

NOTES TO THE ACCOUNTS

1. ACTIVITIES AND CORPORATE AFFILIATION

The Bank, through its branches and subsidiaries, provides a range of banking, financial and related services.

The ultimate holding company of the Bank is Arab Banking Corporation (B.S.C.) which is incorporated in the State of Bahrain and operates as an offshore bank.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

These accounts have been prepared in accordance with all applicable Statements of Standard Accounting Practice and Interpretations issued by the Hong Kong Society of Accountants, accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance.

These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and the recommendations in the Guideline “Financial Disclosures by Locally Incorporated Authorised Institutions” issued by the Hong Kong Monetary Authority. A summary of the significant accounting policies adopted by the Group is set out below.

(b) Basis of preparation of the accounts

The measurement basis used in the preparation of the accounts is historical cost modified by the revaluation of premises in 1989, and the marking to market of certain investments in securities as explained in the accounting policies set out below.

(c) Basis of consolidation

The consolidated accounts include the accounts of the Bank and all its subsidiaries made up to 31 December each year. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from or to the date of their acquisition or disposal, as appropriate. All material intercompany transactions are eliminated on consolidation.

(d) Investments in subsidiaries

A subsidiary is a company in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the composition of the board of directors.

Investments in subsidiaries in the Bank's balance sheet are stated at cost less any provisions for diminution in value which are other than temporary as determined by the directors for each subsidiary individually. Any such provisions are recognised as an expense in the profit and loss account.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(e) **Associated companies**

An associated company is a company in which the Group or the Bank has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

Investments in associated companies are stated at cost less any provisions for diminution in value which is other than temporary as determined by the directors for each associated company individually. The results of the associated companies are included in the Group's and the Bank's profit and loss account to the extent of dividends received and receivable, providing the dividend is in respect of a period ending on or before the accounts of the Group and the Bank are approved by the directors. The results and reserves of associated companies are not equity accounted for in the consolidated accounts as they are considered by the directors to be immaterial to the Group.

(f) **Advances to customers**

Advances are carried at amounts advanced less payments collected and reserves for credit losses. Provision for credit losses is charged to expense and is determined by the directors at a level deemed appropriate to absorb known risks in the loan portfolio. In addition, an amount is set aside as a general reserve for credit losses.

Sales of accounts receivable on mortgage loans without recourse to the Bank or its subsidiaries are recognised when control over the receivables has been irrevocably transferred to a third party and the receivables are then no longer included in the balance sheet.

Assets acquired in exchange for advances in order to achieve an orderly realisation are reclassified to other accounts. The assets acquired are recorded at the carrying value of the advance disposed of at the date of the exchange. Provisions, if necessary, are made to allow for net declines in the estimated fair value of the assets acquired.

(g) **Finance leases and hire purchase contracts**

The amounts due from lessees in respect of finance leases and hire purchase contracts are carried in the balance sheet as advances to customers at the amounts due from lessees in respect of finance leases and hire purchase transactions, net of unearned charges.

Finance income implicit in the rentals receivable is credited to the profit and loss account over the lease period so as to produce an approximately constant periodic rate of return on the net cash investment for each accounting period.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(h) Investments in securities

The Group's and the Bank's policies for investments in securities other than investments in subsidiaries and associated companies are as follows:

- i. Dated debt securities that the Group and/or the Bank have the ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are stated in the balance sheet at amortised cost less any provisions for diminution in value.

The carrying amounts of held-to-maturity securities are reviewed as at the balance sheet date in order to assess the credit risk and whether the carrying amounts are expected to be fully recovered. Provisions are made when carrying amounts are not expected to be fully recovered and are recognised as an expense in the profit and loss account, such provisions being determined for each investment individually.

- ii. Trading securities are stated in the balance sheet at fair value. Changes in fair value are recognised in the profit and loss account as they arise. Securities are presented as trading securities when they were acquired principally for the purpose of generating a profit from short term fluctuations in price or dealer's margin.
- iii. Non-trading securities are stated in the balance sheet at fair value. Changes in fair value are recognised in the investment revaluation reserve until the security is sold, collected, or otherwise disposed of, or until there is objective evidence that the security is impaired, at which time the relevant cumulative gain or loss is transferred from the investment revaluation reserve to the profit and loss account.
- iv. Transfers from the investment revaluation reserve to the profit and loss account as a result of impairments are reversed when the circumstances and events that led to the impairment cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.
- v. Profits or losses on disposal of investments in securities are accounted for in the profit and loss account as they arise. In the case of non-trading securities, the profit and loss includes any amount previously held in the investment revaluation reserve in respect of that security.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Fixed assets

Fixed assets are stated at cost or valuation less depreciation calculated to write off the assets over their estimated useful lives on a straight line basis at the following annual rates:

Leasehold land	over the remaining lease period
Long-term leasehold properties	2% on value of building
Computer equipment and software	14% to 25%
Motor vehicles	25%
Furniture and equipments	20%
Fixtures in long-term leasehold properties	10%
Fixtures in rented properties	over the lease period

Certain of the Group's leasehold land and long-term leasehold properties have been included at Directors' valuation made having regard to independent professional valuations carried out in November 1989. The surplus arising on revaluation was credited to the revaluation reserve. Additions to revalued premises made subsequent to the revaluation are included at cost. Premises which have not been the subject of revaluation are included at cost. The revaluation reserve arising from the November 1989 revaluation was transferred to capital redemption reserve when the Bank redeemed its "A" and "B" preference shares in June 1991. On disposal of premises, the profit and loss is determined as the difference between the net sales proceeds and the carrying amount.

In preparing these accounts, advantage has been taken of the transitional provisions in paragraph 72 of Statement of Standard Accounting Practice 17 'Property, Plant and Equipment' issued by the Hong Kong Society of Accountants with the effect that premises have not been revalued to fair value at the balance sheet date. It is not the Directors' present intention to revalue the premises in the future.

(j) Revenue recognition

Interest income and expenses are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable. Fee income and expenses are recognised when earned or incurred.

Interest income from dated debt securities intended to be held to maturity is recognised as it accrues, as adjusted by the amortisation of the premium or discount on acquisition, so as to achieve a constant rate of return over the period from the date of purchase to the date of maturity.

Dividend income is recognised as follows:

- dividends from listed investments are recognised when the share price of such investments is quoted ex-dividend; and

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(j) Revenue recognition *(continued)*

- Interim dividends from unlisted investments are recognised when the directors of the investee companies declare such dividends; final dividends from unlisted investments are recognised when the shareholders of the investee companies approve the dividends proposed by the directors at the general meeting.

(k) Operating leases

Operating lease payments on rented properties and other equipment are dealt with in the profit and loss account on a straight line basis over the period of the lease.

(l) Deferred taxation

Deferred taxation is provided under the liability method for all significant timing differences in the recognition of revenue and expense for tax and financial reporting purposes, except where it is considered to be probable that the tax effects of such deferrals will continue in the foreseeable future. Future deferred tax benefits are not recognised unless their realization is assured beyond reasonable doubt.

(m) Foreign currency

Transactions in foreign currencies during the year are translated into Hong Kong dollars at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates ruling at the balance sheet date. Exchange gains and losses are included in the profit and loss account.

(n) Off-balance sheet financial instruments

Off-balance sheet financial instruments arise from future, forward, swap and option transactions undertaken in the foreign exchange and interest rate markets. The accounting for these instruments is dependent upon whether the transactions are undertaken for trading purposes, hedging purposes or as part of the management of asset and liability portfolios. Trading transactions are valued at the relevant rates ruling at the balance sheet date and the net unrealised gains or losses arising therefrom are dealt with in the profit and loss account. Transactions designated as hedges are valued on an equivalent basis to the assets, liabilities or net positions which they are hedging. Any profit or loss is recognised on the same basis as that arising from the related assets, liabilities or net positions. Interest rate swap transactions undertaken as part of the management of asset and liability portfolios are separately identified and interest income or expense arising therefrom is netted-off against the related income or expense on the on-balance sheet items that these transactions are hedging.

(o) Related parties

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

3. OTHER OPERATING INCOME

	The Group	
	2000	1999
	<i>HK\$'000</i>	<i>HK\$'000</i>
Fee and commission income	120,018	82,919
Less: Fee and commission expense	(12,046)	(9,593)
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Net fee and commission income	107,972	73,326
Dividend income from listed investments	621	0
Dividend income from unlisted investments	1,300	1,319
Rental income less outgoings	7,033	3,236
Gain on foreign exchange trading	9,997	11,775
Net realised gain on disposal of non-trading securities	38,287	0
Net realised gain on disposal of held-to-maturity securities	5,513	0
Profit on disposal of fixed assets	2,275	53
Profit on disposal of a subsidiary (Note 34)	0	1,679
Others	32,054	27,197
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	205,052	118,585
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Included in the net realised gain on disposal of non-trading securities was a gain of HK\$35 million (1999: HK\$Nil) from the disposal of shares in Hong Kong Exchange and Clearing Limited, which were allotted as a result of the merger scheme.

4. OPERATING EXPENSES

(a) The major items making up the operating expenses are as follows:

	The Group	
	2000	1999
	<i>HK\$'000</i>	<i>HK\$'000</i>
Staff costs		
– Salaries and other costs	213,146	190,079
– Pension costs	12,277	11,810
Premises and other fixed assets		
– Rental of premises	18,068	11,645
– Depreciation	41,841	34,487
– Others	12,362	16,746
Auditors' remuneration	1,560	1,200
Other operating expenses	140,003	120,903
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	439,257	386,870
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4. OPERATING EXPENSES (continued)

- (b) Among the five individuals whose emoluments were the highest in the Group, two (1999: two) were directors of the Bank. The aggregate emoluments of the remaining three (1999: three) highest paid individuals were as follows:

	The Group	
	2000	1999
	HK\$'000	HK\$'000
Basic salaries and other allowances	6,171	6,719
Contributions to pension scheme	491	528
Bonuses	787	1,060
	<u>7,449</u>	<u>8,307</u>

- (c) The number of the three (1999: three) highest paid non-director employees of the Group whose total emoluments fell within the following defined bands are as follows:

	The Group	
	2000	1999
	HK\$'000	HK\$'000
HK\$1,500,001 – HK\$2,000,000	0	1
HK\$2,000,001 – HK\$2,500,000	2	0
HK\$3,000,001 – HK\$3,500,000	1	2

5. DIRECTORS' REMUNERATION

- (a) The aggregate remuneration of the directors disclosed pursuant to section 161 of the Hong Kong Companies Ordinance was as follows:

	The Group	
	2000	1999
	HK\$'000	HK\$'000
Directors' fees	612	448
Basic salaries and other allowances	13,054	10,658
Contributions to pension scheme	845	752
Discretionary bonuses	6,037	4,682
	<u>20,548</u>	<u>16,540</u>

5. DIRECTORS' REMUNERATION (continued)

Included in directors' remuneration were emoluments of HK\$1,861,350 (1999: HK\$1,256,405) paid to the independent non-executive directors during the year.

Certain amounts included in "Basic salaries and other allowances" and "Discretionary bonuses" in 1999 have been reclassified to conform with the current year presentation.

- (b) The number of directors of the Group whose total remuneration fell within the following defined bands are as follows:

	The Group	
	2000	1999
	HK\$'000	<i>HK\$'000</i>
HK\$nil – HK\$1,000,000	8	14
HK\$1,500,001 – HK\$2,000,000	1	0
HK\$3,000,001 – HK\$3,500,000	1	1
HK\$8,500,001 – HK\$9,000,000	0	0
HK\$9,000,001 – HK\$9,500,000	0	1
HK\$11,000,001 – HK\$11,500,000	1	0

6. CHARGE FOR BAD AND DOUBTFUL DEBTS

	The Group	
	2000	1999
	HK\$'000	<i>HK\$'000</i>
General Provision		
– trade bills (<i>Note 13</i>)	(34)	(57)
– advances to customers (<i>Note 14</i>)	10,501	(63,054)
	10,467	(63,111)
Specific Provision on advances to customers (<i>Note 14</i>)	183,747	436,944
	194,214	373,833

7. TAXATION

- (a) Taxation in the consolidated profit and loss account represents:

	The Group	
	2000	1999
	HK\$'000	HK\$'000
Provision for Hong Kong profits tax	31,138	6,275
Rebates	0	(8,273)
	<u>31,138</u>	<u>(1,998)</u>

Hong Kong profits tax has been provided at the rate of 16.0% (1999: 16%) on the estimated assessable profits for the year. The amount for 1999 also includes the tax rebate that was announced in the Financial Secretary's budget speech on 3 March 1999 which relates to the 1997/98 year of assessment, and which was received in 1999. The amounts of unprovided deferred tax liability as at 31 December 2000 and 1999 are not material.

- (b) Taxation in the balance sheets, which is included in "Accrued interest and other accounts" and "Other accounts and provisions", represents:

	The Group	
	2000	1999
	HK\$'000	HK\$'000
Provision for Hong Kong Profits Tax for the year	31,138	6,275
Provisional Profits Tax paid	(2,031)	(12,431)
	<u>29,107</u>	<u>(6,156)</u>
Balance of Profits Tax Provision relating to prior years	(65,905)	(55,068)
	<u>(36,798)</u>	<u>(61,224)</u>
Hong Kong Profits Tax recoverable	(39,218)	(62,218)
Provision for Hong Kong Profits Tax	2,420	994
	<u>(36,798)</u>	<u>(61,224)</u>

7. TAXATION *(continued)*

	The Bank	
	2000	1999
	HK\$'000	HK\$'000
Provision for Hong Kong Profits Tax for the year	18,561	0
Provisional Profits Tax paid	0	0
	<u>18,561</u>	<u>0</u>
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Balance of Profits Tax Provision relating to prior years	(55,368)	(55,368)
	<u>(36,807)</u>	<u>(55,368)</u>
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8. DIVIDENDS

	The Group	
	2000	1999
	HK\$'000	HK\$'000
Interim, paid, of 3.00 cents (1999: 2.00 cents) per share	35,165	23,443
Final, proposed, of 5.00 cents (1999: 3.00 cent) per share	58,608	35,165
	<u>93,773</u>	<u>58,608</u>
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9. EARNINGS PER SHARE

The earnings per share are calculated on earnings of HK\$244,388,000 (1999: HK\$23,838,000) and on the weighted average of 1,172,160,000 (1999: 1,172,160,000) shares in issue during the year. There were no convertible loan capital, options or warrants outstanding which would cause a dilution effect on the earnings per share.

10. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders includes a profit of HK\$134,372,800 (1999: HK\$58,861,000) which has been dealt with in the accounts of the Bank.