

## 1. GENERAL

The Bank is a public limited company incorporated in Hong Kong and its shares are listed on the Stock Exchange of Hong Kong Limited. The Bank is engaged in the provision of banking and related financial services. The address of the registered office of the Bank is disclosed in the Annual Report.

The consolidated financial statements are presented in Hong Kong dollars, which is also the functional currency of the Bank.

## 2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (“HKFRSs”)

In the current year, the Group and the Bank have applied, for the first time, a number of new standards, amendments and interpretations (“new HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), which are either effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. The adoption of the new HKFRSs had no material effect on how the results and the financial position for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

## 3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The Group and the Bank have not early applied the following new standards, amendments or interpretations that have been issued but are not yet effective. The directors of the Bank anticipate that the application of these standards, amendments or interpretations will have no material impact on the results and the financial position of the Group and the Bank.

HKAS 1 (Amendment)	Capital disclosures <sup>1</sup>
HKFRS 7	Financial instruments: Disclosures <sup>1</sup>
HK(IFRIC) - INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies <sup>2</sup>
HK(IFRIC) - INT 8	Scope of HKFRS 2 <sup>3</sup>
HK(IFRIC) - INT 9	Reassessment of embedded derivatives <sup>4</sup>
HK(IFRIC) - INT 10	Interim financial reporting and impairment <sup>5</sup>
HK(IFRIC) - INT 11	HKFRS 2 - Group and treasury share transactions <sup>6</sup>

<sup>1</sup> Effective for annual periods beginning on or after 1 January 2007.

<sup>2</sup> Effective for annual periods beginning on or after 1 March 2006.

<sup>3</sup> Effective for annual periods beginning on or after 1 May 2006.

<sup>4</sup> Effective for annual periods beginning on or after 1 June 2006.

<sup>5</sup> Effective for annual periods beginning on or after 1 November 2006.

<sup>6</sup> Effective for annual periods beginning on or after 1 March 2007.

#### 4. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and by the Companies Ordinance.

##### **Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Bank and entities (including special purpose entities) controlled by the Bank (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Subsidiary companies are companies in which the Group has the power to govern the financial and operating policies to obtain benefits from its activities and this is generally accompanied by a shareholding of more than one half of the voting rights.

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.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Investments in subsidiaries are stated in the Bank's balance sheet at cost less provision for impairment losses. The results of subsidiary companies are accounted for by the Bank on the basis of dividends received or receivable.

##### **Goodwill**

###### ***Goodwill arising on acquisitions prior to 1 January 2005***

Goodwill arising on an acquisition of a subsidiary for which the agreement date is before 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of the relevant subsidiary or jointly controlled entity at the date of acquisition.

Goodwill arising on acquisitions prior to 1 January 2005 continues to be held in reserves, and will be charged to the retained earnings at the time when the business to which the goodwill relates is disposed of or when a cash-generating unit to which the goodwill relates becomes impaired. Such goodwill (net of cumulative amortisation as at 31 December 2005) is tested for impairment annually, and whenever there is an indication that the cash generating unit to which goodwill relates may be impaired.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Goodwill - continued

#### *Goodwill arising on acquisitions on or after 1 January 2005*

Goodwill arising on an acquisition of a subsidiary for which the agreement date is on or after 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the balance sheet.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of a subsidiary or a jointly controlled entity, the attributable amount of goodwill capitalised is included in the determination of the amount of gain or loss on disposal.

### Interests in jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealised profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealised losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognised.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### **Revenue recognition**

#### *Interest income and expenses*

Interest income and expenses are recognised on a time-proportion basis by reference to the principal outstanding and at the effective interest rate applicable. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes significant fees and transaction costs that are an integral part of the effective interest rate, and premiums or discounts.

Once a financial asset has been written down as a result of an impairment loss, interest income is recognised using the original rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

#### *Fees and commission income*

Fees and commission income are accounted for in the period when earned, 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.

#### *Premium income*

Premium income from insurance underwriting is recognised as income when the risk of an insurance policy is inception.

#### *Dividend income*

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

### **Property and equipment**

Leasehold buildings and equipment are stated at cost less subsequent depreciation and impairment losses.

Depreciation is provided to write off the cost of leasehold buildings and equipment over their estimated useful lives after taking into account their estimated residual value, using the straight-line method.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognised.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Property and equipment - continued

#### *Leasehold land and buildings under development for future owner-occupied purpose*

When the leasehold land and buildings are in the course of development for production, rental or for administrative purposes, the leasehold land component is classified as a prepaid lease payment and amortised on a straight-line basis over the lease term. During the construction period, the amortisation charge provided for the leasehold land is included as part of costs of buildings under construction. Buildings under construction are carried at cost, less any identified impairment losses. Depreciation of buildings commences when they are available for use (i.e. when they are in the location and condition necessary for them to be capable of operating in the manner intended by management).

#### **Investment properties**

On initial recognition, investment properties are measured at cost, including any directly attributable expenditure. Subsequent to initial recognition, investment properties are measured using the fair value model. Gains or losses arising from changes in the fair value of investment properties are included in profit or loss for the period in which they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use or no future economic benefits are expected from its disposals. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year in which the item is derecognised.

#### **Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

#### *The Group as lessor*

Amounts due from lessees under finance leases are recorded as receivables 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.

Rental income from operating leases is recognised in the consolidated income statement on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight-line basis over the lease term.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Leasing - continued

#### *The Group as lessee*

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss, unless they are directly attributable to qualifying assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

#### *Prepaid lease payments for land*

Leasehold premises held for own use is split into a lease of land and building in proportion to the relative fair values of the leasehold interests in the land element and the building element of the lease at the inception of the lease. Prepaid lease payments are stated at cost and amortised over the period of the lease.

### Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Bank's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financial statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Foreign currencies - continued

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group (i.e. Hong Kong dollars) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in income statement in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the translation reserve.

### Retirement benefit costs

Payments to the defined contribution retirement benefit plans are charged as an expense when employees have rendered service entitling them to the contributions.

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out with sufficient regularity. Actuarial gains and losses which exceed 10 per cent 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.

The amount recognised in the consolidated 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 future contributions to the plan.

### Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

#### 4. SIGNIFICANT ACCOUNTING POLICIES - continued

##### **Taxation - continued**

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

##### **Borrowing costs**

All borrowing costs are recognised as an included in interest expenses in the consolidated income statement in the period in which they are incurred.

##### **Financial instruments**

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

##### **Financial assets**

The Group's and the Bank's financial assets are classified into one of the four categories, including financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Financial instruments - continued

#### *Financial assets - continued*

##### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss has two subcategories, including financial assets held for trading and those designated at fair value through profit or loss on initial recognition.

A financial asset other than a financial asset held for trading may be designated as at fair value through profit or loss upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and HKAS 39 permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables including cash and short term funds, placements with and advances to banks and other financial institutions, interest receivable, bills receivables, trade bills and loans and advances to customers, loan to a jointly controlled entity and amounts due from subsidiaries are carried at amortised cost using the effective interest method, less any identified impairment losses.

An impairment loss is recognised in profit or loss when there is objective evidence of impairment as a result of the occurrence of loss events that will impact on the estimated future cash flows.

Individual impairment allowances are assessed by a discounted cash flow method for loans and advances that are individually significant and have objective evidence of impairment. The individual impairment allowances are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Financial instruments - continued

#### *Financial assets - continued*

##### *Loans and receivables - continued*

On collective impairment, individually insignificant advances or advances where no impairment has been identified individually are assessed on the basis of contractual cash flows and historical loss experience adjusted for current conditions.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated income statement.

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment allowances are reversed by adjusting the allowance account. The amount of the reversal is recognised in the consolidated income statement.

When a loan is uncollectable, it is written off against the related allowances for loan impairment when all collateral has been realised and further recoveries are considered unlikely. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

##### *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity, other than those that meet the definition of loans and receivables. At each balance sheet date subsequent to initial recognition, held-to-maturity investments are measured at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed on initial recognition. Impairment losses are reversed in subsequent periods when an increase in the investment's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to the restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

##### *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated or not classified as any of the other categories (set out above). At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognised in equity is removed from equity and recognised in profit or loss. Any impairment losses on available-for-sale financial assets are recognised in profit or loss. Impairment losses on available-for-sale equity investments will not reverse in profit or loss in subsequent periods. For available-for-sale debt investments, impairment losses are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### **Financial instruments - continued**

#### *Financial liabilities and equity*

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The Group's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

#### *Financial liabilities at fair value through profit or loss*

At each balance sheet date subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

#### *Other financial liabilities*

Other financial liabilities, including deposits and balances of banks and other financial institutions and deposits from customers, amounts due to subsidiaries and loan capital are subsequently measured at amortised cost, using the effective interest rate method.

#### *Offsetting financial instruments*

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

#### *Equity instruments*

Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

#### *Derivative financial instruments*

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

#### *Embedded derivatives*

Derivatives embedded in non-derivative host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit or loss.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Financial instruments - continued

#### *Financial guarantee contracts*

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. A financial guarantee contract issued by the Group and not designed as at fair value through profit or loss is recognised initially at its fair value less transaction costs that are directly attributable to the issue of the financial guarantee contract. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 Provisions, Contingent Liabilities and Contingent Assets; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 Revenue.

#### *Derecognition*

Financial assets are derecognised when the rights to receive cash flows from the assets expire or the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

#### **Impairment losses (other than goodwill)**

At each balance sheet date, the Group reviews the carrying amounts of its tangible 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. An impairment loss is 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 a revaluation decrease under that Standard.

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

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.

## 4. SIGNIFICANT ACCOUNTING POLICIES - continued

### Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

### Fiduciary assets

The assets held in trust in a fiduciary capacity are not assets of the Group and accordingly are not included in the financial statements.

### Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash, balances with banks and other financial institutions, treasury bills and other eligible bills.

## 5. CRITICAL ACCOUNTING JUDGEMENT AND KEY SOURCE OF ESTIMATION UNCERTAINTY

### Key sources of estimation

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

#### (a) Impairment allowances on loans and advances

The Group establishes, through charges against profit, impairment allowances in respect of estimated incurred loss in loans and advances. The allowances consist of individual impairment allowances and collective impairment allowances. The overall impairment allowances represent the aggregate amount by which management considers necessary to write down its loan portfolio in order to state it in the balance sheet at its estimated net recoverable value.

In determining individual impairment allowances, management considers objective evidence of impairment. When a loan is impaired, an individual impairment allowance is assessed by a discounted cash flow method, measured at the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate. The quantum of the allowance is also impacted by the collateral value and this, in turn, may be discounted in certain circumstances to recognise the impact of forced sale or quick liquidation.

## 5. CRITICAL ACCOUNTING JUDGEMENT AND KEY SOURCE OF ESTIMATION UNCERTAINTY - continued

### Key sources of estimation - continued

#### (a) Impairment allowances on loans and advances - continued

In determining collective impairment allowances, management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. (see note 18)

#### (b) Fair value of financial instruments

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates.

#### (c) Estimated impairment of goodwill

According to HKAS 36, impairment loss is made when the carrying amount of an asset exceeds its recoverable amount, which is calculated at the higher of the fair value less costs to sell and value in use.

For 2006, management reviewed goodwill by comparing its carrying amount and fair value less costs to sell. The fair value was determined by reference to the average price to earnings ratio of other insurance companies listed on The Stock Exchange of Hong Kong Limited.

In the opinion of management, no impairment loss has arisen on the goodwill as at the balance sheet date as the fair value less costs to sell exceeds its carrying amount. (see note 33)

#### (d) Impairment of available-for-sale equity investments

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. (see note 17)

## 5. CRITICAL ACCOUNTING JUDGEMENT AND KEY SOURCE OF ESTIMATION UNCERTAINTY - continued

### Key sources of judgment

In the process of applying the Group's accounting policies which are described in note 4, management has made the following judgments that have significant effect on the amounts recognised in the financial statements.

#### *Held-to-maturity investments*

The Group classified certain non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances - for example, selling an insignificant amount close to maturity - it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost.

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS

### (a) Business segments

For management purposes, the Group is currently organised into the following operating divisions - corporate and retail banking, treasury, securities dealing and other financial services business. 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 cards 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, autopay 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.

Securities dealing activities of the Group include securities trading, stockbroking and futures broking.

Other financial services business activities of the Group include investment holding, insurance, other investment advisory services and property investment.

**6. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued****(a) Business segments - continued**

- (i) Segment information about these businesses for the year ended 31 December 2006 is presented below:

**INCOME STATEMENT**

	Corporate and retail banking HK\$'000	Treasury activities HK\$'000	Securities dealing HK\$'000	Other financial services business activities HK\$'000	Eliminations HK\$'000	Consolidated HK\$'000
Interest income from external customers	1,477,181	1,258,559	4,778	-	-	2,740,518
Interest expenses to external customers	(1,852,569)	(59,410)	-	-	-	(1,911,979)
Inter-segment income (note)	868,714	-	-	-	(868,714)	-
Inter-segment expenses (note)	-	(868,714)	-	-	868,714	-
Net interest income	493,326	330,435	4,778	-	-	828,539
Other operating income	125,235	41,682	78,603	56,169	-	301,689
Operating income	618,561	372,117	83,381	56,169	-	1,130,228
Impairment allowances on loans and advances	(59,801)	-	-	-	-	(59,801)
Net loss on disposals of property and equipment	(913)	-	-	-	-	(913)
Net gain on disposals of available-for-sale securities	-	-	-	54,001	-	54,001
Net gain on fair value adjustment on investment properties	-	-	-	5,390	-	5,390
Operating expenses	(343,071)	(24,472)	(30,748)	(19,977)	-	(418,268)
Segment profit	214,776	347,645	52,633	95,583	-	710,637
Unallocated corporate expenses						(173,269)
Profit from operations						537,368
Share of profit of jointly controlled entities				33,546		33,546
Profit before taxation						570,914
Taxation						(67,770)
Profit for the year						503,144

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

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

### (a) Business segments - continued

(i) Segment information about these businesses as at 31 December 2006 is presented below:

#### BALANCE SHEET

	Corporate and retail banking HK\$'000	Treasury activities HK\$'000	Securities dealing HK\$'000	Other financial services business activities HK\$'000	Consolidated HK\$'000
Assets					
Segment assets	28,544,911	32,929,054	295,609	833,071	62,602,645
Interests in jointly controlled entities	-	-	-	99,256	99,256
Loan to a jointly controlled entity	-	-	-	31,000	31,000
Unallocated corporate assets					296,998
Consolidated total assets					<u>63,029,899</u>
Liabilities					
Segment liabilities	55,006,716	1,498,085	281,035	36,214	56,822,050
Unallocated corporate liabilities					156,119
Consolidated total liabilities					<u>56,978,169</u>

#### OTHER INFORMATION

	Corporate and retail banking HK\$'000	Treasury activities HK\$'000	Securities dealing HK\$'000	Other financial services business activities HK\$'000	Unallocated HK\$'000	Consolidated HK\$'000
Capital additions	139,351	19,729	9,499	2,362	65,487	236,428
Depreciation	16,121	306	1,007	697	12,404	30,535
Amortisation	3,490	-	113	5	1,506	5,114

**6. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued****(a) Business segments - continued**

(ii) Segment information about these businesses for the year ended 31 December 2005 is presented below:

**INCOME STATEMENT**

	Corporate and retail banking HK\$'000	Treasury activities HK\$'000	Securities dealing HK\$'000	Other financial services business activities HK\$'000	Eliminations HK\$'000	Consolidated HK\$'000
Interest income from external customers	997,780	721,558	-	-	-	1,719,338
Interest expenses to external customers	(914,949)	(51,537)	-	-	-	(966,486)
Inter-segment income (note)	333,259	-	-	-	(333,259)	-
Inter-segment expenses (note)	-	(333,259)	-	-	333,259	-
Net interest income	416,090	336,762	-	-	-	752,852
Other operating income	74,945	27,737	45,683	68,764	-	217,129
Operating income	491,035	364,499	45,683	68,764	-	969,981
Impairment allowances on loans and advances	(67,807)	-	-	-	-	(67,807)
Net (loss) gain on disposals of property and equipment	(909)	-	-	2,059	-	1,150
Net gain on disposals of available-for-sale securities	-	-	-	47,534	-	47,534
Net loss on liquidation of a subsidiary	-	-	-	(4)	-	(4)
Net gain on fair value adjustment on investment properties	-	-	-	7,500	-	7,500
Operating expenses	(324,108)	(19,445)	(26,719)	(1,171)	-	(371,443)
Segment profit	98,211	345,054	18,964	124,682	-	586,911
Unallocated corporate expenses						(121,686)
Profit from operations						465,225
Share of profit of jointly controlled entities				3,576		3,576
Profit before taxation						468,801
Taxation						(70,818)
Profit for the year						397,983

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

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

### (a) Business segments - continued

(ii) Segment information about these businesses as at 31 December 2005 is presented below:

#### BALANCE SHEET

	Corporate and retail banking HK\$'000	Treasury activities HK\$'000	Securities dealing HK\$'000	Other financial services business activities HK\$'000	Consolidated HK\$'000
<b>Assets</b>					
Segment assets	25,043,584	23,035,716	46,804	1,521,304	49,647,408
Interests in jointly controlled entities	–	–	–	65,710	65,710
Loan to a jointly controlled entity	–	–	–	31,000	31,000
Unallocated corporate assets					229,634
Consolidated total assets					<u>49,973,752</u>
<b>Liabilities</b>					
Segment liabilities	42,035,905	1,733,891	39,362	52,699	43,861,857
Unallocated corporate liabilities					278,759
Consolidated total liabilities					<u>44,140,616</u>

#### OTHER INFORMATION

	Corporate and retail banking HK\$'000	Treasury activities HK\$'000	Securities dealing HK\$'000	Other financial services business activities HK\$'000	Unallocated HK\$'000	Consolidated HK\$'000
Capital additions	17,092	118	372	1,583	26,236	45,401
Depreciation	18,438	312	193	1,816	14,846	35,605
Amortisation	3,751	–	–	–	1,312	5,063

**6. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued****(b) Geographical segments**

Geographical segmentation is analysed based on the locations of the principal operations of the branches and subsidiary companies responsible for reporting the results or booking the assets. For both years 2005 and 2006, around 90% of the Group's revenue and profit before taxation were generated by assets booked by the principal operations of the branches and subsidiary companies located in Hong Kong. More than 90% of assets were located in Hong Kong and the remaining assets were extended to branches outside Hong Kong, mainly in the Mainland China and America.

Details of geographical segmentation are set out below.

	<b>2006</b>					
	Total	Profit	Total	Total	Total	Capital
	operating	before			contingent	
income	taxation	assets	liabilities	commitments	expenditure	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	during the year
						HK\$'000
Hong Kong	1,061,372	496,045	60,581,313	55,640,229	11,729,612	235,115
Asia Pacific (excluding Hong Kong)	43,248	55,139	1,935,345	1,113,537	274,869	705
America	25,608	19,730	513,241	224,403	147,388	608
<b>Total</b>	<b>1,130,228</b>	<b>570,914</b>	<b>63,029,899</b>	<b>56,978,169</b>	<b>12,151,869</b>	<b>236,428</b>

  

	<b>2005</b>					
	Total	Profit	Total	Total	Total	Capital
	operating	before			contingent	
income	taxation	assets	liabilities	commitments	expenditure	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	during the year
						HK\$'000
Hong Kong	921,944	448,116	46,976,330	41,530,478	9,515,592	44,823
Asia Pacific (excluding Hong Kong)	16,494	19,035	2,304,042	1,989,216	45,648	532
America	31,543	1,650	693,380	620,922	48,488	46
<b>Total</b>	<b>969,981</b>	<b>468,801</b>	<b>49,973,752</b>	<b>44,140,616</b>	<b>9,609,728</b>	<b>45,401</b>

## 7. FINANCIAL RISK MANAGEMENT

### Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments, including derivatives. The Group accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer period at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances; the Group also enters into guarantees and other commitments such as letters of credit and performance, and other bonds.

The Group also trades in financial instruments where it takes positions in traded instruments to take advantage of short-term market movements in equities. The Board of Directors places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. Foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

Market risk arising from the trading book is considered immaterial, as the Group does not maintain significant positions of financial instruments leading to foreign exchange, interest rate, commodity and equity exposures. The Group's business activities involve the use of financial instruments, including derivatives. These activities expose the Group to a variety of financial risks, mainly credit risk, foreign exchange risk, interest rate risk and liquidity risk.

### Credit risk

The Group takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. The Group's maximum exposure to credit risk in the event of the counterparties' failure to perform their obligations in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet and credit commitment granted. Impairment allowances are made for losses that have been incurred at the balance sheet date. Significant changes in the economy, or in the health of a particular industry segment, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk.

The Group's lending policy sets out in detail the credit approval and monitoring mechanism, the loan classification system and provisioning policy, which is established by reference to the requirements and provisions of the Banking Ordinance and the guidelines issued by the Hong Kong Monetary Authority.

Day-to-day credit management is performed by the Loan Committee with reference to the creditworthiness, and concentration risk of and the collateral pledged by the counterparties. Decisions made by the Loan Committee are reviewed regularly by the Executive Loans Committee comprising executive directors.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to a quarter or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved annually by the Board of Directors.

## 7. FINANCIAL RISK MANAGEMENT - continued

### Credit risk - continued

The exposure to any one borrower, including banks and brokers, is further restricted by sub-limits covering on and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

#### (a) Derivatives

The Group does not carry interest and foreign exchange rate positions on its trading book. The derivatives are used to manage the Group's own exposures to market risks as part of its asset and liability management process. The principal derivatives instruments used by the Group are interest and foreign exchange rate related contracts, which are over-the-counter derivatives. Most of the Group's foreign exchange rate and interest rate contracts have been entered into to meet customer demand and manage the Group's own risk.

The Group maintains strict control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair values are positive), which is generally only a small fraction of the nominal value of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

#### (b) Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit - which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties - carry the same credit risk as loans. Documentary and commercial letters of credit - which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions - are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

## 7. FINANCIAL RISK MANAGEMENT - continued

### Credit risk - continued

#### (b) Credit-related commitments - continued

Commitments to extend credit represent unused portions of authorisation to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term of maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Although the Group's business segments are managed on a worldwide basis, their operations are mainly in East Asia. The Group's exposure to credit risk is concentrated in these areas.

Hong Kong is the home territory of the Bank, which is also the main operating entity. The areas of operation include all the primary business segments. As a well-established bank in Hong Kong, the Group accounts for a significant share of credit exposure to many sectors of the economy. However, credit risk is spread over a diversity of personal and commercial customers.

With the exception of Hong Kong, no other individual location contributed more than 10% of consolidated income or assets.

#### Foreign exchange risk

The Group and the Bank do not have any significant foreign exchange risk as foreign exchange dealing is moderate. Structural foreign exchange exposure arising from investments in foreign branches and subsidiaries is accounted for in the translation reserve account. Day-to-day foreign exchange management is performed by the Treasury Management Department within approved limits.

The Group and the Bank take on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on their financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. Off-balance sheet notional position represents the contractual amounts of foreign currencies bought and sold under foreign exchange contracts. Bought currency is represented by positive amount and sold currency is represented by negative amount.

**7. FINANCIAL RISK MANAGEMENT - continued****Foreign exchange risk - continued**

The following table indicates the assets and liabilities denominated in the respective currencies at the balance sheet date:

**THE GROUP**

	HK\$	US\$	MOP	Others	Total
Hong Kong dollars equivalents (HK\$'000)					
At 31 December 2006					
Assets					
Cash and short term funds	8,954,099	4,007,904	71,684	3,223,172	16,256,859
Placements with banks and other financial institutions	2,140,000	388,925	–	109,536	2,638,461
Derivative financial instruments	4,962	–	–	–	4,962
Financial assets at fair value through profit or loss	251,962	358,849	–	–	610,811
Available-for-sale securities	362,256	595,024	–	140,861	1,098,141
Held-to-maturity securities	7,483,646	6,011,026	–	408,501	13,903,173
Advances to customers	24,963,656	1,529,678	35,964	345,240	26,874,538
Other assets	1,558,918	67,835	148	16,053	1,642,954
Total assets	<u>45,719,499</u>	<u>12,959,241</u>	<u>107,796</u>	<u>4,243,363</u>	<u>63,029,899</u>
Liabilities					
Deposits and balances of banks and other financial institutions	95,803	352,218	–	80,972	528,993
Deposits from customers	38,855,766	11,297,915	46,722	4,474,829	54,675,232
Derivative financial instruments	1,716	–	–	–	1,716
Loan capital	(4,624)	972,000	–	–	967,376
Other liabilities	720,559	62,909	3,107	18,277	804,852
Total liabilities	<u>39,669,220</u>	<u>12,685,042</u>	<u>49,829</u>	<u>4,574,078</u>	<u>56,978,169</u>
Net on-balance sheet position	<u>6,050,279</u>	<u>274,199</u>	<u>57,967</u>	<u>(330,715)</u>	<u>6,051,730</u>
Off-balance sheet notional position	<u>(76,456)</u>	<u>(270,227)</u>	<u>–</u>	<u>346,683</u>	<u>–</u>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 7. FINANCIAL RISK MANAGEMENT - continued

### Foreign exchange risk - continued

#### THE GROUP

	HK\$	US\$	MOP	Others	Total
Hong Kong dollars equivalents (HK\$'000)					
At 31 December 2005					
Assets					
Cash and short term funds	5,251,903	2,506,891	87,567	3,952,118	11,798,479
Placements with banks and other financial institutions	1,310,000	391,633	–	327,783	2,029,416
Derivative financial instruments	45,607	–	–	–	45,607
Financial assets at fair value through profit or loss	418,003	391,157	–	–	809,160
Available-for-sale securities	358,900	315,839	–	127,030	801,769
Held-to-maturity securities	4,707,785	4,283,575	–	201,546	9,192,906
Advances to customers	22,538,378	1,408,392	44,955	304,919	24,296,644
Other assets	893,953	91,112	191	14,515	999,771
Total assets	<u>35,524,529</u>	<u>9,388,599</u>	<u>132,713</u>	<u>4,927,911</u>	<u>49,973,752</u>
Liabilities					
Deposits and balances of banks and other financial institutions	1,554,492	622,000	–	87,012	2,263,504
Deposits from customers	28,069,955	8,601,850	72,446	4,762,041	41,506,292
Other liabilities	295,027	28,071	1,559	46,163	370,820
Total liabilities	<u>29,919,474</u>	<u>9,251,921</u>	<u>74,005</u>	<u>4,895,216</u>	<u>44,140,616</u>
Net on-balance sheet position	<u>5,605,055</u>	<u>136,678</u>	<u>58,708</u>	<u>32,695</u>	<u>5,833,136</u>
Off-balance sheet notional position	<u>151,629</u>	<u>(129,072)</u>	<u>(4,004)</u>	<u>(18,553)</u>	<u>–</u>

## 7. FINANCIAL RISK MANAGEMENT - continued

## Foreign exchange risk - continued

## THE BANK

	HK\$	US\$	MOP	Others	Total
Hong Kong dollars equivalents (HK\$'000)					
At 31 December 2006					
Assets					
Cash and short term funds	8,905,413	4,007,904	71,684	3,223,173	16,208,174
Placements with banks and other financial institutions	2,140,000	388,925	–	109,536	2,638,461
Derivative financial instruments	4,962	–	–	–	4,962
Financial assets at fair value through profit or loss	251,539	358,849	–	–	610,388
Available-for-sale securities	180,547	595,024	–	140,862	916,433
Held-to-maturity securities	7,483,646	6,011,026	–	408,501	13,903,173
Advances to customers	24,961,935	1,529,678	35,964	345,241	26,872,818
Other assets	1,979,414	67,835	148	15,978	2,063,375
Total assets	<u>45,907,456</u>	<u>12,959,241</u>	<u>107,796</u>	<u>4,243,291</u>	<u>63,217,784</u>
Liabilities					
Deposits and balances of banks and other financial institutions	95,803	352,218	–	80,972	528,993
Deposits from customers	38,851,708	11,297,915	46,722	4,474,829	54,671,174
Derivative financial instruments	1,716	–	–	–	1,716
Loan capital	(4,624)	972,000	–	–	967,376
Other liabilities	996,148	62,909	3,107	18,205	1,080,369
Total liabilities	<u>39,940,751</u>	<u>12,685,042</u>	<u>49,829</u>	<u>4,574,006</u>	<u>57,249,628</u>
Net on-balance sheet position	<u>5,966,705</u>	<u>274,199</u>	<u>57,967</u>	<u>(330,715)</u>	<u>5,968,156</u>
Off-balance sheet notional position	<u>(76,456)</u>	<u>(270,227)</u>	<u>–</u>	<u>346,683</u>	<u>–</u>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 7. FINANCIAL RISK MANAGEMENT - continued

### Foreign exchange risk - continued

#### THE BANK

	HK\$	US\$	MOP	Others	Total
At 31 December 2005					
Assets					
Cash and short term funds	5,215,029	2,506,891	87,567	3,952,118	11,761,605
Placements with banks and other financial institutions	1,310,000	391,633	–	327,783	2,029,416
Derivative financial instruments	45,607	–	–	–	45,607
Financial assets at fair value through profit or loss	417,440	391,158	–	–	808,598
Available-for-sale securities	233,622	315,839	–	127,030	676,491
Held-to-maturity securities	4,707,785	4,283,575	–	201,546	9,192,906
Advances to customers	22,535,404	1,408,392	44,955	304,919	24,293,670
Other assets	<u>1,376,184</u>	<u>91,112</u>	<u>191</u>	<u>14,513</u>	<u>1,482,000</u>
Total assets	<u>35,841,071</u>	<u>9,388,600</u>	<u>132,713</u>	<u>4,927,909</u>	<u>50,290,293</u>
Liabilities					
Deposits and balances of banks and other financial institutions	1,554,492	622,000	–	87,012	2,263,504
Deposits from customers	28,065,800	8,601,850	72,446	4,762,040	41,502,136
Other liabilities	<u>629,479</u>	<u>28,071</u>	<u>1,559</u>	<u>46,164</u>	<u>705,273</u>
Total liabilities	<u>30,249,771</u>	<u>9,251,921</u>	<u>74,005</u>	<u>4,895,216</u>	<u>44,470,913</u>
Net on-balance sheet position	<u>5,591,300</u>	<u>136,679</u>	<u>58,708</u>	<u>32,693</u>	<u>5,819,380</u>
Off-balance sheet notional position	<u>151,629</u>	<u>(129,072)</u>	<u>(4,004)</u>	<u>(18,553)</u>	<u>–</u>

## 7. FINANCIAL RISK MANAGEMENT - continued

### Cash flow and fair value interest rate risk

#### *Interest sensitivity of assets, liabilities and off balance sheet items - repricing analysis*

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group and the Bank take on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Limits are set on the level of mismatch of interest rate repricing that may be undertaken, which is monitored regularly.

The Group and the Bank do not carry interest rate positions on its trading book. Certain interest rate contracts entered into to manage the Group's and the Bank's own risk are classified as trading securities under the requirements of HKAS 39. Interest rate risk arises primarily from the timing differences in the re-pricing of, and the different bases of pricing interest-bearing assets, liabilities and commitments, and from positions of non-interest bearing balances. Interest rate risk is monitored by regular sensitivity analyses of the net re-pricing gap and of different scenarios of pricing bases of assets and liabilities grouped with reference to their next contractual repricing date or maturity date.

The tables below summarise the Group's and the Bank's exposure to interest rate risks. Included in the tables are the Group's and the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 7. FINANCIAL RISK MANAGEMENT - continued

### Cash flow and fair value interest rate risk - continued

#### THE GROUP

	Weighted average effective interest rate %	Up to 3 months HK\$'000	3 - 12 months HK\$'000	1 - 5 years HK\$'000	Over 5 years HK\$'000	Non- interest bearing HK\$'000	Total HK\$'000
At 31 December 2006							
Assets							
Cash and short term funds	4.58	15,656,479	232,315	-	-	368,065	16,256,859
Placements with banks and other financial institutions	4.34	2,453,461	185,000	-	-	-	2,638,461
Derivative financial instruments	-	-	-	-	-	4,962	4,962
Financial assets at fair value through profit or loss	3.92	184,439	100,682	220,442	-	105,248	610,811
Available-for-sale securities	2.45	417,620	46,677	7,779	-	626,065	1,098,141
Held-to-maturity securities	4.60	8,515,698	1,839,437	3,545,844	-	2,194	13,903,173
Advances to customers	5.49	25,553,255	801,250	39,650	2,925	477,458	26,874,538
Other assets	4.03	56,000	-	-	-	1,586,954	1,642,954
Total assets		<u>52,836,952</u>	<u>3,205,361</u>	<u>3,813,715</u>	<u>2,925</u>	<u>3,170,946</u>	<u>63,029,899</u>
Liabilities							
Deposits and balances of banks and other financial institutions	4.25	516,125	-	-	-	12,868	528,993
Deposits from customers	3.77	49,081,782	2,911,570	194,021	-	2,487,859	54,675,232
Derivative financial instruments	-	-	-	-	-	1,716	1,716
Loan capital	6.32	967,376	-	-	-	-	967,376
Other liabilities	-	-	-	-	-	804,852	804,852
Total liabilities		<u>50,565,283</u>	<u>2,911,570</u>	<u>194,021</u>	<u>-</u>	<u>3,307,295</u>	<u>56,978,169</u>
Total interest sensitivity gap		<u>2,271,669</u>	<u>293,791</u>	<u>3,619,694</u>	<u>2,925</u>	<u>(136,349)</u>	<u>6,051,730</u>

## 7. FINANCIAL RISK MANAGEMENT - continued

## Cash flow and fair value interest rate risk - continued

## THE GROUP - continued

	Weighted average effective interest rate %	Up to 3 months HK\$'000	3 - 12 months HK\$'000	1 - 5 years HK\$'000	Over 5 years HK\$'000	Non- interest bearing HK\$'000	Total HK\$'000
At 31 December 2005							
Assets							
Cash and short term funds	4.32	10,769,415	99,501	228,835	10,000	690,728	11,798,479
Placements with banks and other financial institutions	4.52	2,029,416	-	-	-	-	2,029,416
Derivative financial instruments	-	-	-	-	-	45,607	45,607
Financial assets at fair value through profit or loss	4.50	565,737	-	203,047	-	40,376	809,160
Available-for-sale securities	2.28	-	278,397	-	-	523,372	801,769
Held-to-maturity securities	4.15	5,947,792	1,124,606	2,118,410	98	2,000	9,192,906
Advances to customers	5.44	24,001,286	267,240	24,981	3,137	-	24,296,644
Other assets	-	-	-	-	-	999,771	999,771
<b>Total assets</b>		<b>43,313,646</b>	<b>1,769,744</b>	<b>2,575,273</b>	<b>13,235</b>	<b>2,301,854</b>	<b>49,973,752</b>
Liabilities							
Deposits and balances of banks and other financial institutions	4.14	2,256,977	-	-	-	6,527	2,263,504
Deposits from customers	3.64	37,413,235	1,676,101	267,837	-	2,149,119	41,506,292
Other liabilities	-	-	-	-	-	370,820	370,820
<b>Total liabilities</b>		<b>39,670,212</b>	<b>1,676,101</b>	<b>267,837</b>	<b>-</b>	<b>2,526,466</b>	<b>44,140,616</b>
<b>Total interest sensitivity gap</b>		<b>3,643,434</b>	<b>93,643</b>	<b>2,307,436</b>	<b>13,235</b>	<b>(224,612)</b>	<b>5,833,136</b>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 7. FINANCIAL RISK MANAGEMENT - continued

### Cash flow and fair value interest rate risk - continued

#### THE BANK

	Weighted average effective interest rate %	Up to 3 months HK\$'000	3 - 12 months HK\$'000	1 - 5 years HK\$'000	Over 5 years HK\$'000	Non- interest bearing HK\$'000	Total HK\$'000
At 31 December 2006							
Assets							
Cash and short term funds	4.57	15,607,834	232,315	-	-	368,025	16,208,174
Placements with banks and other financial institutions	4.34	2,453,461	185,000	-	-	-	2,638,461
Derivative financial instruments	-	-	-	-	-	4,962	4,962
Financial assets at fair value through profit or loss	3.92	184,439	100,682	220,442	-	104,825	610,388
Available-for-sale securities	2.94	417,620	46,677	7,779	-	444,357	916,433
Held-to-maturity securities	4.60	8,515,698	1,839,437	3,545,844	-	2,194	13,903,173
Advances to customers	5.49	25,551,535	801,250	39,650	2,925	477,458	26,872,818
Other assets	4.03	56,000	-	-	-	2,007,375	2,063,375
Total assets		<u>52,786,587</u>	<u>3,205,361</u>	<u>3,813,715</u>	<u>2,925</u>	<u>3,409,196</u>	<u>63,217,784</u>
Liabilities							
Deposits and balances of banks and other financial institutions	4.25	516,125	-	-	-	12,868	528,993
Deposits from customers	3.77	49,077,855	2,911,570	194,021	-	2,487,728	54,671,174
Derivative financial instruments	-	-	-	-	-	1,716	1,716
Amounts due to subsidiaries	1.94	609,382	-	-	-	7,210	616,592
Loan capital	6.32	967,376	-	-	-	-	967,376
Other liabilities	-	-	-	-	-	463,777	463,777
Total liabilities		<u>51,170,738</u>	<u>2,911,570</u>	<u>194,021</u>	<u>-</u>	<u>2,973,299</u>	<u>57,249,628</u>
Total interest sensitivity gap		<u>1,615,849</u>	<u>293,791</u>	<u>3,619,694</u>	<u>2,925</u>	<u>435,897</u>	<u>5,968,156</u>

**7. FINANCIAL RISK MANAGEMENT - continued****Cash flow and fair value interest rate risk - continued****THE BANK - continued**

	Weighted average effective interest rate %	Up to 3 months HK\$'000	3 - 12 months HK\$'000	1 - 5 years HK\$'000	Over 5 years HK\$'000	Non- interest bearing HK\$'000	Total HK\$'000
At 31 December 2005							
Assets							
Cash and short term funds	4.32	10,732,581	99,501	228,835	10,000	690,688	11,761,605
Placements with banks and other financial institutions	4.52	2,029,416	-	-	-	-	2,029,416
Derivative financial instruments	-	-	-	-	-	45,607	45,607
Financial assets at fair value through profit or loss	4.50	565,737	-	203,047	-	39,814	808,598
Available-for-sale securities	2.70	-	278,396	-	-	398,095	676,491
Held-to-maturity securities	4.15	5,947,791	1,124,607	2,118,410	98	2,000	9,192,906
Advances to customers	5.44	23,998,741	267,093	24,699	3,137	-	24,293,670
Other assets	-	-	-	-	-	1,482,000	1,482,000
Total assets		<u>43,274,266</u>	<u>1,769,597</u>	<u>2,574,991</u>	<u>13,235</u>	<u>2,658,204</u>	<u>50,290,293</u>
Liabilities							
Deposits and balances of banks and other financial institutions	4.14	2,256,976	-	-	-	6,528	2,263,504
Deposits from customers	3.64	37,409,345	1,675,966	267,837	-	2,148,988	41,502,136
Amounts due to subsidiaries	3.09	328,870	-	-	-	97,211	426,081
Other liabilities	-	-	-	-	-	279,192	279,192
Total liabilities		<u>39,995,191</u>	<u>1,675,966</u>	<u>267,837</u>	<u>-</u>	<u>2,531,919</u>	<u>44,470,913</u>
Total interest sensitivity gap		<u>3,279,075</u>	<u>93,631</u>	<u>2,307,154</u>	<u>13,235</u>	<u>126,285</u>	<u>5,819,380</u>

**Liquidity risk**

The Group and the Bank have laid down liquidity policy which is reviewed regularly by the Board. This policy requires the Group and the Bank to maintain a conservative level of liquid funds on a daily basis to ensure the availability of adequate liquid funds to meet all obligations, and the compliance with the statutory liquidity ratio requirement. The liquidity position is monitored through statutory liquidity ratio, loan-to-deposit ratio, maturity profile of assets and liabilities, and inter-bank transactions undertaken by the Group and the Bank.

The Group and the Bank are exposed to daily calls on their available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives. The Group and the Bank do not maintain cash resources to meet all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Limits are set on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 7. FINANCIAL RISK MANAGEMENT - continued

### Liquidity risk - continued

The tables below analyse the Group's and the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

	THE GROUP						
	Repayable on demand HK\$'000	Repayable within 3 months or less (except on those repayable on demand) HK\$'000	Repayable after 3 months but within 1 year HK\$'000	Repayable after 1 year but within 5 years HK\$'000	Repayable after 5 years HK\$'000	Undated* HK\$'000	Total HK\$'000
As at 31 December 2006							
Assets							
Cash and short-term funds	1,145,253	14,879,291	232,315	-	-	-	16,256,859
Placements with banks and other financial institutions	-	2,453,461	185,000	-	-	-	2,638,461
Derivative financial instruments	-	-	-	-	-	4,962	4,962
Financial assets at fair value through profit or loss	-	104,825	79,083	426,480	-	423	610,811
Available-for-sale securities	-	76,209	38,897	194,482	162,488	626,065	1,098,141
Held-to-maturity securities	-	4,738,140	2,841,907	6,304,607	18,519	-	13,903,173
Advances to customers	1,486,391	4,410,927	4,243,045	9,007,982	7,349,957	376,236	26,874,538
Advances to banks and other financial institutions	-	19,425	38,000	-	-	-	57,425
Other assets	354,989	269,756	71,225	35,935	3,335	850,289	1,585,529
Total assets	<u>2,986,633</u>	<u>26,952,034</u>	<u>7,729,472</u>	<u>15,969,486</u>	<u>7,534,299</u>	<u>1,857,975</u>	<u>63,029,899</u>
Liabilities							
Deposits and balances of banks and other financial institutions	19,140	509,853	-	-	-	-	528,993
Deposits from customers	11,783,183	40,279,921	2,518,105	94,023	-	-	54,675,232
Derivative financial instruments	-	-	-	-	-	1,716	1,716
Loan capital	-	-	-	-	967,376	-	967,376
Other liabilities	504,266	178,467	66,565	50,375	-	5,179	804,852
Total liabilities	<u>12,306,589</u>	<u>40,968,241</u>	<u>2,584,670</u>	<u>144,398</u>	<u>967,376</u>	<u>6,895</u>	<u>56,978,169</u>
Net liquidity gap	<u>(9,319,956)</u>	<u>(14,016,207)</u>	<u>5,144,802</u>	<u>15,825,088</u>	<u>6,566,923</u>	<u>1,851,080</u>	<u>6,051,730</u>

## 7. FINANCIAL RISK MANAGEMENT - continued

## Liquidity risk - continued

	THE GROUP						
	Repayable on demand HK\$'000	Repayable within 3 months or less (except on those repayable on demand) HK\$'000	Repayable after 3 months but within 1 year HK\$'000	Repayable after 1 year but within 5 years HK\$'000	Repayable after 5 years HK\$'000	Undated* HK\$'000	Total HK\$'000
As at 31 December 2005							
Assets							
Cash and short-term funds	1,140,954	10,319,189	99,501	228,835	10,000	–	11,798,479
Placements with banks and other financial institutions	–	2,029,416	–	–	–	–	2,029,416
Derivative financial instruments	–	–	–	–	–	45,607	45,607
Financial assets at fair value through profit or loss	16,024	164,920	54,286	540,598	32,770	562	809,160
Available-for-sale securities	–	–	38,388	144,857	95,151	523,373	801,769
Held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
Advances to customers	1,615,723	4,635,235	3,254,009	8,116,115	6,087,700	587,862	24,296,644
Advances to banks and other financial institutions	–	19,209	38,000	–	–	–	57,209
Other assets	93,094	187,623	46,959	45,728	1,319	567,839	942,562
Total assets	<u>2,865,795</u>	<u>20,096,938</u>	<u>5,829,545</u>	<u>12,925,601</u>	<u>6,530,630</u>	<u>1,725,243</u>	<u>49,973,752</u>
Liabilities							
Deposits and balances of banks and other financial institutions	529,613	1,733,891	–	–	–	–	2,263,504
Deposits from customers	8,630,741	31,289,581	1,385,276	200,694	–	–	41,506,292
Other liabilities	193,149	100,185	54,139	23,347	–	–	370,820
Total liabilities	<u>9,353,503</u>	<u>33,123,657</u>	<u>1,439,415</u>	<u>224,041</u>	<u>–</u>	<u>–</u>	<u>44,140,616</u>
Net liquidity gap	<u>(6,487,708)</u>	<u>(13,026,719)</u>	<u>4,390,130</u>	<u>12,701,560</u>	<u>6,530,630</u>	<u>1,725,243</u>	<u>5,833,136</u>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 7. FINANCIAL RISK MANAGEMENT - continued

### Liquidity risk - continued

	THE BANK						Total HK\$'000
	Repayable on demand HK\$'000	Repayable within 3 months or less (except on those repayable on demand) HK\$'000	Repayable after 3 months but within 1 year HK\$'000	Repayable after 1 year but within 5 years HK\$'000	Repayable after 5 years HK\$'000	Undated* HK\$'000	
As at 31 December 2006							
Assets							
Cash and short-term funds	1,145,213	14,830,646	232,315	-	-	-	16,208,174
Placements with banks and other financial institutions	-	2,453,461	185,000	-	-	-	2,638,461
Derivative financial instruments	-	-	-	-	-	4,962	4,962
Financial assets at fair value through profit or loss	-	104,825	79,083	426,480	-	-	610,388
Available-for-sale securities	-	76,209	38,897	194,482	162,488	444,357	916,433
Held-to-maturity securities	-	4,738,140	2,841,907	6,304,607	18,519	-	13,903,173
Advances to customers	1,486,390	4,409,208	4,243,045	9,007,982	7,349,957	376,236	26,872,818
Advances to banks and other financial institutions	-	19,425	38,000	-	-	-	57,425
Other assets	66,018	266,921	69,969	35,932	3,335	1,563,775	2,005,950
<b>Total assets</b>	<b>2,697,621</b>	<b>26,898,835</b>	<b>7,728,216</b>	<b>15,969,483</b>	<b>7,534,299</b>	<b>2,389,330</b>	<b>63,217,784</b>
Liabilities							
Deposits and balances of banks and other financial institutions	19,140	509,853	-	-	-	-	528,993
Deposits from customers	11,783,183	40,275,863	2,518,105	94,023	-	-	54,671,174
Derivative financial instruments	-	-	-	-	-	1,716	1,716
Loan capital	-	-	-	-	967,376	-	967,376
Other liabilities	510,910	502,698	43,957	19,115	-	3,689	1,080,369
<b>Total liabilities</b>	<b>12,313,233</b>	<b>41,288,414</b>	<b>2,562,062</b>	<b>113,138</b>	<b>967,376</b>	<b>5,405</b>	<b>57,249,628</b>
<b>Net liquidity gap</b>	<b>(9,615,612)</b>	<b>(14,389,579)</b>	<b>5,166,154</b>	<b>15,856,345</b>	<b>6,566,923</b>	<b>2,383,925</b>	<b>5,968,156</b>

## 7. FINANCIAL RISK MANAGEMENT - continued

## Liquidity risk - continued

	THE BANK						
	Repayable on demand HK\$'000	Repayable within 3 months or less (except on those repayable on demand) HK\$'000	Repayable after 3 months but within 1 year HK\$'000	Repayable after 1 year but within 5 years HK\$'000	Repayable after 5 years HK\$'000	Undated*	Total HK\$'000
As at 31 December 2005							
Assets							
Cash and short-term funds	1,140,914	10,282,355	99,501	228,835	10,000	–	11,761,605
Placements with banks and other financial institutions	–	2,029,416	–	–	–	–	2,029,416
Derivative financial instruments	–	–	–	–	–	45,607	45,607
Financial assets at fair value through profit or loss	16,024	164,920	54,286	540,598	32,770	–	808,598
Available-for-sale securities	–	–	38,388	144,857	95,151	398,095	676,491
Held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
Advances to customers	1,615,723	4,635,003	3,253,395	8,115,019	6,086,694	587,836	24,293,670
Advances to banks and other financial institutions	–	19,209	38,000	–	–	–	57,209
Other assets	18,705	184,785	46,458	45,722	1,319	1,127,802	1,424,791
Total assets	2,791,366	20,057,034	5,828,430	12,924,499	6,529,624	2,159,340	50,290,293
Liabilities							
Deposits and balances of banks and other financial institutions	529,613	1,733,891	–	–	–	–	2,263,504
Deposits from customers	8,630,609	31,285,692	1,385,141	200,694	–	–	41,502,136
Other liabilities	229,417	100,237	372,964	2,655	–	–	705,273
Total liabilities	9,389,639	33,119,820	1,758,105	203,349	–	–	44,470,913
Net liquidity gap	(6,598,273)	(13,062,786)	4,070,325	12,721,150	6,529,624	2,159,340	5,819,380

\* Other than those assets and liabilities that have been classified according to their maturity buckets, the undated amounts are expected to be recovered or settled after twelve months.

## 7. FINANCIAL RISK MANAGEMENT - continued

### Liquidity risk - continued

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities are fundamental to the management of the Group. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, as many of these commitments will expire or terminate without being funded.

### Fair value of financial assets and liabilities

Except as detailed in the following table, the directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values:

#### THE GROUP AND THE BANK

	Carrying value		Fair value	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Financial assets				
– Held-to-maturity securities	<u>13,903,173</u>	<u>9,192,906</u>	<u>13,945,888</u>	<u>9,172,671</u>
Financial liabilities				
– Loan capital	<u>967,376</u>	<u>–</u>	<u>985,384</u>	<u>–</u>

Where quoted and observable market prices are not available, fair values are estimated based on a range of methodologies and assumptions. The principal ones are as follows:

The fair value of cash and short term funds, balances and placements with banks and other financial institutions and amounts due from related parties are considered to approximate their carrying values because most of them are mainly priced in market interest rate.

**7. FINANCIAL RISK MANAGEMENT - continued****Fair value of financial assets and liabilities - continued****THE GROUP AND THE BANK - continued**

The Group and the Bank consider the carrying amount of loans and advances to customers, and other accounts, as a reasonable approximation of their fair values. Presently, market and observable prices do not exist as there is currently no ready market wherein exchanges between willing parties occur. In estimating the fair value, loans are categorised into homogeneous groups by products type, risk characteristic, maturity and pricing profile, and non-performing accounts. In evaluating the reasonableness of fair value, the Group and the Bank perform analysis on each of the homogeneous groups, taking into account various hypothetical credit spread and market interest rate scenarios, future expected loss experience and estimated forced sale values of collateral. Impairment allowance under collective assessment is also deducted in arriving at the fair value as a discount for credit risk inherent in the large portfolio of advances to customers.

The Group and the Bank consider the carrying amount of all their deposits, such as non-bank customers' deposits and deposits and balances of banks, amounts due to related parties and amounts due to subsidiaries, as reasonable approximation of their respective fair values given that these are mostly repayable on demand or in the shorter term, and the interest rates are re-priced at short intervals.

**8. NET INTEREST INCOME**

	<b>2006</b>	<b>2005</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Interest income		
Cash and short term funds	802,350	498,440
Investments in securities	470,184	223,118
Loans and advances	1,467,984	997,780
	<u>2,740,518</u>	<u>1,719,338</u>
Interest expense		
Banks and customers	(1,909,027)	(966,486)
Loan capital in issue	(2,952)	-
Net interest income	<u>828,539</u>	<u>752,852</u>
Included within interest income		
Interest income on impaired loans and advances	<u>3,061</u>	<u>21,224</u>

Included within interest income and interest expense are HK\$2,725,915,000 (2005: HK\$1,697,518,000) and HK\$1,911,979,000 (2005: HK\$966,486,000) for financial assets and financial liabilities that are not at fair value through profit or loss, respectively.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 9. OTHER OPERATING INCOME

	2006 HK\$'000	2005 HK\$'000
Fees and commission income		
Securities dealings	79,247	44,569
Credit lines	7,845	11,946
Trade finance	14,042	12,226
Credit card services	30,358	18,382
Agency services	29,908	21,050
Others	10,901	10,506
Total fees and commission income	172,301	118,679
Less: Fees and commission expense	(4,166)	(2,231)
Net fees and commission income	168,135	116,448
Dividend income		
Listed investments	10,538	7,238
Unlisted investments	3,005	3,005
Net gains on dealing in foreign currencies	26,589	27,737
Net gains on financial assets at fair value through profit or loss	12,540	651
Gross rents from properties	4,550	4,384
Less: Outgoings	(992)	(649)
Net rental income	3,558	3,735
Safe deposit box rentals	23,431	22,255
Insurance underwriting	12,190	5,671
Other banking services income	39,460	30,528
Others	2,243	(139)
	<u>301,689</u>	<u>217,129</u>

## 10. OPERATING EXPENSES

	2006 HK\$'000	2005 HK\$'000
Amortisation of prepaid lease payments for land	5,114	5,063
Auditors' remuneration	3,291	2,442
Staff costs		
Salaries and other costs	299,992	251,349
Retirement benefits scheme contributions	22,609	18,901
Total staff costs	322,601	270,250
Depreciation	30,535	35,605
Premises and equipment expenses, excluding depreciation/amortisation		
Rentals and rates for premises	46,610	42,054
Others	16,177	12,207
Other operating expenses	167,209	125,508
	<u>591,537</u>	<u>493,129</u>

Included in the premises and equipment expenses are minimum lease payments under operating lease of HK\$42,455,000 (2005: HK\$38,949,000).

**11. DIRECTORS' AND EMPLOYEES' EMOLUMENTS**

The emoluments paid or payable to each of the 19 (2005: 23) directors were as follows:

	2006				2005			
	Fees HK\$'000	Salaries and other benefits HK\$'000	Contribution to retirement benefits scheme HK\$'000	Total HK\$'000	Fees HK\$'000	Salaries and other benefits HK\$'000	Contribution to retirement benefits scheme HK\$'000	Total HK\$'000
Executive directors (Hong Kong)								
Liu Lit Man	100	5,431	350	5,881	80	5,678	350	6,108
Liu Lit Mo	50	492	45	587	40	494	45	579
Liu Lit Chi	50	8,099	210	8,359	40	7,743	210	7,993
Don Tit Shing Liu	50	1,960	192	2,202	40	1,712	168	1,920
Wilfred Chun Ning Liu	50	2,150	157	2,357	40	1,914	137	2,091
Lau Wai Man	50	1,791	178	2,019	40	1,505	150	1,695
Frank Shui Sang Jin	50	1,762	166	1,978	40	1,715	143	1,898
Kevin Wai Hung Chu	-	-	-	-	22	693	46	761
Andrew Chiu Wing Tsang	50	1,621	128	1,799	15	633	47	695
George Har Kar Wong	50	1,643	109	1,802	15	707	39	761
Total for executive directors	500	24,949	1,535	26,984	372	22,794	1,335	24,501
Non-executive directors (Hong Kong)								
Robin Yau Hing Chan	-	-	-	-	12	-	-	12
Liu Guoyuan	-	-	-	-	35	-	-	35
Timothy George Freshwater	80	80	-	160	40	80	-	120
Toshiaki Arai	50	-	-	50	40	-	-	40
Andrew Liu	50	4	-	54	40	1	-	41
Sun Jiakang	50	-	-	50	40	-	-	40
Dominic Bing Hoi Lam	-	-	-	-	14	-	-	14
Christopher Kwun Shing Liu	50	-	-	50	40	-	-	40
Alfred Cheuk Yu Chow	80	-	-	80	60	-	-	60
Wang Zhi	50	-	-	50	5	-	-	5
Total for non-executive directors	410	84	-	494	326	81	-	407
Independent non-executive directors (Hong Kong)								
Peter Alan Lee Vine	-	-	-	-	23	-	-	23
Robin Yau Hing Chan	80	-	-	80	55	-	-	55
Wanchai Chiranakhorn	80	-	-	80	80	-	-	80
Cheng Yuk Wo	80	-	-	80	80	-	-	80
Total for independent non-executive directors	240	-	-	240	238	-	-	238
Total	1,150	25,033	1,535	27,718	936	22,875	1,335	25,146

The five highest paid individuals in the Group in 2006 and 2005 were all directors of the Bank and details of their emoluments are included in note 11 above.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 12. TAXATION

	2006 HK\$'000	2005 HK\$'000
The tax charge comprises:		
Hong Kong Profits Tax		
- current year	68,831	75,663
- overprovision in prior years	<u>(10,797)</u>	<u>(206)</u>
	58,034	75,457
Overseas taxation	2,573	727
Deferred tax (note 28)	<u>7,163</u>	<u>(5,366)</u>
	<u><u>67,770</u></u>	<u><u>70,818</u></u>

Hong Kong Profits Tax is calculated at 17.5% (2005: 17.5%) of the estimated assessable profit for the year.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

The tax charge for the year can be reconciled to the Group's profit per the consolidated income statement as follows:

	2006 HK\$'000	2005 HK\$'000
Profit before taxation	<u>570,914</u>	<u>468,801</u>
Tax at the domestic income tax rate of 17.5% (2005: 17.5%)	99,910	82,040
Tax effect of share of profit of jointly controlled entities	(5,871)	(626)
Tax effect of expenses not deductible for tax purpose	94	3,653
Tax effect of income not taxable for tax purpose	(14,273)	(13,638)
Utilisation of tax losses previously not recognised	(510)	(398)
Overprovision in prior years	(10,797)	(206)
Effect of different tax rates of subsidiaries operating in other jurisdictions	(221)	(291)
Others	<u>(562)</u>	<u>284</u>
Tax charge for the year	<u><u>67,770</u></u>	<u><u>70,818</u></u>

## 13. DIVIDENDS

	2006 HK\$'000	2005 HK\$'000
Dividends recognised as distribution during the year:		
2006 Interim - HK\$0.19 (2005: HK\$0.18) per share	82,650	78,300
2005 Final - HK\$0.42 (2004: HK\$0.40) per share	<u>182,700</u>	<u>174,000</u>
	<u><u>265,350</u></u>	<u><u>252,300</u></u>

The final dividend of HK\$0.44 (2005: HK\$0.42) per share has been proposed by the directors and is subject to approval by the shareholders in general meeting.

**14. EARNINGS PER SHARE**

The calculation of basic and diluted earnings per share is based on the profit attributable to shareholders of HK\$503,144,000 (2005: HK\$397,983,000) and on 435,000,000 (2005: 435,000,000) ordinary shares in issue during the year.

**15. CASH AND SHORT-TERM FUNDS**

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cash and balances with banks and other financial institutions	997,461	1,010,669	997,421	1,010,629
Money at call and short notice	14,744,553	10,301,297	14,695,908	10,264,463
Exchange fund bills	514,845	486,513	514,845	486,513
	<u>16,256,859</u>	<u>11,798,479</u>	<u>16,208,174</u>	<u>11,761,605</u>

**16. DERIVATIVE FINANCIAL INSTRUMENTS**

	THE GROUP AND THE BANK					
	2006			2005		
	Notional amount	Fair values		Notional amount	Fair values	
HK\$'000	Assets	Liabilities	HK\$'000	Assets	Liabilities	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Derivatives held for trading						
- Foreign currency related contracts	513,269	1,726	128	155,742	-	-
- Interest rate swaps	345,014	1,553	1,588	657,654	45,607	-
- Currency swaps	52,240	1,683	-	-	-	-
		<u>4,962</u>	<u>1,716</u>		<u>45,607</u>	<u>-</u>

The replacement costs and credit risk weighted amounts of the derivatives exposures are as follows:

	THE GROUP AND THE BANK					
	2006			2005		
	Notional amount	Replacement cost	Credit risk weighted amount	Notional amount	Replacement cost	Credit risk weighted amount
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Exchange rate contracts	565,509	3,409	2,195	155,742	451	514
Interest rate contracts	345,014	1,553	710	657,654	45,607	17,490
		<u>4,962</u>	<u>2,905</u>		<u>46,058</u>	<u>18,004</u>

The derivative financial instruments including exchange rate contracts and interest rate contracts have been recognised on balance sheet at fair value.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 16. DERIVATIVE FINANCIAL INSTRUMENTS - continued

Replacement cost is the cost of replacing all contracts that have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking contracts to market. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet dates.

The credit risk weighted amounts are the amounts that have been calculated in accordance with the Third Schedule of the Banking Ordinance and guidelines issued by HKMA. The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

## 17. INVESTMENTS IN SECURITIES

	THE GROUP					THE BANK				
	Financial assets at fair value through profit or loss					Financial assets at fair value through profit or loss				
	Trading assets	Assets designated at fair value	Held-to-maturity securities	Available-for-sale securities	Total	Trading assets	Asset designated at fair value	Held-to-maturity securities	Available-for-sale securities	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
2006										
Equity securities:										
Listed in Hong Kong	423	-	-	359,134	359,557	-	-	-	180,035	180,035
Listed overseas	-	-	-	6,991	6,991	-	-	-	6,991	6,991
	423	-	-	366,125	366,548	-	-	-	187,026	187,026
Unlisted	-	-	-	259,940	259,940	-	-	-	257,331	257,331
	423	-	-	626,065	626,488	-	-	-	444,357	444,357
Debt securities:										
Certificates of deposit	-	-	1,863,937	-	1,863,937	-	-	1,863,937	-	1,863,937
Other debt securities - Unlisted	-	610,388	12,039,236	472,076	13,121,700	-	610,388	12,039,236	472,076	13,121,700
	-	610,388	13,903,173	472,076	14,985,637	-	610,388	13,903,173	472,076	14,985,637
Total:										
Listed in Hong Kong	423	-	-	359,134	359,557	-	-	-	180,035	180,035
Listed overseas	-	-	-	6,991	6,991	-	-	-	6,991	6,991
Unlisted	-	610,388	13,903,173	732,016	15,245,577	-	610,388	13,903,173	729,407	15,242,968
	423	610,388	13,903,173	1,098,141	15,612,125	-	610,388	13,903,173	916,433	15,429,994
Market value of listed securities:										
Listed in Hong Kong	423	-	-	359,134	359,557	-	-	-	180,035	180,035
Listed overseas	-	-	-	6,991	6,991	-	-	-	6,991	6,991
	423	-	-	366,125	366,548	-	-	-	187,026	187,026
As analysed by issuing entities:										
Central government and central banks	-	-	359,143	-	359,143	-	-	359,143	-	359,143
Public sector entities	-	-	18,508	-	18,508	-	-	18,508	-	18,508
Banks and other financial institutions	53	372,463	13,384,170	85,518	13,842,204	-	372,463	13,384,170	66,083	13,822,716
Corporate entities	199	50,679	141,352	246,749	438,979	-	50,679	141,352	120,942	312,973
Others	171	187,246	-	765,874	953,291	-	187,246	-	729,408	916,654
	423	610,388	13,903,173	1,098,141	15,612,125	-	610,388	13,903,173	916,433	15,429,994

## 17. INVESTMENTS IN SECURITIES - continued

At the balance sheet date, all available-for-sale securities and financial assets at fair value through profit or loss are stated at fair value. Fair value of the investments have been determined by reference to bid prices quoted in active markets.

An active market is where price information is readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and the price information is from actual and regularly occurring market transactions on an arm's length basis.

Where the markets for certain financial instruments are not active, fair values are established using valuation techniques commonly used by market participants and based on assumptions and data observable in the market.

Included in financial assets designated at fair value through profit or loss are primarily:

- i) bonds (classified as "other debt securities" above) which contain embedded derivatives that would otherwise have been separately accounted for; and
- ii) bond funds (classified as "other debt securities" above) are designated at fair value through profit or loss because they are managed and evaluated on a fair value basis, in accordance with investment strategy. Information about the bond funds is provided internally on that basis to the Group's key management personnel.

Certain held-to-maturity certificates of deposit of approximately HK\$24,479,000 (2005: HK\$23,924,000) held by the San Francisco Branch of the Bank have been pledged to the State of California of the United States of America in compliance with the requirements of the California Financial Code.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 17. INVESTMENTS IN SECURITIES - continued

	THE GROUP					THE BANK				
	Financial assets at fair value through profit or loss					Financial assets at fair value through profit or loss				
	Trading assets	Assets designated at fair value	Held-to-maturity securities	Available-for-sale securities	Total	Trading assets	Asset designated at fair value	Held-to-maturity securities	Available-for-sale securities	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
2005										
Equity securities:										
Listed in Hong Kong	562	-	-	268,756	269,318	-	-	-	146,087	146,087
Listed overseas	-	-	-	6,385	6,385	-	-	-	6,385	6,385
	562	-	-	275,141	275,703	-	-	-	152,472	152,472
Unlisted	-	-	-	248,232	248,232	-	-	-	245,623	245,623
	562	-	-	523,373	523,935	-	-	-	398,095	398,095
Debt securities:										
Certificates of deposit	-	-	1,960,915	278,396	2,239,311	-	-	1,960,915	278,396	2,239,311
Other debt securities - Unlisted	-	808,598	7,231,991	-	8,040,589	-	808,598	7,231,991	-	8,040,589
	-	808,598	9,192,906	278,396	10,279,900	-	808,598	9,192,906	278,396	10,279,900
Total:										
Listed in Hong Kong	562	-	-	268,756	269,318	-	-	-	146,087	146,087
Listed overseas	-	-	-	6,385	6,385	-	-	-	6,385	6,385
Unlisted	-	808,598	9,192,906	526,628	10,528,132	-	808,598	9,192,906	524,019	10,525,523
	562	808,598	9,192,906	801,769	10,803,835	-	808,598	9,192,906	676,491	10,677,995
Market value of listed securities:										
Listed in Hong Kong	562	-	-	268,756	269,318	-	-	-	146,087	146,087
Listed overseas	-	-	-	6,385	6,385	-	-	-	6,385	6,385
	562	-	-	275,141	275,703	-	-	-	152,472	152,472
As analysed by issuing entities:										
Central government and central banks	-	-	95,109	-	95,109	-	-	95,109	-	95,109
Public sector entities	-	-	25,274	2	25,276	-	-	25,274	-	25,274
Banks and other financial institutions	562	163,158	7,129,927	28,804	7,322,451	-	163,158	7,129,927	20,290	7,313,375
Corporate entities	-	-	1,942,596	227,121	2,169,717	-	-	1,942,596	132,182	2,074,778
Others	-	645,440	-	545,842	1,191,282	-	645,440	-	524,019	1,169,459
	562	808,598	9,192,906	801,769	10,803,835	-	808,598	9,192,906	676,491	10,677,995

## 18. ADVANCES AND OTHER ACCOUNTS

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Advances to customers				
Bills receivable	484,375	330,409	484,375	330,409
Trade bills	138,337	131,549	138,337	131,549
Other advances to customers	26,251,826	23,834,686	26,250,106	23,831,712
	<u>26,874,538</u>	<u>24,296,644</u>	<u>26,872,818</u>	<u>24,293,670</u>
Interest receivable	267,337	196,225	267,055	195,900
Impairment allowances				
- Individually assessed	(32,161)	(54,640)	(32,161)	(54,640)
- Collectively assessed	(104,464)	(131,933)	(104,447)	(131,901)
	<u>27,005,250</u>	<u>24,306,296</u>	<u>27,003,265</u>	<u>24,303,029</u>
Advances to banks and other financial institutions	57,425	57,209	57,425	57,209
	<u>27,062,675</u>	<u>24,363,505</u>	<u>27,060,690</u>	<u>24,360,238</u>
Other accounts	434,345	144,556	141,163	66,802
	<u>27,497,020</u>	<u>24,508,061</u>	<u>27,201,853</u>	<u>24,427,040</u>

Included in the “Advances to customers” of the Group and the Bank are aggregate amounts of approximately HK\$77,785,000 (2005: HK\$139,478,000) due from companies having significant influence on the Group.

Included in the “Advances to banks and other financial institutions” of the Group and the Bank is an amount of approximately HK\$57,425,000 (2005: HK\$57,209,000) placed as reserve funds with the financial institutions in the People’s Republic of China by the Shantou Branch of the Bank in compliance with the requirements of Regulations Governing Foreign Financial Institutions of the People’s Republic of China.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 18. ADVANCES AND OTHER ACCOUNTS - continued

Impairment allowances on advances:

	THE GROUP			THE BANK		
	Individual	Collective	Total	Individual	Collective	Total
	assessment	assessment		assessment	assessment	
HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
Balance at 1 January 2006	54,640	131,933	186,573	54,640	131,901	186,541
Increase in impairment allowances	141,403	-	141,403	141,376	-	141,376
Amounts reversed	(54,115)	(27,487)	(81,602)	(54,115)	(27,472)	(81,587)
Recoveries of advances written off in previous years	47,453	-	47,453	47,453	-	47,453
Effect on discounting	(3,061)	-	(3,061)	(3,061)	-	(3,061)
Amounts written off	(154,159)	-	(154,159)	(154,132)	-	(154,132)
Exchange difference	-	18	18	-	18	18
Balance at 31 December 2006	<u>32,161</u>	<u>104,464</u>	<u>136,625</u>	<u>32,161</u>	<u>104,447</u>	<u>136,608</u>

	THE GROUP			THE BANK		
	Individual	Collective	Total	Individual	Collective	Total
	assessment	assessment		assessment	assessment	
HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
Balance at 1 January 2005	140,509	99,774	240,283	140,509	99,716	240,225
Increase in impairment allowances	61,550	48,515	110,065	61,550	48,515	110,065
Amounts reversed	(4,692)	(16,342)	(21,034)	(4,692)	(16,316)	(21,008)
Effect on discounting	(21,224)	-	(21,224)	(21,224)	-	(21,224)
Amounts written off	(121,503)	-	(121,503)	(121,503)	-	(121,503)
Exchange difference	-	(14)	(14)	-	(14)	(14)
Balance at 31 December 2005	<u>54,640</u>	<u>131,933</u>	<u>186,573</u>	<u>54,640</u>	<u>131,901</u>	<u>186,541</u>

Details of the impaired loans are as follows:

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Gross impaired loans	329,660	642,788	329,660	642,788
Less: Impairment allowances under individual assessment	<u>(32,161)</u>	<u>(54,640)</u>	<u>(32,161)</u>	<u>(54,640)</u>
Net impaired loans	<u>297,499</u>	<u>588,148</u>	<u>297,499</u>	<u>588,148</u>
Gross impaired loans as a percentage of gross advances to customers	<u>1.23%</u>	<u>2.65%</u>	<u>1.23%</u>	<u>2.65%</u>
Market value of collateral pledged	<u>313,786</u>	<u>617,345</u>	<u>313,786</u>	<u>617,345</u>

**18. ADVANCES AND OTHER ACCOUNTS - continued**

In addition to the individually assessed loan impairment allowance, the Group has also provided collectively assessed loan impairment allowance for loans that are individually insignificant or advances where no impairment has been identified individually.

Advances to customers of the Group include receivables under finance leases as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Within one year	97	371	94	327
In the second to fifth year inclusive	—	403	—	377
	<u>97</u>	<u>774</u>	<u>94</u>	<u>704</u>
Less: Unearned finance income	<u>(4)</u>	<u>(70)</u>	<u>—</u>	<u>—</u>
Present value of minimum lease payments receivable	<u>93</u>	<u>704</u>	<u>94</u>	<u>704</u>
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)			—	377
Current finance lease receivables (recoverable within 12 months)			<u>94</u>	<u>327</u>
			<u>94</u>	<u>704</u>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 19. INVESTMENTS IN SUBSIDIARIES

(i)	<b>2006</b>	<b>2005</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Unlisted shares, at cost	<b><u>363,323</u></b>	<b><u>792,484</u></b>

Details of all the subsidiaries as at 31 December 2006 are as follows:

Name of company	Place of incorporation/ operation	Issued and fully paid ordinary share capital	Percentage of issued share capital directly held	Principal activities
Card Alliance Company Limited	Hong Kong	HK\$18,000,000	100%	Credit card management
Chong Hing Commodities and Futures Limited	Hong Kong	HK\$5,000,000	100%	Investment holding and commodities and futures broking
Chong Hing Finance Limited	Hong Kong	HK\$25,000,000	100%	Deposit-taking and lending
Chong Hing Information Technology Limited	Hong Kong	HK\$100,000	100%	Provision of electronic data processing services
Chong Hing Insurance Company Limited	Hong Kong	HK\$50,000,000	100%	Insurance underwriting
Chong Hing (Management) Limited	Hong Kong	HK\$100,000	100%	Inactive
Chong Hing (Nominees) Limited	Hong Kong	HK\$100,000	100%	Provision of nominee services
Chong Hing Securities Limited	Hong Kong	HK\$10,000,000	100%	Stockbroking
Gallbraith Limited	Hong Kong	HK\$16,550,000	100%	Property investment
Liu Chong Hing Banking Corporation, Cayman	Cayman Islands/ Hong Kong	US\$10,000,000	100%	General merchant banking
Right Way Investments Limited	Bermuda/ Hong Kong	US\$12,000	100%	Inactive

None of the subsidiaries had any debt security subsisting at the end of the year or at any time during the year.

### (ii) Amounts due from subsidiaries

	<b>2006</b>	<b>2005</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Amounts due from subsidiaries	<b><u>4,677</u></b>	<b><u>33,305</u></b>

The amounts due from subsidiaries are unsecured, non-interest bearing and, in the opinion of the directors, are repayable within three months.

The directors consider that the fair value of the above balances approximate their carrying amounts at the balance sheet dates.

**20. INTERESTS IN JOINTLY CONTROLLED ENTITIES**

(i)	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Unlisted shares, at cost	–	–	56,500	56,500
Share of net assets	99,256	65,710	–	–
	<u>99,256</u>	<u>65,710</u>	<u>56,500</u>	<u>56,500</u>

The directors consider the Bank has joint control over these jointly controlled entities.

As at 31 December 2006, the Group had interests in the following jointly controlled entities:

Name of company	Place of incorporation and operation	Class of share held	Ownership interest	Proportion of voting power	Nature of business
Bank Consortium Holding Limited	Hong Kong	Ordinary	13.3%	14.3%	Investment holding and provision of trustee, administration and custodian services for retirement schemes
BC Reinsurance Limited	Hong Kong	Ordinary	21.0%	21.0%	Reinsurance
Hong Kong Life Insurance Limited	Hong Kong	Ordinary	16.7%	16.7%	Life insurance underwriting
Net Alliance Co., Limited	Hong Kong	Ordinary	17.6%	15.0%	Provision of internet services

The summarised financial information in respect of Group's jointly controlled entities which are accounted for using equity method is set out below:

	2006	2005
	HK\$'000	HK\$'000
Assets	2,543,487	1,941,821
Liabilities	(1,748,020)	(1,336,529)
Income	421,432	709,247
Expense	<u>(224,746)</u>	<u>(659,132)</u>

## 20. INTERESTS IN JOINTLY CONTROLLED ENTITIES - continued

(ii) Loan to a jointly controlled entity

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Loan to a jointly controlled entity	<u>31,000</u>	<u>31,000</u>	<u>31,000</u>	<u>31,000</u>

The loan to a jointly controlled entity, Bank Consortium Holding Limited amounting to HK\$31,000,000 (2005: HK\$31,000,000) is unsecured, non-interest bearing, and will be repayable on 28 December 2008. The directors consider that the fair value of the above loan approximates its carrying amount at the balance sheet date.

## 21. INVESTMENT PROPERTIES

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January	76,860	69,360	58,860	51,360
Net increase in fair value	<u>5,390</u>	<u>7,500</u>	<u>5,390</u>	<u>7,500</u>
At 31 December	<u>82,250</u>	<u>76,860</u>	<u>64,250</u>	<u>58,860</u>

Investment properties owned by the Group and by the Bank were revalued at 31 December 2006 on an open market value basis by Vigers Hong Kong Limited, independent professionally qualified valuers.

The investment properties are rented out under operating leases.

The carrying amount of investment properties of the Group and the Bank comprises:

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Leasehold properties				
Held in Hong Kong on long-term lease (over 50 years unexpired)	10,250	9,950	10,250	9,950
Held in Hong Kong on medium-term lease (10 - 50 years unexpired)	54,000	48,910	54,000	48,910
Held outside Hong Kong on medium-term lease (10 - 50 years unexpired)	<u>18,000</u>	<u>18,000</u>	–	–
	<u>82,250</u>	<u>76,860</u>	<u>64,250</u>	<u>58,860</u>

**22. PROPERTY AND EQUIPMENT**

	<b>THE GROUP</b>				<b>THE BANK</b>			
	Buildings	Equipment	Construction in progress	Total	Buildings	Equipment	Construction in progress	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>COST</b>								
At 1 January 2006	80,511	308,643	40,454	429,608	80,511	278,556	-	359,067
Additions	14,407	52,633	148,708	215,748	14,407	45,317	189,162	248,886
Disposals	-	(9,924)	-	(9,924)	-	(7,310)	-	(7,310)
Transfer from construction in progress to buildings	189,162	-	(189,162)	-	189,162	-	(189,162)	-
Exchange adjustments	-	(4)	-	(4)	-	(4)	-	(4)
At 31 December 2006	<u>284,080</u>	<u>351,348</u>	<u>-</u>	<u>635,428</u>	<u>284,080</u>	<u>316,559</u>	<u>-</u>	<u>600,639</u>
<b>ACCUMULATED DEPRECIATION</b>								
At 1 January 2006	19,498	213,350	-	232,848	19,498	187,462	-	206,960
Provided for the year	2,064	28,471	-	30,535	2,064	25,843	-	27,907
Eliminated on disposals	-	(8,778)	-	(8,778)	-	(6,341)	-	(6,341)
Exchange adjustments	-	(2)	-	(2)	-	(2)	-	(2)
At 31 December 2006	<u>21,562</u>	<u>233,041</u>	<u>-</u>	<u>254,603</u>	<u>21,562</u>	<u>206,962</u>	<u>-</u>	<u>228,524</u>
<b>CARRYING AMOUNTS</b>								
At 31 December 2006	<u>262,518</u>	<u>118,307</u>	<u>-</u>	<u>380,825</u>	<u>262,518</u>	<u>109,597</u>	<u>-</u>	<u>372,115</u>

	<b>THE GROUP</b>				<b>THE BANK</b>			
	Buildings	Equipment	Construction in progress	Total	Buildings	Equipment	Total	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
<b>COST</b>								
At 1 January 2005		79,771	295,284	21,444	396,499	79,771	266,052	345,823
Additions		2,340	23,283	19,010	44,633	2,340	22,190	24,530
Acquired on acquisition of a subsidiary		-	768	-	768	-	-	-
Disposals		(1,600)	(10,690)	-	(12,290)	(1,600)	(9,684)	(11,284)
Exchange adjustments		-	(2)	-	(2)	-	(2)	(2)
At 31 December 2005		<u>80,511</u>	<u>308,643</u>	<u>40,454</u>	<u>429,608</u>	<u>80,511</u>	<u>278,556</u>	<u>359,067</u>
<b>ACCUMULATED DEPRECIATION</b>								
At 1 January 2005		17,925	188,569	-	206,494	17,925	166,889	184,814
Provided for the year		1,610	33,995	-	35,605	1,610	29,343	30,953
Eliminated on disposals		(37)	(9,212)	-	(9,249)	(37)	(8,768)	(8,805)
Exchange adjustments		-	(2)	-	(2)	-	(2)	(2)
At 31 December 2005		<u>19,498</u>	<u>213,350</u>	<u>-</u>	<u>232,848</u>	<u>19,498</u>	<u>187,462</u>	<u>206,960</u>
<b>CARRYING AMOUNTS</b>								
At 31 December 2005		<u>61,013</u>	<u>95,293</u>	<u>40,454</u>	<u>196,760</u>	<u>61,013</u>	<u>91,094</u>	<u>152,107</u>

The above items of property and equipment are depreciated on a straight-line basis at the following rates per annum:

Leasehold buildings	Over the shorter of the term of the lease or 2%
Equipment	10% -20%

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 22. PROPERTY AND EQUIPMENT - continued

The carrying amount of buildings and construction in progress shown above comprise:

	THE GROUP				THE BANK	
	Buildings		Construction in progress		Building	
	2006	2005	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Leasehold properties						
Held in Hong Kong on long-term lease (over 50 years unexpired)	201,337	12,542	-	40,454	201,337	12,542
Held in Hong Kong on medium-term lease (10-50 years unexpired)	60,299	47,568	-	-	60,299	47,568
Held outside Hong Kong on medium-term lease (10-50 years unexpired)	882	903	-	-	882	903
	<u>262,518</u>	<u>61,013</u>	<u>-</u>	<u>40,454</u>	<u>262,518</u>	<u>61,013</u>

## 23. PREPAID LEASE PAYMENTS FOR LAND

The Group's prepaid lease payments comprise:

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>COST</b>				
In Hong Kong held on:				
Leases of over 50 years	126,035	126,447	651,975	43,409
Leases of between 10 to 50 years	183,952	167,841	183,952	167,841
Outside Hong Kong held on:				
Leases of between 10 to 50 years	6,548	6,681	6,548	6,681
	<u>316,535</u>	<u>300,969</u>	<u>842,475</u>	<u>217,931</u>
Net book value at 1st January	300,969	306,039	217,931	222,901
Additions	20,680	-	630,226	-
Amortisation of prepaid operating lease payments	(5,114)	(5,063)	(5,682)	(4,963)
Disposals	-	(7)	-	(7)
	<u>316,535</u>	<u>300,969</u>	<u>842,475</u>	<u>217,931</u>
Analysed as:				
Current portion	5,114	5,063	5,682	4,963
Non-current portion	311,421	295,906	836,793	212,968
Total	<u>316,535</u>	<u>300,969</u>	<u>842,475</u>	<u>217,931</u>

The allocation of lease payments between leasehold land and building elements was performed by Vigers Hong Kong Limited, independent professionally qualified valuers.

**24. DEPOSITS FROM CUSTOMERS**

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Demand deposits and current accounts	2,479,907	2,144,820	2,479,907	2,144,820
Savings deposits	9,377,813	6,462,001	9,377,813	6,462,001
Time, call and notice deposits	42,817,512	32,899,471	42,813,454	32,895,315
	<u>54,675,232</u>	<u>41,506,292</u>	<u>54,671,174</u>	<u>41,502,136</u>

Included in the balances is an aggregate amount of approximately HK\$127,187,000 (2005: HK\$318,089,000) representing deposits of companies and their subsidiaries having significant influence on the Bank.

**25. LOAN CAPITAL**

	THE GROUP AND THE BANK	
	2006	2005
	HK\$'000	HK\$'000
US\$125 million callable floating rate subordinated notes due 2016	<u>967,376</u>	<u>—</u>

On 15 December 2006 the Bank issued loan capital of face value of US\$125,000,000 subordinated notes qualifying as tier 2 capital.

The above subordinated notes will mature on 16 December 2016 and are redeemable at the option of the Group in December 2011 at their principal amount.

The floating rate notes bear interest at the rate of three month LIBOR plus 0.93 per cent, payable quarterly from the issue date to the call option date. Thereafter, if the notes are not redeemed on the call option date, the interest rate will be reset to three month LIBOR plus 1.93 per cent, payable quarterly.

**26. SHARE CAPITAL**

	2006 & 2005
	HK\$'000
Authorised:	
600,000,000 shares of HK\$0.50 each	<u>300,000</u>
Issued and fully paid:	
435,000,000 shares of HK\$0.50 each	<u>217,500</u>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 27. RESERVES

	Share premium	Land and buildings revaluation reserve	Investment revaluation reserve	General reserve	Translation reserve	Regulatory reserve	Retained profits	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>THE BANK</b>								
At 1 January 2006	1,542,817	-	139,735	1,378,500	(127)	122,837	2,418,118	5,601,880
Revaluation losses, net	-	-	(23,787)	-	-	-	-	(23,787)
Exchange differences arising from translation of foreign operations	-	-	-	-	225	-	-	225
Deferred taxation arising from revaluation movement (Note 28)	-	-	(12,600)	-	-	-	-	(12,600)
Net expenses recognised directly in equity	-	-	(36,387)	-	225	-	-	(36,162)
Profit for the year	-	-	-	-	-	-	480,145	480,145
Reversal of reserves upon disposal	-	-	(29,857)	-	-	-	-	(29,857)
Total recognised income for the year	-	-	(66,244)	-	225	-	480,145	414,126
Interim dividend paid	-	-	-	-	-	-	(82,650)	(82,650)
Final dividend paid	-	-	-	-	-	-	(182,700)	(182,700)
Earmark of retained profits as regulatory reserve	-	-	-	-	-	42,163	(42,163)	-
At 31 December 2006	<u>1,542,817</u>	<u>-</u>	<u>73,491</u>	<u>1,378,500</u>	<u>98</u>	<u>165,000</u>	<u>2,590,750</u>	<u>5,750,656</u>
At 1 January 2005	1,542,817	352,922	110,169	1,378,500	80	103,883	1,984,950	5,473,321
Revaluation gains, net	-	-	65,288	-	-	-	-	65,288
Exchange differences arising from translation of foreign operations	-	-	-	-	(207)	-	-	(207)
Net income recognised directly in equity	-	-	65,288	-	(207)	-	-	65,081
Transfer between reserves	-	(352,922)*	-	-	-	-	352,922	-
Profit for the year	-	-	-	-	-	-	351,500	351,500
Reversal of reserves upon disposal	-	-	(35,722)	-	-	-	-	(35,722)
Total recognised income for the year	-	(352,922)	29,566	-	(207)	-	704,422	380,859
Interim dividend paid	-	-	-	-	-	-	(78,300)	(78,300)
Final dividend paid	-	-	-	-	-	-	(174,000)	(174,000)
Earmark of retained profits as regulatory reserve	-	-	-	-	-	18,954	(18,954)	-
At 31 December 2005	<u>1,542,817</u>	<u>-</u>	<u>139,735</u>	<u>1,378,500</u>	<u>(127)</u>	<u>122,837</u>	<u>2,418,118</u>	<u>5,601,880</u>

The Bank's reserves available for distribution to shareholders as at 31 December 2006 comprised retained profits of HK\$2,590,750,000 (2005: HK\$2,418,118,000) and general reserve of HK\$1,378,500,000 (2005: HK\$1,378,500,000).

The regulatory reserve is set up in compliance with the Hong Kong Monetary Authority's requirements and is distributable to shareholders of the Bank subject to consultation with the Hong Kong Monetary Authority.

The general reserve is comprised of transfers from previous years' retained profits.

\* Amount represents the revaluation surplus which had been realised on disposal of the relevant land and buildings to a wholly-owned subsidiary several years ago.

**28. DEFERRED TAXATION**

The following are the major deferred tax liabilities (assets) recognised and movements thereon during the current and prior reporting year:

	Accelerated tax depreciation HK\$'000	Collectively assessed impairment allowance HK\$'000	Investment properties HK\$'000	Revaluation of available- for-sale securities HK\$'000	Total HK\$'000
<b>THE GROUP</b>					
At 1 January 2006	9,353	(22,433)	6,631	–	(6,449)
Charge to income statement for the year ( <i>Note 12</i> )	1,050	5,170	943	–	7,163
Charge to equity for the year	–	–	–	27,125	27,125
At 31 December 2006	<u>10,403</u>	<u>(17,263)</u>	<u>7,574</u>	<u>27,125</u>	<u>27,839</u>
At 1 January 2005	8,624	(15,025)	5,318	–	(1,083)
Charge (credit) to income statement for the year ( <i>Note 12</i> )	729	(7,408)	1,313	–	(5,366)
At 31 December 2005	<u>9,353</u>	<u>(22,433)</u>	<u>6,631</u>	<u>–</u>	<u>(6,449)</u>
<b>THE BANK</b>					
At 1 January 2006	9,353	(22,427)	6,631	–	(6,443)
Charge to income statement for the year	1,050	5,167	943	–	7,160
Charge to equity for the year	–	–	–	12,600	12,600
At 31 December 2006	<u>10,403</u>	<u>(17,260)</u>	<u>7,574</u>	<u>12,600</u>	<u>13,317</u>
At 1 January 2005	8,392	(15,014)	5,318	–	(1,304)
Charge (credit) to income statement for the year	961	(7,413)	1,313	–	(5,139)
At 31 December 2005	<u>9,353</u>	<u>(22,427)</u>	<u>6,631</u>	<u>–</u>	<u>(6,443)</u>

**29. SHARE OPTION SCHEME**

The Bank's share option scheme (the "Scheme") was adopted pursuant to a resolution passed on 25 April 2002 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 24 April 2012. Under the Scheme, the Board of Directors of the Bank may grant options to eligible employees, including directors of the Bank and its subsidiaries, to subscribe for shares in the Bank. Additionally, the Bank may, from time to time, grant share options to outside third parties for settlement in respect of goods or services provided to the Bank.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Bank in issue at the date of approval of the Scheme, without prior approval from the Bank's shareholders. The number of shares in respect of which options may be granted to any individual is not permitted to exceed 1% of the shares of the Bank in issue at any point in time, without prior approval from the Bank's shareholders.

Options granted must be taken up within 28 days of the date of offer, upon payment of HK\$10 per option. Options may be exercised at any time from the date of grant of the share option to the fifth anniversary of the date of grant. The exercise price is determined by the Board of Directors of the Bank, and will be the highest of the closing price of the Bank's shares on the date of offer, the average closing price of the shares for the five trading days immediately preceding the date of offer and the nominal value of the shares.

No options have been granted under the above-mentioned scheme since the Scheme was adopted.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 30. LOANS TO OFFICERS

The aggregate relevant loans to officers disclosed pursuant to Section 161B of the Companies Ordinance are as follows:

	<b>THE GROUP AND THE BANK</b>	
	<b>2006</b>	<b>2005</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Aggregate balance of all relevant loans outstanding at the balance sheet date	<u>90,865</u>	<u>100,383</u>
Maximum aggregate balance of relevant loans during the year	<u>163,699</u>	<u>135,511</u>

The loans have no fixed repayment terms and the applicable interest rate ranges from 0% to prime rate plus 10%. Included in the loans to officers are loans of HK\$89,369,000 (2005: HK\$94,208,000) with collateral.

## 31. ACQUISITION OF A SUBSIDIARY

In prior year, the Group acquired 100% of the issued share capital of Chong Hing Insurance Company Limited (formerly known as "Liu Chong Hing Insurance Company Limited") for consideration of HK\$213,369,000, including the legal cost of HK\$1,369,000. This acquisition has been accounted for by the acquisition method of accounting. The amount of goodwill arising as a result of the acquisition was HK\$110,606,000.

The net assets acquired in the transaction, and the goodwill arising, were as follows:

	<b>Acquiree's carrying amount before combination HK\$'000</b>	<b>Fair value adjustments HK\$'000</b>	<b>2005 Fair value HK\$'000</b>
Net assets acquired			
Placements with banks and other financial institutions maturing between one and three months	90,410	–	90,410
Advances and other accounts less impairment	9,473	–	9,473
Available-for-sale securities	26,979	3,259	30,238
Property and equipment	768	–	768
Current tax liabilities	(299)	–	(299)
Other accounts and accruals	(27,827)	–	(27,827)
			<u>102,763</u>
Goodwill arising from acquisition			<u>110,606</u>
Total consideration			<u>213,369</u>
Net cash outflow arising from acquisition:			
Cash consideration			213,369
Cash and cash equivalents acquired			(90,410)
Net outflow of cash and cash equivalents in respect of the purchase of this subsidiary			<u>122,959</u>

The goodwill arising in the acquisition of Chong Hing Insurance Company Limited is attributable to the anticipated profitability of the acquired business and the anticipated future operating synergy from the combination.

**32. LIQUIDATION OF A SUBSIDIARY**

In prior year, the Group liquidated its subsidiary, Liu Chong Hing Finance (International) Limited. The amount of net assets of Liu Chong Hing Finance (International) Limited at the date of liquidation were as follows:

	<b>2005</b> <b>HK\$'000</b>
<b>NET ASSETS LIQUIDATED</b>	
Cash and short term funds	2,824
Other accounts and accruals	<u>(42)</u>
	2,782
Loss on liquidation	<u>(4)</u>
Cash received on liquidation	<u>2,778</u>
<b>NET CASH OUTFLOW ARISING FROM LIQUIDATION</b>	
Cash and short-term fund disposed of	(2,824)
Cash received on liquidation	<u>2,778</u>
Cash outflow on liquidation	<u>(46)</u>

**33. IMPAIRMENT TESTING ON GOODWILL**

For the year ended 31 December 2006, the management has reviewed the purchased goodwill as set out in note 31 for impairment. The review comprised a comparison of the carrying amount and fair value less costs to sell of the acquired subsidiary (the smallest cash-generating unit) to which the goodwill has been allocated. The acquired subsidiary is involved in insurance business. The directors estimate the fair value less costs to sell by reference to the average price earnings ratios of insurance companies listed on the Stock Exchange of Hong Kong Limited.

No impairment loss has been recognised in respect of goodwill for the year ended 31 December 2006 as their fair value less costs to sell exceeds the carrying amount.

## 34. CONTINGENT LIABILITIES AND COMMITMENTS

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Contingent liabilities and commitments				
– contractual amounts				
Direct credit substitutes	1,221,388	972,847	1,221,388	972,847
Trade - related contingencies	346,531	371,150	346,531	371,150
Capital commitments	227,967	369,588	227,967	369,588
Lease commitments	71,048	48,080	66,343	47,267
	<u>1,866,934</u>	<u>1,761,665</u>	<u>1,862,229</u>	<u>1,760,852</u>

Included under lease commitments are non-cancellable operating leases commitments in respect of rented premises. At the balance sheet date, the Group had commitments for future minimum lease payments under these non-cancellable operating leases which fall due as follows:

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Within one year	25,975	31,506	23,945	30,693
In the second to fifth years inclusive	43,088	16,574	40,413	16,574
Over five years	1,985	–	1,985	–
	<u>71,048</u>	<u>48,080</u>	<u>66,343</u>	<u>47,267</u>

Operating lease payments represent rental payable by the Group for certain of its office properties. Leases are negotiated for an average term of three years and rentals are fixed.

Additional disclosures as required by the Supervisory Policy Manual FD-1 “Financial Disclosure By Locally Incorporated Authorised Institutions” which do not fall under definition of commitments under HKAS 30: Disclosures in Financial Statements of Banks and Similar Financial Institutions.

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Other commitments				
With an original maturity of under one year or which are unconditionally cancellable	5,798,306	4,238,580	5,798,306	4,238,580
With an original maturity of one year and over	4,486,629	3,609,483	4,486,629	3,609,483
	<u>10,284,935</u>	<u>7,848,063</u>	<u>10,284,935</u>	<u>7,848,063</u>

**34. CONTINGENT LIABILITIES AND COMMITMENTS - continued**

Included under “capital commitments” are as follows:

	THE GROUP		THE BANK	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Capital expenditure contracted for but not provided in the financial statements in respect of:				
– property and equipment	77,725	133,110	77,725	133,110
– investments in funds	150,242	236,478	150,242	236,478
	<u>227,967</u>	<u>369,588</u>	<u>227,967</u>	<u>369,588</u>

The credit risk weighted amount of contingent liabilities and commitments is HK\$3,329,570,000 (2005: HK\$2,820,689,000).

At the balance sheet date, the Group and the Bank as lessor had contracted with tenants for the following future minimum lease payments:

	THE GROUP AND THE BANK	
	2006	2005
	HK\$'000	HK\$'000
Within one year	6	500
In the second to fifth years inclusive	2	–
	<u>8</u>	<u>500</u>

## 35. RETIREMENT BENEFITS SCHEME

At the balance sheet date, the Group had two retirement schemes in operation, a non-contributory defined benefit scheme which was registered under the Occupational Retirement Scheme Ordinance (the “ORSO Scheme”) in 1995 and a Mandatory Provident Fund Scheme (the “MPF Scheme”) established under the Mandatory Provident Fund Ordinance in December 2000. Employees who were members of the ORSO Scheme prior to the establishment of the MPF Scheme stayed within the ORSO Scheme or switched to the MPF Scheme, whereas all new employees joining the Group on or after December 2000 are required to join the MPF Scheme. Most of the employees enrolled in the MPF Scheme in replacement of the ORSO Scheme (the “participating members”). The assets of the schemes are held separately from those of the Group, in funds under the control of trustees. Under the MPF Scheme, the employee contributes 5% of the relevant payroll to the MPF Scheme while the Group contributes from 5% to 10% of the relevant payroll to the MPF Scheme depending on the years of service completed.

The Group operates the ORSO Scheme (Defined Benefit) for qualifying employees. Under the ORSO Scheme (Defined Benefit), the employees are entitled to retirement benefits varying between 0 and 100 percent of total contributions on attainment of a retirement age of 55. Upon retirement, the employees are entitled to monthly pension until death varying between 0 and 50 percent of final salary depending on years of service completed at the time of retirement.

The most recent actuarial valuation of the ORSO Scheme was carried out as at 31 December 2004 by the qualified actuaries of Watson Wyatt Hong Kong Limited. The accrued liabilities and future costs were measured using the Projected Unit Credit method.

At the date of the latest formal independent actuarial valuation made at 31 December 2004, the market value of the ORSO Scheme (Defined Benefit) assets was HK\$37,262,000 which was sufficient to cover the Aggregate Vested Liability and Aggregate Past Service Liability on that date. The Bank carries out actuarial valuation with sufficient regularity and determines that the valuation made on 31 December 2004 does not differ materially from 31 December 2006, had a valuation been done on the later date.

The directors were of the opinion that the fair value of ORSO Scheme (Defined Benefit) assets did not differ materially from the present value of obligations on 31 December 2006 and 2005.

**36. RELATED PARTY TRANSACTIONS**

During the year, the Group and the Bank entered into the following material transactions with related parties:

	Purchase of a subsidiary		Interest, commission and rental income		Interest and rental expenses	
	2006	2005	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Investing enterprises having significant influence on the Bank and their subsidiaries	-	212,000	4,580	7,899	16,663	13,915
Jointly controlled entities	-	-	8,387	6,555	11,728	8,423
Directors and their associates	-	-	43,562	36,127	24,869	14,172

The above transactions were carried out at market rates.

At the balance sheet date, the Group and the Bank had the following material outstanding balances with related parties:

	Amounts due from related parties		Amounts due to related parties	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Investing enterprises having significant influence on the Bank and subsidiaries	77,785	139,478	127,187	318,089
Jointly controlled entities	31,000	31,000	147,701	188,594
Directors and their associates	1,006,461	1,255,108	618,282	537,559

The above outstanding balances bear interest at rates similar to those made available to non-related parties.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

## 36. RELATED PARTY TRANSACTIONS - continued

During the year, the Bank entered into the following material transactions with subsidiaries:

	Interest, commission and rental income		Interest and rental expenses		Computer service expense		Dividend income		Purchase of land and building	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Subsidiaries	<u>2,773</u>	<u>479</u>	<u>19,102</u>	<u>15,928</u>	<u>26,877</u>	<u>27,133</u>	<u>100,000</u>	<u>-</u>	<u>650,000</u>	<u>-</u>

The above transactions were carried out at market rates.

At the balance sheet date, the Bank had the following material outstanding balances with subsidiaries:

	Amounts due from		Amounts due to	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Subsidiaries	<u>4,677</u>	<u>33,305</u>	<u>616,592</u>	<u>426,081</u>

The above outstanding balances are unsecured, non-interest bearing and, in the opinion of the directors, are repayable within three months.

### Compensation of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

	THE GROUP AND THE BANK	
	2006	2005
	HK\$'000	HK\$'000
Short-term benefits	<u>44,048</u>	<u>38,192</u>
Post employment	<u>2,892</u>	<u>2,444</u>
	<u>46,940</u>	<u>40,636</u>

The remuneration of directors and key management is reviewed by Remuneration Committee having regarding to the performance of individuals and market trends.

## 37. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation.