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. ADOPTION OF STATEMENTS OF STANDARD ACCOUNTING PRACTICE

In the current year, the Group has adopted, for the first time, a number of new and revised Statements of Standard Accounting Practice ("SSAPs") issued by the Hong Kong Society of Accountants, which has resulted in the adoption of the following new and revised accounting policies. The adoption of these standards has had no material effect on the results for the current or prior accounting periods, accordingly, no prior period adjustment is required.

(i) The revisions to SSAP 11 "Foreign Currency Translation" have eliminated the choice of translating the income statements of overseas operations and subsidiaries at the closing rate for the period, the policy previously followed by the Group. They are now required to be translated at an average rate. This change in accounting policy has not had any material effect on the results for the current or prior accounting periods.

(ii) In the current period, the Group has adopted SSAP 15 (Revised) "Cash Flow Statements". Under SSAP 15 (Revised), cash flows are classified under three headings - operating, investing and financing, rather than the previous five headings. Interest and dividends received, which were previously presented under a separate heading, are classified as investing cash flows. Cash flows arising from taxes on income are classified as operating activities, unless they can be separately identified with investing or financing activities.

(iii) In the current period, the Group has adopted SSAP 34 "Employee Benefits", which introduces measurement rules for employee benefits, including retirement benefit schemes. The principal effect of the implementation of SSAP 34 is in connection with the recognition of costs for the Group's defined benefit retirement scheme which covers 5 employees and 51 pensioners of the Group. The remaining employees were covered by the defined contribution retirement scheme. Accordingly, the adoption of SSAP 34 has not had any material impact on the financial statements.

In prior periods, the cost of providing retirement benefits under the defined benefit retirement scheme was determined using an attained age method. Under SSAP 34, the cost of providing retirement benefits under this scheme is determined using the projected unit credit method. The independent actuarial valuation will still be carried out every three years. Actuarial gains and losses which exceed 10% of the greater of the present value of the Group's pension obligations and the fair value of plan assets are amortised over the expected average remaining working lives of the employees participating in the plan. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested.

3. 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.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill arising on acquisitions after 1 January 2001 is capitalised and amortised on a straight-line basis over its useful economic life. Goodwill arising on the acquisition of an associate or a jointly controlled entity is included within the carrying amount of the associate or jointly controlled entity. Goodwill arising on the acquisition of subsidiaries is presented separately in the balance sheet.

Goodwill arising on acquisitions prior to 1 January 2001 continues to be held in reserves, and will be charged to the income statement at the time of disposal of the relevant subsidiary, associate or jointly controlled entity, or at such time as the goodwill is determined to be impaired.

Investments in subsidiaries

Investments in subsidiaries are included in the Bank's balance sheet at cost less any identified impairment loss.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Interests in associates

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, less any identified impairment loss.

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 identified impairment loss.

Interests in jointly controlled entities

Joint venture arrangements which involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities.

The Group's interests in jointly controlled entities are included in the consolidated balance sheet at the Group's share of the net assets of the jointly controlled entities less any identified impairment loss. The Group's share of the post-acquisition results of its jointly controlled entities is included in the consolidated income statement.

The Bank's investments in jointly controlled entities are stated at cost, as reduced by any identified impairment loss. The results of jointly controlled entities are accounted for by the Bank on the basis of dividends received and receivable.

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.