# 2006

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

# Annual Report

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# Report of the Directors

The Directors are pleased to present their report together with the audited consolidated financial statements 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 2006.

## 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 45 to the financial statements.

## Results and Appropriations

The results of the Group for the year are set out in the consolidated income statement on page 9.

The Board declared a first interim dividend of HK$66 per ordinary share, totaling HK$198,000,000 on 20 June 2006.

The Board declared a second interim dividend of HK$70 per ordinary share, totaling HK$210,000,000 on 20 December 2006.

## 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 12 and 13 respectively.

## Properties, plant and equipment

Details of movements in properties, plant and equipment of the Group and the Bank are set out in Note 32 to the financial statements.

# Report of the Directors (continued)

## Directors

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

| | |
|---|---|
| **Chairman** | He Guangbei # |
| **Vice Chairman** | Ng Leung Sing # |
| | Ng Man Kung |
| **Directors** | Chiu Ming Wah # |
| | Liu Yanfen # |
| | Mao Xiaowei # |
| | Ouyang Jian# |
| | Tan Wan Chye # |
| | To Chi Wing # |
| | Zhang Qi Hua # |
| | Cheung Wai Hing * (appointed on 22 November 2006) |
| | Woo Chia Wei * |
| | Yu Kwok Chun * |
| | Chan Yiu Fai |

# Non-executive Directors

* Independent non-executive Directors

In accordance with Article 99 of the Bank's Articles of Association, Mr. Woo Chia Wei and Mr. Yu Kwok Chun 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.

# Report of the Directors (continued)

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

The financial statements for the year ended 31 December 2006 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 financial statements 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, 16 March 2007

# Corporate Governance

The Group has compiled with 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 ("EC")***

The EC 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-wide 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 EC are Mr. Ng Man Kung (Chairman), Mr. Chan Yiu Fai and Mr. To Chi Wing. All are Directors of the Bank.

***Audit Committee ("AC")***

The AC 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 AC are Mr. Chiu Ming Wah (Chairman), Mr. Cheung Wai Hing , Ms. Liu Yanfen, Mr. Tan Wan Chye and Mr. Woo Chia Wei. All are non-executive Directors of the Bank.

***Risk Management Committee ("RC")***

The RC 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 RC 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.

# INDEPENDENT AUDITOR'S REPORT

## TO THE SHAREHOLDERS OF CHIYU BANKING CORPORATION LIMITED

(Incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Chiyu Banking Corporation Limited (the "Bank") and its subsidiaries (together, the "Group") set out on pages 9 to 95, which comprise the balance sheets of the Bank and the Group as at 31 December 2006, and the consolidated income statement, the statement of changes in equity of the Bank and the Group and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

**Director's responsibility for the financial statements**

The Directors of the Bank are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit 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.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

# INDEPENDENT AUDITOR'S REPORT (continued)

## TO THE SHAREHOLDERS OF CHIYU BANKING CORPORATION LIMITED (continued)

(Incorporated in Hong Kong with limited liability) (continued)

**Opinion**

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 2006, and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 16 March 2007

集友銀行
Chiyu Banking Corporation Ltd.

## Consolidated Income Statement

| For the year ended 31 December | Notes | **2006** | 2005 |
|---|---|---|---|
| | | **HK$'000** | HK$'000 |
| Interest income | | **1,552,598** | 1,017,790 |
| Interest expense | | **(878,001)** | (461,105) |
| **Net interest income** | 5 | **674,597** | 556,685 |
| Fees and commission income | | **237,114** | 194,689 |
| Fees and commission expenses | | **(41,220)** | (30,312) |
| **Net fees and commission income** | 6 | **195,894** | 164,377 |
| Net trading income | 7 | **48,889** | 37,459 |
| Net gain on disposal of subsidiary | 8 | **-** | 4,853 |
| Net gain on investments in securities | 9 | **6,470** | - |
| Other operating income | 10 | **5,641** | 3,218 |
| **Net operating income before loan impairment allowances** | | **931,491** | 766,592 |
| (Charge)/reversal of loan impairment allowances | 11 | **(33,005)** | 29,871 |
| **Net operating income** | | **898,486** | 796,463 |
| Operating expenses | 12 | **(230,412)** | (219,360) |
| **Operating profit** | | **668,074** | 577,103 |
| Net gain on disposal/revaluation of properties, plant and equipment | 13 | **6,344** | 5,440 |
| Net gain on fair value adjustments on investment properties | 14 | **600** | 8,250 |
| **Profit before taxation** | | **675,018** | 590,793 |
| Taxation | 15 | **(115,200)** | (96,626) |
| **Profit for the year** | | **559,818** | 494,167 |
| **Dividends** | 17 | **408,000** | 375,000 |

The notes on pages 15 to 95 are an integral part of these financial statements.

# Consolidated Balance Sheet

| As at 31 December | Notes | 2006 | 2005 |
|---|---|---|---|
| | | **HK$'000** | HK$'000 |
| **ASSETS** | | | |
| Cash and balances with banks and other financial institutions | 21 | **836,948** | 875,747 |
| Placements with banks and other financial institutions | 22 | **11,847,505** | 10,289,960 |
| Other financial assets at fair value through profit or loss | 24 | **1,220,977** | 1,137,117 |
| Derivative financial instruments | 25 | **125,842** | 179,443 |
| Advances and other accounts | 26 | **11,101,224** | 10,890,769 |
| Investment in securities | | | |
| - Available-for-sale securities | 28 | **20,815** | 26,952 |
| - Held-to-maturity securities | 29 | **6,429,759** | 6,470,849 |
| - Loans and receivables | 30 | **817,969** | 316,647 |
| Properties, plant and equipment | 32 | **528,843** | 548,573 |
| Investment properties | 33 | **54,540** | 53,940 |
| Deferred tax assets | 37 | **110** | 117 |
| Other assets | 34 | **1,001,262** | 443,032 |
| Total assets | | **33,985,794** | 31,233,146 |
| **LIABILITIES** | | | |
| Deposits and balances of banks and other financial institutions | | **625,868** | 633,800 |
| Other financial liabilities at fair value through profit or loss | 35 | **3,026,933** | 2,616,209 |
| Derivative financial instruments | 25 | **47,010** | 104,536 |
| Deposits from customers | 36 | **24,542,695** | 22,860,102 |
| Certificates of deposit issued | | | |
| - at fair value through profit or loss | 35 | **292,272** | 360,848 |
| Current tax liabilities | | **46,180** | 31,015 |
| Deferred tax liabilities | 37 | **56,945** | 62,719 |
| Other accounts and provisions | 38 | **1,404,438** | 772,741 |
| Total liabilities | | **30,042,341** | 27,441,970 |
| **EQUITY** | | | |
| Share capital | 39 | **300,000** | 300,000 |
| Reserves | 40 | **3,643,453** | 3,491,176 |
| Total equity | | **3,943,453** | 3,791,176 |
| Total liabilities and equity | | **33,985,794** | 31,233,146 |

The notes on pages 15 to 95 are an integral part of these financial statements.

Approved by the Board of Directors on 16 March 2007 and signed on behalf of the Board by:

**HE Guangbei**

Director

**NG Man Kung**

Director

**CHIU Ming Wah**

Director

**PO Yuen Fung**

Secretary

# Balance Sheet

| As at 31 December | Notes | 2006 | 2005 |
|---|---|---|---|
| | | **HK$'000** | HK$'000 |
| **ASSETS** | | | |
| Cash and balances with banks and other financial institutions | 21 | **836,948** | 875,747 |
| Placements with banks and other financial institutions | 22 | **11,847,505** | 10,289,960 |
| Other financial assets at fair value through profit or loss | 24 | **1,220,977** | 1,137,117 |
| Derivative financial instruments | 25 | **125,842** | 179,443 |
| Advances and other accounts | 26 | **11,101,224** | 10,891,048 |
| Investment in securities | | | |
| - Available-for-sale securities | 28 | **566** | 6,703 |
| - Held-to-maturity securities | 29 | **6,429,759** | 6,470,849 |
| - Loans and receivables | 30 | **817,969** | 316,647 |
| Interests in subsidiaries | 31 | **37,209** | 37,518 |
| Properties, plant and equipment | 32 | **525,643** | 535,003 |
| Investment properties | 33 | **54,540** | 53,940 |
| Other assets | 34 | **994,931** | 421,677 |
| Total assets | | **33,993,113** | 31,215,652 |
| **LIABILITIES** | | | |
| Deposits and balances of banks and other financial institutions | | **625,868** | 633,800 |
| Other financial liabilities at fair value through profit or loss | 35 | **3,026,933** | 2,616,209 |
| Derivative financial instruments | 25 | **47,010** | 104,536 |
| Deposits from customers | 36 | **24,606,429** | 22,895,039 |
| Certificates of deposit issued | | | |
| - at fair value through profit or loss | 35 | **292,272** | 360,848 |
| Current tax liabilities | | **46,180** | 31,015 |
| Deferred tax liabilities | 37 | **56,945** | 62,719 |
| Other accounts and provisions | 38 | **1,404,634** | 772,882 |
| Total liabilities | | **30,106,271** | 27,477,048 |
| **EQUITY** | | | |
| Share capital | 39 | **300,000** | 300,000 |
| Reserves | 40 | **3,586,842** | 3,438,604 |
| Total equity | | **3,886,842** | 3,738,604 |
| Total liabilities and equity | | **33,993,113** | 31,215,652 |

The notes on pages 15 to 95 are an integral part of these financial statements.

Approved by the Board of Directors on 16 March 2007 and signed on behalf of the Board by:

**HE Guangbei**

Director

**NG Man Kung**

Director

**CHIU Ming Wah**

Director

**PO Yuen Fung**

Secretary

# Consolidated Statement of Changes in Equity

| | Attributable to equity holders of the Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital | Premises revaluation reserve | Reserve for fair value changes of available-for-sale securities | Regulatory reserve* | Translation reserve | Retained earnings | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| At 1 January 2005 | 300,000 | 195,121 | - | 140,148 | 354 | 2,955,851 | 3,591,474 |
| 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 | 300,000 | 275,268 | 742 | 153,807 | - | 3,061,359 | 3,791,176 |
| Bank and subsidiaries | 300,000 | 275,268 | 742 | 153,807 | - | 3,061,359 | 3,791,176 |
| **At 1 January 2006** | **300,000** | **275,268** | **742** | **153,807** | **-** | **3,061,359** | **3,791,176** |
| **Net profit for the year** | **-** | **-** | **-** | **-** | **-** | **559,818** | **559,818** |
| **Currency translation difference** | **-** | **-** | **-** | **-** | **-** | **130** | **130** |
| **2006 first interim dividend paid** | **-** | **-** | **-** | **-** | **-** | **(198,000)** | **(198,000)** |
| **2006 second interim dividend paid** | **-** | **-** | **-** | **-** | **-** | **(210,000)** | **(210,000)** |
| **Revaluation of premises** | **-** | **5,299** | **-** | **-** | **-** | **-** | **5,299** |
| **Release upon disposal of premises** | **-** | **(4,498)** | **-** | **-** | **-** | **4,498** | **-** |
| **Release from deferred tax liabilities** | **-** | **398** | **143** | **-** | **-** | **-** | **541** |
| **Release of reserve upon derecognition of available-for-sale securities** | **-** | **-** | **(885)** | **-** | **-** | **(4,626)** | **(5,511)** |
| **Transfer from retained earnings** | **-** | **-** | **-** | **1,800** | **-** | **(1,800)** | **-** |
| **At 31 December 2006** | **300,000** | **276,467** | **-** | **155,607** | **-** | **3,211,379** | **3,943,453** |
| **Bank and subsidiaries** | **300,000** | **276,467** | **-** | **155,607** | **-** | **3,211,379** | **3,943,453** |

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

The notes on pages 15 to 95 are an integral part of these financial statements.

# Statement of Changes in Equity

| | Attributable to equity holders of the Bank | | | | | |
|---|---|---|---|---|---|---|
| | Share capital | Premises revaluation reserve | Reserve for fair value changes of available-for-sale securities | Regulatory* reserve | Retained earnings | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| At 1 January 2005 | 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 |
| **At 1 January 2006** | **300,000** | **275,268** | **742** | **153,807** | **3,008,787** | **3,738,604** |
| **Net profit for the year** | **-** | **-** | **-** | **-** | **555,972** | **555,972** |
| **Currency translation difference** | **-** | **-** | **-** | **-** | **130** | **130** |
| **2006 first interim dividend paid** | **-** | **-** | **-** | **-** | **(198,000)** | **(198,000)** |
| **2006 second interim dividend paid** | **-** | **-** | **-** | **-** | **(210,000)** | **(210,000)** |
| **Revaluation of premises** | **-** | **5,065** | **-** | **-** | **-** | **5,065** |
| **Release upon disposal of premises** | **-** | **(4,498)** | **-** | **-** | **4,498** | **-** |
| **Release from deferred tax liabilities** | **-** | **439** | **143** | **-** | **-** | **582** |
| **Release of reserve upon derecognition of available-for-sale securities** | | | **(885)** | **-** | **(4,626)** | **(5,511)** |
| **Transfer from retained earnings** | **-** | **-** | **-** | **1,800** | **(1,800)** | **-** |
| **At 31 December 2006** | **300,000** | **276,274** | **-** | **155,607** | **3,154,961** | **3,886,842** |

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

The notes on pages 15 to 95 are an integral part of these financial statements.

## Consolidated Cash Flow Statement

| For the year ended 31 December | Notes | 2006 | 2005 |
|---|---|---|---|
| | | **HK$'000** | HK$'000 |
| **Cash flows from operating activities** | | | |
| Operating cash outflow before taxation | 41 | **(1,619,365)** | (1,115,537) |
| Hong Kong profits tax paid | | **(95,355)** | (85,701) |
| Overseas profits tax paid | | **(9,905)** | (4,754) |
| **Net cash outflow from operating activities** | | **(1,724,625)** | (1,205,992) |
| **Cash flows from investing activities** | | | |
| Purchases of properties, plant and equipment | | **(4,526)** | (9,931) |
| Proceeds from disposal of properties, plant and equipment | | **23,677** | 3,323 |
| Proceeds from disposal of subsidiaries | | **-** | 35,579 |
| **Net cash inflow from investing activities** | | **19,151** | 28,971 |
| **Cash flows from financing activities** | | | |
| Dividends paid to equity holders of the Group | | **(198,000)** | (564,000) |
| **Net cash outflow from financing activities** | | **(198,000)** | (564,000) |
| Decrease in cash and cash equivalents | | **(1,903,474)** | (1,741,021) |
| Cash and cash equivalents at 1 January | | **9,124,459** | 10,865,480 |
| **Cash and cash equivalents at 31 December** | 41 | **7,220,985** | 9,124,459 |

The notes on pages 15 to 95 are an integral part of these financial statements.

# Notes to the Financial Statements

## 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 financial statements 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 financial statements of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") (HKFRSs is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") 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 financial statements 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 HKMA.

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

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

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

**2.1 Basis of preparation (continued)**

**Newly adopted HKFRS**

In 2006, the Group adopted the revised HKFRSs as set out below, which are relevant to its operations.

- HKAS 39 (Amendment) Financial Guarantee Contracts
- HKAS 39 (Amendment) The Fair Value Option

The adoption of the above revised standards did not result in substantial changes to the Group's accounting policies and have no significant impact on its results of operations and financial position. No restatement of comparative figures was made as the amounts were immaterial. In summary:

**(1) Financial Guarantee Contracts**

In prior years, financial guarantee contracts were accounted for under HKAS 37 "Provisions, Contingent Liabilities and Contingent Assets" as contingent liabilities and were disclosed as off-balance sheet items.

With effect from 1 January 2006 and in accordance with the above amendment, financial guarantee contracts issued are recognised as financial liabilities and reported under "Other accounts and provisions". Financial guarantees are recognised initially at fair value and subsequently measured at the higher of (i) the amount recognised under HKAS 37, and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised over the life of the guarantee on a straight-line basis.

Financial liabilities related to financial guarantee contracts recorded under "Other accounts and provisions" at 31 December 2006 and 31 December 2005 were immaterial.

**(2) The Fair Value Option**

The fair value option refines the condition for which financial instruments can be classified as financial assets or financial liabilities at fair value through profit and loss provided that financial assets and liabilities are managed together for internal risk management and investment strategy purposes or accounting mismatches can be eliminated. It also stipulates the condition for which a hybrid contract embedded with derivatives can be entirely designated as at fair value through profit or loss. There is no difference in the Group's practice when compared with the prior year.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.1 Basis of preparation (continued)

**Interpretations to existing standards early adopted by the Group**

- HK(IFRIC) – INT 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006). HK(IFRIC) – INT 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. This interpretation does not have any impact on the Group's financial statements; and

- HK(IFRIC) – INT 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). HK(IFRIC) – 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. This interpretation does not have any impact on the Group's financial statements.

**Standards, amendments and interpretations effective in 2006 but not relevant to the Group's operations**

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

- HKAS 19 (Amendment), Employee Benefits
- HKAS 21 (Amendment), Net investment in a Foreign Operation;
- HKAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- HKFRS 1 (Amendment), First-time adoption of Hong Kong Financial Reporting Standards;
- HKFRS 6 Exploration for and Evaluation of Mineral Resources;
- HKFRS – INT 4, Determining whether an Arrangement contains a Lease;
- HKFRS – INT 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds;
- HK(IFRIC) – INT 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.1 Basis of preparation (continued)

**A standard that is not yet effective and has not been early adopted by the Group**

The Group has chosen not to early adopt the following standard that was issued but not yet effective for accounting periods beginning on 1 January 2006:

HKFRS 7 "Financial Instruments: Disclosures" and the Amendment to HKAS 1 "Presentation of Financial Statements – Capital Disclosures", are effective for annual accounting periods beginning on or after 1 January 2007. HKFRS 7 introduces certain new disclosures relating to financial instruments while incorporating many of the requirements presently in HKAS 32. HKFRS 7 will supersede HKAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements of HKAS 32 Financial Instruments: Disclosure and Presentation. The Group has assessed the impact of HKFRS 7 and the amendment to HKAS 1 and concluded that the key impact will be more qualitative and quantitative disclosures primarily related to fair value measurement and risk management. Accordingly the adoption of this standard will have no effect on the Group's results of operations or financial position. The Group will apply HKFRS 7 and the amendment to HKAS 1 from annual periods beginning 1 January 2007.

**Interpretation to existing standards that are not yet effective and has been assessed to be not relevant to the Group's operations**

- HK(IFRIC) – INT 7, Applying the Restatement Approach under HKAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). HK(IFRIC) – INT 7 provides guidance on how to apply requirements of HKAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional Currency, when the economy was not hyperinflationary in the prior period. As none of the Group entities have a Currency of a hyperinflationary economy as its functional Currency, HK(IFRIC) – INT 7 is not relevant to the Group's operations;

- HK(IFRIC) – INT 8, Scope of HKFRS 2 (effective for annual periods beginning on or after 1 May 2006). HK(IFRIC) – INT 8 requires consideration of transactions involving the issuance of equity instruments - where the identifiable consideration received is less than the fair value of the equity instruments issued - to establish whether or not they fall within the scope of HKFRS 2. As the Group has not issued equity instruments for payment except those exempted under HKFRS 2, HK(IFRIC) – INT 8 is not relevant to the Group's operations;

- HK(IFRIC) – INT 11, HKFRS 2 Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007). HK(IFRIC) – INT 11 addresses how the share-based payment arrangement should be accounted for in the financial statements for the subsidiary that receives services from the employees. As the Group has not issued equity instruments for payment except those exempted under HKFRS 2, HK(IFRIC) – INT 8 is not relevant to the Group's operations.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.2 Consolidation

#### (1) Subsidiaries

Subsidiaries, are all entities (including special purpose entities) over which the Group controls the composition of the Board of Directors, controls more than half of the voting power or holds more than half of the issued capital that entitle the Group to govern the financial and operating policies of the entities. The existence and effect of 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 the acquisition of subsidiaries by the Group. The cost of an acquisition of a company not under common control is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed as of 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 Group’s share of the identifiable net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

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 have been 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 interest represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

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

### 2.4 Foreign currency translation

Items included in the financial statements 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 financial statements are presented in Hong Kong dollars, which is the Bank's functional and presentation currency.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions are recognised directly in the income statement. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date. Non-monetary assets and liabilities that are measured in terms of historical cost are translated using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value are translated using the rate of exchange at the date the fair value was determined. Income and expenses denominated in foreign currencies are translated at average exchange rates or the exchange rates prevailing at the dates of the transactions. The differences arising from translation are recognised in the income statement except for translation differences on non-monetary items classified as available-for-sale financial assets which 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 income statement, as part of the gain or loss on sale.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.5 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at 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.

Derivatives 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.

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 income statement.

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 objectives and strategies 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 hedge 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 income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.5 Derivative financial instruments and hedge accounting (continued)

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged 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 income statement.

### 2.6 Offsetting financial instruments

Financial assets and liabilities 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.

### 2.7 Interest income and expense and fees and commission income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability 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 instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (e.g. prepayment options) but does not consider future credit losses. The calculation includes 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 as interest income or expense over the expected life of the financial instrument.

Once a financial asset or a group of similar financial assets 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.

Fees and commissions that are not an integral part of the effective yield are recognised on an accrual basis ratably over the period when the related service has been provided. Fees and commission income related to credit commitments are 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.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.8 Financial assets

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 financial assets at initial recognition. The classification depends on the purpose for which the financial assets were acquired. All financial assets 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.

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

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception.

A financial asset which has been acquired or incurred principally for the purpose of selling in the short term or is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking is classified as held-for-trading. Derivatives are also classified as held for trading unless they are designated as effective hedges.

A financial asset, other than one held for trading, will be designated as a financial asset at fair value through profit or loss, if it meets the criteria set out below, and is so designated by management:

- eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring the financial assets or financial liabilities or recognising the gains and losses on them on different bases; or
- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about that group of financial instruments is provided internally on that basis to the key management; or
- relates to financial instruments containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial instruments.

These assets are recognised initially at fair value, with transaction costs taken directly to the consolidated income statement, and are subsequently remeasured at fair value.

Gains and losses from changes in the fair value of such assets (excluding the interest component) are reported in net trading income. The interest component is reported as part of interest income.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.8 Financial assets (continued)

#### (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 an 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. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method less allowances for impairment losses.

#### (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. 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. They are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method less allowances for impairment losses.

#### (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 initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at fair value. Unrealized gains and losses arising from changes in the fair value of investments 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 should be transferred to the consolidated income statement. However, interest which includes the amortisation of premium and discount is calculated using the effective interest method and is recognised in the consolidated income statement. Dividends on equity instruments classified as available-for-sale are recognised in the consolidated income statement when the Group's right to receive payment is established.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.9 Financial liabilities

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. Derivatives are also classified as held for trading unless they are designated as effective hedges. It is measured at fair value and any gains and losses from changes in fair value are recognised in the income statement.

**(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. Financial liabilities so designated include certain certificates of deposit issued and certain deposits received from customers that are embedded with derivatives. A financial liability is typically so designated if it meets the following criteria:

- eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring the financial assets or financial liabilities or recognising the gains and losses on them on different bases; or

- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about that group of financial assets or financial liabilities is provided internally on that basis to the key management; or

- relates to financial instruments containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial instruments.

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

**(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 other liabilities are carried at amortised cost. Any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period using the effective interest method.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.10 Recognition and de-recognition of financial instruments

Purchases and sales of financial assets 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 assets. Loans and receivables (except investment securities without an active market) are recognised when cash is advanced to the borrowers. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Trading liabilities, financial liabilities designated as at fair value through profit or loss and debt securities in issue are recognised on the trade date. Deposits other than trading liabilities are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are de-recognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or expired. If the Group purchases its own debt, it is removed from the balance sheet, and the difference between the carrying amount of a liability and the consideration paid is included in net trading income.

Securities and bills sold to a counter-party with an obligation to repurchase at a pre-determined price on a specified future date under a repurchase agreement are referred to as Repos. Securities and bills purchased from a counter-party with an obligation to re-sell to the counter-party at a pre-determined price on a specified future date under a resale agreement are referred to as Reverse repos.

Repos are initially recorded as due to banks, placements from banks and other financial institutions, as appropriate, at the actual amount of cash received from the counter-party. The financial assets used to collateralise repurchase agreements are recorded as investment securities or financial assets at fair value through profit or loss. Reverse repos are initially recorded in the balance sheet as cash and due from banks or placements with banks and other financial institutions, as appropriate, at the actual amount of cash paid to the counter-party. The financial assets received as collateral under reverse repurchase agreements are not recorded on the balance sheet. The difference between sale and repurchase price is recognised as interest income or interest expense over the life of the agreements using the effective interest method.

### 2.11 Determination of fair value of financial instruments

The fair values of financial assets and financial liabilities that are quoted in active markets are based on current bid prices and current ask prices respectively. If the market for financial assets and financial liabilities is not active (such as 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 Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.12 Impairment of financial assets

**(1) Assets carried at amortised cost**

The Group assesses as of each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets 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 asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payments;

(iii) 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;

(iv) it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets 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.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.12 Impairment of financial assets (continued)

#### (1) Assets carried at amortised cost (continued)

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment together with all other financial assets that are not individually significant or for which impairment has not yet been identified. 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 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 income statement. 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 asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

For the purposes of a collective assessment of impairment, financial assets 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 assets 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. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

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 income statement.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.12 Impairment of financial assets (continued)

**(1) Assets carried at amortised cost (continued)**

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 income statement.

**(2) Assets carried at fair value**

The Group assesses as of each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets 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 assets, 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 asset previously recognised in the consolidated income statement, is removed from equity and recognised in the income statement. 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 income statement, the impairment loss is reversed through the income statement. With respect to equity instruments, such reversals are made through the reserve for fair value change of available-for-sale securities within equity.

### 2.13 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a contract between the holder and the debtor.

Financial guarantees are initially recognised as financial liabilities and reported under "Other accounts and provisions" in the financial statements at fair value on the date that the guarantee was given. Subsequent to initial recognition, the Group's liabilities under such guarantees are measured at the higher of (i) the amount determined in accordance with HKAS37 Provisions, Contingent Liabilities and Contingent Assets and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised over the life of the guarantee on a straight-line basis. Any changes in the liability relating to financial guarantees are taken to the income statement.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

**2.14 Impairment of investment in subsidaries and non-financial assets**

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation, but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

**2.15 Properties, plant and equipment**

**(1) Premises, equipment, fixtures and fittings**

Premises comprise primarily 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 are made when there has been a material change. All equipment, fixtures and fittings are stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditures that are directly attributable to the acquisition and installation of the items.

Subsequent costs are included in an 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 income statement 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 income statement. Any subsequent increases are credited to the income statement 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 valuations is released and transferred from the premises revaluation reserve to retained earnings.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.15 Properties, plant and equipment (continued)

**(1) Premises, equipment, fixtures and fittings (continued)**

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

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

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

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 income statement 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 premises revaluation reserve or income statement as appropriate.

Gains and losses on disposals are determined by comparing proceeds with carrying amount,relevant taxes and expenses. These are included in the income statement.

**(2) Property under development**

Property under development represents assets under construction or being installed and is stated at cost less impairment losses. Cost includes equipment cost, cost of development, construction, 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. Impairment losses or reversals are charged to the income statement.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.16 Investment properties

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' financial statements and as premises in consolidated financial statements. 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 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 income statement during the financial period in which they are incurred.

Any changes in fair value are reported directly in the income statement. 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 revaluation loss or impairment loss, the gain is recognised in the income statement up to the amount previously debited.

### 2.17 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 income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has 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.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.17 Leases (continued)

**(2) Financial leases on properties**

Where the land and buildings elements of leasehold properties held for own use can be split reliably at inception of the lease, leasehold land and land use rights are recognised as operating leases if they have indefinite economic lives. The up-front prepayments made or other costs incurred for acquiring the leasehold land and land use rights are expensed in the income statement 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 income statement immediately. Where the land and buildings cannot be split reliably at inception of the lease, the land and buildings 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.

Pursuant to the Bank of China (Hong Kong) Limited (Merger) Ordinance ("Merger Ordinance") 2001, all assets and liabilities of the designated branches and subsidiaries, and the shares of certain entities of the legacy Bank of China Group in Hong Kong were effectively transferred to Bank of China (Hong Kong) Limited ("BOCHK"), which was immediately owned by the then newly formed BOC Hong Kong (Holdings) Limited ("the Merger"). This was a significant event and the Group has therefore adopted the valuation at the date of the Merger as the deemed cost for its leasehold properties to reflect the circumstances at the time of the Merger.

On adoption of the deemed cost at the date of Merger, the Group made reference to the independent property valuation conducted as at 31 August 2001 for the purpose of the Merger, which did not split the values of the leasehold properties between the land and buildings elements. Any means of subsequent allocation of the valuation of the leasehold properties at the date of Merger between the land and buildings elements would be notional and therefore would not represent reliable information. It is determined that the values of the land and buildings elements of the Group's leasehold properties cannot be reliably split and the leasehold properties are treated as finance leases. The Group has also adopted the revaluation model under HKAS 16 "Property, Plant and Equipment" by which assets held for own use arising under these finance leases are measured at fair value less any accumulated depreciation and impairment losses.

### 2.18 Cash and cash equivalents

For the purpose 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, balances with banks and other financial institutions, treasury bills and notes classified as investment securities and certificates of deposit.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.19 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.

### 2.20 Employee benefits

**(1) Retirement benefit costs**

The Group contributes to defined contribution retirement schemes under either recognised The Occupational Retirement Schemes under Occupational Retirement Schemes Ordinance, Chapter 426 of the Laws of Hong Kong ("ORSO") schemes or Mandatory Provident Fund ("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 income statement as incurred and represent contributions payable by the Group to the schemes. Share of contributions 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.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

### 2.21 Deferred income taxes

Deferred income tax is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. 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.

The principal temporary differences arise from asset impairment provisions, depreciation of property and equipment, revaluation of certain assets including available-for-sale securities and properties, and tax losses carried forward. However, the deferred income tax is not recognised 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 income statement except for deferred income tax relates to fair value re-measurement of available-for-sale investments and revaluation of premises which are charged or credited directly to equity, in which case the deferred income tax is also credited or charged directly to equity and is subsequently recognised in the income statement together with the realisation of the deferred gain and loss.

### 2.22 Repossessed assets

Repossessed 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, repossessed assets are measured at the lower of their cost or net realisable value and are reported as ‘Non-current assets held for sale’ under ‘Other assets’.

# Notes to the Financial Statements (continued)

## 2. Summary of significant accounting policies (continued)

**2.23 Fiduciary activities**

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 and other institutions. These assets and any income or losses arising thereon are excluded from these financial statements, as they are not assets of the Group.

**2.24 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 an 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 financial statements. 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 financial statements when an inflow of economic benefits is probable. When the inflow is virtually certain, it will be recognised as an asset.

**2.25 Related parties**

For the purposes of these financial statments, a party is 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.

# Notes to the Financial Statements (continued)

## 3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that 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, including expectations of future events 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. The effect of changes to either the key assumptions or other estimation uncertainties will be presented below if it is practicable to determine. It is possible that actual results may require material adjustments to the estimates referred to below.

### 3.1 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 income statement, 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 and advances 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), or economic conditions that correlate with defaults on assets in the group. 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 estimating expected 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.

### 3.2 Fair values of financial instruments

The fair values 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 with 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 factors could affect reported fair value of financial instruments.

### 3.3 Held-to-maturity investments

The Group follows the guidance of HKAS 39 in classifying certain non-derivative financial assets 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 hold these investments to maturity other than for specific circumstances defined in HKAS 39, such as selling an insignificant amount close to maturity, it will be required to reclassify the entire portfolio of assets as available-for-sale. The investments would then be measured at fair value and not amortised cost. As at 31 December 2006, the fair value of the entire portfolio of held-to-maturity investments is approximately equal to its amortised cost.

# Notes to the Financial Statements (continued)

## 4. Financial risk management

This note summarises the Group's control of credit risk, market risk, interest rate risk and liquidity risk, and presents financial information about the exposure to the use of financial instruments.

**Credit Risk Management**

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet a commitment it has entered into. Credit Risk Management Division ("CRMD"), provides centralised management of credit risk within the Group. Different credit approval and control procedures are adopted according to the level of risk associated with the customer or transaction. Corporate credit applications and retail credit transactions, including residential mortgage loans and personal loans are independently reviewed and objectively assessed by risk management units.

The Group adopts an eight-grade facility grading structure according to HKMA's loan classification requirement. CRMD provides regular credit management information reports and ad hoc reports to members of EC, RC, AC and Board of Directors.

**Market Risk Management**

Market risk is the risk of loss that results form movements in the market rates and prices. The Group's market risk arises from customer-related business. Market risk is managed within the risk limits approved by the RC. The overall risk limits are divided into sub-limits by reference to different risk factors, including interest rate, foreign exchange rate, commodity price and equity price.

CRMD, Finance Division and Settlement Section are responsible for the regularly oversight of the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a regular basis to ensure that they are within established risk limits.

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

**Interest Rate Risk Management**

The Group's interest rate risk exposures are mainly structural driven. The major types of interest rate risk from structural positions are:

repricing risk – mismatches in the maturity or repricing periods of assets and liabilities

basis risk – different pricing basis for different transactions so that yield on assets and cost of liabilities may change by different amounts within the same repricing period

The Group's Assets and Liabilities Management Committee ("ALCO") maintains oversight of interest rate risk and RC sanctions the interest rate risk management policies formulated by ALCO. The interest rate risk is identified and measured on a regular basis. The Treasury Division manages the interest rate risk according to the established policies. The Finance Division closely monitors the related risks and the results are reported to RC and ALCO regularly.

Gap analysis is one of the tools used to measure the Group's exposure to repricing risk. This provides the Group with a static view of the maturity and repricing characteristics of its balance sheet positions. The Group uses interest rate derivatives to hedge its interest rate exposures and in most cases, plain vanilla interest rate swaps are used.

Sensitivities of earnings and economic value to interest rate changes (Earnings at Risk and Economic Value at Risk) are assessed through hypothetical interest rate shock of 200 basis points across the yield curve on both sides. Earnings at Risk and Economic Value at Risk are controlled respectively within an approved percentage of the projected net interest income for the year and the latest capital base as sanctioned by RC. The results are reported to ALCO and RC on a regular basis.

The impact of basis risk is gauged by the projected change in net interest income under scenarios of imperfect correlation in the adjustment of the rates earned and paid on different instruments. Ratios of assets to liabilities with similar pricing basis are established to monitor such risk.

**Liquidity Risk Management**

The aim of liquidity management is to enable the Group, even under adverse market conditions, to meet all its maturing repayment obligations on time and to fund all of its asset growth and strategic opportunities without forced liquidation of its assets at short notice.

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

**Liquidity Risk Management (continued)**

The Group funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Group may issue certificates of deposit to secure long-term funds. Funding may also be secured through adjusting the asset mix in the Group's investment portfolio. The Group uses the majority of funds raised to extend loans, to purchase debt securities or to conduct interbank placements.

The Group monitors the liquidity risks using cash flow analysis and by examining deposit stability, concentration risk, mismatch ratios, loan-to-deposit ratio and liquidity profile of the investment portfolio. The primary objective of the Group's asset and liability management strategy is to achieve optimal return while ensuring adequate levels of liquidity and capital within an effective risk control framework and ALCO is responsible for establishing these policy directives (including the liquidity contingency plan), and RC sanctions the liquidity management policies. The Treasury Department manages the liquidity risk according to the established policies. The Finance Division monitors the Group's liquidity risks and reports to the management and ALCO regularly.

**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 of 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.

| | **2006** | | | | |
|---|---|---|---|---|---|
| | **Total assets** | **Total liabilities** | **Contingent liabilities and commitments** | **Net operating income before loan impairment allowances** | **Capital expenditure** |
| | **HK$'000** | **HK$'000** | **HK$'000** | **HK$'000** | **HK$'000** |
| **Hong Kong** | **32,553,051** | **28,678,000** | **5,040,065** | **850,120** | **3,914** |
| **Mainland China** | **1,432,743** | **1,364,341** | **705,979** | **81,371** | **612** |
| | **33,985,794** | **30,042,341** | **5,746,044** | **931,491** | **4,526** |

| | 2005 | | | | |
|---|---|---|---|---|---|
| | Total assets | Total liabilities | Contingent liabilities and commitments | Net Operating Income Before Loan Impairment Allowances | Capital expenditure |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| Hong Kong | 29,945,133 | 26,182,672 | 5,446,210 | 713,838 | 8,850 |
| Mainland China | 1,288,013 | 1,259,298 | 449,383 | 52,754 | 1,081 |
| | 31,233,146 | 27,441,970 | 5,895,593 | 766,592 | 9,931 |

# Notes to the Financial Statements (continued)

## 4. 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 HK$ equivalent, categorised by the original currency.

| | 2006 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Renminbi | US Dollars | HK Dollars | EURO | Japanese Yen | Pound Sterling | Others | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| **Assets** | | | | | | | | |
| Cash and balances with banks and other financial institutions | 406,791 | 102,943 | 151,975 | 26,506 | 147,629 | 1,104 | - | 836,948 |
| Placements with banks and other financial institutions | 59,994 | 2,931,246 | 8,097,543 | 33,470 | - | 89,449 | 635,803 | 11,847,505 |
| Other financial assets at fair value through profit or loss | - | 1,132,934 | 88,043 | - | - | - | - | 1,220,977 |
| Derivative financial instruments | - | 2,382 | 123,460 | - | - | - | - | 125,842 |
| Advances and other accounts | 382,062 | 1,477,935 | 9,184,973 | 46,615 | 8,394 | 606 | 639 | 11,101,224 |
| Available-for-sale securities | - | - | 20,609 | 206 | - | - | - | 20,815 |
| Held-to-maturity securities | - | 814,821 | 5,098,355 | - | - | - | 516,583 | 6,429,759 |
| Loans and receivables | - | 559,177 | 141,406 | - | - | - | 117,386 | 817,969 |
| Properties, plant and equipment | - | - | 528,843 | - | - | - | - | 528,843 |
| Investment properties | - | - | 54,540 | - | - | - | - | 54,540 |
| Other assets (including deferred tax assets) | 19,655 | 12,810 | 671,509 | 72,573 | 120,154 | 33,529 | 71,142 | 1,001,372 |
| **Total assets** | 868,502 | 7,034,248 | 24,161,256 | 179,370 | 276,177 | 124,688 | 1,341,553 | 33,985,794 |
| **Liabilities** | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (90,019) | (112,723) | (45,491) | (15,395) | (202,774) | - | (159,466) | (625,868) |
| Other financial liabilities at fair value through profit or loss | - | (1,688,848) | (1,338,085) | - | - | - | - | (3,026,933) |
| Derivative financial instruments | - | (11,829) | (35,181) | - | - | - | - | (47,010) |
| Deposits from customers | (556,882) | (4,553,175) | (17,891,100) | (160,096) | (72,777) | (124,449) | (1,184,216) | (24,542,695) |
| Certificates of deposit issued | - | (187,051) | (105,221) | - | - | - | - | (292,272) |
| Other accounts and provisions (including current and deferred tax liabilities) | (24,170) | (163,755) | (1,319,638) | - | - | - | - | (1,507,563) |
| **Total liabilities** | (671,071) | (6,717,381) | (20,734,716) | (175,491) | (275,551) | (124,449) | (1,343,682) | (30,042,341) |
| **Net on-balance sheet position** | 197,431 | 316,867 | 3,426,540 | 3,879 | 626 | 239 | (2,129) | 3,943,453 |
| **Off-balance sheet net notional position*** | 1,992 | (38,238) | (279,102) | 83,888 | 136,660 | 36,280 | 152,428 | 93,908 |
| **Contingent liabilities and commitments** | 68,352 | 1,414,178 | 4,132,724 | 68,978 | 53,810 | 915 | 7,087 | 5,746,044 |

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

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### B) Currency risk (continued)

| | 2005 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Renminbi | US Dollars | HK Dollars | EURO | Japanese Yen | Pound Sterling | Others | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| **Assets** | | | | | | | | |
| Cash and balances with banks and other financial institutions | 397,961 | 201,817 | 206,667 | 13,280 | 37,487 | 2,778 | 15,757 | 875,747 |
| Placements with banks and other financial institutions | - | 2,001,178 | 6,203,362 | 220,752 | - | 248,661 | 1,616,007 | 10,289,960 |
| Other financial assets at fair value through profit or loss | - | 1,053,272 | 83,845 | - | - | - | - | 1,137,117 |
| Derivative financial instruments | - | 4,488 | 174,955 | - | - | - | - | 179,443 |
| Advances and other accounts | 226,152 | 2,182,066 | 8,261,552 | 44,866 | 173,494 | 2,639 | - | 10,890,769 |
| Available-for-sale securities | - | - | 20,609 | 185 | - | - | 6,158 | 26,952 |
| Held-to-maturity securities | - | 841,650 | 5,629,199 | - | - | - | - | 6,470,849 |
| Loans and receivables | - | - | 316,647 | - | - | - | - | 316,647 |
| Properties, plant and equipment | - | - | 548,573 | - | - | - | - | 548,573 |
| Investment properties | - | - | 53,940 | - | - | - | - | 53,940 |
| Other assets (including deferred tax assets) | 4,225 | 24,529 | 412,610 | 185 | - | - | 1,600 | 443,149 |
| **Total assets** | 628,338 | 6,309,000 | 21,911,959 | 279,268 | 210,981 | 254,078 | 1,639,522 | 31,233,146 |
| **Liabilities** | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (31,268) | (126,444) | (56,354) | (2,382) | (373,923) | (2,331) | (41,098) | (633,800) |
| Other financial liabilities at fair value through profit or loss | - | (1,490,303) | (1,125,906) | - | - | - | - | (2,616,209) |
| Derivative financial instruments | - | (6,982) | (97,554) | -, | - | - | - | (104,536) |
| Deposits from customers | (485,663) | (5,626,864) | (14,834,487) | (210,443) | (56,580) | (158,801) | (1,487,264) | (22,860,102) |
| Certificates of deposit issued | - | (212,968) | (147,880) | - | - | - | - | (360,848) |
| Other accounts and provisions (including current and deferred tax liabilities) | (35,682) | (163,777) | (501,921) | (9,866) | (19,255) | (9,583) | (126,391) | (866,475) |
| **Total liabilities** | (552,613) | (7,627,338) | (16,764,102) | (222,691) | (449,758) | (170,715) | (1,654,753) | (27,441,970) |
| Net on-balance sheet position | 75,725 | (1,318,338) | 5,147,857 | 56,577 | (238,777) | 83,363 | (15,231) | 3,791,176 |
| Off-balance sheet net notional position | 961 | 202,577 | (214,443) | (56,075) | 238,119 | (83,320) | 28,377 | 116,196 |
| Contingent liabilities and commitments | 11,101 | 1,089,014 | 4,679,139 | 55,665 | 43,322 | 916 | 16,436 | 5,895,593 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### 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'.

| | 2006 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 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 balances with banks and other financial institutions | 183,463 | - | - | - | - | 653,485 | 836,948 |
| Placements with banks and other financial institutions | 4,265,080 | 6,183,227 | 1,399,198 | - | - | - | 11,847,505 |
| Other financial assets at fair value through profit or loss | 1,067,652 | 48,255 | 62,099 | 42,971 | - | - | 1,220,977 |
| Derivative financial instruments | - | - | - | - | - | 125,842 | 125,842 |
| Advances and other accounts | 9,934,335 | 676,820 | 150,640 | 256,992 | 82,437 | - | 11,101,224 |
| Available-for-sale securities | - | - | - | - | - | 20,815 | 20,815 |
| Held-to-maturity securities | 1,262,644 | 3,639,046 | 1,178,501 | 349,568 | - | - | 6,429,759 |
| Loans and receivables | - | 103,563 | 714,406 | - | - | - | 817,969 |
| Properties, plant and equipment | - | - | - | - | - | 528,843 | 528,843 |
| Investment properties | - | - | - | - | - | 54,540 | 54,540 |
| Other assets (including deferred tax assets) | - | - | - | - | - | 1,001,372 | 1,001,372 |
| Total assets | 16,713,174 | 10,650,911 | 3,504,844 | 649,531 | 82,437 | 2,384,897 | 33,985,794 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### C) Interest rate risk (continued)

| | 2006 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 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 |
| **Liabilities** | | | | | | | |
| Deposits and balances of banks and other financial institutions | (498,211) | (7,576) | (7,341) | - | - | (112,740) | (625,868) |
| Other financial liabilities at fair value through profit or loss | (1,907,049) | (1,119,884) | - | - | - | - | (3,026,933) |
| Derivative financial instruments | - | - | - | - | - | (47,010) | (47,010) |
| Deposits from customers | (19,239,567) | (2,400,701) | (1,143,703) | (518,845) | (18,383) | (1,221,496) | (24,542,695) |
| Certificates of deposit issued | - | - | - | (292,272) | - | - | (292,272) |
| Other accounts and provisions (including current and deferred tax liabilities) | (343,703) | - | - | - | - | (1,163,860) | (1,507,563) |
| Total liabilities | (21,988,530) | (3,528,161) | (1,151,044) | (811,117) | (18,383) | (2,545,106) | (30,042,341) |
| Interest sensitivity gap | (5,275,356) | 7,122,750 | 2,353,800 | (161,586) | 64,054 | (160,209) | 3,943,453 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### C) Interest rate risk (continued)

| | 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 balances with banks and other financial institutions | 351,563 | - | - | - | - | 524,184 | 875,747 |
| Placements with banks and other financial institutions | 6,153,578 | 3,860,454 | 275,928 | - | - | - | 10,289,960 |
| Other financial assets at fair value through profit or loss | 985,840 | 47,143 | 60,466 | - | 43,668 | - | 1,137,117 |
| Derivative financial instruments | - | - | - | - | - | 179,443 | 179,443 |
| Advances and other accounts | 9,908,276 | 274,068 | 209,234 | 310,193 | 188,998 | - | 10,890,769 |
| Available-for-sale securities | - | - | - | - | - | 26,952 | 26,952 |
| Held-to-maturity securities | 666,276 | 3,327,322 | 1,517,535 | 959,716 | - | - | 6,470,849 |
| Loans and receivables | - | 226,243 | 90,404 | - | - | - | 316,647 |
| Properties, plant and equipment | - | - | - | - | - | 548,573 | 548,573 |
| Investment properties | - | - | - | - | - | 53,940 | 53,940 |
| Other assets (including deferred tax assets) | - | - | - | - | - | 443,149 | 443,149 |
| **Total assets** | 18,065,533 | 7,735,230 | 2,153,567 | 1,269,909 | 232,666 | 1,776,241 | 31,233,146 |
| **Liabilities** | | | | | | | |
| Deposits and balances of banks and other financial institutions | (298,029) | (248,969) | (86,802) | - | - | - | (633,800) |
| 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) |
| Deposits from customers | (16,324,270) | (4,635,163) | (1,338,189) | (515,326) | - | (47,154) | (22,860,102) |
| Certificates of deposit issued | - | - | (68,550) | (292,298) | - | - | (360,848) |
| Other accounts and provisions (including current and deferred tax liabilities) | (334,145) | - | - | - | - | (532,330) | (866,475) |
| **Total liabilities** | (17,944,747) | (4,986,435) | (2,167,146) | (1,659,622) | - | (684,020) | (27,441,970) |
| Interest sensitivity gap | 120,786 | 2,748,795 | (13,579) | (389,713) | 232,666 | 1,092,221 | 3,791,176 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### C) Interest rate risk (continued)

Tables below summarise the effective interest rate by major currencies for monetary financial instruments not carried at fair value through profit or loss subject to interest rate risk as at 31 December:

| | **2006** | | | | | |
|---|---|---|---|---|---|---|
| | **Renminbi** | **US Dollars** | **HK Dollars** | **EURO** | **Japanese Yen** | **Pound Sterling** |
| | **%** | **%** | **%** | **%** | **%** | **%** |
| **Assets** | | | | | | |
| **Cash and balances with banks and other financial institutions** | **1.14** | **1.23** | **1.07** | **0.31** | **-** | **-** |
| **Placements with banks and other financial institutions** | **2.16** | **5.34** | **4.06** | **3.72** | **-** | **5.23** |
| **Advances and other accounts** | **6.12** | **6.97** | **5.55** | **5.18** | **4.63** | **-** |
| **Held-to-maturity securities** | **-** | **4.22** | **3.73** | **-** | **-** | **-** |
| **Loans and receivables** | **-** | **5.27** | **4.00** | **-** | **-** | **-** |
| **Liabilities** | | | | | | |
| **Deposits and balances of banks and other financial institutions** | **2.56** | **1.95** | **3.11** | **-** | **0.40** | **-** |
| **Deposits from customers** | **0.99** | **4.06** | **3.22** | **2.43** | **-** | **3.84** |

| | 2005 | | | | | |
|---|---|---|---|---|---|---|
| | Renminbi | US Dollars | HK Dollars | EURO | Japanese Yen | Pound Sterling |
| | % | % | % | % | % | % |
| **Assets** | | | | | | |
| Cash and balances with banks and other financial institutions | 1.38 | 2.07 | 2.02 | - | - | - |
| Placements with banks and other financial institutions | - | 4.22 | 4.18 | 2.43 | - | 4.60 |
| Advances and other accounts | 3.35 | 7.84 | 5.79 | 4.02 | 3.35 | 9.18 |
| Held-to-maturity securities | - | 3.00 | 2.85 | - | - | - |
| Loans and receivables | - | - | 2.43 | - | - | - |
| **Liabilities** | | | | | | |
| Deposits and balances of banks and other financial institutions | 0.53 | 2.50 | 2.79 | - | 0.28 | - |
| Deposits from customers | 0.85 | 1.95 | 2.54 | 0.94 | - | 2.58 |

# Notes to the Financial Statements (continued)

## 4. 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.

| | 2006 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | On demand | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Undated | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| **Assets** | | | | | | | | |
| Cash and balances with banks and other financial institutions | 836,948 | - | - | - | - | - | - | 836,948 |
| Placements with banks and other financial institutions | - | 4,265,080 | 6,183,227 | 1,399,198 | - | - | - | 11,847,505 |
| Other financial assets at fair value through profit or loss – debt securities - certificates of deposit held | - | - | - | - | 333,254 | - | - | 333,254 |
| - others | - | - | - | 22,486 | 563,592 | 301,645 | - | 887,723 |
| Derivative financial instruments | 108,565 | 326 | 113 | 1,529 | 15,309 | - | - | 125,842 |
| Advances and other accounts – advances to customers | 1,139,102 | 785,615 | 843,091 | 1,474,622 | 3,044,707 | 3,606,068 | 112,621 | 11,005,826 |
| – trade bills | - | 62,861 | 20,320 | 12,217 | - | - | - | 95,398 |
| Available-for-sale securities – equity securities | - | - | - | - | - | - | 20,815 | 20,815 |
| Held-to-maturity securities – debt securities - certificates of deposit held | - | - | 186,393 | 395,321 | 57,121 | - | - | 638,835 |
| - others | - | 99,847 | 1,609,891 | 933,066 | 3,148,120 | - | - | 5,790,924 |
| Loans and receivables | - | - | 103,563 | 714,406 | - | - | - | 817,969 |
| Properties, plant and equipment | - | - | - | - | - | - | 528,843 | 528,843 |
| Investment properties | - | - | - | - | - | - | 54,540 | 54,540 |
| Other assets (including deferred tax assets) | 886,743 | 20,397 | - | 85,106 | 4,474 | - | 4,652 | 1,001,372 |
| Total assets | 2,971,358 | 5,234,126 | 8,946,598 | 5,037,951 | 7,166,577 | 3,907,713 | 721,471 | 33,985,794 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### D) Liquidity risk (continued)

| | 2006 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | On demand | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Undated | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| **Liabilities** | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (251,621) | (359,330) | (7,576) | (7,341) | - | - | - | (625,868) |
| Other financial liabilities at fair value through profit or loss | - | (149,511) | (354,197) | (763,515) | (1,458,065) | (301,645) | - | (3,026,933) |
| Derivative financial instruments | (14,817) | (563) | (1,902) | (7,601) | (22,127) | - | - | (47,010) |
| Deposits from customers | (12,317,632) | (8,143,431) | (2,400,701) | (1,143,703) | (518,845) | (18,383) | - | (24,542,695) |
| Certificates of deposit issued | - | - | - | - | (292,272) | - | - | (292,272) |
| Other accounts and provisions (including current and deferred tax liabilities) | (1,150,466) | (41,300) | (229,864) | (24,288) | (61,645) | - | - | (1,507,563) |
| Total liabilities | (13,734,536) | (8,694,135) | (2,994,240) | (1,946,448) | (2,352,954) | (320,028) | - | (30,042,341) |
| Net liquidity gap | (10,763,178) | (3,460,009) | 5,952,358 | 3,091,503 | 4,813,623 | 3,587,685 | 721,471 | 3,943,453 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### D) Liquidity risk (continued)

| | 2005 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | On demand | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Undated | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| **Assets** | | | | | | | | |
| Cash and balances with banks and other financial institutions | 875,747 | - | - | - | - | - | - | 875,747 |
| Placements with banks and other financial institutions | - | 6,153,578 | 3,860,454 | 275,928 | - | - | - | 10,289,960 |
| Other financial assets at fair value through profit or loss | | | | | | | | |
| – debt securities | | | | | | | | |
| - certificates of deposit held | - | - | - | - | 275,008 | 47,143 | - | 322,151 |
| - others | - | - | - | - | 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 |
| – trade bills | - | 142,559 | 593,447 | 52,618 | - | - | - | 788,624 |
| Available-for-sale securities | | | | | | | | |
| – equity securities | - | - | - | - | - | - | 26,952 | 26,952 |
| Held-to-maturity securities | | | | | | | | |
| – debt securities | | | | | | | | |
| - certificates of deposit held | - | - | 706,123 | 376,119 | 529,253 | - | - | 1,611,495 |
| - others | - | - | 1,194,844 | 547,207 | 3,117,303 | - | - | 4,859,354 |
| Loans and receivables | - | - | 226,243 | 90,404 | - | - | - | 316,647 |
| Properties, plant and equipment | - | - | - | - | - | - | 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) |
| Other financial liabilities at fair value through profit or loss | - | - | (55,044) | (612,984) | (1,385,783) | (562,398) | - | (2,616,209) |
| Derivative financial instruments | - | (365) | (53,568) | (11,314) | (35,354) | (3,935) | - | (104,536) |
| Deposits from customers | (9,682,748) | (6,688,676) | (4,635,163) | (1,338,189) | (515,326) | - | - | (22,860,102) |
| Certificates of deposit issued | - | - | - | (67,734) | (293,114) | - | - | (360,848) |
| Other accounts and provisions (including current and deferred tax liabilities) | (706,772) | (516) | - | (96,984) | (62,203) | - | - | (866,475) |
| **Total liabilities** | (10,545,219) | (6,831,887) | (4,992,744) | (2,214,007) | (2,291,780) | (566,333) | - | (27,441,970) |
| Net liquidity gap | (8,180,960) | 115,781 | 2,510,465 | 369,104 | 4,997,394 | 3,288,416 | 690,976 | 3,791,176 |

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

### D) Liquidity risk (continued)

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 installments, 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 after 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.

### E) Fair values of financial assets and liabilities

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

<u>Balances with banks and other financial institutions and Trade bills</u>

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

<u>Advances to customers, banks and other financial institution</u>

Substantially all the advances to customers, banks and other financial institution are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value.

<u>Held-to-maturity securities</u>

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. Their carrying value approximates fair value.

<u>Loans and receivables and Certificates of deposit issued</u>

A discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity and their carrying value approximates fair value.

# Notes to the Financial Statements (continued)

## 4. Financial risk management (continued)

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

Deposits from customers

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

### 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 financial statements. As at 31 December 2006, the Group had a balance of securities custody accounts amounting to approximately HK$10,399,972,000 (2005: HK$8,181,568,000).

# Notes to the Financial Statements (continued)

## 5. Net interest income

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| **Interest income** | | |
| Cash and due from banks and other financial institutions | **598,655** | 370,431 |
| Advances to customers | **703,876** | 433,703 |
| Listed investments | **3,293** | 7,312 |
| Unlisted investments | **237,686** | 194,488 |
| Others | **9,088** | 11,856 |
| | **1,552,598** | 1,017,790 |
| **Interest expense** | | |
| Due to banks, customers and other financial institutions | **(822,140)** | (438,893) |
| Debt securities in issue | **(10,354)** | (10,660) |
| Others | **(45,507)** | (11,552) |
| | **(878,001)** | (461,105) |
| **Net interest income** | **674,597** | 556,685 |

Included within interest income is HK$5,810,000 (2005: HK$2,900,000) of interest with respect to income (Note 27) recognised on advances classified as impaired for the year ended 31 December 2006.

Included within interest income and interest expense are HK$1,499,831,000 (2005: HK$983,733,000) and HK$788,221,000 (2005: HK$401,120,000) for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

## 6. Net fees and commission income

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| **Fees and commission income** | | |
| Securities brokerage | **103,206** | 64,423 |
| Credit cards | **118** | 143 |
| Bills commissions | **38,867** | 40,019 |
| Loan commissions | **13,913** | 13,203 |
| Payment services | **18,236** | 15,478 |
| Insurance | **11,135** | 10,157 |
| Asset management | **12,602** | 5,762 |
| Guarantees | **1,465** | 1,704 |
| Others | | |
| - safe deposit box | **9,787** | 9,510 |
| - currency exchange | **298** | 313 |
| - low deposit balance accounts | **1,691** | 1,818 |
| - BOC cards | **1,086** | 1,196 |
| - dormant accounts | **974** | 951 |
| - agency services | **484** | 348 |
| - postage and telegrams | **1,674** | 1,138 |
| - information search | **1,538** | 1,671 |
| - correspondent banking | **2,138** | 2,005 |
| - sundries | **17,902** | 24,850 |
| | **237,114** | 194,689 |
| **Fees and commission expenses** | **(41,220)** | (30,312) |
| **Net fees and commission income** | **195,894** | 164,377 |

# Notes to the Financial Statements (continued)

## 7. Net trading income

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net gain/(loss) from: | | |
| - foreign exchange and foreign exchange products | **49,917** | 34,672 |
| - interest rate instruments | **(1,028)** | 2,787 |
| | **48,889** | 37,459 |

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

## 8. Net gain on disposal of subsidiary

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net gain on disposal of subsidiary | **-** | 4,853 |

## 9. Net gain on investments in securities

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net gain on disposal of available-for-sale securities | **6,470** | - |

## 10. Other operating income

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Dividend income from investments in securities | | |
| - listed investments | **144** | 138 |
| - unlisted investments | **1,762** | 956 |
| Gross rental income from investment properties | **2,335** | 1,774 |
| Less: Outgoings in respect of investment properties | **(39)** | (74) |
| Others | **1,439** | 424 |
| | **5,641** | 3,218 |

No direct operating expenses related to investment properties that were not let during the year is included in the "Outgoings in respect of investment properties" (2005: Nil).

# Notes to the Financial Statements (continued)

## 11. (Charge)/reversal of loan impairment allowances

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net (charge)/reversal of loan impairment allowances | | |
| - Individually assessed (Note 27) | **(1,914)** | 21,925 |
| - Collectively assessed (Note 27) | **(31,091)** | 7,946 |
| | **(33,005)** | 29,871 |
| Of which | | |
| - new allowances | **(92,145)** | (10,182) |
| - releases | **17,945** | 26,379 |
| - recoveries (Note 27) | **41,195** | 13,674 |
| Net (charge)/credit to income statement (Note 27) | **(33,005)** | 29,871 |

## 12. Operating expenses

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Staff costs (including Directors' emoluments) | | |
| - salaries and other costs | **135,595** | 124,421 |
| - termination benefit | **-** | 136 |
| - pension cost | **10,901** | 11,082 |
| | **146,496** | 135,639 |
| Premises and equipment expenses (excluding depreciation) | | |
| - rental of premises | **14,267** | 13,744 |
| - information technology | **23,807** | 22,904 |
| - others | **4,348** | 4,132 |
| | **42,422** | 40,780 |
| Depreciation | **12,223** | 11,654 |
| Auditors' remuneration | | |
| - audit services | **2,846** | 2,885 |
| - non-audit services | **103** | 104 |
| Other operating expenses | **26,322** | 28,298 |
| | **230,412** | 219,360 |

## 13. Net gain on disposal/revaluation of properties, plant and equipment

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net gain on disposal of premises | **9,721** | 134 |
| Net loss from disposal of other fixed assets | **(5)** | (41) |
| Reversal of impairment losses on premises (Note 32) | **138** | 6,647 |
| Impairment losses on other fixed assets (Note 32) | **(3,510)** | (1,300) |
| | **6,344** | 5,440 |

# Notes to the Financial Statements (continued)

## 14. Net gain on fair value adjustments on investment properties

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net gain on fair value adjustments on investment properties (Note 33) | **600** | 8,250 |

## 15. Taxation

Taxation in the income statement represents:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Hong Kong profits tax | | |
| - current year taxation | **110,166** | 92,443 |
| - over-provision in prior years | **-** | (5,500) |
| Deferred tax (credit)/charge | **(5,226)** | 2,776 |
| | **104,940** | 89,719 |
| Attributable share of estimated Hong Kong profits tax losses arising from investments in partnerships | **-** | (1,005) |
| | **104,940** | 88,714 |
| Investments in partnerships written off | **-** | 910 |
| Hong Kong profits tax | **104,940** | 89,624 |
| Overseas taxation | **10,260** | 7,002 |
| | **115,200** | 96,626 |

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 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 no outstanding investments in aircraft leasing and coupon strip transactions involving special purpose partnerships as at 31 December 2006 (2005: HK$49,412,000).

# Notes to the Financial Statements (continued)

## 15. Taxation (continued)

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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Profit before taxation | **675,018** | 590,793 |
| Calculated at a taxation rate of 17.5% (2005: 17.5%) | **118,128** | 103,389 |
| Effect of different taxation rates in other countries | **(2,821)** | 808 |
| Income not subject to taxation | **(3,967)** | (6,259) |
| Expenses not deductible for taxation purposes | **3,860** | 4,283 |
| Tax benefits from partnership | **-** | (95) |
| Over-provision in prior years | **-** | (5,500) |
| Taxation charge | **115,200** | 96,626 |
| Effective tax rate | **17.07%** | 16.36% |

## 16. Profit attributable to equity holders of the Bank

The profit of the Bank for the year ended 31 December 2006 attributable to equity holders of the Bank and dealt with in the financial statements of the Bank amounted to HK$555,972,000 (2005: HK$489,876,000).

## 17. Dividends

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Per share HK$** | **Total HK$'000** | Per share HK$ | Total HK$'000 |
| First interim dividend paid | **66** | **198,000** | 56 | 168,000 |
| Second interim dividend paid | **70** | **210,000** | 69 | 207,000 |
| | **136** | **408,000** | 125 | 375,000 |

At a meeting held on 20 June 2006, the Board declared a first interim dividend of HK$66 per ordinary share for the first half of 2006 amounting to approximately HK$198,000,000.

At a meeting held on 20 December 2006, the Board declared a second interim dividend of HK$70 per ordinary share for second half of 2006 amounting to approximately HK$210,000,000.

# Notes to the Financial Statements (continued)

## 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 2006 amounted to approximately HK$9,334,216 (2005: approximately HK$9,163,000), after a deduction of forfeited contributions of approximately HK$655,121 (2005: approximately HK$962,000). For the MPF Scheme, the Group contributed approximately HK$700,752 (2005: approximately HK$412,000) for the year ended 31 December 2006.

## 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, BOC Hong Kong (Holdings) Limited ("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.

# Notes to the Financial Statements (continued)

## 19. Share option schemes (continued)

### (a) Share Option Scheme and Sharesave Plan (continued)

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 2006 (2005: 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 granted to employees on or before 7 November 2002.

Details of the share options outstanding as at 31 December 2006 are disclosed as follows:

| | **Total number of share options to Directors of the Group** | **Average Exercise price (HK$ per share)** |
|---|---|---|
| **At 1 January 2006** | **2,019,800** | **8.5** |
| **Less: Share options exercised during the year** | **(485,500)** | **8.5** |
| **At 31 December 2006** | **1,534,300** | **8.5** |
| **Exercisable at 31 December 2006** | **1,534,300** | **8.5** |

| | Total number of share options to Directors of the Group | Average Exercise price (HK$ per share) |
|---|---|---|
| At 1 January 2005 | 2,572,800 | 8.5 |
| Less: Share options exercised during the year | (553,000) | 8.5 |
| At 31 December 2005 | 2,019,800 | 8.5 |
| Exercisable at 31 December 2005 | 1,106,600 | 8.5 |

# Notes to the Financial Statements (continued)

## 19. Share option schemes (continued)

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

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK$16.39 (2005: HK$14.98).

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

Details 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 Bank during the year are as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Fees | **910** | 910 |
| Other emoluments | | |
| - basis salaries and allowances | **2,562** | 3,159 |
| - discretionary bonuses | **587** | 328 |
| - others (including pension contributions) | **524** | 442 |
| | **4,583** | 4,839 |

Fees of HK$140,000 (2005: HK$140,000) were paid to the Independent Non-Executive Directors during the year.

In July 2002, options were granted to several Directors of the Group by the 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, options to purchase 485,500 shares (2005: 553,000 shares) of BOCHKHL were exercised by certain directors and no benefits arising from the granting of these share options were included in the Directors' emoluments disclosed above or recognised in the income statement.

# Notes to the Financial Statements (continued)

## 21. Cash and balances with banks and other financial institutions

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Cash | **139,937** | 114,902 |
| Balances with banks and other financial institutions | **697,011** | 760,845 |
| | **836,948** | 875,747 |

## 22. Placements with banks and other financial institutions

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Placements with banks and other financial institutions maturing within one month | **4,265,080** | 6,153,578 |
| Placements with banks and other financial institutions maturing between one and twelve months | **7,582,425** | 4,136,382 |
| | **11,847,505** | 10,289,960 |

## 23. Cash and short-term funds

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Cash and balances with banks and other financial institutions (Note 21) | **836,948** | 875,747 |
| Placements with banks and other financial institutions maturing within one month (Note 22) | **4,265,080** | 6,153,578 |
| | **5,102,028** | 7,029,325 |

# Notes to the Financial Statements (continued)

## 24. Other financial assets at fair value through profit or loss

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| At fair value | | |
| Debt securities | | |
| - Unlisted | **1,220,977** | 1,137,117 |

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

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Central governments and central banks | **42,971** | 43,668 |
| Banks and other financial institutions | **1,178,006** | 1,093,449 |
| | **1,220,977** | 1,137,117 |

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

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Certificates of deposit held | **333,254** | 322,151 |
| Other financial assets at fair value through profit or loss | **887,723** | 814,966 |
| | **1,220,977** | 1,137,117 |

# Notes to the Financial Statements (continued)

## 25. 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 forwards represent commitments to purchase and sell foreign currency on a future date.

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 prices 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 Financial Statements (continued)

## 25. Derivative financial instruments (continued)

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

| | The Group and the Bank | | | |
|---|---|---|---|---|
| | **2006** | | 2005 | |
| | **Trading** | **Total** | Trading | Total |
| | **HK$'000** | **HK$'000** | HK$'000 | HK$'000 |
| Exchange rate contracts | | | | |
| Spot and forward | **1,822,498** | **1,822,498** | 3,728,130 | 3,728,130 |
| Foreign currency option contracts | | | | |
| - Options purchased | **22,804** | **22,804** | 17,371 | 17,371 |
| - Options written | **22,804** | **22,804** | 17,371 | 17,371 |
| | **1,868,106** | **1,868,106** | 3,762,872 | 3,762,872 |
| Interest rate contracts | | | | |
| Swaps | **2,222,163** | **2,222,163** | 1,915,988 | 1,915,988 |
| Equity contracts | | | | |
| Equity option contracts | | | | |
| - Options purchased | **17,894** | **17,894** | 23,065 | 23,065 |
| - Options written | **17,894** | **17,894** | 23,065 | 23,065 |
| | **35,788** | **35,788** | 46,130 | 46,130 |
| Total | **4,126,057** | **4,126,057** | 5,724,990 | 5,724,990 |

# Notes to the Financial Statements (continued)

## 25. Derivative financial instruments (continued)

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

| | The Group and the Bank | | | |
|---|---|---|---|---|
| | **2006** | | 2005 | |
| | **Trading** | **Total** | Trading | Total |
| | **HK$'000** | **HK$'000** | HK$'000 | HK$'000 |
| **Fair value assets** | | | | |
| Exchange rate contracts | **108,957** | **108,957** | 169,828 | 169,828 |
| Interest rate contracts | **16,838** | **16,838** | 9,519 | 9,519 |
| Equity contracts | **47** | **47** | 96 | 96 |
| | **125,842** | **125,842** | 179,443 | 179,443 |
| **Fair value liabilities** | | | | |
| Exchange rate contracts | **(15,087)** | **(15,087)** | (53,633) | (53,633) |
| Interest rate contracts | **(31,876)** | **(31,876)** | (50,807) | (50,807) |
| Equity contracts | **(47)** | **(47)** | (96) | (96) |
| | **(47,010)** | **(47,010)** | (104,536) | (104,536) |

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:

| | The Group and the Bank | | | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | Credit risk weighted amount | | Replacement cost | |
| | **HK$'000** | HK$'000 | **HK$'000** | HK$'000 |
| Exchange rate contracts | **92** | - | **226** | 67 |
| Interest rate contracts | **1,246** | 1,290 | **3,354** | 613 |
| Equity contracts | **-** | - | **47** | 96 |
| | **1,338** | 1,290 | **3,627** | 776 |

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.

Approximately 60% (2005: 36%) of the Group's and the Bank's transactions in derivative financial instruments contracts are conducted with other financial institutions.

# Notes to the Financial Statements (continued)

## 26. Advances and other accounts

| | The Group | | The Bank | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **HK$'000** | HK$'000 | **HK$'000** | HK$'000 |
| Corporate loans and advances | **7,282,008** | 7,090,910 | **7,282,008** | 7,091,189 |
| Personal loans and advances | **3,771,492** | 3,063,441 | **3,771,492** | 3,063,441 |
| | **11,053,500** | 10,154,351 | **11,053,500** | 10,154,630 |
| Advances to customers | | | | |
| Loan impairment allowances | | | | |
| - Individually assessed (Note 27) | **(7,525)** | (41,918) | **(7,525)** | (41,918) |
| - Collectively assessed (Note 27) | **(40,149)** | (10,288) | **(40,149)** | (10,288) |
| | **(47,674)** | (52,206) | **(47,674)** | (52,206) |
| Trade bills | **95,398** | 788,624 | **95,398** | 788,624 |
| Total | **11,101,224** | 10,890,769 | **11,101,224** | 10,891,048 |

As at 31 December 2006, advances to customers of the Group and the Bank include accrued interest on gross advances of HK$36,423,000 (2005: HK$31,633,000).

Impaired advances to customers are analysed as follows**:**

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Gross impaired advances to customers | **27,152** | 91,804 |
| Loan impairment allowances made in respect of such advances | **7,525** | 41,918 |
| Gross impaired advances to customers as a percentage of gross advances to customers | **0.25%** | 0.90% |

Impaired advances to customers are individually assessed loans with objective evidence of impairment. The loan impairment allowances were made after taking into account the value of collateral in respect of such advances.

As at 31 December 2005 and 31 December 2006, no impairment allowance was made in respect of trade bills and advances to banks and other financial institutions.

Classified advances to customers are analysed as follows**:**

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Gross classified advances to customers | **37,440** | 103,028 |
| Gross classified advances to customers as a percentage of gross advances to customers | **0.34%** | 1.01% |

Classified advances to customers included "substandard", "doubtful" and "loss" under the Group's classification of loan quality.

# Notes to the Financial Statements (continued)

## 27. Loan impairment allowances

| | The Group and the Bank | | |
|---|---|---|---|
| | 2006 | | |
| | **Individual assessment** | **Collective assessment** | **Total** |
| | **HK$'000** | **HK$'000** | **HK$'000** |
| At 1 January 2006 | **41,918** | **10,288** | **52,206** |
| Charged to income statement (Note 11) | **1,914** | **31,091** | **33,005** |
| Loans written off during the year as uncollectible | **(72,922)** | **-** | **(72,922)** |
| Recoveries (Note 11) | **41,195** | **-** | **41,195** |
| Unwinding of discount on allowance | **(4,580)** | **(1,230)** | **(5,810)** |
| At 31 December 2006 | **7,525** | **40,149** | **47,674** |

| | The Group and the Bank | | |
|---|---|---|---|
| | 2005 | | |
| | Individual assessment | Collective assessment | Total |
| | HK$'000 | HK$'000 | HK$'000 |
| At 1 January 2005 | 84,012 | 18,864 | 102,876 |
| Credited to income statement (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 |
| Unwinding of discount on allowance | (2,480) | (420) | (2,900) |
| At 31 December 2005 | 41,918 | 10,288 | 52,206 |

# Notes to the Financial Statements (continued)

## 28. Available-for-sale securities

| | The Group | | The Bank | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **HK$'000** | HK$'000 | **HK$'000** | HK$'000 |
| Equity securities | | | | |
| - Listed outside Hong Kong | **-** | 6,158 | **-** | 6,158 |
| - Unlisted | **20,815** | 20,794 | **566** | 545 |
| Total | **20,815** | 26,952 | **566** | 6,703 |

Available-for-sale securities are analysed by type of issuer as follows:

| | | | | |
|---|---|---|---|---|
| Banks and other financial institutions | **-** | 6,158 | **-** | 6,158 |
| Corporate entities | **20,815** | 20,794 | **566** | 545 |
| | **20,815** | 26,952 | **566** | 6,703 |

The movements in available-for-sale securities are summarised as follows:

| | The Group | | The Bank | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **HK$'000** | HK$'000 | **HK$'000** | HK$'000 |
| At 1 January | **26,952** | 37,609 | **6,703** | 17,360 |
| Disposals and redemptions | **(6,158)** | (10,542) | **(6,158)** | (10,542) |
| Changes in fair value | **-** | 697 | **-** | 697 |
| Exchange differences | **21** | (812) | **21** | (812) |
| At 31 December | **20,815** | 26,952 | **566** | 6,703 |

Available-for-sale securities are analysed as follows:

| | | | | |
|---|---|---|---|---|
| Other available-for-sale securities | **20,815** | 26,952 | **566** | 6,703 |

# Notes to the Financial Statements (continued)

## 29. Held-to-maturity securities

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Listed, at amortised cost | | |
| - in Hong Kong | **-** | 306,783 |
| - outside Hong Kong | **78,356** | 78,237 |
| | **78,356** | 385,020 |
| Unlisted, at amortised cost | **6,351,403** | 6,085,829 |
| Total | **6,429,759** | 6,470,849 |
| Market value of listed securities | **78,070** | 377,413 |

Held-to-maturity securities are analysed by type of issuer as follows:

| | | |
|---|---|---|
| Central governments and central banks | **99,847** | 306,783 |
| Public sector entities | **702,818** | 596,635 |
| Banks and other financial institutions | **5,627,094** | 5,567,431 |
| | **6,429,759** | 6,470,849 |

The movements in held-to-maturity securities are summarised as follows:

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| At 1 January | **6,470,849** | 6,683,000 |
| Additions | **4,675,347** | 2,641,040 |
| Redemptions and maturity | **(4,748,956)** | (2,845,846) |
| Amortisation | **2,112** | (4,682) |
| Exchange differences | **30,407** | (2,663) |
| At 31 December | **6,429,759** | 6,470,849 |

Held-to-maturity securities are analysed as follows:

| | | |
|---|---|---|
| Treasury bills | **99,847** | - |
| Certificates of deposit held | **638,835** | 1,611,495 |
| Other held-to-maturity securities | **5,691,077** | 4,859,354 |
| | **6,429,759** | 6,470,849 |

# Notes to the Financial Statements (continued)

## 30. Loans and receivables

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Unlisted, at amortised cost | **817,969** | 316,647 |

Loans and receivables are analysed by type of issuer as follows:

| | | |
|---|---|---|
| Banks and other financial institutions | **817,969** | 316,647 |

The movements in loans and receivables are summarised as follows:

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| At 1 January | **316,647** | - |
| Additions | **803,782** | 310,941 |
| Redemption and maturity | **(318,500)** | - |
| Amortisation | **10,483** | 5,706 |
| Exchange differences | **5,557** | - |
| At 31 December | **817,969** | 316,647 |

# Notes to the Financial Statements (continued)

## 31. Investment in subsidiaries

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Unlisted shares, at cost | **3,913** | 3,913 |
| Amount due from subsidiaries (Note) | **33,296** | 33,605 |
| | **37,209** | 37,518 |

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

The following is a list of subsidiaries as at 31 December 2006:

| 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 share of US$1 each | 100% | Investment holding |
| Glory Cardinal Limited | Hong Kong | 2 shares of HK$1 each | *100% | Investment holding |
| Glister Company Limited | Hong Kong | 2 shares of HK$1 each | *100% | Investment holding |
| Grace Charter Limited | Hong Kong | 2 shares of HK$1 each | *100% | Investment holding |

* Shares held indirectly by the Bank

# Notes to the Financial Statements (continued)

## 32. Properties, plant and equipment

| | The Group | | | |
|---|---|---|---|---|
| | **Premises** | **Property under development** | **Equipment, fixtures and fittings** | **Total** |
| | **HK$'000** | **HK$'000** | **HK$'000** | **HK$'000** |
| **Net book value at 1 January 2006** | **509,530** | **10,670** | **28,373** | **548,573** |
| **Additions** | **-** | **-** | **4,526** | **4,526** |
| **Disposals** | **(6,796)** | **(7,160)** | **(4)** | **(13,960)** |
| **Revaluation** | **5,437** | **-** | **-** | **5,437** |
| **Depreciation for the year** | **(5,601)** | **-** | **(6,622)** | **(12,223)** |
| **Provision for impairment losses (Note 13)** | **-** | **(3,510)** | **-** | **(3,510)** |
| **Net book value at 31 December 2006** | **502,570** | **-** | **26,273** | **528,843** |
| **At 31 December 2006** | | | | |
| **Cost or valuation** | **502,570** | **-** | **96,224** | **598,794** |
| **Accumulated depreciation and impairment** | **-** | **-** | **(69,951)** | **(69,951)** |
| **Net book value at 31 December 2006** | **502,570** | **-** | **26,273** | **528,843** |

| | The Group | | | |
|---|---|---|---|---|
| | Premises | Property under development | Equipment, fixtures and fittings | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'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 33) | (25,000) | - | - | (25,000) |
| Provision for impairment losses (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 analysis of cost or valuation of the above assets is as follows:

| | | | | |
|---|---|---|---|---|
| **At 31 December 2006** | | | | |
| **At cost** | **-** | **-** | **96,224** | **96,224** |
| **At valuation** | **502,570** | **-** | **-** | **502,570** |
| | **502,570** | **-** | **96,224** | **598,794** |
| 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 |

# Notes to the Financial Statements (continued)

## 32. Properties, plant and equipment (continued)

| | The Bank | | |
|---|---|---|---|
| | **Premises** | **Equipment, fixtures and fittings** | **Total** |
| | **HK$'000** | **HK$'000** | **HK$'000** |
| **Net book value at 1 January 2006** | **506,630** | **28,373** | **535,003** |
| **Additions** | **-** | **4,526** | **4,526** |
| **Disposals** | **(6,796)** | **(4)** | **(6,800)** |
| **Revaluation** | **5,065** | **-** | **5,065** |
| **Depreciation for the year** | **(5,529)** | **(6,622)** | **(12,151)** |
| **Net book value at 31 December 2006** | **499,370** | **26,273** | **525,643** |
| **At 31 December 2006** | | | |
| **Cost or valuation** | **499,370** | **96,224** | **595,594** |
| **Accumulated depreciation and impairment** | **-** | **(69,951)** | **(69,951)** |
| **Net book value at 31 December 2006** | **499,370** | **26,273** | **525,643** |

| | 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 (Note33) | (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 analysis of cost or valuation of the above assets is as follows:

| | Premises | Equipment, fixtures and fittings | Total |
|---|---|---|---|
| **At 31 December 2006** | | | |
| **At cost** | **-** | **96,224** | **96,224** |
| **At valuation** | **499,370** | **-** | **499,370** |
| | **499,370** | **96,224** | **595,594** |
| At 31 December 2005 | | | |
| At cost | - | 93,247 | 93,247 |
| At valuation | 506,630 | - | 506,630 |
| | 506,630 | 93,247 | 599,877 |

# Notes to the Financial Statements (continued)

## 32. Properties, plant and equipment (continued)

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

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Held in Hong Kong | | |
| On long-term lease (over 50 years) | **338,220** | 341,740 |
| On medium-term lease (10 – 50 years) | **153,840** | 157,710 |
| Held outside Hong Kong | | |
| On long-term lease (over 50 years) | **9,130** | 8,580 |
| On medium-term lease (10 – 50 years) | **1,380** | 1,500 |
| | **502,570** | 509,530 |

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Held in Hong Kong | | |
| On long-term lease (over 50 years) | **338,220** | 341,740 |
| On medium-term lease (10 – 50 years) | **150,640** | 154,810 |
| Held outside Hong Kong | | |
| On long-term lease (over 50 years) | **9,130** | 8,580 |
| On medium-term lease (10 – 50 years) | **1,380** | 1,500 |
| | **499,370** | 506,630 |

As at 31 December 2006, premises are included in the consolidated balance sheet at valuation carried out at 31 October 2006 on the basis of their open market value by an independent firm of chartered surveyors, Knight Frank Petty Limited (formerly known as Chesterton Petty Limited). Knight Frank Petty Limited also confirmed that there has been no material change in valuations at 31 December 2006.

As a result of the above-mentioned revaluations, changes in value of the Group's and the Bank's premises were recognised in the Group's and the Bank's premises revaluation reserves, the income statement and minority interests respectively as follows:

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Increase in valuation credited to premises revaluation reserve | **5,299** | 96,645 |
| Increase in valuation credited to income statement (Note 13) | **138** | 6,647 |
| | **5,437** | 103,292 |

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Increase in valuation credited to premises revaluation reserve | **5,065** | 96,645 |
| Increase in valuation credited to income statement | **-** | 5,896 |
| | **5,065** | 102,541 |

# Notes to the Financial Statements (continued)

## 32. Properties, plant and equipment (continued)

As at 31 December 2006, 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$168,709,000(2005: HK$173,000,000).

## 33. Investment properties

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| At 1 January | **53,940** | 20,690 |
| Fair value gains (Note 14) | **600** | 8,250 |
| Reclassification from properties, plant and equipment (Note 32) | **-** | 25,000 |
| At 31 December | **54,540** | 53,940 |

As at 31 December 2006, investment properties are included in the consolidated balance sheet at valuation carried out at 31 October 2006 on the basis of their open market value by an independent firm of chartered surveyors, Knight Frank Petty Limited. Knight Frank Petty Limited also confirmed that there has been no material change in valuations at 31 December 2006.

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

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Held in Hong Kong | | |
| On long-term lease (over 50 years) | **50,920** | 50,000 |
| Held outside Hong Kong | | |
| On medium-term lease (10 – 50 years) | **3,620** | 3,940 |
| | **54,540** | 53,940 |

## 34. Other assets

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Repossessed assets | **84,538** | 2,708 |
| Accounts receivable and pre-payments | **916,724** | 440,324 |
| | **1,001,262** | 443,032 |

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Repossessed assets | **84,538** | 2,708 |
| Accounts receivable and pre-payments | **910,393** | 418,969 |
| | **994,931** | 421,677 |

# Notes to the Financial Statements (continued)

## 35. Other financial liabilities at fair value through profit or loss

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Structured deposits (Note 36) | **3,026,933** | 2,616,209 |
| Certificates of deposit issued – at fair value through profit or loss (per balance sheets) | **292,272** | 360,848 |
| | **3,319,205** | 2,977,057 |

The Group and the Bank designated on initial recognition HK$3,319,205,000 (31 December 2005: HK$2,977,057,000) of financial liabilities 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 carrying amount as at 31 December 2006 is less than the amount that the Group and the Bank would be contractually required to pay at maturity to the holder of these financial liabilities by HK$65,232,000 (2005: HK$115,334,000).

## 36. Deposits from customers

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Current, savings and other deposit accounts (per consolidated balance sheet) | **24,542,695** | 22,860,102 |
| Structured deposits reported as Other financial liabilities at fair value through profit or loss (Note 35) | **3,026,933** | 2,616,209 |
| | **27,569,628** | 25,476,311 |
| Analysed by : | | |
| Demand deposits and current accounts | | |
| - corporate customers | **1,339,087** | 1,210,147 |
| - individual customers | **304,615** | 201,379 |
| | **1,643,702** | 1,411,526 |
| Savings deposits | | |
| - corporate customers | **2,025,832** | 1,730,306 |
| - individual customers | **8,625,635** | 6,489,761 |
| | **10,651,467** | 8,220,067 |
| Time, call and notice deposits | | |
| - corporate customers | **1,893,309** | 2,256,599 |
| - individual customers | **10,354,217** | 10,971,910 |
| | **12,247,526** | 13,228,509 |
| | **24,542,695** | 22,860,102 |

# Notes to the Financial Statements (continued)

## 36. Deposits from customers (continued)

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Current, savings and other deposit accounts (per balance sheet) | **24,606,429** | 22,895,039 |
| Structured deposits reported as Other financial liabilities at fair value through profit or loss (Note 35) | **3,026,933** | 2,616,209 |
| | **27,633,362** | 25,511,248 |
| Analysed by : | | |
| Demand deposits and current accounts | | |
| - corporate customers | **1,355,157** | 1,210,360 |
| - individual customers | **304,615** | 201,379 |
| | **1,659,772** | 1,411,739 |
| Savings deposits | | |
| - corporate customers | **2,073,496** | 1,765,030 |
| - individual customers | **8,625,635** | 6,489,761 |
| | **10,699,131** | 8,254,791 |
| Time, call and notice deposits | | |
| - corporate customers | **1,893,309** | 2,256,599 |
| - individual customers | **10,354,217** | 10,971,910 |
| | **12,247,526** | 13,228,509 |
| | **24,606,429** | 22,895,039 |

## 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 financial statements 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** | | | | | |
|---|---|---|---|---|---|---|
| | **2006** | | | | | |
| | **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 2006** | **5,417** | **58,807** | **(314)** | **(1,824)** | **516** | **62,602** |
| **Charged/(credited) to income statement** | **418** | **106** | **(32)** | **(5,202)** | **(516)** | **(5,226)** |
| **Credited to equity** | **-** | **(541)** | **-** | **-** | **-** | **(541)** |
| **At 31 December 2006** | **5,835** | **58,372** | **(346)** | **(7,026)** | **-** | **56,835** |

# Notes to the Financial Statements (continued)

## 37. Deferred taxation (continued)

| | 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 | 4,792 | 40,723 | (271) | (3,301) | 1,242 | 43,185 |
| Charged/(credited) to income statement | 625 | 1,443 | (43) | 1,477 | (726) | 2,776 |
| Charged to equity | - | 16,641 | - | - | - | 16,641 |
| At 31 December 2005 | 5,417 | 58,807 | (314) | (1,824) | 516 | 62,602 |

| | **The Bank** | | | | |
|---|---|---|---|---|---|
| | **2006** | | | | |
| | **Accelerated tax depreciation** | **Asset revaluation** | **Provisions** | **Other temporary differences** | **Total** |
| | **HK$'000** | **HK$'000** | **HK$'000** | **HK$'000** | **HK$'000** |
| **At 1 January 2006** | **5,220** | **58,807** | **(1,824)** | **516** | **62,719** |
| **Charged/(credited) to income statement** | **421** | **105** | **(5,202)** | **(516)** | **(5,192)** |
| **Credited to equity** | **-** | **(582)** | **-** | **-** | **(582)** |
| **At 31 December 2006** | **5,641** | **58,330** | **(7,026)** | **-** | **56,945** |

| | The Bank | | | | |
|---|---|---|---|---|---|
| | 2005 | | | | |
| | Accelerated tax depreciation | Asset revaluation | Provisions | Other temporary differences | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| At 1 January 2005 | 4,592 | 40,723 | (3,301) | 1,242 | 43,256 |
| Charged/(credited) to income statement | 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 |

# Notes to the Financial Statements (continued)

## 37. Deferred taxation (continued)

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 | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **HK$'000** | HK$'000 | **HK$'000** | HK$'000 |
| Deferred tax assets | **110** | 117 | **-** | - |
| Deferred tax liabilities | **(56,945)** | (62,719) | **(56,945)** | (62,719) |
| | **(56,835)** | (62,602) | **(56,945)** | (62,719) |

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Deferred tax assets to be recovered after more than twelve months | **110** | 117 |
| Deferred tax liabilities to be settled after more than twelve months | **(56,945)** | (62,061) |
| | **(56,835)** | (61,944) |

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Deferred tax assets to be recovered after more than twelve months | **-** | - |
| Deferred tax liabilities to be settled after more than twelve months | **(56,945)** | (62,061) |
| | **(56,945)** | (62,601) |

The deferred tax charged to equity during the year is as follows:

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Fair value reserves in shareholders' equity: | | |
| - premises | **(398)** | 16,498 |
| - available-for-sale securities | **(143)** | 143 |
| | **(541)** | 16,641 |

| | The Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Fair value reserves in shareholders' equity: | | |
| - premises | **(439)** | 16,498 |
| - available-for-sale securities | **(143)** | 143 |
| | **(582)** | 16,641 |

# Notes to the Financial Statements (continued)

## 38. Other accounts and provisions

| | The Group | | The Bank | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **HK$'000** | HK$'000 | **HK$'000** | HK$'000 |
| Dividend payable | **210,404** | 404 | **210,404** | 404 |
| Accruals and other payables | **1,194,034** | 772,337 | **1,194,230** | 772,478 |
| | **1,404,438** | 772,741 | **1,404,634** | 772,882 |

## 39. Share capital

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **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 |

## 40. Reserves

The amounts of the Group's and the Bank's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity and statement of changes in equity on pages 12 and 13 of the financial statements respectively.

# Notes to the Financial Statements (continued)

## 41. Notes to consolidated cash flow statement

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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Operating profit | **668,074** | 577,103 |
| Net gain on disposal of subsidiaries | **-** | (4,853) |
| Depreciation | **12,223** | 11,654 |
| Charge/(Reversal) of loan impairment allowances | **33,005** | (29,871) |
| Unwinding of discount on impairment | **(5,810)** | (2,900) |
| Advances written off net of recoveries | **(31,727)** | (17,899) |
| Change in placements with banks and other financial institutions with original maturity over three months | **(3,538,959)** | (156,772) |
| Change in other financial assets at fair value through profit or loss | **(83,860)** | (203,410) |
| Change in derivative financial instruments | **(3,925)** | 36,674 |
| Change in advances and other accounts | **(205,923)** | (1,893,219) |
| Change in available-for-sale securities | **625** | 11,542 |
| Change in held-to-maturity securities | **140,937** | 240,193 |
| Change in loans and receivables | **(501,322)** | (316,647) |
| Change in other assets | **(558,230)** | 58,815 |
| Change in deposits and balances of banks and other financial institutions repayable over three months | **8,959** | 86,225 |
| Change in other financial liabilities at fair value through profit or loss | **410,724** | 1,351,445 |
| Change in deposits from customers | **1,682,593** | (607,342) |
| Change in certificates of deposit issued | **(68,576)** | (9,231) |
| Change in other accounts and provisions | **421,697** | (247,044) |
| Exchange difference | **130** | - |
| Operating cash outflow before taxation | **(1,619,365)** | (1,115,537) |

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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Cash and balances with banks and other financial institutions | **836,948** | 875,747 |
| Placements with banks and other financial institutions with original maturity within three months | **6,639,962** | 8,621,375 |
| Treasury bills with original maturity within three months | **99,847** | - |
| Deposits and balances of banks and other financial institutions with original maturity within three months | **(355,772)** | (372,663) |
| | **7,220,985** | 9,124,459 |

# Notes to the Financial Statements (continued)

## 41. Notes to consolidated cash flow statement (continued)

### (c) Disposal of subsidiaries

| | 2006 | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Net assets disposed of: | | |
| - Cash and short-term funds | **-** | 25,847 |
| - Other assets | **-** | 1,354 |
| - Properties, plant and equipment | **-** | 21,586 |
| - Advances and other accounts | **-** | 12 |
| | **-** | 48,799 |
| Satisfied by: | | |
| - Cash | **-** | (53,652) |
| Analysis of net inflow of cash and cash equivalents in respect of the disposal of subsidiaries: | | |
| - Cash consideration | **-** | 53,652 |
| - Other assets | **-** | (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 | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Direct credit substitutes | **20,295** | 19,950 |
| Transaction-related contingencies | **105,282** | 102,261 |
| Trade-related contingencies | **921,964** | 918,940 |
| Other commitments with an original maturity of | | |
| - under one year or which are unconditionally cancellable | **3,787,253** | 3,898,649 |
| - one year and over | **911,250** | 955,793 |
| | **5,746,044** | 5,895,593 |
| Credit risk weighted amount | **649,015** | 670,750 |

The calculation basis of credit risk weighted amount has been set out in Note 25 to the financial statements.

# Notes to the Financial Statements (continued)

## 43. Capital commitments

The Group and the Bank have the following outstanding capital commitments not provided for in the financial statements:

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Authorised and contracted for but not provided for | **1,854** | - |
| Authorised but not contracted for | **1,053** | 345 |
| | **2,907** | 345 |

The above capital commitments mainly relate to commitments to purchase computer equipment and software, and to renovate the Group's and the Bank's premises.

## 44. Operating lease commitments

### (a) As lessee

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

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Land and buildings | | |
| - not later than one year | **11,402** | 11,385 |
| - later than one year but not later than five years | **12,554** | 9,135 |
| - later than five years | **-** | 184 |
| | **23,956** | 20,704 |

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

### (b) As lessor

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

| | The Group and the Bank | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Land and buildings | | |
| - not later than one year | **2,502** | 1,712 |
| - later than one year but not later than five years | **929** | 1,675 |
| | **3,431** | 3,387 |

The Group and the Bank lease its investment properties (Note 33) 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 prevailing market conditions. None of the leases includes contingent rentals.

# Notes to the Financial Statements (continued)

## 45. 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.

Information about four business segments is provided in segmental reporting. They are Retail Banking, Corporate Banking, Treasury and Investment Activities.

Both Retail Banking and Corporate Banking segments provide general banking services. Retail Banking mainly serves individual customers and small companies. Corporate Banking mainly deals with medium to large companies. The Treasury segment is responsible for managing the capital, liquidity, and the interest rate and foreign exchange positions of the Group. Investment Activities include the Group's holdings of premises and investment properties. "Others" 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. In relation to 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. During the period, the Group has revised the allocation bases and comparative amounts have been reclassified to conform with the current year's presentation. There is no impact on the Group's income statement and balance sheet. Inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group. The charge on any such funding is mainly made by reference to the corresponding money market rate.

# Notes to the Financial Statements (continued)

## 45. Segmental reporting (continued)

| | 2006 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Retail | Corporate | Treasury | Investment | Others | Subtotal | Eliminations | Consolidated |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| Net interest income/(expenses) | 302,395 | 217,000 | 178,493 | (23,291) | - | 674,597 | - | 674,597 |
| Net fees and commission income/(expenses) | 130,549 | 65,651 | (451) | - | 145 | 195,894 | - | 195,894 |
| Net trading income | 27,262 | 17,970 | 3,641 | 16 | - | 48,889 | - | 48,889 |
| Net gain on investments in securities | - | - | - | 6,470 | - | 6,470 | - | 6,470 |
| Other operating income | 1,294 | 488 | 1 | 27,708 | - | 29,491 | (23,850) | 5,641 |
| Total operating income before loan impairment allowances | 461,500 | 301,109 | 181,684 | 10,903 | 145 | 955,341 | (23,850) | 931,491 |
| Charge for loan impairment allowances | (11,300) | (21,705) | - | - | - | (33,005) | - | (33,005) |
| Net operating income | 450,200 | 279,404 | 181,684 | 10,903 | 145 | 922,336 | (23,850) | 898,486 |
| Operating expenses | (166,423) | (48,853) | (5,601) | (8,404) | (24,981) | (254,262) | 23,850 | (230,412) |
| Operating profit/(loss) | 283,777 | 230,551 | 176,083 | 2,499 | (24,836) | 668,074 | - | 668,074 |
| Net gain on disposal/revaluation of properties, plant and equipment | - | - | - | 6,344 | - | 6,344 | - | 6,344 |
| Net gain on disposal of/fair value adjustments on investment properties | - | - | - | 600 | - | 600 | - | 600 |
| Profit/(loss) before taxation | 283,777 | 230,551 | 176,083 | 9,443 | (24,836) | 675,018 | - | 675,018 |
| Assets | | | | | | | | |
| Segment assets | 5,040,030 | 7,434,002 | 20,934,784 | 570,825 | 6,153 | 33,985,794 | - | 33,985,794 |
| Liabilities | | | | | | | | |
| Segment liabilities | 25,586,676 | 3,450,517 | 666,087 | 210,939 | 128,122 | 30,042,341 | - | 30,042,341 |
| Other information | | | | | | | | |
| Additions of properties, plant and equipment | - | - | - | 4,526 | - | 4,526 | - | 4,526 |
| Depreciation | 5,020 | 1,370 | 64 | 5,601 | 168 | 12,223 | - | 12,223 |
| Amortisation of securities | - | - | 12,595 | - | - | 12,595 | - | 12,595 |

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# Notes to the Financial Statements (continued)

## 45. Segmental reporting (continued)

| | 2005 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Retail | Corporate | Treasury | Investment | Others | Subtotal | Eliminations | Consolidated |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'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 | 24,794 | 7,621 | 5,040 | 4 | - | 37,459 | - | 37,459 |
| Net gain on disposal of subsidiary | - | - | - | 4,853 | - | 4,853 | - | 4,853 |
| Other operating income | 185 | 215 | 25 | 25,293 | - | 25,718 | (22,500) | 3,218 |
| Total operating income before loan impairment allowances | 403,966 | 247,589 | 127,542 | 9,995 | - | 789,092 | (22,500) | 766,592 |
| Reversal of loan impairment allowances | 3,040 | 26,831 | - | - | - | 29,871 | - | 29,871 |
| Net operating income | 407,006 | 274,420 | 127,542 | 9,995 | - | 818,963 | (22,500) | 796,463 |
| Operating expenses | (141,974) | (46,710) | (3,960) | (14,680) | (34,536) | (241,860) | 22,500 | (219,360) |
| Operating profit/(loss) | 265,032 | 227,710 | 123,582 | (4,685) | (34,536) | 577,103 | - | 577,103 |
| Net gain on disposal/revaluation of properties, plant and equipment | - | - | - | 5,440 | - | 5,440 | - | 5,440 |
| Net gain on disposal of/fair value adjustments on investment properties | - | - | - | 8,250 | - | 8,250 | - | 8,250 |
| 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 properties, plant and equipments | - | - | - | 9,931 | - | - | - | 9,931 |
| Depreciation | 6,337 | 260 | 50 | 4,847 | 160 | 11,654 | - | 11,654 |
| Amortisation of securities | - | - | 1,024 | - | - | 1,024 | - | 1,024 |

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# Notes to the Financial Statements (continued)

## 46. Loans to Directors and officers

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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Aggregate amount of relevant loans outstanding at year end | **1,519** | 1,730 |
| Maximum aggregate amount of relevant loans outstanding during the year | **1,726** | 1,934 |

## 47. 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.

Transactions with related parties, which the Group entered into during the year 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, the intermediate holding companies of the Bank as well as subsidiaries and associates of BOC are summarised as follows:

| | | **2006** | |
|---|---|---|---|
| | Notes | **Immediate and intermediate holding companies** | **Other related parties[1]** |
| | | **HK$'000** | **HK$'000** |
| Income statement items: | | | |
| Interest income | (i) | **73,746** | **16,472** |
| Interest expense | (ii) | **(21,000)** | **(3,214)** |
| Insurance commission received (net) | (iii) | **-** | **9,540** |
| Administrative services fees paid/payable | (iv) | **(29,574)** | **(1,875)** |
| Securities brokerage commission paid/payable (net) | (v) | **-** | **(8,671)** |
| Rental, property management and letting agency fees paid/payable | (v) | **(1,187)** | **-** |
| Funds selling commission received | (vi) | - | **932** |

# Notes to the Financial Statements (continued)

## 47. 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 HK$'000 | 2005 Other related parties[1] HK$'000 |
|---|---|---|---|
| Income statement 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 |

| | Notes | **2006 Immediate and intermediate holding companies HK$'000** | **2006 Other related parties[1] HK$'000** |
|---|---|---|---|
| Balance sheet items: | | | |
| Cash and balances with banks and other financial institutions | (i) | **502,369** | **353** |
| Placements with banks and other financial institutions | (i) | **1,203,372** | **-** |
| Derivative financial instruments assets | (vii) | **684** | |
| Advances and other accounts | (i) | **-** | **250,803** |
| Other assets | (viii) | **159,053** | **247,646** |
| Deposits and balances of banks and other financial institutions | (ii) | **(566,410)** | **-** |
| Deposits from customers | (ii) | **-** | **(52,294)** |
| Derivative financial instruments liabilities | (vii) | **(5,435)** | **-** |
| Other accounts and provisions | (viii) | **(310,902)** | **(250,869)** |

| | Notes | 2005 Immediate and intermediate holding companies HK$'000 | 2005 Other related parties[1] HK$'000 |
|---|---|---|---|
| Balance sheet items: | | | |
| Cash and balances with banks and other financial institutions | (i) | 532,518 | 1,104 |
| Placements with banks and other financial institutions | (i) | 1,543,693 | 85,415 |
| Derivative financial instruments assets | (vii) | 735 | - |
| Advances and other accounts | (i) | - | 251,387 |
| 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) |

[1] 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 Financial Statements (continued)

## 47. Significant related party transactions (continued)

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

Notes:

**(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 balances with banks and other financial institutions, 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 BOC 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 internal audit, technology, human resources support and training to the intermediate 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 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 were priced at the relevant market rates at the time of the transactions.

# Notes to the Financial Statements (continued)

## 47. Significant related party transactions (continued)

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

Notes：(continued)

**(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.

**(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. As at 31 December 2006, the aggregate notional amount of such derivative transactions amounted to HK$ 395,056,000 (2005: HK$365,144,000) whilst the corresponding derivative financial instruments assets and liabilities amounted to HK$684,000 (2005: HK$735,000) and HK$5,435,000 (2005: HK$8,290,000) respectively. 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.

# Notes to the Financial Statements (continued)

## 47. Significant related party transactions (continued)

### (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 2006, the total undrawn loan commitments, trade finance-related contingencies and guarantees amounted to HK$2,703,000 (2005: HK$911,000).

### (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 Senior Management. 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 periods, 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 2006 and 31 December 2005 is detailed as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Salaries and other short-term employee benefits | **4,583** | 4,839 |

# Notes to the Financial Statements (continued)

## 47. 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 expenses for the year are as follows:

**(i) Treasury bonds**

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Interest income | **2,678** | 2,745 |

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Outstanding balance at beginning of the year | **38,768** | 50,245 |
| Outstanding balance at end of the year | **38,881** | 38,768 |

**(ii) Due from banks and other financial institutions**

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Interest income | **1,230** | 965 |

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Outstanding balance at beginning of the year | **132,070** | 76,401 |
| Outstanding balance at end of the year | **129,888** | 132,070 |

**(iii) Due from banks and other financial institutions**

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Interest expenses | **-** | 5 |

There is no outstanding balance at the beginning of the year of 2005 and 2006 and outstanding balance at the year end of 2005 and 2006.

# Notes to the Financial Statements (continued)

## 47. Significant related party transactions (continued)

### (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 or enter into any transactions with Central SAFE for the year ended 31 December 2006 (2005: Nil).

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 business. These include loans, investment securities and money market transactions. The outstanding balances at the year end, and the related income and expenses for the year are as follows:

**(i) Due from banks and other financial institutions**

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Interest income | **9,151** | 4,462 |

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Outstanding balance at beginning of the year | **204,295** | - |
| Outstanding balance at end of the year | **217,734** | 204,295 |

### (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 through its government authorities, agencies and affiliates. 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, transport, telecommunication and postal services.

Utilities, transport, 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. Details of other transactions are set forth below.

# Notes to the Financial Statements (continued)

## 47. Significant related party transactions (continued)

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

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

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

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Interest income | **30,852** | 24,885 |
| Charge for individually assessed loan impairment allowances | **(64)** | (4,089) |

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Outstanding balance at beginning of the year | **679,561** | 562,136 |
| Outstanding balance at end of the year | **478,608** | 679,561 |
| Less: individually assessed loan impairment allowances | **-** | (64) |
| | **478,608** | 679,497 |

**(ii) Due from banks and other financial institutions**

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Interest income | **30,945** | 15,373 |

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Outstanding balance at beginning of the year | **626,085** | 260,000 |
| Outstanding balance at end of the year | **432,649** | 626,085 |

**(iii) Due to banks and other financial institutions**

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Interest expense | **501** | 181 |

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Outstanding balance at beginning of the year | **26,479** | 5,073 |
| Outstanding balance at end of the year | **42,658** | 26,479 |

# Notes to the Financial Statements (continued)

## 47. Significant related party transactions (continued)

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

#### (vi) Deposits from customers

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Interest expense | **7,498** | 3,578 |

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Outstanding balance at beginning of the year | **296,629** | 315,929 |
| Outstanding balance at end of the year | **295,492** | 296,629 |

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| **(v) Contingent liabilities and commitments (including guarantees)** | **656,038** | 801,730 |

# Notes to the Financial Statements (continued)

## 48. Ultimate holding company

Central SAFE, acting on behalf of the State is the ultimate holding company of the Group whilst BOC is the Group's intermediate holding company.

## 49. Comparative amounts

For the purpose of presentation of income statement, certain items are now reclassified and included as part of the operating profit of the Group as management believes that this better reflects the Group's operations. Certain comparative amounts have been reclassified to conform with the current year's presentation.

## 50. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 16 March 2007.

# Unaudited Supplementary Financial Information

## 1. Capital adequacy ratio

| | 2006 | 2005 |
|---|---|---|
| Capital adequacy ratio | **23.83%** | 25.34% |
| Adjusted capital adequacy ratio | **23.62%** | 25.24% |

The Capital adequacy ratio ("CAR") is computed on the combined basis that comprises the positions of Bank and certain subsidiaries 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 HKMA 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 2006 and 31 December 2005 and reported to the HKMA is analysed as follows:

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| Core capital: | | |
| Paid up ordinary share capital | **300,000** | 300,000 |
| Reserves | **3,068,902** | 2,905,343 |
| Income statement | **125,052** | 160,413 |
| | **3,493,954** | 3,365,756 |
| Supplementary capital: | | |
| Premises and investment properties revaluation reserves | **224** | 224 |
| Reserves on revaluation of holding of securities not held for trading purposes | **(56,843)** | (73,800) |
| Collective loan impairment allowances | **34,151** | 10,288 |
| Regulatory reserve | **155,607** | 153,807 |
| Total capital base | **3,627,093** | 3,456,275 |
| Deduction from total capital base: | | |
| Shareholdings in subsidiaries or holding company | **(3,913)** | (3,913) |
| Exposures to connected companies | **(77,036)** | (76,341) |
| Investments in the capital of other banks or other financial institutions | **-** | (6,158) |
| | **(80,949)** | (86,412) |
| Total capital base after deductions | **3,546,144** | 3,369,863 |

# Unaudited Supplementary Financial Information (continued)

## 3. Liquidity ratio

| | **2006** | 2005 |
|---|---|---|
| Average liquidity ratio | **42.79%** | 46.79% |

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

| | **2006** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Equivalent in thousand of HK$** | | | | | | | |
| | **US Dollars** | **Japanese Yen** | **Euro** | **Australian Dollars** | **New Zealand Dollars** | **Renminbi Yuan** | **Others** | **Total** |
| **Spot assets** | **7,231,041** | **164,236** | **105,502** | **706,323** | **425,858** | **840,751** | **233,998** | **9,707,709** |
| **Spot liabilities** | **(6,853,253)** | **(300,240)** | **(188,274)** | **(672,276)** | **(425,162)** | **(736,875)** | **(454,728)** | **(9,630,808)** |
| **Forward purchases** | **154,071** | **146,296** | **109,046** | **6,149** | **4,117** | **22,829** | **234,208** | **676,716** |
| **Forward sales** | **(223,407)** | **(9,636)** | **(25,158)** | **(38,872)** | **(4,480)** | **(230)** | **(12,413)** | **(314,196)** |
| **Net long position** | **308,452** | **656** | **1,116** | **1,324** | **333** | **126,475** | **1,065** | **439,421** |
| **Net structural position** | **-** | **-** | **-** | **-** | **-** | **59,755** | **-** | **59,755** |

| | 2005 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Equivalent in thousand of HK$ | | | | | | | |
| | US Dollars | Swiss Francs | Japanese Yens | Australian Dollars | New Zealand Dollars | Renminbi Yuan | Others | Total |
| Spot assets | 6,536,498 | 2,429 | 213,993 | 1,062,912 | 466,985 | 340,552 | 633,397 | 9,256,766 |
| Spot liabilities | (6,328,148) | (53,775) | (452,669) | (1,024,152) | (435,713) | (296,682) | (533,670) | (9,124,809) |
| Forward purchases | 301,029 | 56,722 | 290,005 | 16,791 | 11,927 | 961 | 64,294 | 741,729 |
| Forward sales | (117,053) | (4,724) | (51,886) | (50,413) | (42,814) | - | (162,801) | (429,691) |
| Net long/(short) position | 392,326 | 652 | (557) | 5,138 | 385 | 44,831 | 1,220 | 443,995 |
| Net structural position | - | - | - | - | - | 28,824 | - | 28,824 |

# 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:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Loans for use in Hong Kong | | |
| Industrial, commercial and financial | | |
| - Property development | **343,690** | 478,299 |
| - Property investment | **2,012,101** | 1,668,561 |
| - Financial concerns | **659,308** | 552,239 |
| - Stockbrokers | **1,453** | 7,648 |
| - Wholesale and retail trade | **572,035** | 642,622 |
| - Manufacturing | **701,263** | 965,418 |
| - Transport and transport equipment | **76,614** | 102,545 |
| - Others | **944,969** | 795,224 |
| Individuals | | |
| - Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | **115,291** | 132,149 |
| - Loans for purchase of other residential properties | **2,383,996** | 2,427,885 |
| - Others | **791,995** | 439,255 |
| Total loans for use in Hong Kong | **8,602,715** | 8,211,845 |
| Trade finance | **896,200** | 1,029,034 |
| Loans for use outside Hong Kong | **1,554,585** | 913,472 |
| Gross advances to customers | **11,053,500** | 10,154,351 |

* Certain comparative amounts have been reclassified to conform with the current year's presentation.

### (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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Hong Kong | **9,906,775** | 9,224,250 |
| Mainland China | **1,146,725** | 930,101 |
| | **11,053,500** | 10,154,351 |

# 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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Hong Kong | **32,663** | 68,967 |
| Mainland China | **6,228** | 18,607 |
| | **38,891** | 87,574 |

## 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** | **Others** | **Total** |
|---|---|---|---|
| | **HK$' 000** | **HK$' 000** | **HK$' 000** |
| **At 31 December 2006** | | | |
| **Asia, other than Hong Kong** | | | |
| **- China** | **2,161,000** | **787,000** | **2,948,000** |
| **- Others** | **4,509,000** | **237,000** | **4,746,000** |
| | **6,670,000** | **1,024,000** | **7,694,000** |
| **Western Europe** | **11,270,000** | **244,000** | **11,514,000** |
| **Total** | **17,940,000** | **1,268,000** | **19,208,000** |

# Unaudited Supplementary Financial Information (continued)

## 6. Cross-border claims (continued)

| | Banks and other financial institutions | Others | Total |
|---|---|---|---|
| | HK$' 000 | HK$' 000 | 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 |
| | 6,703,000 | 136,000 | 6,839,000 |
| North America | | | |
| - United States | 1,999,000 | - | 1,999,000 |
| - Others | 478,000 | 1,000 | 479,000 |
| | 2,477,000 | 1,000 | 2,478,000 |
| Western Europe | 8,360,000 | 249,000 | 8,609,000 |
| Total | 17,540,000 | 386,000 | 17,926,000 |

## 7. Overdue and rescheduled assets

### (a) Gross amount of overdue loans

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Amount** | **% of gross advances to customers** | Amount | % of gross advances to customers |
| | **HK$'000** | | HK$'000 | |
| Gross advances to customers which have been overdue for: | | | | |
| - six months or less but over three months | **14,124** | **0.13%** | 3,069 | 0.03% |
| - one year or less but over six months | **4,917** | **0.04%** | 485 | 0.00% |
| - over one year | **19,850** | **0.18%** | 84,020 | 0.83% |
| Advances overdue for over three months | **38,891** | **0.35%** | 87,574 | 0.86% |

As at 31 December 2006 and 31 December 2005, 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.

# Unaudited Supplementary Financial Information (continued)

## 7. Overdue and rescheduled assets (continued)

### (b) Rescheduled advances to customers

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Amount** | **% of gross advances to customers** | Amount | % of gross advances to customers |
| | **HK$'000** | | HK$'000 | |
| Rescheduled advances to customers | **2,933** | **0.03%** | 702 | 0.01% |

As at 31 December 2006 and 31 December 2005, there were no rescheduled advances to banks and other financial institutions.

Rescheduled advances are those advances that have been restructured or renegotiated because of 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

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Estimated market value of repossessed assets held | **121,020** | 79,950 |

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.

## 9. Risk management

### Overview

The Group believes that sound risk management is a key success factor for any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business growth and development. The principal types of risk inherent in the Group's businesses are reputation risk, legal and compliance risk, strategic risk, credit risk, market risk, interest rate risk, liquidity risk and operational risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits.

# Unaudited Supplementary Financial Information (continued)

## 9. Risk Management (continued)

### Risk Management Governance Structure

The Group's risk management governance structure is designed to cover the whole process of all businesses and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure as well as comprehensive policies and procedures to identify measure, monitor and control various risks that may arise for the organisation. These risk management policies and procedures are regularly reviewed and modified to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision making authority of the Bank and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for the determination of risk management strategies and for ensuring that the Group has an effective risk management system to implement these risk management strategies. RC, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, reviewing and approving high level risk related policies and overseeing their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it believes that the transaction shall not proceed. AC assists the Board in fulfilling its role on overseeing internal control system.

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, BOCHK. The Group executes its risk management strategy independently and functionally reports to BOCHK on a regular basis.

# Unaudited Supplementary Financial Information (continued)

## 9. Risk Management (continued)

### Reputation Risk Management

Reputation risk is the risk that negative publicity regarding the Group's 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 business operation and covers a wide spectrum of issues.

In order to mitigate reputation risk, the Group has formulated its Reputation Risk Management Policy that is diligently implemented. This policy establishes standards to prevent and to manage reputation risk proactively at an early stage. It requires constant monitoring of external reputation risk incidents and published failures of risk incidents within the financial industry.

### Legal and compliance risk management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operation or financial condition of the Group. Compliance risk is the risk of penalty arising from any failure to comply with relevant regulations governing the conduct of businesses in specific countries. By establishing and maintaining appropriate policies and guidelines, the Compliance Section is responsible for proactively identifying and managing these risks.

### Strategic Risk Management

Strategic risk generally refers to the risks that may induce immediate or future negative impact on the financial and market positions of the Group because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The Group has developed a Strategic Risk Management Policy that clearly defines the management and oversight of such risks.

### Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet a commitment it has entered into. CRMD, provides centralised management of credit risk within the Group. Different credit approval and control procedures are adopted according to the level of risk associated with the customer or transaction. Corporate credit applications and retail credit transactions, including residential mortgage loans and personal loans are independently reviewed and objectively assessed by risk management units.

The Group adopts an eight-grade facility grading structure according to HKMA's loan classification requirement. CRMD provides regular credit management information reports and ad hoc reports to members of EC, RC, AC and Board of Directors.

# Unaudited Supplementary Financial Information (continued)

## 9. Risk Management (continued)

### Market Risk Management

Market risk is the risk of loss that results form movements in the market rates and prices. The Group's market risk arises from customer-related business. Market risk is managed within the risk limits approved by the RC. The overall risk limits are divided into sub-limits by reference to different risk factors, including interest rate, foreign exchange rate, commodity price and equity price.

CRMD, Finance Division and Settlement Section are responsible for the regularly oversight of the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a regular basis to ensure that they are within established risk limits.

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.

### Interest Rate Risk Management

The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are:

| | |
|---|---|
| repricing risk | – mismatches in the maturity or repricing periods of assets and liabilities |
| basis risk | – different pricing basis for different transactions so that yield on assets and cost of liabilities may change by different amounts within the same repricing period |

The Group's ALCO maintains oversight of interest rate risk and RC sanctions the interest rate risk management policies formulated by ALCO. The interest rate risk is identified and measured on a regular basis. The Treasury Division manages the interest rate risk according to the established policies. The Finance Division closely monitors the related risks and the results are reported to RC and ALCO regularly.

Gap analysis is one of the tools used to measure the Group's exposure to repricing risk. This provides the Group with a static view of the maturity and repricing characteristics of its balance sheet positions. The Group uses interest rate derivatives to hedge its interest rate exposures and in most cases, plain vanilla interest rate swaps are used.

# Unaudited Supplementary Financial Information (continued)

## 9. Risk Management (continued)

### Interest Rate Risk Management (continued)

Sensitivities of earnings and economic value to interest rate changes (Earnings at Risk and Economic Value at Risk) are assessed through hypothetical interest rate shock of 200 basis points across the yield curve on both sides. Earnings at Risk and Economic Value at Risk are controlled respectively within an approved percentage of the projected net interest income for the year and the latest capital base as sanctioned by RC. The results are reported to ALCO and RC on a regular basis.

The impact of basis risk is gauged by the projected change in net interest income under scenarios of imperfect correlation in the adjustment of the rates earned and paid on different instruments. Ratios of assets to liabilities with similar pricing basis are established to monitor such risk.

### Liquidity Risk Management

The aim of liquidity management is to enable the Group, even under adverse market conditions, to meet all its maturing repayment obligations on time and to fund all of its asset growth and strategic opportunities without forced liquidation of its assets at short notice.

The Group funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Group may issue certificates of deposit to secure long-term funds. Funding may also be secured through adjusting the asset mix in the Group's investment portfolio. The Group uses the majority of funds raised to extend loans, to purchase debt securities or to conduct interbank placements.

The Group monitors the liquidity risks using cash flow analysis and by examining deposit stability, concentration risk, mismatch ratios, loan-to-deposit ratio and liquidity profile of the investment portfolio. The primary objective of the Group's asset and liability management strategy is to achieve optimal return while ensuring adequate levels of liquidity and capital within an effective risk control framework and ALCO is responsible for establishing these policy directives (including the liquidity contingency plan), and RC sanctions the liquidity management policies. The Treasury Department manages the liquidity risk according to the established policies. The Finance Division monitors the Group's liquidity risks and reports to the management and ALCO regularly.

# Unaudited Supplementary Financial Information (continued)

## 9. Risk Management (continued)

### Operational Risk Management

Operational risk relates to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Strategic Planning and Control Department ("SCD") oversees the entire operational risk management framework of the Group.

The Group has put in place an effective internal control process which requires the establishment of detailed policies and control procedures for all the key activities. Proper segregation of duties and independent authorisation are the fundamental principles followed by the Group. Business line management is responsible for managing and reporting operational risks specific to their business units by identifying, assessing and controlling the risks inherent in their business processes, activities and products. These are followed by periodic monitoring and ongoing review of changes by SCD. SCD formulates corporate-level policies and procedures concerning operational risk management which are approved by RC. SCD evaluates the operational risk profile, records operational risk data and reports operational risk issues to RC and senior management.

Business continuity plans are in place to support business operations in the event of emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted. The Group also arranges insurance cover to reduce potential losses in respect of operational risk.

### Capital Management

The major objective of capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The Group periodically reviews its capital structure and adjusts the capital mix where appropriate to achieve the lowest overall cost of capital. ALCO monitors the Group's capital adequacy. The Group has complied with all the statutory capital standards for all the periods presented in the report.

### Stress Testing

The Group supplements the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating the Group's risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis and ALCO monitors the results against limits approved by RC. Stress test results are also reported to the Board and RC regularly.

## Branch Network

| BRANCH (Br.) | ADDRESS | TELEPHONE |
|---|---|---|
| HONG KONG ISLAND | | |
| Central Br. | 78, Des Voeux Road Central, Hong Kong | 2843 0187 |
| 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. | 967-967A, 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. | G/F, 226-228 Castle Peak Road, Kowloon | 2720 5187 |
| Kowloon Bay Br. | G/F, Shop 10, 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 703A, 7/F., Tsz Wan Shan Shopping Centre, 23 Yuk Wah ST., 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) 8781 0078 |