3. SIGNIFICANT ACCOUNTING POLICIES – continued

**Property and equipment**

Property and equipment are stated at cost or valuation less depreciation and amortisation and accumulated impairment losses.

Land and buildings are stated in the balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on revaluation of land and buildings is credited to the revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in net carrying amount arising on revaluation of an asset is dealt with as an expense to the extent that it exceeds the balance, if any, on the revaluation reserve relating to a previous revaluation of that asset. On the subsequent sale or retirement of a revalued asset, the attributable revaluation surplus is transferred to retained profits.

Depreciation and amortisation are provided to write off the cost or valuation of items of property and equipment over their estimated useful lives and after taking into account their estimated residual value, using the straight line method, at the following rates per annum:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leasehold land</td>
<td>Over the term of the lease</td>
</tr>
<tr>
<td>Buildings</td>
<td>Over the shorter of the term of the lease or 2%</td>
</tr>
<tr>
<td>Equipment</td>
<td>10%-20%</td>
</tr>
</tbody>
</table>

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

**Investment properties**

Investment properties are completed properties which are held for their investment potential, any rental income being negotiated at arm’s length.

Investment properties are stated at their open market value based on independent professional valuations at the balance sheet date. Any surplus or deficit arising on the revaluation of investment properties is credited or charged to the investment property revaluation reserve unless the balance of this reserve is insufficient to cover a deficit, in which case the excess of the deficit over the balance on the investment property revaluation reserve is charged to the income statement. Where a deficit has previously been charged to the income statement and a revaluation surplus subsequently arises, this surplus is credited to the income statement to the extent of the deficit previously charged.
3. **SIGNIFICANT ACCOUNTING POLICIES – continued**

**Investment properties – continued**

On disposal of an investment property, the balance on the investment property revaluation reserve attributable to that property is transferred to income statement.

No depreciation is provided on investment properties except where the unexpired term of the relevant lease is 20 years or less.

**Impairment**

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately, unless the relevant asset is carried at a revalued amount under another Standard, in which case the impairment loss is treated as revaluation decrease under that Standard.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount under another Standard, in which case the reversal of the impairment loss is treated as a revaluation increase under that other Standard.

**Leased assets**

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the lessees.

Amounts due from lessees under finance leases are recorded as advances and other accounts at the amount of the Group’s net investment in the leases.

Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group’s net investment outstanding in respect of the leases.

Initial direct costs are dealt with as an expense in the year in which they arise.

All other leases are classified as operating leases and the rental income is recognised on a straight line basis over the lease term.
NOTES TO THE  
FINANCIAL STATEMENTS  
for the year ended 31 December 2001

3.  SIGNIFICANT ACCOUNTING POLICIES – continued

Investments in securities

Investments in securities are recognised on a trade date basis and are initially measured at cost.

At subsequent reporting dates, debt securities that the Group has the expressed intention and ability to hold to maturity (held-to-maturity securities) are measured at amortised cost, less any impairment loss recognised to reflect irrecoverable amounts. The annual amortisation of any discount or premium on the acquisition of a held-to-maturity security is aggregated with other investment income receivable over the term of the instrument so that the revenue recognised in each period represents a constant yield on the investment.

All securities other than held-to-maturity debt securities are measured at subsequent reporting dates at fair value.

Where securities are held for trading purposes, unrealised gains and losses are included in net profit or loss for the year. For other securities, unrealised gains and losses are dealt with in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss is included in net profit or loss for the year.

Taxation

The charge for taxation is based on the results for the year as adjusted for items which are non-assessable or disallowed. Timing differences arise from the recognition for tax purposes of certain items of income and expense in a different accounting period from that in which they are recognised in the financial statements. The tax effect of timing differences, computed using the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or an asset will crystallise in the foreseeable future.

Operating leases

Rental costs under operating leases are charged to the income statement on a straight line basis over the lease term.

Financial derivative products

Financial derivative products, which include financial futures and forward contracts, interest rate swaps, options and similar derivative products, are recognised on a trade date basis and are initially measured at cost. Financial derivative products outstanding at the year end, except for those designated as hedges, are valued at market rate, with realised gains and losses included in the income statement. Gains and losses related to these derivative products that are designated as hedges are dealt with in accordance with the accounting treatment applicable to the position hedged.

Fiduciary assets

The assets of staff retirement benefits scheme and assets held in trust in a fiduciary capacity are not assets of the Group and accordingly are not included in the financial statements.
3. SIGNIFICANT ACCOUNTING POLICIES – continued

Retirement benefits scheme

A non-contributory defined benefit scheme (the “Scheme”) has been in operation for all eligible employees since 1995. In December 2000, most of the Scheme members have chosen to enroll in a defined contribution mandatory provident fund scheme (the “MPF Scheme”) in replacement of the Scheme.

Retirement benefits scheme contributions charged to the income statement represent payments made in respect of the Scheme and the MPF Scheme.

Payments in respect of the Scheme are calculated by reference to the recommendations made by professionally qualified actuaries so as to spread the costs of providing retirement benefits over the service lives of employees in such a way that the cost is a substantially level percentage of current and expected future pensionable payroll.

Payments in respect of the MPF Scheme are based on specified rates in compliance with the Mandatory Provident Fund Schemes Ordinance.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

(a) Business segments

For management purposes, the Group is currently organised into three operating divisions - corporate and retail banking, treasury and foreign exchange activities and other activities. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, chequing facilities and the provision of fixed deposits and savings accounts. The Group also provides fully automated telephone and internet banking services to its customers. Other financial services offered include remittance and money exchange, safe deposit boxes, mandatory provident fund services, life insurance and mutual funds agency.

Treasury activities mainly comprise inter-bank placement and deposit transactions, management of overall interest rate risk and liquidity of the Group and centralised cash management. Income from foreign exchange activities is generated from services provided to customers in the form of foreign exchange trading and forward contracts.

Other business activities of the Group include investment holding, securities trading, stockbroking, commodities and future broking, other investment advisory services and property investment.