1. GENERAL

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

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

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES

(a) Application of Hong Kong Financial Reporting Standards

In the current year, the Group and the Bank have applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") that are effective for accounting periods beginning on or after 1 January 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, balance sheets and consolidated statement of changes in equity.

The application of the new HKFRSs has resulted in changes to the Group's and Bank's accounting policies in the following areas that have an effect on how the results for the current and/or prior accounting years are prepared and presented:

Owner-occupied leasehold interest in land

In previous years, owner-occupied leasehold land and buildings were included in property and equipment and measured using the revaluation model. In the current year, the Group and the Bank have applied HKAS 17 "Leases". Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively (see Note 2A for the financial impact).

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES - continued

(a) Application of Hong Kong Financial Reporting Standards - continued

Investment properties

In the current year, the Group and the Bank have, for the first time, applied HKAS 40 "Investment Property". The Group and the Bank have elected to use the fair value model to account for its investment properties which requires gains or losses arising from changes in the fair value of investment properties to be recognised directly in profit or loss for the year in which they arise. In previous years, investment properties under the predecessor Standard were measured at open market values, with revaluation surplus or deficits credited or charged to investment property revaluation reserve unless the balance on this reserve was insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the investment property revaluation reserve was charged to the income statement. Where a decrease had previously been charged to the income statement and a revaluation surplus subsequently arose, that increase was credited to the income statement to the extent of the decrease previously charged. The Group and the Bank have applied the relevant transitional provisions in HKAS 40 and elected to apply HKAS 40 from 1 January 2005 onwards. The amount held in the investment property revaluation reserve at 1 January 2005 has been transferred to the Group's and the Bank's retained profits (Note 2A for the financial impact).

Deferred taxes related to investment properties

In previous years, deferred tax consequences in respect of revalued investment properties were assessed on the basis of the tax consequence that would follow from recovery of the carrying amount of the properties through sale in accordance with the predecessor Interpretation. In the current year, the Group and the Bank have applied HK(SIC) Interpretation 21 "Income Taxes - Recovery of Revalued Non-Depreciable Assets" which removes the presumption that the carrying amount of investment properties is to be recovered through sale. Therefore, the deferred tax consequences of the investment properties are now assessed on the basis that reflect the tax consequences that would follow from the manner in which the Group and the Bank expect to recover the property at each balance sheet date. In the absence of any specific transitional provisions in HK(SIC) Interpretation 21, this change in accounting policy has been applied retrospectively. Comparative figures for 2004 have been restated.

Business combinations

In the current year, the Group has applied HKFRS 3 "Business Combinations" which is effective for business combinations for which the agreement date is on or after 1 January 2005. The principal effects of the application of HKFRS 3 to the Group are summarised below:

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES - continued

(a) Application of Hong Kong Financial Reporting Standards - continued

Business combinations - continued

Goodwill

In previous years, goodwill arising on acquisitions prior to 1 January 2001 was held in reserves, and goodwill arising on acquisitions after 1 January 2001 was capitalised and amortised over its estimated useful life. The Group has applied the relevant transitional provisions in HKFRS 3. Goodwill previously recognised in reserves of HK$182,000 as at 1 January 2005 continues to be held in reserves and will be transferred to the retained earnings of the Group 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.

In accordance with HKFRS 3, any excess of the Group's interest in the net fair value of acquiree’s identifiable assets, liabilities and contingent liabilities over the cost of acquisition (“discount on acquisition”) is recognised immediately in profit or loss in the period in which the acquisition takes place. In previous periods, negative goodwill arising on acquisitions prior to 1 January 2001 was held in reserves, and negative goodwill arising on acquisitions after 1 January 2001 was presented as a deduction from assets and released to income based on an analysis of the circumstances from which the balance resulted. In accordance with the relevant transitional provisions in HKFRS 3, the Group derecognised all negative goodwill on 1 January 2005 (of which negative goodwill of HK$641,000 was previously presented as a deduction from assets). A corresponding adjustment to the Group’s retained profits of HK$641,000 has been made.

Goodwill arising on acquisition after 1 January 2005 is measured at cost less accumulated impairment losses (if any) after initial recognition. As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current year. Comparative figures for 2004 have not been restated (see Note 2A for the financial impact).

Financial instruments

In the current year, the Group and the Bank have applied HKAS 32 “Financial Instruments: Disclosure and Presentation” and HKAS 39 “Financial Instruments: Recognition and Measurement”. HKAS 32 requires retrospective application. The application of HKAS 32 has had no material effect on how the results for the current or prior accounting years are prepared. HKAS 39, which is effective for annual periods beginning on or after 1 January 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS39 are summarised as follows:

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES - continued

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Classification and measurement of financial assets and financial liabilities

The Group and the Bank have applied the relevant transitional provisions in HKAS 39 with respect to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

Debt and equity securities

Prior to 31 December 2004, the Group and the Bank classified and measured its investments in debt and equity securities in accordance with the alternative treatment of Statement of Standard Accounting Practice 24 ("SSAP 24"). Under SSAP 24, investments in debt or equity securities are classified as "trading securities", "other securities" or "held-to-maturity securities" as appropriate. Both "trading securities" and "other securities" are measured at fair value. Unrealised gains or losses of "trading securities" are reported in profit or loss for the period in which gains or losses arise. Unrealised gains or losses of "other securities" are reported in equity until the securities are sold or determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for that period.

From 1 January 2005 onwards, the Group and the Bank have classified and measured its investments in debt and equity securities in accordance with HKAS 39. Under HKAS 39, financial assets are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables", or "held-to-maturity financial assets". "Financial assets at fair value through profit or loss" and "available-for-sale financial assets" are carried at fair value, with changes in fair values recognised in profit or loss and equity respectively. Available-for-sale equity investments that do not have quoted market prices in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost less impairment after initial recognition. "Loans and receivables" and "held-to-maturity financial assets" are measured at amortised cost using the effective interest method after initial recognition.

On 1 January 2005, the Group applied the relevant transitional provisions in HKAS 39 and reclassified its previous carrying amounts of trading securities of HK$234,663,000, held-to-maturity securities of HK$3,388,300,000, other securities of HK$377,847,000, and certificates of deposit held of HK$1,309,515,000 into various classes of financial assets. The reclassification resulted in the categorisation of the aforesaid investments in debt and equity securities and restatement into financial assets designated at fair value through profit or loss at HK$745,350,000, available-for-sale securities at HK$596,372,000, and held-to-maturity securities at HK$3,973,361,000.

The effect of fair value adjustments relating to the abovementioned reclassification and restatement increased the retained profits as at 1 January 2005 by HK$4,758,000, comprising the effect relating to financial assets designated at fair value through profit or loss amounted to HK$2,400,000, and that relating to available-for-sale securities amounted to HK$2,358,000.

On 1 January 2005, the Bank applied the relevant transitional provisions in HKAS 39 and reclassified its previous carrying amounts of trading securities of HK$234,508,000, held-to-maturity securities of HK$3,388,300,000, other securities of HK$347,141,000 and certificates of deposit held of HK$1,309,515,000 into various classes of financial assets. The reclassification resulted in the categorisation of the aforesaid investmetns in debt and equity securities and restatement into financial assets designated at fair value through profit or loss at HK$745,195,000, available-for-sale securities at HK$565,666,000 and held-to-maturity securities at HK$3,973,361,000.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES - continued

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Debt and equity securities - continued

The effect of fair value adjustments relating to the abovementioned reclassification and restatement increased the retained profits as at 1 January 2005 by HK$4,758,000, comprising the effect relating to financial assets at fair value through profit or loss amounted to HK$2,400,000, and that relating to available-for-sale securities amounted to HK$2,358,000.

Financial assets and financial liabilities other than debt and equity securities

From 1 January 2005 onwards, the Group and the Bank have classified and measured its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. As mentioned above, financial assets under HKAS 39 are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables" or "held-to-maturity financial assets". Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "other financial liabilities". Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in profit or loss directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

Advances to customers

In prior years, advances to customers, advances to banks and other financial institutions and accrued interest and other accounts are stated in the consolidated balance sheet of the Group and balance sheet of the Bank after deducting provision for estimated losses.

Provisions for bad and doubtful debts are made, having regard to both specific and general risks.

The specific element of the provision relates to those loans that have been individually reviewed and specifically identified as bad or doubtful. Factors which are considered include expected cash flows, financial condition of the borrower and current economic conditions. The general element of the provision relates to those losses that, although not yet specifically identified, are known from experience to be present in the Group's portfolio of loans and advances. In determining the level of the provision required, management considers numerous factors including, but not limited to, domestic and international economic condition, the composition of the loan portfolio and prior loan loss experience.

From 1 January 2005 onwards following the adoption of HKAS 39, an impairment loss is recognised 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.

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.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES - continued

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Advances to customers - continued

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 income statement.

The Group and the Bank have applied the transitional rules in HKAS 39. At 1 January 2005, specific provision was fully reversed and individual impairment allowances were made resulting in a net increasing effect of HK$39,118,000 on the previous carrying amount of HK$101,391,000. Similarly, at 1 January 2005, general provision was fully reversed and collective impairment allowances were made resulting in a net decreasing effect of HK$102,102,000 on the previous carrying amount. In addition, the brought forward balance of HK$45,931,000 in interest-in-suspense account was fully written back on 1 January 2005. The combined effect of the above changes was a reduction of the previous carrying amount of the total provision for bad and doubtful debts or a corresponding increase of the previous carrying amount of advances and other accounts of HK$108,915,000.

In addition, a regulatory reserve has been set up in compliance with Hong Kong Monetary Authority's requirements by setting aside an amount of HK$103,883,000 upon application of HKAS 39 on 1 January 2005.

Due to the abovementioned a reversal of general provision of HK$102,102,000 on adoption of HKAS 39, the related deferred tax asset amounting to HK$17,868,000 was reversed accordingly.

Derivatives and hedging

Prior to 1 January 2005, financial derivative products, which include forward contracts, interest rate swaps and similar derivative products, are recognised on a trade-date basis and are initially measured at cost. Financial derivative products outstanding at the year end, except for those designated as hedges, are valued at fair value, with unrealised gains and losses included in the income statement. Gains and losses related to those derivative products that are designated as hedges are dealt with in accordance with the accounting treatment applicable to the position hedged and there is no offsetting of assets and liabilities until the position is closed. To qualify as a hedge, the derivative is expected to be effective in reducing the price or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative are expected to be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. The financial derivative products of the Group are mainly used for hedging purposes.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES - continued

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Derivatives and hedging - continued

From 1 January 2005 onwards, all derivatives that are within the scope of HKAS 39 are required to be carried at fair value at each balance sheet date regardless of whether they are deemed as held for trading or designated as effective hedging instruments. Under HKAS 39, derivatives (including embedded derivatives separately accounted for from the non-derivative host contracts) are deemed as held-for-trading financial assets or financial liabilities, unless they qualify and are designated as effective hedging instruments. The corresponding adjustments on changes in fair values would depend on whether the derivatives are designated as effective hedging instruments, and if so, the nature of the item being hedged. For derivatives that are deemed as held for trading, changes in fair values of such derivatives are recognised in profit or loss for the period in which they arise.

On 1 January 2005, the Group and the Bank applied the relevant transitional provisions in HKAS 39 and recognised the derivative financial instruments, not held for hedging purpose or not qualified as held for hedging under HKAS 39, as financial assets/liabilities designated at fair value through profit or loss on balance sheet. That resulted in the recognition of financial assets designated at fair value through profit or loss amounting to HK$734,000 and included in advances and other accounts. In addition, financial liabilities designated at fair value through profit or loss HK$149,000 was recognised and included in other accounts and accruals.

The net effect of the abovementioned recognition of derivative financial instruments amounted to an increase in retained profits as at 1 January 2005 of HK$585,000.

(b) Change of Accounting Policy for Property and Equipment

In the current year, the Group and the Bank have elected to use the cost model, which is allowable under HKAS 16, to account for its buildings held for own use, consistent with the measurement basis of the Group's interest in leasehold lands. Under the cost model, the buildings are carried at cost less accumulated depreciation and accumulated impairment losses (if any).

In previous years, buildings held for own use are stated in the balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent accumulated impairment losses. Buildings held under the predecessor Standard were measured at open market values, with revaluation surplus or deficits credited or charged to property revaluation reserve unless the balance on this reserve was insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the revaluation reserve of the buildings was charged to the income statement. Where a decrease had previously been charged to the income statement and a revaluation surplus subsequently arose, that increase was credited to the income statement to the extent of the decrease previously charged.

The Group and the Bank have applied this change in accounting policy to carry the buildings at cost retrospectively. As a result, the carrying amount of property and equipment and the related deferred tax liabilities have been restated (Note 2A for the financial impact).

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior years are as follows:

	2005 HK$'000	2004 HK$'000
Decrease in negative goodwill released to income	(213)	–
Non-amortisation of goodwill	2,750	–
Gain on disposal of property and equipment	1,962	4,954
Gain on fair value adjustment of investment properties	7,500	–
Increase in operating expenses relating to prepaid lease payments for land *(Note 21)*	(5,063)	(5,063)
Reversal of depreciation of land and buildings	12,617	10,191
(Decrease) increase in deferred tax assets	(4,335)	772
Increase in interest income relating to impaired loans	21,224	–
Increase in impairment allowance - individual assessment	(21,955)	–
Decrease in impairment allowance - collective assessment	3,317	–
Decrease in fair value changes of derivatives	(372)	–
Increase in profit for the year	17,432	10,854

Analysis of increase in profit for the year by line items presented according to their function

	2005 HK$'000	2004 HK$'000
Increase in interest income	21,224	–
Decrease in other operating income	(585)	–
Decrease in operating expenses	7,554	5,128
Increase in gain on fair value adjustment on investment properties	7,500	–
Increase in gain on disposal of property and equipment	1,962	4,954
Increase in impairment allowance on loans and advances	(18,638)	–
Non-amortisation of goodwill	2,750	–
(Increase) decrease in taxation	(4,335)	772
Increase in profit for the year	17,432	10,854

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES - continued

THE GROUP

	As at 31 December 2004 (originally stated) HK$'000	HKAS 16 HK$'000	HKAS 17 HK$'000	HK (SIC) INT-21 HK$'000	As at 31 December 2004 HK$'000	HKFRS 3 HK$'000	HKAS 39 HK$'000	HKAS 40 HK$'000	As at 1 January 2005 HK$'000
Trading securities	234,663	–	–	–	234,663	–	(234,663)	–	–
Financial assets at fair value through profit or loss	–	–	–	–	–	–	745,350	–	745,350
Available-for-sale securities	–	–	–	–	–	–	596,372	–	596,372
Held-to-maturity securities	3,388,300	–	–	–	3,388,300	–	585,061	–	3,973,361
Other securities	377,847	–	–	–	377,847	–	(377,847)	–	–
Certificates of deposit held	1,309,515	–	–	–	1,309,515	–	(1,309,515)	–	–
Advances and other accounts	20,246,034	–	–	–	20,246,034	641	109,649	–	20,356,324
Property and equipment	1,264,949	(16,984)	(1,057,960)	–	190,005	–	–	–	190,005
Prepaid lease payments for land	–	–	306,039	–	306,039	–	–	–	306,039
Other accounts and accruals	(279,129)	–	–	–	(279,129)	–	(149)	–	(279,278)
Deferred tax (liabilities) assets	(106,179)	(2,093)	132,433	(5,210)	18,951	–	(17,868)	–	1,083
Total effects on assets and liabilities	26,436,000	(19,077)	(619,488)	(5,210)	25,792,225	641	96,390	–	25,889,256
Retained profits	2,245,680	(28,991)	34,534	108	2,251,331	641	(7,493)	29,022	2,273,501
Investment property revaluation reserve	34,340	–	–	(5,318)	29,022	–	–	(29,022)	–
Land and buildings revaluation reserve	644,108	9,914	(654,022)	–	–	–	–	–	–
Regulatory reserve	–	–	–	–	–	–	103,883	–	103,883
Total effects on equity	2,924,128	(19,077)	(619,488)	(5,210)	2,280,353	641	96,390	–	2,377,384

The financial effects of the application of the new HKFRSs to the Group's equity on 1 January 2004 are summarised below:

	As originally stated HK$'000	Adjustments HK$'000	As restated HK$'000
Retained profits	2,117,130	544	2,117,674
Investment property revaluation reserve	29,344	(4,707)	24,637
Land and buildings revaluation reserve	572,240	(572,240)	–
Total effects on equity	2,718,714	(576,403)	2,142,311

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES - continued

THE BANK

	As at 31 December 2004 (originally stated) HK$'000	HKAS 16 HK$'000	HKAS 17 HK$'000	HK (SIC) INT-21 HK$'000	As at 31 December 2004 HK$'000	HKAS 39 HK$'000	HKAS 40 HK$'000	As at 1 January 2005 HK$'000
Trading securities	234,508	–	–	–	234,508	(234,508)	–	–
Financial assets at fair value through profit or loss	–	–	–	–	–	745,195	–	745,195
Available-for-sale securities	–	–	–	–	–	565,666	–	565,666
Held-to-maturity securities	3,388,300	–	–	–	3,388,300	585,061	–	3,973,361
Other securities	347,141	–	–	–	347,141	(347,141)	–	–
Certificates of deposit held	1,309,515	–	–	–	1,309,515	(1,309,515)	–	–
Advances and other accounts	20,136,354	–	–	–	20,136,354	109,649	–	20,246,003
Property and equipment	712,853	3,316	(555,160)	–	161,009	–	–	161,009
Prepaid lease payments for land	–	–	222,901	–	222,901	–	–	222,901
Other accounts and accruals	(179,512)	–	–	–	(179,512)	(149)	–	(179,661)
Deferred tax (liabilities) assets	(96,815)	(192)	121,389	(5,210)	19,172	(17,868)	–	1,304
Total effects on assets and liabilities	25,852,344	3,124	(210,870)	(5,210)	25,639,388	96,390	–	25,735,778
Retained profits	1,924,145	2,171	38,501	108	1,964,925	(7,493)	27,518	1,984,950
Investment property revaluation reserve	32,836	–	–	(5,318)	27,518	–	(27,518)	–
Land and buildings revaluation reserve	601,340	953	(249,371)	–	352,922	–	–	352,922
Regulatory reserve	–	–	–	–	–	103,883	–	103,883
Total effects on equity	2,558,321	3,124	(210,870)	(5,210)	2,345,365	96,390	–	2,441,755

The financial effects of the application of the new HKFRSs to the Bank's equity on 1 January 2004 are summarised below:

	As originally stated HK$'000	Adjustments HK$'000	As restated HK$'000
Retained profits	1,829,896	35,575	1,865,471
Investment property revaluation reserve	29,344	(4,707)	24,637
Land and buildings revaluation reserve	529,472	(176,550)	352,922
Total effects on equity	2,388,712	(145,682)	2,243,030

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES - continued

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

HKAS 1 (Amendment)	Capital disclosure [1]
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures [2]
HKAS 21 (Amendment)	Net investment in a foreign operation [2]
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions [2]
HKAS 39 (Amendment)	The fair value option [2]
HKAS 39 and HKFRS 4 (Amendments)	Financial guarantee contracts [2]
HKFRS 6	Exploration for and evaluation of mineral resources [2]
HKFRS 7	Financial instruments: Disclosures [1]
HKFRS - INT 4	Determining whether an arrangement contains a lease [2]
HKFRS - INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds [2]
HK(IFRIC) - INT 6	Liabilities arising from participating in a specific market, waste electrical and electronic equipment [3]
HK(IFRIC) - INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies [4]

[1] *Effective for annual periods beginning on or after 1 January 2007.*

[2] *Effective for annual periods beginning on or after 1 January 2006.*

[3] *Effective for annual periods beginning on or after 1 December 2005.*

[4] *Effective for annual periods beginning on or after 1 March 2006.*

3. SIGNIFICANT ACCOUNTING POLICIES

The 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 financial statements have been prepared in accordance with HKFRS issued by the HKICPA. In addition, the 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 its subsidiaries.

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 or a jointly controlled entity 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 2001 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.

3. 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 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.

Any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of acquisition ("discount on acquisition") is recognised immediately in profit or loss in the period in which the acquisition takes place.

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 the 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 profit or loss and of changes in equity 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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Interests in jointly controlled entities - continued

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.

Interest income and expenses

Interest income and expenses are recognised on a time-proportion basis using the effective interest method. 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.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cashflow discounted at original effective interest rate of the instrument, and thereafter amortising the discount as interest income.

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.

In prior years, interest income on loans and advances and debt securities and interest expense on deposits was recognised on an accrual basis using the contract or coupon interest rates. Amortisation of premium and discounts were recognised as interest expense and interest income respectively on a straight-line basis over the life of the asset or liability. In the case of doubtful debts, interest was credited to a suspense account which was netted off against accrued interest receivable except for credit card advances and overdrafts, where interest was accrued and the related specific provision on the interest receivable was included in the charge for bad and doubtful debts.

Fees and commission income

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

Dividend income

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

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Property and equipment

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

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

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

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.

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.

In prior years, investment properties are stated at their open market value based on independent professional valuations at the balance sheet date. Any revaluation increase or decrease arising on the revaluation of investment properties is credited or charged to the investment property revaluation reserve unless the balance of this reserve is insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the investment property revaluation reserve is charged to the income statement. Where a decrease has previously been charged to the income statement and a revaluation increase subsequently arises, this increase is credited to the income statement to the extent of the decrease previously charged. On disposal of an investment property, the balance on the investment property revaluation reserve attributable to that property is transferred to the income statement. No depreciation is provided on investment properties except where the unexpired term of the relevant lease is 20 years or less.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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 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.

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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 its 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.

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 on or after 1 January 2005 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 Mandatory Provident Fund Scheme are charged as an expense as they fall due.

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. 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.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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 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.

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.

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

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.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are those designated at fair value through profit or loss on initial recognition and those held for trading. 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 income statement 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, placement with and advances to banks and other financial institutions, interest receivable, 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.

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 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 income statement.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Financial assets - continued

Loans and receivables - continued

When a loan is uncollectable, it is written off against the related allowances for loan impairment when all collaterals have 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.

In prior years, advances to customers, banks and other financial institutions and accrued interest and other accounts are stated in the balance sheet after deducting provision for estimated losses.

Provisions for bad and doubtful debts is made, having regard to both specific and general risks.

The specific element of the provision relates to those loans that have been individually reviewed and specifically identified as bad or doubtful. Factors which considered include expected cash flows, financial condition of the borrower and current economic conditions. The general element of the provision relates to those losses that, although not yet specifically identified, are known from experience to be present in the Group’s portfolio of loans and advances. In determining the level of the provision required, management considers numerous factors including, but not limited to, domestic and international economic condition, the composition of the loan portfolio and prior loan loss experience.

Provisions are applied to write off advances when all collateral have been realised and further recoveries are considered unlikely.

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. 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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Financial assets - continued

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 income statement. Any impairment losses on available-for-sale financial assets are recognised in income statement. Impairment losses on available-for-sale equity investments will not reverse 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.

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 classified into other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Other financial liabilities

Other financial liabilities, including deposits and balances of banks and other financial institutions and deposits from customers and amounts due to subsidiaries 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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Derivative financial instruments

All derivatives of the Group do not meet the requirements of hedge accounting in accordance with HKAS 39. All derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at the fair values. The gain or loss on remeasurement to fair value at the balance sheet date is taken to the income statement.

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 the cumulative gain or loss that had been recognised directly in equity is recognised in income statement.

For financial liabilities, they are removed from the Group's balance sheet 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 received or receivable is recognised in income statement.

Embedded derivatives

Derivatives embedded in non-derivative host contracts are separated from the relevant host contracts and deemed as held-for-trading when the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contracts, and the combined contracts are not measured at fair value through profit or loss. In all other circumstances, derivatives embedded are not separated and are accounted for together with the host contracts in accordance with appropriate standards. Where the Group needs to separate an embedded derivative but is unable to measure the embedded derivative, the entire combined contracts are treated as held-for-trading.

Impairment losses (other than goodwill)

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible 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.

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Repossessed assets

Collateral repossessed pending for realisation are in relation to those impaired loans and advances (or non-performing loans) continue to be reported as loans and advances. Impairment is made on the shortfall between the expected sales proceeds from realisation of the repossessed assets and the outstanding loans and advances.

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, other eligible bills and certificates of deposit.

4. 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.

4. CRITICAL ACCOUNTING JUDGEMENT AND KEY SOURCE OF ESTIMATION UNCERTAINTY - 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. (Note 16)

(b) Fair value of derivatives

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) 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. (Note 15)

(d) Estimated impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise.

Key sources of judgment

In the process of applying the entity's accounting policies which are described in note 3, 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.

5. BUSINESS AND GEOGRAPHICAL SEGMENTS

(a) Business segments

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

Principal activities are as follows:

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current and savings accounts, credit card 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.

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

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

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

INCOME STATEMENT

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Eliminations HK$'000	Consolidated HK$'000
Interest income from external customers	997,780	721,558	–	–	1,719,338
Interest expense to external customers	(914,949)	(51,537)	–	–	(966,486)
Inter-segment income *(Note)*	333,259	–	–	(333,259)	–
Inter-segment expense *(Note)*	–	(333,259)	–	333,259	–
Net interest income	416,090	336,762	–	–	752,852
Other operating income	74,945	27,737	114,447	–	217,129
Operating income	491,035	364,499	114,447	–	969,981
Impairment allowances for impaired loans	(67,807)	–	–	–	(67,807)
Net (loss) gain on disposal of property and equipment	(909)	–	2,059	–	1,150
Net gain on disposal 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)	(27,890)	–	(371,443)
Segment profit	98,211	345,054	143,646	–	586,911
Unallocated corporate expenses					(121,686)
Profit from operations					465,225
Share of results 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 deposits interest rates.

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

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

BALANCE SHEET

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Consolidated HK$'000
Assets				
Segment assets	25,043,584	23,035,716	1,568,108	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				49,973,752
Liabilities				
Segment liabilities	42,035,905	1,733,891	92,061	43,861,857
Unallocated corporate liabilities				278,759
Consolidated total liabilities				44,140,616

OTHER INFORMATION

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Unallocated HK$'000	Consolidated HK$'000
Capital additions	17,092	118	1,955	26,236	45,401
Depreciation	18,438	312	2,009	14,846	35,605
Amortisation	3,751	–	–	1,312	5,063

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

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

INCOME STATEMENT

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Eliminations HK$'000	Consolidated HK$'000 (restated)
Interest income from external customers	631,115	359,698	–	–	990,813
Interest expense to external customers	(333,967)	(7,349)	–	–	(341,316)
Inter-segment income *(Note)*	106,001	–	–	(106,001)	–
Inter-segment expense *(Note)*	–	(106,001)	–	106,001	–
Net interest income	403,149	246,348	–	–	649,497
Other operating income	95,939	27,562	144,552	–	268,053
Operating income	499,088	273,910	144,552	–	917,550
Charge for bad and doubtful debts	(51,175)	–	–	–	(51,175)
Net (loss) gain on disposal of property and equipment	(122)	–	5,034	–	4,912
Net gain on disposal of other securities and an associate	–	–	3,863	–	3,863
Operating expenses	(285,129)	(19,094)	(27,695)	–	(331,918)
Segment profit	162,662	254,816	125,754	–	543,232
Unallocated corporate expenses					(125,296)
Profit from operations					417,936
Share of results of jointly controlled entities			11,319		11,319
Profit before taxation					429,255
Taxation					(69,398)
Profit for the year					359,857

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

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

(ii) Segment information about these businesses as at 31 December 2004 is presented below: - continued

BALANCE SHEET

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Consolidated HK$'000 (restated)
Assets				
Segment assets	20,728,257	19,649,998	686,045	41,064,300
Interests in jointly controlled entities	–	–	37,875	37,875
Loan to a joint controlled entity	–	–	31,000	31,000
Unallocated corporate assets				228,056
Consolidated total assets				41,361,231
Liabilities				
Segment liabilities	33,988,496	1,522,769	99,159	35,610,424
Unallocated corporate liabilities				191,156
Consolidated total liabilities				35,801,580

OTHER INFORMATION

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Unallocated HK$'000	Consolidated HK$'000
Capital additions	31,600	103	373	23,462	55,538
Depreciation	17,488	647	4,268	16,381	38,784
Amortisation	3,751	–	–	1,312	5,063

(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 2004 and 2005, more than 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 Mainland China and America.

Details of geographical segmentation are set out in note 3 and note 6 of the unaudited supplementary financial information.

6. 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.

6. FINANCIAL RISK MANAGEMENT - continued

Strategy in using financial instruments - continued

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 as at 31 December 2005 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. 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 in accordance with 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 Loans Committee with reference to the creditworthiness, and concentration risk of and the collateral pledged by the counterparties. Decisions made by the Loans 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.

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.

6. FINANCIAL RISK MANAGEMENT - continued

Credit risk - continued

(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 to 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.

Commitments to extent credit represent unused portions of authorisations 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.

6. FINANCIAL RISK MANAGEMENT - continued

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 reserves 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 effect of fluctuations in the prevailing foreign currency exchange rates on its 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.

The following table indicates the concentration of currency risk at the balance sheet date:

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
Financial assets at fair value through profit or loss	463,610	391,157	–	–	854,767
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 *(Note 16)*	22,538,378	1,408,392	44,955	304,919	24,296,644
Other assets, including tax assets	893,953	91,112	191	14,515	999,771
Total assets	35,524,529	9,388,599	132,713	4,927,911	49,973,752
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, including tax liabilities	295,027	28,071	1,559	46,163	370,820
Total liabilities	29,919,474	9,251,921	74,005	4,895,216	44,140,616
Net on-balance sheet position	5,605,055	136,678	58,708	32,695	5,833,136
Off-balance sheet notional position	151,629	(129,072)	(4,004)	(18,553)	–

6. FINANCIAL RISK MANAGEMENT - continued

Foreign exchange risk - continued

THE GROUP

	HK$	US$	MOP	Others	Total
Hong Kong dollars equivalents (HK$'000)					
At 31 December 2004					
Assets					
Cash and short term funds	7,247,933	3,316,429	74,774	2,967,811	13,606,947
Placements with banks and other financial institutions	639,000	622,184	–	283,511	1,544,695
Trading securities	156	96,806	–	137,701	234,663
Held-to-maturity securities	1,143,039	1,867,369	–	377,892	3,388,300
Other securities	274,766	99,867	–	3,214	377,847
Certificates of deposit held	1,270,628	38,887	–	–	1,309,515
Advances to customers *(Note 16)*	18,446,933	1,468,812	38,836	335,638	20,290,219
Other assets, including tax assets	590,434	5,326	–	13,285	609,045
Total assets	29,612,889	7,515,680	113,610	4,119,052	41,361,231
Liabilities					
Deposits and balances of banks and other financial institutions	1,127,958	277,035	–	154,640	1,559,633
Deposits from customers	22,847,087	7,188,584	45,138	3,870,822	33,951,631
Other liabilities, including tax liabilities	226,149	12,233	–	51,934	290,316
Total liabilities	24,201,194	7,477,852	45,138	4,077,396	35,801,580
Net on-balance sheet position	5,411,695	37,828	68,472	41,656	5,559,651
Off-balance sheet notional position	57,235	(25,522)	–	(31,713)	–

6. FINANCIAL RISK MANAGEMENT - continued

Foreign exchange risk - continued

THE BANK

	HK$	US$	MOP	Others	Total
Hong Kong dollars equivalents (HK$'000)					
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
Financial assets at fair value through profit or loss	463,047	391,158	–	–	854,205
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 *(Note 16)*	22,535,404	1,408,392	44,955	304,919	24,293,670
Other assets, including tax assets	1,376,184	91,112	191	14,513	1,482,000
Total assets	35,841,071	9,388,600	132,713	4,927,909	50,290,293
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, including tax liabilities	629,479	28,071	1,559	46,164	705,273
Total liabilities	30,249,771	9,251,921	74,005	4,895,216	44,470,913
Net on-balance sheet position	5,591,300	136,679	58,708	32,693	5,819,380
Off-balance sheet notional position	151,629	(129,072)	(4,004)	(18,553)	–
At 31 December 2004					
Assets					
Cash and short term funds	7,247,926	3,316,429	74,774	2,967,811	13,606,940
Placements with banks and other financial institutions	639,000	622,184	–	283,511	1,544,695
Trading securities	1	96,806	–	137,701	234,508
Held-to-maturity securities	1,143,039	1,867,369	–	377,892	3,388,300
Other securities	244,060	99,867	–	3,214	347,141
Certificates of deposit held	1,270,628	38,887	–	–	1,309,515
Advances to customers *(Note 16)*	18,441,704	1,468,812	38,836	335,638	20,284,990
Other assets, including tax assets	969,960	5,326	–	13,285	988,571
Total assets	29,956,318	7,515,680	113,610	4,119,052	41,704,660
Liabilities					
Deposits and balances of banks and other financial institutions	1,127,957	277,035	–	154,641	1,559,633
Deposits from customers	22,836,806	7,188,584	45,138	3,870,822	33,941,350
Other liabilities, including tax liabilities	545,079	12,233	–	51,934	609,246
Total liabilities	24,509,842	7,477,852	45,138	4,077,397	36,110,229
Net on-balance sheet position	5,446,476	37,828	68,472	41,655	5,594,431
Off-balance sheet notional position	57,235	(25,522)	–	(31,713)	–

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

THE GROUP

	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
Financial assets at fair value through profit or loss	4.50%	565,737	–	203,047	–	85,983	854,767
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 *(Note 16)*	5.44%	24,001,286	267,240	24,981	3,137	–	24,296,644
Other assets	–	–	–	–	–	999,771	999,771
Total assets		43,313,646	1,769,744	2,575,273	13,235	2,301,854	49,973,752
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
Total liabilities		39,670,212	1,676,101	267,837	–	2,526,466	44,140,616
Total interest sensitivity gap		3,643,434	93,643	2,307,436	13,235	(224,612)	5,833,136
At 31 December 2004							
Assets							
Cash and short term funds	0.51%	13,170,430	114,931	69,635	10,000	241,951	13,606,947
Placements with banks and other financial institutions	1.88%	1,544,695	–	–	–	–	1,544,695
Trading securities	3.49%	173,924	31,407	–	–	29,332	234,663
Held-to-maturity securities	2.69%	2,613,961	52,694	680,660	38,985	2,000	3,388,300
Certificates of deposit held	0.78%	65,887	1,243,628	–	–	–	1,309,515
Advances to customers *(Note 16)*	2.62%	18,956,360	470,760	5,840	3,096	854,163	20,290,219
Other assets	–	–	–	–	–	986,892	986,892
Total assets		36,525,257	1,913,420	756,135	52,081	2,114,338	41,361,231
Liabilities							
Deposits and balances of banks and other financial institutions	0.66%	1,401,782	150,000	–	–	7,851	1,559,633
Deposits from customers	1.19%	29,719,281	1,351,642	73,000	–	2,807,708	33,951,631
Other liabilities	–	–	–	–	–	290,316	290,316
Total liabilities		31,121,063	1,501,642	73,000	–	3,105,875	35,801,580
Total interest sensitivity gap		5,404,194	411,778	683,135	52,081	(991,537)	5,559,651

6. FINANCIAL RISK MANAGEMENT - continued

Cash flow and fair value interest rate risk - continued

THE BANK

	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
Financial assets at fair value through profit or loss	4.50%	565,737	–	203,047	–	85,421	854,205
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 *(Note 16)*	5.44%	23,998,741	267,093	24,699	3,137	–	24,293,670
Other assets	–	–	–	–	–	1,482,000	1,482,000
Total assets		43,274,266	1,769,597	2,574,991	13,235	2,658,204	50,290,293
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		39,995,191	1,675,966	267,837	–	2,531,919	44,470,913
Total interest sensitivity gap		3,279,075	93,631	2,307,154	13,235	126,285	5,819,380
At 31 December 2004							
Assets							
Cash and short term funds	0.51%	13,170,430	114,931	69,635	10,000	241,944	13,606,940
Placements with banks and other financial institutions	1.88%	1,544,695	–	–	–	–	1,544,695
Trading securities	3.49%	173,924	31,407	–	–	29,177	234,508
Held-to-maturity securities	2.69%	2,613,961	52,694	680,660	38,985	2,000	3,388,300
Certificates of deposit held	0.78%	65,887	1,243,628	–	–	–	1,309,515
Advances to customers *(Note 16)*	2.61%	18,952,685	470,229	4,817	3,096	854,163	20,284,990
Other assets	–	–	–	–	–	1,335,712	1,335,712
Total assets		36,521,582	1,912,889	755,112	52,081	2,462,996	41,704,660
Liabilities							
Deposits and balances of banks and other financial institutions	0.67%	1,401,782	150,000	–	–	7,851	1,559,633
Deposits from customers	1.19%	29,710,663	1,351,508	73,000	–	2,806,179	33,941,350
Amounts due to subsidiaries	0.37%	76,802	260,415	–	–	83,346	420,563
Other liabilities	–	–	–	–	–	188,683	188,683
Total liabilities		31,189,247	1,761,923	73,000	–	3,086,059	36,110,229
Total interest sensitivity gap		5,332,335	150,966	682,112	52,081	(623,063)	5,594,431

6. FINANCIAL RISK MANAGEMENT - continued

Liquidity risk

The Group and the Bank have laid down liquidity policy which is reviewed regularly by the Board. This policy requires the Group 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 its 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.

The table below analyses 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$'000	Repayable within 3 months or less (except those repayable on demand) HK$'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
Advances to banks and other financial institutions *(Note 16)*	–	19,209	38,000	–	–	–	57,209
Advances to customers *(Note 16)*	1,615,723	4,635,235	3,254,009	8,116,115	6,087,700	587,862	24,296,644
Debt securities included in:							
- financial assets at fair value through profit or loss	16,024	164,920	54,286	540,598	78,377	–	854,205
- available-for-sale securities	–	–	38,388	144,857	95,151	–	278,396
- held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
	16,024	2,906,266	2,391,076	4,534,923	477,218	–	10,325,507
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

6. FINANCIAL RISK MANAGEMENT - continued

Liquidity risk - continued

THE GROUP

	Repayable on demand HK$'000	Repayable within 3 months or less (except those repayable on demand) HK$'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 2004							
Assets							
Cash and short-term funds	699,814	12,712,567	114,931	69,635	10,000	–	13,606,947
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions *(Note 16)*	–	20,212	38,000	–	–	–	58,212
Advances to customers *(Note 16)*	1,401,718	3,450,550	3,164,119	7,027,496	4,788,574	457,762	20,290,219
Debt securities included in:							
- trading securities	79,282	123,819	31,407	–	–	–	234,508
- held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
Liabilities							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,777,613	20,749,367	1,351,642	73,009	–	–	33,951,631

THE BANK

	Repayable on demand HK$'000	Repayable within 3 months or less (except those repayable on demand) HK$'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	1,140,914	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
Advances to banks and other financial institutions *(Note 16)*	–	19,209	38,000	–	–	–	57,209
Advances to customers *(Note 16)*	1,615,723	4,635,003	3,253,395	8,115,019	6,086,694	587,836	24,293,670
Debt securities included in:							
- financial assets at fair value through profit or loss	16,024	164,920	54,286	540,598	78,377	–	854,205
- available-for-sale securities	–	–	38,388	144,857	95,151	–	278,396
- held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
	16,024	2,906,266	2,391,076	4,534,923	477,218	–	10,325,507
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

6. FINANCIAL RISK MANAGEMENT - continued

Liquidity risk - continued

THE BANK

	Repayable on demand HK$'000	Repayable within 3 months or less (except those repayable on demand) HK$'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 2004							
Assets							
Cash and short-term funds	699,807	12,712,567	114,931	69,635	10,000	–	13,606,940
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions *(Note 16)*	–	20,212	38,000	–	–	–	58,212
Advances to customers *(Note 16)*	1,401,718	3,450,174	3,163,023	7,025,143	4,787,196	457,736	20,284,990
Debt securities included in:							
- trading securities	79,282	123,819	31,407	–	–	–	234,508
- held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
Liabilities							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,776,084	20,740,749	1,351,508	73,009	–	–	33,941,350

In addition to those assets and liabilities analysed above, the remaining assets and liabilities comprise property and equipment, investment properties and goodwill that are non-current, while the other remaining assets and liabilities are current.

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.

6. FINANCIAL RISK MANAGEMENT - continued

Fair value of financial assets and liabilities

The following table summarises the carrying amounts and fair values of financial assets, held-to-maturity, of the Group and the Bank:

THE GROUP AND THE BANK

	Carrying value		Fair value	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Financial assets				
- Held-to-maturity securities	9,192,906	3,388,300	9,172,671	3,410,258

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 these are of negligible credit risk and are mainly priced in market interest rate.

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.

7. NET INTEREST INCOME

	2005 HK$'000	2004 HK$'000
Interest income		
Cash and short term funds	498,440	259,148
Investments in securities	223,118	100,301
Loans and advances	997,780	631,364
	1,719,338	990,813
Interest expense		
Banks and customers	(966,486)	(341,316)
Net interest income	752,852	649,497

Included in interest income is HK$21,224,000 (2004: Nil) with respect to effective interest income of impaired loans and advances released from impairment allowances, and HK$21,820,000 (2004: Nil) with respect of financial assets that are designated at fair value through profit or loss.

8. OTHER OPERATING INCOME

	2005 HK$'000	2004 HK$'000
Fees and commission income		
Securities dealings	44,569	53,064
Credit lines	11,946	14,151
Trade finance	12,226	13,383
Credit card services	18,382	15,520
Agency services	21,050	23,241
Others	10,506	10,452
Total fees and commission income	118,679	129,811
Less: Fees and commission expense	(2,231)	(3,197)
Net fees and commission income	116,448	126,614
Dividend income		
Listed investments	7,238	6,899
Unlisted investments	3,005	46,530
Net gains on dealing in foreign currencies	27,737	27,562
Net gains on sale of trading securities	–	562
Net gains on financial assets at fair value through profit or loss		
- net realised losses	(52)	–
- net unrealised gains	703	–
Gross rents from properties	4,384	4,349
Less: Outgoings	(649)	(592)
Net rental income	3,735	3,757
Safe deposit box rentals	22,255	22,310
Insurance underwriting	5,671	–
Other banking services income	30,528	33,259
Others	(139)	560
	217,129	268,053

9. OPERATING EXPENSES

	2005 HK$'000	2004 HK$'000 (restated)
Amortisation of prepaid lease payments for land	5,063	5,063
Auditors' remuneration	2,442	2,004
Staff costs		
Salaries and other costs	251,349	225,979
Retirement benefits scheme contributions	18,901	17,249
Total staff costs	270,250	243,228
Depreciation	35,605	38,784
Premises and equipment expenses, excluding depreciation/amortisation		
Rentals and rates for premises	42,054	40,741
Others	12,207	12,622
Other operating expenses	125,508	114,772
	493,129	457,214

Included in the premises and equipment expenses are minimum lease payment under operating lease of HK$38,949,000 (2004: HK$37,959,000).

10. DIRECTORS' AND EMPLOYEES' EMOLUMENTS

The emoluments paid or payable to each of the 23 (2004: 20) directors were as follows:

	2005				2004			
	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	80	5,678	350	6,108	80	5,262	350	5,692
Liu Lit Mo	40	494	45	579	40	495	44	579
Liu Lit Chi	40	7,743	210	7,993	40	6,730	210	6,980
Don Tit Shing Liu	40	1,712	168	1,920	40	1,566	153	1,759
Wilfred Chun Ning Liu	40	1,914	137	2,091	40	1,990	103	2,133
Lau Wai Man	40	1,505	150	1,695	40	1,360	135	1,535
Frank Shui Sang Jin	40	1,715	143	1,898	40	1,602	115	1,757
Kevin Wai Hung Chu 1.1.2005 - 16.7.2005	22	693	46	761	23	792	52	867
Andrew Chiu Wing Tsang 17.8.2005 - 31.12.2005	15	633	47	695	–	–	–	–
George Har Kar Wong 17.8.2005 - 31.12.2005	15	707	39	761	–	–	–	–
Dominic Bing Hoi Lam 1.1.2005 - 10.5.2005	–	–	–	–	30	906	90	1,026
Total executive directors	372	22,794	1,335	24,501	373	20,703	1,252	22,328

10. DIRECTORS' AND EMPLOYEES' EMOLUMENTS - continued

	2005				2004			
	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
Non-executive directors (Hong Kong)								
Dominic Bing Hoi Lam 1.1.2005 - 10.5.2005	14	–	–	14	10	–	–	10
Wang Zhi 16.11.2005 - 31.12.2005	5	–	–	5	–	–	–	–
Timothy George Freshwater	40	80	–	120	70	80	–	150
Alfred Cheuk Yu Chow	60	–	–	60	70	–	–	70
Andrew Liu	40	1	–	41	40	1	–	41
Toshiaki Arai	40	–	–	40	40	–	–	40
Liu Guoyuan 1.1.2005 - 16.11.2005	35	–	–	35	40	–	–	40
Christopher Kwun Shing Liu	40	–	–	40	40	–	–	40
Sun Jiakang	40	–	–	40	40	–	–	40
Robin Yau Hing Chan 1.1.2005 - 26.4.2005	12	–	–	12	40	–	–	40
Total non-executive directors	326	81	–	407	390	81	–	471
Independent non-executive directors (Hong Kong)								
Robin Yau Hing Chan 26.4.2005 - 31.12.2005	55	–	–	55	–	–	–	–
Wanchai Chiranakhorn	80	–	–	80	80	–	–	80
Peter Alan Lee Vine 1.1.2005 - 13.4.2005	23	–	–	23	80	–	–	80
Cheng Yuk Wo	80	–	–	80	20	–	–	20
Total independent non-executive directors	238	–	–	238	180	–	–	180
Total	936	22,875	1,335	25,146	943	20,784	1,252	22,979

The five highest paid individuals in the Group in 2005 and 2004 were all directors of the Bank and details of their emoluments are included in note 10 above.

11. TAXATION

	2005 HK$'000	2004 HK$'000 (restated)
The tax charge comprises:		
Hong Kong Profits Tax		
- current year	75,663	58,818
- (over)under provision in prior years	(206)	2,455
	75,457	61,273
Overseas taxation	727	2,996
Deferred tax *(Note 25)*	(5,366)	5,129
	70,818	69,398

Hong Kong Profits Tax is calculated at 17.5% (2004: 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 income statement as follows:

	2005 HK$'000	2004 HK$'000 (restated)
Profit before taxation	468,801	429,255
Tax at the domestic income tax rate of 17.5% (2004: 17.5%)	82,040	75,120
Tax effect of share of results of jointly controlled entities	(626)	–
Tax effect of expenses not deductible for tax purpose	3,653	4,278
Tax effect of income not taxable for tax purpose	(13,638)	(12,433)
Tax effect of utilisation of tax losses not recognised previously	(398)	–
(Over)under provision in prior years	(206)	2,455
Effect of different tax rates of subsidiaries operating in other jurisdictions	(291)	(47)
Others	284	25
Tax charge for the year	70,818	69,398

12. DIVIDENDS

	2005 HK$'000	2004 HK$'000
Ordinary shares:		
Interim dividend paid - HK$0.18 (2004: HK$0.17) per share	78,300	73,950
Final dividend proposed - HK$0.42 (2004: HK$0.40) per share	182,700	174,000
	261,000	247,950

A final dividend of HK$0.42 (2004: HK$0.40) per share has been proposed by the directors and is subject to approval by the shareholders at the forthcoming general meeting.

13. EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the profit attributable to shareholders of HK$397,983,000 (2004 (restated): HK$359,857,000) and on 435,000,000 (2004: 435,000,000) ordinary shares in issue during the year.

The following table summarise the impact on earnings per share as a result of changes in accounting policies.

	2005 HK$'000	2004 HK$'000
Figures before adjustments	0.87	0.80
Adjustments arising from changes in accounting policies *(Note 2)*	0.04	0.03
As reported/restated	0.91	0.83

14. CASH AND SHORT-TERM FUNDS

	THE GROUP		THE BANK	
	2005 HK$'000	2004 HK$'000	2005 HK$'000	2004 HK$'000
Cash and balances with banks and other financial institutions	1,010,669	560,601	1,010,629	560,594
Money at call and short notice	10,301,297	12,548,402	10,264,463	12,548,402
Exchange fund bills	486,513	497,944	486,513	497,944
	11,798,479	13,606,947	11,761,605	13,606,940

15. INVESTMENTS IN SECURITIES/CERTIFICATES OF DEPOSIT HELD

	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	Assets 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 held	–	–	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
Derivative	45,607	–	–	–	45,607	45,607	–	–	–	45,607
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	45,607	808,598	9,192,906	526,628	10,573,739	45,607	808,598	9,192,906	524,019	10,571,130
	46,169	808,598	9,192,906	801,769	10,849,442	45,607	808,598	9,192,906	676,491	10,723,602
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	1	–	25,274	2	25,277	–	–	25,274	–	25,274
Banks and other financial institutions	46,024	163,158	7,129,927	28,804	7,367,913	45,607	163,158	7,129,927	20,290	7,358,982
Corporate entities	–	–	1,942,596	227,121	2,169,717	–	–	1,942,596	132,182	2,074,778
Others	144	645,440	–	545,842	1,191,426	–	645,440	–	524,019	1,169,459
	46,169	808,598	9,192,906	801,769	10,849,442	45,607	808,598	9,192,906	676,491	10,723,602

The Group and the Bank have applied HKAS 39 on 1 January 2005. Under the prospective application requirement of HKAS 39, certain financial assets were designated at fair value through profit or loss or classified as available for sale on 1 January 2005. There was no such designation in 2004.

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. If without quoted price, the valuation will be performed by the qualified personnel by using reasonable valuation model.

Certain held-to-maturity certificates of deposit of approximately HK$23,924,000 (2004: HK$23,510,000) 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.

15. INVESTMENTS IN SECURITIES/CERTIFICATES OF DEPOSIT HELD - continued

	THE GROUP				THE BANK			
	Trading securities HK$'000	Held-to-maturity securities HK$'000	Other securities HK$'000	Total HK$'000	Trading securities HK$'000	Held-to-maturity securities HK$'000	Other securities HK$'000	Total HK$'000
2004								
Equity securities:								
Listed in Hong Kong	155	–	157,678	157,833	–	–	126,972	126,972
Listed overseas	–	–	5,650	5,650	–	–	5,650	5,650
	155	–	163,328	163,483	–	–	132,622	132,622
Unlisted	–	–	214,519	214,519	–	–	214,519	214,519
	155	–	377,847	378,002	–	–	347,141	347,141
Debt securities:								
Unlisted	234,508	3,388,300	–	3,622,808	234,508	3,388,300	–	3,622,808
Total:								
Listed in Hong Kong	155	–	157,678	157,833	–	–	126,972	126,972
Listed overseas	–	–	5,650	5,650	–	–	5,650	5,650
Unlisted	234,508	3,388,300	214,519	3,837,327	234,508	3,388,300	214,519	3,837,327
	234,663	3,388,300	377,847	4,000,810	234,508	3,388,300	347,141	3,969,949
Market value of listed securities:								
Listed in Hong Kong	155	–	157,678	157,833	–	–	126,972	126,972
Listed overseas	–	–	5,650	5,650	–	–	5,650	5,650
	155	–	163,328	163,483	–	–	132,622	132,622
As analysed by issuing entities:								
Central government and central banks	–	50,024	–	50,024	–	50,024	–	50,024
Public sector entities	–	29,762	41,380	71,142	–	29,762	39,896	69,658
Banks and other financial institutions	35	1,915,305	16,457	1,931,797	–	1,915,305	13,658	1,928,963
Corporate entities	120	1,392,514	82,111	1,474,745	–	1,392,514	79,068	1,471,582
Others	234,508	695	237,899	473,102	234,508	695	214,519	449,722
	234,663	3,388,300	377,847	4,000,810	234,508	3,388,300	347,141	3,969,949
Certificates of deposit held				1,309,515				1,309,515

16. ADVANCES AND OTHER ACCOUNTS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Bills receivable	330,409	410,792	330,409	410,792
Trade bills	131,549	89,366	131,549	89,366
Other advances to customers	23,834,686	19,790,061	23,831,712	19,784,832
	24,296,644	20,290,219	24,293,670	20,284,990
Interest receivable	196,225	86,900	195,900	86,893
Impairment allowances				
- Individually assessed	(54,640)	–	(54,640)	–
- Collectively assessed	(131,933)	–	(131,901)	–
Provision for bad and doubtful debts				
- General	–	(201,876)	–	(201,818)
- Specific	–	(101,391)	–	(101,391)
Interest in suspense	–	(45,931)	–	(45,931)
	24,306,296	20,027,921	24,303,029	20,022,743
Advances to banks and other financial institutions	57,209	58,212	57,209	58,212
	24,363,505	20,086,133	24,360,238	20,080,955
Other accounts	144,556	159,901	66,802	55,399
	24,508,061	20,246,034	24,427,040	20,136,354

Included in the "Advances to customers" of the Group and the Bank are aggregate amounts of approximately HK$139,478,000 (2004: HK$225,503,000) 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$57,209,000 (2004: HK$58,212,000) 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.

16. ADVANCES AND OTHER ACCOUNTS - continued

Impairment allowances on advances:

	THE GROUP					THE BANK				
	Individual assessment HK$'000	Collective assessment HK$'000	Total assessment HK$'000	Suspended interest HK$'000	Total HK$'000	Individual assessment HK$'000	Collective assessment HK$'000	Total assessment HK$'000	Suspended interest HK$'000	Total HK$'000
Balance at 1 January 2005										
- as previously reported	101,391	201,876	303,267	45,931	349,198	101,391	201,818	303,209	45,931	349,140
- effect of application of HKAS 39	39,118	(102,102)	(62,984)	(45,931)	(108,915)	39,118	(102,102)	(62,984)	(45,931)	(108,915)
- as restated	140,509	99,774	240,283	–	240,283	140,509	99,716	240,225	–	240,225
Increase in impairment allowances	61,550	48,515	110,065	–	110,065	61,550	48,515	110,065	–	110,065
Effective interest income released	(21,224)	–	(21,224)	–	(21,224)	(21,224)	–	(21,224)	–	(21,224)
Amounts reversed	(4,692)	(16,342)	(21,034)	–	(21,034)	(4,692)	(16,316)	(21,008)	–	(21,008)
Net charge to income statement	35,634	32,173	67,807	–	67,807	35,634	32,199	67,833	–	67,833
Exchange difference	–	(14)	(14)	–	(14)	–	(14)	(14)	–	(14)
Amounts written off	(121,503)	–	(121,503)	–	(121,503)	(121,503)	–	(121,503)	–	(121,503)
Balance at 31 December 2005	54,640	131,933	186,573	–	186,573	54,640	131,901	186,541	–	186,541

Provisions against advances and other accounts as at 31 December 2004:

	THE GROUP				THE BANK			
	Specific HK$'000	General HK$'000	Total HK$'000	Suspended interest HK$'000	Specific HK$'000	General HK$'000	Total HK$'000	Suspended interest HK$'000
Balance at 1 January 2004	215,255	215,730	430,985	140,603	214,474	214,608	429,082	140,528
New provisions	105,170	–	105,170	–	105,168	–	105,168	–
Amounts reversed	(41,142)	(12,853)	(53,995)	–	(41,142)	(12,796)	(53,938)	–
Net charge to income statement	64,028	(12,853)	51,175	–	64,026	(12,796)	51,230	–
Interest suspended during the year	–	–	–	40,142	–	–	–	40,142
Interest recovered during the year	–	–	–	(19,952)	–	–	–	(19,952)
Exchange difference	–	6	6	–	–	6	6	–
Amounts written off	(177,892)	(1,007)	(178,899)	(114,862)	(177,109)	–	(177,109)	(114,787)
Balance at 31 December 2004	101,391	201,876	303,267	45,931	101,391	201,818	303,209	45,931

The individual impairment allowances/specific provisions were made after taking into account the value of collateral in respect of the corresponding advances to customers.

16. ADVANCES AND OTHER ACCOUNTS - continued

Details of the impaired loans/non-performing loans are as follows:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Gross non-performing loans	–	790,980	–	790,980
Gross impaired loans	642,788	–	642,788	–
Less: Impairment allowances under individual assessment	(54,640)	–	(54,640)	–
Less: Specific provisions	–	(95,142)	–	(95,142)
Net impaired/non-performing loans	588,148	695,838	588,148	695,838
Gross impaired/non-performing loans as a percentage of gross advances to customers	2.65%	3.90%	2.65%	3.90%
Market value of collateral pledged	617,345	704,626	617,345	704,626
Interest in suspense	–	45,931	–	45,931

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	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Within one year	371	818	327	721
In the second to fifth year inclusive	403	1,104	377	1,023
	774	1,922	704	1,744
Less: Unearned finance income	(70)	(178)	–	–
Present value of minimum lease payments receivable	704	1,744	704	1,744
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)			377	1,023
Current finance lease receivables (recoverable within 12 months)			327	721
			704	1,744

17. INVESTMENTS IN SUBSIDIARIES

	2005 HK$'000	2004 HK$'000
Unlisted shares, at cost	792,484	580,719

Details of all the subsidiaries as at 31 December 2005 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
Liu Chong Hing (Management) Limited	Hong Kong	HK$100,000	100%	Provision of property management services
Liu Chong Hing (Nominees) Limited	Hong Kong	HK$100,000	100%	Provision of nominee services
Liu Chong Hing Finance Limited	Hong Kong	HK$25,000,000	100%	Deposit-taking and lending
Liu Chong Hing Data Processing Limited	Hong Kong	HK$100,000	100%	Provision of electronic data processing services
Liu Chong Hing Banking Corporation, Cayman	Cayman Islands/ Hong Kong	US$65,000,000	100%	General merchant banking
Chong Hing Securities Limited	Hong Kong	HK$10,000,000	100%	Stockbroking
Chong Hing Commodities and Futures Limited	Hong Kong	HK$5,000,000	100%	Investment holding and commodities and futures broking
Right Way Investments Limited	Bermuda/ Hong Kong	US$12,000	100%	Property investment
Gallbraith Limited	Hong Kong	HK$16,550,000	100%	Property investment
Card Alliance Company Limited	Hong Kong	HK$18,000,000	100%	Credit card management
Chong Hing Insurance Company Limited *(Note 28)*	Hong Kong	HK$50,000,000	100%	Insurance

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

17A. AMOUNTS DUE FROM SUBSIDIARIES

	2005 HK$'000	2004 HK$'000
Amounts due from subsidiaries	33,305	14,546

The amounts due from subsidiaries are unsecured, non-interest bearing and, in the opinion of the directors, are not repayable within three months.

18. INTERESTS IN JOINTLY CONTROLLED ENTITIES

	THE GROUP		THE BANK	
	2005 HK$'000	2004 HK$'000	2005 HK$'000	2004 HK$'000
Unlisted shares, at cost	–	–	56,500	56,500
Share of net assets	65,710	37,875	–	–
	65,710	37,875	56,500	56,500

The directors consider the Bank has joint control on those jointly controlled entities.

During the year, the Group has acquired 10.5% and 5% of the share capital, through acquisition of the subsidiary, of BC Reinsurance Limited and Hong Kong Life Insurance Limited respectively. The investments were reclassified to jointly controlled entities in accordance with the existing interest of the Group in the respective entities.

As at 31 December 2005, 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	15.0%	15.0%	Provision of internet services

18A. LOAN TO A JOINTLY CONTROLLED ENTITY

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Loan to a jointly controlled entity	31,000	31,000	31,000	31,000

The loan to a jointly controlled entity, Bank Consortium Holding Limited amounting to HK$31,000,000 (2004: HK$31,000,000) is unsecured, non-interest bearing, and will be repayable on 28 December 2008.

19. INVESTMENT PROPERTIES

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January	69,360	47,868	51,360	47,868
Additions	–	16,496	–	–
Net increase in fair value	7,500	4,996	7,500	3,492
At 31 December	76,860	69,360	58,860	51,360

Investment properties owned by the Group and by the Bank were revalued at 31 December 2005 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	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Leasehold properties				
Held in Hong Kong on long-term lease (over 50 years unexpired)	9,950	9,350	9,950	9,350
Held in Hong Kong on medium-term lease (10 - 50 years unexpired)	48,910	42,010	48,910	42,010
Held outside Hong Kong on medium-term lease (10 - 50 years unexpired)	18,000	18,000	–	–
	76,860	69,360	58,860	51,360

20. PROPERTY AND EQUIPMENT

	THE GROUP				THE BANK		
	Buildings HK$'000	Equipment HK$'000	Construction in progress HK$'000	Total HK$'000	Buildings HK$'000	Equipment HK$'000	Total HK$'000
COST AND VALUATION							
At 1 January 2005							
- as originally stated	613,690	295,284	544,544	1,453,518	613,690	266,052	879,742
- effect of changes in accounting policies	(533,919)	–	(523,100)	(1,057,019)	(533,919)	–	(533,919)
- as restated	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)
Currency realignment	–	(2)	–	(2)	–	(2)	(2)
At 31 December 2005	80,511	308,643	40,454	429,608	80,511	278,556	359,067
ACCUMULATED DEPRECIATION							
At 1 January 2005							
- as originally stated	–	188,569	–	188,569	–	166,889	166,889
- effect of changes in accounting policies	17,925	–	–	17,925	17,925	–	17,925
- as restated	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)
Currency realignment	–	(2)	–	(2)	–	(2)	(2)
At 31 December 2005	19,498	213,350	–	232,848	19,498	187,462	206,960
NET BOOK VALUE							
At 31 December 2005	61,013	95,293	40,454	196,760	61,013	91,094	152,107

20. PROPERTY AND EQUIPMENT - continued

	THE GROUP				THE BANK		
	Buildings HK$'000	Equipment HK$'000	Construction in progress HK$'000	Total HK$'000	Buildings HK$'000	Equipment HK$'000	Total HK$'000
COST AND VALUATION							
At 1 January 2004							
- as originally stated	526,594	269,148	529,237	1,324,979	526,594	246,412	773,006
- effect of changes in accounting policies	(458,350)	–	(523,100)	(981,450)	(458,350)	–	(458,350)
- as restated	68,244	269,148	6,137	343,529	68,244	246,412	314,656
Additions	12,027	28,204	15,307	55,538	12,027	27,851	39,878
Acquired on acquisition of a subsidiary	–	6,319	–	6,319	–	–	–
Disposals	(500)	(8,387)	–	(8,887)	(500)	(8,211)	(8,711)
At 31 December 2004	79,771	295,284	21,444	396,499	79,771	266,052	345,823
ACCUMULATED DEPRECIATION							
At 1 January 2004							
- as originally stated	–	159,703	–	159,703	–	143,815	143,815
- effect of changes in accounting policies	16,580	–	–	16,580	16,580	–	16,580
- as restated	16,580	159,703	–	176,283	16,580	143,815	160,395
Provided for the year	1,595	37,189	–	38,784	1,595	31,221	32,816
Eliminated on disposals	(250)	(8,323)	–	(8,573)	(250)	(8,147)	(8,397)
At 31 December 2004	17,925	188,569	–	206,494	17,925	166,889	184,814
NET BOOK VALUE							
At 31 December 2004	61,846	106,715	21,444	190,005	61,846	99,163	161,009

Prior to 1 January 2005, the buildings and leasehold lands included in construction in progress were stated at their revalued amounts. The Group and the Bank have elected to use the cost model, which is allowable under HKAS 16. Under the cost model, the buildings and construction in progress are restated and carried at cost less accumulated depreciation and accumulated impairment losses (if any).

20. PROPERTY AND EQUIPMENT - continued

The net book value of buildings and construction in progress shown above comprise:

	THE GROUP				THE BANK	
	Buildings		Construction in progress		Buildings	
	2005	2004	2005	2004	2005	2004
	HK$'000	HK$'000 (restated)	HK$'000	HK$'000 (restated)	HK$'000	HK$'000 (restated)
Leasehold properties						
Held in Hong Kong on long-term lease (over 50 years unexpired)	12,542	12,922	40,454	21,444	12,542	12,922
Held in Hong Kong on medium-term lease (10-50 years unexpired)	47,568	48,001	–	–	47,568	48,001
Held outside Hong Kong on medium-term lease (10-50 years unexpired)	903	923	–	–	903	923
	61,013	61,846	40,454	21,444	61,013	61,846

In previous years, owner-occupied leasehold land and buildings were included in property and equipment and measured using the revaluation model. In the current year, the Group has applied HKAS 17 "Leases". Under HKAS 17, the land and buildings elements of a lease of land and buildings are apportioned separately for the purposes of lease classified. The apportionment of the values for land and buildings was performed by Vigers Hong Kong Limited, independent professionally qualified valuers.

21. PREPAID LEASE PAYMENTS FOR LAND

The Group's prepaid lease payments comprise:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
In Hong Kong held on:				
Leases of over 50 years	126,447	126,863	43,409	43,725
Leases of between 10 to 50 years	167,841	172,328	167,841	172,328
Outside Hong Kong held on:				
Leases of between 10 to 50 years	6,681	6,848	6,681	6,848
	300,969	306,039	217,931	222,901

21. PREPAID LEASE PAYMENTS FOR LAND - continued

The Group's prepaid lease payments comprise: - continued

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Net book value at 1 January				
- as originally stated	–	–	–	–
- effect of application of HKAS 17	306,039	311,619	222,901	228,381
- as restated	306,039	311,619	222,901	228,381
Amortisation of prepaid operating lease payment	(5,063)	(5,063)	(4,963)	(4,963)
Disposal	(7)	(517)	(7)	(517)
	300,969	306,039	217,931	222,901
Analysed as:				
Current portion	5,063	5,063	4,963	4,963
Non-current portion	295,906	300,976	212,968	217,938
Total	300,969	306,039	217,931	222,901

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

22. DEPOSITS FROM CUSTOMERS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Demand deposits and current accounts	2,144,820	2,803,982	2,144,820	2,803,982
Savings deposits	6,462,001	8,954,061	6,462,001	8,954,061
Time, call and notice deposits	32,899,471	22,193,588	32,895,315	22,183,307
	41,506,292	33,951,631	41,502,136	33,941,350

Included in the balances is an aggregate amount of approximately HK$318,089,000 (2004: HK$86,297,000) representing deposits of companies having significant influence on the Bank and their subsidiaries placed with the Group and the Bank.

23. SHARE CAPITAL

	2005 & 2004
	HK$'000
Authorised:	
600,000,000 shares of HK$0.50 each	300,000
Issued and fully paid:	
435,000,000 shares of HK$0.50 each	217,500

24. RESERVES

	Share premium HK$'000	Investment property revaluation reserve HK$'000	Land and buildings revaluation reserve HK$'000	Investment revaluation reserve HK$'000	General reserve HK$'000	Translation reserve HK$'000	Regulatory reserve HK$'000	Retained profits HK$'000	Total HK$'000
THE BANK									
At 1 January 2005									
- as originally stated	1,542,817	32,836	601,340	110,169	1,378,500	80	–	1,924,145	5,589,887
- effect of changes in accounting policies *(Note 2A)*	–	(5,318)	(248,418)	–	–	–	–	40,780	(212,956)
- as restated	1,542,817	27,518	352,922	110,169	1,378,500	80	–	1,964,925	5,376,931
Effect of initial application of HKAS 39	–	–	–	–	–	–	–	96,390	96,390
Effect of initial application of HKAS 40	–	(27,518)	–	–	–	–	–	27,518	–
Earmark of retained profits as regulatory reserve	–	–	–	–	–	–	103,883	(103,883)	–
As restated on 1 January 2005	1,542,817	–	352,922	110,169	1,378,500	80	103,883	1,984,950	5,473,321
Revaluation gains	–	–	–	44,616	–	–	–	–	44,616
Exchange differences arising from translation of foreign operations	–	–	–	–	–	(207)	–	–	(207)
Net income recognised directly in equity	–	–	–	44,616	–	(207)	–	–	44,409
Transfer between reserves	–	–	(352,922)*	–	–	–	–	352,922	–
Profit for the year	–	–	–	–	–	–	–	351,500	351,500
Reversal of reserves upon disposal	–	–	–	(15,050)	–	–	–	–	(15,050)
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	1,542,817	–	–	139,735	1,378,500	(127)	122,837	2,418,118	5,601,880
At 1 January 2004									
- as originally stated	1,542,817	29,344	529,472	57,793	1,378,500	(26)	–	1,829,896	5,367,796
- effect of changes in accounting policies *(Note 2A)*	–	(4,707)	(176,550)	–	–	–	–	35,575	(145,682)
- as restated	1,542,817	24,637	352,922	57,793	1,378,500	(26)	–	1,865,471	5,222,114
Revaluation gains	–	3,492	–	48,675	–	–	–	–	52,167
Deferred taxation arising from revaluation gains	–	(611)	–	–	–	–	–	–	(611)
Exchange differences arising from translation of foreign operations	–	–	–	–	–	106	–	–	106
Net income recognised directly in equity	–	2,881	–	48,675	–	106	–	–	51,662
Profit for the year	–	–	–	–	–	–	–	325,654	325,654
Reversal of reserves upon disposal	–	–	–	3,701	–	–	–	–	3,701
Total recognised income for the year	–	2,881	–	52,376	–	106	–	325,654	381,017
Interim dividend paid	–	–	–	–	–	–	–	(73,950)	(73,950)
Final dividend paid	–	–	–	–	–	–	–	(152,250)	(152,250)
At 31 December 2004	1,542,817	27,518	352,922	110,169	1,378,500	80	–	1,964,925	5,376,931

The Bank's reserves available for distribution to the shareholders as at 31 December 2005 comprised retained profits of HK$2,418,118,000 (2004 (restated): HK$1,964,925,000) and general reserve of HK$1,378,500,000 (2004: HK$1,378,500,000).

The regulatory reserve is set up in compliance with 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 and inner reserve.

* *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.*

25. 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$'000	Revaluation of properties HK$'000	Collectively assessed impairment allowance/ General provisions for bad and doubtful debts HK$'000	Investment properties HK$'000	Others HK$'000	Total HK$'000
THE GROUP						
At 1 January 2005						
- as originally stated	**11,246**	**127,826**	**(32,893)**	**–**	**–**	**106,179**
- effect of changes in accounting policies *(Note 2A)*	**(2,622)**	**(127,826)**	**–**	**5,318**	**–**	**(125,130)**
As restated	**8,624**	**–**	**(32,893)**	**5,318**	**–**	**(18,951)**
Effect of initial application of HKAS 39	**–**	**–**	**17,868**	**–**	**–**	**17,868**
	8,624	**–**	**(15,025)**	**5,318**	**–**	**(1,083)**
Charge (credit) to income statement for the year *(Note 11)*	**729**	**–**	**(7,408)**	**1,313**	**–**	**(5,366)**
At 31 December 2005	**9,353**	**–**	**(22,433)**	**6,631**	**–**	**(6,449)**
At 1 January 2004						
- as originally stated	6,225	113,731	(36,310)	–	1,439	85,085
- effect of changes in accounting policies *(Note 2A)*	(984)	(113,731)	–	4,707	–	(110,008)
As restated	5,241	–	(36,310)	4,707	1,439	(24,923)
Charge (credit) to income statement for the year *(Note 11)*	3,151	–	3,417	–	(1,439)	5,129
Acquisition of a subsidiary	232	–	–	–	–	232
Charge to investment property revaluation reserve	–	–	–	611	–	611
At 31 December 2004, as restated	8,624	–	(32,893)	5,318	–	(18,951)
THE BANK						
At 1 January 2005						
- as originally stated	**11,014**	**118,683**	**(32,882)**	**–**	**–**	**96,815**
- effect of changes in accounting policies *(Note 2A)*	**(2,622)**	**(118,683)**	**–**	**5,318**	**–**	**(115,987)**
As restated	**8,392**	**–**	**(32,882)**	**5,318**	**–**	**(19,172)**
Effect of initial application of HKAS 39	**–**	**–**	**17,868**	**–**	**–**	**17,868**
	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	**9,353**	**–**	**(22,427)**	**6,631**	**–**	**(6,443)**
At 1 January 2004						
- as originally stated	6,225	104,588	(36,289)	–	1,439	75,963
- effects of changes in accounting policies *(Note 2A)*	(984)	(104,588)	–	4,707	–	(100,865)
As restated	5,241	–	(36,289)	4,707	1,439	(24,902)
Charge (credit) to income statement for the year	3,151	–	3,407	–	(1,439)	5,119
Charge to investment property revaluation reserve	–	–	–	611	–	611
At 31 December 2004, as restated	8,392	–	(32,882)	5,318	–	(19,172)

At the balance sheet date, the Group has unused tax losses of HK$ 3,871,000 (2004: HK$ 6,145,000) available for offset against future profits. No deferred tax assets has been recognised in respect of tax losses since the amount was considered insignificant. The Bank has no tax losses available for offset against future profits.

26. 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.

27. LOANS TO OFFICERS

The aggregate relevant loans to officers disclosed pursuant to Section 161B(4B) of the Companies Ordinance are as follows:

	THE GROUP AND THE BANK	
	2005	**2004**
	HK$'000	**HK$'000**
Aggregate balance of all relevant loans outstanding at the balance sheet date	**100,383**	**118,514**
Maximum aggregate balance of relevant loans during the year	**135,511**	**287,579**

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$ 94,208,000 (2004: 109,241,000) with collateral.

28. ACQUISITION OF A SUBSIDIARY

On 27 June 2005, 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, are as follows:

	Acquiree's carrying amount before combination HK$'000	Fair value adjustments HK$'000	2005 Fair value HK$'000
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)
			102,763
Goodwill arising from acquisition			110,606
Total consideration			213,369
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 a subsidiary			122,959

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.

The subsidiary acquired during the year contributed HK$6,515,000 to the Group's operating income, and a profit of HK$914,000 to the Group's profit from operations for the period between the date of acquisition and the balance sheet date.

If the acquisition had been completed on 1 January 2005, total Group's operating income for the year would have been HK$978,187,000 and profit for the year would have been HK$399,091,000. The proforma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2005, nor is it intended to be a projection of future results.

28. ACQUISITION OF A SUBSIDIARY - continued

In prior year, the Group acquired 66.7% of the issued share capital of Card Alliance Company Limited and a shareholder's loan of HK$7,500,000 for consideration of HK$7,965,000. This acquisition has been accounted for by the acquisition method of accounting. The amount of negative goodwill arising as a result of the acquisition was HK$641,000 and is included in advances and other accounts.

	HK$'000
Net assets acquired	
Placements with banks and other financial institutions maturing between one and twelve months	8,387
Advances and other accounts less provision	3,326
Fixed assets	6,319
Deferred tax liabilities	(232)
Other accounts and accruals	(1,142)
Shareholder's loan	(15,000)
Share of net assets before acquisition	(552)
	1,106
Negative goodwill arising on acquisition	(641)
	465
Shareholder's loan	7,500
Total consideration	7,965
Satisfied by:	
Cash	7,965
Net cash inflow arising on acquisition:	
Cash consideration	7,965
Cash and cash equivalents acquired	(8,387)
Net inflow of cash and cash equivalents in respect of the purchase of a subsidiary	(422)

29. LIQUIDATION OF A SUBSIDIARY

On 30 December 2005, 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:

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

30. IMPAIRMENT TESTING ON GOODWILL

For the year ended 31 December 2005, the management has reviewed goodwill as set out in note 28 for impairment. The review comprised a comparison of the carrying amount and value in use of the acquired subsidiary (the smallest cash-generating unit) to which the goodwill has been allocated. The acquired subsidiary is involved in insurance business. Value in use is derived at by discounting the expected future cash flows over a 40-year period at 9% discount rate. Management's financial model assumes an overall growth in gross written premium of 10.3% per annum during the first 5 years, 7.4% per annum from years 6 to 10 and 5.5% per annum from years 11 to 30. The financial model, which has a projection horizon of 40 years, assumes no premium growth beyond year 30.

No impairment loss has been recognised in respect of goodwill for the year ended 31 December 2005 as their value in use exceeds the carrying amount.

31. CONTINGENT LIABILITIES AND COMMITMENTS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Contingent liabilities and commitments - contractual amounts				
Direct credit substitutes	972,847	1,023,725	972,847	1,023,725
Trade - related contingencies	371,150	351,095	371,150	351,095
Other commitments				
With an original maturity of under one year or which are unconditionally cancellable	4,270,086	3,998,729	4,269,273	3,998,087
With an original maturity of one year and over	3,626,057	3,108,000	3,626,057	3,107,572
Capital commitments	369,588	50,291	369,588	50,291
	9,609,728	8,531,840	9,608,915	8,530,770
Derivatives notional amounts				
- Exchange rate contracts	111,566	135,335	111,566	135,335
- Interest rate swap contracts	657,654	387,760	657,654	387,760

Included under "Other 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	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Within one year	31,506	37,080	30,693	36,438
In the second to fifth years inclusive	16,574	41,422	16,574	40,994
Over five years	–	979	–	979
	48,080	79,481	47,267	78,411

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.

Included under "capital commitments" are as follows:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	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	133,110	24,532	133,110	24,532
- investment in fund	236,478	25,759	236,478	25,759
	369,588	50,291	369,588	50,291

31. CONTINGENT LIABILITIES AND COMMITMENTS - continued

The replacement costs and credit risk weighted amounts of the above contingent liabilities, commitments and derivatives exposures are as follows:

	THE GROUP				THE BANK			
	2005		2004		2005		2004	
	Replacement cost HK$'000	Credit risk weighted amount HK$'000	Replacement cost HK$'000	Credit risk weighted amount HK$'000	Replacement cost HK$'000	Credit risk weighted amount HK$'000	Replacement cost HK$'000	Credit risk weighted amount HK$'000
Contingent liabilities and commitments	N/A	2,820,689	N/A	2,272,921	N/A	2,820,689	N/A	2,272,921
Exchange rate contracts	451	514	1,015	1,461	451	514	1,015	1,461
Interest rate contracts	45,607	17,490	8,972	3,941	45,607	17,490	8,972	3,941
	46,058	2,838,693	9,987	2,278,323	46,058	2,838,693	9,987	2,278,323

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

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.

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	
	2005 HK$'000	2004 HK$'000
Within one year	500	1,821
In the second to fifth years inclusive	–	524
	500	2,345

32. RETIREMENT BENEFITS SCHEME

At the balance sheet date, the Group had two retirement schemes in operation, a non-contributory defined benefit scheme which is 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 were either staying within the ORSO Scheme or switching 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. As a result, retirement benefits accruing subsequent to the establishment of the MPF Scheme are covered therefrom, as far as the ORSO Scheme members participating in the MPF Scheme are concerned. The ORSO Scheme continues to provide retirement benefits to non-participating members and those retirement benefits accrued prior to MPF Scheme to the participating members.

32. RETIREMENT BENEFITS SCHEME - continued

The Group operates the ORSO Scheme for qualifying employees. Under the ORSO Scheme, the employees are entitled to retirement benefits varying between 0 and 100 percent of total contributions made by the Group 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. 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 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. The main actuarial assumptions used were as follows:

Discount rate	4% per annum
Expected return on Scheme assets	5% per annum
Expected rate of salary increase	3% per annum

At the date of the latest formal independent actuarial valuation made at 31 December 2004, the market value of the Scheme assets was HK$166,305,000 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 2005, had a valuation been done on the later date.

33. MAJOR NON-CASH TRANSACTIONS

During the year, the Group has written off approximately HK$121,517,000 (2004: HK$ 178,893,00) advances to customers to the impairment allowances/provisions against advances and other accounts.

34. RELATED PARTY TRANSACTIONS

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

	Purchase of a subsidiary		Interest, commission and rental income		Interest and rental expenses	
	2005	2004	2005	2004	2005	2004
	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	–	7,899	7,062	13,915	11,851
Associate and jointly controlled entities	–	–	6,555	13,720	8,423	6,019
Directors and their associates	–	–	36,127	17,659	14,172	3,629

The above transactions were carried out at market rates.

34. RELATED PARTY TRANSACTIONS - continued

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

	Amounts owed by related parties		Amounts owed to related parties	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Investing enterprises having significant influence on the Bank and subsidiaries	139,478	225,503	318,089	86,297
Jointly controlled entities	31,000	31,000	188,594	217,284
Directors and their associates	1,255,108	1,049,225	537,559	602,839

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

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

	Interest, commission and rental income		Interest and rental expenses	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Subsidiaries	479	850	15,928	6,036

The above transactions were carried out at market rates.

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

	Amounts owed by		Amounts owed to	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Subsidiaries	33,305	14,546	426,081	420,563

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

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	
	2005	2004
	HK$'000	HK$'000
Short-term benefits	40,636	40,567

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