

2003 Interim Report and Audited Accounts



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 first half of 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 in the first half of 2003 by business segments is set out in Note 38 to the accounts.

Results and Appropriations

The results of the Group for the first half of 2003 are set out in the consolidated profit and loss account on page 5.

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 amounted to HK\$4,678,000 in the first half of 2003.

Fixed Assets

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

Interim Dividend

The directors have resolved to declare an interim dividend of HK\$0.045 per ordinary share for the first half of 2003.

Directors

The directors of the Bank in the first half of 2003 and up to the date of this report are:

Executive Director

HE Guangbei (Vice Chairman, appointed on 28 May 2003)
LIU Jinbao (Vice Chairman, 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
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

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. 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					
				Granted on 5 July 2002	Balances as at 1 January 2003	Exercised during the period	Surrendered during the period	Lapsed during the period	Balances as at 30 June 2003
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
PING Yue	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**
Total:				13,737,000	13,737,000	—	1,735,200	—	12,001,800

* Resigned with effect from 28 May 2003.

** According to the terms of the Pre-Listing Share Option Scheme, these options will remain exercisable before the expiration of three months after Mr. Liu's cessation as an employee of the Group and of Bank of China or any of its subsidiaries.

Save as disclosed above, at no time during the period 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.

Report of the Directors (continued)

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 period or at any time during the period.

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.

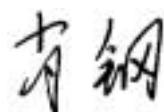
Compliance with the guideline on "Interim Financial Disclosure by Locally Incorporated Authorized Institutions"

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

Auditors

The accounts for the first half of 2003 have been audited by PricewaterhouseCoopers.

On behalf of the Board



XIAO Gang
Chairman
Hong Kong, 5 September 2003

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 5 to 64 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 judgments 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 30 June 2003 and of the profit and cash flows of the Group for the six month period then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

The comparative figures in respect of the Group's consolidated profit and loss account and cash flow statement; the Bank's and the Group's statement of changes in equity; and the related disclosure notes, for the six month period ended 30 June 2002 are not audited. Details of this matter are described in Note 2 to the accounts.



PricewaterhouseCoopers
Certified Public Accountants
Hong Kong, 5 September 2003

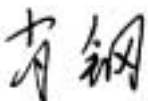
Consolidated Profit and Loss Account

	Note	Half-year ended 30 June 2003 HK\$'m	(Unaudited) As restated Half-year ended 30 June 2002 HK\$'m
Interest income	4	9,358	10,958
Interest expense		(2,776)	(4,067)
Net interest income		6,582	6,891
Other operating income	5	2,254	2,010
Operating income		8,836	8,901
Operating expenses	6	(2,697)	(2,899)
Operating profit before provisions		6,139	6,002
Charge for bad and doubtful debts	7	(1,669)	(1,766)
Operating profit after provisions		4,470	4,236
Net (loss)/gain from disposal/revaluation of fixed assets	8	(1,220)	8
Net gain/(loss) from disposal of held-to-maturity securities and investment securities		1	(2)
Write-back of provision/(provision) for impairment on held-to-maturity securities and investment securities	9	20	(7)
Net loss on disposal of a subsidiary		(1)	—
Write-back of provision/(provision) for impairment on investments in associates		6	(30)
Share of net (losses)/profits of associates		(10)	6
Profit before taxation		3,266	4,211
Taxation	10	(178)	(733)
Profit after taxation		3,088	3,478
Minority interests		(57)	(63)
Profit attributable to shareholders	11	3,031	3,415
Dividend	12	1,937	1,937

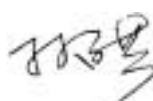
Consolidated Balance Sheet

	Note	At 30 June 2003 HK\$'m	As restated At 31 December 2002 HK\$'m
ASSETS			
Cash and short-term funds	16	94,830	115,075
Placements with banks and other financial institutions maturing between one and twelve months		91,688	80,159
Trade bills		708	592
Certificates of deposit held	17	18,795	17,528
Hong Kong SAR Government certificates of indebtedness	26	30,540	29,110
Held-to-maturity securities	18	92,875	94,227
Investment securities	19	53	46
Other investments in securities	20	74,708	64,360
Advances and other accounts	21	308,847	308,332
Investments in associates	24	399	483
Fixed assets	25	17,921	20,212
Other assets		4,130	5,421
Total assets		735,494	735,545
LIABILITIES			
Hong Kong SAR currency notes in circulation	26	30,540	29,110
Deposits and balances of banks and other financial institutions		38,485	29,957
Deposits from customers	27	585,446	600,977
Other accounts and provisions	29	24,787	20,300
Total liabilities		679,258	680,344
CAPITAL RESOURCES			
Minority interests		1,117	1,114
Share capital	31	43,043	43,043
Reserves	32	12,076	11,044
Shareholders' funds		55,119	54,087
Total capital resources		56,236	55,201
Total liabilities and capital resources		735,494	735,545

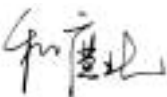
Approved by the Board of Directors on 5 September 2003 and signed on behalf of the Board by:



XIAO Gang
Director



SUN Changji
Director



HE Guangbei
Director

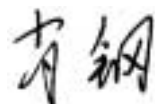


ZHU Chi
Deputy Chief Executive

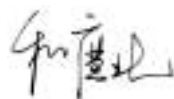
Balance Sheet

	Note	At 30 June 2003 HK\$'m	As restated At 31 December 2002 HK\$'m
ASSETS			
Cash and short-term funds	16	68,304	90,757
Placements with banks and other financial institutions maturing between one and twelve months		75,313	60,329
Trade bills		235	222
Certificates of deposit held	17	16,633	15,899
Hong Kong SAR Government certificates of indebtedness	26	30,540	29,110
Held-to-maturity securities	18	71,164	74,038
Investment securities	19	42	34
Other investments in securities	20	74,704	64,293
Advances and other accounts	21	262,288	263,729
Investments in subsidiaries	23	13,687	13,800
Investments in associates	24	348	490
Fixed assets	25	13,783	15,631
Other assets		3,901	5,579
Total assets		630,942	633,911
LIABILITIES			
Hong Kong SAR currency notes in circulation	26	30,540	29,110
Deposits and balances of banks and other financial institutions		37,120	30,189
Deposits from customers	27	489,390	504,342
Other accounts and provisions	29	20,707	17,638
Total liabilities		577,757	581,279
CAPITAL RESOURCES			
Share capital	31	43,043	43,043
Reserves	32	10,142	9,589
Shareholders' funds		53,185	52,632
Total liabilities and capital resources		630,942	633,911

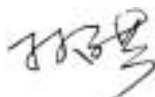
Approved by the Board of Directors on 5 September 2003 and signed on behalf of the Board by:



XIAO Gang
Director



HE Guangbei
Director



SUN Changji
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 first half of 2002, as restated	—	—	—	—	3,415	3,415
Currency translation differences	—	—	—	1	—	1
Dividend	—	—	—	—	(1,937)	(1,937)
Release to deferred tax liabilities	—	(22)	—	—	—	(22)
At 30 June 2002, as restated	43,043	373	40	(8)	9,797	53,245
Bank and subsidiaries	43,043	373	40	(8)	9,644	53,092
Associates	—	—	—	—	153	153
	43,043	373	40	(8)	9,797	53,245
At 1 July 2002, as previously reported	43,043	456	40	(8)	10,121	53,652
Effect of adoption of SSAP 12 (revised)	—	(83)	—	—	(324)	(407)
At 1 July 2002, as restated	43,043	373	40	(8)	9,797	53,245
Net profit for the second half of 2002, as restated	—	—	—	—	3,407	3,407
Currency translation differences	—	—	—	(1)	—	(1)
Reclassification	—	5	(5)	—	—	—
Dividend	—	—	—	—	(2,583)	(2,583)
Release from deferred tax liabilities	—	23	—	—	—	23
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	43,043	413	—	(9)	10,910	54,357
Effect of adoption of SSAP 12 (revised)	—	(60)	—	—	(210)	(270)
At 1 January 2003, as restated	43,043	353	—	(9)	10,700	54,087
Net profit for the first half of 2003	—	—	—	—	3,031	3,031
Dividend	—	—	—	—	(1,937)	(1,937)
Release from deferred tax liabilities	—	8	—	—	—	8
Revaluation of properties	—	(70)	—	—	—	(70)
At 30 June 2003	43,043	291	—	(9)	11,794	55,119
Bank and subsidiaries	43,043	291	—	(9)	11,810	55,135
Associates	—	—	—	—	(16)	(16)
	43,043	291	—	(9)	11,794	55,119

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 first half of 2002, as restated	—	—	—	3,379	3,379
Revaluation of properties	—	—	(5)	—	(5)
Dividend	—	—	—	(1,937)	(1,937)
At 30 June 2002, as restated	43,043	315	18	8,895	52,271
At 1 July 2002, as previously reported	43,043	383	18	9,231	52,675
Effect of adoption of SSAP 12 (revised)	—	(68)	—	(336)	(404)
At 1 July 2002, as restated	43,043	315	18	8,895	52,271
Net profit for the second half of 2002, as restated	—	—	—	2,932	2,932
Dividend	—	—	—	(2,583)	(2,583)
Release from deferred tax liabilities	—	16	—	—	16
Revaluation of properties	—	14	(18)	—	(4)
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	43,043	326	—	9,527	52,896
Effect of adoption of SSAP 12 (revised)	—	(52)	—	(212)	(264)
At 1 January 2003, as restated	43,043	274	—	9,315	52,632
Net profit for the first half of 2003	—	—	—	2,521	2,521
Dividend	—	—	—	(1,937)	(1,937)
Release from deferred tax liabilities	—	1	—	—	1
Revaluation of properties	—	(32)	—	—	(32)
At 30 June 2003	43,043	243	—	9,899	53,185

Consolidated Cash Flow Statement

	Note	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Cash flow from operating activities			
Operating cash outflow before taxation	33(a)	(16,713)	(27,547)
Disposal of loans to Bank of China Grand Cayman Branch		—	8,722
Hong Kong profits tax refunded/(paid)		369	(202)
Overseas profits tax paid		(4)	(11)
Net cash outflow from operating activities		(16,348)	(19,038)
Cash flow from investing activities			
Purchase of fixed assets		(40)	(26)
Proceeds from disposal of fixed assets		561	9
Purchase of investment securities		(6)	—
Proceeds from disposal of a subsidiary	33(d)	157	—
Proceeds from dissolution of an associate		19	—
Dividend received from an associate		1	2
Loans repaid by associates		59	—
Net cash inflow/(outflow) from investing activities		751	(15)
Cash flow from financing activities			
2002 second interim dividend paid		(2,583)	—
Dividend paid to minority shareholders	33(b)	(54)	—
Net cash outflow from financing activities		(2,637)	—
Decrease in cash and cash equivalents		(18,234)	(19,053)
Cash and cash equivalents at 1 January		83,065	120,664
Cash and cash equivalents at 30 June	33(c)	64,831	101,611

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 "Interim 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 adopted the following revised SSAP issued by the HKSA which is effective for accounting periods commencing on or after 1 January 2003:

SSAP 12 (revised): Income taxes

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

The comparative figures in respect of the Group's consolidated profit and loss account, cash flow statement, statement of changes in equity, and corresponding note disclosures, for the six month period ended 30 June 2002 are not audited. The Group's external auditors carried out a review of the interim financial statements for the six month period ended 30 June 2002 in accordance with the Statement of Auditing Standards 700 "Engagement to Review Interim Financial Reports" issued by the HKSA and issued a review report to the board of directors. The review report issued was unmodified from the specimen issued by the HKSA.

3. Principal accounting policies

(a) Basis of consolidation

The consolidated accounts include the accounts of the Bank and its subsidiaries made up to 30 June. 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 period 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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(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 period. 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.

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.

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.

(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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(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.

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 revaluation reserve. Upon disposal of premises, the relevant portion of the revaluation reserve realised in respect of previous valuations is released and transferred from the 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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(f) Fixed assets (continued)

(ii) Investment properties (continued)

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 revaluation reserve realised in respect of previous valuations is released from the investment properties revaluation reserve to the profit and loss account.

(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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(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.

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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(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.

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 the revised SSAP 12 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. The profit and amount charged to equity for the six months ended 30 June 2002 have been reduced by HK\$3 million and HK\$22 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. The profit for the six months ended 30 June 2002 have been increased by HK\$11 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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(k) Foreign currency translation (continued)

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 which are available to all 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.

(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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

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

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, hedging objective, strategy and all relationships between hedging risk and items be fully documented. It must also be demonstrated that a derivative would be expected to be highly effective in accomplishing the objective of offsetting the risk being hedged throughout the contract period. 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.

(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.

Notes to the Accounts (continued)

3. Principal accounting policies (continued)

(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

	Half-year ended 30 June 2003 HK\$m	(Unaudited) Half-year ended 30 June 2002 HK\$m
Interest income from listed investments	899	515
Interest income from unlisted investments	1,602	1,722
Other interest income	6,857	8,721
	9,358	10,958

5. Other operating income

	Half-year ended 30 June 2003 HK\$m	(Unaudited) Half-year ended 30 June 2002 HK\$m
Fees and commission income (Note)	1,690	1,705
Less: Fees and commission expenses	(311)	(357)
Net fees and commission income	1,379	1,348
Dividend income from investments in securities		
— unlisted investments	31	11
Net gain from other investments in securities	156	70
Net gain from foreign exchange activities	478	402
Net gain from other dealing activities	17	4
Gross rental income from investment properties	128	137
Less: Outgoings in respect of investment properties	(40)	(44)
Others	105	82
	2,254	2,010

Notes to the Accounts (continued)

5. Other operating income (continued)

Note:

Fees and commission income

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Bills and loans commissions	516	643
Payment services	151	138
Insurance	113	59
Securities brokerage	198	202
Asset management	82	75
Trust services	33	25
Guarantees	20	22
Credit card	249	234
Other		
— Safe deposit box	84	82
— BOC cards	21	26
— Dormant accounts	9	20
— Sundry	214	179
	1,690	1,705

6. Operating expenses

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Staff costs (including directors' emoluments)		
— salaries and other costs	1,509	1,632
— termination benefit	—	2
— pension cost	123	127
	1,632	1,761
Premises and equipment expenses (excluding depreciation)		
— rental of premises	107	137
— information technology	110	98
— others	92	125
	309	360
Depreciation on owned fixed assets	322	359
Auditors' remuneration	10	2
Other operating expenses	424	417
	2,697	2,899

Notes to the Accounts (continued)

7. Charge for bad and doubtful debts

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Net charge for bad and doubtful debts		
Specific provisions		
— new provisions	2,537	3,289
— releases	(482)	(1,173)
— recoveries (Note 22)	(220)	(350)
	1,835	1,766
General provisions	(166)	—
Net charge to profit and loss account (Note 22)	1,669	1,766

8. Net (loss)/gain from disposal/revaluation of fixed assets

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Net (loss)/gain on disposal of fixed assets	(18)	8
Net loss on revaluation of fixed assets	(1,202)	—
	(1,220)	8

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

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Write-back of provision/(provision) for impairment on held-to-maturity securities	19	(7)
Write-back of provision for impairment on investment securities	1	—
	20	(7)

Notes to the Accounts (continued)

10. Taxation

Taxation in the profit and loss account represents:

	Half-year ended 30 June 2003 HK\$m	(Unaudited) Half-year ended 30 June 2002 HK\$m
Hong Kong profits tax		
— current year taxation	732	738
— over-provision in prior years	(718)	(6)
Deferred tax charge	162	3
	176	735
Attributable share of estimated Hong Kong profits tax losses arising from investments in partnerships	—	(7)
	176	728
Investments in partnerships written off	—	6
Hong Kong profits tax	176	734
Overseas taxation	1	5
	177	739
Share of taxation attributable to associates	1	(6)
	178	733

Hong Kong profits tax has been provided at the rate of 17.5% (2002: 16%) on the estimated assessable profit for the first half of 2003. Taxation on overseas profits has been calculated on the estimated assessable profit for the first half of 2003 at the rates of taxation prevailing in the countries in which the Group operates.

The Group's tax over-provision of HK\$718 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 the first half of 2003.

The Group has entered into a number of aircraft leasing and coupon strip transactions involving special purpose partnerships in which the Group is the majority general partner. The Group does not control the partnerships and consequently they are not consolidated in the Group's accounts. As at 30 June 2003, the Group's investments in such partnerships, which are included in "Other assets" in the consolidated balance sheet amounted to HK\$389 million (31 December 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:

	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Assets	1,476	4,721
Liabilities	1,047	3,182

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

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Profit before taxation	3,266	4,211
Calculated at a taxation rate of 17.5% (2002: 16%)	572	674
Effect of different taxation rates in other countries	(23)	(3)
Income not subject to taxation	(69)	(39)
Expenses not deductible for taxation purposes	251	109
Tax losses not recognised	2	2
Temporary differences not recognised	162	3
Over-provision in prior periods	(718)	(6)
Tax benefits from partnerships	—	(1)
Share of taxation attributable to associates	1	(6)
Taxation charge	178	733

11. Profit attributable to shareholders

The profit of the Bank for the first half of 2003 attributable to shareholders and dealt with in the accounts of the Bank amounted to HK\$2,521 million (first half of 2002: HK\$3,379 million, as restated).

12. Dividend

	Half-year ended 30 June 2003		(Unaudited) Half-year ended 30 June 2002	
	Per share HK\$	Total HK\$'m	Per share HK\$	Total HK\$'m
Interim dividend	0.045	1,937	0.045	1,937

Notes to the Accounts (continued)

13. Retirement benefit costs

The Group operates certain defined contribution schemes which are ORSO schemes exempted under the Mandatory Provident Fund Schemes Ordinance ("MPF Schemes Ordinance"). Under the 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 Mandatory Provident Fund Scheme (the "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 first half of 2003 amounted to approximately HK\$117 million (first half of 2002: approximately HK\$122 million), after a deduction of forfeited contributions of approximately HK\$10 million (first half of 2002: approximately HK\$8 million). For the MPF Scheme, the Group contributed approximately HK\$4 million and HK\$3 million respectively for the first half of 2003 and 2002.

14. Share option schemes

(a) 2002 Share Option Scheme and 2002 Sharesave Plan

The principal terms of the 2002 Share Option Scheme and the 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 2002 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 2002 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 2002 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.

The two schemes have not commenced as at 30 June 2003.

Notes to the Accounts (continued)

14. Share option schemes (continued)

(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 30 June 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
Add: Share options granted in the first half of 2003	—	—	—
Less: Share options exercised in the first half of 2003	—	—	—
Less: Share options surrendered in the first half of 2003	1,735,200	—	1,735,200
Less: Share options lapsed in the first half of 2003	—	365,400	365,400
At 30 June 2003	12,001,800	16,856,200	28,858,000

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 ten 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 in the first half of 2003 are as follows:

	Half-year ended 30 June 2003 HK\$m	(Unaudited) Half-year ended 30 June 2002 HK\$m
Fees	1	1
Other emoluments for executive directors — basic salaries and allowances	2	2
	3	3

Notes to the Accounts (continued)

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

(a) Directors' emoluments (continued)

Emoluments of the directors were within the following bands:

	Number of directors	
	Half-year ended 30 June 2003	(Unaudited) Half-year ended 30 June 2002
Up to HK\$1,000,000	13	12
HK\$2,000,001 — HK\$2,500,000	1	1

The aggregate amount of emoluments paid to the Independent Non-executive Directors for the first half of 2003 was HK\$400,000 (first half of 2002: HK\$400,000).

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). In the first half of 2003, 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.

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the first half of 2003 include 1 director (2002: 1) whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining 4 individuals (2002: 4) for the first half of 2003 are as follows:

	Half-year ended 30 June 2003 HK\$m	(Unaudited) Half-year ended 30 June 2002 HK\$m
	Basic salaries and allowances	5
Contribution to pension schemes (including benefits in kind)	1	1
	6	6

Emoluments of individuals were within the following bands:

	Number of individuals	
	Half-year ended 30 June 2003	(Unaudited) Half-year ended 30 June 2002
HK\$1,000,001 — HK\$1,500,000	2	2
HK\$1,500,001 — HK\$2,000,000	2	2

For the first half of 2003, no directors 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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
	Cash	3,427	2,637	3,031
Balances with banks and other financial institutions	3,188	2,370	2,442	1,742
Money at call and short notice maturing within one month	69,088	95,997	45,045	73,732
Treasury bills (including Exchange Fund Bills)	19,127	14,071	17,786	13,026
	94,830	115,075	68,304	90,757
An analysis of treasury bills held is as follows:				
	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
	Unlisted, held-to-maturity, at amortised cost	15,041	10,933	13,850
Unlisted, other investments in securities, at fair value	4,086	3,138	3,936	2,838
	19,127	14,071	17,786	13,026

17. Certificates of deposit held

	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
	Held-to-maturity, at amortised cost — Unlisted	6,350	8,342	4,188
Other investments in securities, at fair value — Unlisted	12,445	9,186	12,445	9,186
	18,795	17,528	16,633	15,899

Notes to the Accounts (continued)

18. Held-to-maturity securities

	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Listed, at amortised cost	39,978	35,219	33,743	28,593
Less: Provision for impairment in value	(12)	(12)	(12)	(12)
	39,966	35,207	33,731	28,581
Unlisted, at amortised cost	52,919	59,049	37,443	45,486
Less: Provision for impairment in value	(10)	(29)	(10)	(29)
	52,909	59,020	37,433	45,457
Total	92,875	94,227	71,164	74,038
Listed, at amortised cost less provision				
— in Hong Kong	4,019	2,946	2,101	1,102
— outside Hong Kong	35,947	32,261	31,630	27,479
	39,966	35,207	33,731	28,581
Market value of listed securities	41,069	36,073	34,563	29,255
Held-to-maturity securities are analysed by issuers as follows:				
	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
— Central governments and central banks	3,015	3,620	1,096	1,708
— Public sector entities	13,259	17,028	10,954	14,131
— Banks and other financial institutions	59,331	64,457	44,986	52,368
— Corporate entities	17,270	9,122	14,128	5,831
	92,875	94,227	71,164	74,038

Notes to the Accounts (continued)

19. Investment securities

	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 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 50	2 44	2 40	1 33
Total	53	46	42	34
Market value of listed equity securities	6	4	2	1
Investment securities are analysed by issuers as follows:				
	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 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	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
At fair value				
Debt securities				
— Listed in Hong Kong	359	1,313	359	1,313
— Listed outside Hong Kong	23,308	20,818	23,308	20,799
	23,667	22,131	23,667	22,112
— Unlisted	50,896	42,078	50,896	42,076
	74,563	64,209	74,563	64,188
Equity securities				
— Listed in Hong Kong	96	121	96	78
— Unlisted	49	30	45	27
	145	151	141	105
Total	74,708	64,360	74,704	64,293
Other investments in securities are analysed by issuers as follows:				
	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
— Central governments and central banks	9,652	3,069	9,652	3,069
— Public sector entities	3,953	4,914	3,953	4,914
— Banks and other financial institutions	59,380	46,662	59,380	46,642
— Corporate entities	1,723	9,715	1,719	9,668
	74,708	64,360	74,704	64,293

At 30 June 2003, liabilities included in "Deposits and balances of banks and other financial institutions" of the Group and the Bank amounting to HK\$6,309 million (31 December 2002: Nil) are subject to "sell and buy back" arrangements. The amount of assets deposited by the Group and the Bank amounting to HK\$6,298 million (31 December 2002: Nil) was included in "Other investments in securities".

Notes to the Accounts (continued)

21. Advances and other accounts

	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
	Advances to customers	321,181	321,034	272,567
Accrued interest	1,894	2,006	1,546	1,607
	323,075	323,040	274,113	275,837
Provision for bad and doubtful debts				
— General	(6,197)	(6,363)	(4,650)	(4,651)
— Specific	(8,973)	(8,650)	(8,116)	(7,762)
	(15,170)	(15,013)	(12,766)	(12,413)
	307,905	308,027	261,347	263,424
Advances to banks and other financial institutions	942	305	941	305
	308,847	308,332	262,288	263,729
Non-performing loans are analysed as follows:				
	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Non-performing loans	25,049	25,659	22,986	23,470
Specific provisions made in respect of such advances	8,452	8,637	7,601	7,759
As a percentage of total advances to customers	7.80%	7.99%	8.43%	8.56%
Amount of interest in suspense	388	408	370	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 30 June 2003 and 31 December 2002, 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)	1,835	(166)	1,669	—
Amounts written off	(1,732)	—	(1,732)	(38)
Recoveries of advances written off in previous years (Note 7)	220	—	220	—
Interest suspended during the period	—	—	—	90
Suspended interest recovered	—	—	—	(72)
At 30 June 2003	8,973	6,197	15,170	388
Deducted from:				
— advances to customers	8,973	6,197	15,170	

	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	1,633	(1)	1,632	—
Amounts written off	(1,435)	—	(1,435)	(28)
Recoveries of advances written off in previous years	156	—	156	—
Interest suspended during the period	—	—	—	75
Suspended interest recovered	—	—	—	(70)
At 30 June 2003	8,116	4,650	12,766	370
Deducted from:				
— advances to customers	8,116	4,650	12,766	

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	3,033	(178)	2,855	—
Amounts written off	(3,229)	—	(3,229)	(37)
Recoveries of advances written off in previous years	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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Unlisted shares, at cost	12,563	12,588
Less: Provision for impairment in value	(302)	(214)
	12,261	12,374
Amounts due from subsidiaries	1,426	1,426
	13,687	13,800

The following is a list of principal subsidiaries as at 30 June 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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Unlisted shares, at cost	—	—	129	160
Share of net assets	158	186	—	—
Less: Provision for impairment in value	(20)	(22)	(42)	(65)
	138	164	87	95
Loans to associates (Note)	287	346	261	449
Less: Provision for loans to associates	(26)	(27)	—	(54)
	261	319	261	395
	399	483	348	490

Note:

At 30 June 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 30 June 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 ATM 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
Wealthy Full Enterprises Limited	Hong Kong	10,000 ordinary shares of HK\$1 each	*35%	Property investment
Zhejiang Commercial Bank Limited	People's Republic of China	Registered capital	*25%	Banking and related financial services

* Shares held indirectly by the Bank.

In the current period, CCIC Finance Limited has commenced members' voluntary winding up.

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	—	—	—	40	40
Disposals	(230)	(343)	—	(83)	(656)
Disposal of a subsidiary	(160)	—	—	(1)	(161)
Revaluation	(981)	(494)	—	—	(1,475)
Reclassification	(162)	162	—	—	—
At 30 June 2003	11,912	5,050	39	3,480	20,481
Accumulated depreciation					
At 1 January 2003	2	—	7	2,512	2,521
Depreciation for the period	204	—	—	118	322
Disposals	—	—	—	(77)	(77)
Disposal of a subsidiary	(3)	—	—	—	(3)
Write-back on revaluation	(203)	—	—	—	(203)
At 30 June 2003	—	—	7	2,553	2,560
Net book value					
At 30 June 2003	11,912	5,050	32	927	17,921
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 30 June 2003					
At cost	—	—	39	3,480	3,519
At valuation	11,912	5,050	—	—	16,962
	11,912	5,050	39	3,480	20,481
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	—	—	—	28	28
Disposals	(226)	(336)	—	(77)	(639)
Revaluation	(802)	(414)	—	—	(1,216)
Reclassification	32	(32)	—	—	—
At 30 June 2003	8,976	4,013	—	2,974	15,963
Accumulated depreciation					
At 1 January 2003	—	—	—	2,159	2,159
Depreciation for the period	160	—	—	93	253
Disposals	—	—	—	(72)	(72)
Write-back on revaluation	(160)	—	—	—	(160)
At 30 June 2003	—	—	—	2,180	2,180
Net book value					
At 30 June 2003	8,976	4,013	—	794	13,783
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 30 June 2003					
At cost	—	—	—	2,974	2,974
At valuation	8,976	4,013	—	—	12,989
	8,976	4,013	—	2,974	15,963
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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Held in Hong Kong				
On long-term lease (over 50 years)	7,282	8,217	5,459	5,986
On medium-term lease (10-50 years)	4,351	4,942	3,394	3,862
On short-term lease (less than 10 years)	2	3	2	3
Held outside Hong Kong				
On long-term lease (over 50 years)	52	53	15	15
On medium-term lease (10-50 years)	219	222	106	106
On short-term lease (less than 10 years)	6	6	—	—
	11,912	13,443	8,976	9,972

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

	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Held in Hong Kong				
On long-term lease (over 50 years)	4,048	4,666	3,368	4,051
On medium-term lease (10-50 years)	879	929	546	642
Held outside Hong Kong				
On long-term lease (over 50 years)	33	37	21	22
On medium-term lease (10-50 years)	90	93	78	80
	5,050	5,725	4,013	4,795

As at 30 June 2003, the premises are included in the balance sheet at directors' valuation, having regard to the valuation carried out at 30 June 2003 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 at 30 June 2003 on the basis of their open market value by Chesterton Petty Limited.

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		
	Premises HK\$'m	Investment properties HK\$'m	Total HK\$'m
Decrease in valuation debited to property revaluation reserves	(70)	—	(70)
Decrease in valuation charged to profit and loss account	(708)	(494)	(1,202)
	(778)	(494)	(1,272)

	The Bank		
	Premises HK\$'m	Investment properties HK\$'m	Total HK\$'m
Decrease in valuation debited to property revaluation reserves	(32)	—	(32)
Decrease in valuation charged to profit and loss account	(610)	(414)	(1,024)
	(642)	(414)	(1,056)

As at 30 June 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\$5,890 million (31 December 2002: HK\$7,448 million) and HK\$4,512 million (31 December 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.

Notes to the Accounts (continued)

27. Deposits from customers

	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Demand deposits and current accounts	20,716	21,476	17,356	17,938
Savings deposits	226,087	204,363	191,927	173,158
Time, call and notice deposits	338,643	375,138	280,107	313,246
	585,446	600,977	489,390	504,342

28. Assets pledged as security

At 30 June 2003, liabilities of the Group amounting to HK\$4,371 million (31 December 2002: HK\$3,198 million) and of the Bank amounting to HK\$4,071 million (31 December 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\$4,497 million (31 December 2002: HK\$3,400 million) and by the Bank were HK\$4,196 million (31 December 2002: HK\$3,400 million) included in "Cash and short-term funds".

29. Other accounts and provisions

	The Group		The Bank	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Interest payable	815	1,167	695	1,007
Current taxation (Note 30(a))	924	544	732	454
Deferred taxation (Note 30(b))	446	328	274	264
Restructuring provision (Note)	649	649	649	649
Dividend payable	1,937	2,583	1,937	2,583
Accruals and other payables	20,016	15,029	16,420	12,681
	24,787	20,300	20,707	17,638

Notes to the Accounts (continued)

29. Other accounts and provisions (continued)

Note:

Restructuring provision

	The Group and the Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
At 1 January	649	666
Utilised during the period/year	—	(17)
	649	649

The restructuring provision was made in relation to the restructuring and merger of the Group, which mainly represented the stamp duty payable that arose from restructuring activities of the Group.

30. Tax liabilities

	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Current taxation (Note a)	924	544	732	454
Deferred taxation (Note b)	446	328	274	264
	1,370	872	1,006	718

(a) Current taxation

	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Hong Kong profits tax	914	531	731	451
Overseas taxation	10	13	1	3
	924	544	732	454

Notes to the Accounts (continued)

30. Tax liabilities (continued)

(b) Deferred taxation

In the current period, 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 revised SSAP 12. The adoption of the revised SSAP 12 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 first half of 2003 showing the impact of the adoption of revised SSAP 12, 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
(Credited)/charged to profit and loss account	(4)	(29)	—	204	(9)	162
Credited to equity	—	(8)	—	—	—	(8)
At 30 June 2003	243	1,006	(2)	(805)	(7)	435

Notes to the Accounts (continued)

30. Tax liabilities (continued)

(b) Deferred taxation (continued)

	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 Credited to equity	3	—	—	—	—	3
	—	(1)	—	—	—	(1)
At 31 December 2002, as restated	247	1,043	(2)	(1,009)	2	281

	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
(Credited)/charged to profit and loss account	(4)	(30)	—	55	(10)	11
Credited to equity	—	(1)	—	—	—	(1)
At 30 June 2003	234	736	—	(683)	(13)	274

Notes to the Accounts (continued)

30. Tax liabilities (continued)

(b) Deferred taxation (continued)

	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
(Credited)/charged 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

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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Deferred tax assets (Note)	(11)	(47)	—	—
Deferred tax liabilities	446	328	274	264
	435	281	274	264

Note: The amounts have been included in "Other assets".

Notes to the Accounts (continued)

30. Tax liabilities (continued)

(b) Deferred taxation (continued)

	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Deferred tax assets to be recovered after more than twelve months	(824)	(1,029)	(691)	(748)
Deferred tax liabilities to be settled after more than twelve months	259	262	235	239
	(565)	(767)	(456)	(509)

31. Share capital

	At 30 June 2003 HK\$m	At 31 December 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

32. Reserves

	The Group		The Bank	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Premises revaluation reserve	291	353	243	274
Translation reserve	(9)	(9)	—	—
Retained earnings	11,794	10,700	9,899	9,315
	12,076	11,044	10,142	9,589

Notes to the Accounts (continued)

33. Notes to consolidated cash flow statement

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

	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Operating profit after provisions	4,470	4,236
Depreciation	322	359
Charge for bad and doubtful debts	1,669	1,766
Advances written off net of recoveries	(1,512)	(664)
Change in money at call and short notice with original maturity over three months	2,572	14,611
Change in treasury bills with original maturity over three months	855	4,275
Change in placements with banks and other financial institutions with original maturity over three months	(14,645)	(2,686)
Change in trade bills	(116)	(202)
Change in certificates of deposit held with original maturity over three months	(1,006)	812
Change in held-to-maturity securities	1,372	(51,576)
Change in other investments in securities	(10,348)	7,409
Change in advances and other accounts	(672)	(5,699)
Change in other assets	1,255	2,209
Change in deposits and balances of banks and other financial institutions repayable over three months	9,967	(6,540)
Change in deposits from customers	(15,531)	5,042
Change in other accounts and provisions	4,635	(900)
Exchange differences	—	1
Operating cash outflow before taxation	(16,713)	(27,547)

(b) Analysis of changes in financing

	2003		
	Share capital HK\$'m	Certificates of deposit issued HK\$'m	Minority interests HK\$'m
At 1 January 2003	43,043	—	1,114
Minority interests share of profits	—	—	57
Dividend paid to minority shareholders	—	—	(54)
At 30 June 2003	43,043	—	1,117

Notes to the Accounts (continued)

33. Notes to consolidated cash flow statement (continued)

(b) Analysis of changes in financing (continued)

	(Unaudited) 2002		
	Share capital HK\$m	Certificates of deposit issued HK\$m	Minority interests HK\$m
At 1 January 2002	43,043	5,000	1,066
Minority interests share of profits	—	—	63
Dividend payable to minority shareholders	—	—	(45)
At 30 June 2002	43,043	5,000	1,084

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

	At 30 June 2003 HK\$m	(Unaudited) At 30 June 2002 HK\$m
Cash and balances with banks and other financial institutions	6,615	5,217
Money at call and short notice with original maturity within three months	53,017	72,193
Treasury bills with original maturity within three months	14,169	4,904
Placements with banks and other financial institutions with original maturity within three months	16,607	34,302
Certificates of deposit held with original maturity within three months	495	—
Deposits and balances of banks and other financial institutions with original maturity within three months	(26,072)	(15,005)
	64,831	101,611

Notes to the Accounts (continued)

33. Notes to consolidated cash flow statement (continued)

(d) Disposal of a subsidiary

	Half-year ended 30 June 2003 HK\$m	(Unaudited) Half-year ended 30 June 2002 HK\$m
Net assets disposed:		
— Fixed assets	158	—
— Loss on disposal	(1)	—
	157	—
Satisfied by:		
— Cash	157	—
Analysis of net cash inflow in respect of the disposal of a subsidiary:		
— Cash consideration received	157	—

34. Maturity profile

The maturity profile of assets and liabilities analysed by the remaining period as at 30 June 2003 and 31 December 2002 to the contractual maturity dates is as follows:

	The Group						
	At 30 June 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
Assets							
Treasury bills	—	16,699	2,428	—	—	—	19,127
Cash and other short-term funds	6,615	69,088	—	—	—	—	75,703
Placements with banks and other financial institutions	15	73,858	17,815	—	—	—	91,688
Certificates of deposit held	—	4,755	4,268	9,573	199	—	18,795
Debt securities included in:							
— held-to-maturity securities	—	9,006	9,233	67,650	6,963	45	92,897
— other investments in securities	—	13,847	8,819	50,272	1,625	—	74,563
Advances to customers	24,093	19,645	27,319	128,077	96,867	25,180	321,181
Advances to banks and other financial institutions	—	1	1	550	390	—	942
Liabilities							
Deposits and balances of banks and other financial institutions	4,790	31,222	2,473	—	—	—	38,485
Deposits from customers	249,830	317,955	17,333	328	—	—	585,446

Notes to the Accounts (continued)

34. Maturity profile (continued)

	The Bank						
	At 30 June 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
Assets							
Treasury bills	—	15,537	2,249	—	—	—	17,786
Cash and other short-term funds	5,474	45,044	—	—	—	—	50,518
Placements with banks and other financial institutions	15	59,240	16,058	—	—	—	75,313
Certificates of deposit held	—	3,968	3,985	8,482	198	—	16,633
Debt securities included in:							
— held-to-maturity securities	—	2,261	4,622	59,367	4,891	45	71,186
— other investments in securities	—	13,847	8,819	50,272	1,625	—	74,563
Advances to customers	19,045	15,995	23,587	110,362	80,445	23,133	272,567
Advances to banks and other financial institutions	—	1	1	549	390	—	941
Liabilities							
Deposits and balances of banks and other financial institutions	4,380	30,330	2,410	—	—	—	37,120
Deposits from customers	211,772	263,514	13,839	265	—	—	489,390

	The Group						
	At 31 December 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
Assets							
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
Liabilities							
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						
	At 31 December 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
Assets							
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
Liabilities							
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 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, which 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	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Direct credit substitutes	2,317	3,839	1,930	3,493
Transaction-related contingencies	4,067	2,286	3,934	2,150
Trade-related contingencies	15,626	16,409	12,487	12,973
Other commitments with an original maturity of:				
— under one year or which are unconditionally cancellable	77,965	75,844	47,147	46,736
— one year and over	54,457	64,402	48,063	58,935
	154,432	162,780	113,561	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					
	At 30 June 2003			At 31 December 2002		
	Trading HK\$m	Hedging HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Total HK\$m
Exchange rate contracts						
Spot	24,598	—	24,598	13,697	—	13,697
Forward and futures contracts	971	—	971	224	—	224
Swaps	164,892	5,935	170,827	179,544	6,082	185,626
Foreign exchange option contracts						
— Currency options purchased	1,174	—	1,174	622	—	622
— Currency options written	27,472	—	27,472	28,633	—	28,633
	219,107	5,935	225,042	222,720	6,082	228,802
Interest rate contracts						
Interest rate swaps	78	20,194	20,272	228	20,055	20,283
Interest rate futures	156	—	156	—	—	—
	234	20,194	20,428	228	20,055	20,283
Bullion contracts						
Bullion contracts	687	—	687	779	—	779
Gold options purchased	5	—	5	—	—	—
Gold options written	6	—	6	—	—	—
	698	—	698	779	—	779
Equity contracts						
Equity options purchased	1,055	—	1,055	975	—	975
Equity options written	764	—	764	873	—	873
	1,819	—	1,819	1,848	—	1,848
Other contracts						
Bond options purchased	780	—	780	—	—	—
Bond options written	780	—	780	—	—	—
	1,560	—	1,560	—	—	—
Total	223,418	26,129	249,547	225,575	26,137	251,712

Notes to the Accounts (continued)

35. Off-balance sheet exposures (continued)

(b) Derivatives (continued)

	The Bank					
	At 30 June 2003			At 31 December 2002		
	Trading HK\$'m	Hedging HK\$'m	Total HK\$'m	Trading HK\$'m	Hedging HK\$'m	Total HK\$'m
Exchange rate contracts						
Spot	23,478	—	23,478	12,900	—	12,900
Forward and futures contracts	597	—	597	202	—	202
Swaps	163,656	5,638	169,294	178,344	5,797	184,141
Foreign exchange option contracts						
— Currency options purchased	1,174	—	1,174	622	—	622
— Currency options written	27,472	—	27,472	28,633	—	28,633
	216,377	5,638	222,015	220,701	5,797	226,498
Interest rate contracts						
Interest rate swaps	78	17,305	17,383	228	17,499	17,727
Interest rate futures	156	—	156	—	—	—
	234	17,305	17,539	228	17,499	17,727
Bullion contracts						
Bullion contracts	687	—	687	779	—	779
Gold options purchased	5	—	5	—	—	—
Gold options written	6	—	6	—	—	—
	698	—	698	779	—	779
Equity contracts						
Equity options purchased	952	—	952	975	—	975
Equity options written	662	—	662	873	—	873
	1,614	—	1,614	1,848	—	1,848
Other contracts						
Bond options purchased	780	—	780	—	—	—
Bond options written	780	—	780	—	—	—
	1,560	—	1,560	—	—	—
Total	220,483	22,943	243,426	223,556	23,296	246,852

The trading transactions include 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:

	The Group			
	At 30 June 2003	At 31 December 2002	At 30 June 2003	At 31 December 2002
	Credit risk weighted amount HK\$m	HK\$m	Replacement cost HK\$m	HK\$m
Contingent liabilities and commitments	31,942	45,936	N/A	N/A
Derivatives:				
— Exchange rate contracts	647	596	1,294	870
— Interest rate contracts	50	60	76	120
— Bullion contracts	4	5	10	13
— Equity contracts	31	33	13	17
— Other contracts	1	—	3	—
	733	694	1,396	1,020
Total	32,675	46,630	1,396	1,020

	The Bank			
	At 30 June 2003	At 31 December 2002	At 30 June 2003	At 31 December 2002
	Credit risk weighted amount HK\$m	HK\$m	Replacement cost HK\$m	HK\$m
Contingent liabilities and commitments	28,200	41,040	N/A	N/A
Derivatives:				
— Exchange rate contracts	640	590	1,289	866
— Interest rate contracts	42	47	71	96
— Bullion contracts	4	5	10	13
— Equity contracts	31	33	13	17
— Other contracts	1	—	3	—
	718	675	1,386	992
Total	28,918	41,715	1,386	992

The contract or notional amounts of these instruments indicate the volume of transactions outstanding as at 30 June 2003 and 31 December 2002; they do not represent the amounts at risk.

Notes to the Accounts (continued)

35. Off-balance sheet exposures (continued)

(b) Derivatives (continued)

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.

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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Authorised and contracted for but not recorded	229	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	
	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Land and buildings				
— not later than one year	188	164	201	158
— later than one year but not later than five years	193	175	214	167
— later than five years	9	9	2	—
	390	348	417	325
Computer equipment				
— not later than one year	1	—	—	—
	1	—	—	—

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	
	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Land and buildings				
— not later than one year	187	198	151	213
— later than one year but not later than five years	184	226	164	247
— later than five years	—	2	—	2
	371	426	315	462

38. 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)

38. Segmental reporting (continued)

(a) By class of business

	Half-year ended 30 June 2003					
	Commercial banking HK\$'m	Treasury HK\$'m	Unallocated HK\$'m	Subtotal HK\$'m	Eliminations HK\$'m	Consolidated HK\$'m
Net interest income	4,985	1,275	322	6,582	—	6,582
Other operating income	1,445	639	424	2,508	(254)	2,254
Operating income	6,430	1,914	746	9,090	(254)	8,836
Operating expenses	(2,143)	(82)	(726)	(2,951)	254	(2,697)
Operating profit before provisions	4,287	1,832	20	6,139	—	6,139
Charge for bad and doubtful debts	(1,669)	—	—	(1,669)	—	(1,669)
Operating profit after provisions	2,618	1,832	20	4,470	—	4,470
Net loss from disposal/ revaluation of fixed assets	—	—	(1,220)	(1,220)	—	(1,220)
Net gain from disposal of held-to-maturity securities and investment securities	—	—	1	1	—	1
Write-back of provision for impairment on held-to-maturity securities and investment securities	—	19	1	20	—	20
Net loss on disposal of a subsidiary	—	—	(1)	(1)	—	(1)
Write-back of provision for impairment on investments in associates	—	—	6	6	—	6
Share of net losses of associates	—	—	(10)	(10)	—	(10)
Profit/(loss) before taxation	2,618	1,851	(1,203)	3,266	—	3,266
Assets						
Segment assets	313,249	403,275	18,459	734,983	—	734,983
Investments in associates	—	—	399	399	—	399
Unallocated corporate assets	—	—	112	112	—	112
	313,249	403,275	18,970	735,494	—	735,494
Liabilities						
Segment liabilities	599,053	75,796	2,129	676,978	—	676,978
Unallocated corporate liabilities	—	—	2,280	2,280	—	2,280
	599,053	75,796	4,409	679,258	—	679,258
Other Information						
Additions of fixed assets	—	—	40	40	—	40
Depreciation	—	—	322	322	—	322
Amortisation of premium/ discount of held-to-maturity securities	—	348	—	348	—	348
Non-cash expenses other than depreciation/ amortisation	1,669	—	—	1,669	—	1,669

Notes to the Accounts (continued)

38. Segmental reporting (continued)

(a) By class of business (continued)

	(Unaudited) Half-year ended 30 June 2002					
	Commercial banking HK\$m	Treasury HK\$m	Unallocated HK\$m	Subtotal HK\$m	Eliminations HK\$m	Consolidated HK\$m
Net interest income	5,497	1,030	364	6,891	—	6,891
Other operating income	1,456	457	383	2,296	(286)	2,010
Operating income	6,953	1,487	747	9,187	(286)	8,901
Operating expenses	(2,260)	(88)	(837)	(3,185)	286	(2,899)
Operating profit/(loss) before provisions	4,693	1,399	(90)	6,002	—	6,002
Charge for bad and doubtful debts	(1,766)	—	—	(1,766)	—	(1,766)
Operating profit/(loss) after provisions	2,927	1,399	(90)	4,236	—	4,236
Net gain from disposal of fixed assets	—	—	8	8	—	8
Net loss from disposal of held-to-maturity securities and investment securities	—	(2)	—	(2)	—	(2)
Provision for impairment on held-to-maturity securities and investment securities	—	(7)	—	(7)	—	(7)
Provision for impairment on investments in associates	—	—	(30)	(30)	—	(30)
Share of net profits of associates	—	—	6	6	—	6
Profit/(loss) before taxation	2,927	1,390	(106)	4,211	—	4,211
Assets						
Segment assets	308,963	406,116	20,724	735,803	—	735,803
Investments in associates	—	—	366	366	—	366
Unallocated corporate assets	—	—	1,666	1,666	—	1,666
	308,963	406,116	22,756	737,835	—	737,835
Liabilities						
Segment liabilities	621,777	57,688	2,255	681,720	—	681,720
Unallocated corporate liabilities	—	—	1,786	1,786	—	1,786
	621,777	57,688	4,041	683,506	—	683,506
Other Information						
Additions of fixed assets	—	—	26	26	—	26
Depreciation	—	—	359	359	—	359
Amortisation of premium/ discount of held-to- maturity securities	—	651	—	651	—	651
Non-cash expenses other than depreciation/ amortisation	1,766	—	—	1,766	—	1,766

Notes to the Accounts (continued)

38. 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. 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 interbank rates of the relevant financial period. In addition, the gains and losses on the foreign exchange activities of the Group are included under "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, investment securities, investments in associates and other items that cannot be reasonably allocated to a specific business segment. The interest benefit of the capital of the Group 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 under "Unallocated".

(b) By geographical area

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

39. Loans to directors and officers

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

	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Aggregate amount of relevant loans outstanding at period/year end	37	99
Maximum aggregate amount of relevant loans outstanding during the period/year	99	137

Notes to the Accounts (continued)

40. 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.

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 30 June 2003, the ultimate holding company and a fellow subsidiary provided guarantees for loans in favour of the Group amounting to HK\$2,016 million (31 December 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 the ultimate holding company, fellow subsidiaries, and associates are summarised as follows:

	Note	Half-year ended 30 June 2003 HK\$'m	(Unaudited) Half-year ended 30 June 2002 HK\$'m
Profit and loss items:			
Interest income	(i)	181	361
Interest expense	(ii)	(166)	(122)
Insurance commission received (net)	(iii)	43	11
Administrative services fees received/receivable	(iv)	12	10
Rental fees received/receivable	(iv)	15	11
Funds selling commission received	(vi)	8	79
Correspondent banking fee received	(vii)	4	4
Loan services fees received	(viii)	5	2
Credit card commission paid/payable (net)	(v)	(19)	(22)
Securities brokerage commission paid/payable (net)	(v)	(42)	(54)
Rental, property management and letting agency fees paid/payable	(v)	(35)	(37)
Charge for bad and doubtful debts		(1)	15

Notes to the Accounts (continued)

40. Significant related party transactions (continued)

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

	Note	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Balance sheet items:			
Cash and short-term funds	(i)	11,724	15,041
Placements with banks and other financial institutions	(i)	14,869	17,539
Advances and other accounts	(i), (ix)	769	867
Other investments in securities	(i)	233	234
Other assets	(x)	53	15
Deposits from and balances of banks and other financial institutions	(ii)	19,435	20,304
Deposits from customers	(ii)	5,501	4,409
Other accounts and provisions	(x)	27	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. 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.

(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, fellow subsidiaries and associates 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 provides various administrative services including internal audit, technology, human resources support and training to, and receives office premises rental fees from the ultimate holding company, fellow subsidiaries and associates on normal commercial terms.

(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.

Notes to the Accounts (continued)

40. Significant related party transactions (continued)

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

Notes (continued):

(vi) Funds selling commission received

In the ordinary course of business, the Group receives commission and acts as an intermediary 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 at a fee agreed among the parties from time to time.

(ix) Advances and other accounts

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

(x) 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 receivables and payables arose from transactions carried out in the normal course of business.

(d) Off-balance sheets items

Contingent liabilities and commitments

In the ordinary course of business, the Group provides guarantees for the obligations of fellow subsidiaries on normal commercial terms. Such guarantees as at 30 June 2003 amounted to HK\$170 million (31 December 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\$20,550 million as at 30 June 2003 (31 December 2002: HK\$12,722 million). These transactions are executed on normal commercial terms with reference to prevailing market rates.

Notes to the Accounts (continued)

40. Significant related party transactions (continued)

(e) Balances with group companies and associates

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

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Cash and short-term funds	11,618	15,031
Placements with banks and other financial institutions	14,867	17,533
Advances and other accounts	46	4
Other investments in securities	233	234
Other assets	3	—
Deposits from and balances of banks and other financial institutions	18,239	19,107
Other accounts and provisions	25	—

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

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Cash and short-term funds	106	10
Placements with banks and other financial institutions	2	6
Advances and other accounts	462	517
Other assets	50	15
Deposits from and balances of banks and other financial institutions	1,189	1,195
Deposits from customers	5,431	4,352
Other accounts and provisions	2	15

Notes to the Accounts (continued)

40. 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:

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Cash and short-term funds	450	1,281
Placements with banks and other financial institutions	387	—
Advances and other accounts	690	950
Other assets	1,149	1,815
Deposits from and balances of banks and other financial institutions	567	1,817
Deposits from customers	812	894
Other accounts and provisions	1,133	1,567

There were no material balances with associates of the Group as at 30 June 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 period 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.

41. 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 current period, the presentation of certain items and balances in the accounts have been revised to comply with the new requirements. Accordingly, certain comparative amounts have been reclassified to conform to the current period's presentation.

42. Approval of interim accounts

This audited interim accounts were approved and authorised for issue by the Board of Directors on 5 September 2003.

43. Ultimate holding company

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

Unaudited Supplementary Financial Information

1. Capital adequacy ratio

	At 30 June 2003	At 31 December 2002*
Capital adequacy ratio	14.66%	13.99%
Adjusted capital adequacy ratio	14.87%	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 30 June 2003 and 31 December 2002 and reported to the HKMA is analysed as follows:

	At 30 June 2003 HK\$'m	At 31 December 2002* HK\$'m
Core capital:		
Paid up ordinary share capital	43,043	43,043
Reserves	10,452	8,087
Profit and loss account	1,302	2,360
Minority interests	892	867
	55,689	54,357
Supplementary capital:		
General provisions for doubtful debts	5,077	5,200
Total capital base before deductions	60,766	59,557
Deductions:		
Shareholdings in subsidiaries or holding company	(449)	(482)
Exposures to connected companies	(841)	(918)
Equity investments of 20% or more in non-subsidiary companies	(117)	(171)
Investments in the capital of other banks or other financial institutions	(1)	(1)
	(1,408)	(1,572)
Total capital base after deductions	59,358	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

	Half-year ended 30 June 2003	Half-year ended 30 June 2002
Average liquidity ratio	37.93%	41.26%

The average liquidity ratios for the half-year ended 30 June 2003 and 30 June 2002 are calculated as the simple average of each calendar month's average liquidity ratio of the Bank for the period.

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.

	At 30 June 2003										
	Equivalent in millions of HK\$										
	US Dollars	Pound Sterling	Japanese Yen	Euro Dollars	Swiss Franc	Australian Dollars	New Zealand Dollars	Macau Pataca	Renminbi Yuan	Others	Total
Spot assets	161,334	8,619	12,040	19,666	146	19,876	10,009	137	1,023	7,132	239,982
Spot liabilities	(132,231)	(14,816)	(3,002)	(11,956)	(718)	(25,792)	(13,492)	(1)	(750)	(11,289)	(214,047)
Forward purchases	114,186	9,850	13,550	11,868	8,988	17,621	7,983	—	—	5,774	189,820
Forward sales	(142,654)	(3,786)	(22,645)	(19,957)	(8,358)	(11,824)	(4,561)	—	—	(1,639)	(215,424)
Net options position	(647)	13	8	182	—	216	178	—	—	51	1
Net long/(short) position	(12)	(120)	(49)	(197)	58	97	117	136	273	29	332

	At 31 December 2002										
	Equivalent in millions of HK\$										
	US Dollars	Pound Sterling	Japanese Yen	Euro Dollars	Swiss Franc	Australian Dollars	New Zealand Dollars	Macau Pataca	Renminbi Yuan	Others	Total
Spot assets	168,003	7,641	19,227	16,688	404	23,525	11,809	141	611	5,176	253,225
Spot liabilities	(135,565)	(16,461)	(2,595)	(10,753)	(703)	(27,799)	(15,226)	(1)	(425)	(6,548)	(216,076)
Forward purchases	102,549	12,188	14,640	7,025	5,756	8,798	5,381	—	—	2,076	158,413
Forward sales	(138,688)	(3,474)	(31,354)	(13,279)	(5,491)	(4,541)	(1,884)	—	—	(703)	(199,414)
Net options position	(444)	13	—	41	—	192	100	—	—	101	3
Net long/(short) position	(4,145)	(93)	(82)	(278)	(34)	175	180	140	186	102	(3,849)

There were no significant net structural positions for the Group as at 30 June 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:

	At 30 June 2003 HK\$'m	At 31 December 2002 HK\$'m
Loans for use in Hong Kong		
Industrial, commercial and financial		
— Property development	28,247	26,591
— Property investment	48,728	50,992
— Financial concerns	8,214	8,891
— Stockbrokers	84	82
— Wholesale and retail trade	23,709	23,781
— Manufacturing	13,122	12,834
— Transport and transport equipment	12,643	11,192
— Others	43,047	40,440
Individuals		
— Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	18,890	19,956
— Loans for purchase of other residential properties	84,895	85,853
— Credit card advances	3,385	3,554
— Others	7,950	8,469
Total loans for use in Hong Kong	292,914	292,635
Trade finance	9,195	8,873
Loans for use outside Hong Kong	19,072	19,526
Gross advances to customers	321,181	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

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Hong Kong	304,393	304,924
Mainland China	7,094	4,456
Others	9,694	11,654
	321,181	321,034

(ii) Advances overdue for over three months

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Hong Kong	15,760	17,060
Mainland China	923	1,402
Others	145	163
	16,828	18,625

(iii) Non-performing loans

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Hong Kong	23,525	23,653
Mainland China	1,259	1,755
Others	265	251
	25,049	25,659

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:

	Banks and other financial institutions HK\$'m	Public sector entities HK\$'m	Others HK\$'m	Total HK\$'m
At 30 June 2003				
Asia, other than Hong Kong				
— Mainland China	31,677	2,081	8,046	41,804
— Others	43,608	680	4,855	49,143
	75,285	2,761	12,901	90,947
North America				
— United States	9,081	15,143	17,563	41,787
— Others	14,379	2,865	11	17,255
	23,460	18,008	17,574	59,042
Western Europe				
— France	30,858	—	2,837	33,695
— Germany	37,448	—	6,231	43,679
— Others	85,248	896	11,405	97,549
	153,554	896	20,473	174,923
Total	252,299	21,665	50,948	324,912

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				
— France	28,623	—	3,372	31,995
— Germany	36,172	—	10,743	46,915
— Others	81,220	1,451	9,139	91,810
	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

	At 30 June 2003		At 31 December 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	1,952	0.61%	2,240	0.70%
— one year or less but over six months	2,174	0.68%	3,486	1.08%
— over one year	12,702	3.95%	12,899	4.02%
Advances overdue for over three months	16,828	5.24%	18,625	5.80%
Less:				
Amount overdue for over three months and on which interest is still being accrued	(158)	(0.05%)	(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	1,319	0.41%	1,436	0.45%
— others	7,060	2.20%	6,148	1.91%
Gross non-performing loans	25,049	7.80%	25,659	7.99%

At 30 June 2003 and 31 December 2002, there were no advances to banks and other financial institutions that were overdue for over three months.

Unaudited Supplementary Financial Information (continued)

7. Overdue and rescheduled assets (continued)

(b) Other overdue assets

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Overdue for:		
— six months or less but over three months	4	3
— one year or less but over six months	2	1
	6	4

As at 30 June 2003, other overdue assets represented the accrued interest.

(c) Rescheduled advances to customers

	At 30 June 2003		At 31 December 2002	
	Amount HK\$m	% of gross advances to customers	Amount HK\$m	% of gross advances to customers
Rescheduled advances to customers	1,335	0.42%	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 under 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 30 June 2003 and 31 December 2002, there were no rescheduled advances to banks and other financial institutions.

Unaudited Supplementary Financial Information (continued)

8. Repossessed assets held

	At 30 June 2003 HK\$m	At 31 December 2002 HK\$m
Repossessed assets held	1,703	2,097

Repossessed 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 repossessed assets are realised. Specific provisions will be made after taking into account the market value of the repossessed assets which are yet to be disposed. Upon disposal of the repossessed assets, any specific provisions previously made will be utilised to write off the loans and advances.

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 (including interest rate 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 increase shareholder value, while maintaining its risk exposures within acceptable limits.

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 the Bank's risk management goals, the Bank established, in connection with its reorganisation, a more 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.

Unaudited Supplementary Financial Information (continued)

9. Risk management (continued)

Risk Management Structure (continued)

The Bank has developed and implemented comprehensive risk management policies and procedures to identify, measure, monitor and control credit risk, market risk, liquidity risk and operational risk across the organisation. 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 the 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 to 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 the financial position of the bank relating to interest rate risk and liquidity risk to the ALCO and the RMC on a regular basis.

The Bank’s principal banking subsidiaries, Nanyang and Chiyu, 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 functionally report to the Bank’s management on a regular basis.

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 operations.

The Bank’s primary goal in credit risk management is to maximise its risk-adjusted rate of return 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 RMC sets the Group’s overall risk management strategy and policies, the Group’s overall risk limits and credit authorisation systems. The RMC is responsible for reviewing and approving the Group’s risk management policies and procedures as well as modifications to these policies and procedures. 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 control over credit risk.

Unaudited Supplementary Financial Information (continued)

9. Risk management (continued)

Credit Risk Management (continued)

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 Audit Committee respectively. All these committees and departments form an independent line of control.

In addition, respective responsibilities, accountabilities 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 significant 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 shareholder's 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 loans 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 strategies 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 development 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 and low-risk loans.

Low risk credit transactions that fulfil certain requirements relating to credit types, loan purposes, loan amount, guarantee, collateral coverage and security adequacy are 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 include loans exceeding the credit extension limit of the deputy chief executives of the Group's credit initiation units, 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 approval right of the CRO and loan applications which have been vetoed by our CRO and in respect of which an appeal has been lodged with the Credit Committee. Significant loans 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 the 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 an independent dedicated division in RMD to conduct thorough and comprehensive monitoring on each obligor and group of obligors to identify and control the individual and overall credit risk in our loan portfolio.

To detect early signs of deterioration in credit status of obligors and to trigger closer monitoring to prevent further deterioration, an early alert program for potential problem customers has been established.

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

Market Risk Management

Market risk is the risk of loss relating to the change in value of a financial instrument or a portfolio due to changes in the value of market variables, such as interest rates, foreign exchange rates and 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 set into sub-limits by reference to different risk factors, which are interest rate, foreign exchange, commodity 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 an acceptable level.

Value at Risk ("VaR") is a statistical measure of the dollar amount of potential losses from adverse market movements in market rates and prices over a specified time horizon and to a given level of confidence. The VaR methodology used by the Bank is based 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 30 June 2003, the VaR for all trading market risk exposure of the Bank was HK\$5.4 million compared with HK\$3.3 million at 31 December 2002, the VaR for all trading interest rate risk exposure was HK\$5.1 million (HK\$2.1 million at 31 December 2002) and the VaR for all trading foreign exchange risk exposure was HK\$1.1 million (HK\$1.1 million at 31 December 2002). The average VaR for the first half of 2003 was HK\$4.1 million, with a maximum of HK\$12.6 million and a minimum of HK\$1.2 million for the period.

For the first half of 2003, the average daily revenue of the Bank earned from market risk-related trading activities was HK\$2.3 million (HK\$2.4 million for the first half of 2002). The standard deviation of these daily trading revenues was HK\$3.2 million (HK\$1.5 million for the first half of 2002). The most frequent result was daily trading revenue of between HK\$1 million to HK\$4 million, with 61 occurrences. The highest daily revenue was HK\$11.4 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 risks through its interbank market activities. In particular, the Bank mitigates exchange rate risks 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 exposures comprise trading exposures and structural interest rate 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 Risk Management Committee of the Board of Directors 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 gap is the difference between the amount of interest-earning assets and interest-bearing liabilities that mature or must be re-priced within a specific time band. The Treasurer calculates the gaps by classifying all assets, liabilities and off-balance sheet items for each currency into appropriate time bands according to contracted maturities or anticipated re-pricing time bands. The magnitude of the gaps indicate 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, and are controlled according to the gap limits approved by the Board. 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 is assessed through hypothetical interest rate shock of 100 basis points (on both sides) across the yield curve. This is refined using scenario analysis, based on alternative scenarios around the most likely interest rate path. Variations in net interest income are controlled within 5% of the budgeted amount for the year. Basis risk is directly related to the relative change in assets and liabilities that are indexed to the base lending rate or money market rate. The impact is gauged by the projected change in net interest income under scenarios of uncorrelated movements in rates, given the mix of pricing bases of assets and liabilities. The results of analysis are monitored by the CFO on a daily basis.

Unaudited Supplementary Financial Information (continued)

9. Risk management (continued)

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 for the Bank to be able, even under adverse market conditions, to meet all its maturing repayment obligations on time and to fund all of its investment 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. The Bank may also borrow in the short-term interbank markets, although it is typically a net lender of funds. In addition, the Bank may from time to time 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.

The Bank maintains a buffer portfolio of liquid, high quality securities that is managed by the Bank's Treasurer 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. 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 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 the ALCO, and also provides reporting and analytical services 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;
- 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.

Unaudited Supplementary Financial Information (continued)

9. Risk management (continued)

Capital Management

The major objective of capital management is to maximise the returns to shareholders with the requirement to maintain strong capital ratio and high debt ratings. We maintain our strong capital ratio through internal capital generation, and would consider adjusting the capital mix when appropriate. The ALCO 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. On consolidated basis, the Bank's unadjusted CAR and adjusted CAR incorporating market risk increased from 13.99% and 14.39% as at the end of last year to 14.66% and 14.87% respectively as at 30 June of this year. The main reasons were the increase in retained earnings on the one hand and decrease in loan commitments on the other. The ratios were well above the statutory minimum standards.

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 control, the Bank is to maintain adequate documentation of its business processes and operating procedures. 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 to meet the requirements of Basel Committee's New Capital Accord.

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