

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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 forward contracts, interest rate swaps 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 fair value, with unrealised gains and losses included in the income statement. Gains and losses related to those derivative products that are designated as hedges are dealt with in accordance with the accounting treatment applicable to the position hedged and there is no offsetting of assets and liabilities until the position is closed. To qualify as a hedge, the derivative is expected to be effective in reducing the price or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative are expected to be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. The financial derivative products of the Group are mainly used for hedging purposes.

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.

Retirement benefit costs

Payments to the Mandatory Provident Fund Scheme are charged as expenses as they fall due.

For defined benefit retirement schemes, the cost of providing benefits is determined using the projected unit credit method with actuarial valuations being 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 participating employees. 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. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in the future contributions to the plan.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in the future contributions to the plan.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

(a) Business segments

For management purposes, the Group is currently organised into two operating divisions - corporate and retail banking, and treasury and foreign exchange 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, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current and savings accounts, credit card, insurance and personal wealth management services. 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, auto pay and direct debit services.

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, futures broking, other investment advisory services and property investment.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

- (i) Segment information about these businesses for the year ended 31 December 2004 is presented below:

INCOME STATEMENT

	Corporate and retail banking HK\$'000	Treasury and foreign exchange activities HK\$'000	Other business activities HK\$'000	Eliminations HK\$'000	Consolidated HK\$'000
Interest income from external customers	631,115	359,698	–	–	990,813
Interest expense to external customers	(333,967)	(7,349)	–	–	(341,316)
Inter-segment income <i>(Note)</i>	106,001	–	–	(106,001)	–
Inter-segment expense <i>(Note)</i>	–	(106,001)	–	106,001	–
Net income	403,149	246,348	–	–	649,497
Other operating income	95,939	27,562	144,552	–	268,053
Operating income	499,088	273,910	144,552	–	917,550
Charge for bad and doubtful debts	(51,175)	–	–	–	(51,175)
Net (losses) gains from disposal of property and equipment	(122)	–	79	–	(43)
Net gains from disposal of other securities and an associate	–	–	3,863	–	3,863
Operating expenses	(289,261)	(19,094)	(27,695)	–	(336,050)
Segment profit	158,530	254,816	120,799	–	534,145
Unallocated corporate expenses					(126,291)
Profit from operations					407,854
Share of results of jointly controlled entities			11,319		11,319
Profit from ordinary activities before taxation					419,173
Taxation					(70,170)
Net profit for the year					349,003

Note: Inter-segment pricing is charged at prevailing customer deposits interest rates.