, construction and installation, interest and other direct costs attributable to the development. Items classified as property under development are transferred to premises or investment properties when such assets are ready for their intended use, and the depreciation charge commences from the month such assets are transferred to premises.

Impairment losses are recognised for idle projects with respect to which management has determined that resumption in the foreseeable future is not probable. The impairment loss is equal to the extent to which the estimated recoverable amount of a specific project is less than its carrying amount. The recoverable amount is the asset's fair value less costs to sell. Any impairment losses or reversals are charged or credited to the profit and loss account.

2.15 Investment properties

From 1 January 2004 to 31 December 2004

Investment properties were carried at valuation assessed by professional valuers on the basis of open market value. Changes in the value of investment properties were treated as a movement in the investment properties revaluation reserve on a portfolio basis. Unless the total of the reserve was insufficient to cover a deficit, then the deficit exceeded the total investment properties revaluation reserve was charged to the profit and loss account. Any subsequent revaluation surplus was credited to the profit and loss account to the extent of the deficit previously charged.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.15 Investment properties (continued)

Properties leased out within consolidated group companies were classified as premises in both the individual companies' accounts and consolidated accounts.

From 1 January 2005 onwards

Properties that are held for long-term rental yields or for capital appreciation or both, and that are not occupied by the companies in the consolidated Group, are classified as investment properties. Properties leased out within consolidated group companies are classified as investment properties in individual companies' accounts and as premises in consolidated accounts. Land held under operating lease is classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it is a finance lease.

Investment properties are recognised initially at its cost, including related transaction costs. After initial recognition, investment properties are measured at fair value assessed by professional valuers on the basis of open market value.

Subsequent expenditure is charged to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are expensed in the profit and loss account during the financial period in which they are incurred.

Any changes in fair value are reported directly in the profit and loss account. Deferred income tax is provided on revaluation surpluses of investment properties in accordance with HKAS-Int 21 ("Income Taxes – Recovery of Revalued Non-Depreciable Assets") on HKAS 12 ("Income Taxes").

If an investment property becomes owner-occupied, it is reclassified as premises, and its fair value at the date of reclassification becomes its cost for accounting purposes. If an item of premises becomes an investment property because its use has changed, any difference resulting between the carrying amount and the fair value of this item at the date of transfer is recognised in equity as a revaluation of premises under HKAS 16 ("Property, Plant and Equipment"). However, if a fair value gain reverses a previous impairment loss, the gain is recognised in the profit and loss account.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.16 Leases

(1) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. The total payments made under operating leases (net of any incentives received from the lessor) which include land use rights with payments that are separately identifiable at inception of the lease are charged to the profit and loss account on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period is expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Where the Group is a lessor, the assets subject to the operating lease are accounted for as investment properties. Rental income from operating leases is recognised on a straight-line basis over the lease term.

(2) Finance Leases on properties

From 1 January 2004 to 31 December 2004

Leasehold properties regarded as finance lease were stated at valuation determined by the directors with reference to a valuation conducted by independent professional valuers. No apportionment of the value between the land and buildings elements was made.

From 1 January 2005 onwards

Upon adoption of HKAS 17 ("Leases"), where the land and buildings elements of leasehold properties held for own use can be split reliably as at inception of the lease, this results in a change in the classification of leasehold land and land use rights from fixed assets to operating leases. The up-front prepayments made or other costs incurred for acquiring the leasehold land and land use rights are expensed in the profit and loss account on a straight-line basis over the period of the lease. Where there is impairment of the up-front prepayments, the impairment is expensed in the profit and loss account immediately. Where the land and building cannot be split reliably as at the inception of the lease, the land and building elements will continue to be treated as finance leases and measured at fair value.

Separate measurement of the land and buildings elements is not required when the Group's interest in both land and buildings is classified as investment properties as if it is finance lease and is measured at fair value.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.16 Leases (continued)

From 1 January 2005 onwards

Consistent with the accounting policy of BOC Hong Kong (Holdings) Limited ("BOCHKHL"), the Group has adopted the valuation at the date of the merger of BOCHKHL ("the Merger") as the deemed cost for its leasehold properties use to reflect the circumstances at the time of the Merger.

It is also determined that the values of the land building elements of the Group's leasehold properties cannot be reliably split and the leasehold properties are treated as finance leases. The Group has therefore adopted the revaluation model under HKAS16 by which assets arising under these finance leases are carried at fair value less any accumulated depreciation and impairment losses.

2.17 Cash and cash equivalents

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise balances with original maturity less than three months from the date of acquisition, including cash, due from banks, balances with banks and other financial institutions, and short-term bills and notes categorised as investment securities and certificates of deposits.

2.18 Provisions

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 embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.19 Employee benefits

(1) Retirement benefit costs

The Group contributes to defined contribution retirement schemes under either recognised ORSO schemes or MPF schemes that are available to the Group's employees. Contributions to the schemes by the Group and employees are calculated as a percentage of employees' basic salaries for the ORSO schemes and in accordance with the MPF rules for MPF schemes. The retirement benefit scheme costs are charged to the profit and loss account as incurred and represent contributions payable by the Group to the schemes share of contribution made by the Group that are forfeited by those employees who leave the ORSO scheme prior to the full vesting of their entitlement to the contributions are used by the Group to reduce the existing level of contributions or to meet its expenses under the trust deed of the ORSO schemes.

The assets of the schemes are held in independently-administered funds separate from those of the Group.

(2) Leave entitlements

Employee entitlements to annual leave and sick leave are recognised when they accrue to employees. A provision is made for the estimated liability for unused annual leave and the amount of sick leave expected to be paid as a result of services rendered by employees up to the balance sheet date.

Compensated absences other than annual leave and sick leave are non-accumulating; they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the Group. Such compensated absences are recognised when the absences occur.

(3) Bonus plans

The expected cost of bonus payments are recognised as a liability when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made. Liabilities for bonus plans are expected to be settled within twelve months and are measured at the amounts expected to be paid when they are settled.

2.20 Deferred income taxes

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated accounts. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.20 Deferred income taxes (continued)

The principal temporary differences arise from asset impairment provisions, depreciation of property and equipment, revaluation of certain financial instruments including derivative contracts and available-for-sale securities, properties and tax losses carried forward. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax liabilities are provided in full on all taxable temporary differences and deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise.

Deferred income tax is charged or credited in the profit and loss account except when it relates to items charged or credited directly to equity, in which case the deferred income tax is also dealt with in equity, such as the fair value re-measurement of available-for-sale investments and revaluation of premises.

2.21 Repossessed assets

From 1 January 2004 to 31 December 2004

Reposessed assets continued to be reported as non-performing loans and advances until all collection efforts were exhausted and the reposessed assets were realised. Before realisation, loan impairment allowances were made after taking into account the market value of the reposessed assets to adjust the carrying value of related loans and advances to their net realisable value.

From 1 January 2005 onwards

Upon adoption of HKFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations"), reposessed assets are initially recognised at the lower of their fair value or the amortised cost of the related outstanding loans on the date of repossession. The related loans and advances together with the related impairment allowances are then derecognised from the balance sheet. Subsequently, reposessed assets are measured at the lower of their cost or net realisable value and are reported as 'Noncurrent assets held for sale' under 'Other assets'.



Notes to the Accounts (continued)

2. Summary of significant accounting policies (continued)

2.22 Fiduciary duties

The Group commonly acts as a trustee, or in other fiduciary capacities, that result in its holding or managing assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets and any income or losses arising thereon are excluded from these accounts, as they are not assets of the Group.

2.23 Contingent liabilities and contingent assets

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 as a provision 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, it will be recognised as an asset.

2.24 Related parties

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly and indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control. Related parties may be individuals or entities.

3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that may affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors that are believed to be reasonable under the circumstances. Areas susceptible to changes in essential estimates and judgements, which affect the carrying value of assets and liabilities, are set out below. It is impracticable to determine the effect of changes to either the key assumptions discussed below or other estimation uncertainties. It is possible that actual results may require material adjustments to the estimates referred to below.



Notes to the Accounts (continued)

3. Critical accounting estimates and judgements in applying accounting policies

(a) Impairment allowances on loans and advances

The Group reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the consolidated profit and loss account, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group (e.g. payment delinquency or default). Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Fair value of financial instruments

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Valuation techniques used include discounted cash flows analysis and models within built-in functions available in externally acquired financial analysis or risk management systems widely used by the industry. To the extent practical, models use only observable data. However, in case of missing data, the Group uses interpolation or extrapolation methods to estimate the data required. Changes in assumptions about these estimates could affect reported fair value of financial instruments.

(c) Held-to-maturity investments

The Group follows the guidance of HKAS 39 on classifying non-derivative financial instruments with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would then be measured at fair value and not amortised cost.

(d) Income taxes

The Group is subject to income taxes in different jurisdictions. Significant estimates are required in determining the respective provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary courses of business. The Group recognises liabilities for anticipated tax issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that are initially recorded, such differences will impact the income tax and deferred income tax and relevant assets and liabilities in the period in which such determination is made.



Notes to the Accounts (continued)

4. Effect of adopting new HKASs

(a) The estimated effect of adopting these new accounting standards on consolidated balance sheet items are as follows:

	HKFRS 5	HKAS32 & HKAS39	HKAS 40 & HKAS-INT 21	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Increase/(decrease) in assets as at 31 December 2005				
Cash and short-term funds	-	27,754	-	27,754
Placements with banks and other financial institutions maturing between one and twelve months	-	17,628	-	17,628
Trade bills	-	58	-	58
Other financial assets at fair value through profit or loss	-	814,966	-	814,966
Derivative financial instruments	-	179,443	-	179,443
Certificates of deposit held	-	(28,856)	-	(28,856)
Advances and other accounts	(46,943)	45,273	-	(1,670)
Available-for-sale securities	-	26,952	-	26,952
Held-to-maturity securities	-	(1,119,172)	-	(1,119,172)
Loans and receivables	-	316,647	-	316,647
Investment securities	-	(21,447)	-	(21,447)
Other assets	46,943	(116,351)	-	(69,408)
	-	142,895	-	142,895
Increase/(decrease) in liabilities as at 31 December 2005				
Deposits and balances of banks and other financial institutions	-	176	-	176
Other financial liabilities at fair value through profit or loss	-	2,616,209	-	2,616,209
Derivative financial instruments	-	104,536	-	104,536
Deposits from customers	-	(2,674,903)	-	(2,674,903)
Certificates of deposit issued	-	(6,408)	-	(6,408)
Deferred tax liabilities	-	26,003	1,854	27,857
Other accounts and provisions	-	(63,670)	-	(63,670)
	-	1,943	1,854	3,797
Increase/(decrease) in equity as at 31 December 2005				
Investment properties revaluation reserves	-	-	(17,250)	(17,250)
Reserve for fair value changes of available-for-sale securities	-	743	-	743
Regulatory reserve*	-	153,807	-	153,807
Retained earnings	-	(13,598)	15,396	1,798
	-	140,952	(1,854)	139,098

* The regulatory reserve has been set up, as a consequence of the adoption of HKAS 39, for general banking risks in accordance with the requirements of the HKMA.

Notes to the Accounts (continued)

4. Effect of adopting new HKASs (continued)

(a) The estimated effect of adopting these new accounting standards on consolidated balance sheet items are as follows (continued):

	HKAS32 & HKAS39	HKAS 40 & HKAS-INT 21	Total
	HK\$'000	HK\$'000	HK\$'000
Increase/(decrease) in assets as at 1 January 2005			
Cash and short-term funds	10,546	-	10,546
Placements with banks and other financial institutions maturing between one and twelve months	4,369	-	4,369
Trade bills	18	-	18
Other financial assets at fair value through profit or loss	611,556	-	611,556
Derivative financial instruments	216,117	-	216,117
Certificates of deposit held	(3,311)	-	(3,311)
Advances and other accounts	20,517	-	20,517
Available-for-sale securities	37,609	-	37,609
Held-to-maturity securities	(582,480)	-	(582,480)
Investment securities	(21,677)	-	(21,677)
Other assets	(124,012)	-	(124,012)
	169,252	-	169,252
Increase/(decrease) in liabilities as at 1 January 2005			
Deposits and balances of banks and other financial institutions	108	-	108
Other financial liabilities at fair value through profit or loss	1,319,111	-	1,319,111
Derivative financial instruments	50,189	-	50,189
Deposits from customers	(1,322,577)	-	(1,322,577)
Certificates of deposit issued	788	-	788
Deferred tax liabilities	24,526	411	24,937
Other accounts and provisions	(27,481)	-	(27,481)
	44,664	411	45,075
Increase/(decrease) in equity as at 1 January 2005			
Investment properties revaluation reserves	-	(9,000)	(9,000)
Regulatory reserve*	140,148	-	140,148
Retained earnings	(15,560)	8,589	(6,971)
	124,588	(411)	124,177

* The regulatory reserve has been set up, as a consequence of the adoption of HKAS 39, for general banking risks in accordance with the requirements of the HKMA.



Notes to the Accounts (continued)

4. Effect of adopting new HKASs (continued)

(b) The estimated effect of adopting new accounting standards on consolidated profit and loss account are as follows:

	HKAS 32 & HKAS 39 HK\$'000	HKAS 40 & HKAS-INT 21 HK\$'000	Total HK\$'000
For the year ended 31 December 2005			
Increase/(decrease) in			
Net interest income	11,776	-	11,776
Net fees and commission income	(4,856)	-	(4,856)
Net trading income	974	-	974
Reversal of loan impairment allowances on advances	9,205	-	9,205
Net gain on fair value adjustments on investments properties	-	8,250	8,250
Taxation	(1,478)	(1,443)	(2,921)
Total effect for the year	15,621	6,807	22,428

There is no significant effect of adopting new accounting standards on the consolidated profit and loss account for the year ended 31 December 2004.



Notes to the Accounts (continued)

5. Financial risk management

This note presents financial information about the Group's exposure to the use of financial instruments.

A) Geographical concentrations of assets, liabilities and off-balance sheet items

The following note incorporates the requirements on risk disclosures of HKAS 32 and geographical concentrations risk of HKAS 30, based on the location of the subsidiary or branch in which the related item is recorded.

Capital expenditure is shown by the geographical area in which the buildings and equipment are located.

	The Group				
	2005				
			Contingent liabilities and commitments	Operating income	Capital expenditure
	Total assets	Total liabilities			
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Hong Kong	29,945,133	(26,182,672)	5,446,210	(708,984)	8,850
Mainland China	1,288,013	(1,259,298)	449,383	(52,755)	1,081
	31,233,146	(27,441,970)	5,895,593	(761,739)	9,931
	2004				
			Contingent liabilities and commitments	Operating income	Capital expenditure
	Total assets	Total liabilities			
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Hong Kong	30,352,747	(26,895,950)	4,579,341	(728,004)	4,515
Mainland China	574,332	(563,832)	295,046	(28,535)	543
	30,927,079	(27,459,782)	4,874,387	(756,539)	5,058

Notes to the Accounts (continued)

5. Financial risk management (continued)

B) Currency risk

Tables below summarise the Group's exposure to foreign currency exchange rate risk as at 31 December. Included in the tables are the Group's assets and liabilities at carrying amounts in Hong Kong dollars equivalent, categorised by the original currency.

	The Group						
	2005						
	Renminbi	US Dollar	HK Dollars	EURO	Japanese Yen	Pound Sterling	Other
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets							
Cash and short-term funds	397,961	1,249,905	3,420,262	234,032	37,487	251,439	1,438,239
Placements with banks and other financial institutions	-	953,090	2,989,767	-	-	-	193,525
Trade bills	-	708,590	6,061	180	73,793	-	-
Certificates of deposit held	-	546,356	1,387,290	-	-	-	-
Available-for-sale securities	-	-	20,609	185	-	-	6,158
Held-to-maturity securities	-	533,600	4,325,754	-	-	-	-
Loans and receivable securities	-	-	316,647	-	-	-	-
Other financial assets at fair value through profit or loss	-	814,966	-	-	-	-	-
Derivative financial instruments	-	4,488	174,955	-	-	-	-
Advances and other accounts	226,152	1,473,476	8,255,491	44,686	99,701	2,639	-
Fixed assets	-	-	548,573	-	-	-	-
Investment properties	-	-	53,940	-	-	-	-
Other assets (including deferred tax assets)	4,225	24,529	412,610	185	-	-	1,600
Total assets	628,338	6,309,000	21,911,959	279,268	210,981	254,078	1,639,522
Liabilities							
Deposits and balances of banks and other financial institutions	(31,268)	(126,444)	(56,354)	(2,382)	(373,923)	(2,331)	(41,098)
Deposits from customers	(485,663)	(5,626,864)	(14,834,487)	(210,443)	(56,580)	(158,801)	(1,487,264)
Other financial liabilities at fair value through profit or loss	-	(1,490,303)	(1,125,906)	-	-	-	-
Derivative financial instruments	-	(6,982)	(97,554)	-	-	-	-
Certificates of deposit issued	-	(212,968)	(147,880)	-	-	-	-
Other accounts and provisions (including deferred tax liabilities)	(35,682)	(163,777)	(501,921)	(9,866)	(19,255)	(9,583)	(126,391)
Total liabilities	(552,613)	(7,627,338)	(16,764,102)	(222,691)	(449,758)	(170,715)	(1,654,753)
Net on-balance sheet position	75,725	(1,318,338)	5,147,857	56,577	(238,777)	83,363	(15,231)
Off-balance sheet net notional position*	961	202,577	(214,443)	(56,075)	238,119	(83,320)	28,377
Contingent liabilities and commitments	11,101	1,089,014	4,679,139	55,665	43,322	916	16,436

*Off-balance sheet net notional position represents the net notional amounts of foreign currency derivative financial instrument, which are principally used to reduce the Group's exposures to currency movements.

Notes to the Accounts (continued)

5. Financial risk management (continued)

B) Currency risk (continued)

	The Group						
	2004						
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Other
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets							
Cash and short-term funds	292,898	2,382,459	5,772,834	84,046	41,249	93,623	767,552
Placements with banks and other financial institutions	-	1,423,864	1,779,000	-	-	-	595,867
Trade bills	-	103,647	-	-	-	-	-
Certificates of deposit held	-	470,734	1,576,454	-	-	-	-
Held-to-maturity securities	-	1,155,260	4,405,163	-	11,374	-	-
Investment securities	-	-	20,859	165	-	-	653
Advances and other accounts	40,176	1,243,954	7,311,997	38,725	180,382	2,616	4,847
Fixed assets	20,379	-	498,431	-	-	-	-
Other assets (including deferred tax assets)	713	19,460	583,489	166	2,721	-	1,322
Total assets	354,166	6,799,378	21,948,227	123,102	235,726	96,239	1,370,241
Liabilities							
Deposits and balances of banks and other financial institutions	-	(104,100)	(41,389)	(23,969)	(646,767)	(137)	(229,457)
Deposits from customers	(233,349)	(5,299,713)	(17,751,794)	(142,071)	(18,580)	(98,898)	(1,219,769)
Certificates of deposit issued	-	(218,691)	(150,600)	-	-	-	-
Other accounts and provisions (including deferred tax liabilities)	(109,235)	(189,281)	(850,187)	(2,925)	(17,978)	(3,331)	(107,561)
Total liabilities	(342,584)	(5,811,785)	(18,793,970)	(168,965)	(683,325)	(102,366)	(1,556,787)
Net on-balance sheet position	11,582	987,593	3,154,257	(45,863)	(447,599)	(6,127)	(186,546)
Off-balance sheet net notional position*	939	(222,584)	(284,383)	45,407	430,639	6,201	195,879
Contingent liabilities and commitments	12,817	961,183	3,760,533	36,312	101,387	1,740	415

C) Interest rate risk

Tables below summarise the Group's exposure to interest rate risk as at 31 December. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The carrying amounts of derivative financial instruments which are principally used to reduce the Group's exposure to interest rate movements are under the column captioned 'Non-interest bearing'.



Notes to the Accounts (continued)

5. Financial risk management (continued)

C) Interest rate risk (continued)

	The Group						
	2005						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets							
Cash and short-term funds	7,029,325	-	-	-	-	-	7,029,325
Placements with banks and other financial institutions maturing between one and twelve months	-	3,860,454	275,928	-	-	-	4,136,382
Trade bills	788,624	-	-	-	-	-	788,624
Certificates of deposit held	230,596	1,152,450	460,992	89,608	-	-	1,933,646
Available-for-sale securities	-	-	-	-	-	26,952	26,952
Held-to-maturity securities	666,275	2,222,015	1,100,956	870,108	-	-	4,859,354
Loans and receivable	-	226,243	90,404	-	-	-	316,647
Other financial assets at fair value through profit or loss	755,244	-	16,054	-	43,668	-	814,966
Derivative financial instruments	-	-	-	-	-	179,443	179,443
Advances and other accounts	9,119,652	274,068	209,234	310,193	188,998	-	10,102,145
Fixed assets	-	-	-	-	-	548,573	548,573
Investment properties	-	-	-	-	-	53,940	53,940
Other assets (including deferred tax assets)	-	-	-	-	-	443,149	443,149
Total assets	18,589,716	7,735,230	2,153,568	1,269,909	232,666	1,252,057	31,233,146
Liabilities							
Deposits and balances of banks and other financial institutions	(298,029)	(248,969)	(86,802)	-	-	-	(633,800)
Deposits from customers	(16,324,270)	(4,635,163)	(1,338,189)	(515,326)	-	(47,154)	(22,860,102)
Other financial liabilities at fair value through profit or loss	(988,303)	(102,303)	(673,605)	(851,998)	-	-	(2,616,209)
Derivative financial instruments	-	-	-	-	-	(104,536)	(104,536)
Certificates of deposit issued	-	(249,899)	(110,949)	-	-	-	(360,848)
Other accounts and provisions (including deferred tax liabilities)	(334,145)	-	-	-	-	(532,330)	(866,475)
Total liabilities	(17,944,747)	(5,236,334)	(2,209,545)	(1,367,324)	-	(684,020)	(27,441,970)
Interest sensitivity gap	644,969	2,498,896	(55,977)	(97,415)	232,666	568,037	3,791,176

Notes to the Accounts (continued)

5. Financial risk management (continued)

C) Interest rate risk (continued)

	2004						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets							
Cash and short-term funds	9,434,661	-	-	-	-	-	9,434,661
Placements with banks and other financial institutions maturing between one and twelve months	-	3,249,671	549,060	-	-	-	3,798,731
Trade bills	103,647	-	-	-	-	-	103,647
Certificates of deposit held	249,323	768,812	699,409	329,644	-	-	2,047,188
Held-to-maturity securities	958,843	1,994,616	1,478,311	1,101,155	38,872	-	5,571,797
Investment securities	-	-	-	-	-	21,677	21,677
Advances and other accounts	8,530,714	218,753	46,901	26,329	-	-	8,822,697
Fixed assets	-	-	-	-	-	518,810	518,810
Other assets (including deferred tax assets)	-	-	-	-	-	607,871	607,871
Total assets	19,277,188	6,231,852	2,773,681	1,457,128	38,872	1,148,358	30,927,079
Liabilities							
Deposits and balances of banks and other financial institutions	(987,173)	(12,409)	(46,237)	-	-	-	(1,045,819)
Deposits from customers	(19,929,948)	(2,197,860)	(1,055,081)	(347,815)	(87,072)	(1,146,398)	(24,764,174)
Certificates of deposit issued	-	-	(186,248)	(183,043)	-	-	(369,291)
Other accounts and provisions (including deferred tax liabilities)	(379,853)	-	-	-	-	(900,645)	(1,280,498)
Total liabilities	(21,296,974)	(2,210,269)	(1,287,566)	(530,858)	(87,072)	(2,047,043)	(27,459,782)
Interest sensitivity gap	(2,019,786)	4,021,583	1,486,115	926,270	(48,200)	(898,685)	3,467,297

Notes to the Accounts (continued)

5. Financial risk management (continued)

C) Interest rate risk (continued)

Tables below summarise the effective interest rate by major currencies for monetary financial instruments subject to interest rate risk as at 31 December:

	The Group					
	2005					
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling
	%	%	%	%	%	%
Assets						
Cash and short-term funds	0.55	4.13	4.12	2.43	-	4.60
Placements with banks and other financial institutions	-	4.30	4.19	-	-	-
Held-to-maturity securities	-	3.00	2.85	-	-	-
Loans and receivables	-	-	2.43	-	-	-
Advances to customers	3.35	7.63	5.79	4.01	3.47	9.18
Liabilities						
Deposits and balances of banks and others financial institutions	0.53	2.50	2.79	-	0.28	-
Deposits from customers	0.85	1.95	2.54	0.94	-	2.58
Certificates of deposit issued	-	2.88	3.08	-	-	-

	The Group					
	2004					
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling
	%	%	%	%	%	%
Assets						
Cash and short-term funds	0.65	2.23	0.29	2.10	-	4.67
Placements with banks and other financial institutions	-	2.34	0.69	-	-	-
Held-to-maturity securities	-	3.91	2.66	-	1.72	-
Advances to customers	5.74	4.39	3.16	3.82	1.61	7.94
Liabilities						
Deposits and balances of banks and others financial institutions	-	0.68	0.46	2.40	0.02	-
Deposits from customers	0.83	0.86	0.08	0.54	-	2.51
Certificates of deposit issued	-	2.55	2.80	-	-	-



Notes to the Accounts (continued)

5. Financial risk management (continued)

D) Liquidity risk

Tables below analyse assets and liabilities of the Group as at 31 December into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

	The Group							
	2005							
	On	Up to 1	1-3	3-12	1-5	Over 5	Undated	Total
	demand	month	months	months	years	years		
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets								
Cash and short-term funds	875,747	6,153,578	-	-	-	-	-	7,029,325
Placements with banks and other financial institutions	-	-	3,860,454	275,928	-	-	-	4,136,382
Trade bills	-	142,559	593,447	52,618	-	-	-	788,624
Certificates of deposit held	-	-	706,123	376,119	804,261	47,143	-	1,933,646
Available-for-sale securities – equity securities	-	-	-	-	-	-	26,952	26,952
Held-to-maturity securities	-	-	1,194,844	547,207	3,117,303	-	-	4,859,354
Loans and receivables securities	-	-	226,243	90,404	-	-	-	316,647
Other financial assets at fair value through profit or loss	-	-	-	-	257,438	557,528	-	814,966
Derivative financial instruments	-	362	169,592	1,701	7,788	-	-	179,443
Advances and other accounts – advances to customers	1,095,005	651,056	752,506	1,239,134	3,052,855	3,250,078	61,511	10,102,145
Fixed assets	-	-	-	-	-	-	548,573	548,573
Investment properties	-	-	-	-	-	-	53,940	53,940
Other assets (including deferred tax assets)	393,507	113	-	-	49,529	-	-	443,149
Total assets	2,364,259	6,947,668	7,503,209	2,583,111	7,289,174	3,854,749	690,976	31,233,146
Liabilities								
Deposits and balances of banks and other financial institutions	(155,699)	(142,330)	(248,969)	(86,802)	-	-	-	(633,800)
Deposits from customers	(9,682,748)	(6,688,676)	(4,635,163)	(1,338,189)	(515,326)	-	-	(22,860,102)
Other financial liabilities at fair value through profit or loss	-	-	(55,044)	(612,984)	(1,385,783)	(562,398)	-	(2,616,209)
Derivative financial instrument	-	(365)	(53,568)	(11,314)	(35,354)	(3,935)	-	(104,536)
Certificates of deposit issued	-	-	-	(67,734)	(293,114)	-	-	(360,848)
Other accounts and provisions (including deferred tax liabilities)	(706,772)	(516)	-	(155,791)	(3,396)	-	-	(866,475)
Total liabilities	(10,545,219)	(6,831,887)	(4,992,744)	(2,272,814)	(2,232,973)	(566,333)	-	(27,441,970)
Net liquidity gap	(8,180,960)	115,781	2,510,465	310,297	5,056,201	3,288,416	690,976	3,791,176

Notes to the Accounts (continued)

5. Financial risk management (continued)

D) Liquidity risk (continued)

	The Group						
	2004						
	On demand HK\$'000	Up to 1 month HK\$'000	1-3 months HK\$'000	3-12 months HK\$'000	1-5 years HK\$'000	Over 5 years HK\$'000	Undated HK\$'000
Assets							Total HK\$'000
Cash and short-term funds	634,246	8,800,415	-	-	-	-	9,434,661
Placements with banks and other financial institutions	-	-	3,249,671	549,060	-	-	3,798,731
Trade bills	4,281	54,965	41,167	3,234	-	-	103,647
Certificates of deposit held	-	-	767,989	-	1,166,472	112,727	2,047,188
Held-to-maturity securities	-	-	962,130	1,140,818	3,035,820	433,029	5,571,797
Investment securities	-	-	-	-	-	-	21,677
Advances and other accounts	826,276	588,592	1,039,391	909,940	2,756,471	2,519,254	8,822,697
Fixed assets	-	-	-	-	-	-	518,810
Other assets (including deferred tax assets)	-	545,728	-	3,484	53,787	694	4,178
Total assets	1,464,803	9,989,700	6,060,348	2,606,536	7,012,550	3,065,704	727,438
Liabilities							
Deposits and balances of banks and other financial institutions	(113,106)	(874,067)	(12,409)	(46,237)	-	-	(1,045,819)
Customers accounts	(13,627,081)	(7,081,360)	(1,771,317)	(911,178)	(1,107,357)	(265,881)	(24,764,174)
Certificates of deposit issued	-	-	-	(186,248)	(183,043)	-	(369,291)
Other accounts and provisions (including deferred tax liabilities)	(1,470)	(746,145)	(456,052)	(84,951)	16,657	(4)	(8,533)
Total liabilities	(13,741,657)	(8,701,572)	(2,239,778)	(1,228,614)	(1,273,743)	(265,885)	(8,533)
Net liquidity gap	(12,276,854)	1,288,128	3,820,570	1,377,922	5,738,807	2,799,819	718,905

The above maturity classifications have been prepared in accordance with the guideline on “Financial Disclosure by Locally Incorporated Authorized Institutions” under the Supervisory Policy Manual issued by the HKMA. In accordance with the guideline, the Group has reported assets such as advances and debt securities which have been overdue for not more than one month as “Repayable on demand”. In the case of an asset that is repayable by different payments or instalments, only that portion of the asset that is actually overdue is reported as overdue. Any part of the asset that is not due is reported according to the residual maturity unless the repayment of the asset is in doubt in which case the amount is reported as “Undated”. The above assets are stated before deduction of provisions, if any.

The analysis of debt securities by remaining period to maturity is disclosed in order to comply with the guideline on “Financial Disclosure by Locally Incorporated Authorized Institutions” under the Supervisory Policy Manual issued by the HKMA. The disclosure does not imply that the securities will be held to maturity.



Notes to the Accounts (continued)

5. Financial risk management (continued)

E) Fair value of financial instruments

Fair value estimates are made at a specific point in time based on relevant market information and information about the various financial instruments. The following methods and assumptions have been used to estimate the fair value of each class of financial instruments as far as practicable.

Balances with banks and other financial institutions maturing between one and twelve months and Trade bills

The maturities of these financial instruments are within one year and the carrying value approximates fair value.

Advances to customers

Substantially all of the advances to customers are on floating rate term, bear interest at prevailing market interest rates and their carrying value approximates fair value.

Held-to-maturity securities (including Certificate of deposit held)

Fair value for held-to-maturity securities is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Loans and receivables and Certificates of deposits issued

A discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Deposits from customers

Substantially all the deposits from customers mature within one year from balance sheet date and their carrying value approximates fair value.



Notes to the Accounts (continued)

5. Financial risk management (continued)

E) Fair values of financial assets and liabilities (continued)

	The Group			
	Carrying Value		Fair Value	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
Financial assets				
- Held-to-maturity securities (including certificates of deposits held)	<u>6,470,849</u>	<u>7,618,985</u>	<u>6,381,370</u>	<u>7,608,714</u>
- Loans and receivables	<u>316,647</u>	<u>-</u>	<u>315,495</u>	<u>-</u>
Financial liabilities				
- Certificates of deposits issued	<u>-</u>	<u>(369,291)</u>	<u>-</u>	<u>(370,079)</u>

F) Fiduciary activities

The Group provides custody, trustee and investment management services to third parties which involve the Group providing both settlement functions and book keeping services to the beneficiaries. Those assets that are held in a fiduciary capacity are not included in these accounts. As at 31 December 2005, the Group had a balance of securities custody accounts amounting to approximately HK\$ 8,181,568,000 (2004: HK\$7,731,840,000).

Note: There is no significant difference between the financial information of the Group and the Bank and thus the above financial risk management information is disclosed for the Group only.



Notes to the Accounts (continued)

6. Net interest income

	2005 HK\$'000	2004 HK\$'000
Interest income		
Cash and due from banks and other financial institutions	370,431	174,814
Advances to customers	433,703	289,904
Listed investments	7,312	48,899
Unlisted investments	194,488	176,775
Others	11,856	12,187
	1,017,790	702,579
Interest expense		
Due to banks, customers and other financial institutions	(438,893)	(150,848)
Debt securities in issue	(10,660)	(11,550)
Others	(11,552)	(5,622)
	(461,105)	(168,020)
Net interest income	556,685	534,559

Included within interest income is HK\$2,900,000 of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2005.

7. Net fees and commission income

	2005 HK\$'000	2004 HK\$'000
Fees and commission income		
Securities brokerage	64,423	75,121
Credit cards	143	284
Bills commissions	40,019	41,402
Loan commissions	13,203	21,511
Payment services	15,478	14,031
Insurance	10,157	8,762
Asset management	5,762	4,351
Guarantees	1,704	1,589
Others		
- safe deposit box	9,510	8,927
- low deposit balance accounts	1,818	2,804
- currency exchange	313	368
- BOC cards	1,196	1,300
- dormant accounts	951	1,038
- agency services	348	372
- postage and telegrams	1,138	1,017
- information search	1,671	1,301
- correspondent banking	2,005	1,759
- sundries	24,850	27,991
	194,689	213,928
Fees and commission expenses	(30,312)	(33,762)
Net fees and commission income	164,377	180,166



Notes to the Accounts (continued)

8. Net trading income

	2005 HK\$'000	2004 HK\$'000
Net gain from:		
- foreign exchange and foreign exchange products	34,071	38,252
- interest rate instruments	3,377	-
	37,448	38,252

Foreign exchange net trading income includes gains and losses from forward contracts, options, swaps and translation of foreign currency assets and liabilities.

9. Other operating income

	2005 HK\$'000	2004 HK\$'000
Dividend income from investments in securities		
- listed investments	138	94
- unlisted investments	956	1,013
Gross rental income from investment properties	1,774	1,355
Less: Outgoings in respect of investment properties	(74)	(66)
Others	435	1,166
	3,229	3,562

10. Operating expenses

	2005 HK\$'000	2004 HK\$'000
Staff costs (including directors' emoluments)		
- salaries and other costs	124,421	119,648
- termination benefit	136	-
- pension cost	11,082	9,846
	135,639	129,494
Premises and equipment expenses (excluding depreciation)		
- rental of premises	13,744	13,308
- information technology	22,904	22,638
- others	4,132	4,709
	40,780	40,655
Depreciation on owned fixed assets	11,654	12,174
Auditors' remuneration		
- audit services	2,885	2,473
- non-audit services	104	51
Other operating expenses	28,298	25,308
	219,360	210,155



Notes to the Accounts (continued)

11. Reversal of loan impairment allowances on advances

	2005 HK\$'000	2004 HK\$'000
Net release of loan impairment allowances on advances		
Individually assessed (Note 26)	21,925	-
Collectively assessed (Note 26)	7,946	-
	29,871	-
Of which		
- new allowances	(10,182)	-
- releases	26,379	-
- recoveries (Note 26)	13,674	-
Net credit to profit and loss account (Note 26)	29,871	-

12. Charge for bad and doubtful debts

	2005 HK\$'000	2004 HK\$'000
Net charge for bad and doubtful debts		
Specific provisions		
- new provisions	-	(74,023)
- releases	-	50,869
- recoveries (Note 27)	-	20,246
	-	(2,908)
General provisions (Note 27)	-	-
Net charge to profit and loss account (Note 27)	-	(2,908)

13. Net gain from disposal/revaluation of fixed assets

	2005 HK\$'000	2004 HK\$'000
Net gain on disposal of premises	134	-
Net loss on disposal of other fixed assets	(41)	(24)
Surplus on revaluation of premises (Note 33)	6,647	21,566
Provision for impairment loss on fixed assets (Note 33)	(1,300)	-
	5,440	21,542

14. Net gain from fair value adjustments on investment properties

	2005 HK\$'000	2004 HK\$'000
Net gain on fair value adjustments on investment properties (Note 34)	8,250	-

Notes to the Accounts (continued)

15. Taxation

Taxation in the profit and loss account represents:

	2005 HK\$'000	2004 HK\$'000
Hong Kong profits tax		
- current period taxation	92,443	89,728
- over-provision in prior years	(5,500)	(19,800)
Deferred tax charge	2,776	241
	89,719	70,169
Attributable share of estimated Hong Kong profits tax losses arising from investments in partnerships	(1,005)	(3,386)
	88,714	66,783
Investments in partnerships written off	910	2,968
Hong Kong profits tax	89,624	69,751
Overseas taxation	7,002	2,857
	96,626	72,608

Hong Kong profits tax has been provided at the rate of 17.5% (2004: 17.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

The Group has entered into an aircraft leasing transaction involving special purpose partnerships. As at 31 December 2005, the Group's investments in such partnerships, which are included in "Other assets" in the consolidated balance sheet, amounted to HK\$49,412,000 (2004: HK\$108,000,000). The Group's investments in partnerships are amortised over the life of the partnerships in proportion to the taxation benefits resulting from those investments.

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate of Hong Kong as follows:

	2005 HK\$'000	2004 HK\$'000
Profit before taxation	590,793	565,758
Calculated at a taxation rate of 17.5% (2004: 17.5%)	103,389	99,008
Effect of different taxation rates in other countries	808	507
Income not subject to taxation	(6,259)	(10,996)
Expenses not deductible for taxation purposes	4,283	4,307
Over-provision in prior years	(5,500)	(19,800)
Tax benefits from partnership	(95)	(418)
Taxation charge	96,626	72,608
Effective tax rate	16.36%	12.83%



Notes to the Accounts (continued)

16. Profit attributable to equity holders of the Bank

The profit of the Bank for the year ended 31 December 2005 attributable to equity holders of the Bank and dealt with in the accounts of the Bank amounted to HK\$489,876,000 (2004: HK\$ 491,698,000).

17. Dividends

	2005		2004	
	Per share HK\$	Total HK\$'000	Per share HK\$	Total HK\$'000
First interim dividend paid	56	168,000	50	150,000
Second interim dividend paid	69	207,000	63	189,000
	125	375,000	113	339,000

At a meeting held on 28 June 2005, the Board declared a first interim dividend of HK\$56 per ordinary share for the first half of 2005 amounting to approximately HK\$ 168,000,000.

At a meeting held on 23 November 2005, the Board declared a second interim dividend of HK\$69 per ordinary share for the second half of 2005 amounting to approximately HK\$ 207,000,000.

18. Retirement benefit costs

The principal defined contribution schemes for the Group's employees are ORSO schemes exempted under the MPF Schemes Ordinance and the BOC-Prudential Easy Choice MPF Scheme. Under the ORSO schemes, employees make monthly contributions to the ORSO schemes equal to 5% of their basic salaries, while the employer makes monthly contributions equal to 5% to 15% of the employees' monthly basic salaries, depending on years of service. The employees are entitled to receive 100% of the employer's contributions upon termination of employment after completing 20 years of service, or at a scale ranging from 20% to 95% for employees who have completed between 3 to 20 years of service, on conditions of retirement, early retirement, permanent incapacity and ill-health or termination of employment other than summary dismissal.

With the implementation of the MPF Schemes Ordinance on 1 December 2000, the Group also participates in the BOC-Prudential Easy Choice MPF Scheme, of which the trustee is BOCI-Prudential Trustee and the investment manager is BOCI-Prudential Manager, which are related parties of the Group.

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2005 amounted to approximately HK\$ 9,163,000 (2004: approximately HK\$9,011,000), after a deduction of forfeited contributions of approximately HK\$962,000 (2004: approximately HK\$911,000). For the MPF Scheme, the Group contributed approximately HK\$ 412,000 (2004: approximately HK\$268,000) for the year ended 31 December 2005.



Notes to the Accounts (continued)

19. Share option schemes

(a) Share Option Scheme and Sharesave Plan

The principal terms of the Share Option Scheme and the Sharesave Plan were approved and adopted by written resolutions of all the shareholders of the Bank's intermediate holding company, BOCHKHL, dated 10 July 2002.

The purpose of the Share Option Scheme is to provide the participants with the opportunity to acquire proprietary interests in BOCHKHL. The Board of BOCHKHL (the "BOCHKHL Board") may, in its absolute discretion, offer to grant options under the Share Option Scheme to any person as the BOCHKHL Board may select. The subscription price for the shares shall be determined on the date of grant by the BOCHKHL Board as an amount per share calculated on the basis of established rules. An option may be exercised in whole or in part at any time after the date prescribed by the BOCHKHL Board and from time to time as specified in the offer and on or before the termination date prescribed by the BOCHKHL Board.

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the shares of BOCHKHL. The amount of the monthly contribution under the savings contract to be made in connection with an option shall be the amount which the relevant eligible employee is willing to contribute, which amount shall not be less than 1% and not more than 10% of the eligible employee's monthly salary as at the date of application or such other maximum or minimum amounts as permitted by the BOCHKHL Board. When an option is exercised during an exercise period, it may be exercised in whole or in part.

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year of 2005 (2004: Nil).

(b) Pre-Listing Share Option Scheme

On 5 July 2002, several directors of the Group were granted options by BOC Hong Kong (BVI) Limited ("BOC (BVI)"), the immediate holding company of BOCHKHL, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 3,652,800 existing issued shares of BOCHKHL. The Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the new recognition and measurement policies have not been applied to all options grants to employees on or before 7 November 2002.



Notes to the Accounts (continued)

19. Share option schemes (continued)

(b) Pre-Listing Share Option Scheme (continued)

Details of the share options outstanding as at 31 December 2005 are disclosed as follows:

	Total number of share options to Directors of the Group	Average exercise price (HK\$ per share)
At 1 January 2005	2,572,800	
Less: Share options exercised during the period	<u>(553,000)</u>	8.5
At 31 December 2005	<u>2,019,800</u>	
Exercisable at 31 December 2005	<u>1,106,600</u>	
At 1 January 2004	3,168,800	
Less: Share options exercised during the period	<u>(596,000)</u>	8.5
At 31 December 2004	<u>2,572,800</u>	
Exercisable at 31 December 2004	<u>746,400</u>	

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK\$15.01 (2004: HK\$14.14).

The options granted under this scheme can be exercised at HK\$8.50 per share in respect of the option price of HK\$1.00. These options have a vesting period of four years (25% of the number of shares subject to such options will vest at the end of each year) from the date on which dealings in the shares commenced on the Stock Exchange with a valid exercise period of ten years. No offer to grant any options under the Pre-Listing Share Option Scheme will be made on or after the date on which dealings in the shares commenced on the Stock Exchange.

20. Directors' and senior management's emoluments

Directors' emoluments

Detail of the emoluments paid to or receivable by the directors of the Bank in respect of their services rendered for managing the subsidiaries within the Group during the year are as follows:

	2005 HK\$'000	2004 HK\$'000
Fees	910	910
Other emoluments		
- basis salaries and allowances	3,159	3,642
- discretionary bonuses	328	402
- others (including pension contributions)	<u>442</u>	<u>492</u>
	<u>4,839</u>	<u>5,446</u>

Fees of HK\$ 140,000 (2004: HK\$140,000) were paid to the Independent Non-Executive Directors during the year.



Notes to the Accounts (continued)

20. Directors' and senior management's emoluments (continued)

Directors' emoluments (continued)

In July 2002, options were granted to several directors of the Group by BOC (BVI), the immediate holding company of BOCHKHL, under the Pre-Listing Share Option Scheme. Full details of the scheme are stated in Note 19(b). During the year, certain options exercised but no benefits arising from the granting of these share options were included in the directors' emoluments disclosed above or recognised in the profit and loss account.

21. Cash and short-term funds

	The Group and the Bank	
	2005 HK\$'000	2004 HK\$'000
Cash	114,902	100,985
Balances with banks and other financial institutions	760,845	533,261
Money at call and short notice maturing within one month	6,153,578	8,800,415
	7,029,325	9,434,661

22. Other financial assets at fair value through profit or loss

	The Group and the Bank	
	2005 HK\$'000	2004 HK\$'000
At fair value		
Debt securities		
- Unlisted	814,966	-

Other financial assets at fair value through profit or loss are analysed by issuers as follows:

	2005 HK\$'000	2004 HK\$'000
Central governments and central banks	43,668	-
Banks and other financial institutions	771,298	-
	814,966	-

Other financial assets at fair value through profit or loss are classified as follows in:

	2005 HK\$'000	2004 HK\$'000
Certificates of deposits (Note 24)	322,151	-
Other financial assets at fair value through profits or loss	814,966	-
	1,137,117	-



Notes to the Accounts (continued)

23. Derivative financial instruments

The Group enters into the following equity, foreign exchange and interest rate related derivative financial instruments for trading and risk management purposes:

Currency forward represent commitments to purchase and sell foreign currency on a future date. Interest rate futures are contractual obligations to receive or pay a net amount based on changes interest rates or buy or sell interest rate financial instruments on a future date at an agreed price in the financial market under the administration of the stock exchange.

Interest rate swaps are commitments to exchange one set of cash flows or commodity for another. Swaps result in an exchange of interest rates (for example, fixed rate for floating rate).

Foreign currency, interest rate and equity options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of the financial instrument at a predetermined price. In consideration for the assumption of foreign exchange and interest rate risk, the seller receives a premium from the purchaser. Options are negotiated over-the-counter ("OTC") between the Group and its counterparty or traded through the stock exchange (for example, exchange-traded stock option).

The contract/notional amounts and fair values of derivative financial instruments held by the Group are set out in the following tables. The contract/notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet dates and certain of them provide a basis for comparison with fair value instruments recognised on the consolidated balance sheet. However, they do not necessarily indicate the amounts of future cash flows involved or the current fair values of the instruments and, therefore, do not indicate the Group's exposure to credit or market risks. The derivative financial instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates, foreign exchange rates or equity relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

Notes to the Accounts (continued)

23. Derivative financial instruments (continued)

The following is a summary of the contract/notional amounts of each significant type of derivative financial instruments:

	The Group and the Bank				
	2005		2004		
	Trading HK\$' 000	Total HK\$' 000	Trading HK\$' 000	Hedging HK\$' 000	Total HK\$' 000
Exchange rate contracts					
Spot & Forward	3,728,130	3,728,130	127,109	-	127,109
Foreign currency option contracts					
- Options purchased	17,371	17,371	72,063	-	72,063
- Options written	17,371	17,371	72,063	-	72,063
	<u>3,762,872</u>	<u>3,762,872</u>	<u>271,235</u>	<u>-</u>	<u>271,235</u>
Interest rate contracts					
Swaps	1,915,988	1,915,988	524,579	50,246	574,825
Interest rate option contracts					
- Swaptions purchased	-	-	15,549	-	15,549
- Swaptions written	-	-	205,847	-	205,847
	<u>1,915,988</u>	<u>1,915,988</u>	<u>745,975</u>	<u>50,246</u>	<u>796,221</u>
Equity contracts					
Equity option contracts					
- Options purchased	23,065	23,065	52,245	-	52,245
- Options written	23,065	23,065	52,245	-	52,245
	<u>46,130</u>	<u>46,130</u>	<u>104,490</u>	<u>-</u>	<u>104,490</u>
Total	<u>5,724,990</u>	<u>5,724,990</u>	<u>1,121,700</u>	<u>50,246</u>	<u>1,171,946</u>

The following table summarises the fair values of each class of derivative financial instruments as at 31 December 2005:

	The Group and the Bank			
	Fair value assets		Fair value liabilities	
	Trading HK\$'000	Total HK\$'000	Trading HK\$'000	Total HK\$'000
Exchange rate contracts	169,828	169,828	(53,633)	(53,633)
Interest rate contracts	9,519	9,519	(50,807)	(50,807)
Equity contracts	96	96	(96)	(96)
	<u>179,443</u>	<u>179,443</u>	<u>(104,536)</u>	<u>(104,536)</u>

The replacement costs and credit risk weighted amounts of the above derivative financial instruments, which do not take into account the effects of bilateral netting arrangements are as follows:

	2005	2004	2005	2004
	Credit risk weighted amount HK\$' 000	HK\$' 000	Replacement cost HK\$' 000	HK\$' 000
Exchange rate contracts	-	847	67	1,398
Interest rate contracts	1,290	835	613	1,024
Equity contracts	-	-	96	-
Total	<u>1,290</u>	<u>1,682</u>	<u>776</u>	<u>2,422</u>

Notes to the Accounts (continued)

23. Derivative financial instruments (continued)

The credit risk weighted amounts are the amounts that have been calculated in accordance with the Third Schedule of the Banking Ordinance and guidelines issued by the HKMA. The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

Replacement cost is the cost of replacing all contracts that have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking contracts to market. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet dates and is calculated in accordance with the guidelines issued by the HKMA. Accrued interest has been excluded in the calculation.

The Group and the Bank both undertake approximately 36% of their transactions in derivative financial instruments contracts with other financial institutions.

24. Certificates of deposit held

	The Group and the Bank	
	2005	2004
	HK\$'000	HK\$'000
Unlisted, at fair value		
- Other financial assets at fair value through profit or loss	322,151	-
Unlisted, at amortised cost		
- Held-to-maturity securities	1,611,495	2,047,188
	1,933,646	2,047,188

25. Advances and other accounts

	The Group	
	2005	2004
	HK\$'000	HK\$'000
Advances to customers	10,154,351	8,985,561
Accrued interest	-	85,813
	10,154,351	9,071,374
Loan impairment allowances/Provision for bad and doubtful debts		
- Individually assessed (Note 26)	(41,918)	-
- Collectively assessed (Note 26)	(10,288)	-
- Specific provision (Note 27)	-	(89,665)
- General provision (Note 27)	-	(159,012)
	(52,206)	(248,677)
Total	10,102,145	8,822,697

As at 31 December 2005, advances to customers include accrued interest on gross advances of HK\$31,633,000.



Notes to the Accounts (continued)

25. Advances and other accounts (continued)

	The Bank	
	2005	2004
	HK\$'000	HK\$'000
Advances to customers	10,154,630	8,986,298
Accrued interest	-	85,813
	10,154,630	9,072,111
Loan impairment allowances/provision for bad and doubtful debts		
- Individually assessed (Note 26)	(41,918)	-
- Collectively assessed (Note 26)	(10,288)	-
- Specific provision (Note 27)	-	(89,665)
- General provision (Note 27)	-	(159,012)
	(52,206)	(248,677)
Total	10,102,424	8,823,434

As at 31 December 2005, advances to customers include accrued interest on gross advances of HK\$31,633,000.

No advance to banks and financial institutions were made in 2005 and 2004.

As at 31 December 2005, impaired advances to customers are analysed as follows:

	The Group and the Bank
	2005
	HK\$'000
Gross impaired advances to customers (Note a)	103,028
Loan impairment allowances made in respect of such advances	45,743
Gross impaired advances to customers as a percentage of gross advances to customers	1.01%

As at 31 December 2004, non-performing loans were analysed as follows:

	The Group and the Bank
	2004
	HK\$'000
Non-performing loans (Note b)	266,710
Specific provisions made in respect of such advances	89,665
Non-performing loans as a percentage of total advances to customers	2.97%

As at 31 December 2005, no loan impairment allowances were made in respect of advances to banks and other financial institutions.

The above loan impairment allowances/specific provisions were made after taking into account the value of collateral in respect of such advances.

There were no advances to banks and other financial institutions on which interest has been placed in suspense or on which interest accrual has ceased as at 31 December 2004, nor were there any specific provisions made.

Notes to the Accounts (continued)

25. Advances and other accounts (continued)

Notes:

- (a) Impaired advances to customers are those individual advances where full repayment of principal and/or interest is considered unlikely and are classified as such when such a situation becomes apparent. Accordingly, impaired advances represented advances which have been classified as "substandard", "doubtful" and "loss" under the Group's classification of loan quality.
- (b) Non-performing loans are defined as loans and advances to customers on which interest is being placed in suspense or on which interest accrual has ceased.

26. Loan impairment allowances

	The Group and the Bank		
	Individual assessment	Collective assessment	Total
	HK\$'000	HK\$'000	HK\$'000
At 1 January 2005			
As previously reported (Note 27)	89,665	159,012	248,677
Opening adjustments to comply with HKAS 39	(5,653)	(140,148)	(145,801)
Balance after opening adjustments	84,012	18,864	102,876
Credited to profit and loss account (Note 11)	(21,925)	(7,946)	(29,871)
Loans written off during the year as uncollectible	(31,363)	(210)	(31,573)
Recoveries (Note 11)	13,674	-	13,674
Unwind of discount on allowance	(2,480)	(420)	(2,900)
At 31 December 2005	41,918	10,288	52,206

27. Provisions for bad and doubtful debts

	The Group and the Bank			
	2004			
	Specific	General	Total	Suspended Interest
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2004	103,910	159,012	262,922	3,542
Charged to profit and loss account (Note 12)	2,908	-	2,908	-
Amounts written off	(37,399)	-	(37,399)	-
Recoveries of advances written off in previous years (Note 12)	20,246	-	20,246	-
Interest suspended during the year	-	-	-	2,270
Suspended interest recovered	-	-	-	(949)
At 31 December 2004	89,665	159,012	248,677	4,863
Deducted from:				
- advances to customers	89,665	159,012	248,677	



Notes to the Accounts (continued)

28. Available-for-sale securities

	The Group		The Bank	
	2005	2004	2005	2004
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Equity securities				
- Listed outside Hong Kong	6,158	-	6,158	-
- Unlisted	20,794	-	545	-
Total	26,952	-	6,703	-

Available-for-sale securities are analysed by issuers as follows:

Banks and other financial institutions	6,158	-	6,158	-
Corporate entities	20,794	-	545	-
	26,952	-	6,703	-

The movement in available-for-sale securities may be summarised as follows:

	The Group		The Bank	
	2005	2004	2005	2004
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January				
As previously reported	-	-	-	-
Opening adjustments to comply with HKAS 39	37,609	-	17,360	-
Balance after opening adjustments	37,609	-	17,360	-
Disposals (sale and redemption)	(10,542)	-	(10,542)	-
Changes in fair value	697	-	697	-
Exchange differences	(812)	-	(812)	-
At 31 December	26,952	-	6,703	-
Available-for-sale securities are classified as follows on:				
Available for sale securities	26,952	-	6,703	-



Notes to the Accounts (continued)

29. Held-to-maturity securities

	The Group and the Bank	
	2005 HK\$'000	2004 HK\$'000
Listed, at amortised cost	385,020	302,135
Unlisted, at amortised cost	4,474,334	5,269,662
Total	4,859,354	5,571,797
Listed, at amortised cost less impairment		
- in Hong Kong	306,783	302,135
- outside Hong Kong	78,237	-
	385,020	302,135
Market value of listed securities	377,413	304,072
Held-to-maturity securities are analysed by issuers as follows:		
Central governments and central banks	306,783	352,380
Public sector entities	596,635	310,000
Banks and other financial institutions	3,955,936	4,909,417
	4,859,354	5,571,797

The movement in held-to-maturity securities may be summarised as follows:

	The Group and the Bank	
	2005 HK\$'000	2004 HK\$'000
At 1 January		
As previously reported	7,618,985	7,301,996
Opening adjustments to comply with HKAS 39	(935,985)	-
Balance after opening adjustments	6,683,000	7,301,996
Additions	2,641,040	4,601,551
Redemption and maturity	(2,845,846)	(4,250,133)
Amortisation	(4,682)	(20,259)
Exchange differences	(2,663)	(14,170)
At 31 December	6,470,849	7,618,985
Held-to-maturity securities are classified as follows in:		
Certificates of deposit held (Note 24)	1,611,495	2,047,188
Held-to-maturity securities	4,859,354	5,571,797
	6,470,849	7,618,985

Notes to the Accounts (continued)

30. Loans and receivables

	The Group and the Bank	
	2005 HK\$'000	2004 HK\$'000
Unlisted, at amortised cost	316,647	-
Loans and receivables are analysed by issuers as follows:		
Banks and other financial institutions	316,647	-

The amortisation arising from "Loans and receivables" of the Group during the year is HK\$5,706,000.

31. Investment securities

	The Group		The Bank	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
Unlisted debt securities, at cost	-	250	-	250
Equity securities, at cost				
- Listed outside Hong Kong	-	653	-	653
- Unlisted	-	21,834	-	525
Less: Provision for impairment in value	-	(1,060)	-	-
		20,774	-	525
	-	21,427	-	1,178
Total		21,677	-	1,428
Market value of listed equity securities	-	5,279	-	5,279
Investment securities are analysed by issuers as follows:				
Banks and other financial institutions	-	653	-	653
Corporate entities	-	21,024	-	775
	-	21,677	-	1,428



Notes to the Accounts (continued)

32. Investments in subsidiaries

	The Bank	
	2005	2004
	HK\$'000	HK\$'000
Unlisted shares, at cost	3,913	3,913
Amounts due from subsidiaries (Note (a))	54,123	53,573
Amounts due to subsidiaries (Note (a))	(20,518)	(20,523)
	37,518	36,963

Note (a): Amounts due from/to subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

Details of the subsidiaries as at 31 December 2005 are set out below:

Name	Place of incorporation	Particulars of issued share capital	Interest held	Principal activities
Chiyu Banking Corporation (Nominees) Limited	Hong Kong	1,000 shares of HK\$100 each	100%	Investment holding
Seng Sun Development Company Limited	Hong Kong	2,800 shares of HK\$1,000 each	100%	Investment holding
Pacific Trend Profits Corporation	The British Virgin Islands	1 shares of US\$1 each	100%	Investment holding
Glory Cardinal Limited	Hong Kong	2 shares of HK\$1each	*100%	Investment holding
Glister Company Limited	Hong Kong	2 shares of HK\$1each	*100%	Investment holding
Grace Charter Limited	Hong Kong	2 shares of HK\$1each	*100%	Investment holding

* Shares held indirectly by the Bank

In December 2005, the Group disposed of its entire interests in Seng Sun Development (Xiamen) Co. Ltd. to independent third parties.



Notes to the Accounts (continued)

33. Fixed assets

	The Group			
	Premises HK\$'000	Property under development HK\$'000	Equipment, fixtures and fittings HK\$'000	Total HK\$'000
Net book value at 1 January 2005	439,090	32,349	26,681	498,120
Additions	-	1,206	8,725	9,931
Disposals	(3,005)	(21,585)	(226)	(24,816)
Revaluation	103,292	-	-	103,292
Depreciation for the year	(4,847)	-	(6,807)	(11,654)
Reclassification to investment properties (Note 34)	(25,000)	-	-	(25,000)
Provision for impairment for the year (Note 13)	-	(1,300)	-	(1,300)
Net book value at 31 December 2005	509,530	10,670	28,373	548,573
At 31 December 2005				
Cost or valuation	509,530	18,470	93,263	621,263
Accumulated depreciation and impairment	-	(7,800)	(64,890)	(72,690)
Net book value at 31 December 2005	509,530	10,670	28,373	548,573

	The Group			
	Premises HK\$'000	Property under development HK\$'000	Equipment, fixtures and fittings HK\$'000	Total HK\$'000
Net book value at 1 January 2004	320,562	32,349	28,756	381,667
Additions	-	-	5,058	5,058
Disposals	-	-	(25)	(25)
Revaluation	123,594	-	-	123,594
Depreciation for the year	(5,066)	-	(7,108)	(12,174)
Net book value at 31 December 2004	439,090	32,349	26,681	498,120
At 31 December 2004				
Cost or valuation	439,090	38,849	88,563	566,502
Accumulated depreciation and impairment	-	(6,500)	(61,882)	(68,382)
Net book value at 31 December 2004	439,090	32,349	26,681	498,120

The analysis of cost or valuation of the above assets is as follows:

At 31 December 2005				
At cost	-	18,470	93,263	111,733
At valuation	509,530	-	-	509,530
	509,530	18,470	93,263	621,263
At 31 December 2004				
At cost	-	38,849	88,563	127,412
At valuation	439,090	-	-	439,090
	439,090	38,849	88,563	566,502



Notes to the Accounts (continued)

33. Fixed assets (continued)

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK\$'000	HK\$'000	HK\$'000
Net book value at 1 January 2005	436,890	26,681	463,571
Additions	-	8,725	8,725
Disposals	(3,010)	(226)	(3,236)
Revaluation	102,541	-	102,541
Depreciation for the year	(4,791)	(6,807)	(11,598)
Reclassification to investment properties (Note34)	(25,000)	-	(25,000)
Net book value at 31 December 2005	506,630	28,373	535,003
At 31 December 2005			
Cost or valuation	506,630	93,247	599,877
Accumulated depreciation and impairment	-	(64,874)	(64,874)
Net book value at 31 December 2005	506,630	28,373	535,003

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK\$'000	HK\$'000	HK\$'000
Net book value at 1 January 2004	319,073	28,756	347,829
Additions	-	5,058	5,058
Disposals	-	(25)	(25)
Revaluation	122,851	-	122,851
Depreciation for the year	(5,034)	(7,108)	(12,142)
Net book value at 31 December 2004	436,890	26,681	463,571
At 31 December 2004			
Cost or valuation	436,890	88,547	525,437
Accumulated depreciation and impairment	-	(61,866)	(61,866)
Net book value at 31 December 2004	436,890	26,681	463,571

The analysis of cost or valuation of the above assets is as follow:

At 31 December 2005			
At cost	-	93,247	93,247
At valuation	506,630	-	506,630
	506,630	93,247	599,877
At 31 December 2004			
At cost	-	88,547	88,547
At valuation	436,890	-	436,890
	436,890	88,547	525,437



Notes to the Accounts (continued)

33. Fixed assets (continued)

The carrying value of premises is analysed based on the remaining terms of the leases as follows:

	The Group	
	2005 HK\$'000	2004 HK\$'000
Held in Hong Kong		
On long-term lease (over 50 years)	341,740	293,580
On medium-term lease (10 – 50 years)	157,710	135,270
Held outside Hong Kong		
On long-term lease (over 50 years)	8,580	8,620
On medium-term lease (10 – 50 years)	1,500	1,620
	509,530	439,090

	The Bank	
	2005 HK\$'000	2004 HK\$'000
Held in Hong Kong		
On long-term lease (over 50 years)	341,740	293,580
On medium-term lease (10 – 50 years)	158,810	133,070
Held outside Hong Kong		
On long-term lease (over 50 years)	8,580	8,620
On medium-term lease (10 – 50 years)	1,500	1,620
	510,630	436,890

As at 31 December 2005, the premises are included in the consolidated balance sheet at valuation carried out at 31 October 2005 on the basis of their open market value by an independent firm of chartered surveyors, Chesterton Petty Limited. Chesterton Petty Limited also confirmed that there has been no material change in valuations as at 31 December 2005.

As a result of the above-mentioned revaluations, changes in value of the Group's premises were recognised in the Group's premises revaluation reserve, the profit and loss account and minority interests respectively as follows:

	The Group	
	2005 HK\$'000	2004 HK\$'000
Increase in valuation credited to premises revaluation reserve	96,645	102,028
Increase in valuation credited to profit and loss account (Note 13)	6,647	21,566
	103,292	123,594

	The Bank	
	2005 HK\$'000	2004 HK\$'000
Increase in valuation credited to premises revaluation reserve	96,645	102,028
Increase in valuation credited to profit and loss account	5,896	20,823
	102,541	122,851



Notes to the Accounts (continued)

33. Fixed assets (continued)

As at 31 December 2005, the net book value of premises that would have been included in the Group's consolidated balance sheet had the assets been carried at cost less accumulated depreciation and impairment losses were HK\$173,000,000 (2004: HK\$180,000,000).

34. Investment properties

	The Group and the Bank	
	2005	2004
	HK\$'000	HK\$'000
At 1 January	20,690	17,380
Fair value gains (Note 14)	8,250	3,310
Reclassification	25,000	-
At 31 December	53,940	20,690

As at 31 December 2005, the investment properties are included in the consolidated balance sheet at valuation carried out at 31 October 2005 on the basis of their open market value by an independent firm of chartered surveyors, Chesterton Petty Limited. Chesterton Petty limited also confirmed that there has been no material change in valuation as at 31 December 2005.

The carrying value of investment properties is analysed based on the remaining terms of the leases as follows:

	2005	2004
	HK\$'000	HK\$'000
Held in Hong Kong		
On long-term lease (over 50 years)	50,000	17,650
Held outside Hong Kong		
On medium-term lease (10 – 50 years)	3,940	3,040
	53,940	20,690

Notes to the Accounts (continued)

35. Deposits from customers

The Group	
2005	2004
HK\$'000	HK\$'000
Current, savings and other deposit accounts (per consolidated balance sheet)	24,764,174
Structured deposits reported as other financial liabilities at fair value through profit or loss (Note 36)	-
25,476,311	24,764,174
Analysed by:	
Demand deposits and current accounts	1,497,472
Savings deposits	12,046,043
Time, call and notice deposits	11,220,659
25,476,311	24,764,174
The Bank	
2005	2004
HK\$'000	HK\$'000
Current, savings and other deposit accounts (per consolidated balance sheet)	24,810,289
Structured deposits reported as other financial liabilities at fair value through profit or loss (Note 36)	-
25,511,248	24,810,289
Analysed by:	
Demand deposits and current accounts	1,497,834
Savings deposits	12,065,881
Time, call and notice deposits	11,246,574
25,511,248	24,810,289

36. Other financial liabilities at fair value through profit or loss

The Group and the Bank	
2005	2004
HK\$'000	HK\$'000
Per consolidated balance sheet	-
Structured deposits (Note 35)	-
Certificate of deposits issued at fair value through profit or loss	-
2,977,057	-

The Group and the Bank designated on initial recognition HK\$2,977,057,000 of financial liabilities as at fair value through profit or loss. The amount of change in their fair values is attributable to changes in a benchmark interest rate. The difference between the carrying amount and the amount that the Group and the Bank would be contractually required to pay at maturity to the holders of these financial liabilities is HK\$ 115,334,000.

Notes to the Accounts (continued)

37. Deferred taxation

Deferred tax is recognised in respect of the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts in accordance with HKAS 12 "Income taxes".

The major components of deferred tax assets and liabilities recorded in the consolidated balance sheet, and the movements during the year are as follows:

	The Group					
	2005					
	Accelerated tax depreciation	Asset revaluation	Losses	Provisions	Other temporary differences	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2005						
As previously reported	4,792	40,312	(271)	(27,827)	1,242	18,248
Opening adjustments (Note 4)	-	411	-	24,526	-	24,937
Balance after opening adjustments	4,792	40,723	(271)	(3,301)	1,242	43,185
Charged/(credited) to profit and loss account	625	1,443	(43)	1,477	(726)	2,776
Charged to equity	-	16,641	-	-	-	16,641
At 31 December 2005	<u>5,417</u>	<u>58,807</u>	<u>(314)</u>	<u>(1,824)</u>	<u>516</u>	<u>62,602</u>

	The Group					
	2004					
	Accelerated tax depreciation	Asset revaluation	Losses	Provisions	Other temporary differences	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2004	2,781	22,667	(255)	(27,705)	2,874	362
Charged/(credited) to profit and loss account	2,011	-	(16)	(122)	(1,632)	241
Charged to equity	-	17,645	-	-	-	17,645
At 31 December 2004	<u>4,792</u>	<u>40,312</u>	<u>(271)</u>	<u>(27,827)</u>	<u>1,242</u>	<u>18,248</u>

Notes to the Accounts (continued)

37. Deferred taxation (continued)

	The Bank				
	2005				
	Accelerated tax depreciation HK\$'000	Asset revaluation HK\$'000	Provisions HK\$'000	Other temporary differences HK\$'000	Total HK\$'000
At 1 January 2005					
As previously reported	4,592	40,312	(27,827)	1,242	18,319
Opening adjustments (Note 4)	-	411	24,526	-	24,937
Balance after opening adjustments	4,592	40,723	(3,301)	1,242	43,256
Charged/(credited) to profit and loss account	628	1,443	1,477	(726)	2,822
Charged to equity		16,641			16,641
At 31 December 2005	5,220	58,807	(1,824)	516	62,719

	The Bank				
	2004				
	Accelerated tax depreciation HK\$'000	Asset revaluation HK\$'000	Provisions HK\$'000	Other temporary differences HK\$'000	Total HK\$'000
At 1 January 2004	2,578	22,667	(27,705)	2,874	414
Charged/(credited) to profit and loss account	2,014	-	(122)	(1,632)	260
Charged to equity	-	17,645	-	-	17,645
At 31 December 2004	4,592	40,312	(27,827)	1,242	18,319

Deferred tax assets and liabilities are offset on an individual entity basis when there is a legal right to set off current tax assets against current tax liabilities and when the deferred taxation relates to the same authority. The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet:

	The Group		The Bank	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
Deferred tax assets	117	71	-	-
Deferred tax liabilities	(62,719)	(18,319)	(62,719)	(18,319)
	(62,602)	(18,248)	(62,719)	(18,319)

Notes to the Accounts (continued)

37. Deferred taxation (continued)

	The Group	
	2005	2004
	HK\$'000	HK\$'000
Deferred tax assets to be recovered after more than twelve months	2,138	28,098
Deferred tax liabilities to be settled after more than twelve months	(5,418)	(5,291)
	(3,280)	22,807

	The Bank	
	2005	2004
	HK\$'000	HK\$'000
Deferred tax assets to be recovered after more than twelve months	1,824	27,827
Deferred tax liabilities to be settled after more than twelve months	(5,220)	(5,091)
	(3,396)	22,736

38. Other accounts and provisions

	The Group		The Bank	
	2005	2004	2005	2004
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Dividend payable	404	189,404	404	189,404
Interest payable	-	26,783	-	26,783
Current taxation (Note)	31,015	28,530	31,015	28,531
Accruals and other payables	772,337	1,017,462	772,478	999,556
	803,756	1,262,179	803,897	1,244,274

Note:

	The Group		The Bank	
	2005	2004	2005	2004
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Current taxation				
Hong Kong profits tax	28,926	28,690	28,926	28,691
Overseas taxation	2,089	(160)	2,089	(160)
	31,015	28,530	31,015	28,531

39. Share capital

	2005	2004
	HK\$'000	HK\$'000
Authorised:		
3,000,000 ordinary shares of HK\$100.00 each	300,000	300,000
Issued and fully paid:		
3,000,000 ordinary shares of HK\$100.00 each	300,000	300,000

Notes to the Accounts (continued)

40. Reserves

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 11 of the accounts.

(b) Bank

The amounts of the Bank's reserves and the movements therein for the current and prior years are presented in the statement of changes in equity on page 12 of the accounts.

41. Notes to consolidated cash flow statement

(a) Reconciliation of operating profit to operating cash (outflow)/inflow before taxation:

	2005 HK\$'000	2004 HK\$'000
Operating profit	572,250	543,476
Dividend income from investments in securities	(1,094)	(1,107)
Depreciation	11,654	12,174
Impairment loss on other assets	350	-
Impairment loss on loans and advances	(29,871)	-
Charge for bad and doubtful debts	-	2,908
Advances written off net of recoveries	(17,899)	(17,153)
Change in money at call and short notice with original maturity over three months	(207,153)	281,256
Change in placements with banks and other financial institutions with original maturity over three months	50,381	(783,932)
Change in trade bills	(684,959)	(47,191)
Change in certificates of deposit held with original maturity over three months	110,230	(715,717)
Change in available-for-sale securities	11,542	-
Change in held-to-maturity securities	129,963	398,727
Change in loans and receivable securities	(316,647)	-
Change in other financial assets/liabilities at fair value through profit or loss	1,148,035	-
Change in derivative financial instruments	36,674	-
Change in advances and other accounts	(1,211,160)	68,830
Change in other assets	58,465	551,423
Change in deposits and balances of banks and other financial institutions repayable over three months	86,225	(18,661)
Change in deposits from customers	(607,342)	490,540
Change in certificates of deposit issued	(9,231)	(45,037)
Change in other accounts and provisions	(247,044)	(497,611)
Exchange difference	-	(67)
Operating cash (outflow)/inflow before taxation	(1,116,631)	222,858



Notes to the Accounts (continued)

41. Notes to consolidated cash flow statement (continued)

(b) Analysis of the balances of cash and cash equivalents

	2005 HK\$'000	2004 HK\$'000
Cash and balances with banks and other financial institutions	875,747	634,246
Money at call and short notice with original maturity within three months	5,840,254	8,704,791
Placements with banks and other financial institutions with original maturity within three months	2,781,121	2,397,458
Deposits and balances of banks and other financial institutions with original maturity within three months	(372,663)	(871,015)
	9,124,459	10,865,480

(c) Disposal of subsidiaries

	2005 HK\$'000	2004 HK\$'000
Net assets disposed of:		
- Cash and short-term fund	25,847	-
- Other asset	1,354	-
- Fixed assets	21,586	-
- Advance and other accounts	12	-
	48,799	-
Satisfied by:		
- Cash consideration	(53,652)	-
Analysis of net inflow of cash and cash equivalents in respect of the disposal of subsidiaries:		
- Cash consideration	53,652	-
- Other asset	(18,073)	-
	35,579	-

42. Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment and the corresponding aggregate credit risk weighted amount:

	The Group and the Bank	
	2005 HK\$'000	2004 HK\$'000
Direct credit substitutes	19,950	13,519
Transaction-related contingencies	102,261	67,622
Trade-related contingencies	918,940	1,046,820
Other commitments with an original maturity of		
- under one year or which are unconditionally cancellable	3,898,649	2,958,119
- one year and over	955,793	788,307
	5,895,593	4,874,387
Credit risk weighted amount	670,750	609,676

The calculation basis of credit risk weighted amount has been set out in Note 23 to the accounts.



Notes to the Accounts (continued)

43. Operating lease commitments

(a) The Group as lessee

The Group has commitments to make the following future minimum lease payments under non-cancellable operating leases:

	The Group and the Bank	
	2005	2004
	HK\$'000	HK\$'000
Land and buildings		
- not later than one year	11,385	11,049
- later than one year but not later than five years	9,135	13,933
- later than five years	184	-
	20,704	24,982

Certain non-cancellable operating leases included in the above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified agreed dates.

(b) The Group as lessor

The Group has contracted with tenants for the following future minimum lease receivables under non-cancellable operating leases:

	The Group and the Bank	
	2005	2004
	HK\$'000	HK\$'000
Land and buildings		
- not later than one year	1,712	1,338
- later than one year but not later than five years	1,675	899
	3,387	2,237

The Group leases its investment properties (Note 34) under operating lease arrangements, with leases typically for a period from one to three years. The terms of the leases generally require the tenants to pay security deposits and provide for periodic rent adjustments according to the then prevailing market conditions. None of the leases includes contingent rentals.

44. Segmental reporting

The Group engages in many businesses in several regions. For segmental reporting purposes, information is solely provided in respect of business segments. Geographical segment information is not presented because over 90% of the Group's revenues, profits before tax and assets are derived from Hong Kong.

Starting from the interim report this year, the Group adopted a new approach in segmental reporting to provide investors with more details. Under the current approach, information about five business segments is provided. They are Retail Banking, Corporate Banking, Treasury, Investment Activities and Unallocated.

Notes to the Accounts (continued)

44. Segmental reporting (continued)

Both Retail Banking and Corporate Banking segments provide general banking services. Retail Banking mainly serves individual customers and small companies. Corporate Banking mainly manages medium to large companies. Treasury segment is responsible for managing the capital, the liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. Investment Activities include the Group's holdings of premises and investment properties. The segment "Unallocated" refers to those items related to the Group as a whole but independent of the other four business segments.

Revenues, expenses, assets and liabilities of any business segment mainly include items directly attributable to the segment. Regarding occupation of the Group's premises, rentals are internally charged on market rates according to the areas occupied. For management overheads, allocations are made on reasonable bases. Inter-segment fund flows are charged according to the internal funds transfer pricing mechanism of the Group. The charge on any of such flow is mainly made by reference to the corresponding money market rates of the currency and period same as those of the fund flown. Although there are internal charges on any fund transferred between business segments, no assets and liabilities are created in any form for any segment in respect of such transfers for segmental reporting purposes.

	2005							
	Retail HK\$'000	Corporate HK\$'000	Treasury HK\$'000	Investment HK\$'000	unallocated HK\$'000	Subtotal HK\$'000	Eliminations HK\$'000	Consolidated HK\$'000
Net interest income/(expenses)	276,358	177,240	123,242	(20,155)	-	556,685	-	556,685
Net fees and commission income /(expenses)	102,629	62,513	(765)	-	-	164,377	-	164,377
Net trading income	24,776	7,621	5,047	4	-	37,448	-	37,448
Other operating income	203	215	18	25,293	-	25,729	(22,500)	3,229
Operating income	403,966	247,589	127,542	5,142	-	784,239	(22,500)	761,739
Operating expenses	(141,974)	(46,710)	(3,960)	(14,680)	(34,536)	(241,860)	22,500	(219,360)
Operating profit/(loss) before impairment on advances	261,992	200,879	123,582	(9,538)	(34,536)	542,379	-	542,379
Reversal of loan impairment allowances on advances	3,040	26,831	-	-	-	29,871	-	29,871
Operating profit/(loss)	265,032	227,710	123,582	(9,538)	(34,536)	572,250	-	572,250
Net gain from disposal/revaluation of fixed assets	-	-	-	5,440	-	5,440	-	5,440
Net gain from disposal/revaluation of investment properties	-	-	-	8,250	-	8,250	-	8,250
Gain on disposal of subsidiaries	-	-	-	4,853	-	4,853	-	4,853
Profit/(loss) before taxation	265,032	227,710	123,582	9,005	(34,536)	590,793	-	590,793
Assets								
Segment assets	4,063,856	7,272,168	19,191,556	700,944	4,622	31,233,146	-	31,233,146
Liabilities								
Segment liabilities	23,456,852	3,012,904	856,335	861	115,018	27,441,970	-	27,441,970
Other information								
Additions of fixed assets	-	-	-	9,931	-	-	-	9,931
Depreciation	6,337	260	50	4,847	160	11,654	-	11,654
Amortisation of premium/discount of held-to-maturity securities and Loans and receivables	-	-	10,388	-	-	10,388	-	10,388

Notes to the Accounts (continued)

44. Segmental reporting (continued)

	2004							
	Retail HK\$'000	Corporate HK\$'000	Treasury HK\$'000	Investment HK\$'000	Unallocated HK\$'000	Subtotal HK\$'000	Eliminations HK\$'000	Consolidated HK\$'000
Net interest income/(expenses)	132,176	159,914	244,348	(1,879)	-	534,559	-	534,559
Net fees and commission income/(expenses)	111,402	69,475	(711)	-	-	180,166	-	180,166
Net trading income	28,835	4,340	5,040	37	-	38,252	-	38,252
Other operating income	57	-	825	25,180	-	26,062	(22,500)	3,562
Operating income	272,470	233,729	249,502	23,338	-	779,039	(22,500)	756,539
Operating expenses	(119,125)	(51,344)	(2,990)	(14,683)	(44,513)	(232,655)	22,500	(210,155)
Operating profit/(loss) before provisions on advances	153,345	182,385	246,512	8,655	(44,513)	546,384	-	546,384
Write-back of bad and doubtful debts	(410)	(2,498)	-	-	-	(2,908)	-	(2,908)
Operating profit/(loss)	152,935	179,887	246,512	8,655	(44,513)	543,476	-	543,476
Net gain from disposal/revaluation of fixed assets	-	-	-	21,542	-	21,542	-	21,542
Net gain from disposal of available for sale securities	-	-	-	740	-	740	-	740
Profit/(loss) before taxation	152,935	179,887	246,512	30,937	(44,513)	565,758	-	565,758
Assets								
Segment assets	3,647,016	5,724,701	20,898,806	652,853	3,703	30,927,079	-	30,927,079
Liabilities								
Segment liabilities	23,071,357	2,817,840	1,295,395	207,554	67,636	27,459,782	-	27,459,782
Other information								
Additions of fixed assets	-	-	-	5,058	-	5,058	-	5,058
Depreciation	6,728	210	50	5,066	120	12,174	-	12,174
Amortisation of premium/discount of held-to-maturity securities	-	-	20,259	-	-	20,259	-	20,259

45. Loans to directors and officers

Particulars of advances made to directors and officers of the Group pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2005 HK\$'000	2004 HK\$'000
Aggregate amount of relevant loans outstanding at year end	1,730	1,934
Maximum aggregate amount of relevant loans outstanding during the year	1,934	2,139

46. Significant related party transactions

Related parties are those parties that have 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. Related parties may be individuals or other entities.



Notes to the Accounts (continued)

46. Significant related party transactions (continued)

Transactions with related parties which the Group were entered into during the period are summarised as follows:

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies

The aggregate income and expenses arising from related party transactions with the immediate holding company, intermediate holding companies of the Bank as well as subsidiaries and associates of BOC are summarised as follows:

	Notes	2005	
		Immediate and intermediate holding companies ¹	Other related Parties ²
		HK\$'000	HK\$'000
Profit and loss items:			
Interest income	(i)	72,754	14,327
Interest expense	(ii)	(2,737)	(21,196)
Insurance commission received (net)	(iii)	-	7,320
Administrative services fees paid/payable	(iv)	(23,228)	(1,599)
Securities brokerage commission paid/payable (net)	(v)	-	(4,753)
Rental, property management and letting agency fees paid/payable	(v)	(1,135)	-
Funds selling commission received	(vi)	-	1,235
<hr/>			
	Notes	2004	
		Immediate and intermediate holding companies ¹	Other related Parties ²
		HK\$'000	HK\$'000
Profit and loss items:			
Interest income	(i)	44,191	3,845
Interest expense	(ii)	(2,401)	(1,498)
Insurance commission received (net)	(iii)	-	6,630
Administrative services fees paid/payable	(iv)	(27,180)	(1,419)
Securities brokerage commission paid/payable (net)	(v)	-	(11,095)
Rental, property management and letting agency fees paid/payable	(v)	(1,135)	-
Funds selling commission received	(vi)	-	1,720

Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

	Notes	2005	
		Immediate and intermediate holding companies ¹	Other related Parties ²
		HK\$'000	HK\$'000
Balance sheet items:			
Cash and short-term funds	(i)	1,380,116	31,761
Placements with banks and other financial institutions	(i)	696,095	54,758
Advances and other accounts	(i)	-	251,387
Derivative financial instruments - assets	(vii)	735	-
Other assets	(viii)	36,693	36,000
Deposits and balances of banks and other financial institutions	(ii)	(573,176)	-
Deposits from customers	(ii)	-	(567,414)
Derivative financial instruments - liabilities	(vii)	(8,290)	-
Other accounts and provisions	(viii)	(117,996)	(69,147)

	Notes	2004	
		Immediate and intermediate holding companies ¹	Other related Parties ²
		HK\$'000	HK\$'000
Balance sheet items:			
Cash and short-term funds	(i)	2,131,818	11,652
Placements with banks and other financial institutions	(i)	1,999,908	178,809
Advances and other accounts	(i)	9,092	200,731
Other assets	(viii)	71,100	104,253
Deposits and balances of banks and other financial institutions	(ii)	(1,008,159)	-
Deposits from customers	(ii)	-	(1,167,330)
Other accounts and provisions	(viii)	(195,338)	(96,005)

¹ Immediate and intermediate holding companies are state-controlled entities. Transactions with BOC for year ended 31 December 2004 have been disclosed as transactions with immediate and intermediate holding companies to ensure comparability notwithstanding that BOC was the Bank's ultimate holding company before August 2004. Following the reorganisation of BOC in August 2004, Central SAFE holds substantial equity capital of BOC on behalf of the State. Accordingly, Central SAFE, acting on behalf of the State has become the ultimate holding company of the Bank whilst BOC became the Group's intermediate holding company.

² Subsidiaries and associates of BOC and post-employment benefit plans for the benefit of employees of the Bank are collectively disclosed as other related parties and certain of which are state-controlled entities.



Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

(i) Interest income

In the ordinary course of business, the Group enters into various transactions with BOC and its subsidiaries and associates including deposit of cash and short-term funds, placement of interbank deposits and provision of loans and credit facilities. The transactions were conducted at prices and terms that are no more favourable than those charged to and contracted with other third party customers of the Group.

(ii) Interest expense

In the ordinary course of business, the Group accepts interbank deposits and current, fixed, savings and other deposits from the immediate holding company, intermediate holding companies and subsidiaries and associates of at the relevant market rates at the time of the transactions.

(iii) Insurance commission received (net)

In the ordinary course of business, the Group provides insurance agency services to and purchases general and life insurance policies from subsidiaries of BOC at the relevant market rates at the time of the transactions.

(iv) Administrative services fees paid/payable

In the ordinary course of business, the Group pays administrative services fees for the provision of various administrative services including technology and training to the immediate holding company and subsidiaries of BOC. These transactions have been entered into in the ordinary course of business and were priced at the relevant market rates at the time of the transactions.

(v) Commission, property management, letting agency fees and rental fees paid/payable

In the ordinary course of business, the Group pays commission fees for securities brokerage services, property management and letting agency fees to BOC and its subsidiaries. The Group also pays rental fees to subsidiaries of BOC. These transactions have been entered into in the ordinary course of business and were priced at the relevant market rates at the time of the transactions.

(vi) Funds selling commission received

In the ordinary course of business, the Group receives commission for engaging in promotion and sale of fund products of a fellow subsidiary to customers of the Group at the relevant market rates at the time of the transactions.



Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

(vii) Derivative financial instruments assets/liabilities

In the ordinary course of business, the Group enters into foreign exchange contracts and interest rate contracts with BOC and its subsidiaries. The aggregate notional amount of such derivative transactions amounted to HK\$365,144,000 as at 31 December 2005 whilst the corresponding derivative financial instruments assets and liabilities amounted to HK\$735,000 and HK\$8,290,000 respectively as at that date. These transactions are executed at the relevant market rates at the time of the transactions.

(viii) Other assets and other accounts and provisions

Included within "Other assets" and "Other accounts and provisions" are receivables from and payables to intermediate holding companies and subsidiaries of BOC. The amounts mainly represent the accounts receivables from and payables to a subsidiary of BOC in relation to dealing securities trading transactions on behalf of the Group's customers. The receivables and payables arose from transactions carried out in the normal course of business.

(b) Contingent liabilities and commitments

In the ordinary course of business, the Group provides loan facilities and trade finance services to, and guarantees for the obligations of BOC and its subsidiaries and associates on normal commercial terms. As at 31 December 2005, the total undrawn loan commitments, trade finance-related contingencies and guarantees amounted to HK\$911,000 (31 December 2004: HK\$18,144,000).

(c) Key management personnel

Key management are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and officers. The Group accepts deposits from and grants loans and credit facilities to key management personnel in the ordinary course of business. During both the current and prior years, no material transaction was conducted with key management personnel of the Group, its holding companies and parties related to them.

The key management compensation for the year ended 31 December 2005 and 31 December 2004 is detailed as follows:

	2005 HK\$'000	2004 HK\$'000
Salaries and other short-term employee benefits	<u>4,839</u>	<u>5,446</u>

Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(d) Transactions with Ministry of Finance and The People's Bank of China

The Group enters into banking transactions with these entities in the normal course of business. These include purchases and redemption of treasury bonds and money market transactions. The outstanding balances at the year end, and the related income and expense for the year are as follows:

(i) Treasury bonds

	2005 HK\$'000	2004 HK\$'000
Interest income	2,745	2,834
	2005 HK\$'000	2004 HK\$'000
Outstanding balance at beginning of the year	50,245	49,704
Outstanding at balance at end of the year	38,768	50,245

(ii) Due from banks and other financial institutions

	2005 HK\$'000	2004 HK\$'000
Interest income	965	1,058
	2005 HK\$'000	2004 HK\$'000
Outstanding balance at beginning of the year	76,401	95,489
Outstanding balance at end of the year	132,070	76,401

(e) Transactions with Central SAFE and other companies controlled by Central SAFE

Central SAFE is the controlling entity of BOC. Central SAFE is approved by the State Council of the PRC to assume the rights and obligations of the equity owner on behalf of the State. Accordingly, Central SAFE, acting on behalf of the State, has become the ultimate holding company of the Group by virtue of its interest in BOC.

The Group did not have any balances and enter into any transactions with Central SAFE for the years ended 31 December 2004 and 2005 respectively.



Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(e) Transactions with Central SAFE and other companies controlled by Central SAFE (continued)

Central SAFE has controlling equity interests in certain other banks in the PRC. The Group enters into banking transactions with these companies in the normal course of its business. These include loans and money market transactions. The outstanding balances at the year end, and the related income and expense for the year are as follows:

(i) Due from banks and other financial institutions

	2005 HK\$'000	2004 HK\$'000
Interest income	4,462	-

	2005 HK\$'000	2004 HK\$'000
Outstanding balance at end of the year	204,295	-

There is no outstanding balance at the beginning of the year of 2004 and 2005.

(ii) Due to banks and other financial institutions

	2005 HK\$'000	2004 HK\$'000
Interest expense	5	-

There is no outstanding balance at the beginning of the year of 2004 and 2005 and outstanding balance at the year end of 2004 and 2005.

(f) Transactions with other state-controlled entities

The state-controlled entities are those, other than BOC (the intermediate holding company and its subsidiaries) and Central SAFE and its controlled companies over which the PRC government directly or indirectly holds over 50% of the outstanding shares or voting rights, and has the ability to control or the power to govern their financial or operational policies. The Group is ultimately controlled by the PRC government, which also directly and indirectly controls a significant number of entities through its government authorities, agencies and affiliates. Accordingly, the Group has extensive transactions with other state controlled entities. These transactions, conducted in the ordinary course of business, may include, but are not limited to, the following:

- lending, provision of credits and guarantees and deposit taking;
- inter-bank balance taking and placing;
- sale, purchase, underwriting and redemption of bonds issued by other state-controlled entities;
- rendering of foreign exchange, remittance, investment related services;
- provision of fiduciary activities; and
- purchase of utilities, transportation, telecommunication and postal services.

Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(f) Transactions with other state-controlled entities (continued)

Utilities, transportation, telecommunication and postal services are charged by service providers at market rates. Management believes that, based on their assessment, the amounts of such related party transactions are insignificant for the year and therefore are not disclosed below. Details of other transactions are set forth below.

The Group enters into banking transactions with other state-controlled entities in the ordinary course of business. These include loans, deposits, money market transactions and off-balance sheet exposures. The outstanding balances and related provisions at the year end, and the related income and expense for the year are as follows:

(i) Advances to customers/banks and other financial institutions

	2005 HK\$'000	2004 HK\$'000
Interest income	24,885	12,949
(Charge for individually assessed loan impairment allowances)/write-back of bad and doubtful debts	(4,089)	(18,457)
	2005 HK\$'000	2004 HK\$'000
Outstanding balance at beginning of the year	562,136	586,770
Outstanding balance at end of the year	679,561	562,136
Less: individually assessed loan impairment allowances	(64)	-
Less: Specific provisions	-	(4,408)
	679,497	557,728

(ii) Due from banks and other financial institutions

	2005 HK\$'000	2004 HK\$'000
Interest income	15,373	1,566
	2005 HK\$'000	2004 HK\$'000
Outstanding balance at beginning of the year	260,000	229,667
Outstanding balance at end of the year	626,085	260,000

Notes to the Accounts (continued)

46. Significant related party transactions (continued)

(f) Transactions with other state-controlled entities (continued)

(iii) Due to banks and other financial institutions

	2005 HK\$'000	2004 HK\$'000
Interest expense	181	24

	2005 HK\$'000	2004 HK\$'000
Outstanding balance at beginning of the year	5,073	11,554
Outstanding balance at end of the year	26,479	5,073

(iv) Deposit from customers

	2005 HK\$'000	2004 HK\$'000
Interest expense	3,578	789

	2005 HK\$'000	2004 HK\$'000
Outstanding balance at beginning of the year	315,929	266,759
Outstanding balance at end of the year	296,629	315,929

(v) Contingent liabilities and commitments (including guarantees)

	2005 HK\$'000	2004 HK\$'000
	801,730	226,780

47. Ultimate holding company

BOC was the Group's ultimate holding company before August 2004. Following the reorganisation of BOC in August 2004, Central SAFE (previously known as China SAFE Investments Ltd) holds substantial equity capital of BOC on behalf of the State. Accordingly, Central SAFE, acting on behalf of the State has become the ultimate holding company of the Group whilst BOC has become the Group's intermediate holding company.



Notes to the Accounts (continued)

48. Comparative amounts

As further explained in Note 2 to the accounts, due to the adoption of certain new HKFRSs, HKASs and Interpretations during the year, the accounting treatment and presentation of certain items and balances in the accounts have been prepared to comply with the new requirements. Accordingly, certain opening adjustments have been made and certain comparative amounts have been reclassified to conform to with the current year's presentation.

49. Approval of accounts

The accounts were approved and authorised for issue by the Board of Directors on 22 March 2006.

Unaudited Supplementary Financial Information

1. Capital adequacy ratio

	2005	2004
Capital adequacy ratio	25.34%	26.45%
Adjusted capital adequacy ratio	25.24%	26.42%

The Capital adequacy ratio ("CAR") is computed on the combined basis, as specified by the HKMA for its regulatory purposes and in accordance with the Third Schedule of the Banking Ordinance.

The adjusted CAR taking into account market risk exposure as at the balance sheet date is computed in accordance with the guideline on "Maintenance of Adequate Capital Against Market Risks" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority and on the same basis as for the unadjusted CAR.

2. Components of capital base after deductions

The combined capital base after deductions used in the calculation of the above capital adequacy ratios as at 31 December 2005 and 31 December 2004 and reported to the HKMA is analysed as follows:

	2005 HK\$'000	2004 HK\$'000
Core capital:		
Paid up ordinary share capital	300,000	300,000
Reserves	2,905,343	2,761,842
Profit and loss account	160,413	152,699
	3,365,756	3,214,541
Supplementary capital:		
Premises and investment properties revaluation reserves	224	224
Reserves on revaluation of holding of securities not held for trading purposes	(73,800)	-
Collective loan impairment allowances	10,288	-
Regulatory reserve	153,807	-
General provisions for doubtful debts	-	158,182
Total capital base	3,456,275	3,372,947
Deduction from total capital base:		
Shareholdings in subsidiaries or holding company	(3,913)	(3,913)
Exposures to connected companies	(76,341)	(75,789)
Investments in the capital of other banks or other financial institutions	(6,158)	(653)
	(86,412)	(80,355)
Total capital base after deductions	3,369,863	3,292,592

Unaudited Supplementary Financial Information (continued)

3. Liquidity ratio

	2005	2004
Average liquidity ratio	46.79%	51.25%

The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of Bank for the year.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule of the Banking Ordinance.

4. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net options position is calculated based on the worst-case approach set out in the prudential return "Foreign Currency Position" issued by the HKMA.

	2005						
	Equivalent in thousand of HK\$						
	US Dollars	Swiss Francs	Japanese Yens	Australian Dollars	New Zealand Dollars	Renminbi Yuan	Others
Spot assets	6,536,498	2,429	213,993	1,062,912	466,985	340,552	633,397
Spot liabilities	(6,328,148)	(53,775)	(452,669)	(1,024,152)	(435,713)	(296,682)	(533,670)
Forward purchases	301,029	56,722	290,005	16,791	11,927	961	64,294
Forward sales	(117,053)	(4,724)	(51,886)	(50,413)	(42,814)	-	(162,801)
Net long/(short) position	392,326	652	(557)	5,138	385	44,831	1,220
Net structural position	-	-	-	-	-	28,824	-

	2004						
	Equivalent in thousand of HK\$						
	US Dollars	Euro	Canadian Dollars	Australian Dollars	New Zealand Dollars	Renminbi Yuan	Others
Spot assets	7,058,388	123,660	155,509	921,064	285,324	241,235	340,038
Spot liabilities	(6,046,774)	(169,163)	(167,376)	(886,058)	(287,789)	(250,839)	(986,911)
Forward purchases	79,319	71,864	14,211	4,242	3,734	12,746	699,617
Forward sales	(333,081)	(26,457)	(2,586)	(38,629)	(3,075)	(4,000)	(45,672)
Net long/(short) position	757,852	(96)	(242)	619	(1,806)	(858)	7,072
Net structural position	-	-	-	-	-	93,941	-

Unaudited Supplementary Financial Information (continued)

5. Segmental information

(a) Sectoral analysis of gross advances to customers

The information concerning gross advances to customers has been analysed into loans used inside or outside Hong Kong by industry sectors of the borrowers as follows:

	2005 HK\$'000	2004 HK\$'000
Loans for use in Hong Kong		
Industrial, commercial and financial		
- Property development	478,299	469,928
- Property investment	1,668,561	1,518,515
- Financial concerns	552,239	300,783
- Stockbrokers	7,648	2,394
- Wholesale and retail trade	642,622	661,125
- Manufacturing	965,418	890,894
- Transport and transport equipment	102,545	123,143
- Others	795,224	595,017
Individuals		
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	132,149	152,903
- Loans for purchase of other residential properties	2,427,885	2,414,109
- Others	439,255	356,836
Total loans for use in Hong Kong	8,211,845	7,485,647
Trade finance	1,029,034	874,176
Loans for use outside Hong Kong	913,472	625,739
Gross advances to customers	10,154,351	8,985,562

(b) Geographical analysis of gross advances to customers and overdue advances

The following geographical analysis of gross advances to customers and advances overdue for over three months is based on the location of the counterparties, after taking into account the transfer of risk in respect of such advances where appropriate.

(i) Gross advances to customers

	2005 HK\$'000	2004 HK\$'000
Hong Kong	9,224,250	8,369,354
Mainland China	930,101	616,208
	10,154,351	8,985,562

Unaudited Supplementary Financial Information (continued)

5. Segmental information (continued)

(b) Geographical analysis of gross advances to customers and overdue advances (continued)

(ii) Advances overdue for over three months

	2005 HK\$'000	2004 HK\$'000
Hong Kong	68,967	166,793
Mainland China	18,607	42,822
	<u>87,574</u>	<u>209,615</u>

6. Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	Banks and other financial institutions HK\$' 000	Others HK\$' 000	Total HK\$' 000
At 31 December 2005			
Asia, other than Hong Kong			
- China	3,242,000	55,000	3,297,000
- Others	3,461,000	81,000	3,542,000
	<u>6,703,000</u>	<u>136,000</u>	<u>6,839,000</u>
North America			
- United States	1,999,000	-	1,999,000
- Others	478,000	1,000	479,000
	<u>2,477,000</u>	<u>1,000</u>	<u>2,478,000</u>
Western Europe	8,360,000	249,000	8,609,000
Total	<u>17,540,000</u>	<u>386,000</u>	<u>17,926,000</u>
At 31 December 2004			
Asia, other than Hong Kong			
- Mainland China	4,354,000	365,000	4,719,000
- Others	2,962,000	141,000	3,103,000
	<u>7,316,000</u>	<u>506,000</u>	<u>7,822,000</u>
Western Europe			
- United Kingdom	2,315,000	-	2,315,000
- Others	7,989,000	240,000	8,229,000
	<u>10,304,000</u>	<u>240,000</u>	<u>10,544,000</u>
Total	<u>17,620,000</u>	<u>746,000</u>	<u>18,366,000</u>



Unaudited Supplementary Financial Information (continued)

7. Overdue and rescheduled assets

(a) Gross amount of overdue loans

	2005		2004	
	Amount HK\$'000	% of gross advances to customers	Amount HK\$'000	% of gross advances to customers
Gross advances to customers which have been overdue for:				
- six months or less but over three months	3,069	0.03%	29,271	0.33%
- one year or less but over six months	485	0.00%	2,022	0.02%
- over one year	84,020	0.83%	178,322	1.98%
Advances overdue for over three months	87,574	0.86%	209,615	2.33%

As at 31 December 2005 and 31 December 2004, there were no advances to banks and other financial institutions that were overdue for over three months.

Advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid. Advances repayable by regular instalments are classified as overdue when an instalment payment is overdue and remains unpaid. Advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction or when the advances have remained continuously outside the approved limit that was advised to the borrower.

(b) Rescheduled advances to customers

	2005		2004	
	Amount HK\$'000	% of gross advances to customers	Amount HK\$'000	% of gross advances to customers
Rescheduled advances to customers	702	0.01%	3,795	0.04%

As at 31 December 2005 and 31 December 2004, there were no rescheduled advances to banks and other financial institutions. Rescheduled advances are those advances that have been restructured or renegotiated because of a deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms, either of interest or of repayment period, are non-commercial. Rescheduled advances, which have been overdue for more than three months under the revised repayment terms, are included in overdue advances. Rescheduled advances are stated before deduction of loan impairment allowances.

8. Repossessed assets held

	2005 HK\$'000	2004 HK\$'000
Estimated market value of repossessed assets held	79,950	110,754

Repossessed assets are properties or securities in respect of which the Group has acquired access or control (e.g. through court proceedings or voluntary actions by the borrowers concerned) for release in full or in part of the obligations of the borrowers.



Unaudited Supplementary Financial Information (continued)

9. Capital management

The Group monitors the adequacy of its capital using the CAR as one of the major measurements, which is subject to the HKMA's regulatory requirements. The Group maintains its capital to comply with all the statutory standards for all the periods presented in the report. The Assets and Liabilities Management Committee, with the assistance of the Finance Division, monitors the adequacy of its capital using the CAR as one of the major measurements, which is subject to HKMA's regulatory requirements. On combined basis, the Bank's unadjusted CAR and adjusted CAR incorporating market risk were 25.34% and 25.24% at 31 December 2005 respectively. Both were well above the statutory minimum ratio of 8%

10. Risk management

Overview

The principal types of risk inherent in the Group's business include credit risk, market risk (exchange rate risk), interest rate risk, liquidity risk and operational risk. The Group's risk management goal is to maximise its return on capital while maintaining risk exposure within acceptable parameters.

Risk Management Structure

The Group's risk management policies are designed to identify and analyse credit risk, market risk, interest rate risk, liquidity risk and operational risk, to set appropriate risk limits, and to continually monitor these risks and limits by means of administrative procedures and information systems. The Group continually modifies and enhances its risk management policies and procedures to reflect changes in markets and products.

To achieve the Group's risk management goals, the Group has established a centralised risk management structure that involves the following elements:

- a corporate governance structure to provide active oversight and participation by the Board of Directors, committees and senior management;
- reporting lines that are independent of the Group's Business Units;
- uniform risk management policies, procedures and limits by which the Group identifies, measures, monitors and controls inherent risks;
- improved risk measurement, monitoring and management information systems to support business activities and risk management; and
- clearly defined risk management responsibilities and accountability.

The Group faces the same types of inherent business risks and adopts consistent risk management strategies and policies as its immediate holding company, Bank of China (Hong Kong) Limited ("BOCHK"). The Group executes its risk management strategy independently and functionally reports to BOCHK on a regular basis.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.1 Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into with the Group. Credit risk arises principally from the Group's lending, trade finance and treasury operations.

The Group's primary goal in credit risk management is to maximise its risk-adjusted rate of return while maintaining its credit risk exposure within acceptable parameters. In particular, the Group has developed and implemented comprehensive policies and procedures to identify, measure, monitor and control credit risk across the organisation. The Group's Board of Directors, with the assistance of the Risk Management Committee, sets the Group's overall risk management strategy and policies, and the Group's overall risk limits and credit authorisation guidelines. The Risk Management Committee is responsible for reviewing and approving the Group's risk management policies and procedures as well as modifications to these policies and procedures. The primary goals of the credit risk management structure are:

- establishing an appropriate credit risk environment;
- enforcing prudent procedures for approving credits;
- maintaining an appropriate credit administration, measurement and monitoring process; and
- ensuring adequate independent oversight and control over credit risk.

To be consistent with the Group's overall risk management objectives, the key principles that ensure effective implementation of the Group's credit risk management strategy are:

- balancing the Group's tolerance for risk with the level of expected returns;
- diversifying the Group's loan portfolio by geographic regions, industries, products, customers, maturities and currencies;
- maintaining the independence of the credit review process to ensure risk assessment and monitoring are conducted in an objective, fair and comprehensive manner;
- emphasising the importance of cash flow as an essential factor in assessing borrowers' repayment ability;
- ensuring compliance with legal and regulatory requirements;
- assigning clearly defined credit risk management responsibilities and accountability to each relevant operating unit and staff involved in the risk management process;
- avoiding over-reliance on collaterals and guarantees;
- ensuring accurate measurement and full disclosure of credit risk exposure; and
- maintaining of consistent credit policy.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.1 Credit Risk Management (continued)

(a) Credit Risk Management Structure

The Group's Board of Directors, representing the shareholders' overall interests, is responsible for determining its credit risk management strategic objectives and principles. The Board, with the aim of maximising the Group's risk-adjusted returns as well as shareholders' wealth, holds ultimate responsibility for the Group's overall credit risk management process.

The Risk Management Committee is a board level committee that has the responsibility of determining and revising the Group's credit risk management policies and procedures.

The Group believes that independence and proper checks-and-balances are of critical importance in effective risk management. To achieve these purposes, in the Group's managerial/organisational structure, the Credit Risk Management Division ("CRMD") and the Audit Division report directly to the Risk Management Committee and Audit Committee respectively. All these committees and departments form an independent line of control.

In addition, respective responsibilities, accountabilities and authorities related to credit risk management are clearly defined throughout the Group.

The General Manager is responsible for, among other things, implementing the credit risk management strategy and significant policies approved by the Board. The General Manager is also charged with balancing the Group's goal of generating a high yield on its assets and the need to maintain risk exposure within the tolerance levels stipulated by the Risk Management Committee.

The Risk Management Committee has the responsibility for reviewing and approving loans exceeding the credit approval limit of the General Manager.

The Group's credit initiation units, such as Corporate Banking Department, Retail Banking Department, Treasury Division and China Business Division, act as the first line of risk control. They are required to conduct business activities within the limits of delegated authorities and in accordance with the Group's credit risk management strategy, policies and procedures. Multi-level credit approval authorities are set depending mostly on the credit officers' professional experience, skill and responsibilities.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.1 Credit Risk Management (continued)

(a) Credit Risk Management Structure (continued)

The CRMD, being structurally independent from credit initiation units, reports to and assists the General Manager in managing credit risk based on the credit risk management strategies and policies. It also provides independent analysis and review for the purpose of identifying, measuring, monitoring and controlling credit risk.

To avoid any potential conflicts of interest, the credit review functions are independent of the business development units.

The CRMD is also responsible for the collection of overdue loans.

(b) Credit Approval Procedures

The Group employs discriminatory approval procedures for high-risk loans and low-risk loans. All credit approval and review authorities are originated from the Group's Board of Directors.

Low-risk loans that fulfil certain requirements relating to loan types, loan purposes, loan amount, guarantee, collateral coverage and security adequacy can be approved by authorised credit officers in the credit initiation units without prior review of the CRMD. Loan review officers in the CRMD conduct independent post-approval reviews and assess if initial credit decisions have been made in accordance with the established policies and procedures.

On the other hand, high-risk loans are subject to pre-approval review by the review officers in the CRMD to assess compliance with policies and procedures, adequacy of credit risk assessment, and information sufficiency. The CRMD is authorised to exercise the right of veto or concurrence based on the review conclusions.

(c) Credit Risk Assessment

The result of credit risk assessment is a critical factor in making credit decisions. The Group's credit assessment emphasises a thorough understanding of the purpose and structure of the loan, the borrower's financial status, cash flow position and repayment ability as well as business management. The Group also evaluates the industry risk associated with the corporate borrowers. When assessing an individual loan application, the Group considers overall credit risk at the portfolio level.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.1 Credit Risk Management (continued)

(d) Credit Risk Monitoring

The Group has well-established policies and procedures by means of robust and just-in-time administrative information systems. An independent dedicated section in CRMD conducts thorough and comprehensive monitoring of each obligor and group of obligors to identify and control the individual and overall credit risk in the loan portfolio.

An early alert program for potential problem customers has been established in order to detect early signs of deterioration in the credit status of obligors and trigger close monitoring to prevent further deterioration. Also, conservative collateral discount policy has been implemented to reflect the current stagnant property market in Hong Kong.

To achieve sustainable improvement in asset quality, the Group has established internal targets to evaluate the effort and performance in the resolution of criticised loans. CRMD provides regular monitoring reports to senior management for high-level oversight. An incentive scheme has also been developed to provide appreciation and reward to those who have made the most contribution and merit in the process.

10.2 Market Risk Management

Market risk is the risk of losses in on- and off-balance sheet positions arising from changes in interest rates, foreign exchange rates and equity prices, on the Group's assets, liabilities and commitments.

The Group's market risk is originated from the holding of its foreign exchange position, debt securities and derivatives in its trading books. The Group does not engage in proprietary trading in foreign exchange and equity instruments. The Group's trading activities on foreign exchange and derivative instruments mainly arise from the execution of trade orders from customers and positions taken in order to hedge other elements of the trading books.

The Group's maximum market risk exposures in different activities are set by management. Exposures are measured and monitored on the basis of principal (or notional) amount, outstanding position and stop-loss limit, and are controlled within the limits approved by the management for each business unit, business type and in aggregate.

The Group has met the "de minimis" criteria set out in the Maintenance of Adequate Capital Against Market Risk guideline issued by the HKMA. As a result, the Group considers that the market risk arising from its trading book is not material and no further qualitative or quantitative disclosure is made of market risk in these accounts.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.2 Market Risk Management (continued)

(a) Foreign Exchange Risk Management

The Group provides foreign exchange deposit, margin trading and forward transaction services to its customers. Foreign exchange risk is the risk arising from changes in foreign exchange rates on the Group's assets, liabilities and commitments, thus causing profits or losses.

The Group's exchange exposures mainly comprise of currency exposures originated from its commercial banking business. It is the Group's policy to close out foreign exchange positions by the end of the business day. The Settlement Section in Operation Division ensures that all foreign currency transactions are conducted in accordance with the guidelines established by management.

10.3 Interest Rate Risk Management

The Group's balance sheet consists predominantly of Hong Kong dollar-denominated interest rate sensitive assets and liabilities. The Group's primary sources of interest rate risk are mismatches in the maturities or re-pricing periods of these assets and liabilities and movements in market interest rates. In addition, different pricing bases for different transactions may also lead to interest rate risk for the Group's assets and liabilities within the same re-pricing period.

Interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income. The Risk Management Committee sets up strict internal guidelines to monitor and control interest rate exposures. The Assets and Liabilities Management Committee formulates strategies to manage the Group's money market operations, investment in bills, commercial papers, certificates of deposit and notes. Only small interest rate positions may be taken for yield enhancement within the risk limits.

10.4 Liquidity Risk Management

Liquidity risk arises in the funding of lending, trading and investment activities and in the management of trading positions. Liquidity risk includes both the risk of unexpected increase in the cost of funding to refinance the Group's asset portfolio at appropriate maturities and the risk of being unable to liquidate a position in a timely manner and/or at a reasonable price. The goal of liquidity management is for the Group to be able, even under adverse market conditions, to meet all its maturing repayment obligations on time and to fund all its asset growth and strategic opportunities. The Group's average liquidity ratio of 46.79% for the year ended 31 December 2005 was well above the statutory minimum ratio of 25%.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.4 Liquidity Risk Management (continued)

The Group maintains flexibility in meeting its funding requirements by maintaining diverse sources of liquidity. The Group funds its operations principally by accepting deposits from retail and corporate depositors. The Group also borrows in the short-term interbank markets, although it is typically a net lender of funds. In addition, the Group from time to time raises funds through the disposal of investments.

The Group uses the majority of funds raised to extend loans, to make investments in debt securities or to conduct interbank placements. Generally, the average maturity of deposits is shorter than that of loans or investments but is longer than that of interbank placements.

The primary goal of the Group's asset and liability management strategy is to achieve an optimal return while ensuring adequate levels of liquidity and capital within an effective risk control framework and at reasonable cost of funding. The Assets and Liabilities Management Committee is responsible for establishing these policy directives and works closely with the Finance Division to ensure that the Group maintains adequate levels of liquidity and secures the lowest possible cost of funding, while closely planning and monitoring the Group's on- and off-balance sheet assets and liabilities with regard to the risk incurred. The Finance Division provides reporting and analytical services to Assets and Liabilities Management Committee with respect to current and planned positions taken for investment, funding and foreign exchange management purposes. In particular, the Group has implemented various measures to:

- improve its management information system to provide timely information on the movement of its liquid assets and that of its customer deposits on a daily, weekly and monthly basis;
- monitor liquidity ratios in compliance with the HKMA's requirements;
- prepare regular maturity gap analysis to enable management to review and monitor the Group's liquidity position on a timely basis;
- conduct scenario analysis to estimate the impact of various risk factors on the liquidity position;
- establish a range of liquidity risk factors for monitoring purposes and a liquidity risk warning index system to detect early signs of any irregularities; and
- create a three-tier response system to effectively deal with any emergencies.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.5 Operational Risk Management

Operational risk is the risk of loss resulting from inadequate internal processes, people and systems or from external events. The Board recognises operational risk as a distinct risk category that should be managed with full attention and should be kept up with the best practice of the industry.

The Group has formulated and implemented the Operational Risk Management Policy which provides a bank-wide classification of operational risks and sets out the requirements on identification, assessment, reporting, monitoring and mitigation.

To ensure operational risks being under proper monitoring and supervision, effective internal control system has been enforced by means of computer systems and rigorous procedures. In addition, through coaching and frequent training, the Group has maintained teams of experienced and competent staff in all business and management areas to execute and monitor the operations of the Group.

The Group's policies and procedures will be reviewed vigilantly and updated in accordance with the new promulgated requirements from time to time. Furthermore, the Audit Division performs independent checking to ascertain that the procedures are properly followed and reports discrepancies found directly to the Audit Committee.

Records and details of the operational risk losses and incidents are collected and analyzed centrally in order to meet regulatory bodies' requirements and to facilitate the implementation of operational risk management framework.

The Group has reviewed and enhanced the Business Continuity Plan of all critical banking services. To ensure practicality of the plan, drill on contingency plans on certain critical business functions has been duly performed and the result was satisfactory.



Unaudited Supplementary Financial Information (continued)

10. Risk management (continued)

10.6 Reputation risk management

Reputation risk is the risk that negative publicity regarding the business practices, whether genuine or not, will cause a potential decline in the customer base or lead to costly litigation or revenue erosion. Reputation risk is inherent in every aspect of the Group's business operation and covers a wide spectrum of issues. Market rumors or public perceptions are significant factors in determining the level of risk in this category.

In order to mitigate reputation risk, the Group has formulated and implemented a Reputation Risk Management Policy, which establishes standards to prevent and to manage reputation risk proactively at an early stage. In order to eliminate or alleviate the negative impact on the Group's reputation, incidents related to reputation risk are handled promptly in accordance with the Emergency Contingency Plan and Special Reporting System for Special Incidents.

In addition, precautionary measures have been taken and special attentions have been drawn in the combat of the Anti-Money Laundering and Anti-Terrorist Financing activities. Specific procedure manuals and self-checking compliance list have been issued and trainings have been provided to all staff to stipulate the Group's policy and stance in order to prevent the Group's services being used by the villains for illegal activities.

10.7 Legal and compliance risk management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial condition of the Group.

Compliance risk is the risk of legal and regulatory sanctions, financial loss, or loss to reputation that the Group may suffer as a result of its failure to comply with all applicable laws, regulations, international practices, local trade standards, codes of conduct and standards of good practice. By establishing and maintaining appropriate policies and guidelines, the Group ensures to conduct its business in compliance with the requirements of relevant laws and regulations.

10.8 Strategic risk management

Strategic risk generally refers to the risks that may induce some current or future negative impacts on the earnings, capital, reputation or market position of the Group because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The Group has developed its Strategic Risk Management Policy that defines the responsibilities of the Board and the Management when implementing its desired strategies.



BRANCH NETWORK

BRANCH (Br.)	ADDRESS	TELEPHONE
HONG KONG ISLAND		
Central Br.	78, Des Voeux Road Central, Hong Kong	2843 1817
North Point Br.	390-394 King's Road, North Point, Hong Kong	2570 6381
Wanchai Br.	325 Hennessy Road, Wanchai, Hong Kong	2572 2823
Sheung Wan Br.	22-24 Bonham Strand West, Hong Kong	2544 1678
Western Br.	443 Queen's Road West, Hong Kong	2548 2298
Quarry Bay Br.	997 King's Road, Quarry Bay, Hong Kong	2811 3131
KOWLOON		
Hung Hom Br.	23-25 Gillies Avenue, Hung Hom, Kowloon	2362 0051
Kwun Tong Br.	42-44 Mut Wah Street, Kwun Tong, Kowloon	2343 4174
Sham Shui Po Br.	235-237 Laichikok Road, Kowloon	2789 8668
San Po Kong Br.	61-63 Hong Keung Street, San Po Kong, Kowloon	2328 5691
Yau Ma Tei Br.	117-119 Shanghai Street, Yaumatei, Kowloon	2332 2533
Castle Peak Road Br.	226-228 Castle Peak Road, Kowloon	2720 5187
Kowloon Bay Br.	Shop 10, G/F., Kai Lok House, Kai Yip Estate, Kowloon Bay, Kowloon	2796 8968
Tokwawan Br.	G/F, Shop 11-13, 78 Tokwawan Road, Kowloon	2765 6118
Tsz Wan Shan Br.	Shop 202, 2/F., Tsz Wan Shan Shopping Centre, 23 Yuk Wah Street, Tsz Wan Shan, Kowloon	2322 3313
NEW TERRITORIES		
Tuen Mun Yau Oi Estate Br.	Shop 103-104, G/F Restaurant Block Yau Oi Estate Tuen Mun, N. T.	2452 3666
Kwai Hing Estate Br.	Shop 1, G/F, Hing Yat House, Kwai Hing Estate, Kwai Chung, N. T.	2487 3332
Tai Po Tai Wo Estate Br.	Shop 112-114, G/F., On Wo House, Tai Wo Estate, Tai Po, N. T.	2656 3386
Belvedere Garden Br.	Shop 5A, G/F., Belvedere Square, Tsuen Wan, N.T	2411 6789
Tsuen Wan Br.	Shop 1 and 1D, Level 2, Discovery Park Commercial Centre, Tsuen Wan, N.T.	2413 8111
Shatin Sui Wo Court Br.	Shop F7, Commercial Centre, Sui Wo Court, Shatin, N.T.	2601 5888
Ma On Shan Br.	Shop 313, Level 3, Ma On Shan Plaza Bayshore Tower, Ma On Shan, N.T.	2640 0733
Sheung Tak Estate Br.	Shop 238, Sheung Tak Shopping Centre, Sheung Tak Est., Tseung Kwan O, N.T.	2178 2278
THE MAINLAND OF CHINA		
Xiamen Branch	1/F, 859 Xiahe Road, Xiamen, Fujian Province, China	(86-592) 585 1691
Fuzhou Branch	1/F, International Bldg., 210 Wusi Road, Fuzhou, Fujian Province, China	(86-591) 781 0078