

NOTES TO THE ACCOUNTS (continued)**35. Notes to consolidated cash flow statement****(a) Reconciliation of operating profit to net cash (outflow)/inflow from operating activities**

	2001 HK\$m	2000 HK\$m
Operating profit after provisions	5,750	6,537
Depreciation	460	514
Charge for bad and doubtful debts	7,412	8,593
Advances written off net of recoveries	(9,905)	(11,040)
Dividend income from investments in securities	(66)	(42)
Change in treasury bills with original maturity over three months	(12,464)	4,782
Change in placements with banks and other financial institutions with original maturity over three months	(10,212)	(9,660)
Change in money at call and short notice with original maturity over three months	(9,507)	1,877
Change in trade bills	157	(53)
Change in certificates of deposit held with original maturity over three months	331	(5,737)
Change in other investments in securities	(22,288)	(20,783)
Change in held-to-maturity securities	(2,639)	(3,492)
Change in advances and other accounts	19,914	(5,536)
Change in deposits and balances of banks and other financial institutions repayable over three months	(13,801)	2,444
Change in other assets	824	927
Change in current, fixed, savings and other deposits from customers	(18,298)	35,305
Change in other accounts and provisions	10,045	1,714
Exchange differences	(4)	(56)
Net cash (outflow)/inflow from operating activities	(54,291)	6,294

NOTES TO THE ACCOUNTS (continued)

35. Notes to consolidated cash flow statement (continued)

(b) Analysis of changes in financing

	Share capital HK\$m	Certificates of deposit issued HK\$m	Minority interests HK\$m
As at 1 January 2001	52,864	9,000	1,532
Cash outflow upon redemption	-	(4,000)	-
Minority interests' share of profit	-	-	133
Dividends paid to minority shareholders	-	-	(638)
Minority interests' share of revaluation reserve	-	-	49
Release on disposal of subsidiaries	-	-	(10)
As at 31 December 2001	52,864	5,000	1,066

	Share capital HK\$m	Certificates of deposit issued HK\$m	Minority interests HK\$m
As at 1 January 2000	52,864	9,660	1,456
Cash outflow upon redemption	-	(660)	-
Minority interests' share of profit	-	-	151
Dividends paid to minority shareholders	-	-	(75)
As at 31 December 2000	52,864	9,000	1,532

(c) Analysis of the balances of cash and cash equivalents

	2001 HK\$m	2000 HK\$m
Cash and balances with banks and other financial institutions	59,898	85,373
Money at call and short notice with original maturity within three months	87,183	135,144
Treasury bills with original maturity within three months	3,194	10,722
Placements with banks and other financial institutions with original maturity within three months	16,843	54,696
Certificates of deposit held with original maturity within three months	1,191	7,059
Deposits from and balances of banks and other financial institutions with original maturity within three months	(47,645)	(108,314)
	120,664	184,680

NOTES TO THE ACCOUNTS (continued)

35. Notes to consolidated cash flow statement (continued)

(d) Purchase of subsidiaries

	2001 HK\$m	2000 HK\$m
Net assets acquired:		
Property under development	-	332
Fixed assets	13	-
Other accounts	-	99
Cash and bank balances	61	2
Other accounts and provisions	(37)	(281)
Deposits from and balances of banks and other financial institutions	-	(245)
	37	(93)
Goodwill arising on consolidation	-	93
	37	-
Satisfied by:		
Cash consideration	37	-
Analysis of net inflow of cash and cash equivalents in respect of the purchase of subsidiaries		
Cash consideration	(37)	-
Cash and bank balances	61	2
	24	2

NOTES TO THE ACCOUNTS (continued)

35. Notes to consolidated cash flow statement (continued)

(e) Disposal of subsidiaries

	2001 HK\$m	2000 HK\$m
Net assets disposed of:		
Cash and short-term funds	31	-
Investment securities	48	-
Investments in associates	15	-
Other investments in securities	9	-
Advances and other accounts	461	348
Fixed assets	593	-
Other accounts and provisions	(847)	(348)
	<u>310</u>	<u>-</u>
Minority interest	(2)	-
	<u>308</u>	<u>-</u>
Total consideration	320	-
	<u>12</u>	<u>-</u>
Satisfied by:		
Cash consideration	283	-
Accounts receivable	37	-
	<u>320</u>	<u>-</u>
Analysis of net inflow of cash and cash equivalents in respect of the disposal of subsidiaries		
Cash consideration	283	-
Cash and short-term funds	(31)	-
	<u>252</u>	<u>-</u>

(f) Significant non-cash transactions

The disposal of shareholdings in BOC Insurance and dividends received from BOC Insurance (note 3(a)) have been treated as cash capital contributions and are shown as financing items in the consolidated cash flow statement. Other capital contributions are included in the change in other accounts and provisions in the consolidated cash flow statement.

NOTES TO THE ACCOUNTS (continued)

36. Maturity profile (continued)

	The Bank						
	Repayable on demand HK\$m	3 months or less HK\$m	1 year or less but over 3 months HK\$m	5 years or less but over 1 year HK\$m	After 5 years HK\$m	Undated HK\$m	Total HK\$m
As at 31 December 2001							
Assets							
- Treasury bills	-	11,968	6,151	-	-	-	18,119
- Placements with banks and other financial institutions	-	38,876	22,771	-	-	-	61,647
- Certificates of deposit held	-	4,501	6,140	7,272	149	-	18,062
- Advances to customers	26,344	17,764	19,708	93,514	86,310	33,235	276,875
- Advances to banks and other financial institutions	-	-	-	4	-	-	4
- Debt securities included in:							
- held-to-maturity securities	2	2,741	4,260	21,456	4,258	-	32,717
- other investments in securities	-	27,021	5,885	21,960	1,043	-	55,909
Liabilities							
- Deposits and balances of banks and other financial institutions	4,576	47,325	1,529	-	-	-	53,430
- Current, fixed, savings and other deposits from customers	174,109	311,611	24,848	939	-	-	511,507
- Certificates of deposit issued	-	-	5,000	-	-	-	5,000

	The Bank						
	Repayable on demand HK\$m	3 months or less HK\$m	1 year or less but over 3 months HK\$m	5 years or less but over 1 year HK\$m	After 5 years HK\$m	Undated HK\$m	Total HK\$m
As at 31 December 2000							
Assets							
- Treasury bills	-	2,295	1,065	-	-	-	3,360
- Placements with banks and other financial institutions	-	7,526	1,870	-	-	-	9,396
- Certificates of deposit held	-	-	-	147	-	-	147
- Advances to customers	714	839	1,145	5,634	11,411	591	20,334
- Advances to banks and other financial institutions	-	-	-	6	-	-	6
- Debt securities included in:							
- held-to-maturity securities	-	77	264	438	-	-	779
Liabilities							
- Deposits and balances of banks and other financial institutions	4,141	324	66	-	-	-	4,531
- Current, fixed, savings and other deposits from customers	7,381	26,030	1,259	35	-	-	34,705

NOTES TO THE ACCOUNTS (continued)

36. Maturity profile (continued)

The above maturity classifications have been prepared in accordance with the guideline on “Financial Disclosure by Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority. In accordance with the guideline, the Group has reported assets such as advances and debt securities which have been overdue for not more than one month as “Repayable on demand” and assets which are non-performing or which are overdue for more than one month as “Undated”. In the case of an asset which is repayable by different payments or instalments, only that portion of the asset which is actually overdue is reported as overdue. Any part of the asset which is not due is reported according to the residual maturity unless the repayment of the asset is in doubt in which case the amount is reported as “Undated”. The above assets are stated before deduction of provisions, if any.

The analysis of other investments in securities by remaining period to maturity is disclosed in order to comply with the module on “Financial Disclosure by Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority. The disclosure does not imply that the securities will be held to maturity.

37. Off-balance sheet exposures

(a) Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2001 HK\$'m	2000 HK\$'m	2001 HK\$'m	2000 HK\$'m
Direct credit substitutes	1,967	5,515	1,598	189
Transaction-related contingencies	2,273	3,528	2,177	-
Trade-related contingencies	16,391	22,088	13,553	396
Other commitments				
- under 1 year or which are unconditionally cancellable	84,497	86,072	57,291	1,938
- 1 year and over	43,879	24,733	40,629	664
Forward forward deposits placed	11,872	6,988	10,357	-
Others	88	115	88	-
	160,967	149,039	125,693	3,187

NOTES TO THE ACCOUNTS (continued)

37. Off-balance sheet exposures (continued)

(b) Derivatives

The following is a summary of the notional amounts of each significant type of derivative:

	The Group					
	2001			2000		
	Trading HK\$m	Hedging HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Total HK\$m
Exchange rate contracts						
Spot	18,766	-	18,766	41,629	-	41,629
Forward and futures	3,224	-	3,224	22,825	-	22,825
Swaps	124,585	4,688	129,273	139,351	3,573	142,924
Options purchased	2,195	-	2,195	706	-	706
Options written	19,850	-	19,850	2,628	-	2,628
Interest rate contracts						
Swaps	60	10,088	10,148	516	6,379	6,895
Forward rate agreements	1,280	-	1,280	-	-	-
Bullion contracts	545	-	545	446	-	446

	The Bank					
	2001			2000		
	Trading HK\$m	Hedging HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Total HK\$m
Exchange rate contracts						
Spot	18,373	-	18,373	-	-	-
Forward and futures	3,203	-	3,203	21,995	-	21,995
Swaps	123,586	4,426	128,012	-	-	-
Options purchased	2,195	-	2,195	-	-	-
Options written	19,850	-	19,850	-	-	-
Interest rate contracts						
Swaps	60	8,902	8,962	-	98	98
Forward rate agreements	1,280	-	1,280	-	-	-
Bullion contracts	545	-	545	446	-	446

NOTES TO THE ACCOUNTS (continued)

37. Off-balance sheet exposures (continued)

(b) Derivatives (continued)

The replacement costs and credit risk weighted amounts of the above off-balance sheet exposures which do not take into account the effects of bilateral netting arrangements are as follows:

	The Group			
	2001		2000	
	Replacement cost HK\$'m	Credit risk weighted amount HK\$'m	Replacement cost HK\$'m	Credit risk weighted amount HK\$'m
Contingent liabilities and commitments	-	29,490	-	22,388
Exchange rate contracts	457	407	791	534
Interest rate contracts	99	37	204	48
Bullion contracts	6	5	3	3
	<u>562</u>	<u>29,939</u>	<u>998</u>	<u>22,973</u>

	The Bank			
	2001		2000	
	Replacement cost HK\$'m	Credit risk weighted amount HK\$'m	Replacement cost HK\$'m	Credit risk weighted amount HK\$'m
Contingent liabilities and commitments	-	26,750	-	590
Exchange rate contracts	427	393	167	80
Interest rate contracts	53	25	-	-
Bullion contracts	6	5	3	3
	<u>486</u>	<u>27,173</u>	<u>170</u>	<u>673</u>

The contract or notional amounts of these instruments indicate the volume of transactions outstanding as at the balance sheet date; they do not represent amounts at risk.

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

Replacement cost is the cost of replacing all contracts which 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.

NOTES TO THE ACCOUNTS (continued)

38. Capital commitments

The Group has the following outstanding capital commitments not provided for in the consolidated financial statements:

	The Group		The Bank	
	2001 HK\$m	2000 HK\$m	2001 HK\$m	2000 HK\$m
Authorised and contracted for but not recorded	74	5	74	-
Authorised but not contracted for	25	1	25	-
	99	6	99	-

An analysis of the above capital commitments by nature is as follows:

	The Group		The Bank	
	2001 HK\$m	2000 HK\$m	2001 HK\$m	2000 HK\$m
Property development and leasehold improvements	-	5	-	-
Acquisition of fixed assets	99	1	99	-
	99	6	99	-

NOTES TO THE ACCOUNTS (continued)

39. Operating lease commitments

As lessee

The Group and the Bank have commitments to make the following future minimum lease payments under non-cancellable operating leases:

	The Group		The Bank	
	2001 HK\$m	2000 HK\$m	2001 HK\$m	2000 HK\$m
Land and buildings				
- not later than one year	333	304	302	2
- later than one year but not later than five years	150	279	136	3
	483	583	438	5

As lessor

The Group and the Bank have contracted with tenants for the following future minimum lease receivables:

	The Group		The Bank	
	2001 HK\$m	2000 HK\$m	2001 HK\$m	2000 HK\$m
Land and buildings				
- not later than one year	241	292	218	-
- later than one year but not later than five years	291	466	286	-
	532	758	504	-

NOTES TO THE ACCOUNTS (continued)**40. Significant related party transactions**

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

The Group entered into various transactions with related parties including the ultimate holding company, the associates of the Group and entities, directly or indirectly, controlled or significantly influenced by the ultimate holding company.

(a) Sale of certain assets to related parties**Sale of loans to Bank of China Grand Cayman Branch in 2002**

Pursuant to a sale and purchase agreement entered into in June 2002 between the Bank and BOC (acting through its Grand Cayman branch), the Bank disposed of all of its beneficial interest in certain loans with a gross book value of HK\$11,401 million net of specific provisions of HK\$2,679 million for a consideration of HK\$8,722 million.

The sale and purchase agreement provides that the Bank sells and BOC acquires, on and from the transaction date, without recourse the beneficial interests of the Bank in the loans together with certain related security.

Service and administration of loans sold to related parties

Pursuant to servicing agreements entered into in June 2002 between the Bank, Nanyang, BOC and Zhong Gang (Cayman) Company Limited, the Bank and Nanyang undertake to service and administer the loans and the related securities transferred in 2002 as well as loans which are previously transferred in 1999 at a fee which is agreed between the parties from time to time.

Disposal of subsidiaries, associates and investments

The Group disposed of certain subsidiaries, associates and investments to fellow subsidiaries. Details of the disposals are summarised below:

	For the year ended 31 December	
	2001 HK\$'m	2000 HK\$'m
Sales consideration	606	-
Group's share of net asset value of subsidiaries and associates and carrying amount of investments as at the respective disposal dates	(707)	-
Net loss on disposal	(101)	-

As set out in note 1, in 2001 the Group transferred its interest in a number of subsidiaries and associates which are not related to commercial banking business to fellow subsidiaries as part of the Reorganisation. A portion of the consideration paid by a fellow subsidiary was financed by a loan from the Bank of HK\$377 million. The loan is unsecured and interest is charged at a rate based on commercial terms.

Disposal of shareholdings in BOC Insurance

In 2001, the Group disposed of its shareholdings in BOC Insurance for a consideration of HK\$247 million. As outlined in Note 3(a), the results of BOC Insurance have not been included in the accounts. The consideration received on disposal has been included as a capital contribution (Note 34).

NOTES TO THE ACCOUNTS (continued)

40. Significant related party transactions (continued)

(b) Loans to related parties

In the ordinary course of business, the Group extends loans and credit facilities to fellow subsidiaries, associates of BOC and associates of the Group on normal commercial terms with reference to prevailing market rates. The revenue from such transactions would include interest income on the amount drawn as well as arrangement fees.

The gross value of loans outstanding are set out below:

	As at 31 December	
	2001 HK\$m	2000 HK\$m
Loans at normal commercial terms (gross value)	6,531	7,480

In 2002, certain loans granted to related parties with a gross book value HK\$5,693 million net of specific provision of HK\$749 million were sold to BOC, acting through its Grand Cayman Branch, for a consideration of HK\$4,944 million (Note 40(a)). The gross and net book value of these loans included in the balance sheet as at 31 December 2001 amounted to HK\$5,418 million and HK\$4,635 million, respectively. The related party loans remaining in the Group's books after this disposal relate to loans to fellow subsidiaries on normal commercial terms with reference to prevailing market rates.

As at 31 December 2001, a fellow subsidiary provided guarantees for loans amounting to HK\$1,900 million granted to certain third parties in which the fellow subsidiary has equity interests of less than 20%.

(c) Summary of transactions entered into during the ordinary course of business with the related parties

The aggregate income and expenses arising from the related party transactions with BOC, fellow subsidiaries, and associates are summarised as follows:

	Notes	For the year ended 31 December	
		2001 HK\$m	2000 HK\$m
Profit and loss items:			
Interest income	(i)	4,349	8,722
Interest expense	(ii)	(2,795)	(5,181)
Insurance commission received (net)	(iii)	39	86
Securities brokerage commission paid (net)	(iv)	(119)	(190)
Charge for bad and doubtful debts		(403)	(1)

		As at 31 December	
		2001 HK\$m	2000 HK\$m
Balance sheet items:			
Cash and short-term funds	(i)	69,458	110,309
Placements with banks and other financial institutions	(i)	13,400	36,063
Advances	(i), (v)	6,531	7,480
Other investments in securities	(i)	234	233
Other assets	(vi)	106	106
Deposits from and balances of banks and other financial institutions	(ii)	48,386	117,911
Current, fixed, savings and other deposits from Customers	(ii)	3,958	4,098

NOTES TO THE ACCOUNTS (continued)**40. Significant related party transactions (continued)****(c) Summary of transactions entered into during the ordinary course of business with the related parties (continued)**

Notes:

(i) Interest income

In the ordinary course of business, the Group enters into various transactions with BOC, fellow subsidiaries and associates including deposit of cash and short term funds, placement of interbank deposits, investments in its securities and provision of loans. The transactions were conducted in the normal course of business at prices and terms which are no more favourable than those charged to and contracted with other third party customers of the Group.

(ii) Interest expense

In the ordinary course of the business, the Group accepts interbank deposits and current, fixed, savings and other deposits from BOC, fellow subsidiaries and associates on normal commercial terms with reference to prevailing market rates.

(iii) Insurance commission received (net)

In the ordinary course of the business, the Group provides insurance agency services to and purchases general and life insurance policies from fellow subsidiaries on normal commercial terms with reference to prevailing market rates.

(iv) Securities brokerage commission paid (net)

The Group pays commission expenses to a subsidiary of BOC for securities brokerage services provided in the ordinary course of business on commercial terms with reference to prevailing market rates.

(v) Advances to related parties

In the ordinary course of business, the Group extends loans and credit facilities to BOC, fellow subsidiaries, and associates on normal commercial terms with reference to prevailing market rates. The revenue from such transactions would include interest income on the amount drawn as well as arrangement and commitment fees.

(vi) Other assets

Included within "other assets" are receivables due from BOC. The receivables arose from transactions carried out in the normal course of business.

Off-balance sheet exposures:**Direct credit substitutes**

In the ordinary course of business, the Group provides guarantees for the obligations of fellow subsidiaries and associates on normal commercial terms. Such guarantees amounted to HK\$297 million as at 31 December 2001. Fees are receivable for such guarantees granted in favour of independent third parties and BOC.

Derivatives

In the ordinary course of business, the Group enters into foreign exchange contracts and interest rate contracts with BOC, fellow subsidiaries, and associates. Such derivative transactions amounted to HK\$10,655 million as at 31 December 2001 (2000: HK\$29,439 million). These transactions are executed on normal commercial terms with reference to prevailing market rates.

NOTES TO THE ACCOUNTS (continued)

40. Significant related party transactions (continued)

(d) Balances with group companies and associates

Included in the following balance sheet captions are balances with the ultimate holding company:

	2001 HK\$'m	2000 HK\$'m
Cash and short-term funds	69,197	109,806
Placements with banks and other financial institutions	13,053	35,552
Advances	37	150
Other investments in securities	234	233
Other assets	106	106
Deposits from and balances of banks and other financial institutions	48,004	117,902

Included in the following balance sheet captions are balances with fellow subsidiaries of the ultimate holding company:

	2001 HK\$'m	2000 HK\$'m
Cash and short-term funds	191	429
Placements with banks and other financial institutions	347	419
Advances	5,717	5,951
Deposits from and balances of banks and other financial institutions	379	9
Current, fixed, savings and other deposits from customers	3,936	3,371

Included in the following balance sheet captions are balances with subsidiaries of the Bank:

	2001 HK\$'m	2000 HK\$'m
Cash and short-term funds	1,564	-
Advances	956	-
Other assets	577	-
Deposits from and balances of banks and other financial institutions	618	-
Current, fixed, savings and other deposits from customers	964	2,055
Other accounts and provisions	2,120	13

Included in the following balance sheet captions are balances with associates:

	2001 HK\$'m	2000 HK\$'m
Cash and short-term funds	70	74
Placements with banks and other financial institutions	-	92
Advances	777	1,379
Deposits from and balances of banks and other financial institutions	3	-
Current, fixed, savings and other deposits from customers	22	727

NOTES TO THE ACCOUNTS (continued)

41. Litigation

In February 2001, BOC New York Branch brought a lawsuit against NBM L.L.C and related companies for breach of contract due to default on loan repayment of US\$34 million owed to BOC New York Branch, amongst other allegations, in the United States District Court of New York. BOC New York Branch seeks damages of repayment of the outstanding balance of loan of US\$34 million plus attorney costs and interest.

On 18 January 2002, the defendants in the above mentioned claim brought a third party summons counterclaim against a number of branches of BOC, including the New York Branch and the Bank. The counterclaim third party complaint alleges that, amongst other things, the named branches of BOC and the Bank conducted illegal and improper acts and violated federal and state law and implied contractual obligations.

The defendants further alleged that they have suffered substantial losses due to such illegal and improper acts conducted by the named branches of BOC and the Bank.

As against all third party defendants, the defendants have counterclaimed for compensatory and punitive damages, to be proven or determined at trial totalling US\$372 million plus interest and costs.

No provisions have been made against this counterclaim because the directors believe that the Group has meritorious defences against the counterclaim from defendants.

In addition to the above, the Group is currently being served a number of claims and counterclaims by various independent parties. These claims and counterclaims are in relation to the normal commercial activities of the Group.

The Directors have not provisioned against these claims and counterclaims because they believe the Group has meritorious defences against the claimants or the amounts involved in these claims are not expected to be material.

42. Subsequent event

On 18 June 2002, the Board of Directors declared an interim dividend in respect of the period to 31 May 2002 of approximately HK\$0.045 per ordinary share amounting to HK\$1,937 million.

43. Comparatives

Certain comparative amounts have been restated to conform to the current year presentation.

44. Ultimate holding company

The ultimate holding company is Bank of China, a state-owned commercial bank established under the laws of the PRC.

45. Approval of accounts

The accounts were approved by the Board of Directors on 26 June 2002.