

Independent Auditor's Report



Ernst & Young
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To the members of BOC Hong Kong (Holdings) Limited

(Incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated financial statements of BOC Hong Kong (Holdings) Limited (the "Company") and its subsidiaries (the "Group") set out on pages 125 to 282, which comprise the consolidated balance sheet as at 31 December 2016, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the *HKICPA's Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matters:	How our audit addressed the key audit matters:
<p><i>Impairment assessment of advances to customers</i></p> <p>Refer to summary of significant accounting policies in Note 2.14, critical accounting estimates and judgements in applying accounting policies in Note 3.1, and disclosures on credit risk and loan impairment allowances respectively in Note 4.1 and Note 26 to the financial statements.</p> <p>As at 31 December 2016, gross advances to customers amounted to HK\$973,071 million, representing 41.80% of total assets; and the impairment allowance for advances to customers amounted to HK\$3,124 million. The assessment of impairment for advances to customers involved significant management judgements and estimates of the losses incurred within the loan portfolios at the reporting date.</p> <p>The Group adopted an individual impairment assessment approach in respect of individually significant loans or impaired loans; and a collective impairment assessment approach in respect of loans not individually significant or not individually impaired. Under the collective approach, the assessment of future cash flows for loan portfolios was based on the historical loss experience of loans with similar credit risk characteristics, with adjustments based on economic factors and judgemental overlays. Parameters associated with the historical loss experience included probability of default, loss given default and loss identification period.</p>	<p>We obtained an understanding of the Group's credit policy and evaluated and tested the design and the operating effectiveness of the key controls over the processes of credit assessment, loan classification and loan impairment assessment. Our control testing on the loan impairment process included the identification of impairment indicators and assessment of the assumptions used in the individual and collective impairment models.</p> <p>In assessing the individually assessed impairment allowances made by the Group, we adopted a risk-based sampling approach for our loan review procedures. We selected samples based on risk characteristics of individual items including the industry and geographic location of the operations of borrowers, internal loan grading and past due history. We formed an independent view on the classification of the loans and the level of provisions recognised by the Group through reviewing the borrowers' detailed information about their financial performance, recoverable cash flows and valuation of collaterals, as well as re-calculating samples of discounted cash flows for the impaired loans.</p> <p>We assessed the collective impairment model, data input and related management's assumptions on the impact of macro-economic trends and judgemental overlays for the various types of loan portfolios. We evaluated these assumptions by considering various factors including the period of historical data used in the model, observable economic data, market information and specific industry trends. We also performed testing on the relevant data quality by sample checking to the relevant data source and re-computed management's calculation of the collective impairment.</p> <p>Furthermore, we evaluated and tested the design and operating effectiveness of the Group's key controls related to disclosures on credit risk in Note 4.1 to the financial statements.</p>

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Key audit matters:	How our audit addressed the key audit matters:
<p data-bbox="151 372 494 394"><i>Valuation of financial instruments</i></p> <p data-bbox="151 441 762 605">Refer to summary of significant accounting policies in Note 2.12, critical accounting estimates and judgements in applying accounting policies in Note 3.3, and disclosures on fair values of financial instruments in Notes 5.1 and 5.2 to the financial statements.</p> <p data-bbox="151 653 762 924">The Group has applied valuation techniques to determine the fair value of financial instruments that are not quoted in active markets. These valuation techniques, in particular those that include significant unobservable inputs, involve management using subjective judgements and assumptions. With different valuation techniques and assumptions applied, the valuation results can vary significantly.</p> <p data-bbox="151 972 762 1343">As at 31 December 2016, the Group's financial assets and liabilities measured at fair value amounted to HK\$662,708 million and HK\$62,660 million respectively, representing 28.47% and 2.99% of total assets and total liabilities respectively. Financial instruments which had significant unobservable inputs in the valuation, and hence were categorised within level 3 of the fair value hierarchy, involved a higher degree of uncertainty in their valuation. As at 31 December 2016, 77.03% and 0.83% of the Group's financial assets measured at fair value were categorised within level 2 and level 3, respectively.</p>	<p data-bbox="813 441 1444 573">We evaluated and tested the design and operating effectiveness of key controls related to the valuation of financial instruments, including independent price verification, independent model validation and approval.</p> <p data-bbox="813 620 1444 924">We focused on the valuation methodologies and assumptions of financial instruments that were classified as level 2 and level 3 in the fair value hierarchy. We involved our valuation specialists in evaluating the valuation techniques, inputs and assumptions through comparison with the valuation techniques that are commonly used in the market, the validation of observable inputs using external market data, and comparison with valuation outcomes obtained from various pricing sources.</p> <p data-bbox="813 972 1444 1103">We also evaluated and tested the design and operating effectiveness of the Group's key controls related to the fair value disclosures in Notes 5.1 and 5.2 to the financial statements.</p>

Key audit matters:	How our audit addressed the key audit matters:
<p><i>Recognition of deferred tax assets</i></p> <p>Refer to summary of significant accounting policies in Note 2.23, critical accounting estimates and judgements in applying accounting policies in Note 3.6, and disclosures on deferred taxation in Note 37 to the financial statements.</p> <p>As at 31 December 2016, the Group recognised deferred tax assets of HK\$430 million relating to temporary differences arising from impairment allowances and HK\$1,132 million relating to other temporary differences and tax credits. The majority of the other temporary differences and tax credits related to tax credits recoverable from the tax authorities in Hong Kong under double tax treaty arrangements, arising from withholding income taxes payable in other jurisdictions on certain interest income. Application on such tax credits will be made to the tax authorities in Hong Kong after the corresponding withholding income taxes payable is settled and evidenced by respective payment receipts issued from the corresponding tax authorities. These deferred tax assets, where required by accounting standards, were offset against and included within deferred tax liabilities as shown in Note 37 to the financial statements. The recognition of the deferred tax assets involved significant management judgements and assumptions, based upon the estimation of available tax credits and the possibility to recover such deferred tax assets recognised.</p>	<p>Our audit procedures included, amongst others, the involvement of our tax specialists to assist in evaluating the judgements and assumptions adopted by management to determine the recognition and recoverability of the deferred tax assets, in light of current tax laws. We also assessed management's estimates of the Group's entitlement to the tax credits and examined correspondences between the Group and relevant tax authorities.</p> <p>In addition, we also assessed the adequacy of disclosures in Note 37 to the financial statements with respect to compliance with HKAS 12 – Income Taxes.</p>

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Key audit matters:	How our audit addressed the key audit matters:
<p data-bbox="151 372 566 394"><i>Valuation of insurance contract liabilities</i></p> <p data-bbox="151 441 762 605">Refer to summary of significant accounting policies in Note 2.19, critical accounting estimates and judgements in applying accounting policies in Note 3.5, and disclosures on insurance contract liabilities in Note 38 to the financial statements.</p> <p data-bbox="151 653 762 817">As at 31 December 2016, the Group, through its consolidated subsidiary BOC Group Life Assurance Company Limited, had insurance contract liabilities amounting to HK\$86,534 million, representing 4.13% of the Group's total liabilities.</p> <p data-bbox="151 864 762 1198">The measurement of insurance contract liabilities involved significant judgements over uncertain future outcomes, mainly the estimated ultimate total settlement value of insurance contract liabilities, including any guarantees provided to policyholders. Economic assumptions, such as investment return and associated discount rates, and operating assumptions, such as mortality and morbidity, were the key inputs used to estimate these insurance contract liabilities as reported in the consolidated balance sheet.</p>	<p data-bbox="813 441 1444 674">We used our actuarial specialists to assist in the performance of our audit procedures. These included a review of the product features and the methodology used in valuing the insurance contract liabilities in accordance with the relevant regulations and accounting requirements. We also tested the internal controls performed by management over the valuation process.</p> <p data-bbox="813 722 1444 920">We also assessed the economic assumptions and operating assumptions used in the insurance contract liabilities valuation with reference to market data and policyholder experience and assessed the accuracy of the calculation of policy reserves through performing independent recalculation.</p> <p data-bbox="813 968 1444 1166">In addition, we assessed the validity of the Group's liability adequacy test under HKFRS 4 – Insurance Contracts. Our assessment included an evaluation of management's projected cash flows based on relevant product features. We tested the associated assumptions by comparing with industry experience data.</p>

Other information included in the Annual Report

The directors of the Company are responsible for the other information. The other information comprises the information included in the Annual Report, other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the consolidated financial statements

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors of the Company are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors of the Company either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors of the Company are assisted by the Audit Committee in discharging their responsibilities for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our report is made solely to you, as a body, in accordance with section 405 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.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSA's, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

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- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Tso Pui Sze.

The logo for Ernst & Young, featuring the company name in a stylized, cursive script.

Ernst & Young

Certified Public Accountants

Hong Kong, 31 March 2017