

# 2003 Annual Report



中國銀行(香港)有限公司  
BANK OF CHINA (HONG KONG) LIMITED

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## Report of the Directors

The directors are pleased to present their report together with the audited consolidated accounts of Bank of China (Hong Kong) Limited (the "Bank") and its subsidiaries (together with the Bank hereinafter referred to as the "Group") for the year ended 31 December 2003.

### Principal Activities

The Bank is a licensed bank authorised under the Hong Kong Banking Ordinance. The principal activities of the Group are the provision of banking and related financial services. An analysis of the Group's performance for the year by business segments is set out in Note 39 to the accounts.

### Results and Appropriations

The results of the Group for the year are set out in the consolidated profit and loss account on page 10.

On 30 June 2003, the directors declared a first interim dividend of HK\$0.045 per ordinary share, totaling approximately HK\$1,937 million, which was paid on 2 October 2003.

On 31 December 2003, the directors declared a second interim dividend of HK\$0.09 per ordinary share, totaling approximately HK\$3,874 million, which will be paid on 5 May 2004.

### Reserves

Details of the reserves of the Group and the Bank are set out in Note 32 to the accounts.

### Donations

Charitable and other donations made by the Group during the year amounted to HK\$4,678,000.

### Fixed Assets

Details of the movements in fixed assets of the Group and the Bank are set out in Note 25 to the accounts.

### Directors

The directors of the Bank during the year and up to the date of this report are:

#### Executive Director

HE Guangbei (Vice Chairman and Chief Executive, appointed on 28 May 2003)

LIU Jinbao (Vice Chairman and Chief Executive, resigned on 28 May 2003)

#### Non-executive Directors

XIAO Gang (Chairman, appointed on 28 May 2003)

LIU Mingkang (Chairman, resigned on 28 May 2003)

SUN Changji (Vice Chairman)

PING Yue (resigned on 2 February 2004)

HUA Qingshan

LI Zaohang

ZHOU Zaiqun

ZHANG Yanling

## Report of the Directors (continued)

### Directors (continued)

#### Independent Non-executive Directors

CHIA Pei-Yuan (resigned on 11 July 2003)

FUNG Victor Kwok King

SHAN Weijian

TUNG Chee Chen

YANG Linda Tsao (appointed on 12 November 2003)

There being no provision in the Bank's Articles of Association for retirement by rotation, all the directors continue in office.

### Directors' Rights to Acquire Shares

On 5 July 2002, the following directors were granted options by BOC Hong Kong (BVI) Limited ("BOC (BVI)"), an indirect holding company of the Bank, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 13,737,000 existing issued shares of BOC Hong Kong (Holdings) Limited ("BOCHK (Holdings)"), the immediate holding company of the Bank, at a price of HK\$8.50 per share. The option shares represent approximately 0.13% of the issued share capital of BOCHK (Holdings) as at the date of grant and as at 31 December 2003. None of these options may be exercised within one year from 25 July 2002. These options have a vesting period of four years from 25 July 2002 with a valid exercise period of ten years. 25% of the number of shares subject to such options will vest at the end of each year. No offer to grant any options under the Pre-Listing Share Option Scheme may be made on or after 25 July 2002, the date on which dealings in BOCHK (Holdings)'s shares commenced on The Stock Exchange of Hong Kong Limited ("Stock Exchange").

Particulars of the options granted to the directors under the Pre-Listing Share Option Scheme are set out below:

	Date of grant	Exercise price (HK\$)	Exercisable period	Number of share options					Balances as at 31 December 2003
				Granted on 5 July 2002	Balances as at 1 January 2003	Exercised during the year	Surrendered during the year	Lapsed during the year	
SUN Changji	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,590,600	1,590,600	—	—	—	1,590,600
HE Guangbei	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,446,000	1,446,000	—	—	—	1,446,000
HUA Qingshan	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,446,000	1,446,000	—	—	—	1,446,000
LI Zaohang	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,446,000	1,446,000	—	—	—	1,446,000
ZHOU Zaiqun	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,446,000	1,446,000	—	—	—	1,446,000
ZHANG Yanling	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,446,000	1,446,000	—	—	—	1,446,000
LIU Mingkang*	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,735,200	1,735,200	—	1,735,200	—	—
LIU Jinbao*	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,735,200	1,735,200	—	—	—	1,735,200
PING Yue**	5 July 2002	8.50	25 July 2003 to 4 July 2012	1,446,000	1,446,000	—	—	—	1,446,000
Total:				13,737,000	13,737,000	—	1,735,200	—	12,001,800

\* Resigned with effect from 28 May 2003.

\*\* Resigned with effect from 2 February 2004.

## Report of the Directors (continued)

### Directors' Rights to Acquire Shares (continued)

Save as disclosed above, at no time during the year was the Bank or its holding companies, or any of its subsidiaries or fellow subsidiaries a party to any arrangements to enable the directors to acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate.

### Directors' Interests in Contracts of Significance

No contracts of significance, in relation to the Group's business to which the Bank, its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

### Management Contracts

There exists a services agreement between BOCHK (Holdings) and the Bank whereby BOCHK (Holdings) provides management and investor relations services to the Bank and under which costs are reimbursed and fees are payable. The said agreement can be terminated by either party giving not less than three months' prior notice.

### Compliance with the guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions"

The accounts for the year ended 31 December 2003 fully comply with the requirements set out in the guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority ("HKMA").

### Auditors

The accounts have been audited by PricewaterhouseCoopers. A resolution for their re-appointment as auditors for the ensuing year will be proposed at the forthcoming Annual General Meeting.

On behalf of the Board



**XIAO Gang**  
Chairman  
Hong Kong, 22 March 2004

## Corporate Governance

We believe sound corporate governance is crucial to our development in the long term and we aspire to the highest standards of governance. Our governance policy and practices embody a high degree of transparency, responsibility and accountability. To safeguard the interests of shareholders, customers, staff and other stakeholders, we are committed to embracing international best practices and, as a financial institution in Hong Kong, complying with the guidelines and rules of the HKMA.

### Governance Structure

Our governance structure is one that is overseen by the Board, with special emphasis on the supervisory role of the Independent Non-executive Directors. At the same time, it also clearly separates the roles and responsibilities of the Board and the Management.

The Board forms the core of our governance structure. It is primarily responsible for formulating the Group's long-term development strategies and plans as well as setting business targets. It takes care of the selection, evaluation and remuneration of the senior management. It also provides guidance and supervision to the Management.

Under the Board, there are three standing committees, namely, Audit Committee, Risk Management Committee, and Nomination and Remuneration Committee. The committees perform distinct roles in accordance with their respective terms of reference and assist the Board in supervising the performance of the Management.

The Management answers to the Board and is responsible for implementing the business strategies and plans agreed by the Board and running the Group on a daily basis. It reports to the Board on both a regular and a needs-be basis on matters relating to the performance of the Group.

The Board is headed by the Chairman whereas the Management is headed by the Chief Executive. The roles of the Chairman and the Chief Executive are clearly separated.

Under this governance structure, all major transactions, acquisitions, investments and disposals of assets must be reviewed and approved by the Board. The Board also reviews and approves the Group's annual budget and business plans.

### The Board

The composition of the Board is such that Non-executive Directors form the majority in order to ensure the highest degree of impartiality and objectivity of the Board in supervising the Management.

As at the end of 2003, the Board comprised 12 Directors, of whom four were Independent Non-executive Directors, seven were Non-executive Directors and one was Executive Director. In addition, the Board is assisted by a highly experienced and reputable person as its Senior Adviser. The Senior Adviser is invited to attend Board meetings and give objective advice to the Board. The term of appointment of the Non-executive Directors and the Senior Adviser is three years from the date of appointment.

The following changes occurred in the composition of the Board since the last annual report:

On 28 May 2003, Chairman Liu Mingkang and Vice Chairman and Chief Executive Liu Jinbao resigned from the Board. On the same day, Mr. Xiao Gang was appointed Chairman and Mr. He Guangbei Vice Chairman and Chief Executive.

On 11 July 2003, Independent Non-executive Director Chia Pei-yuan resigned from the Board for personal reasons.

On 12 November 2003, Ambassador Yang Linda Tsao was appointed Independent Non-executive Director of the Board with immediate effect.

On 2 February 2004, Non-executive Director Ping Yue retired from the Board.

To enhance the independence and impartiality of the Board, we will consider appointing more Independent Non-executive Directors.

Except for the Independent Non-executive Directors and Senior Adviser, all the Directors of the Board are also members of the Board of the Bank of China, the Bank's ultimate holding company. Mr. Xiao Gang and Mr. Sun Changji are also the Chairman and Vice Chairman of the Bank of China respectively.

## Corporate Governance (continued)

### The Board (continued)

The Board held five meetings during 2003. Individual attendance records are as follows:

Director/Senior Adviser	Number of board meetings attended	Attendance rate
<b>Non-executive Directors</b>		
Mr. XIAO Gang (Chairman) (Note 1)	4 out of 4	100%
Mr. SUN Changji (Vice Chairman) (Note 2)	4 out of 5	80%
Mr. PING Yue (Note 3)	5 out of 5	100%
Mr. HUA Qingshan (Note 4)	4 out of 5	80%
Mr. LI Zaohang	5 out of 5	100%
Mr. ZHOU Zaiqun (Note 5)	3 out of 5	60%
Ms. ZHANG Yanling	5 out of 5	100%
<b>Independent Non-executive Directors</b>		
Dr. FUNG Victor Kwok King	5 out of 5	100%
Mr. SHAN Weijian	5 out of 5	100%
Mr. TUNG Chee Chen	5 out of 5	100%
Ambassador YANG Linda Tsao (Note 6)	0 out of 1	0%
<b>Executive Director</b>		
Mr. HE Guangbei (Vice Chairman and Chief Executive) (Note 7)	5 out of 5	100%
<b>Senior Adviser</b>		
Mr. NEOH Anthony Francis	5 out of 5	100%

Notes:

- Mr. Xiao was appointed Director and Chairman of the Board in May 2003.
- Mr. Sun could not attend the meeting on 17 June 2003 for business reasons.
- Mr. Ping retired from the Board with effect from 2 February 2004.
- Mr. Hua could not attend the meeting on 1 December 2003 for business reasons.
- Mr. Zhou could not attend the two meetings in May and June for health reasons.
- Ambassador Yang was appointed to the Board in November 2003. She could not attend the meeting on 1 December due to family bereavement.
- Mr. He was appointed Vice Chairman and Chief Executive in May 2003.

### The Board Committees

#### Audit Committee

The Audit Committee consists only of Non-executive Directors, the majority of whom are Independent Non-executive Directors. It is chaired by Independent Non-executive Director Mr. Shan Weijian.

Based on the principle of independence, the Audit Committee assists the Board in monitoring the financial reports, internal control, internal audit and external audit of the Group.



## Corporate Governance (continued)

### The Board Committees (continued)

#### Audit Committee (continued)

The Committee held 11 meetings during the year. Individual Directors' attendance records are as follows:

Director (Note 1)	Number of committee meetings attended	Attendance rate
Mr. SHAN Weijian (Chairman)	11 out of 11	100%
Mr. PING Yue (Note 2)	11 out of 11	100%
Mr. ZHOU Zaiqun (Note 3)	2 out of 11	18%
Dr. FUNG Victor Kwok King	11 out of 11	100%
Mr. TUNG Chee Chen	11 out of 11	100%

Notes:

1. Ambassador Yang Linda Tsao was appointed Independent Non-executive Director of the Board in November 2003 and became a member of the Audit Committee on 30 January 2004.
2. Mr. Ping resigned from the Board and the Audit Committee on 2 February 2004.
3. Mr. Zhou could not attend nine of the meetings held between May and August 2003 for health reasons.

#### Risk Management Committee

The Risk Management Committee is responsible for scrutinising, approving and monitoring the Group's risk management policies, procedures and execution. It also evaluates whether the Group's risk management is in line with the established strategies, policies and procedures.

Because the work of the Risk Management Committee is closely related to the Group's operation, we have initiated a number of reforms in 2003, with a view to increasing operational efficiency and mitigate the duplication of roles.

In September, the Risk Control Committee, previously under the Risk Management Committee, was dissolved. The Risk Management Committee was reconstituted to include only Non-executive Directors and the Senior Adviser. The Committee's chairman is Mr. Xiao Gang. The other members are Mr. Anthony Neoh, Mr. Hua Qingshan and Ms. Zhang Yanling. Having regard to the monitoring guidelines of the HKMA and with a view to enhancing corporate governance, we have ensured that the role of the Committee is more clearly defined and comprehensive.

We are pleased to report that after the above reforms, the Committee functions more efficiently and effectively than before, thus further enhancing our capabilities in risk control.

## Corporate Governance (continued)

### The Board Committees (continued)

#### Risk Management Committee (continued)

The Committee held four meetings during the year. Individual attendance records are as follows:

Director/Senior Adviser	Number of committee meetings attended	Attendance rate
Mr. XIAO Gang (Chairman) (Note 1)	3 out of 3	100%
Mr. NEOH Anthony Francis (Note 2)	3 out of 3	100%
Mr. HUA Qingshan	3 out of 4	75%
Ms. ZHANG Yanling	3 out of 4	75%

Notes:

1. Mr. Xiao was appointed Director and Chairman of the Board in May 2003 and Chairman of the Risk Management Committee in September 2003.
2. Mr. Neoh was appointed a member of the Committee in September 2003.

#### Nomination and Remuneration Committee

In September 2003, the Board resolved to expand the terms of reference of the former Remuneration Committee and also renamed it Nomination and Remuneration Committee.

The Committee is responsible for assisting the Board in ensuring that the Group's human resources and remuneration policies as well as the selection of Directors and senior management are in line with the Group's overall development strategies.

The Committee now consists of five members, including Mr. Sun Changji, Vice Chairman of the Board, three Independent Non-executive Directors and one Non-executive Director. It met three times during 2003 and individual members' attendance records are as follows:

Director	Number of committee meetings attended	Attendance rate
Mr. SUN Changji (Chairman)	3 out of 3	100%
Mr. LI Zaohang	3 out of 3	100%
Dr. FUNG Victor Kwok King	1 out of 3	33%
Mr. SHAN Weijian	3 out of 3	100%
Mr. TUNG Chee Chen	3 out of 3	100%

## Corporate Governance (continued)

### Auditors' fees

The Group's 2003 accounts were audited by PricewaterhouseCoopers at a total fee of HK\$29 million that was approved by the Audit Committee and the Board.

The Group also paid PricewaterhouseCoopers a fee of HK\$9 million for non-audit services.

### Project Tian Xing Jian and enhancement of corporate governance

In June 2003, the Board set up a Special Committee to undertake a comprehensive review of the credit approval process, risk management and corporate governance of the Group in light of a loan to New Nongkai Global Investments Limited in 2002. The members of the Special Committee included the Senior Adviser to the Board and two Independent Non-executive Directors. The audit firms of KPMG and Moores Rowland were engaged to conduct the review and a specialist from overseas was appointed to give expert advice. The Special Committee's review was completed and its full report published in September 2003.

Based on the recommendations of the Special Committee, we soon launched Project Tian Xing Jian that aims at improving the Group's systems and mechanisms relating to top-level control, credit risk management and control, interest risk management, legal and compliance, internal control and so on.

Ensuring good corporate governance is our strategic goal and continuous task. Project Tian Xing Jian gives us an excellent opportunity to conduct an internal review and improve ourselves further. In the coming year, we will continue to implement the Project and enhance the Group's corporate governance in accordance with established regulations, guidelines and international best practices, with special emphasis on enhancing the Board's functions, building a corporate culture and perfecting information disclosure. As Project Tian Xing Jian continues to make progress, we believe we can attain higher standards in our corporate governance.

## Report of the Auditors

### Auditors' Report to the shareholders of Bank of China (Hong Kong) Limited

(incorporated in Hong Kong with limited liability)

We have audited the accounts set out on pages 10 to 73 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### Respective responsibilities of directors and auditors

The Hong Kong Companies Ordinance requires the directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the Bank and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31 December 2003 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.



PricewaterhouseCoopers  
Certified Public Accountants  
Hong Kong, 22 March 2004

## Consolidated Profit and Loss Account

For the year ended 31 December

	Note	2003 HK\$m	As restated 2002 HK\$m
Interest income	4	17,759	21,463
Interest expense		(4,888)	(7,521)
<b>Net interest income</b>		<b>12,871</b>	13,942
Other operating income	5	4,385	4,177
<b>Operating income</b>		<b>17,256</b>	18,119
Operating expenses	6	(5,660)	(6,029)
<b>Operating profit before provisions</b>		<b>11,596</b>	12,090
Charge for bad and doubtful debts	7	(1,671)	(2,855)
<b>Operating profit after provisions</b>		<b>9,925</b>	9,235
Net loss from disposal/revaluation of fixed assets	8	(1,098)	(995)
Write-back of provision/(provision) for impairment on held-to-maturity securities and investment securities	9	30	(7)
Net loss on disposal of a subsidiary		(1)	—
Provision for impairment on investments in associates		(132)	(27)
Share of profits less losses of associates		(9)	(100)
<b>Profit before taxation</b>		<b>8,715</b>	8,106
Taxation	10	(601)	(1,157)
<b>Profit after taxation</b>		<b>8,114</b>	6,949
Minority interests		(139)	(127)
<b>Profit attributable to shareholders</b>	11	<b>7,975</b>	6,822
<b>Dividends</b>	12	<b>5,811</b>	4,520

## Consolidated Balance Sheet

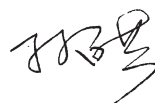
As at 31 December

	Note	2003 HK\$'m	As restated 2002 HK\$'m
<b>ASSETS</b>			
Cash and short-term funds	16	<b>134,106</b>	115,075
Placements with banks and other financial institutions maturing between one and twelve months		<b>78,240</b>	80,159
Trade bills		<b>691</b>	592
Certificates of deposit held	17	<b>18,776</b>	17,528
Hong Kong SAR Government certificates of indebtedness	26	<b>31,460</b>	29,110
Held-to-maturity securities	18	<b>101,065</b>	94,227
Investment securities	19	<b>53</b>	46
Other investments in securities	20	<b>71,400</b>	64,360
Advances and other accounts	21	<b>300,094</b>	308,332
Investments in associates	24	<b>278</b>	483
Fixed assets	25	<b>17,582</b>	20,212
Other assets		<b>8,841</b>	5,421
<b>Total assets</b>		<b>762,586</b>	735,545
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation	26	<b>31,460</b>	29,110
Deposits and balances of banks and other financial institutions		<b>41,347</b>	29,957
Deposits from customers	27	<b>600,826</b>	600,977
Certificates of deposit issued		<b>2,432</b>	—
Other accounts and provisions	29	<b>29,163</b>	20,300
<b>Total liabilities</b>		<b>705,228</b>	680,344
<b>CAPITAL RESOURCES</b>			
Minority interests		<b>1,156</b>	1,114
Share capital	31	<b>43,043</b>	43,043
Reserves	32	<b>13,159</b>	11,044
<b>Shareholders' funds</b>		<b>56,202</b>	54,087
<b>Total capital resources</b>		<b>57,358</b>	55,201
<b>Total liabilities and capital resources</b>		<b>762,586</b>	735,545

Approved by the Board of Directors on 22 March 2004 and signed on behalf of the Board by:



**XIAO Gang**  
Director



**SUN Changji**  
Director



**HE Guangbei**  
Director



**ZHU Chi**  
Deputy Chief Executive

## Balance Sheet

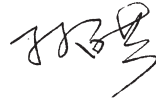
As at 31 December

	Note	2003 HK\$'m	As restated 2002 HK\$'m
<b>ASSETS</b>			
Cash and short-term funds	16	107,053	90,757
Placements with banks and other financial institutions maturing between one and twelve months		66,431	60,329
Trade bills		314	222
Certificates of deposit held	17	14,368	15,899
Hong Kong SAR Government certificates of indebtedness	26	31,460	29,110
Held-to-maturity securities	18	79,329	74,038
Investment securities	19	42	34
Other investments in securities	20	70,709	64,293
Advances and other accounts	21	252,081	263,729
Investments in subsidiaries	23	13,713	13,800
Investments in associates	24	217	490
Fixed assets	25	13,470	15,631
Other assets		7,479	5,579
Total assets		656,666	633,911
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation	26	31,460	29,110
Deposits and balances of banks and other financial institutions		41,225	30,189
Deposits from customers	27	505,179	504,342
Certificates of deposit issued		1,359	—
Other accounts and provisions	29	23,250	17,638
Total liabilities		602,473	581,279
<b>CAPITAL RESOURCES</b>			
Share capital	31	43,043	43,043
Reserves	32	11,150	9,589
Shareholders' funds		54,193	52,632
Total liabilities and capital resources		656,666	633,911

Approved by the Board of Directors on 22 March 2004 and signed on behalf of the Board by:



**XIAO Gang**  
Director



**SUN Changji**  
Director



**HE Guangbei**  
Director



**ZHU Chi**  
Deputy Chief Executive

## Consolidated Statement of Changes in Equity

	Share capital HK\$m	Premises revaluation reserve HK\$m	Investment properties revaluation reserve HK\$m	Translation reserve HK\$m	Retained earnings HK\$m	Total HK\$m
At 1 January 2002, as previously reported	43,043	456	40	(9)	8,640	52,170
Effect of adoption of SSAP 12 (revised)	—	(61)	—	—	(321)	(382)
At 1 January 2002, as restated	43,043	395	40	(9)	8,319	51,788
Net profit for the year, as restated	—	—	—	—	6,822	6,822
Reclassification	—	5	(5)	—	—	—
2002 interim dividend	—	—	—	—	(4,520)	(4,520)
Release from deferred tax liabilities	—	1	—	—	—	1
Revaluation of properties	—	31	(35)	—	—	(4)
Transfer on disposal of properties	—	(79)	—	—	79	—
At 31 December 2002, as restated	43,043	353	—	(9)	10,700	54,087
Bank and subsidiaries	43,043	353	—	(9)	10,708	54,095
Associates	—	—	—	—	(8)	(8)
	43,043	353	—	(9)	10,700	54,087
At 1 January 2003, as previously reported	<b>43,043</b>	<b>413</b>	—	<b>(9)</b>	<b>10,910</b>	<b>54,357</b>
Effect of adoption of SSAP 12 (revised)	—	<b>(60)</b>	—	—	<b>(210)</b>	<b>(270)</b>
At 1 January 2003, as restated	<b>43,043</b>	<b>353</b>	—	<b>(9)</b>	<b>10,700</b>	<b>54,087</b>
Net profit for the year	—	—	—	—	7,975	7,975
Currency translation difference	—	—	—	(1)	—	(1)
2003 first interim dividend	—	—	—	—	(1,937)	(1,937)
2003 second interim dividend	—	—	—	—	(3,874)	(3,874)
Release from deferred tax liabilities	—	23	—	—	—	23
Revaluation of properties	—	(71)	—	—	—	(71)
Transfer on disposal of properties	—	(44)	—	—	44	—
At 31 December 2003	<b>43,043</b>	<b>261</b>	—	<b>(10)</b>	<b>12,908</b>	<b>56,202</b>
Bank and subsidiaries	<b>43,043</b>	<b>261</b>	—	<b>(10)</b>	<b>12,924</b>	<b>56,218</b>
Associates	—	—	—	—	(16)	(16)
	<b>43,043</b>	<b>261</b>	—	<b>(10)</b>	<b>12,908</b>	<b>56,202</b>



## Statement of Changes in Equity

	Share capital HK\$'m	Premises revaluation reserve HK\$'m	Investment properties revaluation reserve HK\$'m	Retained earnings HK\$'m	Total HK\$'m
At 1 January 2002, as previously reported	43,043	383	23	7,800	51,249
Effect of adoption of SSAP 12 (revised)	—	(68)	—	(347)	(415)
At 1 January 2002, as restated	43,043	315	23	7,453	50,834
Net profit for the year, as restated	—	—	—	6,311	6,311
2002 interim dividend	—	—	—	(4,520)	(4,520)
Release from deferred tax liabilities	—	16	—	—	16
Revaluation of properties	—	14	(23)	—	(9)
Transfer on disposal of properties	—	(71)	—	71	—
At 31 December 2002, as restated	43,043	274	—	9,315	52,632
At 1 January 2003, as previously reported	<b>43,043</b>	<b>326</b>	—	<b>9,527</b>	<b>52,896</b>
Effect of adoption of SSAP 12 (revised)	—	(52)	—	(212)	(264)
At 1 January 2003, as restated	<b>43,043</b>	<b>274</b>	—	<b>9,315</b>	<b>52,632</b>
Net profit for the year	—	—	—	7,388	7,388
2003 first interim dividend paid	—	—	—	(1,937)	(1,937)
2003 second interim dividend payable	—	—	—	(3,874)	(3,874)
Release from deferred tax liabilities	—	15	—	—	15
Revaluation of properties	—	(31)	—	—	(31)
Transfer on disposal of properties	—	(44)	—	44	—
At 31 December 2003	<b>43,043</b>	<b>214</b>	—	<b>10,936</b>	<b>54,193</b>

## Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2003 HK\$'m	2002 HK\$'m
<b>Cash flow from operating activities</b>			
Operating cash outflow before taxation	33(a)	(6,099)	(37,891)
Disposal of loans to the Cayman Islands Branch of Bank of China		—	8,722
Hong Kong profits tax paid		(103)	(397)
Overseas profits tax paid		(18)	(20)
<b>Net cash outflow from operating activities</b>		<b>(6,220)</b>	<b>(29,586)</b>
<b>Cash flow from investing activities</b>			
Dividends received from investment securities		32	—
Purchase of fixed assets		(369)	(434)
Proceeds from disposal of fixed assets		1,061	553
Purchase of investment securities		(6)	—
Acquisition of subsidiaries		—	(890)
Proceeds from disposal of a subsidiary	33(d)	157	—
Proceeds from dissolution of an associate		19	—
Dividends received from associates		4	50
Loans to associates		(358)	(336)
Loans repaid by associates		397	60
<b>Net cash inflow/(outflow) from investing activities</b>		<b>937</b>	<b>(997)</b>
<b>Cash flow from financing activities</b>			
Certificates of deposit redeemed		—	(5,000)
Dividend paid on ordinary shares		(4,520)	(1,937)
Dividend paid to minority shareholders	33(b)	(97)	(79)
<b>Net cash outflow from financing activities</b>		<b>(4,617)</b>	<b>(7,016)</b>
Decrease in cash and cash equivalents		(9,900)	(37,599)
Cash and cash equivalents at 1 January		83,065	120,664
<b>Cash and cash equivalents at 31 December</b>	33(c)	<b>73,165</b>	<b>83,065</b>

## Notes to the Accounts

### 1. Principal activities

The Group is principally engaged in the provision of banking and related financial services in Hong Kong.

### 2. Basis of preparation

The accounts have been prepared under the historical cost convention as modified by the revaluation of certain investments in securities, off-balance sheet financial instruments, premises and investment properties, and in accordance with accounting principles generally accepted in Hong Kong and comply with the Statements of Standard Accounting Practice ("SSAPs") issued by the Hong Kong Society of Accountants ("HKSA"). In addition, these accounts comply fully with the requirements set out in the guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions" under the Supervisory Policy Manual issued by the HKMA.

The accounting policies and methods of computation used in the preparation of the accounts are consistent with those used in the preparation of the Group's accounts for the year ended 31 December 2002. In the current year, the Group has adopted SSAP 12 (revised) "Income taxes" issued by the HKSA, which is effective for accounting periods commencing on or after 1 January 2003.

The impact of adopting this SSAP has been shown on the respective notes to the accounts.

### 3. Principal accounting policies

#### (a) Basis of consolidation

The consolidated accounts include the accounts of the Bank and its subsidiaries made up to 31 December. Subsidiaries are those entities in which the Group, directly and indirectly, controls the composition of the board of directors, controls more than half of the voting power or holds more than half of the issued share capital. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

The gain or loss on the disposal of a subsidiary represents the difference between: a) the proceeds of the sale and, b) the Group's share of its net assets together with any unamortised goodwill (or goodwill taken to reserves and which was not previously charged or recognised in the consolidated profit and loss account) and any related accumulated foreign currency translation difference.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

In the Bank's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Bank on the basis of dividends received and receivable.

#### (b) Associates

An associate is a company, not being a subsidiary, in which an equity interest is held for the long-term and significant influence is exercised in its management.

The consolidated profit and loss account includes the Group's share of the results of associates for the year. The consolidated balance sheet includes the Group's share of the net assets of the associates plus goodwill/negative goodwill (net of accumulated amortisation) on acquisition and net of any provision for impairment losses.

## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (b) Associates (continued)

Unless the Group has incurred obligations or guaranteed obligations in respect of the associate, its share of further losses is discontinued when the share of losses of an associate equals or exceeds the carrying value of the investment in the associate.

In the Bank's balance sheet, the investments in associates are stated at cost less provision for impairment in value. The results of associates are accounted for by the Bank on the basis of dividends received and receivable.

#### (c) Revenue recognition

Interest income is recognised in the profit and loss account as it accrues, except in the case of doubtful debts, where interest is credited to a suspense account which is netted in the balance sheet against the relevant balances.

Fees and commission income are recognised in the period when earned unless they relate to transactions involving an interest rate risk or other risks which extend beyond the current period, in which case they are amortised over the period of the transaction.

Dividend income is recognised when the right to receive payment is established.

Rental income under operating leases is recognised on a straight-line basis over the period of the lease unless another systematic basis is more representative of the pattern in which the benefit derived from the leased asset is used.

#### (d) Advances

Advances to customers, banks and other financial institutions are reported on the balance sheet at the principal amount outstanding net of provisions for bad and doubtful debts and suspended interest. Advances to banks and other financial institutions include placements with banks and other financial institutions of more than one year.

All advances are recognised when cash is advanced to the borrowers.

Assets acquired by repossession of collateral for realisation would continue to be reported as advances, except in the case of a loan restructuring where the asset acquired is part of the terms of a new loan agreement and the assets are recognised on the balance sheet under the relevant assets category. When the repossessed asset is realised, the sales proceeds are applied against the outstanding advance and any shortfall is written off to the profit and loss account.

#### (e) Provisions for bad and doubtful debts

The Group internally classifies loans and advances into categories reflecting the Group's assessment of the borrower's capacity to repay and on the degree of doubt about the collectibility of interest and/or principal.

Provisions are made against specific loans and advances as and when the directors have doubt on the ultimate recoverability of principal or interest in full. Based on the directors' assessment of the potential losses on those identified loans and advances on a case-by-case basis, specific provision is made to reduce the carrying value of the assets, taking into account available collateral to their expected net realisable value. Where it is not possible to reliably estimate the loss, the Group applies pre-determined provisioning levels to the unsecured portion of loans and advances based on the Group's loan classification procedures.

## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (e) Provisions for bad and doubtful debts (continued)

In addition, amounts have been set aside as a general provision for bad and doubtful debts. Specific and general provisions are deducted from "Advances and other accounts" in the consolidated balance sheet. When there is no realistic prospect of recovery, the outstanding debt is written off against the balance sheet asset and provision in part, or in whole.

#### (f) Fixed assets

##### (i) Premises

Premises are stated at cost or valuation less accumulated impairment losses and accumulated depreciation calculated to write off the assets over their estimated useful lives on a straight-line basis as follows:

Leasehold land	Over the remaining period of lease
Buildings	Over the shorter of the remaining period of the lease and 15 to 50 years

Independent valuations are performed every three years on individual properties on the basis of open market values. In the intervening years, the directors review the carrying value of individual properties and adjustment is made when they consider that there has been a material change. Increases in valuation are credited to the premises revaluation reserve. Decreases in valuation are first set off against increases on earlier valuations in respect of the same individual asset and thereafter are debited to the profit and loss account. Any subsequent increases are credited to the profit and loss account up to the amount previously debited, and then to the premises revaluation reserve. Upon disposal of premises, the relevant portion of the premises revaluation reserve realised in respect of previous valuations is released and transferred from the premises revaluation reserve to retained earnings.

The gain or loss on disposal of premises is the difference between the net sales proceeds and the carrying value of the relevant asset, and is recognised in the profit and loss account.

##### (ii) Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are held for their investment potential, any rental income being negotiated at arm's length.

Investment properties are valued annually and independent valuations are performed at intervals of not more than three years; in each of the intervening years, valuations are undertaken by professionally qualified persons appointed by the Group. The valuations are on an open market value basis. Changes in the value of investment properties are treated as movements in the investment properties revaluation reserve, unless the total of the reserve is insufficient to cover a deficit on a portfolio basis. In such cases, the amount by which the deficit exceeds the total amount in the investment properties revaluation reserve is charged to the profit and loss account. Where a deficit has previously been charged to the profit and loss account and a revaluation surplus subsequently arises, this surplus is credited to the profit and loss account to the extent of the deficit previously charged.

Investment properties held on leases with unexpired periods of 20 years or less are depreciated over the remaining terms of the leases.

Upon the disposal of an investment property, the relevant portion of the investment properties revaluation reserve realised in respect of previous valuations is released from the investment properties revaluation reserve to the profit and loss account.

## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (f) Fixed assets (continued)

##### (iii) Property under development

Property under development is carried at cost less impairment losses. Cost includes development and construction expenditure incurred, interest and other direct costs attributable to the development. On completion, the property is transferred to premises or investment properties.

##### (iv) Equipment, fixtures and fittings

Equipment, fixtures and fittings are stated at cost less accumulated impairment losses and accumulated depreciation calculated on a straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 and 15 years.

The gain or loss on disposal of equipment, fixtures and fittings is recognised in the profit and loss account.

##### (v) Impairment and gain or loss on sale

At each balance sheet date, both internal and external sources of information are considered to determine whether there is any indication that premises, equipment, fixtures and fittings are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a revaluation decrease.

The gain or loss on disposal of fixed assets is the difference between the net sales proceeds and the carrying value of the relevant assets, and is recognised in the profit and loss account.

#### (g) Investments in securities

##### (i) Held-to-maturity securities

Held-to-maturity securities are dated debt securities which the Group has the expressed intention and ability to hold to maturity. These securities are stated at cost adjusted for the amortisation of premiums or discounts arising on acquisition over the periods to maturity, less provision for impairment in their value which is other than temporary. Provisions are made for the amount of the carrying value which the Group does not expect to recover and are recognised as an expense in the profit and loss account as they arise.

The amortisation of premiums and discounts arising on acquisition of dated debt securities is included as part of interest income in the profit and loss account. Gain or loss on realisation of held-to-maturity securities is accounted for in the profit and loss account as they arise.

##### (ii) Investment securities

Securities which are intended to be held on a continuing basis for an identified long-term purpose at the time of acquisition (for example, for strategic purposes), are stated in the balance sheet at cost less any provisions for impairment in value which is other than temporary.

## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (g) Investments in securities (continued)

##### (ii) Investment securities (continued)

The carrying value of investment securities are reviewed as at the balance sheet date in order to assess whether the fair value has declined below the carrying value. When such a decline has occurred, the carrying value is reduced to the fair value unless there is evidence that the decline is temporary. The amount of the reduction is recognised as an expense in the profit and loss account.

Fair value is the amount for which an asset can be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.

##### (iii) Other investments in securities

All other investments in securities (whether held for trading or otherwise) are stated in the balance sheet at fair value. Changes in fair value are recognised in the profit and loss account as they arise.

Provisions against the carrying value of held-to-maturity securities and investment securities are written back when the circumstances and events that led to the write-downs cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. The amount written back is limited to the amount of the write-downs.

#### (h) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases. Rentals applicable to such operating leases net of any incentives received from the lessor are charged to the profit and loss account on a straight-line basis over the lease term.

Where the Group is the lessor, the assets subject to the lease are included in fixed assets in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned fixed assets. Rental income from operating leases is recognised on a straight-line basis over the lease term. Initial direct costs incurred specifically to earn revenue from an operating lease are recognised as an expense in the profit and loss account in the period in which they are incurred.

#### (i) Provisions

A provision is recognised when the Group has a present obligation, legal or constructive, as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

A provision for restructuring costs is recognised when the above general recognition criteria are met and a detailed formal plan for the restructuring has been implemented, or has been announced and communicated to those affected by it in a sufficiently specific manner to raise a valid expectation that the restructuring will be carried out without long delay.

#### (j) Deferred taxation

Deferred taxation is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. The principal temporary differences arise from depreciation on fixed assets, revaluations of properties, general provision for bad and doubtful debts and tax losses carried forward. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (j) Deferred taxation (continued)

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax liabilities are provided in full on all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilised.

In prior year, deferred taxation was provided at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the profit and loss account to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. The adoption of SSAP 12 (revised) "Income taxes" represents a change in accounting policy, which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

As detailed in the consolidated statement of changes in equity, opening retained earnings at 1 January 2002 and 2003 have been reduced by HK\$321 million and HK\$210 million respectively which represent the unprovided net deferred tax liabilities. This change has resulted in an increase in deferred tax assets and deferred tax liabilities at 31 December 2002 by HK\$47 million and HK\$317 million respectively. For the year ended 31 December 2002, profit after taxation and the amount charged to equity increased by HK\$111 million and HK\$1 million respectively.

For the Bank's own statement of changes in equity, opening retained earnings at 1 January 2002 and 2003 have been reduced by HK\$347 million and HK\$212 million respectively which represent the unprovided net deferred tax liabilities. This change has resulted in an increase in deferred tax liabilities at 31 December 2002 by HK\$264 million. For the year ended 31 December 2002, profit after taxation increased by HK\$135 million.

#### (k) Foreign currency translation

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases are dealt with in the profit and loss account.

The balance sheets of subsidiaries and associates expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss account is translated at an average rate for the period. Exchange differences are dealt with as a movement in reserves.

#### (l) Employee benefits

##### (i) Retirement benefit costs

The Group contributes to defined contribution retirement schemes under either recognised occupation retirement schemes ("ORSO schemes") or mandatory provident fund ("MPF") schemes that are available to the Group's employees. Contributions to the schemes by the Group and employees are calculated as a percentage of employees' basic salaries for the ORSO schemes and in accordance with the MPF rules for MPF schemes. The retirement benefit scheme costs are charged to the profit and loss account as incurred and represent contributions payable by the Group to the schemes. Forfeited contributions by those employees who leave the ORSO scheme prior to the full vesting of their contributions are used by the Group to reduce the existing level of contributions or to meet its expenses under the trust deed of the ORSO schemes.

The assets of the schemes are held in independently-administered funds separate from those of the Group.



## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (l) Employee benefits (continued)

##### (ii) Leave entitlements

Employee entitlements to annual leave and sick leave are recognised when they accrue to employees. A provision is made for the estimated liability for unused annual leave and the amount of sick leave expected to be paid as a result of services rendered by employees up to the balance sheet date.

Compensated absences other than annual leave and sick leave are non-accumulating; they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the Group. Such compensated absences are recognised when the absences occur.

##### (iii) Bonus plans

The expected cost of bonus payments are recognised as a liability when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

Liabilities for bonus plans are expected to be settled within twelve months and are measured at the amounts expected to be paid when they are settled.

#### (m) Off-balance sheet financial instruments

Off-balance sheet financial instruments arise from futures, forwards, swaps, options and other transactions undertaken by the Group in the foreign exchange, interest rate, equity and other markets. The accounting for these instruments is dependent upon whether the transactions are undertaken for dealing or hedging purposes. The Group designates a derivative as held for dealing or hedging purposes when it enters into a derivative contract.

Transactions undertaken for dealing purposes are marked to market at fair value. For exchange traded contracts, fair value is based on quoted market prices. For non-exchange traded contracts, fair value is based on dealers' quotes, pricing models or quoted prices for instruments with similar characteristics. The gain or loss arising from changes in fair value is recognised in the profit and loss account as "Net gain/(loss) from foreign exchange activities" or "Net gain/(loss) from other dealing activities".

Unrealised gains on transactions which are marked to market are included in "Other assets". Unrealised losses on transactions which are marked to market are included in "Other accounts and provisions".

Hedging derivative transactions are designated as such at inception and require that the hedging instrument are expected to be highly effective in accomplishing the objective of offsetting the risk being hedged throughout the life of the hedge. Hedging instruments are valued on an equivalent basis to the assets, liabilities or net positions that they are hedging. Any profit or loss is recognised in the profit and loss account on the same basis as that arising from the related assets, liabilities or net positions.

If the derivative transaction no longer meets the criteria for a hedge, the derivative is deemed to be held for dealing purposes and is accounted for as set out above.

Assets and liabilities arising from derivative transactions are netted off only when the Group has entered into master netting agreements or other legally enforceable arrangements, which assures beyond doubt, the Group's right to insist on settlement with the same counterparty on a net basis in all situations of default by the other party or parties including insolvency of any parties to the contract.

Derivative transactions are not offset unless the related settlement currencies are the same, or are denominated in freely convertible currencies for which quoted exchange rates are available in an active market.

## Notes to the Accounts (continued)

### 3. Principal accounting policies (continued)

#### (n) Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, it will be recognised as an asset.

#### (o) Cash and cash equivalents

For the purposes of the consolidated 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.

#### (p) Dividends

Dividends proposed or declared after the balance sheet date are disclosed as a post balance sheet event and are not recognised as a liability at the balance sheet date.

### 4. Interest income

	<b>2003</b>	2002
	<b>HK\$m</b>	HK\$m
Interest income from listed investments	<b>1,669</b>	1,341
Interest income from unlisted investments	<b>3,059</b>	3,621
Other interest income	<b>13,031</b>	16,501
	<b>17,759</b>	21,463

## Notes to the Accounts (continued)

### 5. Other operating income

	2003 HK\$m	2002 HK\$m
Fees and commission income (Note)	3,855	3,649
Less: Fees and commission expenses	(852)	(696)
Net fees and commission income	3,003	2,953
Dividend income from investments in securities		
— unlisted investments	45	34
Net loss from other investments in securities	(108)	(61)
Net gain from foreign exchange activities	965	824
Net gain from other dealing activities	42	14
Gross rental income from investment properties	241	279
Less: Outgoings in respect of investment properties	(80)	(87)
Others	277	221
	<b>4,385</b>	<b>4,177</b>

Note:

Fees and commission income

	2003 HK\$m	2002 HK\$m
Securities brokerage	733	465
Credit cards	560	544
Bills commissions	556	586
Loan commissions	473	714
Payment services	315	296
Insurance	235	154
Asset management	211	123
Trust services	76	54
Guarantees	39	46
Others		
— safe deposit box	166	163
— low deposit balance accounts	106	43
— exchange	45	65
— BOC cards	40	51
— dormant accounts	24	31
— agency services	24	26
— postage and telegrams	19	17
— information search	16	7
— correspondent banking	15	16
— sundries	202	248
	<b>3,855</b>	<b>3,649</b>

## Notes to the Accounts (continued)

### 6. Operating expenses

	2003 HK\$m	2002 HK\$m
Staff costs (including directors' emoluments)		
— salaries and other costs	3,066	3,318
— termination benefit	1	7
— pension cost	246	253
	<b>3,313</b>	3,578
Premises and equipment expenses (excluding depreciation)		
— rental of premises	213	245
— information technology	310	266
— others	208	292
	<b>731</b>	803
Depreciation on owned fixed assets	611	632
Auditors' remuneration		
— audit services	29	18
— non-audit services	9	11
Other operating expenses	967	987
	<b>5,660</b>	6,029

### 7. Charge for bad and doubtful debts

	2003 HK\$m	2002 HK\$m
Net charge for bad and doubtful debts		
Specific provisions		
— new provisions	3,834	4,519
— releases	(768)	(582)
— recoveries (Note 22)	(438)	(904)
	<b>2,628</b>	3,033
General provisions (Note 22)	(957)	(178)
Net charge to profit and loss account (Note 22)	<b>1,671</b>	2,855

## Notes to the Accounts (continued)

### 8. Net loss from disposal/revaluation of fixed assets

	2003 HK\$m	2002 HK\$m
Net gain on disposal of premises	(8)	—
Net (gain)/loss on disposal of investment properties	(5)	5
Loss on disposal of other fixed assets	23	50
Deficit on revaluation of bank premises (Note 25)	718	756
Deficit on revaluation of investment properties (Note 25)	370	184
	<b>1,098</b>	995

### 9. Write-back of provision/(provision) for impairment on held-to-maturity securities and investment securities

	2003 HK\$m	2002 HK\$m
Write-back of provision/(provision) for impairment on held-to-maturity securities	29	(4)
Write-back of provision/(provision) for impairment on investment securities	1	(3)
	<b>30</b>	(7)

## Notes to the Accounts (continued)

### 10. Taxation

Taxation in the profit and loss account represents:

	<b>2003</b> <b>HK\$m</b>	As restated 2002 HK\$m
Hong Kong profits tax		
— current year taxation	<b>1,470</b>	1,505
— over-provision in prior years	<b>(732)</b>	(130)
Deferred tax charge/(credit)	<b>67</b>	(111)
	<b>805</b>	1,264
Attributable share of estimated Hong Kong profits tax losses arising from investments in partnerships	<b>(817)</b>	(488)
	<b>(12)</b>	776
Investments in partnerships written off	<b>600</b>	365
Hong Kong profits tax	<b>588</b>	1,141
Overseas taxation	<b>11</b>	15
	<b>599</b>	1,156
Share of taxation attributable to associates	<b>2</b>	1
	<b>601</b>	1,157

Hong Kong profits tax has been provided at the rate of 17.5% (2002: 16%) on the estimated assessable profit for the year. In 2003, the Hong Kong Special Administrative Region Government enacted a change in the profits tax rate from 16% to 17.5% for the fiscal year 2003/2004. Taxation on overseas profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the countries in which the Group operates.

The Group's tax over-provision of HK\$732 million represents a write-back of excess tax provision made in prior years. This amount was written back after the finalisation of tax losses arising from predecessor merging branches and tax positions of the Bank by the Inland Revenue Department in 2003.

The Group has entered into a number of aircraft leasing and coupon strip transactions involving special purpose partnerships. As at 31 December 2003, the Group's investments in such partnerships, which are included in "Other assets" in the consolidated balance sheet, amounted to HK\$1,474 million (2002: HK\$1,122 million). The Group's investments in partnerships are amortised over the life of the partnerships in proportion to the taxation benefits resulting from those investments.

## Notes to the Accounts (continued)

### 10. Taxation (continued)

The total assets and liabilities of the aforementioned partnerships are as follows:

	<b>2003</b> HK\$m	2002 HK\$m
Assets	<b>6,159</b>	4,721
Liabilities	<b>4,098</b>	3,182

The taxation on the Group's profit before taxation that differs from the theoretical amount that would arise using the taxation rate of Hong Kong is as follows:

	<b>2003</b> HK\$m	2002 HK\$m
Profit before taxation	<b>8,715</b>	8,106
Calculated at a taxation rate of 17.5% (2002: 16%)	<b>1,525</b>	1,297
Effect of different taxation rates in other countries	<b>(31)</b>	(16)
Income not subject to taxation	<b>(494)</b>	(245)
Expenses not deductible for taxation purposes	<b>497</b>	481
Tax losses not recognised	<b>5</b>	7
Temporary differences not recognised	<b>67</b>	—
Utilisation of previously unrecognised tax losses	<b>(21)</b>	(4)
Recognition of previously unrecognised temporary differences	<b>—</b>	(111)
Over-provision in prior years	<b>(732)</b>	(130)
Tax benefits from partnerships	<b>(217)</b>	(123)
Share of taxation attributable to associates	<b>2</b>	1
Taxation charge	<b>601</b>	1,157

## Notes to the Accounts (continued)

### 11. Profit attributable to shareholders

The profit of the Bank for the year ended 31 December 2003 attributable to shareholders and dealt with in the accounts of the Bank amounted to HK\$7,388 million (2002: HK\$6,311 million, as restated).

### 12. Dividends

	2003		2002	
	Per share HK\$	Total HK\$m	Per share HK\$	Total HK\$m
First interim dividend	<b>0.045</b>	<b>1,937</b>	0.045	1,937
Second interim dividend	<b>0.090</b>	<b>3,874</b>	0.060	2,583
	<b>0.135</b>	<b>5,811</b>	0.105	4,520

### 13. Retirement benefit costs

The principal defined contribution schemes for the Group's employees are ORSO schemes exempted under the Mandatory Provident Fund Scheme Ordinance ("MPF Scheme Ordinance") and the BOC-Prudential Easy Choice Mandatory Provident Fund Scheme ("MPF Scheme"). Under the ORSO schemes, employees make monthly contributions to the ORSO schemes equal to 5% of their basic salaries, while the employer makes monthly contributions equal to 5% to 15% of the employees' monthly basic salaries, depending on years of service. The employees are entitled to receive 100% of the employer's contributions upon termination of employment after completing 20 years of service, or at a scale ranging from 20% to 95% for employees who have completed between 3 to 20 years of service, on conditions of retirement, early retirement, permanent incapacity and ill-health or termination of employment other than summary dismissal.

With the implementation of the MPF Schemes Ordinance on 1 December 2000, the Group also participates in the BOC-Prudential Easy Choice MPF Scheme, of which the trustee is BOCI-Prudential Trustee Limited and the investment manager is BOCI-Prudential Asset Management Limited, which are related parties of the Bank.

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2003 amounted to approximately HK\$233 million (2002: approximately HK\$242 million), after a deduction of forfeited contributions of approximately HK\$19 million (2002: approximately HK\$17 million). For the MPF Scheme, the Group contributed approximately HK\$9 million (2002: approximately HK\$7 million) for the year ended 31 December 2003.



## Notes to the Accounts (continued)

### 14. Share option schemes

#### (a) Share Option Scheme and Sharesave Plan

The principal terms of the Share Option Scheme (previously known as 2002 Share Option Scheme) and the Sharesave Plan (previously known as 2002 Sharesave Plan) were approved and adopted by written resolutions of all the shareholders of BOCHK (Holdings) dated 10 July 2002.

The purpose of the Share Option Scheme is to provide the participants with the opportunity to acquire proprietary interests in BOCHK (Holdings). The Board of Directors of BOCHK (Holdings) (the "Board of BOCHK (Holdings)") may, in its absolute discretion, offer to grant options under the Share Option Scheme to any person as the Board of BOCHK (Holdings) may select. The subscription price for the shares shall be determined on the date of grant by the Board of BOCHK (Holdings) as an amount per share calculated on the basis of established rules. An option may be exercised in whole or in part at any time after the date prescribed by the Board of BOCHK (Holdings) and from time to time as specified in the offer and on or before the termination date prescribed by the Board of BOCHK (Holdings).

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the shares of BOCHK (Holdings). The amount of the monthly contribution under the savings contract to be made in connection with an option shall be the amount which the relevant eligible employee is willing to contribute, which amount shall not be less than 1% and not more than 10% of the eligible employee's monthly salary as at the date of application or such other maximum or minimum amounts as permitted by the Board of BOCHK (Holdings). When an option is exercised during an exercise period, it may be exercised in whole or in part.

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year.

#### (b) Pre-Listing Share Option Scheme

On 5 July 2002, several directors together with approximately 60 senior management personnel of the Group were granted options by BOC (BVI), the indirect holding company of the Bank, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 31,132,600 existing issued shares of BOCHK (Holdings).

Details of the share options outstanding as at 31 December 2003 are as follows:

	Directors	Senior management	Total number of share options
At 1 January 2003	13,737,000	17,221,600	30,958,600
Less: Share options exercised during the year	—	(1,591,000)	(1,591,000)
Less: Share options surrendered during the year	(1,735,200)	—	(1,735,200)
Less: Share options lapsed during the year	—	(924,900)	(924,900)
At 31 December 2003	<b>12,001,800</b>	<b>14,705,700</b>	<b>26,707,500</b>
At 1 January 2002	—	—	—
Add: Share options granted during the year	13,737,000	17,395,600	31,132,600
Less: Share options lapsed during the year	—	(174,000)	(174,000)
At 31 December 2002	13,737,000	17,221,600	30,958,600

## Notes to the Accounts (continued)

### 14. Share option schemes (continued)

#### (b) Pre-Listing Share Option Scheme (continued)

The options granted under this scheme can be exercised at HK\$8.50 per share in respect of the option price of HK\$1.00. None of these options may be exercised within one year from the date on which dealings in the shares commenced on the Stock Exchange. These options have a vesting period of four years (25% of the number of shares subject to such options will vest at the end of each year) from the date on which dealings in the shares commenced on the Stock Exchange with a valid exercise period of 10 years. No offer to grant any options under the Pre-Listing Share Option Scheme will be made on or after the date on which dealings in the shares commenced on the Stock Exchange.

### 15. Directors' and senior management's emoluments

#### (a) Directors' emoluments

Details of the emoluments paid and payable to the directors of the Bank during the year are as follows:

	2003 HK\$m	2002 HK\$m
Fees	2	3
Other emoluments for executive directors		
— basic salaries and allowances	4	4
— discretionary bonuses	—	1
— others (including benefits in kind)	1	—
	<b>7</b>	<b>8</b>

Emoluments of the directors were within the following bands:

	Number of directors	
	2003	2002
Up to HK\$1,000,000	13	12
HK\$2,000,001 – HK\$2,500,000	1	—
HK\$2,500,001 – HK\$3,000,000	1	—
HK\$5,000,001 – HK\$5,500,000	—	1

The aggregate amount of emoluments paid to the Independent Non-executive Directors during the year was HK\$700,000 (2002: HK\$800,000).

In July 2002, options were granted to several directors of the Bank by the indirect holding company, BOC (BVI), under the Pre-Listing Share Option Scheme. Full details of the scheme are stated in Note 14(b). During the year, no options were exercised and no benefits arising from the granting of these share options were included in the directors' emoluments disclosed above or recognised in the profit and loss account.

## Notes to the Accounts (continued)

### 15. Directors' and senior management's emoluments (continued)

#### (b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include 1 director (2002: 1) whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining 4 individuals (2002: 4) during the year are as follows:

	<b>2003</b> HK\$m	2002 HK\$m
Basic salaries and allowances	<b>9</b>	9
Discretionary bonuses	<b>1</b>	1
Others (including pension schemes)	<b>1</b>	1
	<b>11</b>	11

Emoluments of individuals were within the following bands:

	<b>Number of individuals</b>	
	<b>2003</b>	2002
HK\$2,000,001 – HK\$2,500,000	<b>1</b>	—
HK\$2,500,001 – HK\$3,000,000	<b>2</b>	2
HK\$3,000,001 – HK\$3,500,000	<b>1</b>	2

During the year, no director waived any emoluments and the Group has not paid any emoluments to the directors or any of the 5 highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

## Notes to the Accounts (continued)

### 16. Cash and short-term funds

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Cash	4,247	2,637	3,839	2,257
Balances with banks and other financial institutions	8,300	2,370	6,921	1,742
Money at call and short notice maturing within one month	100,987	95,997	76,549	73,732
Treasury bills (including Exchange Fund Bills)	20,572	14,071	19,744	13,026
	<b>134,106</b>	115,075	<b>107,053</b>	90,757
An analysis of treasury bills held is as follows:				
	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Unlisted, held-to-maturity, at amortised cost	17,867	10,933	17,039	10,188
Unlisted, other investments in securities, at fair value	2,705	3,138	2,705	2,838
	<b>20,572</b>	14,071	<b>19,744</b>	13,026

### 17. Certificates of deposit held

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Held-to-maturity, at amortised cost — Unlisted	6,585	8,342	2,238	6,713
Other investments in securities, at fair value — Unlisted	12,191	9,186	12,130	9,186
	<b>18,776</b>	17,528	<b>14,368</b>	15,899

## Notes to the Accounts (continued)

### 18. Held-to-maturity securities

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Listed, at amortised cost	<b>40,051</b>	35,219	<b>33,247</b>	28,593
Less: Provision for impairment in value	<b>(12)</b>	(12)	<b>(12)</b>	(12)
	<b>40,039</b>	35,207	<b>33,235</b>	28,581
Unlisted, at amortised cost	<b>61,026</b>	59,049	<b>46,094</b>	45,486
Less: Provision for impairment in value	—	(29)	—	(29)
	<b>61,026</b>	59,020	<b>46,094</b>	45,457
Total	<b>101,065</b>	94,227	<b>79,329</b>	74,038
Listed, at amortised cost less provision				
— in Hong Kong	<b>4,000</b>	2,946	<b>2,054</b>	1,102
— outside Hong Kong	<b>36,039</b>	32,261	<b>31,181</b>	27,479
	<b>40,039</b>	35,207	<b>33,235</b>	28,581
Market value of listed securities	<b>40,906</b>	36,073	<b>33,850</b>	29,255
Held-to-maturity securities are analysed by issuers as follows:				
	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
— Central governments and central banks	<b>2,698</b>	3,620	<b>1,075</b>	1,708
— Public sector entities	<b>23,060</b>	17,028	<b>20,791</b>	14,131
— Banks and other financial institutions	<b>57,668</b>	64,457	<b>43,089</b>	52,368
— Corporate entities	<b>17,639</b>	9,122	<b>14,374</b>	5,831
	<b>101,065</b>	94,227	<b>79,329</b>	74,038

## Notes to the Accounts (continued)

### 19. Investment securities

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Equity securities				
— Listed in Hong Kong, at cost	16	16	16	16
Less: Provision for impairment in value	(14)	(15)	(14)	(15)
	2	1	2	1
— Listed outside Hong Kong, at cost	1	1	—	—
— Unlisted, at cost	3	2	2	1
	50	44	40	33
Total	53	46	42	34
Market value of listed equity securities	7	4	3	1
Investment securities are analysed by issuers as follows:				
	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
— Banks and other financial institutions	1	1	—	—
— Corporate entities	52	45	42	34
	53	46	42	34

## Notes to the Accounts (continued)

### 20. Other investments in securities

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
At fair value				
Debt securities				
— Listed in Hong Kong	286	1,313	240	1,313
— Listed outside Hong Kong	25,440	20,818	25,364	20,799
	25,726	22,131	25,604	22,112
— Unlisted	45,629	42,078	45,069	42,076
	71,355	64,209	70,673	64,188
Equity securities				
— Listed in Hong Kong	41	121	35	78
— Unlisted	4	30	1	27
	45	151	36	105
Total	71,400	64,360	70,709	64,293
Other investments in securities are analysed by issuers as follows:				
	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
— Central governments and central banks	3,192	3,069	3,192	3,069
— Public sector entities	4,873	4,914	4,858	4,914
— Banks and other financial institutions	62,395	46,662	61,728	46,642
— Corporate entities	940	9,715	931	9,668
	71,400	64,360	70,709	64,293

## Notes to the Accounts (continued)

### 21. Advances and other accounts

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Advances to customers	<b>308,582</b>	321,034	<b>259,229</b>	274,230
Accrued interest	<b>1,905</b>	2,006	<b>1,621</b>	1,607
	<b>310,487</b>	323,040	<b>260,850</b>	275,837
Provision for bad and doubtful debts				
— General (Note 22)	<b>(5,406)</b>	(6,363)	<b>(4,526)</b>	(4,651)
— Specific (Note 22)	<b>(5,507)</b>	(8,650)	<b>(4,763)</b>	(7,762)
	<b>(10,913)</b>	(15,013)	<b>(9,289)</b>	(12,413)
Advances to banks and other financial institutions	<b>299,574</b>	308,027	<b>251,561</b>	263,424
	<b>520</b>	305	<b>520</b>	305
	<b>300,094</b>	308,332	<b>252,081</b>	263,729
Non-performing loans are analysed as follows:				
	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Non-performing loans	<b>17,832</b>	25,659	<b>16,150</b>	23,470
Specific provisions made in respect of such advances	<b>5,467</b>	8,637	<b>4,763</b>	7,759
As a percentage of total advances to customers	<b>5.78%</b>	7.99%	<b>6.23%</b>	8.56%
Amount of interest in suspense	<b>324</b>	408	<b>310</b>	393

Non-performing loans (“NPLs”) are defined as loans and advances to customers on which interest is being placed in suspense or on which interest accrual has ceased. Specific provisions were made after taking into account the value of collateral in respect of such advances.

There were no advances to banks and other financial institutions on which interest has been placed in suspense or on which interest accrual has ceased as at 31 December 2003 (2002: Nil), nor were there any specific provisions made.



## Notes to the Accounts (continued)

### 22. Provisions for bad and doubtful debts

	The Group			
	2003			
	Specific HK\$'m	General HK\$'m	Total HK\$'m	Suspended interest HK\$'m
At 1 January 2003	8,650	6,363	15,013	408
Charged/(credited) to profit and loss account (Note 7)	2,628	(957)	1,671	—
Amounts written off	(6,209)	—	(6,209)	(119)
Recoveries of advances written off in previous years (Note 7)	438	—	438	—
Interest suspended during the year	—	—	—	210
Suspended interest recovered	—	—	—	(175)
At 31 December 2003	<b>5,507</b>	<b>5,406</b>	<b>10,913</b>	<b>324</b>
Deducted from:				
— advances to customers	<b>5,507</b>	<b>5,406</b>	<b>10,913</b>	

	The Bank			
	2003			
	Specific HK\$'m	General HK\$'m	Total HK\$'m	Suspended interest HK\$'m
At 1 January 2003	7,762	4,651	12,413	393
Charged/(credited) to profit and loss account	2,196	(125)	2,071	—
Amounts written off	(5,486)	—	(5,486)	(94)
Recoveries of advances written off in previous years	291	—	291	—
Interest suspended during the year	—	—	—	184
Suspended interest recovered	—	—	—	(173)
At 31 December 2003	<b>4,763</b>	<b>4,526</b>	<b>9,289</b>	<b>310</b>
Deducted from:				
— advances to customers	<b>4,763</b>	<b>4,526</b>	<b>9,289</b>	

## Notes to the Accounts (continued)

### 22. Provisions for bad and doubtful debts (continued)

	The Group			
	2002			
	Specific HK\$m	General HK\$m	Total HK\$m	Suspended interest HK\$m
At 1 January 2002	10,621	6,541	17,162	610
Charged/(credited) to profit and loss account (Note 7)	3,033	(178)	2,855	—
Amounts written off	(3,229)	—	(3,229)	(37)
Recoveries of advances written off in previous years (Note 7)	904	—	904	—
Amounts written off on disposal	(2,679)	—	(2,679)	—
Interest suspended during the year	—	—	—	296
Suspended interest recovered	—	—	—	(461)
At 31 December 2002	8,650	6,363	15,013	408
Deducted from:				
— advances to customers	8,650	6,363	15,013	

	The Bank			
	2002			
	Specific HK\$m	General HK\$m	Total HK\$m	Suspended interest HK\$m
At 1 January 2002	9,655	4,684	14,339	598
Charged/(credited) to profit and loss account	2,457	(33)	2,424	—
Amounts written off	(2,477)	—	(2,477)	(4)
Recoveries of advances written off in previous years	806	—	806	—
Amounts written off on disposal	(2,679)	—	(2,679)	—
Interest suspended during the year	—	—	—	254
Suspended interest recovered	—	—	—	(455)
At 31 December 2002	7,762	4,651	12,413	393
Deducted from:				
— advances to customers	7,762	4,651	12,413	

## Notes to the Accounts (continued)

### 23. Investments in subsidiaries

	The Bank	
	2003 HK\$m	2002 HK\$m
Unlisted shares, at cost	12,563	12,588
Less: Provision for impairment in value	(319)	(214)
	<b>12,244</b>	12,374
Amounts due from subsidiaries	<b>1,469</b>	1,426
	<b>13,713</b>	13,800

The following is a list of principal subsidiaries as at 31 December 2003.

Name	Place of incorporation	Particulars of issued share capital	Interest held	Principal activities
Nanyang Commercial Bank, Limited	Hong Kong	6,000,000 ordinary shares of HK\$100 each	100%	Banking business
Chiyu Banking Corporation Limited	Hong Kong	3,000,000 ordinary shares of HK\$100 each	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong	1,000,000 ordinary shares of HK\$100 each	100%	Credit card services
Po Sang Futures Limited	Hong Kong	250,000 ordinary shares of HK\$100 each	*100%	Commodities brokerage

\* Shares held indirectly by the Bank

## Notes to the Accounts (continued)

### 24. Investments in associates

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Unlisted shares, at cost	—	—	129	160
Share of net assets	155	186	—	—
Less: Provision for impairment in value	(17)	(22)	(52)	(65)
	138	164	77	95
Loans to associates (Note)	280	346	280	449
Less: Provision for loans to associates	(140)	(27)	(140)	(54)
	140	319	140	395
	278	483	217	490

Note:

At 31 December 2003, loans to associates are all on commercial terms and carry interest at the prevailing market interest rates.

The following is a list of the principal associates as at 31 December 2003, all of which are corporate entities.

Name	Place of incorporation & establishment	Particulars of issued share capital	Group's equity interest held	Principal activities
Charleston Investments Company Limited	Hong Kong	100,000 ordinary shares of HK\$10 each	40%	Property investment
CJM Insurance Brokers Limited	Hong Kong	6,000,000 ordinary shares of HK\$1 each	33%	Insurance broker
Joint Electronic Teller Services Limited	Hong Kong	100,238 ordinary shares of HK\$100 each	19.96%	Operation of a private interbank message switching network in respect of Automated Teller Machine services
Kincheng-Tokyo Finance Company Limited	Hong Kong	1,000,000 ordinary shares of HK\$100 each	50%	Deposit taking company
Trilease International Limited	Hong Kong	30,000,000 ordinary shares of HK\$1 each	40%	Provision of leasing finance
Zhejiang Commercial Bank, Ltd.	People's Republic of China	Registered capital	*25%	Banking and related financial services

\* Shares held indirectly by the Bank.

CCIC Finance Limited and Wealthy Full Enterprises Limited have commenced members' voluntary winding up during the year.

## Notes to the Accounts (continued)

### 25. Fixed assets

	The Group				
	2003				
	Premises HK\$'m	Investment properties HK\$'m	Property under development HK\$'m	Equipment, fixtures and fittings HK\$'m	Total HK\$'m
Cost or valuation					
At 1 January 2003	13,445	5,725	39	3,524	22,733
Additions	—	27	—	342	369
Disposals	(312)	(735)	—	(269)	(1,316)
Disposal of a subsidiary	(160)	—	—	(1)	(161)
Revaluation	(994)	(370)	—	—	(1,364)
Reclassification	(347)	347	—	—	—
At 31 December 2003	<b>11,632</b>	<b>4,994</b>	<b>39</b>	<b>3,596</b>	<b>20,261</b>
Accumulated depreciation and impairment losses					
At 1 January 2003	2	—	7	2,512	2,521
Depreciation for the year	372	—	—	239	611
Disposals	—	—	—	(245)	(245)
Disposal of a subsidiary	(3)	—	—	—	(3)
Write-back on revaluation	(205)	—	—	—	(205)
At 31 December 2003	<b>166</b>	<b>—</b>	<b>7</b>	<b>2,506</b>	<b>2,679</b>
Net book value					
At 31 December 2003	<b>11,466</b>	<b>4,994</b>	<b>32</b>	<b>1,090</b>	<b>17,582</b>
At 31 December 2002	13,443	5,725	32	1,012	20,212
The analysis of cost or revaluation of the above assets is as follows:					
At 31 December 2003					
At cost	—	—	39	3,596	3,635
At valuation	11,632	4,994	—	—	16,626
	<b>11,632</b>	<b>4,994</b>	<b>39</b>	<b>3,596</b>	<b>20,261</b>
At 31 December 2002					
At cost	—	—	39	3,524	3,563
At valuation	13,445	5,725	—	—	19,170
	13,445	5,725	39	3,524	22,733

## Notes to the Accounts (continued)

### 25. Fixed assets (continued)

	The Bank				
	2003				
	Premises HK\$m	Investment properties HK\$m	Property under development HK\$m	Equipment, fixtures and fittings HK\$m	Total HK\$m
Cost or valuation					
At 1 January 2003	9,972	4,795	—	3,023	17,790
Additions	—	—	—	271	271
Disposals	(308)	(655)	—	(250)	(1,213)
Revaluation	(815)	(316)	—	—	(1,131)
Reclassification	(148)	148	—	—	—
At 31 December 2003	8,701	3,972	—	3,044	15,717
Accumulated depreciation and impairment losses					
At 1 January 2003	—	—	—	2,159	2,159
Depreciation for the year	288	—	—	188	476
Disposals	(1)	—	—	(226)	(227)
Write-back on revaluation	(161)	—	—	—	(161)
At 31 December 2003	126	—	—	2,121	2,247
Net book value					
At 31 December 2003	8,575	3,972	—	923	13,470
At 31 December 2002	9,972	4,795	—	864	15,631
The analysis of cost or revaluation of the above assets is as follows:					
At 31 December 2003					
At cost	—	—	—	3,044	3,044
At valuation	8,701	3,972	—	—	12,673
	8,701	3,972	—	3,044	15,717
At 31 December 2002					
At cost	—	—	—	3,023	3,023
At valuation	9,972	4,795	—	—	14,767
	9,972	4,795	—	3,023	17,790

## Notes to the Accounts (continued)

### 25. Fixed assets (continued)

The carrying value of premises is analysed based on the remaining terms of the leases as follows:

	The Group		The Bank	
	2003 HK\$'m	2002 HK\$'m	2003 HK\$'m	2002 HK\$'m
Held in Hong Kong				
On long-term lease (over 50 years)	<b>7,051</b>	8,217	<b>5,252</b>	5,986
On medium-term lease (10 – 50 years)	<b>4,152</b>	4,942	<b>3,214</b>	3,862
On short-term lease (less than 10 years)	<b>2</b>	3	<b>2</b>	3
Held outside Hong Kong				
On long-term lease (over 50 years)	<b>40</b>	53	<b>3</b>	15
On medium-term lease (10 – 50 years)	<b>215</b>	222	<b>104</b>	106
On short-term lease (less than 10 years)	<b>6</b>	6	—	—
	<b>11,466</b>	13,443	<b>8,575</b>	9,972

The carrying value of investment properties is analysed based on the remaining terms of the leases as follows:

	The Group		The Bank	
	2003 HK\$'m	2002 HK\$'m	2003 HK\$'m	2002 HK\$'m
Held in Hong Kong				
On long-term lease (over 50 years)	<b>4,070</b>	4,666	<b>3,387</b>	4,051
On medium-term lease (10 – 50 years)	<b>792</b>	929	<b>487</b>	642
Held outside Hong Kong				
On long-term lease (over 50 years)	<b>34</b>	37	<b>34</b>	22
On medium-term lease (10 – 50 years)	<b>98</b>	93	<b>64</b>	80
	<b>4,994</b>	5,725	<b>3,972</b>	4,795

Premises are included in the balance sheet at directors' valuation, having regard to the valuation carried out on the basis of their open market value by an independent firm of chartered surveyors, Chesterton Petty Limited, on the majority of the premises. Investment properties were also revalued on the basis of their open market value by Chesterton Petty Limited. Revaluations of the Group's premises and investment properties were performed at 30 June 2003 and 31 October 2003.

The results of the June revaluations were fully incorporated into the accounts at 30 June 2003.

With respect to the October revaluations, the change in valuation of investment properties was charged to the profit and loss account. As there was no material change in valuation since the previous revaluation at 30 June 2003, no adjustment was made to the carrying amount of premises.

Chesterton Petty Limited also confirmed that there has been no material change in valuations at 31 December 2003.

## Notes to the Accounts (continued)

### 25. Fixed assets (continued)

As a result of the above-mentioned revaluations, decreases in value of the Group's and the Bank's premises and investment properties were recognised in the Group's and the Bank's property revaluation reserves and the profit and loss account respectively as follows:

	The Group		
	2003		
	Premises HK\$'m	Investment properties HK\$'m	Total HK\$'m
Decrease in valuation debited to property revaluation reserves	(71)	—	(71)
Decrease in valuation charged to profit and loss account (Note 8)	(718)	(370)	(1,088)
	<b>(789)</b>	<b>(370)</b>	<b>(1,159)</b>

	The Bank		
	2003		
	Premises HK\$'m	Investment properties HK\$'m	Total HK\$'m
Decrease in valuation debited to property revaluation reserves	(31)	—	(31)
Decrease in valuation charged to profit and loss account	(623)	(316)	(939)
	<b>(654)</b>	<b>(316)</b>	<b>(970)</b>

	The Group		
	2002		
	Premises HK\$'m	Investment properties HK\$'m	Total HK\$'m
Increase/(decrease) in valuation credited/(debited) to property revaluation reserves	31	(35)	(4)
Decrease in valuation charged to profit and loss account (Note 8)	(756)	(184)	(940)
	<b>(725)</b>	<b>(219)</b>	<b>(944)</b>



## Notes to the Accounts (continued)

### 25. Fixed assets (continued)

	The Bank		
	2002		
	Premises HK\$m	Investment properties HK\$m	Total HK\$m
Increase/(decrease) in valuation credited/(debited) to property revaluation reserves	14	(23)	(9)
Decrease in valuation charged to profit and loss account	(601)	(104)	(705)
	(587)	(127)	(714)

As at 31 December 2003, the net book value of premises that would have been included in the Group's and the Bank's balance sheets had the assets been carried at cost less accumulated depreciation and impairment losses were HK\$5,653 million (2002: HK\$7,448 million) and HK\$4,289 million (2002: HK\$5,515 million) respectively.

### 26. Hong Kong SAR currency notes in circulation

The Hong Kong SAR currency notes in circulation are secured by deposit of funds in respect of which the Hong Kong SAR Government certificates of indebtedness are held.

### 27. Deposits from customers

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Demand deposits and current accounts	<b>26,974</b>	21,476	<b>22,673</b>	17,938
Savings deposits	<b>271,439</b>	204,363	<b>229,820</b>	173,158
Time, call and notice deposits	<b>302,413</b>	375,138	<b>252,686</b>	313,246
	<b>600,826</b>	600,977	<b>505,179</b>	504,342

### 28. Assets pledged as security

At 31 December 2003, liabilities of the Group amounting to HK\$2,735 million (2002: HK\$3,198 million) and of the Bank amounting to HK\$2,705 million (2002: HK\$3,198 million) were secured by assets deposited with central depositories to facilitate settlement operations. The amounts of assets pledged by the Group to secure these liabilities were HK\$2,918 million (2002: HK\$3,400 million) and by the Bank were HK\$2,888 million (2002: HK\$3,400 million) included in "Cash and short-term funds".

## Notes to the Accounts (continued)

### 29. Other accounts and provisions

	The Group		The Bank	
	2003 HK\$m	As restated 2002 HK\$m	2003 HK\$m	As restated 2002 HK\$m
Interest payable	850	1,167	748	1,007
Current taxation (Note 30(a))	355	544	273	454
Deferred taxation (Note 30(b))	341	328	193	264
Short positions in Exchange Fund Bills (Note 28)	2,735	3,198	2,705	3,198
Dividend payable	3,874	2,583	3,874	2,583
Accruals and other payables	21,008	12,480	15,457	10,132
	<b>29,163</b>	<b>20,300</b>	<b>23,250</b>	<b>17,638</b>

### 30. Tax liabilities

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Current taxation (Note a)	355	544	273	454
Deferred taxation (Note b)	341	328	193	264
	<b>696</b>	<b>872</b>	<b>466</b>	<b>718</b>

#### (a) Current taxation

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Hong Kong profits tax	349	531	273	451
Overseas taxation	6	13	—	3
	<b>355</b>	<b>544</b>	<b>273</b>	<b>454</b>

## Notes to the Accounts (continued)

### 30. Tax liabilities (continued)

#### (b) Deferred taxation

During the year, deferred tax is recognised in respect of the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts according to SSAP 12 (revised) "Income taxes". The adoption of SSAP 12 (revised) "Income taxes" represents a change in accounting policy, which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

The major components of deferred tax assets and liabilities recorded in the Group's and the Bank's balance sheets, and the movements during the year showing the impact of the adoption of SSAP 12 (revised) "Income taxes", are as follows:

	The Group					
	2003					
	Accelerated tax depreciation HK\$m	Asset revaluation HK\$m	Losses HK\$m	Provisions HK\$m	Other temporary differences HK\$m	Total HK\$m
At 1 January 2003, as previously reported	11	—	—	—	—	11
Effect of adoption of SSAP 12 (revised)	236	1,043	(2)	(1,009)	2	270
At 1 January 2003, as restated	247	1,043	(2)	(1,009)	2	281
Charged/(credited) to profit and loss account	15	(36)	(1)	73	16	67
Credited to equity	—	(23)	—	—	—	(23)
At 31 December 2003	262	984	(3)	(936)	18	325

	The Group					
	2002					
	Accelerated tax depreciation HK\$m	Asset revaluation HK\$m	Losses HK\$m	Provisions HK\$m	Other temporary differences HK\$m	Total HK\$m
At 1 January 2002, as previously reported	8	—	—	—	—	8
Effect of adoption of SSAP 12 (revised)	197	1,230	(4)	(1,039)	(2)	382
At 1 January 2002, as restated	205	1,230	(4)	(1,039)	(2)	390
Charged/(credited) to profit and loss account	39	(186)	2	30	4	(111)
Acquisition of a subsidiary	3	—	—	—	—	3
Credited to equity	—	(1)	—	—	—	(1)
At 31 December 2002, as restated	247	1,043	(2)	(1,009)	2	281

## Notes to the Accounts (continued)

### 30. Tax liabilities (continued)

#### (b) Deferred taxation (continued)

	The Bank					
	2003					
	Accelerated tax depreciation HK\$'m	Asset revaluation HK\$'m	Losses HK\$'m	Provisions HK\$'m	Other temporary differences HK\$'m	Total HK\$'m
At 1 January 2003, as previously reported	—	—	—	—	—	—
Effect of adoption of SSAP 12 (revised)	238	767	—	(738)	(3)	264
At 1 January 2003, as restated	238	767	—	(738)	(3)	264
Charged/(credited) to profit and loss account	16	(36)	—	(47)	11	(56)
Credited to equity	—	(15)	—	—	—	(15)
At 31 December 2003	254	716	—	(785)	8	193

	The Bank					
	2002					
	Accelerated tax depreciation HK\$'m	Asset revaluation HK\$'m	Losses HK\$'m	Provisions HK\$'m	Other temporary differences HK\$'m	Total HK\$'m
At 1 January 2002, as previously reported	—	—	—	—	—	—
Effect of adoption of SSAP 12 (revised)	206	961	—	(744)	(8)	415
At 1 January 2002, as restated	206	961	—	(744)	(8)	415
Charged/(credited) to profit and loss account	32	(178)	—	6	5	(135)
Credited to equity	—	(16)	—	—	—	(16)
At 31 December 2002, as restated	238	767	—	(738)	(3)	264

## Notes to the Accounts (continued)

### 30. Tax liabilities (continued)

#### (b) Deferred taxation (continued)

Deferred tax assets and liabilities are offset on an individual entity basis when there is a legal right to set off current tax assets against current tax liabilities and when the deferred taxation relates to the same authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheets:

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Deferred tax assets (Note)	(16)	(47)	—	—
Deferred tax liabilities	341	328	193	264
	<b>325</b>	281	<b>193</b>	264

Note: This amount has been included in "Other assets".

	The Group		The Bank	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Deferred tax assets to be recovered after more than twelve months	(961)	(1,029)	(799)	(748)
Deferred tax liabilities to be settled after more than twelve months	274	262	255	239
	<b>(687)</b>	(767)	<b>(544)</b>	(509)

### 31. Share capital

	2003 HK\$m	2002 HK\$m
Authorised: 100,000,000,000 ordinary shares of HK\$1.00 each	100,000	100,000
Issued and fully paid: 43,042,840,858 ordinary shares of HK\$1.00 each	43,043	43,043

## Notes to the Accounts (continued)

### 32. Reserves

	The Group		The Bank	
	2003 HK\$m	As restated 2002 HK\$m	2003 HK\$m	As restated 2002 HK\$m
Premises revaluation reserve	261	353	214	274
Translation reserve	(10)	(9)	—	—
Retained earnings	12,908	10,700	10,936	9,315
	<b>13,159</b>	<b>11,044</b>	<b>11,150</b>	<b>9,589</b>

### 33. Notes to consolidated cash flow statement

#### (a) Reconciliation of operating profit after provisions to operating cash outflow before taxation:

	2003 HK\$m	2002 HK\$m
Operating profit after provisions	9,925	9,235
Dividend income from investment securities	(32)	—
Depreciation	611	632
Charge for bad and doubtful debts	1,671	2,855
Advances written off net of recoveries	(5,771)	(2,325)
Change in money at call and short notice with original maturity over three months	(17,420)	11,620
Change in treasury bills with original maturity over three months	372	9,904
Change in placements with banks and other financial institutions with original maturity over three months	(1,040)	3,494
Change in trade bills	(99)	(210)
Change in certificates of deposit held with original maturity over three months	103	989
Change in held-to-maturity securities	(6,809)	(43,243)
Change in other investments in securities	(7,040)	(8,191)
Change in advances and other accounts	12,338	(9,524)
Change in other assets	(4,051)	1,348
Change in deposits and balances of banks and other financial institutions repayable over three months	1,115	(5,204)
Change in deposits from customers	(151)	(5,451)
Change in certificates of deposit issued	2,432	—
Change in other accounts and provisions	7,748	(3,820)
Exchange difference	(1)	—
Operating cash outflow before taxation	<b>(6,099)</b>	<b>(37,891)</b>

## Notes to the Accounts (continued)

### 33. Notes to consolidated cash flow statement (continued)

#### (b) Analysis of changes in financing

	2003	
	Share capital HK\$m	Minority interests HK\$m
At 1 January 2003	43,043	1,114
Minority interests share of profits	—	139
Dividend paid to minority shareholders	—	(97)
At 31 December 2003	43,043	1,156

	2002	
	Share capital HK\$m	Minority interests HK\$m
At 1 January 2002	43,043	1,066
Minority interests share of profits	—	127
Dividend paid to minority shareholders	—	(79)
At 31 December 2002	43,043	1,114

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

	2003 HK\$m	2002 HK\$m
Cash and balances with banks and other financial institutions	12,547	5,007
Money at call and short notice with original maturity within three months	64,924	77,354
Treasury bills with original maturity within three months	15,131	8,258
Placements with banks and other financial institutions with original maturity within three months	16,764	19,723
Certificates of deposit held with original maturity within three months	1,585	234
Deposits and balances of banks and other financial institutions with original maturity within three months	(37,786)	(27,511)
	73,165	83,065

## Notes to the Accounts (continued)

### 33. Notes to consolidated cash flow statement (continued)

#### (d) Disposal of a subsidiary

	<b>2003</b>	2002
	<b>HK\$'m</b>	HK\$'m
Net assets disposed of:		
— Fixed assets	<b>158</b>	—
— Loss on disposal	<b>(1)</b>	—
	<b>157</b>	—
Satisfied by:		
— Cash	<b>157</b>	—
Analysis of net cash inflow in respect of the disposal of a subsidiary:		
— Cash consideration received	<b>157</b>	—

The results of the subsidiary disposed of during the year had no significant impact on the group's consolidated operating income or profit for the year.



## Notes to the Accounts (continued)

### 34. Maturity profile

The maturity profile of assets and liabilities analysed by the remaining period as at 31 December to the contractual maturity dates is as follows:

	The Group						
	2003						
	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	Over 5 years HK\$m	Undated HK\$m	Total HK\$m
<b>Assets</b>							
Treasury bills	—	18,923	1,649	—	—	—	20,572
Cash and other short-term funds	12,547	100,987	—	—	—	—	113,534
Placements with banks and other financial institutions	16	64,521	13,703	—	—	—	78,240
Certificates of deposit held	—	3,870	3,702	10,923	281	—	18,776
Debt securities included in:							
— held-to-maturity securities	—	13,358	9,161	71,227	7,297	34	101,077
— other investments in securities	—	12,122	12,521	44,938	1,774	—	71,355
Advances to customers	23,690	19,161	23,859	125,786	97,944	18,142	308,582
Advances to banks and other financial institutions	—	1	1	518	—	—	520
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions	6,800	32,151	2,396	—	—	—	41,347
Deposits from customers	303,519	278,509	17,586	1,212	—	—	600,826
Certificates of deposit issued	—	—	—	2,432	—	—	2,432

## Notes to the Accounts (continued)

### 34. Maturity profile (continued)

	The Bank						
	2003						
	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	Over 5 years HK\$m	Undated HK\$m	Total HK\$m
<b>Assets</b>							
Treasury bills	—	18,195	1,549	—	—	—	19,744
Cash and other short-term funds	10,760	76,549	—	—	—	—	87,309
Placements with banks and other financial institutions	16	54,285	12,130	—	—	—	66,431
Certificates of deposit held	—	2,258	3,023	8,885	202	—	14,368
Debt securities included in:							
— held-to-maturity securities	—	9,393	3,387	61,505	5,022	34	79,341
— other investments in securities	—	12,122	12,139	44,639	1,773	—	70,673
Advances to customers	17,812	15,652	19,388	107,716	82,328	16,333	259,229
Advances to banks and other financial institutions	—	1	1	518	—	—	520
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions	7,083	31,746	2,396	—	—	—	41,225
Deposits from customers	256,509	235,040	13,417	213	—	—	505,179
Certificates of deposit issued	—	—	—	1,359	—	—	1,359

## Notes to the Accounts (continued)

### 34. Maturity profile (continued)

	The Group						
	2002						
	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	Over 5 years HK\$m	Undated HK\$m	Total HK\$m
<b>Assets</b>							
Treasury bills	—	12,567	1,504	—	—	—	14,071
Cash and other short-term funds	5,007	95,997	—	—	—	—	101,004
Placements with banks and other financial institutions	21	72,411	7,727	—	—	—	80,159
Certificates of deposit held	—	1,921	6,589	8,824	194	—	17,528
Debt securities included in:							
— held-to-maturity securities	—	11,565	12,798	65,763	4,064	78	94,268
— other investments in securities	—	15,919	6,068	39,178	3,044	—	64,209
Advances to customers	26,979	17,172	25,702	124,813	100,533	25,835	321,034
Advances to banks and other financial institutions	—	1	1	303	—	—	305
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions	4,164	25,403	390	—	—	—	29,957
Deposits from customers	228,103	350,232	22,215	427	—	—	600,977

## Notes to the Accounts (continued)

### 34. Maturity profile (continued)

	The Bank						
	2002						
	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	Over 5 years HK\$m	Undated HK\$m	Total HK\$m
<b>Assets</b>							
Treasury bills	—	11,572	1,454	—	—	—	13,026
Cash and other short-term funds	3,999	73,732	—	—	—	—	77,731
Placements with banks and other financial institutions	20	54,391	5,918	—	—	—	60,329
Certificates of deposit held	—	1,783	5,901	8,021	194	—	15,899
Debt securities included in:							
— held-to-maturity securities	—	5,887	5,414	60,305	2,395	78	74,079
— other investments in securities	—	15,919	6,067	39,158	3,044	—	64,188
Advances to customers	22,139	13,729	22,100	108,149	84,489	23,624	274,230
Advances to banks and other financial institutions	—	1	1	303	—	—	305
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions	3,758	26,257	174	—	—	—	30,189
Deposits from customers	193,027	292,505	18,476	334	—	—	504,342

The majority of other assets and other accounts and provisions are due within 1 year as at 31 December 2003 and 31 December 2002.

The above maturity classifications have been prepared in accordance with the guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions" under the Supervisory Policy Manual issued by the HKMA. 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 that is repayable by different payments or instalments, only that portion of the asset that is actually overdue is reported as overdue. Any part of the asset that 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 guideline on "Financial Disclosure by Locally Incorporated Authorized Institutions" under the Supervisory Policy Manual issued by the HKMA. The disclosure does not imply that the securities will be held to maturity.

## Notes to the Accounts (continued)

### 35. 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	
	2003 HK\$'m	2002 HK\$'m	2003 HK\$'m	2002 HK\$'m
Direct credit substitutes	<b>1,264</b>	3,839	<b>901</b>	3,493
Transaction-related contingencies	<b>4,427</b>	2,286	<b>4,248</b>	2,150
Trade-related contingencies	<b>16,120</b>	16,409	<b>12,830</b>	12,973
Other commitments with an original maturity of:				
— under one year or which are unconditionally cancellable	<b>78,291</b>	75,844	<b>45,570</b>	46,736
— one year and over	<b>49,037</b>	64,402	<b>42,668</b>	58,935
	<b>149,139</b>	162,780	<b>106,217</b>	124,287

## Notes to the Accounts (continued)

### 35. Off-balance sheet exposures (continued)

#### (b) Derivatives

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

	The Group					
	2003			2002		
	Trading HK\$m	Hedging HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Total HK\$m
Exchange rate contracts						
Spot	14,673	—	14,673	13,697	—	13,697
Forward and futures contracts	950	—	950	224	—	224
Swaps	184,524	6,254	190,778	179,544	6,082	185,626
Foreign exchange option contracts						
— Currency options purchased	1,476	—	1,476	622	—	622
— Currency options written	4,435	—	4,435	28,633	—	28,633
	<b>206,058</b>	<b>6,254</b>	<b>212,312</b>	222,720	6,082	228,802
Interest rate contracts						
Interest rate swaps	381	21,087	21,468	228	20,055	20,283
Interest rate option contracts						
— Swaption written	1,446	—	1,446	—	—	—
	<b>1,827</b>	<b>21,087</b>	<b>22,914</b>	228	20,055	20,283
Bullion contracts						
Bullion contracts	606	—	606	779	—	779
Gold option contracts						
— Gold options purchased	31	—	31	—	—	—
— Gold options written	30	—	30	—	—	—
	<b>667</b>	<b>—</b>	<b>667</b>	779	—	779
Equity contracts						
Equity option contracts						
— Equity options purchased	1,016	—	1,016	975	—	975
— Equity options written	829	—	829	873	—	873
	<b>1,845</b>	<b>—</b>	<b>1,845</b>	1,848	—	1,848
Total	<b>210,397</b>	<b>27,341</b>	<b>237,738</b>	225,575	26,137	251,712

## Notes to the Accounts (continued)

### 35. Off-balance sheet exposures (continued)

#### (b) Derivatives (continued)

	The Bank					
	2003			2002		
	Trading HK\$m	Hedging HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Total HK\$m
Exchange rate contracts						
Spot	14,437	—	14,437	12,900	—	12,900
Forward and futures contracts	909	—	909	202	—	202
Swaps	184,402	5,941	190,343	178,344	5,797	184,141
Foreign exchange option contracts						
— Currency options purchased	1,476	—	1,476	622	—	622
— Currency options written	4,435	—	4,435	28,633	—	28,633
	<b>205,659</b>	<b>5,941</b>	<b>211,600</b>	220,701	5,797	226,498
Interest rate contracts						
Interest rate swaps	243	18,084	18,327	228	17,499	17,727
Interest rate option contracts						
— Swaption purchased	236	—	236	—	—	—
— Swaption written	959	—	959	—	—	—
	<b>1,438</b>	<b>18,084</b>	<b>19,522</b>	228	17,499	17,727
Bullion contracts						
Bullion contracts	606	—	606	779	—	779
Gold option contracts						
— Gold options purchased	31	—	31	—	—	—
— Gold options written	30	—	30	—	—	—
	<b>667</b>	—	<b>667</b>	779	—	779
Equity contracts						
Equity options contracts						
— Equity options purchased	937	—	937	975	—	975
— Equity options written	750	—	750	873	—	873
	<b>1,687</b>	—	<b>1,687</b>	1,848	—	1,848
Total	<b>209,451</b>	<b>24,025</b>	<b>233,476</b>	223,556	23,296	246,852

The trading transactions include positions arising from dealing activities and positions arising from the execution of trade orders from customers or transactions taken to hedge those positions.

## Notes to the Accounts (continued)

### 35. 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:

	<b>The Group</b>			
	<b>2003</b>	2002	<b>2003</b>	2002
	<b>Credit risk weighted amount HK\$m</b>	HK\$m	<b>Replacement cost HK\$m</b>	HK\$m
Contingent liabilities and commitments	<b>29,813</b>	45,936	<b>N/A</b>	N/A
Derivatives:				
— Exchange rate contracts	<b>673</b>	596	<b>1,227</b>	870
— Interest rate contracts	<b>57</b>	60	<b>112</b>	120
— Bullion contracts	<b>10</b>	5	<b>33</b>	13
— Equity contracts	<b>29</b>	33	<b>9</b>	17
	<b>769</b>	694	<b>1,381</b>	1,020
Total	<b>30,582</b>	46,630	<b>1,381</b>	1,020

	<b>The Bank</b>			
	<b>2003</b>	2002	<b>2003</b>	2002
	<b>Credit risk weighted amount HK\$m</b>	HK\$m	<b>Replacement cost HK\$m</b>	HK\$m
Contingent liabilities and commitments	<b>25,850</b>	41,040	<b>N/A</b>	N/A
Derivatives:				
— Exchange rate contracts	<b>669</b>	590	<b>1,226</b>	866
— Interest rate contracts	<b>42</b>	47	<b>77</b>	96
— Bullion contracts	<b>10</b>	5	<b>33</b>	13
— Equity contracts	<b>29</b>	33	<b>9</b>	17
	<b>750</b>	675	<b>1,345</b>	992
Total	<b>26,600</b>	41,715	<b>1,345</b>	992

The contract or notional amounts of these instruments indicate the volume of transactions outstanding as at 31 December 2003 and 31 December 2002; they do not represent the amounts at risk.

The credit risk weighted amounts are the amounts that have been calculated in accordance with the Third Schedule of the Banking Ordinance and guidelines issued by the HKMA. 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 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.



## Notes to the Accounts (continued)

### 36. Capital commitments

The Group and the Bank have the following outstanding capital commitments not provided for in the accounts:

	The Group and the Bank	
	2003 HK\$m	2002 HK\$m
Authorised and contracted for but not recorded	117	303

The above capital commitments mainly relate to commitments to purchase computer equipment and software.

### 37. 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	
	2003 HK\$m	2002 HK\$m	2003 HK\$m	2002 HK\$m
Land and buildings				
— not later than one year	183	164	199	158
— later than one year but not later than five years	182	175	186	167
— later than five years	9	9	4	—
	374	348	389	325
Computer equipment				
— not later than one year	1	—	—	—

Certain non-cancellable operating leases included in above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified date agreed.

## Notes to the Accounts (continued)

### 37. Operating lease commitments (continued)

#### As lessor

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

	The Group		The Bank	
	2003 HK\$'m	2002 HK\$'m	2003 HK\$'m	2002 HK\$'m
Land and buildings				
— not later than one year	<b>168</b>	198	<b>142</b>	213
— later than one year but not later than five years	<b>132</b>	226	<b>120</b>	247
— later than five years	—	2	—	2
	<b>300</b>	426	<b>262</b>	462

### 38. Litigation

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.

No material provision was made against these claims and counterclaims because the directors believe that the Group has meritorious defences against the claimants or the amounts involved in these claims are not expected to be material.

### 39. Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products and services (business segment), or in providing products and services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other business or geographical segments. The Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment and those that can be allocated on a reasonable basis to that segment. The allocation of revenue reflects the benefits of capital and other funding resources allocated to the business or geographical segments by way of internal capital allocations and fund transfer mechanisms.

## Notes to the Accounts (continued)

### 39. Segmental reporting (continued)

#### (a) By class of business

	The Group					
	2003					
	Commercial banking HK\$m	Treasury HK\$m	Unallocated HK\$m	Subtotal HK\$m	Eliminations HK\$m	Consolidated HK\$m
Net interest income	9,389	2,982	500	12,871	—	12,871
Other operating income	3,116	918	838	4,872	(487)	4,385
Operating income	12,505	3,900	1,338	17,743	(487)	17,256
Operating expenses	(4,402)	(162)	(1,583)	(6,147)	487	(5,660)
Operating profit/(loss) before provisions	8,103	3,738	(245)	11,596	—	11,596
Charge for bad and doubtful debts	(1,671)	—	—	(1,671)	—	(1,671)
Operating profit/(loss) after provisions	6,432	3,738	(245)	9,925	—	9,925
Net loss from disposal/revaluation of fixed assets	—	—	(1,098)	(1,098)	—	(1,098)
Write-back of provision for impairment on held-to-maturity securities and investment securities	—	29	1	30	—	30
Net loss on disposal of a subsidiary	—	—	(1)	(1)	—	(1)
Provision for impairment on investments in associates	—	—	(132)	(132)	—	(132)
Share of profits less losses of associates	—	—	(9)	(9)	—	(9)
Profit/(loss) before taxation	6,432	3,767	(1,484)	8,715	—	8,715
<b>Assets</b>						
Segment assets	310,008	432,947	18,438	761,393	—	761,393
Investments in associates	—	—	278	278	—	278
Unallocated corporate assets	—	—	915	915	—	915
	310,008	432,947	19,631	762,586	—	762,586
<b>Liabilities</b>						
Segment liabilities	621,395	77,671	4,522	703,588	—	703,588
Unallocated corporate liabilities	—	—	1,640	1,640	—	1,640
	621,395	77,671	6,162	705,228	—	705,228
<b>Other Information</b>						
Additions of fixed assets	—	—	369	369	—	369
Depreciation	—	—	611	611	—	611
Amortisation of premium/discount of held-to-maturity securities	—	544	—	544	—	544
Non-cash expenses other than depreciation/amortisation	1,671	—	—	1,671	—	1,671

## Notes to the Accounts (continued)

### 39. Segmental reporting (continued)

#### (a) By class of business (continued)

	The Bank					
	2003					
	Commercial banking HK\$m	Treasury HK\$m	Unallocated HK\$m	Subtotal HK\$m	Eliminations HK\$m	Consolidated HK\$m
Net interest income/(expense)	7,373	3,375	(372)	10,376	—	10,376
Other operating income	2,397	772	2,046	5,215	(364)	4,851
Operating income	9,770	4,147	1,674	15,591	(364)	15,227
Operating expenses	(3,345)	(147)	(1,243)	(4,735)	364	(4,371)
Operating profit before provisions	6,425	4,000	431	10,856	—	10,856
Charge for bad and doubtful debts	(2,071)	—	—	(2,071)	—	(2,071)
Operating profit after provisions	4,354	4,000	431	8,785	—	8,785
Net loss from disposal/revaluation of fixed assets	—	—	(941)	(941)	—	(941)
Write-back of provision for impairment on held-to-maturity securities and investment securities	—	29	1	30	—	30
Provision for impairment on investments in subsidiaries	—	—	(105)	(105)	—	(105)
Provision for impairment on investments in associates	—	—	(138)	(138)	—	(138)
Profit/(loss) before taxation	4,354	4,029	(752)	7,631	—	7,631
<b>Assets</b>						
Segment assets	259,395	368,052	28,106	655,553	—	655,553
Investments in associates	—	—	217	217	—	217
Unallocated corporate assets	—	—	896	896	—	896
	259,395	368,052	29,219	656,666	—	656,666
<b>Liabilities</b>						
Segment liabilities	518,846	77,758	4,475	601,079	—	601,079
Unallocated corporate liabilities	—	—	1,394	1,394	—	1,394
	518,846	77,758	5,869	602,473	—	602,473
<b>Other Information</b>						
Additions of fixed assets	—	—	271	271	—	271
Depreciation	—	—	476	476	—	476
Amortisation of premium/discount of held-to-maturity securities	—	427	—	427	—	427
Non-cash expenses other than depreciation/amortisation	2,071	—	—	2,071	—	2,071

## Notes to the Accounts (continued)

### 39. Segmental reporting (continued)

#### (a) By class of business (continued)

	As restated The Group					
	2002					
	Commercial banking HK\$m	Treasury HK\$m	Unallocated HK\$m	Subtotal HK\$m	Eliminations HK\$m	Consolidated HK\$m
Net interest income	10,876	2,375	691	13,942	—	13,942
Other operating income	3,110	745	866	4,721	(544)	4,177
Operating income	13,986	3,120	1,557	18,663	(544)	18,119
Operating expenses	(4,504)	(174)	(1,895)	(6,573)	544	(6,029)
Operating profit/(loss) before provisions	9,482	2,946	(338)	12,090	—	12,090
Charge for bad and doubtful debts	(2,855)	—	—	(2,855)	—	(2,855)
Operating profit/(loss) after provisions	6,627	2,946	(338)	9,235	—	9,235
Net loss from disposal/revaluation of fixed assets	—	—	(995)	(995)	—	(995)
Provision for impairment on held-to- maturity securities and investment securities	—	(4)	(3)	(7)	—	(7)
Provision for impairment on investments in associates	—	—	(27)	(27)	—	(27)
Share of profits less losses of associates	—	—	(100)	(100)	—	(100)
Profit/(loss) before taxation	6,627	2,942	(1,463)	8,106	—	8,106
<b>Assets</b>						
Segment assets	313,429	400,100	21,182	734,711	—	734,711
Investments in associates	—	—	483	483	—	483
Unallocated corporate assets	—	—	351	351	—	351
	313,429	400,100	22,016	735,545	—	735,545
<b>Liabilities</b>						
Segment liabilities	612,240	62,431	2,469	677,140	—	677,140
Unallocated corporate liabilities	—	—	3,204	3,204	—	3,204
	612,240	62,431	5,673	680,344	—	680,344
<b>Other Information</b>						
Additions of fixed assets	—	—	1,351	1,351	—	1,351
Depreciation	—	—	632	632	—	632
Amortisation of premium/discount of held-to-maturity securities	—	1,089	—	1,089	—	1,089
Non-cash expenses other than depreciation/amortisation	2,855	—	—	2,855	—	2,855

## Notes to the Accounts (continued)

### 39. Segmental reporting (continued)

#### (a) By class of business (continued)

	As restated The Bank					
	2002					
	Commercial banking HK\$m	Treasury HK\$m	Unallocated HK\$m	Subtotal HK\$m	Eliminations HK\$m	Consolidated HK\$m
Net interest income/(expense)	8,691	3,128	(607)	11,212	—	11,212
Other operating income	2,266	654	1,476	4,396	(417)	3,979
Operating income	10,957	3,782	869	15,608	(417)	15,191
Operating expenses	(3,493)	(158)	(1,425)	(5,076)	417	(4,659)
Operating profit/(loss) before provisions	7,464	3,624	(556)	10,532	—	10,532
Charge for bad and doubtful debts	(2,424)	—	—	(2,424)	—	(2,424)
Operating profit/(loss) after provisions	5,040	3,624	(556)	8,108	—	8,108
Net loss from disposal/revaluation of fixed assets	—	—	(765)	(765)	—	(765)
Provision for impairment on held-to-maturity securities and investment securities	—	(4)	(3)	(7)	—	(7)
Provision for impairment on investments in subsidiaries	—	—	(116)	(116)	—	(116)
Provision for impairment on investments in associates	—	—	(78)	(78)	—	(78)
Profit/(loss) before taxation	5,040	3,620	(1,518)	7,142	—	7,142
<b>Assets</b>						
Segment assets	267,711	335,441	29,978	633,130	—	633,130
Investments in associates	—	—	490	490	—	490
Unallocated corporate assets	—	—	291	291	—	291
	267,711	335,441	30,759	633,911	—	633,911
<b>Liabilities</b>						
Segment liabilities	512,167	63,814	2,688	578,669	—	578,669
Unallocated corporate liabilities	—	—	2,610	2,610	—	2,610
	512,167	63,814	5,298	581,279	—	581,279
<b>Other Information</b>						
Additions of fixed assets	—	—	610	610	—	610
Depreciation	—	—	488	488	—	488
Amortisation of premium/discount of held-to-maturity securities	—	880	—	880	—	880
Non-cash expenses other than depreciation/amortisation	2,424	—	—	2,424	—	2,424

## Notes to the Accounts (continued)

### 39. Segmental reporting (continued)

#### (a) By class of business (continued)

Commercial banking business includes acceptance of deposits, mortgage lending, credit card advances, remittance, provision of securities brokerage and insurance agency services, commercial lending, trade finance and overdraft facilities.

Treasury activities include money market, foreign exchange dealing and capital market activities. Treasury manages funding of the Group and the Bank. Treasury provides funding to all other business segments and receives funds from commercial banking's deposit taking activities. These inter-segment funding transactions are priced either at market bid/offer rates as appropriate or at an internal funding rate as determined by the average funding requirements of other business segments and the average one-month inter-bank rates of the relevant financial year. In addition, the gains and losses on the foreign exchange activities of the Group and the Bank are included in "Treasury". The profit and loss information presented in this note has been prepared using inter-segment charging/income transactions. The segmental assets and liabilities have not been adjusted to reflect the effect of inter-segment borrowing and lending (i.e. segmental profit and loss information is not comparable to segmental assets and liabilities information).

Unallocated items mainly comprise fixed assets of the Group and the Bank, investment securities, investments in associates and other items which cannot be reasonably allocated to a specific business segment. The interest benefit of the capital of the Group and the Bank is also included as unallocated within net interest income. Rental expenses are allocated to business segments based on a fixed rate per square footage occupied.

Operating expenses of a functional unit are allocated to the relevant business segment that is the predominant user of the services provided by the unit. Operating expenses of other shared services, which cannot be allocated to a specific business segment, are included in "Unallocated".

#### (b) By geographical area

No geographical reporting is provided as over 90% of the revenues of the Group and the Bank are derived from Hong Kong and over 90% of the assets of the Group and the Bank are originated from business decisions and operations based in Hong Kong.

### 40. Loans to directors and officers

Particulars of advances made to directors and officers of the Bank pursuant to section 161B(4B) of the Hong Kong Companies Ordinance are as follows:

	<b>2003</b> HK\$m	2002 HK\$m
Aggregate amount of relevant loans outstanding at year end	<b>35</b>	99
Maximum aggregate amount of relevant loans outstanding during the year	<b>100</b>	137

## Notes to the Accounts (continued)

### 41. Significant related party transactions

Related parties are those parties that 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. Related parties may be individuals or other entities.

During the year, 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 properties to Bank of China Group Insurance Company Limited (“BOC Insurance”)

In April 2003, the Bank completed the disposal of Sin Hua Bank Centre, at the consideration of HK\$193 million, to BOC Insurance. Following the disposal, the Bank leased back part of the subject property from BOC Insurance at a monthly rental of HK\$400,000 (exclusive of rates and management fees) for the operation of its Gilman Street Branch.

#### (b) Advances to third parties guaranteed by related parties

As at 31 December 2003, the ultimate holding company and a fellow subsidiary provided guarantees for loans in favour of the Group amounting to HK\$2,886 million (2002: HK\$1,982 million) to certain third parties. The fellow subsidiary held equity interests of not more than 20% in these third parties.

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

The aggregate income and expenses arising from related party transactions with ultimate holding company, immediate holding company, intermediate holding companies, fellow subsidiaries and associates of the Bank as well as associates of the ultimate holding company are summarised as follows:

	Note	2003 HK\$m	2002 HK\$m
Profit and loss items:			
Interest income	(i)	314	491
Interest expense	(ii)	(260)	(247)
Insurance commission received (net)	(iii)	123	98
Administrative services fees received/receivable	(iv)	45	24
Rental fees received/receivable	(iv)	30	28
Funds selling commission received	(vi)	58	103
Correspondent banking fee received	(vii)	8	9
Loan services fees received	(viii)	11	7
Credit card commission paid/payable (net)	(v)	(44)	(47)
Securities brokerage commission paid/payable (net)	(v)	(119)	(82)
Rental, property management and letting agency fees paid/payable	(v)	(62)	(53)
Charge for bad and doubtful debts		(125)	(15)
Other expenses	(x)	(29)	(10)



## Notes to the Accounts (continued)

### 41. Significant related party transactions (continued)

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

	Note	2003 HK\$m	2002 HK\$m
Balance sheet items:			
Cash and short-term funds	(i)	27,913	15,041
Placements with banks and other financial institutions	(i)	9,535	17,539
Advances and other accounts	(i)	604	867
Other investments in securities	(i)	234	234
Other assets	(ix)	2,507	15
Deposits from and balances of banks and other financial institutions	(ii)	19,779	20,304
Deposits from customers	(ii)	17,957	4,409
Other accounts and provisions	(ix)	2,270	15

Notes:

#### (i) Interest income

In the ordinary course of business, the Group enters into various transactions with the ultimate holding company, fellow subsidiaries and associates including deposit of cash and short-term funds, placement of interbank deposits, investments in securities and provision of loans and credit facilities. The transactions were conducted at prices and terms that are no more favourable than those charged to and contracted with other third party customers of the Group. The revenue from loans and credit facilities included interest income on the amount drawn as well as arrangement and commitment fees.

#### (ii) Interest expense

In the ordinary course of business, the Group accepts interbank deposits and current, fixed, savings and other deposits from the ultimate holding company, immediate holding company, intermediate holding companies and fellow subsidiaries of the Bank as well as associates of the ultimate holding company on normal commercial terms with reference to prevailing market rates.

#### (iii) Insurance commission received (net)

In the ordinary course of 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) Administrative services fees and rental fees received/receivable

In the ordinary course of business, the Group receives administrative services fees for the provision of various administrative services including internal audit, technology, human resources support and training to the ultimate holding company and fellow subsidiaries mainly on the basis of cost plus a margin of 5%, and receives office premises rental fees from the fellow subsidiaries on normal commercial terms.

## Notes to the Accounts (continued)

### 41. Significant related party transactions (continued)

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

Notes (continued):

##### (v) Commission, property management, letting agency fee and rental fees paid/payable

In the ordinary course of business, the Group pays commission fees for credit card administrative and promotional services, securities brokerage services, property management and letting agency fees to the ultimate holding company and fellow subsidiaries. The Group also pays rental fees to the ultimate holding company and its fellow subsidiaries. These transactions have been entered into in the ordinary course of business and on normal commercial terms.

##### (vi) Funds selling commission received

In the ordinary course of business, the Group receives commission for engaging in promotion and sale of fund products of a fellow subsidiary to customers of the Group on normal commercial terms.

##### (vii) Correspondent banking fee received

In the ordinary course of business, the ultimate holding company provides services to the Group's customers including the remittance services and advising on and collecting letters of credit issued by the Group. The Group shares the fees paid by its customers with the ultimate holding company on the basis agreed between the parties from time to time.

##### (viii) Loan services fees received

In the ordinary course of business, the Group undertakes to service and administer the loans and the related securities transferred to a fellow subsidiary and the ultimate holding company in prior years at a fee agreed among the parties from time to time.

During the year, the fellow subsidiary and the ultimate holding company disposed of all the relevant loans to another fellow subsidiary ("the Transferee") and a third party. Notwithstanding the sales, the original loan servicing agreements continue in effect on the same terms in order to deal with any continuing servicing matters relating to the fellow subsidiary and the ultimate holding company.

Subsequently, the Transferee entered into a Deed of Assignment with the fellow subsidiary and the ultimate holding company, to which the Group is also a party, pursuant to which the Group agrees to service the loans assigned to the Transferee, commencing in 2004, for essentially the same compensation, adjusted on a pro rata basis, as contained in the original loan servicing agreements.

##### (ix) Other assets and other accounts and provisions

Included within "Other assets" and "Other accounts and provisions" are receivables from and payables to the ultimate holding company and fellow subsidiaries. The amounts mainly represent the accounts receivables from and payables to a fellow subsidiary in relation to dealing securities trading transactions on behalf of the Group's customers. The receivables and payables arose from transactions carried out in the normal course of business.

##### (x) Other expenses

In the ordinary course of business, the Group pays management fee for the provision of management services to the immediate holding company at rates agreed from time to time.

## Notes to the Accounts (continued)

### 41. Significant related party transactions (continued)

#### (d) Off-balance sheets items

##### Contingent liabilities and commitments

In the ordinary course of business, the Group provides loan facilities and trade finance services to, and guarantees for the obligations of ultimate holding company, fellow subsidiaries and associates on normal commercial terms. As at 31 December 2003, the total undrawn loan commitments and trade finance-related contingencies amounted to HK\$942 million (2002: HK\$130 million). The guarantees as at 31 December 2003 amounted to HK\$190 million (2002: HK\$185 million).

##### Derivatives

In the ordinary course of business, the Group enters into foreign exchange contracts and interest rate contracts with the ultimate holding company and fellow subsidiaries. The aggregate notional amount of such derivative transactions amounted to HK\$19,323 million as at 31 December 2003 (2002: HK\$12,722 million). These transactions are executed on normal commercial terms with reference to prevailing market rates.

#### (e) Balances with group companies and associates

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

	2003 HK\$m	2002 HK\$m
Cash and short-term funds	27,789	15,031
Placements with banks and other financial institutions	9,532	17,533
Advances and other accounts	18	4
Other investments in securities	234	234
Other assets	35	—
Deposits from and balances of banks and other financial institutions	19,066	19,107
Other accounts and provisions	29	—

Included in the following balance sheet captions are balances with immediate holding company, intermediate holding companies and fellow subsidiaries of the Bank as well as associates of the ultimate holding company:

	2003 HK\$m	2002 HK\$m
Cash and short-term funds	124	10
Placements with banks and other financial institutions	3	6
Advances and other accounts	446	517
Other assets	2,472	15
Deposits from and balances of banks and other financial institutions	710	1,195
Deposits from customers	17,881	4,352
Other accounts and provisions	2,241	15

## Notes to the Accounts (continued)

### 41. Significant related party transactions (continued)

#### (e) Balances with group companies and associates (continued)

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

	2003 HK\$'m	2002 HK\$'m
Cash and short-term funds	1,698	1,281
Placements with banks and other financial institutions	537	—
Advances and other accounts	777	950
Other assets	1,394	1,815
Deposits from and balances of banks and other financial institutions	1,357	1,817
Deposits from customers	917	894
Other accounts and provisions	528	1,567

There were no material balances with associates of the Group as at 31 December 2003.

#### (f) Key management personnel

The Group accepts deposits from and grants loans and credit facilities to key management personnel in the ordinary course of business. During the year and that of the prior year, no material transaction was conducted with key management personnel of the Bank, its holding companies and parties related to them.

### 42. Comparative figures

As further explained in Notes 10 and 30 to the accounts, due to the adoption of SSAP 12 (revised) "Income taxes" during the year, the presentation of certain items and balances in the accounts have been revised to comply with the new requirements.

### 43. Ultimate holding company

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

### 44. Approval of accounts

The accounts were approved and authorised for issue by the Board of Directors on 22 March 2004.

## Unaudited Supplementary Financial Information

### 1. Capital adequacy ratio

	2003	2002*
Capital adequacy ratio	<b>15.11%</b>	13.99%
Adjusted capital adequacy ratio	<b>15.21%</b>	14.39%

The capital adequacy ratio ("CAR") is computed on the consolidated basis that comprises the positions of the Bank and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Third Schedule of the Banking Ordinance.

The adjusted CAR taking into account market risk exposure as at the balance sheet date is computed in accordance with the guideline on "Maintenance of Adequate Capital Against Market Risks" under the Supervisory Policy Manual issued by the HKMA and on the same basis as for the unadjusted CAR.

### 2. Components of capital base after deductions

The consolidated capital base after deductions used in the calculation of the above capital adequacy ratios as at 31 December 2003 and 31 December 2002 and reported to the HKMA is analysed as follows:

	2003 HK\$m	2002* HK\$m
Core capital:		
Paid up ordinary share capital	<b>43,043</b>	43,043
Reserves	<b>10,468</b>	8,087
Profit and loss account	<b>2,327</b>	2,360
Minority interests	<b>917</b>	867
	<b>56,755</b>	54,357
Supplementary capital:		
General provisions for doubtful debts	<b>4,997</b>	5,200
Total capital base before deductions	<b>61,752</b>	59,557
Deductions:		
Shareholdings in subsidiaries or holding company	<b>(449)</b>	(482)
Exposures to connected companies	<b>(872)</b>	(918)
Equity investments of 20% or more in non-subsidiary companies	<b>(107)</b>	(171)
Investments in the capital of other banks or other financial institutions	<b>(1)</b>	(1)
	<b>(1,429)</b>	(1,572)
Total capital base after deductions	<b>60,323</b>	57,985

\* Prior year comparatives have not been restated on adoption of SSAP 12 (revised) "Income taxes".

## Unaudited Supplementary Financial Information (continued)

### 3. Liquidity ratio

	2003	2002
Average liquidity ratio	<b>37.76%</b>	41.17%

The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of the Bank for the year.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule of the Banking Ordinance.

### 4. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net option position is calculated based on the worst-case approach set out in the prudential return "Foreign Currency Position" issued by the HKMA.

	2003							
	Equivalent in millions of HK\$							
	US Dollars	Euro	Canadian Dollars	Australian Dollars	New Zealand Dollars	Renminbi Yuan	Others	Total
Spot assets	164,349	21,619	6,358	22,007	7,295	1,144	25,847	248,619
Spot liabilities	(142,187)	(11,011)	(9,978)	(28,336)	(13,579)	(563)	(19,155)	(224,809)
Forward purchases	125,005	13,252	4,619	20,289	10,701	—	35,530	209,396
Forward sales	(149,283)	(24,134)	(1,080)	(14,112)	(4,665)	—	(42,074)	(235,348)
Net options position	(974)	59	(11)	837	92	—	14	17
Net long/(short) position	(3,090)	(215)	(92)	685	(156)	581	162	(2,125)

	2002							
	Equivalent in millions of HK\$							
	US Dollars	Euro	Canadian Dollars	Australian Dollars	New Zealand Dollars	Renminbi Yuan	Others	Total
Spot assets	168,003	16,688	5,002	23,525	11,809	611	27,587	253,225
Spot liabilities	(135,565)	(10,753)	(6,352)	(27,799)	(15,226)	(425)	(19,956)	(216,076)
Forward purchases	102,549	7,025	1,964	8,798	5,381	—	32,696	158,413
Forward sales	(138,688)	(13,279)	(610)	(4,541)	(1,884)	—	(40,412)	(199,414)
Net options position	(444)	41	101	192	100	—	13	3
Net long/(short) position	(4,145)	(278)	105	175	180	186	(72)	(3,849)

There were no significant net structural positions for the Group as at 31 December 2003 and 31 December 2002.

## Unaudited Supplementary Financial Information (continued)

### 5. Segmental information

#### (a) Sectoral analysis of gross advances to customers

The information concerning gross advances to customers has been analysed into loans used inside or outside Hong Kong by industry sectors of the borrowers as follows:

	2003 HK\$m	2002 HK\$m
Loans for use in Hong Kong		
Industrial, commercial and financial		
— Property development	23,162	26,591
— Property investment	46,754	50,992
— Financial concerns	6,589	8,891
— Stockbrokers	41	82
— Wholesale and retail trade	18,858	23,781
— Manufacturing	11,342	12,834
— Transport and transport equipment	12,385	11,192
— Others	38,529	40,440
Individuals		
— Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	18,244	19,956
— Loans for purchase of other residential properties	90,003	85,853
— Credit card advances	3,756	3,554
— Others	7,387	8,469
Total loans for use in Hong Kong	<b>277,050</b>	292,635
Trade finance	9,851	8,873
Loans for use outside Hong Kong	21,681	19,526
Gross advances to customers	<b>308,582</b>	321,034

## Unaudited Supplementary Financial Information (continued)

### 5. Segmental information (continued)

#### (b) Geographical analysis of gross advances to customers, overdue advances and non-performing loans

The following geographical analysis of gross advances to customers, advances overdue for over three months and NPLs is based on the location of the counterparties, after taking into account the transfer of risk in respect of such advances where appropriate.

##### (i) Gross advances to customers

	2003 HK\$m	2002 HK\$m
Hong Kong	289,129	304,924
Mainland China	8,434	4,456
Others	11,019	11,654
	<b>308,582</b>	<b>321,034</b>

##### (ii) Advances overdue for over three months

	2003 HK\$m	2002 HK\$m
Hong Kong	11,066	17,060
Mainland China	469	1,402
Others	69	163
	<b>11,604</b>	<b>18,625</b>

##### (iii) Non-performing loans

	2003 HK\$m	2002 HK\$m
Hong Kong	16,801	23,653
Mainland China	887	1,755
Others	144	251
	<b>17,832</b>	<b>25,659</b>



## Unaudited Supplementary Financial Information (continued)

### 6. Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country, which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	<b>Banks and other financial institutions HK\$'m</b>	<b>Public sector entities HK\$'m</b>	<b>Others HK\$'m</b>	<b>Total HK\$'m</b>
At 31 December 2003				
Asia, other than Hong Kong				
— Mainland China	45,698	2,157	8,507	56,362
— Others	49,750	1,180	4,981	55,911
	<b>95,448</b>	<b>3,337</b>	<b>13,488</b>	<b>112,273</b>
North America				
— United States	7,571	14,850	18,130	40,551
— Others	15,013	2,997	39	18,049
	<b>22,584</b>	<b>17,847</b>	<b>18,169</b>	<b>58,600</b>
Western Europe				
— Germany	38,563	—	5,359	43,922
— Others	117,451	1,470	13,949	132,870
	<b>156,014</b>	<b>1,470</b>	<b>19,308</b>	<b>176,792</b>
Total	<b>274,046</b>	<b>22,654</b>	<b>50,965</b>	<b>347,665</b>

## Unaudited Supplementary Financial Information (continued)

### 6. Cross-border claims (continued)

	Banks and other financial institutions HK\$m	Public sector entities HK\$m	Others HK\$m	Total HK\$m
At 31 December 2002				
Asia, other than Hong Kong				
— Mainland China	36,489	2,665	5,426	44,580
— Others	44,078	6,015	4,160	54,253
	80,567	8,680	9,586	98,833
North America				
— United States	8,133	10,594	15,703	34,430
— Others	12,158	2,647	14	14,819
	20,291	13,241	15,717	49,249
Western Europe				
— Germany	36,172	—	10,743	46,915
— Others	109,843	1,451	12,511	123,805
	146,015	1,451	23,254	170,720
Total	246,873	23,372	48,557	318,802

## Unaudited Supplementary Financial Information (continued)

### 7. Overdue and rescheduled assets

#### (a) Overdue and non-performing loans

	2003		2002	
	Amount HK\$m	% of gross advances to customers	Amount HK\$m	% of gross advances to customers
Gross advances to customers which have been overdue for:				
— six months or less but over three months	977	0.31%	2,240	0.70%
— one year or less but over six months	2,521	0.82%	3,486	1.08%
— over one year	8,106	2.63%	12,899	4.02%
Advances overdue for over three months	11,604	3.76%	18,625	5.80%
Less:				
Amount overdue for over three months and on which interest is still being accrued	(67)	(0.02%)	(550)	(0.17%)
Add:				
Amount overdue for three months or less and on which interest is being placed in suspense or on which interest accrual has ceased				
— included in rescheduled advances	798	0.26%	1,436	0.45%
— others	5,497	1.78%	6,148	1.91%
Gross non-performing loans	17,832	5.78%	25,659	7.99%

At 31 December 2003 and 31 December 2002, there were no advances to banks and other financial institutions that were overdue for over three months.

#### (b) Other overdue assets

	2003 HK\$m	2002 HK\$m
Overdue for:		
— six months or less but over three months	2	3
— one year or less but over six months	—	1
— over one year	2	—
	4	4

As at 31 December 2003 and 31 December 2002, other overdue assets represented the accrued interest.

## Unaudited Supplementary Financial Information (continued)

### 7. Overdue and rescheduled assets (continued)

#### (c) Rescheduled advances to customers

	2003		2002	
	Amount HK\$m	% of gross advances to customers	Amount HK\$m	% of gross advances to customers
Rescheduled advances to customers	851	0.28%	1,464	0.46%

Advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid. Advances repayable by regular instalments are classified as overdue when an instalment payment is overdue and remains unpaid. Advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction or when the advances have remained continuously outside the approved limit that was advised to the borrower.

Rescheduled advances are those advances that have been restructured or renegotiated because of a deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms, either of interest or of repayment period, are non-commercial. Rescheduled advances, which have been overdue for more than three months under the revised repayment terms, are included in overdue advances. Rescheduled advances are stated after deduction of accrued interest that has been charged to customers but accrued to a suspense account and before deduction of specific provisions.

As at 31 December 2003 and 31 December 2002, there were no rescheduled advances to banks and other financial institutions.

### 8. Repossessed assets held

	2003 HK\$m	2002 HK\$m
Reposessed assets held	1,757	2,097

Reposessed assets are properties or securities in respect of which the Group has acquired access or control (e.g. through court proceedings or voluntary actions by the borrowers concerned) for release in full or in part of the obligations of the borrowers. Upon repossession of the assets, the related loans and advances will continue to be recorded as loans and advances until all collection efforts have been exhausted and the reposessed assets are realised. Specific provisions will be made after taking into account the market value of the reposessed assets which are yet to be disposed. Upon disposal of the reposessed assets, any specific provisions previously made will be utilised to write off the loans and advances.

## Unaudited Supplementary Financial Information (continued)

### 9. Risk management

#### Overview

Management of risk is fundamental to the business of the Group and is an integral part of its strategy. The principal types of risk inherent in the Group's business include credit risk, market risk (comprising interest rate risk and exchange rate risk), liquidity risk and operational risk. The Group's risk management goal is to maximise its long-term risk-adjusted return on capital, reduce the wide volatility in earnings and enhance shareholder value. To achieve this, the Bank measures and controls the risks involved in its business activities and ensure that they are within acceptable levels.

#### Risk Management Structure

The Bank's risk management policies are designed to identify and analyse credit risk, market risk, liquidity risk and operational risk, to set appropriate risk limits, and to continually monitor these risks and limits by means of administrative procedures and information systems. The Bank continually modifies and enhances its risk management policies and procedures to reflect changes in markets and products.

To achieve risk management goals, the Bank has established a centralised, independent and comprehensive risk management structure that involves the following elements:

- a standardised corporate governance structure to provide active oversight and participation by the Board of Directors, committees and senior management;
- reporting lines that are independent of the Bank's Strategic Business Units ("SBUs");
- uniform risk management policies, procedures and limits by which the Bank identifies, measures, monitors and controls inherent risks;
- improved risk measurement, monitoring and management information systems to support business activities and risk management; and
- clearly defined risk management responsibilities and accountability.

The Risk Management Committee ("RMC") under the Board of Directors is responsible for approving risk management policies and procedures and significant asset and liability management policies proposed by the Asset and Liability Management Committee ("ALCO").

Each SBU is responsible for implementation of appropriate policies, procedures and controls in relation to risk management. Our Chief Risk Officer ("CRO") oversees and monitors the operations of the Risk Management Department ("RMD") and reports directly to the RMC. Our CRO is also responsible for assisting the Chief Executive on the bank-wide credit risk, market risk and operational risk management and submitting the RMC the independent risk management report each month.

Our Chief Financial Officer ("CFO") has oversight responsibilities for the soundness of the Group's capitalisation and earnings. In addition, our CFO, with assistance of the Treasurer, monitors the bank-wide interest rate risk and liquidity risk and reports to the ALCO and the RMC on a regular basis.

The Audit Department of the Bank reports to the Board and the Audit committee that risk management policies, procedures and internal controls are in place and are being followed.

The Bank's principal banking subsidiaries, Nanyang Commercial Bank, Limited and Chiyu Banking Corporation Limited, also face the same types of inherent business risks and they adopt consistent risk management strategies and policies as the Bank. These subsidiaries execute their risk management strategy independently and report functionally to the Bank on a regular basis.

## Unaudited Supplementary Financial Information (continued)

### 9. Risk management (continued)

#### Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into with the Bank. Credit risk arises principally from the Bank's lending, trade finance and treasury activities.

The Bank's primary goal in credit risk management is to maximise its risk-adjusted returns while maintaining its credit risk exposure within acceptable parameters. In particular, the Bank has developed and implemented comprehensive policies and procedures to identify, measure, monitor and control credit risk across the organisation. The Bank's credit risk management structure seeks to meet its primary goal by:

- establishing an appropriate credit risk environment;
- enforcing prudent procedures for approving credits;
- maintaining an appropriate credit administration, measurement and monitoring process; and
- ensuring adequate independent oversight and controls over credit risk.

Consistent with the Bank's overall risk management objectives, the key principles that ensure effective implementation of the Bank's credit risk management strategy are:

- balancing the Bank's tolerance for risk with the level of expected returns;
- diversifying the Bank's loan portfolio by geographic regions, industries, products, customers, maturities and currencies;
- maintaining the independence of the credit review process to ensure risk assessment and monitoring are conducted in an objective and comprehensive manner;
- emphasising the importance of cash flow as an essential factor in assessing applicants' repayment ability;
- compliance with legal and regulatory requirements;
- assigning clearly defined credit risk management responsibilities and accountability to each relevant operating unit and people involved in the risk management process;
- avoiding over-reliance on collateral and guarantees;
- ensuring accurate measurement and full disclosure of credit risk exposure; and
- maintenance of consistent credit policy.

#### Credit Risk Management Structure

The Bank's Board of Directors, representing the shareholders' overall interests, is responsible for determining its credit risk management strategic objectives and principles. The Board, with the aim of maximising the Bank's risk-adjusted returns as well as shareholders' wealth, holds ultimate responsibility for the Bank's overall credit risk management process.

The RMC is a board level committee that has the responsibility of determining and revising the Bank's credit risk management policies and procedures. The Bank believes that independence and proper checks-and-balances are of critical importance in effective risk management. To this purpose, in the Bank's managerial/organisational structure, the RMD and the Audit Department are placed onto the hierarchical position in which they report directly to the RMC and the Audit Committee respectively. All these committees and departments form an independent line of control.

In addition, respective responsibilities, accountability and authorities related to credit risk management are clearly defined throughout the Bank.

The Chief Executive is responsible for, among other things, implementing the credit risk management strategy and policies approved by the Board. The Chief Executive is also charged with balancing the Bank's goal of generating a high yield on its assets with the need to maintain risk exposure within the shareholders' tolerance level.

## Unaudited Supplementary Financial Information (continued)

### 9. Risk management (continued)

#### Credit Risk Management Structure (continued)

The Credit Committee has primary responsibility for reviewing and approving significant loans, which exceeding the credit extension limit of the deputy chief executives of credit initiation unit, loans exceeding the credit extension limit of the head of the Special Assets Management Department in the course of restructuring classified loans, loans exceeding the veto right of the CRO and applications which have been vetoed by our CRO and in respect of which an appeal has been lodged with the Credit Committee. The Bank's credit initiation units, such as Corporate Banking, Retail Banking and China Business Head Office, act as the first line of risk control. They are required to conduct business activities within the limits of delegated authority and in accordance with the Bank's credit risk management strategy, policies and procedures.

The RMD, being structurally independent to credit initiation units, assists the Chief Executive in managing credit risk based on the credit risk management strategy and policies. It also provides independent due diligence relating to identifying, measuring, monitoring and controlling credit risk. To avoid any potential conflicts of interest, the credit review functions are independent of the business units. Multilevel credit approval authorities are set depending mostly on the credit officers' professional experience, skill and responsibilities. All credit approval and review authorities originate from the Bank's Board of Directors.

The Special Assets Management Department is responsible for the collection of NPLs. Other departments, though not specified above, are also charged with relevant matters in relation to credit risk management.

#### Credit Approval Procedures

The Bank employs discriminatory approval procedures for high-risk loans, low-risk loans and significant loans.

Low-risk credit transaction that fulfill certain requirements relating to credit types, loan purposes, loan amount, guarantees, collateral coverage and security adequacy processed using low-risk loan approval procedures. Under these procedures, authorised credit officers in credit initiation units may approve this type of credit applications without prior review by the RMD. The corresponding loan review officer in the RMD should conduct independent post-approval reviews of such pre-approved low-risk credit transactions and assess if initial credit decisions have been made in accordance with the established procedures.

For high-risk loans, credit officers in credit initiation units can only accept and review loan applications and make the initial lending decisions. These credit applications are then independently evaluated by review officers in the RMD in the respect of compliance with policies and procedures, adequacy of credit risk assessment, and information sufficiency. The RMD is authorised to exercise the right of veto or concurrence based on the review conclusions.

Significant loans as above-mentioned are reviewed and approved by the Credit Committee.

#### Credit Risk Assessment

The result of credit risk assessments is a critical factor in making credit decisions. The Bank's credit assessment emphasises a thorough understanding of the purpose and structure of a loan, the borrower's financial status, cash flow position and repayment ability as well as business management. The Bank also evaluates the industry risk associated with the corporate borrowers. When assessing an individual loan application, the Bank considers overall credit risk at the portfolio level.

## Unaudited Supplementary Financial Information (continued)

### 9. Risk management (continued)

#### Credit Risk Monitoring

The Bank has a dedicated division, the RMD, to conduct thorough and comprehensive post-disbursement monitoring on each obligor and group of obligors in order to identify and control individual and overall credit risk in the loan portfolio.

An early alert programme for potential problem customers is in place, to detect early signs of deterioration in credit status of obligors and to trigger closer monitoring process to prevent further deterioration.

To ensure that adequate efforts are dedicated to resolve NPLs, the Bank has set up internal targets to evaluate the performance in the resolution of criticised loans. The RMD provides regular monitoring reports on the progress to senior management for high-level oversight.

#### Market Risk Management

Market risk is the risk that the movements in interest rates or market prices will result in losses in on- and off-balance sheet positions. The Bank's market risk arises from customer-related business and from position taking. Market risk trading positions are subject to daily mark-to-market valuation.

Market risk is managed within risk limits approved by the RMC. The overall risk limits are divided into sub-limits by reference to different risk factors, which are interest rates, foreign exchange rates, commodity prices and equity prices. Considering the different nature of the products involved, limits are set by using a combination of risk measurement techniques, including position limits and sensitivity limits.

Having set up the monitoring limits and supervisory procedures, the Market Risk Division in the RMD is responsible for the daily market risk management. Through the daily risk monitoring process, the Market Risk Division measures risk exposures against approved limits and initiates specific action, to ensure that the overall and individual market risks are managed within acceptable levels.

Value at Risk ("VaR") is a statistical technique which estimates the potential losses that could occur on risk positions taken due to movements in interest rates, foreign exchange rates, commodity prices and equity prices over a specified time horizon and to a given level of confidence. The model used by the Bank to calculate portfolio and individual VaR on a variance/covariance basis, uses historical movements in market rates and prices, a 99% confidence level and a 1-day holding period and generally takes account of correlations between different markets and rates.

At 31 December 2003, the VaR for all trading market risk exposure of the Bank was HK\$0.8 million (2002: HK\$3.3 million), the VaR for all trading interest rate risk exposure was HK\$0.7 million (2002: HK\$2.1 million) and the VaR for all trading foreign exchange risk exposure was HK\$0.6 million (2002: HK\$1.1 million). For the year ended 31 December 2003, the average VaR was HK\$5.9 million (2002: HK\$3.3 million). The average VaR in 2003 was higher than previous year due to higher market volatility.

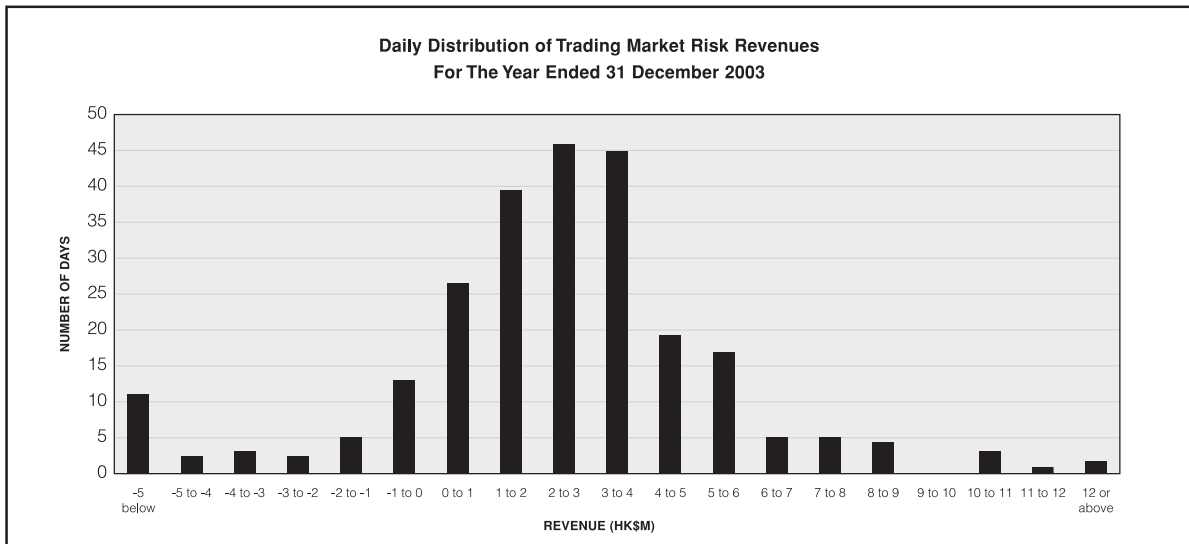


## Unaudited Supplementary Financial Information (continued)

### 9. Risk management (continued)

#### Market Risk Management (continued)

For the year ended 31 December 2003, the average daily revenue of the Bank earned from market risk-related trading activities was HK\$1.9 million (2002: HK\$2.3 million). The standard deviation of these daily trading revenues was HK\$9.0 million (2002: HK\$1.5 million). An analysis on the frequency distribution of daily trading revenues illustrated below shows that 36 losses (2002: 10 losses) were recorded out of 248 trading days for the year ended 31 December 2003 and the maximum daily loss was HK\$119 million (2002: HK\$2.8 million). The most frequent result was a daily trading revenue of between HK\$2.0 million to HK\$4.0 million (2002: HK\$2.0 million to HK\$2.5 million). The highest daily revenue was HK\$36.3 million (2002: HK\$7.0 million).



## Unaudited Supplementary Financial Information (continued)

### 9. Risk management (continued)

#### Foreign Exchange Risk Management

The Bank provides foreign exchange deposit, margin trading and forward transaction services to its customers. The Bank's trading activities in the foreign currency markets expose it to exchange rate risk. The Bank manages exchange rate risk through its interbank market activities. In particular, the Bank mitigates exchange rate risk by establishing position limits and limits on the loss of the whole foreign exchange trading floor. All these limits are approved by the RMC. The RMD is responsible for monitoring foreign exchange exposure and related stop-loss limits on a day-to-day basis as well as controlling the Bank's credit risk exposure arising from foreign exchange transactions.

#### Interest Rate Risk Management

The Bank's interest rate risk exposures comprise trading and structural exposures. The major types of interest rate risk are: (1) Re-pricing risk: mismatches in the maturities or re-pricing periods of assets and liabilities; (2) Basis risk: different pricing bases for different transactions so that yield on assets and cost of liabilities may change by different amounts within the same re-pricing period.

The Bank's ALCO maintains oversight of interest rate risk; the RMC sanctions the interest rate risk management policies formulated by the ALCO. The Treasurer, under the supervision of the CFO, carries out approved policies and develops risk management system to identify, measure, monitor, and control interest rate risk.

Gap analysis is the primary tool used to measure the Bank's exposure to interest rate risk. It provides the Bank with a static view of the maturity and re-pricing characteristics of its balance sheet positions. The magnitude of the gaps indicates the extent to which the Bank is exposed to the risk of potential changes in the margins on new or re-priced assets and liabilities. The Bank uses interest rate derivatives to hedge its interest rate exposures; in most cases, plain vanilla interest rate swap is used.

Sensitivity of earnings to interest rate changes (Earnings at Risk) is assessed through hypothetical interest rate shock of 100 basis points across the yield curve on both sides. Variations in net interest income are controlled within 5% of the budgeted amount for the year. The impact of basis risk is gauged by the projected change in net interest income under scenarios of uncorrelated movements in interest rate indices. Furthermore, the Bank periodically assesses its potential vulnerability under stressed scenarios that represent exceptional but plausible events, and decide whether to take remedial actions basing on the stress-testing results and the circumstances of each case. The results of analysis are regularly monitored by the CFO.

#### Liquidity Risk Management

Liquidity risk arises in the funding of lending, trading and investment activities and in the management of trading positions. Liquidity risk includes both the risk of unexpected increase in the cost of funding to refinance the Bank's asset portfolio at appropriate maturities and the risk of being unable to liquidate a position in a timely manner and/or at a reasonable price.

The goal of liquidity management is to enable the Bank, even under adverse market conditions, to meet all its maturing repayment obligations on time and to fund all of its asset growth and strategic opportunities.

The Bank maintains flexibility in meeting its funding requirements by maintaining diverse sources of liquidity. The Bank funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Bank may issue certificates of deposit to secure a long-term financing source or may raise funds through the sale of investments.

The Bank uses the majority of funds raised to extend loans, to purchase debt securities or to conduct interbank placements. Generally deposits have a shorter average maturity than interbank placements that in turn are of shorter average maturity compared with that of loans or investments.

## Unaudited Supplementary Financial Information (continued)

### 9. Risk management (continued)

#### Liquidity Risk Management (continued)

The Bank maintains a buffer portfolio of liquid, high quality securities that is managed under the supervision of the CFO and the ALCO. These securities may generally be sold at any time at market prices to meet the Bank's emergent liquidity needs. The Bank may also manage its liquidity by borrowing in the interbank markets on a short-term basis, although typically the Bank is a net lender of funds. The interbank markets generally provide an adequate amount of liquidity, at borrowing rates that are subject to market conditions.

The primary goal of the Bank's asset and liability management strategy is to achieve an optimal return while ensuring adequate levels of liquidity and capital within an effective risk control framework and at reasonable cost of funding. The Bank's ALCO is responsible for establishing these policy directives and works closely with the Treasurer to ensure that the Bank maintains adequate levels of liquidity and secures the lowest possible cost of funding, while closely planning and monitoring the Bank's on- and off-balance sheet assets and liabilities with regard to the risk incurred. The Treasurer adjusts, as necessary, the Bank's liquidity and structural foreign exchange positions in line with the policies of ALCO, and also provides reporting and analytical support to the ALCO with respect to current and planned positions taken for investment, funding and structural foreign exchange management purposes. In particular, the Bank has implemented various measures to:

- improve its management information system to provide timely information on the movement of its liquid assets and that of its customer deposits on a daily, weekly and monthly basis;
- monitor liquidity ratios in compliance with the HKMA's requirements;
- prepare regular maturity gap analysis to enable management to review and monitor the Bank's liquidity position on a timely basis;
- conduct scenario analysis to estimate the impact of various risk factors on the liquidity position;
- perform stress testing to assess the ability to sustain extreme but plausible stress situation;
- establish a range of liquidity risk factors for monitoring purposes and a liquidity risk warning index system to detect early signs of any irregularities; and
- create a three-tier response system to effectively deal with any emergencies.

#### Capital Management

The major objective of capital management is to maximise the returns to shareholders with the requirement to maintain strong capital adequacy ratio and high credit ratings. We maintain our strong capital adequacy ratio mainly through internal capital generation. We would consider the issuance of capital instruments or the adjustment of capital mix when appropriate to achieve the lowest overall cost of capital. The ALCO, with the assistance of the Treasurer, monitors the adequacy of its capital using the CAR as one of the major measurements, which is subject to the HKMA regulatory requirements. The Group maintained its capital to comply with all the statutory standards for all the periods presented in the report.

#### Operational Risk Management

Operational risk, one of the major risks exposed to the Bank, is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is the Bank's objective to manage this risk in line with the best practice of the industry.

In order to achieve effective internal controls, the Bank maintains adequate documentation of its business processes and operational procedures whereby operational risks are identified and control procedures are set. It also emphasises on segregation of duties and independent authorisation among all business activities.

The Bank monitors operational risk losses and periodically collects loss data in preparation for Basel New Capital Accord.

Business Continuity Plan is in place. Adequate backup facilities are maintained and duly tested to support business operations in the event of disasters. In the Severe Acute Respiratory Syndrome outbreak, our contingency mechanism reacted and operated effectively. The Bank also arranges insurance cover to mitigate potential losses in respect of operational risk.