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, the revised Statement of Standard Accounting Practice (“SSAP”) 12 “Income Taxes” issued by the Hong Kong Society of Accountants.

The principal effect of the implementation of SSAP 12 (revised) is in relation to deferred tax. In previous years, partial provision was made for deferred tax using the income statement liability method, i.e. a liability was recognised in respect of timing differences arising, except where those timing differences were not expected to reverse in the foreseeable future. SSAP 12 (revised) requires the adoption of a balance sheet liability method, whereby deferred tax is recognised in respect of all temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with limited exceptions. In the absence of any specific transitional requirements in SSAP 12 (revised), the new accounting policy has been applied retrospectively. Comparative figures for 2002 have been restated accordingly.

As a result of this change in policy, the balance of retained profits of the Group at 1 January 2002 has been increased by HK$29,957,000 representing the cumulative effect of the change in policy on the results for periods prior to 1 January 2002. The balance of the Group’s land and buildings revaluation reserve as at 1 January 2002 has been decreased by HK$113,964,000, representing the deferred tax liability recognised in respect of the revaluation surplus on the Group’s properties at that date. The change has resulted in an increase in the Group’s profit for the year and a decrease in the Group’s land and buildings revaluation reserve of HK$4,998,000 and HK$10,454,000 respectively for the year ended 31 December 2003 (2002: increase of HK$1,917,000 and HK$2,461,000 respectively).

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 and the provisions of the Companies Ordinance. 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.
3. SIGNIFICANT ACCOUNTING POLICIES - continued

**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.

**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.
3. **SIGNIFICANT ACCOUNTING POLICIES - continued**

**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.

Assets held through repossession of collateral for realisation continue to be treated as securities for loans and advances. In this regard, provision has been made on the shortfall between the carrying amount of the loans and advances and the expected net sales proceeds from realisation of the repossessed assets.