(1) The Hong Kong Institute of Certified Public Accountants ("HKICPA") has issued a number of new Hong Kong Financial Reporting Standards ("HKFRSs") and Hong Kong Accounting Standards ("HKASs") and Interpretations, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has adopted the new HKFRSs and HKASs in the interim financial statements for the period end up to 30 June 2005 and these are as follows:

- **HKAS 17 Leases**

  Leasehold properties were previously stated in the balance sheet at their revalued amounts less subsequent accumulated depreciation and impairment losses, if any. In accordance with HKAS 17, where leasehold properties are held for own use and where the land and buildings elements can be allocated reliably at the inception of the leases, the land element should be treated as an operating lease. Where the two elements cannot be allocated reliably, leasehold properties should continue to be accounted for as finance leases and carried at fair value. As the total costs of acquiring most of the leasehold properties cannot be allocated reliably, they continue to be classified as finance leases. As such, the impact of adopting of HKAS 17 is insignificant.

- **HKAS 32 Financial Instruments: Disclosure and Presentation**
- **HKAS 39 Financial Instruments: Recognition and Measurement**

  The adoption of HKAS 32 and HKAS 39 has resulted in a change in accounting policy for recognition, measurement, de-recognition and disclosure of financial instruments, in particular, loans and advances and securities investment.

  Loans and Advances

  Provisions for bad and doubtful debts were made in prior periods having regard to both specific and general risks. The specific element of the provisions related to those loans and advances that were individually reviewed and specifically identified as bad or doubtful. The general element of the provisions related to those losses that, although not yet specifically identified, were known from experience to be present in the Bank's portfolio of loans and advances. On adoption of HKAS 32 and HKAS 39, impairment allowances for loans and advances are based on individual and collective impairment assessments. Where objective evidence of impairment exists, the recoverable amount of a loan is calculated as the present value of the expected future cash flows discounted using the original effective interest rate. The difference between the carrying amount and the recoverable amount is recognised as impairment and is charged to profit and loss. The individual impairment assessment applies to those loans that are reviewed individually for impairment. In determining the expected future cash flows of an impaired account that is reviewed individually, due considerations are given to the financial position of the borrower, current economic conditions and the value of the collateral in the open market. The collective impairment assessment applies to losses inherent in the portfolio of loans and advances the impairment of which cannot be individually identified yet. Evaluation is made on a portfolio basis by reference to credit risk characteristics that are indicative of borrowers' ability to pay all amounts in accordance with the contractual terms. Expected future cash flows of loans and advances that are assessed collectively for impairment are estimated on the basis of prior loan loss experience.

  Securities Investment

  Securities investment were classified into trading securities, held-to-maturity securities and other securities and were stated at fair value or amortised cost. On adoption of HKAS 32 and HKAS 39, securities are now classified into securities measured at fair value through profit and loss, held-to-maturity securities and available-for-sale securities. These securities should be accounted for on a fair value basis except for held-to-maturity securities which are carried at amortised cost. Gains and losses arising from changes in fair value for securities measured at fair value through profit and loss and available-for-sale securities are recognised in the profit and loss account and reserve account respectively.

  The changes in accounting policy on adoption of HKAS 39 are applied with effect from 1 January 2005. The opening balance sheet has been restated with net increases in total assets of HK$117,448,000, retained profits of HK$4,758,000, and regulatory reserves of HK$112,690,000. The relevant financial assets and liabilities are re-classified to suit the new definition and requirements of the accounting standard and disclosure requirements. Profit from operation for the current period is increased by HK$281,000.

- **HKAS 40 Investment Property**

  The adoption of HKAS 40 has resulted in a change in accounting policy for investment property. Changes in valuation of investment properties dealt with in an investment properties revaluation reserve previously are now recognised in the profit and loss account after the adoption of HKAS 40. The change in accounting policy was applied restrospectively. At 31 December 2004, the balance of investment properties revaluation reserves of HK$34,340,000 was transferred to retained profits. The revaluation movement for the current period is insignificant.

(2) Hong Kong profits tax is calculated at 17.5% (2004: 17.5%) of the estimated assessable profit for the period.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

(3) The calculation of earnings per share, basic and diluted, is based on the profit attributable to shareholders of HK$191,989,000 (2004: HK$175,858,000) and on 435,000,000 (2004: 435,000,000) ordinary shares in issue during the period.

(4) Risk management

The Group has established policies, procedures, and controls for measuring, monitoring and controlling risks arising from the banking and related financial services business. These policies, procedures, and controls are implemented by various committees and departments of the Group and are regularly reviewed by the Board of Directors. The internal auditors also play an important role in the risk management process by performing regular, as well as sporadic compliance audits.

The management of assets and liabilities of the Group is conducted under the guidance of the Asset and Liability Management Committee ("the ALCO"). The ALCO comprises executive directors and senior managers representing major operations of the Group. It holds weekly meetings, and more frequent meetings when required, to review and direct the relevant policies, and to monitor the bank-wide positions. The day-to-day management of the liquidity risk, foreign exchange, interest rate and other market risks, and the compliance with the ALCO policies are monitored by the Treasury Management and the Finance Departments with the assistance of various qualitative and quantitative analyses.

(i) Capital management

The Group has adopted a policy of maintaining a strong capital base to support its business growth. Capital adequacy ratio has remained at around 18% to 20% for the past five financial years, well above the statutory minimum ratio of 8%.

(ii) Credit risk

Credit risk is the risk that a customer or counter-party may fail to meet a commitment when it falls due.

The Group's lending policy sets out in detail the credit approval and monitoring mechanism, the loan classification system and provisioning policy, which is established in accordance with the requirements and provisions of the Banking Ordinance and the guidelines issued by the Hong Kong Monetary Authority.

Day-to-day credit management is performed by the Loans Committee with reference to the creditworthiness, and concentration risk of and the collateral pledged by the counterparties. Decisions made by the Loans Committee are reviewed regularly by the Executive Loans Committee comprising executive directors.

(iii) Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current obligations when they fall due.

The Group has laid down liquidity policy which is reviewed regularly by the Board of Directors, and the ALCO. This policy requires the Group to maintain a conservative level of liquid funds on a daily basis to ensure the availability of adequate liquid funds to meet all obligations, and the compliance with the statutory liquidity ratio requirement. The liquidity position is monitored through statutory liquidity ratio, loan-to-deposit ratio, maturity profile of assets and liabilities, and inter-bank transactions undertaken by the Group.

(4) Risk management - continued

(iv) Market risk

Market risk is the risk of losses in assets, liabilities and off-balance sheet positions arising from movements in market rates and prices.

Market risk arising from the trading book is considered immaterial, as the Group does not maintain significant positions of financial instruments leading to foreign exchange, interest rate, commodity and equity exposures. Structural foreign exchange exposure is explained further under (v) foreign exchange risk.

(v) Foreign exchange risk

The Group does not have any significant foreign exchange risk as foreign exchange dealing is minimal. Structural foreign exchange exposure arising from investments in foreign branches and subsidiaries is accounted for in the reserves account. Day-to-day foreign exchange management is performed by the Treasury Management Department within approved limits.

(vi) Interest rate risk

Interest rate risk is the risk that the Group's position may be adversely affected by the change in market interest rate.

The Group does not carry interest rate positions on its trading book. Interest rate risk arises primarily from the timing differences in the re-pricing of, and the different bases of pricing interest-bearing assets, liabilities and commitments, and from positions of non-interest bearing balances. Interest rate risk is monitored by regular sensitivity analyses of the net re-pricing gap and of different scenarios of pricing bases of assets and liabilities grouped with reference to their next contractual repricing date or maturity date.

(vii) Operational and legal risk

Operational risk is the risk of unexpected losses attributable to human error, systems failures, fraud, or inadequate internal controls and procedures.

Executive directors, department heads, in-house legal counsels, and internal auditors collaborate to manage operational and legal risks through proper human resources policies, delegation of authorities, segregation of duties, and timely and accurate management information. Senior management and the Audit Committee are accountable to the Board of Directors for maintaining a strong and disciplined control environment to provide reasonable assurance that the operational and legal risks are prudently managed.

A comprehensive contingency plan is available to ensure that key business functions continue and normal operations are restored effectively and efficiently in the event of business interruption.

(viii) Reputation risk

Reputation risk is the risk to earnings or capital rising from negative public opinion.

Reputation risk is managed by ensuring proper and adequate communications and public relation efforts to foster the reputation of the Group. A risk management mechanism guided by the senior management including executive directors and senior managers has been established to manage the media exposure, handle customers' and other relevant parties' complaints and suggestions, and to ensure that new business activities and agents acting on our behalf do not jeopardise our reputation.

(5) Business and geographical segments

(i) Business segments

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current 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, futures broking, other investment advisory services and property investment.

(a) Segment information about these businesses for the period ended 30 June 2005 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	384,292	283,886	–	–	668,178
Interest expense to external customers	(298,584)	(14,917)	–	–	(313,501)
Inter-segment income *(Note)*	109,311	–	–	(109,311)	–
Inter-segment expense *(Note)*	–	(109,311)	–	109,311	–
Net income	195,019	159,658	–	–	354,677
Other operating income	47,243	12,118	43,137	–	102,498
Operating income	242,262	171,776	43,137	–	457,175
Impairment losses and impairment allowances for impaired assets	(13,769)	–	–	–	(13,769)
Net (losses) gains from disposal of property and equipment	(831)	–	31	–	(800)
Net gain from disposal of available-for-sale securities	–	–	22,353	–	22,353
Operating expenses	(151,696)	(9,251)	(10,346)	–	(171,293)
Segment profit	75,966	162,525	55,175	–	293,666
Unallocated corporate expenses					(67,062)
Profit from operations					226,604
Share of results of jointly controlled entities			568		568
Profit from ordinary activities before taxation					227,172
Net taxation charge					(35,183)
Profit for the period					191,989

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

(5) Business and geographical segments - continued

(i) Business segments - continued

(b) Segment information about these businesses for the period ended 30 June 2004 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 (restated)
Interest income from external customers	337,807	164,686	–	–	502,493
Interest expense to external customers	(146,586)	(2,616)	–	–	(149,202)
Inter-segment income *(Note)*	44,562	–	–	(44,562)	–
Inter-segment expense *(Note)*	–	(44,562)	–	44,562	–
Net income	235,783	117,508	–	–	353,291
Other operating income	45,857	11,702	64,589	–	122,148
Operating income	281,640	129,210	64,589	–	475,439
Impairment losses and impairment allowances for impaired assets	(51,817)	–	–	–	(51,817)
Net (losses) gains from disposal of property and equipment	(46)	–	31	–	(15)
Net gain from disposal of other securities and an associate	–	–	1,176	–	1,176
Operating expenses	(133,288)	(9,272)	(11,109)	–	(153,669)
Segment profit	96,489	119,938	54,687	–	271,114
Unallocated corporate expenses					(69,553)
Profit from operations					201,561
Share of results of jointly controlled entities			5,500		5,500
Profit from ordinary activities before taxation					207,061
Net taxation charge					(31,203)
Profit for the period					175,858

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

(ii) Geographical segments

Geographical segmentation is analysed based on the locations of the principal operations of the branches and subsidiary companies responsible for reporting the results or booking the assets. For both six months ended 2004 and 2005, more than 90% of the Group's revenue and profit from ordinary activities before taxation were generated by assets booked by the principal operations of the branches and subsidiary companies located in Hong Kong.

(6) Other operating income

	6 months ended 30 June 2005 HK$'000	6 months ended 30 June 2004 HK$'000
Fees and commission income	**58,497**	64,822
Less: Fees and commission expenses	**(1,157)**	(1,557)
Net fees and commisssion income	**57,340**	63,265
Dividend income	**5,972**	19,939
Gains less losses from dealing in foreign currencies	**12,118**	11,703
Gross rental income from properties	**2,243**	2,140
Less: Outgoings	**(322)**	(338)
Net rental income	**1,921**	1,802
Safe deposit box rentals	**10,524**	10,184
Other banking services income	**14,416**	14,329
Others	**207**	926
	102,498	122,148

(7) Operating expenses

	6 months ended 30 June 2005 HK$'000	6 months ended 30 June 2004 HK$'000
Staff costs		
Salaries and other costs	**119,412**	111,868
Retirement benefits scheme contributions	**9,093**	7,653
Total staff costs	**128,505**	119,521
Depreciation and amortisation	**22,820**	20,923
Premises and equipment expenses, excluding depreciation		
Rentals and rates for premises	**20,868**	20,166
Others	**7,264**	5,324
Other operating expenses	**58,898**	57,288
	238,355	223,222

(8) Deposits from customers

	30 June 2005 HK$'000	31 December 2004 HK$'000
Demand deposits and current accounts	**2,280,945**	2,803,982
Savings deposits	**7,447,859**	8,954,061
Time, call and notice deposits	**27,988,893**	22,193,588
	37,717,697	33,951,631

(9) Purchase of a subsidiary

On 27 June 2005, the Group acquired 100% of the issued share capital of Chong Hing Insurance Company Limited (formerly known as "Liu Chong Hing Insurance Company Limited"), engaged in general insurance business, for the consideration and other cost of acquisition of HK$213,369,000. The net assets acquired are as follow:

	6 months ended 30 June 2005 HK$'000	6 months ended 30 June 2004 HK$'000
Placements with banks and other financial institutions maturing between one and twelve months	**90,410**	8,387
Advances and other accounts less provisions	**9,473**	3,326
Available for sale securities	**5,979**	–
Interest in jointly controlled entities	**21,000**	–
Property and equipment	**768**	6,319
Deferred tax liabilities	**–**	(232)
Provision for taxation	**(299)**	–
Other accounts and provisions	**(27,827)**	(1,142)
Shareholder's loan	**–**	(15,000)
Share of net assets before acquisition	**–**	(552)
	99,504	1,106
Goodwill (Negative goodwill) arising on consolidation	**113,865**	(641)
Shareholder's loan	**–**	7,500
Total purchase price paid, satisified in cash	**213,369**	7,965
Less: Cash and cash equivalents acquired	**(90,410)**	(8,387)
Net outflow (inflow) of cash and cash equivalents in respect of the purchase of a subsidiary	**122,959**	(422)

(10) Maturity profiles

The maturity profiles of certain assets and liabilities of the Group as at 30 June 2005 are analysed as follows:

	Repayable on demand HK$'000	Repayable within 3 months or less (except those repayable on demand) HK$'000	Repayable after 3 months but within 1 year HK$'000	Repayable after 1 year but within 5 years HK$'000	Repayable after more than 5 years HK$'000	Undated HK$'000	Total HK$'000
ASSETS							
Cash and short-term fund	1,361,232	10,501,265	98,926	59,759	19,994	–	12,041,176
Placements with banks and other financial institutions	–	2,170,413	155,426	–	–	–	2,325,839
Advances to banks and other financial institutions	–	19,527	38,000	–	–	–	57,527
Advances to customers	1,388,124	3,559,953	3,958,343	7,524,006	5,063,657	564,218	22,058,301
Debt securities							
– Securities measure at fair value through profit and loss	137,715	69,624	109,636	615,175	38,857	–	971,007
– Held-to-maturity securities	–	1,348,065	1,451,576	2,138,172	28,752	–	4,966,565
– Available for sale securities	–	–	38,468	78,141	97,797	–	214,406
	137,715	1,417,689	1,599,680	2,831,488	165,406	–	6,151,978
Certificates of deposit held	–	–	239,905	787,581	200,000	–	1,227,486
LIABILITIES							
Deposits and balances of banks and other financial institutions	4,159	1,190,397	–	–	–	–	1,194,556
Deposits from customers	9,733,961	26,736,660	1,134,980	112,096	–	–	37,717,697

(10) Maturity profiles - continued

The maturity profiles of certain assets and liabilities of the Group as at 31 December 2004 are analysed as follows:

	Repayable on demand HK$'000	Repayable within 3 months or less (except those repayable on demand) HK$'000	Repayable after 3 months but within 1 year HK$'000	Repayable after 1 year but within 5 years HK$'000	Repayable after more than 5 years HK$'000	Undated HK$'000	Total HK$'000
ASSETS							
Cash and short-term fund	699,814	12,712,567	114,931	69,635	10,000	–	13,606,947
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions	–	20,212	38,000	–	–	–	58,212
Advances to customers	1,401,718	3,450,550	3,164,119	7,027,496	4,788,574	457,762	20,290,219
Debt securities							
– Trading securities	79,282	123,819	31,407	–	–	–	234,508
– Held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
LIABILITIES							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,777,613	20,749,367	1,351,642	73,009	–	–	33,951,631