NOTES TO THE FINANCIAL STATEMENTS  
for the year ended 31 December 2000

1. GENERAL

The Bank is a listed public limited company incorporated in Hong Kong and is engaged in the provision of banking and related financial services.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention as modified for the revaluation of certain properties and investments in securities.

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries made up to 31 December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant inter-company transactions and balances within the Group have been eliminated on consolidation.

**Goodwill**

Goodwill represents the excess of the purchase consideration over the fair value ascribed to the Group's share of the net assets at the date of acquisition of a subsidiary and is written off to reserves immediately on acquisition. Negative goodwill, which represents the excess of the fair value ascribed to the Group's share of the separable net assets at the date of acquisition of a subsidiary over the purchase consideration is credited to reserves.

Any premium or discount arising on the acquisition of an interest in an associate, representing the excess or shortfall respectively of the purchase consideration over the fair value ascribed to the Group's share of the separable net assets of the associate at the date of acquisition, is dealt with in the same manner as that described above for goodwill.

On disposal of a subsidiary or an associate, the attributable amount of goodwill previously eliminated against or credited to reserves is included in the determination of the profit or loss on disposal of the subsidiary or associate.

**Subsidiaries**

A subsidiary is an enterprise in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or where the Group controls the composition of its board of directors or equivalent governing body.

Investments in subsidiaries are included in the Bank's balance sheet at cost as reduced by any decline in the value of the subsidiary that is other than temporary. Results of subsidiaries are accounted for by the Bank on the basis of dividends received or receivable during the year.
2. SIGNIFICANT ACCOUNTING POLICIES – continued

**Associates**
An associate is an enterprise over which the Group is in a position to exercise significant influence, including participation in financial and operating policy decisions.

The consolidated income statement includes the Group's share of the post-acquisition results of its associates for the year. In the consolidated balance sheet, interests in associates are stated at the Group's share of the net assets of the associates.

When the Group transacts with its associates, unrealised profits and losses are eliminated to the extent of the Group's interest in the relevant associates, except where unrealised losses provide evidence of an impairment of the asset transferred.

The results of associates are accounted for by the Bank on the basis of dividends received and receivable during the year. In the Bank's balance sheet, investments in associates are stated at cost as reduced by any decline in the value of the associate that is other than temporary.

**Advances and other accounts**
Advances to customers, banks and other financial institutions and accrued interest and other accounts are stated in the balance sheet after deducting provision for estimated losses.

Provision for bad and doubtful debts is made, having regard to both specific and general risks.

The specific element of the provision relates to those loans that have been individually reviewed and specifically identified as bad or doubtful. Factors which are considered include expected cashflows, financial condition of the borrower and current economic conditions. The general element of the provision relates to those losses that, although not yet specifically identified, are known from experience to be present in the Group's portfolio of loans and advances. In determining the level of the provision required, management considers numerous factors including, but not limited to, domestic and international economic conditions, the composition of the loan portfolio and prior loan loss experience.

Provisions are applied to write off advances when all security has been realised and further recoveries are considered unlikely.

Loans with a specific due date are classified as overdue when the principal or interest is overdue and remains unpaid as at the year-end date. Loans repayable by regular instalments are treated as overdue when an instalment payment is overdue and remains unpaid as at the year-end date. Loans repayable on demand are categorised 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, the loan has remained continuously outside the approved limit that was advised to the borrower for more than three months.

Rescheduled advances refer to those loans that have been restructured or renegotiated due to the deterioration in the financial position of the borrower or the inability of the borrower to meet the original repayment schedule. Rescheduled advances which have been overdue over three months under the revised repayment terms are classified as overdue advances and not as rescheduled advances.
2. **SIGNIFICANT ACCOUNTING POLICIES – continued**

**Foreign currencies**
Transactions in foreign currencies are translated at the rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates ruling on the balance sheet date. Profits and losses arising on translation are dealt with in the income statement.

On consolidation, the financial statements of overseas branches and subsidiaries which are denominated in currencies other than Hong Kong dollar are translated at the rates ruling on the balance sheet date. All exchange differences arising on consolidation are dealt with in reserves.

**Revenue recognition**
Interest income is recognised in the income statement as it accrues, except in the case of doubtful debts where interest is credited to a suspense account which is netted in the balance sheet against the relevant balances. Doubtful debts are those debts where there is reasonable doubt about the ultimate collectibility of principal or interest; or against which a specific provision has been made; or where contractual payments of principal and/or interest are more than 3 months in arrears and where the net realisable value of the security is insufficient to cover payment of principal and accrued interest.

Interest income ceases to be accrued or is placed into suspense account for those debts where the contractual payments of principal and/or interest are more than 12 months in arrears, irrespective of the net realisable value of collateral.

When interest has been placed in suspense or has ceased to be accrued, accrual of interest to the income statement is resumed only if all arrears of principal and interest from the borrower have been cleared and it is probable that the customer is capable of fully servicing his obligations for the foreseeable future.

Fees and commission income are accounted for in the period when receivable, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised on an appropriate basis over the relevant period.

Dividend income from investments in securities is recognised when the Group's right to receive payment has been established.

**Property and equipment**
Property and equipment other than investment properties are stated at cost or valuation less depreciation and amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of the asset.