3. SIGNIFICANT ACCOUNTING POLICIES - continued

Taxation - continued

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in jointly controlled entities, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited to the income statement, 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 assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Operating leases

Rental costs under operating leases are charged to the income statement on a straight line basis over the lease term.

Financial derivative products

Financial derivative products, which include forward contracts, interest rate swaps and similar derivative products, are recognised on a trade date basis and are initially measured at cost. Financial derivative products outstanding at the year end, except for those designated as hedges, are valued at fair value, with unrealised gains and losses included in the income statement. Gains and losses related to those derivative products that are designated as hedges are dealt with in accordance with the accounting treatment applicable to the position hedged and there is no offsetting of assets and liabilities until the position is closed. To qualify as a hedge, the derivative is expected to be effective in reducing the price or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative are expected to be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. The financial derivative products of the Group are mainly used for hedging purposes.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Fiduciary assets

The assets of staff retirement benefits scheme and assets held in trust in a fiduciary capacity are not assets of the Group and accordingly are not included in the financial statements.

Retirement benefit costs

Payments to the Mandatory Provident Fund Scheme are charged as expenses as they fall due.

For defined benefit retirement schemes, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out every three years. Actuarial gains and losses which exceed 10% of the greater of the present value of the Group's pension obligations and the fair value of plan assets are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

(a) Business segments

For management purposes, the Group is currently organised into two operating divisions - corporate and retail banking, and treasury and foreign exchange activities. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, chequing facilities, mandatory provident fund services, provision of fixed deposits and savings accounts, credit card, insurance and personal wealth management services . The Group also provides fully automated telephone and internet banking services to its customers. Other financial services offered include remittance and money exchange, safe deposit boxes, auto pay and direct debit services.

Treasury activities mainly comprise inter-bank placement and deposit transactions, management of overall interest rate risk and liquidity of the Group and centralised cash management. Income from foreign exchange activities is generated from services provided to customers in the form of foreign exchange trading and forward contracts.

Other business activities of the Group include investment holding, securities trading, stockbroking, commodities and futures broking, other investment advisory services and property investment.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

(i) Segment information about these businesses for the year ended 31 December 2003 is presented below:

INCOME STATEMENT

	Corporate and retail banking HK$'000	Treasury and foreign exchange activities HK$'000	Other business activities HK$'000	Eliminations HK$'000	Consolidated HK$'000
Interest income from external customers	669,630	364,543	–	–	1,034,173
Interest expense to external customers	(357,850)	(6,145)	–	–	(363,995)
Inter-segment income *(Note)*	121,776	–	–	(121,776)	–
Inter-segment expense *(Note)*	–	(121,776)	–	121,776	–
Net income	433,556	236,622	–	–	670,178
Other operating income	89,546	34,270	90,024	–	213,840
Operating income	523,102	270,892	90,024	–	884,018
Charge for bad and doubtful debts	(62,803)	–	–	–	(62,803)
Net losses from disposal of property and equipment	(2,140)	(126)	(398)	–	(2,664)
Net gains from disposal of other securities	–	–	22,192	–	22,192
Provision for diminution in value of other investments	–	–	(7,809)	–	(7,809)
Operating expenses	(280,402)	(20,337)	(28,858)	–	(329,597)
Segment profit	177,757	250,429	75,151	–	503,337
Unallocated corporate expenses					(133,557)
Profit from operations					369,780
Share of results of jointly controlled entities			(2,000)		(2,000)
Profit from ordinary activities before taxation					367,780
Taxation					(56,305)
Net profit for the year					311,475

Note: Inter-segment pricing is charged at prevailing customer deposits interest rates.