



Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended 31 December 2005

Standard Chartered Bank (Hong Kong) Limited
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Report of the directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2005.

Principal place of business

Standard Chartered Bank (Hong Kong) Limited (the "Bank") is a bank incorporated and domiciled in Hong Kong and has its registered office at 4 – 4A Des Voeux Road Central, Hong Kong.

Principal activities

The Bank is a licensed bank registered under the Hong Kong Banking Ordinance. The Bank's principal activities are the provision of banking and related financial services. The principal activities and other particulars of the Bank's subsidiaries are set out in note 18 to the financial statements.

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2005 and the state of the Bank and its subsidiaries' affairs as at that date are set out in the financial statements on pages 5 to 77.

The directors do not recommend any payment of dividend (2004: HK\$ Nil) in respect of the year.

Other movements in reserves are set out in note 32 to the financial statements.

Charitable donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$11 million (2004 : HK\$9 million).

Fixed assets

Details of movements in fixed assets are set out in note 20 to the financial statements.

Share capital

Details of the movements in the share capital of the Bank during the year are set out in note 31 to the financial statements.

Directors

The directors during the year and up to the date of this report are:

Executive directors

Peter David Sullivan

Julian Fong Loong Choon

Non-executive directors

Chow Chung Kong*, Chairman
Kaikhushru Shiavax Nargolwala
Michael Bernard DeNoma
Raymond Kwok Ping Luen*
Edgar Cheng Wai Kin*
Ma Xuezheng*
Norman Lyle* (appointed on 1 April 2005)

** Independent non-executive directors*

Mr Norman Lyle will retire in accordance with Article 109 of the Bank's Articles of Association at the forthcoming annual general meeting. Mr Lyle, being eligible, offers himself for re-election.

Directors' service contracts

The independent non-executive directors were appointed by the board of directors for a term of 3 years. Their remuneration is determined by the shareholders at the general meeting.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Peter David Sullivan, Julian Fong Loong Choon, Kaikhushru Shiavax Nargolwala and Michael Bernard DeNoma were granted options under these schemes.

Directors' rights to acquire shares

At no time during the year was the Bank, any of its holding companies, subsidiaries, or fellow subsidiaries, a party to any other arrangement to enable the directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate.

Directors' interests in contracts

No contract of significance to which the Bank, its holding companies, subsidiaries or fellow subsidiaries was a party and in which a director of the Bank had a material interest, subsisted at the end of the year or at any time during the year.

Compliance with Supervisory Policy Manual on Financial Disclosure by Locally Incorporated Authorised Institutions

The financial statements for the year ended 31 December 2005 have complied fully with the guideline on "Financial Disclosure by Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority ("HKMA").

Auditors

The financial statements have been audited by KPMG who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Bank is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

A handwritten signature in black ink, appearing to read "C K Chow". The signature is written in a cursive, flowing style.

Sir C K Chow
Chairman

Hong Kong, 2 March 2006

Auditors' report to the shareholders of Standard Chartered Bank (Hong Kong) Limited

(Incorporated in Hong Kong SAR with limited liability)

We have audited the financial statements on pages 5 to 77 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 financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements 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 Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances and to the circumstances of the Bank and its subsidiaries on a consolidated basis, 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 financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Bank and of the consolidated state of affairs of the Bank and its subsidiaries as at 31 December 2005 and of the consolidated profit and cash flows of the Bank and its subsidiaries for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants
Hong Kong, 2 March 2006

Consolidated income statement

For the year ended 31 December 2005

(Expressed in millions of Hong Kong dollars)

	Note	2005 HK\$'M	2004 (restated) HK\$'M
Interest income	3(a)	12,299	9,073
Interest expense	3(b)	(5,014)	(2,105)
Net interest income		<u>7,285</u>	<u>6,968</u>
Fee and commission income		3,353	3,259
Fee and commission expense		(631)	(734)
Net fee and commission income		2,722	2,525
Net trading gains	3(c)	747	585
Net income from financial instruments designated at fair value through profit or loss	3(d)	24	–
Net gains from disposal of available-for-sale securities	5	81	–
Other operating income	3(e)	83	77
		<u>3,657</u>	<u>3,187</u>
Total operating income		10,942	10,155
Staff costs		(2,251)	(2,313)
Premises and equipment expense		(803)	(761)
Others		(1,584)	(1,801)
Operating expenses	3(f)	<u>(4,638)</u>	<u>(4,875)</u>
Operating profit before impairment		6,304	5,280
Impairment losses on loans and advances	4(a)	(827)	–
Net charge for bad and doubtful debts	4(b)	–	(856)
Impairment losses on available-for-sale securities	4(c)	(5)	–
Profit before taxation		5,472	4,424
Taxation	6(a)	(931)	(725)
Profit after taxation		4,541	3,699
Profit attributable to minority interests		(5)	(4)
Profit attributable to shareholders	32	<u>4,536</u>	<u>3,695</u>

The notes on pages 12 to 77 form part of these financial statements.

Consolidated balance sheet as at 31 December 2005*(Expressed in millions of Hong Kong dollars)*

	Note	2005 HK\$'M	2004 (restated) HK\$'M
Assets			
Cash and balances with banks and other financial institutions	9	5,764	7,857
Placements with banks and other financial institutions	10	39,625	18,860
Hong Kong SAR Government certificates of indebtedness	11	19,321	19,681
Trading assets	12	19,773	16,416
Advances to customers	13(a)	168,876	169,689
Amounts due from immediate holding company	17	32,310	64,521
Amounts due from fellow subsidiaries	17	4,948	28
Available-for-sale securities	15	39,866	–
Non-trading securities	16	–	34,315
Interest in an associate	19	959	–
Fixed assets	20	2,807	1,541
Intangible assets	21	845	1,024
Deferred tax assets	26	121	137
Other assets		1,945	1,693
		<u>337,160</u>	<u>335,762</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	19,321	19,681
Deposits and balances of banks and other financial institutions	22	8,723	10,373
Deposits from customers	23	247,663	238,922
Trading liabilities	27	14,587	15,262
Financial liabilities designated at fair value through profit or loss	24	5,153	–
Debt securities issued	25	–	931
Certificates of deposit issued		5,178	10,525
Amounts due to immediate holding company	17	5,067	8,978
Amounts due to fellow subsidiaries	17	69	261
Current taxation		430	114
Deferred tax liabilities	26	25	24
Other liabilities	28	3,706	3,950
Dated capital notes	30	3,781	8,383
		<u>313,703</u>	<u>317,404</u>
Equity			
Share capital	31	3,901	3,878
Reserves	32	19,505	14,432
Shareholders' equity		23,406	18,310
Minority interests	32(d)	51	48
		<u>23,457</u>	<u>18,358</u>
		<u>337,160</u>	<u>335,762</u>

Approved and authorised for issue by the Board of Directors on 2 March 2006.

Sir C K Chow
Chairman

Julian Fong Loong Choon
Director

Peter David Sullivan
Director

Lai Wing Nga
Company Secretary

The notes on pages 12 to 77 form part of these financial statements.

Balance sheet as at 31 December 2005*(Expressed in millions of Hong Kong dollars)*

	Note	2005 HK\$'M	2004 (restated) HK\$'M
Assets			
Cash and balances with banks and other financial institutions	9	5,764	7,850
Placements with banks and other financial institutions	10	39,623	18,859
Hong Kong SAR Government certificates of indebtedness	11	19,321	19,681
Trading assets	12	19,764	16,416
Advances to customers	13(a)	168,262	169,051
Amounts due from immediate holding company	17	32,310	64,458
Amounts due from fellow subsidiaries	17	4,948	28
Amounts due from subsidiaries of the Bank	17	507	577
Available-for-sale securities	15	39,696	–
Non-trading securities	16	–	34,315
Investments in subsidiaries of the Bank	18	302	86
Interest in an associate	19	959	–
Fixed assets	20	2,806	1,535
Intangible assets	21	845	1,024
Deferred tax assets	26	121	137
Other assets		1,930	1,678
		<u>337,158</u>	<u>335,695</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	19,321	19,681
Deposits and balances of banks and other financial institutions	22	8,723	10,373
Deposits from customers	23	247,663	238,922
Trading liabilities	27	14,587	15,262
Financial liabilities designated at fair value through profit or loss	24	5,153	–
Debt securities issued	25	–	931
Certificates of deposit issued		5,178	10,525
Amounts due to immediate holding company	17	5,060	8,951
Amounts due to fellow subsidiaries	17	69	261
Amounts due to subsidiaries of the Bank	17	121	22
Current taxation		426	114
Other liabilities	28	3,663	3,911
Dated capital notes	30	3,781	8,383
		<u>313,745</u>	<u>317,336</u>
Equity			
Share capital	31	3,901	3,878
Reserves	32	19,512	14,481
Shareholders' equity		<u>23,413</u>	<u>18,359</u>
		<u>337,158</u>	<u>335,695</u>

Approved and authorised for issue by the Board of Directors on 2 March 2006.

Sir C K Chow
Chairman

Julian Fong Loong Choon
Director

Peter David Sullivan
Director

Lai Wing Nga
Company Secretary

The notes on pages 12 to 77 form part of these financial statements.

Consolidated statement of changes in equity For the year ended 31 December 2005

(Expressed in millions of Hong Kong dollars)

	Note	2005 HK\$'M	2004 (restated) HK\$'M
Total equity at 1 January			
Attributable to shareholders of the Bank		18,403	1,475
Minority interests	32(d)	48	48
		<u>18,451</u>	<u>1,523</u>
Prior year adjustments arising from changes in accounting policies:			
– HKAS 19		(93)	–
		<u>18,358</u>	<u>1,523</u>
As restated, before opening balance adjustments		18,358	1,523
Opening balance adjustments in respect of HKAS 39			
– attributable to shareholders		626	–
– attributable to minority interests		(2)	–
		<u>18,982</u>	<u>1,523</u>
At 1 January, after prior year and opening balance adjustments		<u>18,982</u>	<u>1,523</u>
Prior year adjustments arising from changes in accounting policies:			
– HKAS 19		–	(93)
Hedging reserve			
– effective portion of changes in fair value		(41)	–
– deferred tax		7	–
Available-for-sale securities			
– changes in fair value		(113)	–
– transfer to income statement on disposal		6	–
– deferred tax		13	–
Actuarial gains on defined benefits plan		62	–
Non-trading securities			
– changes in fair value		–	98
– deferred tax		–	(17)
		<u>(66)</u>	<u>(12)</u>
Net losses recognised directly in equity		(66)	(12)
Profit attributable to shareholders of the Bank		4,536	3,720
Profit attributable to minority interests		5	4
Net profit for the year, before restatement		4,541	3,724
Prior year adjustments arising from changes in accounting policies:			
– HKFRS 2		–	(25)
		<u>4,541</u>	<u>3,699</u>
Net profit for the year, as restated		4,541	3,699

Total recognised income and expense for the year attributable to:

– shareholders of the Bank (restated)	4,470	3,683
– minority interests	5	4
	4,475	3,687
Dividends declared attributable to		
– shareholders of the Bank	–	(5)
– minority interests	–	(4)
Dividends declared during the year	–	(9)
Prior year adjustments arising from changes in accounting policies:		
– HKFRS 2	–	25
Issue of preference shares	–	3,800
Issue of ordinary shares	23	78
Premium received on shares issued	–	12,500
Movement in reserves arising from Hong Kong Incorporation	–	(3,246)
Capitalisation of share premium	(23)	–
Movements in shareholders' equity arising from capital transactions with shareholders	–	13,157
Total equity at 31 December	<u>23,457</u>	<u>18,358</u>
Restatements of total recognised income and expense for the year are attributable to:		
Equity shareholders of the Bank		(118)
Minority interests		–
		<u>(118)</u>
Arising from restatements of:		
Net losses recognised directly in equity		(93)
Net profit for the year		(25)
		<u>(118)</u>

The notes on pages 12 to 77 form part of these financial statements.

Consolidated cash flow statement

For the year ended 31 December 2005

(Expressed in millions of Hong Kong dollars)

	Note	2005 HK\$'M	2004 HK\$'M
Operating activities			
Profit before taxation		5,472	4,424
Adjustments for:			
Charge for bad and doubtful debts		–	856
Impairment losses on loans and advances and available-for-sale securities		832	–
Advances written off net of recoveries		(676)	(955)
Unwinding of discount on loan impairment losses		(22)	–
Gain on disposal of fixed assets		–	(16)
Depreciation		219	190
Amortisation of goodwill		–	38
Amortisation of intangible assets		221	321
Interest expense on dated capital notes		163	110
Equity-settled share-based payment expenses		–	25
Amortisation and exchange movement of dated capital notes		(7)	–
		6,202	4,993
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		1,987	423
Trading assets		(3,164)	(3,967)
Available-for-sale securities		(39,846)	–
Gross advances to customers		2,870	(6,804)
Amounts due from immediate holding company and fellow subsidiaries		14,298	(17,319)
Non-trading securities		34,315	2,016
Other assets		(279)	(825)
Increase/(decrease) in operating liabilities:			
Deposits and balances from banks and other financial institutions		(2,053)	(3,482)
Deposits from customers		12,397	20,088
Certificates of deposit issued		(5,347)	(4,637)
Financial liabilities designated at fair value through profit or loss		589	–
Debt securities issued		(36)	22
Amounts due to immediate holding company and fellow subsidiaries		(7,430)	(8,640)
Trading liabilities		(895)	3,670
Other liabilities		(281)	1,629
		13,327	(12,833)
Cash generated from / (used in) operations			
Tax paid			
Hong Kong profits tax paid		(666)	(816)
		12,661	(13,649)
Net cash generated from / (used in) operating activities		12,661	(13,649)

	Note	2005 HK\$'M	2004 HK\$'M
Investing activities			
Purchase of a subsidiary, net of cash and cash equivalents acquired		(287)	–
Payment for purchase of an associate		(959)	–
Payment for purchase of fixed assets		(1,485)	(524)
Payment for purchase of intangible assets		(76)	(73)
Proceeds from disposal of intangible assets		34	12
Proceeds from disposal of fixed assets		–	82
Net cash used in investing activities		<u>(2,773)</u>	<u>(503)</u>
Financing activities			
Proceeds from the issue of ordinary shares		–	78
Share premium received on shares issued		–	12,500
Proceeds from the issue of preference shares		–	3,800
Proceeds from the issue of dated capital notes		–	8,383
Payment arising from Hong Kong Incorporation		–	(3,246)
Dividends paid to shareholders of the Bank		–	(5)
Dividends paid to minority shareholders		–	(4)
Redemption of dated capital notes		(4,500)	–
Interest paid on dated capital notes		(260)	–
Net cash (used in) / generated from financing activities		<u>(4,760)</u>	<u>21,506</u>
Net increase in cash and cash equivalents		5,128	7,354
Cash and cash equivalents at 1 January	33	<u>47,386</u>	<u>40,032</u>
Cash and cash equivalents at 31 December	33	<u>52,514</u>	<u>47,386</u>
Cash flows from operating activities include:			
Interest received		11,998	9,032
Interest paid		(4,621)	(2,053)
Dividends received		19	12

The notes on pages 12 to 77 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

The principal activities of Standard Chartered Bank (Hong Kong) Limited (“the Bank”) and its subsidiaries are the provision of banking and related financial services.

2 Significant accounting policies

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKAS”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance.

(b) Basis of preparation of the financial statements

(i) Hong Kong Incorporation

Standard Chartered Bank (Hong Kong) Limited was incorporated with limited liability on 12 December 2003 under the Hong Kong Companies Ordinance (Cap. 32) as a non-private company (registered number 875305). On 4 March 2004, it obtained a banking licence from the HKMA. From the date of incorporation to 30 June 2004 it did not carry out any operations.

On 1 July 2004, the Bank acquired the businesses of Manhattan Card Company Limited (“MCCL”), Standard Chartered Finance Limited (“SCF”), Standard Chartered International Trade Products Limited (“SCITP”) and Chartered Capital Corporation Limited (“CCC”) for cash payments equal to their respective book values at that date. The business of the Hong Kong SAR branch of Standard Chartered Bank (“SCB”) was acquired by the Bank in exchange for the issuance of ‘B’ ordinary shares.

The mechanisms by which the Bank acquired these businesses were the Standard Chartered Bank (Hong Kong) Limited (Merger) Ordinance (a Hong Kong SAR private ordinance), an Order of the High Court of Justice in England and Wales (pursuant to a scheme under Part VII of the English Financial Services and Markets Act 2000), and through bilateral agreements.

In accordance with the provisions of the Standard Chartered Bank (Hong Kong) Limited (Merger) Ordinance, the businesses including their subsidiaries and the properties, reserves and liabilities of the Hong Kong SAR branch of SCB and of MCCL, SCF, SCITP and CCC were transferred to the Bank on 1 July 2004 at their carrying values in their financial statements immediately prior to the transfer.

(ii) Basis of Preparation

These financial statements are prepared in accordance with HKFRSs. In accordance with the HKAS 27 “Consolidated and Separate Financial Statements”, the financial statements have been prepared on a consolidated basis. The 2004 comparative figures are restated so that they are presented on the same basis under Hong Kong Financial Reporting Standards with the exception of HKAS 39 “Financial Instruments: recognition and measurement” which was adopted prospectively commencing 2005 as required by the transitional rules.

(iii) Consolidated Financial Statements

During the year, the Bank had subordinated debt in issue. These were issued under a note issuance programme which is listed on both the Stock Exchange of Hong Kong and the London Stock Exchange. Consequently, the Bank is now required to produce consolidated financial statements following the issue of HKAS 27 "Consolidated and Separate Financial Statements". These financial statements have been prepared on the basis that the entities referred to above (in the note on Hong Kong Incorporation) had always been part of the Bank. The comparative figures for 2004 are, therefore, an amalgamation of the results for the entities involved expressed on a full-year basis.

(iv) New and revised HKFRSs

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. The impacts of these changes are set out on note 42 where practicable. The accounting policies applied in each respective year are provided in the accounting policies set out below.

(c) Subsidiaries

Subsidiaries, in accordance with the Hong Kong Companies Ordinance, are companies in which the Bank holds directly or indirectly 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. Subsidiaries are considered to be controlled if the Bank has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Inter-company transactions, balances and unrealised gains are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

In the Bank's balance sheet, investments in subsidiaries are stated at cost less any impairment losses.

(d) Associates

Associates are all entities over which the Bank has significant influence but not control. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost.

The Bank's share of its associate's post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Bank's share of losses in an associate is equal to or exceeds its interest in the associate, including any other unsecured receivables, the Bank does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Bank and its associates are eliminated to the extent of the Bank's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In the Bank's balance sheet, the investment in an associate is stated at cost less any impairment losses.

(e) Intangible assets**(i) Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Bank's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition.

Up to 31 December 2004, goodwill was amortised to the income statement on a straight line basis over its estimated useful economic life of 20 years and was stated in the balance sheet at cost less accumulated amortisation and any impairment losses.

From 1 January 2005, goodwill is tested annually for impairment and carried at cost less accumulated impairment losses, if any. Goodwill is allocated to cash-generating units for the purpose of impairment testing.

(ii) Computer software

Computer software is grouped within intangible assets. Capitalised software is amortised to the income statement on a straight-line basis over its estimated useful economic life of 2 to 5 years and is stated in the balance sheet at cost less accumulated amortisation and any impairment losses.

(f) Investment properties

Investment properties are land and/or buildings which are owned either to earn rental income or for capital appreciation or for both. Investment properties are stated in the balance sheet at depreciated cost less impairment. Investment properties are depreciated over their estimated useful lives on a straight-line basis.

(g) Other property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Buildings are stated at cost less accumulated depreciation less impairment, if any.

Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings and leasehold improvements, the shorter of their estimated useful lives, being 50 years from the date of completion, and the unexpired terms of the lease.
- Equipment and motor vehicles, 3 to 15 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposals are included in the income statement.

(h) Leases

Where the Bank is the lessee

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the leases.

Where the Bank is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

(i) Financial assets and liabilities (other than derivatives)

From 1 January 2004 to 31 December 2004

Financial assets and liabilities were classified in the following categories: securities and advances to customers.

(i) Securities

Investment in securities, other than investments in subsidiaries, comprised trading securities and non-trading securities.

Trading securities, which were purchased for resale over a short period of time or for market making, were stated in the balance sheet at fair value. The fair value was based on the quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price was not available or the securities were not actively traded, the fair value was estimated using pricing models or discounted cash flow techniques. Changes in fair value were recognised in the income statement.

Non-trading securities were securities held for liquidity purposes or other securities not held for trading purposes and stated at fair value. The fair value was based on the quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price was not available or the securities are not actively traded, the fair value was estimated using pricing models or discounted cash flow techniques.

Changes in fair value were recognised in the non-trading investment reserve until the security was sold, collected, or otherwise disposed of, or until there was objective evidence that the security was impaired, at which time the relevant cumulative gain or loss was transferred from the non-trading securities revaluation reserve to the income statement.

Profits or losses on disposal of investments in securities were determined as the difference between the net disposal proceeds and the carrying amounts of the investments and were accounted for in the income statement as they arise. In the case of non-trading securities, the profit or loss included any amount previously held in the non-trading investment reserve in respect of that security.

(ii) Advances to customers

Advances to customers including trade bills were measured at the cash consideration at the time of drawdown and were stated in the balance sheet at the principal amounts outstanding net of any suspended interest and provisions for bad and doubtful debts. Cash rebates granted in relation to residential mortgage loans were charged to the income statement when incurred.

From 1 January 2005

Financial assets and liabilities are classified in the following categories: financial assets and liabilities at fair value through profit or loss, loans and receivables, and available-for-sale securities. Financial liabilities are classified as either at fair value through profit or loss, or at amortised cost. Management determines the classification of its financial assets and liabilities on initial recognition. Financial assets and liabilities are recognised initially at fair value plus transaction costs. Financial assets and liabilities are derecognised when the rights to receive cash flows from the financial assets have expired or when the Bank has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are recognised on a trade-date basis.

(i) Financial assets and liabilities at fair value through profit or loss

This category includes financial assets and liabilities held for trading, and those designated at fair value through profit or loss at inception. Changes in the fair value are included in the income statement in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the income statement. A financial asset or liability is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the receivable. These are recognised when cash is advanced to the customer. Loans and receivables are carried at amortised cost using the effective interest method less impairment.

(iii) Available-for-sale securities

Available-for-sale securities are those intended to be held for an indefinite period of time, which may be sold before maturity for various reasons. Available-for-sale securities are carried at fair value.

Gains and losses arising from changes in the fair value of available-for-sale securities are recognised directly in equity, until the securities are derecognised or impaired at which time the cumulative gains or losses previously recognised in equity should be recognised in profit or loss. However, interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity securities are recognised in the income statement when the Bank's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

(j) Derivative financial instruments and hedge accounting

From 1 January 2004 to 31 December 2004

Derivatives are valued with reference to market prices and the resultant profit or loss is included in the income statement, except where the position in the instrument has been designated as a hedge. The differences in marking hedges to market is dealt with in the same way as the accounting treatment applied to the position hedged.

Trading positions are valued at market rates, and non-trading positions are valued on the same basis as the items being hedged. Netting occurs where transactions with the same counterparty meet the following requirements: (1) the balances must be determinable and in freely convertible currencies, and (2) the Bank can insist on net settlement and this ability is beyond doubt.

From 1 January 2005

Derivatives are initially recognised at fair values on the date on which a derivative contract entered into and are subsequently re-measured at their fair values. Fair values are obtained from market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when their fair values are positive and as liabilities when their fair values are negative.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities, or commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Bank documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity. The adjustment to the carrying amount of a hedged security remains in retained earnings until the disposal of the hedged security.

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting

Derivative instruments that do not qualify for hedge accounting are categorised as held for trading. Changes in the fair value of these derivative instrument are recognised immediately in the income statement.

(k) Impairment of assets

(i) Impairment of financial assets

From 1 January 2004 to 31 December 2004

Loans were designated as non-performing as soon as management has doubts as to the ultimate recoverability of principal or interest or when contractual payments of principal or interest are 90 days overdue.

Provisions for bad and doubtful debts are held in respect of loans and advances. The provisions comprise two elements – specific and general.

Provisions against loans and advances are based on an appraisal of the loan portfolio. Specific provisions are made where the repayment of identified loans is in doubt and reflect an estimate of the amount of loss expected. The general provision is for the inherent risk of losses which, although they have not been separately identified, are known from experience to be present in any loan portfolio and to other material uncertainties where specific provisioning is not appropriate. The amount of the general provision reflects past experience and judgements about current conditions in particular locations or business sectors.

Provisions are applied to write off advances, in part or in whole, when they are considered wholly or partly irrecoverable.

Interest on loans and advances is accrued to income until such time as reasonable doubt exists about its collectability; thereafter, and until all or part of the loan is written off, interest continues to accrue on customers' accounts, but is not included in income. Such suspended interest is deducted from loans and advances on the balance sheet.

From 1 January 2005

Assets carried at amortised cost

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using observable market prices.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Assets carried at fair value

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment;
- intangible assets;
- investments in subsidiaries and associates; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated.

(l) Cash equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition, including cash and balances with other banks, treasury bills and other eligible bills and placement with other banks.

(m) Revenue recognition

(i) Interest income and expense

From 1 January 2004 to 31 December 2004

Interest income and expense were recognised in the income statement on a time-apportioned basis by reference to the principal outstanding and the rate applicable.

From 1 January 2005

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(ii) *Fees and commissions*

From 1 January 2004 to 31 December 2004

Fee and commission income was recognised when the corresponding service was provided, except where the fee was charged to cover the costs of a continuing service to, or risk borne for, the customer, or was interest in nature. In these cases, the fee was recognised as income in the accounting period in which the costs or risk was incurred accounted for as interest income.

From 1 January 2005

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

(n) *Income tax*

(i) *Income tax*

Income tax payable on profits for the period is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

(ii) *Deferred tax*

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates, and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred tax related to items which are charged or credited directly to equity, is credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss, subject to certain limited exceptions.

(o) *Provisions*

Provisions for restructuring costs and legal claims are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

(p) *Employee benefits*

(i) *Short term employee benefits*

Salaries, annual bonuses, and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Pension obligations

The Bank has defined contribution plans and defined benefit plans.

For defined contribution plans, the Bank pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Bank has no further payment obligations once the contributions have been paid.

The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Past service costs are recognised immediately to the extent that benefits are vested and are otherwise recognised over the average period until benefits are vested on a straight-line basis. Current service costs and any past service costs together with the expected return on plan assets less unwinding of the discount on the plan liabilities are charged to operating expenses.

Previously, in calculating the Bank's obligation results in respect of plan, if any cumulative unrecognised actuarial gain or loss exceeded ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion was recognised in profit or loss over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss was not recognised.

The Bank has early adopted "Amendment to HKAS19 Employee Benefits", which was adopted retrospectively. For defined benefit plans, the liability recognised in the balance sheet is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. Actuarial gains and losses that arise are recognised in shareholders' equity and presented in the statement of changes in equity in the period they arise.

(iii) Share-based compensation

The Standard Chartered PLC Group operates equity-settled share-based compensation plan in which the Bank's employees participate. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. For equity-settled awards, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable.

In order to comply with HKFRS 2, the Bank and its subsidiaries recognise the fair value of such share options as an expense. The new accounting policy has been applied retrospectively with comparatives restated. The impacts are set out in note 42.

(q) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates on transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Exchange gains and losses are dealt with in the income statement.

(r) Related parties

For the purposes of these financial statements, parties are considered to be related to the Bank and its subsidiaries if the Bank and its subsidiaries have 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 Bank and its subsidiaries and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Bank where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Bank or of any entity that is a related party of the Bank.

3 Operating profit

The operating profit for the year is stated after taking into account of the following:

	2005 HK\$'M	2004 HK\$'M
(a) Interest income		
Interest income on listed securities	320	220
Interest income on unlisted securities	1,177	765
Other interest income	10,802	8,088
	<u>12,299</u>	<u>9,073</u>
Other interest income includes the amount of interest income on unwinding of discount on loan impairment losses of HK\$22 million (note 14) for the year ended 31 December 2005.		
(b) Interest expense		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued and debt securities issued	4,851	1,995
Interest expense on dated capital notes	163	110
	<u>5,014</u>	<u>2,105</u>
(c) Net trading gains		
Gains less losses from dealing in foreign currencies	673	565
Gains less losses from trading securities	114	8
(Losses)/gains from other dealing activities	(40)	12
	<u>747</u>	<u>585</u>
(d) Net income from financial instruments designated at fair value through profit or loss		
Net realised and unrealised gains	24	–

(e) Other operating income

Dividend income from listed available-for-sale securities	3	1
Dividend income from unlisted available-for-sale securities	16	11
Gain on disposal of fixed assets	–	16
Others	64	49
	<u>83</u>	<u>77</u>

(f) Operating expenses

Staff costs		
– contributions to defined contribution plan	47	43
– current service costs in respect of defined benefits plan (note 29(d))	52	70
– equity-settled share-based payment expenses	75	67
– salaries and other staff costs	2,077	2,133
Depreciation (note 20(a))	219	190
Premises and equipment expense, excluding depreciation		
– rental of premises	346	337
– others	238	234
Amortisation		
– goodwill (note 21)	–	38
– other intangible assets (note 21)	221	321
Other computer costs	509	400
Auditors' remuneration	7	7
Others	847	1,035
	<u>4,638</u>	<u>4,875</u>

4 Impairment losses on loans and advances/net charge for bad and doubtful debts

	2005 HK\$'M	2004 HK\$'M
(a) Impairment losses on loans and advances		
Individual impairment provisions		
– additions (note 14)	1,229	–
– releases (note 14)	(124)	–
– recoveries (note 14)	(427)	–
	<u>678</u>	<u>–</u>
Portfolio impairment provisions		
– additions (note 14)	244	–
– releases (note 14)	(95)	–
	<u>149</u>	<u>–</u>
	<u>827</u>	<u>–</u>

(b) Net charge for bad and doubtful debts

Specific provisions		
– additions (note 14)	–	1,593
– releases (note 14)	–	(261)
– recoveries (note 14)	–	(223)
	<u>–</u>	<u>1,109</u>
	–	–
General provisions		
– additions (note 14)	–	9
– releases (note 14)	–	(262)
	<u>–</u>	<u>(253)</u>
	–	–
	<u>–</u>	<u>856</u>

(c) Impairment losses on available-for-sale securities

– additions	5	–
	<u>5</u>	<u>–</u>

5 Net gains from disposal of available-for-sale securities

	2005 HK\$'M	2004 HK\$'M
Profit arising in current year	87	–
Net revaluation loss transferred from reserves (note 32(a))	<u>(6)</u>	<u>–</u>
	<u>81</u>	<u>–</u>

6 Taxation in the consolidated income statement**(a) Taxation in the consolidated income statement represents:**

	2005 HK\$'M	2004 HK\$'M
<i>Current tax – Hong Kong Profits Tax</i>		
Provision for the year	976	724
Over-provision in respect of prior year	<u>–</u>	<u>(9)</u>
	976	715
<i>Deferred tax</i>		
(Reversal)/origination of temporary differences (note 26)	<u>(45)</u>	<u>10</u>
	<u>931</u>	<u>725</u>

The provision for Hong Kong Profits Tax for 2005 is calculated at 17.5% (2004: 17.5%) of the estimated assessable profits for the year.

(b) Reconciliation between tax expenses and accounting profit at applicable tax rates:

	2005 HK\$'M	2004 HK\$'M
Profit before taxation	5,472	4,424
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 17.5%	958	774
Tax effect of non-deductible expenses	36	42
Tax effect of non-taxable revenue	(57)	(60)
Over-provision in prior year	–	(9)
Others	(6)	(22)
Actual tax expense	931	725

7 Directors' remuneration

Directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

	<i>Bank</i>	
	2005 HK\$'M	2004 HK\$'M
Fees	2	1
Salaries and other emoluments	25	11
	27	12

The Bank had no operations in first half of 2004. The amount stated for the period ended 31 December 2004 therefore represented the remuneration for six months.

8 Segmental reporting

	<i>Consumer banking</i>		<i>Wholesale banking</i>		<i>Other banking</i>		<i>Consolidated Total</i>	
	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M
Total operating income	6,892	6,890	3,777	3,004	273	261	10,942	10,155
Total operating expenses	(2,887)	(3,121)	(1,691)	(1,623)	(60)	(131)	(4,638)	(4,875)
Operating profit	4,005	3,769	2,086	1,381	213	130	6,304	5,280
Impairment losses	(184)	(481)	(648)	(375)	–	–	(832)	(856)
	3,821	3,288	1,438	1,006	213	130	5,472	4,424
Segment assets	111,263	118,356	219,828	214,048	6,069	3,358	337,160	335,762
Segment liabilities	155,116	152,193	151,707	153,738	6,880	11,473	313,703	317,404
Depreciation and amortisation for the year	(199)	(267)	(150)	(225)	(91)	(57)	(440)	(549)
Capital expenditure incurred during the year	(55)	(37)	(110)	(86)	(1,396)	(474)	(1,561)	(597)

The Bank and its subsidiaries comprises two main business segments: Consumer Banking which provides financial services to customers including lending and deposit taking activities, credit card facilities and investment services; and Wholesale Banking which provides financial services to corporations and institutions, including lending and deposit taking activities, structured finance products, syndicated loans, cash management, investment advice, distributing fixed income and equity investments, interbank and capital market activities and foreign exchange transactions. The Bank and its subsidiaries comprise only one geographical segment as over 90% of the business is based in Hong Kong.

9 Cash and balances with banks and other financial institutions

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cash in hand	1,237	1,222	1,237	1,222
Balance with central bank	1,800	3,476	1,800	3,476
Balances with banks and other financial institutions	<u>2,727</u>	<u>3,159</u>	<u>2,727</u>	<u>3,152</u>
	<u>5,764</u>	<u>7,857</u>	<u>5,764</u>	<u>7,850</u>

10 Placements with banks and other financial institutions

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross placements with banks and other financial institutions				
– maturing within one month	31,775	11,121	31,775	11,121
– maturing between one month and one year	<u>7,850</u>	<u>7,739</u>	<u>7,848</u>	<u>7,738</u>
	<u>39,625</u>	<u>18,860</u>	<u>39,623</u>	<u>18,859</u>

11 Hong Kong SAR Government certificates of indebtedness and currency notes in circulation

The Hong Kong Special Administrative Region currency notes in circulation are secured by the deposit of funds in respect of which the Government of the Hong Kong Special Administrative Region certificates of indebtedness are held.

12 Trading assets

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities	16,064	9,934	16,064	9,934
Positive fair values of derivatives	3,004	6,076	2,995	6,076
Others	705	406	705	406
	<u>19,773</u>	<u>16,416</u>	<u>19,764</u>	<u>16,416</u>
Treasury bills (including Exchange Fund Bills)	8,640	7,183	8,640	7,183
Certificates of deposit held	3,238	170	3,238	170
Debt securities	4,186	2,581	4,186	2,581
	<u>16,064</u>	<u>9,934</u>	<u>16,064</u>	<u>9,934</u>
Issued by:				
Central governments and central banks	10,507	9,344	10,507	9,344
Public sector entities	111	106	111	106
Banks and other financial institutions	4,994	254	4,994	254
Corporate entities	452	230	452	230
	<u>16,064</u>	<u>9,934</u>	<u>16,064</u>	<u>9,934</u>
By place of listing:				
Listed in Hong Kong	1,867	2,173	1,867	2,173
Listed outside Hong Kong	55	–	55	–
	<u>1,922</u>	<u>2,173</u>	<u>1,922</u>	<u>2,173</u>
Unlisted (including Exchange Fund Bills)	14,142	7,761	14,142	7,761
	<u>16,064</u>	<u>9,934</u>	<u>16,064</u>	<u>9,934</u>

13 Advances to customers**(a) Advances to customers**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances to customers	165,730	167,431	165,114	166,791
Trade bills	5,835	5,310	5,835	5,310
	<u>171,565</u>	<u>172,741</u>	<u>170,949</u>	<u>172,101</u>
Less : Impairment losses				
– individually assessed (note 14)	(2,275)	–	(2,274)	–
– collectively assessed (note 14)	(414)	–	(413)	–
Less : Provisions for bad and doubtful debts				
– specific (note 14)	–	(2,267)	–	(2,267)
– general (note 14)	–	(785)	–	(783)
	<u>168,876</u>	<u>169,689</u>	<u>168,262</u>	<u>169,051</u>

(b) Advances to customers analysed by industry sector

The analysis of gross advances to customers by industry sector is based on the categories used by the Hong Kong Monetary Authority.

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances for use in Hong Kong				
<i>Industrial, commercial and financial</i>				
– Property development	3,140	3,181	3,140	3,181
– Property investment	17,171	14,769	17,171	14,769
– Financial concerns	8,010	9,192	8,010	9,192
– Stockbrokers	542	719	542	719
– Wholesale and retail trade	5,135	3,325	5,135	3,325
– Manufacturing	6,803	6,217	6,803	6,217
– Transport and transport equipment	2,956	3,601	2,340	2,963
– Others	4,726	5,611	4,726	5,611
<i>Individuals</i>				
– Advances for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	2,178	2,525	2,178	2,525
– Advances for the purchase of other residential properties	85,607	86,793	85,607	86,793
– Credit card advances	9,892	9,875	9,892	9,875
– Others	4,725	4,276	4,725	4,276
Total gross advances for use in Hong Kong	150,885	150,084	150,269	149,446
Trade finance	12,435	10,872	12,435	10,870
Gross advances for use outside Hong Kong	2,410	6,475	2,410	6,475
Gross advances to customers (note 13(a))	165,730	167,431	165,114	166,791

(c) Impaired / non-performing advances to customers

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to customers	2,919	–	2,918	–
Gross non-performing advances to customers	–	3,391	–	3,391
Impairment losses – individually assessed	(2,275)	–	(2,274)	–
Specific provisions for bad and doubtful debts	–	(2,267)	–	(2,267)
	644	1,124	644	1,124
As a % of total advances to customers				
– gross impaired advances to customers (including trade bills)	1.70%	–	1.71%	–
– gross non-performing advances to customers (including trade bills)	–	1.96%	–	1.97%

Impaired advances are individually assessed loans with objective evidence of impairment on an individual basis.

Non-performing advances are loans on which interest is being suspended or on which interest accrual has ceased.

Individually assessed impairment losses and specific provisions were made after taking into account the value of collateral in respect of such advances.

There were no impaired advances to banks and other financial institutions as at 31 December 2005 and 31 December 2004.

(d) Net investment in finance leases

Advances to customers include the net investment in equipment leased to customers under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end, are as follows:

	<i>Consolidated</i>					
	2005			2004		
	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	423	59	482	468	57	525
After 1 year but within 5 years	586	75	661	666	63	729
After 5 years	136	45	181	204	31	235
	<u>1,145</u>	<u>179</u>	<u>1,324</u>	<u>1,338</u>	<u>151</u>	<u>1,489</u>
Impairment losses:						
– individually assessed	(1)			–		
Provisions for bad and doubtful debts	–			(4)		
Net investment in finance leases	<u>1,144</u>			<u>1,334</u>		
	<i>Bank</i>					
	2005			2004		
	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	152	28	180	188	27	215
After 1 year but within 5 years	241	50	291	306	40	346
After 5 years	136	45	181	204	31	235
	<u>529</u>	<u>123</u>	<u>652</u>	<u>698</u>	<u>98</u>	<u>796</u>
Impairment losses:						
– individually assessed	(1)			–		
Provisions for bad and doubtful debts	–			(1)		
Net investment in finance leases	<u>528</u>			<u>697</u>		

14 Movement in impairment losses on advances to customers**Consolidated**

	<i>Individually assessed HK\$'M</i>	<i>2005 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2005	2,267	785	3,052
Opening balance adjustment in respect of HKAS 39	28	(520)	(492)
At 1 January 2005 (restated)	2,295	265	2,560
Amounts written off	(1,103)	–	(1,103)
Recoveries of advances written off in previous years (note 4(a))	427	–	427
New impairment losses charged to the income statement (note 4(a))	1,229	244	1,473
Impairment losses released to the income statement (note 4(a))	(551)	(95)	(646)
Unwind of discount on loan impairment losses (note 3(a))	(22)	–	(22)
At 31 December 2005 (note 13(a))	<u>2,275</u>	<u>414</u>	<u>2,689</u>

Bank

	<i>Individually assessed HK\$'M</i>	<i>2005 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2005	2,267	783	3,050
Opening balance adjustment in respect of HKAS 39	28	(518)	(490)
At 1 January 2005 (restated)	2,295	265	2,560
Amounts written off	(1,102)	–	(1,102)
Recoveries of advances written off in previous years	427	–	427
New impairment losses charged to the income statement	1,225	243	1,468
Impairment losses released to the income statement	(549)	(95)	(644)
Unwind of discount on loan impairment losses	(22)	–	(22)
At 31 December 2005 (note 13(a))	<u>2,274</u>	<u>413</u>	<u>2,687</u>

Consolidated

	<i>Specific HK\$'M</i>	<i>2004 General HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2004	2,113	1,038	3,151
Amounts written off	(1,178)	–	(1,178)
Recoveries of advances previously written off (note 4(b))	223	–	223
Charged to the income statement (note 4(b))	1,593	9	1,602
Released to the income statement (note 4(b))	(484)	(262)	(746)
At 31 December 2004 (note 13(a))	<u>2,267</u>	<u>785</u>	<u>3,052</u>

Bank

		2004	
	Specific HK\$'M	General HK\$'M	Total HK\$'M
Additions through business acquisitions	2,283	1,028	3,311
Amounts written off	(496)	–	(496)
Recoveries of advances previously written off	117	–	117
Charged to the income statement	592	–	592
Released to the income statement	(229)	(245)	(474)
	<u>2,267</u>	<u>783</u>	<u>3,050</u>
At 31 December 2004 (note 13(a))	<u>2,267</u>	<u>783</u>	<u>3,050</u>

15 Available-for-sale securities

	Consolidated		Bank	
	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M
Treasury bills (including Exchange Fund Bills)	8,836	–	8,836	–
Certificates of deposit held	479	–	479	–
Debt securities	30,252	–	30,252	–
Equity shares	304	–	134	–
	<u>39,871</u>	<u>–</u>	<u>39,701</u>	<u>–</u>
Less: Impairment losses	(5)	–	(5)	–
	<u>39,866</u>	<u>–</u>	<u>39,696</u>	<u>–</u>
Issued by:				
Central governments and central banks	12,728	–	12,728	–
Public sector entities	2,258	–	2,258	–
Banks and other financial institutions	23,608	–	23,438	–
Corporate entities	1,277	–	1,277	–
	<u>39,871</u>	<u>–</u>	<u>39,701</u>	<u>–</u>
By place of listing:				
Listed in Hong Kong	511	–	511	–
Listed outside Hong Kong	1,224	–	1,224	–
	<u>1,735</u>	<u>–</u>	<u>1,735</u>	<u>–</u>
Unlisted (including Exchange Fund Bills)	38,136	–	37,966	–
	<u>39,871</u>	<u>–</u>	<u>39,701</u>	<u>–</u>

Following the adoption of HKAS 39 in 2005, non-trading securities of HK\$34,315 million at 1 January 2005 were re-designated as available-for-sale securities.

Available-for-sale securities included HK\$2,273 million of securities that are issued by the immediate holding company.

16 Non-trading securities

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Treasury bills (including Exchange Fund Bills)	–	14,751
Certificates of deposit held	–	1,304
Debt securities	–	18,099
Equity shares	–	161
	<u>–</u>	<u>34,315</u>
Issued by:		
Central governments and central banks	–	20,216
Public sector entities	–	4,197
Banks and other financial institutions	–	8,967
Corporate entities	–	935
	<u>–</u>	<u>34,315</u>
By place of listing:		
Listed in Hong Kong	–	2,329
Listed outside Hong Kong	–	1,142
	<u>–</u>	<u>3,471</u>
Unlisted (including Exchange Fund Bills)	–	30,844
	<u>–</u>	<u>34,315</u>

17 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank**(a) The amounts due from immediate holding company, fellow subsidiaries and subsidiaries of the Bank represent:**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Balances with banks	1,046	4,139	1,046	4,139
Placements with banks	35,433	60,135	35,433	60,135
Advances	33	–	520	514
Other assets	746	275	766	275
	<u>37,258</u>	<u>64,549</u>	<u>37,765</u>	<u>65,063</u>
Immediate holding company	32,310	64,521	32,310	64,458
Fellow subsidiaries	4,948	28	4,948	28
Subsidiaries of the Bank	–	–	507	577
	<u>37,258</u>	<u>64,549</u>	<u>37,765</u>	<u>65,063</u>

The amounts due from immediate holding company, fellow subsidiaries and subsidiaries of the Bank are unsecured. HK\$35,466 million (2004: HK\$60,135 million) in the consolidated balance sheet and HK\$35,953 million (2004: HK\$60,649 million) in the Bank's balance sheet has fixed maturity and bears interest on normal commercial terms. The remaining balances are interest-free and repayable on demand.

(b) The amounts due to immediate holding company, fellow subsidiaries and subsidiaries of the Bank represent:

	Consolidated		Bank	
	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M
Balances from banks	3,111	3,582	3,111	3,582
Deposits from banks	1,708	5,050	1,708	5,050
Deposits from customers	47	214	168	236
Other liabilities	270	393	263	366
	<u>5,136</u>	<u>9,239</u>	<u>5,250</u>	<u>9,234</u>
Immediate holding company	5,067	8,978	5,060	8,951
Fellow subsidiaries	69	261	69	261
Subsidiaries of the Bank	—	—	121	22
	<u>5,136</u>	<u>9,239</u>	<u>5,250</u>	<u>9,234</u>

The amounts due to immediate holding company, fellow subsidiaries and subsidiaries of the Bank are unsecured. HK\$1,755 million (2004: HK\$5,264 million) in the consolidated balance sheet and HK\$1,876 million (2004: HK\$5,286 million) in the Bank's balance sheet has fixed maturity and bears interest on normal commercial terms. The remaining balances are interest-free and repayable on demand.

(c) Transactions with group companies:

During the year, the Bank and its subsidiaries entered into transactions with related parties in the ordinary course of its banking business including lending, acceptance and placement of inter-bank deposits, correspondent banking transactions, banking operation/outsourcing activities and off-balance sheet transactions.

(i) Consolidated

The amounts of material transactions during the year and outstanding balances at the end of the year are set out below:

	Immediate holding company		Fellow subsidiaries	
	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M
Income	<u>970</u>	<u>925</u>	<u>169</u>	<u>30</u>
Expense	<u>158</u>	<u>759</u>	<u>254</u>	<u>206</u>
	Immediate holding company		Fellow subsidiaries	
	2005 HK\$'M	2004 HK\$'M	2005 HK\$'M	2004 HK\$'M
Amounts due from group companies:				
At 1 January	<u>64,521</u>	<u>47,957</u>	<u>28</u>	<u>550</u>
At 31 December	<u>32,310</u>	<u>64,521</u>	<u>4,948</u>	<u>28</u>
Average balance during the year	<u>41,818</u>	<u>44,760</u>	<u>1,125</u>	<u>370</u>
Amounts due to group companies:				
At 1 January	<u>8,978</u>	<u>17,994</u>	<u>261</u>	<u>285</u>
At 31 December	<u>5,067</u>	<u>8,978</u>	<u>69</u>	<u>261</u>
Average balance during the year	<u>6,845</u>	<u>11,642</u>	<u>108</u>	<u>425</u>

(ii) *The Bank*

The amounts of material transactions during the year/period and outstanding balances at the end of the year are set out below:

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>		<i>Subsidiaries of the Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Income	970	656	169	–	6	5
Expense	158	576	254	105	4	–
	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>		<i>Subsidiaries of the Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from group companies:						
At 1 January 2005/1 July 2004	64,458	49,208	28	548	577	570
At 31 December	32,310	64,458	4,948	28	507	577
Average balance during the year/period	41,800	46,673	1,035	203	510	562
Amounts due to group companies:						
At 1 January 2005/1 July 2004	8,951	16,325	261	1,338	22	1
At 31 December	5,060	8,951	69	261	121	22
Average balance during the year/period	6,838	9,257	101	560	72	97

18 Investments in subsidiaries of the Bank

	<i>Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted shares, at cost less impairment losses, if any	302	86

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Bank and its subsidiaries. The class of shares held is ordinary unless otherwise stated.

<i>Name of company</i>	<i>Place of incorporation</i>	<i>Particulars of issued and paid up capital and securities</i>	<i>Proportion of ownership interest held by the bank</i>	<i>Principal activity</i>
C.E.C. Finance Limited	Hong Kong	12,800,000 shares of HK\$1 each	51%	Provision of instalment finance and hire purchase facilities
Standard Chartered Investment Services Limited	Hong Kong	1,500,000 shares of HK\$10 each	100%	Investment advisory services
Standard Chartered Asset Consulting Services Company Limited	The People's Republic of China	US\$1,330,000	100%	Consultancy services
SC Learning Limited	Hong Kong	2 shares of HK\$1 each	100%	Provision of learning solutions
SCL Consulting (Shanghai) Company Limited	The People's Republic of China	US\$140,000	100%*	Consultancy services
Standard Chartered APR Limited	United Kingdom	21,971,715 shares of US\$1 each	100%	Investment holdings
Horsford Nominees Limited	Hong Kong	10 shares of HK\$10 each	100%	Provision of nominee services
Korea First Finance Limited	Hong Kong	7,000 shares of US\$1,000 each	100%	In liquidation

* indirectly held

All of these in the list are controlled subsidiaries as defined under note 2(c) and have been consolidated into the consolidated financial statements.

19 Interest in an associate

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted shares, at cost less impairment losses, if any	959	—

The following list contains only the particulars of the associate which principally affected the results or assets of the Bank and its subsidiaries:

<i>Name of associate</i>	<i>Place of establishment and operation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest</i>	<i>Principal activity</i>
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	5,000,000,000 ordinary shares of RMB1 each	19.99%	Provision of banking and related financial services

Bohai commenced operations on 16 February 2006.

20 Fixed assets

(a) Consolidated

	2005				
	<i>Buildings held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2005	1,473	541	2,014	–	2,014
Additions	974	126	1,100	385	1,485
Disposals	(41)	(148)	(189)	–	(189)
At 31 December 2005	2,406	519	2,925	385	3,310
Accumulated depreciation:					
At 1 January 2005	146	327	473	–	473
Charge for the year (note 3(f))	79	132	211	8	219
Written back on disposals	(41)	(148)	(189)	–	(189)
At 31 December 2005	184	311	495	8	503
Net book value:					
At 31 December 2005	2,222	208	2,430	377	2,807
	2004				
	<i>Buildings held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2004	1,073	717	1,790	–	1,790
Additions	472	52	524	–	524
Disposals	(72)	(228)	(300)	–	(300)
At 31 December 2004	1,473	541	2,014	–	2,014
Accumulated depreciation:					
At 1 January 2004	104	413	517	–	517
Charge for the year (note 3(f))	51	139	190	–	190
Written back on disposals	(9)	(225)	(234)	–	(234)
At 31 December 2004	146	327	473	–	473
Net book value:					
At 31 December 2004	1,327	214	1,541	–	1,541

(b) Bank

	2005				
	<i>Buildings held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2005	1,473	532	2,005	–	2,005
Additions	974	126	1,100	385	1,485
Disposals	(41)	(146)	(187)	–	(187)
	<u>2,406</u>	<u>512</u>	<u>2,918</u>	<u>385</u>	<u>3,303</u>
At 31 December 2005	2,406	512	2,918	385	3,303
Accumulated depreciation:					
At 1 January 2005	146	324	470	–	470
Charge for the year	79	127	206	8	214
Written back on disposals	(41)	(146)	(187)	–	(187)
	<u>184</u>	<u>305</u>	<u>489</u>	<u>8</u>	<u>497</u>
At 31 December 2005	184	305	489	8	497
Net book value:					
At 31 December 2005	<u>2,222</u>	<u>207</u>	<u>2,429</u>	<u>377</u>	<u>2,806</u>
	2004				
	<i>Buildings held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
Additions through business acquisitions	1,017	681	1,698	–	1,698
Other additions	462	46	508	–	508
Disposals	(6)	(195)	(201)	–	(201)
	<u>1,473</u>	<u>532</u>	<u>2,005</u>	<u>–</u>	<u>2,005</u>
At 31 December 2004	1,473	532	2,005	–	2,005
Accumulated depreciation:					
Additions through business acquisitions	126	457	583	–	583
Charge for the year	26	62	88	–	88
Written back on disposals	(6)	(195)	(201)	–	(201)
	<u>146</u>	<u>324</u>	<u>470</u>	<u>–</u>	<u>470</u>
At 31 December 2004	146	324	470	–	470
Net book value:					
At 31 December 2004	<u>1,327</u>	<u>208</u>	<u>1,535</u>	<u>–</u>	<u>1,535</u>

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at cost		
– medium-term leases	2,191	1,283
– short leases	31	44
	<u>2,222</u>	<u>1,327</u>

The investment properties are stated at depreciated cost less impairment. The fair value of the investment properties as at 31 December 2005 was HK\$377 million which was based on an open market value basis calculated by reference to net rental income allowing for reversionary income potential. The valuations were carried out by an independent firm who has among its staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued.

21 Intangible assets

	<i>Consolidated and Bank</i>		
	<i>2005</i>		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2005	1,007	772	1,779
Opening balance adjustment to eliminate accumulated amortisation	–	(161)	(161)
At 1 January 2005 (restated)	1,007	611	1,618
Additions	76	–	76
Disposals	(370)	–	(370)
At 31 December 2005	<u>713</u>	<u>611</u>	<u>1,324</u>
Accumulated amortisation:			
At 1 January 2005	594	161	755
Opening balance adjustment to eliminate against cost	–	(161)	(161)
At 1 January 2005 (restated)	594	–	594
Charge for the year (note 3(f))	221	–	221
Written back on disposal	(336)	–	(336)
At 31 December 2005	<u>479</u>	<u>–</u>	<u>479</u>
Carrying amount:			
At 31 December 2005	<u>234</u>	<u>611</u>	<u>845</u>

	<i>Consolidated 2004</i>		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2004	1,094	772	1,866
Additions	73	–	73
Disposals	(160)	–	(160)
	<u>1,007</u>	<u>772</u>	<u>1,779</u>
At 31 December 2004	1,007	772	1,779
Accumulated amortisation:			
At 1 January 2004	421	123	544
Charge for the year (note 3(f))	321	38	359
Written back on disposal	(148)	–	(148)
	<u>594</u>	<u>161</u>	<u>755</u>
At 31 December 2004	594	161	755
Carrying amount:			
At 31 December 2004	<u>413</u>	<u>611</u>	<u>1,024</u>
		<i>Bank 2004</i>	
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
Additions through business acquisitions	1,109	772	1,881
Other additions	13	–	13
Disposals	(115)	–	(115)
	<u>1,007</u>	<u>772</u>	<u>1,779</u>
At 31 December 2004	1,007	772	1,779
Accumulated amortisation:			
Additions through business acquisitions	545	142	687
Charge for the period	164	19	183
Written back on disposal	(115)	–	(115)
	<u>594</u>	<u>161</u>	<u>755</u>
At 31 December 2004	594	161	755
Carrying amount:			
At 31 December 2004	<u>413</u>	<u>611</u>	<u>1,024</u>

In 2004, goodwill was amortised on a straight-line basis over 20 years. The amortisation of goodwill for the year was included in “operating expenses” in the income statement.

As explained further in note 2(e)(i), with effect from 1 January 2005 the Bank and its subsidiaries no longer amortise goodwill. In accordance with the transitional provisions set out in HKFRS 3, the accumulated amortisation of goodwill as at 1 January 2005 has been eliminated against the cost of goodwill as at that date.

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Bank and its subsidiaries' cash-generating units ("CGU") as follows:

	2005 HK\$'M	2004 HK\$'M
Credit cards and personal loans	611	611

The recoverable amount of the CGU is determined based on value in use calculations. These calculations use cash flow projections based on financial budgets covering one year approved by management and projections covering a twenty-year period extrapolated using the estimated rates stated below.

Key assumptions used for value-in-use calculations:

	2005 %
Growth rate	5.0
Discount rate	14.5

Management determined the budgeted gross margin based on past performance and its expectation for market development. The discount rate used is consistent with the cost of capital of the Bank and its subsidiaries.

22 Deposits and balances of banks and other financial institutions

	<i>Consolidated and Bank</i>	
	2005 HK\$'M	2004 HK\$'M
Deposits and balances of central bank	3,845	4,372
Deposits and balances of other banks	4,878	6,001
	<u>8,723</u>	<u>10,373</u>

23 Deposits from customers

	<i>Consolidated and Bank</i>	
	2005 HK\$'M	2004 HK\$'M
Demand deposits and current accounts	21,505	23,534
Savings deposits	96,649	118,787
Time, call and notice deposits	129,509	96,601
	<u>247,663</u>	<u>238,922</u>

24 Financial liabilities designated at fair value through profit or loss

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Structured customer deposits	4,254	–
Debt securities issued	899	–
	<u>5,153</u>	<u>–</u>

At 1 January 2005, the Bank and its subsidiaries designated on initial recognition HK\$5,482 million of financial liabilities at fair value through profit or loss upon the adoption of HKAS 39.

At 31 December 2005, the difference between the carrying amount and the contractual amount payable at maturity for the Bank and its subsidiaries amounted to HK\$45 million (Bank: HK\$45 million). This change is attributable to changes in market rates.

25 Debt securities issued

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Debt securities issued	–	931
	<u>–</u>	<u>931</u>

26 Taxation in the balance sheet***Deferred tax assets and liabilities:***

The components of gross deferred tax (assets)/liabilities recognised in the balance sheet and the movements during the year/period are as follows:

Consolidated

	<i>Depreciation allowances in excess of related depreciation</i>	<i>Impairment losses on financial assets</i>	<i>Others</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
<i>Deferred tax arising from:</i>				
At 1 January 2004 (restated)	92	(181)	(51)	(140)
(Credited)/charged to income statement (note 6(a))	(43)	44	9	10
Charged to reserves (note 32(a))	–	–	17	17
	<u>49</u>	<u>(137)</u>	<u>(25)</u>	<u>(113)</u>
At 31 December 2004 (restated)				
At 1 January 2005 (restated before opening balance adjustment)	49	(137)	(25)	(113)
– opening balance adjustment	–	91	(9)	82
– as restated after opening balance adjustment	49	(46)	(34)	(31)
(Credited)/charged to income statement (note 6(a))	(36)	(25)	16	(45)
Credited to reserves (note 32(a))	–	–	(20)	(20)
	<u>13</u>	<u>(71)</u>	<u>(38)</u>	<u>(96)</u>
At 31 December 2005				

Bank

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
Deferred tax arising from:				
Addition through business acquisitions	33	(179)	8	(138)
(Credited)/charged to income statement	(12)	42	–	30
Credited to reserves (note 32(b))	–	–	(29)	(29)
	<u>21</u>	<u>(137)</u>	<u>(21)</u>	<u>(137)</u>
At 31 December 2004 (restated)				
At 1 January 2005				
(restated before opening balance adjustment)	21	(137)	(21)	(137)
– opening balance adjustment	–	91	(7)	84
	<u>21</u>	<u>(46)</u>	<u>(28)</u>	<u>(53)</u>
– as restated after opening balance adjustment				
(Credited)/charged to income statement	(33)	(25)	10	(48)
Credited to reserves (note 32(b))	–	–	(20)	(20)
	<u>(12)</u>	<u>(71)</u>	<u>(38)</u>	<u>(121)</u>
At 31 December 2005				
	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Analysed by:				
Net deferred tax asset recognised on the balance sheet	(121)	(137)	(121)	(137)
Net deferred tax liability recognised on the balance sheet	25	24	–	–
	<u>(96)</u>	<u>(113)</u>	<u>(121)</u>	<u>(137)</u>

27 Trading liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Short positions in securities	10,491	9,264	10,491	9,264
Negative fair values of derivatives	3,214	5,754	3,214	5,754
Others	882	244	882	244
	<u>14,587</u>	<u>15,262</u>	<u>14,587</u>	<u>15,262</u>

28 Other liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Accrued charges	1,638	1,317	1,624	1,298
Negative fair values of hedging derivatives	165	–	165	–
Others	1,903	2,633	1,874	2,613
	<u>3,706</u>	<u>3,950</u>	<u>3,663</u>	<u>3,911</u>

29 Employee retirement benefits

The Bank makes contributions to a defined benefit retirement scheme (the “Scheme”) which covers 46% (2004: 53%) of the Bank’s employees. The Scheme is administered by a trustee, with the assets held separately from those of the Bank.

(a) The amounts recognised in the Bank and its subsidiaries’ balance sheet are as follows:

	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fair value of plan assets	1,415	1,237
Present value of wholly or partly funded obligations	<u>(1,377)</u>	<u>(1,296)</u>
Net asset/(liability) recognised in the balance sheet (included in “other assets” and “other liabilities”)	<u>38</u>	<u>(59)</u>

(b) Movements in the present value of the obligation:

	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
At the beginning of the year	1,296	1,162
Current service cost	94	91
Interest cost	50	59
Benefits paid	(67)	(104)
Actuarial losses on obligation	4	88
	<u>1,377</u>	<u>1,296</u>

(c) Movements in the fair value of assets:

	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
At the beginning of the year	1,237	1,016
Contributions	87	250
Expected return on assets	92	80
Benefits paid	(67)	(104)
Actuarial gains/(losses) on plan assets	66	(5)
	<u>1,415</u>	<u>1,237</u>

(d) Movements in the net asset/(liabilities) recognised in the Bank and its subsidiaries' balance sheet are as follows:

	2005 HK\$'M	2004 HK\$'M
At the beginning of the year	(59)	(146)
Contributions	87	250
Expense recognised in the income statement (note 3(f))	(52)	(70)
Actuarial gains/(losses) to pension reserve	62	(93)
	<u>38</u>	<u>(59)</u>

As at 31 December 2005, the Scheme did not invest in the Bank's own financial instruments and properties (2004: HK\$Nil). The Bank expects to contribute approximately HK\$70 million to the Scheme in 2006.

(e) The expense recognised in the consolidated income statement for the year is as follows:

	2005 HK\$'M	2004 HK\$'M
Current service cost	94	91
Interest cost	50	59
Actuarial expected return on plan assets	(92)	(80)
	<u>52</u>	<u>70</u>

The actual return on plan assets (taking into account all charges in the fair value of the plan assets excluding contributions paid and received) was a net income of HK\$158 million (2004: HK\$75 million).

(f) The principal actuarial assumptions used in the valuation are as follows:

	2005	2004
Discount rate	4.25%	4.00%
Expected rate of return on plan assets	6.50%	7.00%
Future salary increases	4.50%	4.50%

The expected return on Scheme is based on market expectation, at the beginning of the year, for the return net of administration costs, over the entire life of the related obligations.

(g) The major categories of assets as a percentage of total assets are as follows:

	2005	2004
Equities	53%	55%
Bonds	43%	42%
Cash	4%	3%
	<u>100%</u>	<u>100%</u>

30 Dated capital notes

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<i>Dated capital notes from immediate holding company</i>		
HK\$4,500 million 4.3% Notes 2009/2014	—	4,500
<i>Other dated capital notes</i>		
HK\$670 million Floating Rate Step-Up Notes 2014	669	669
HK\$500 million 3.5% Fixed/Floating Rate Step-Up Notes 2014	477	498
US\$350 million 4.375% Fixed/Floating Rate Step-Up Notes 2014	2,635	2,716
	<u>3,781</u>	<u>3,883</u>
	<u>3,781</u>	<u>8,383</u>

All dated capital notes are unsecured and subordinated to the claims of other creditors. The HK\$4,500 million 4.3% notes were repaid in full to the immediate holding company during the year.

31 Share capital

	<i>2005</i>		<i>2004</i>	
	<i>No. of shares in million</i>	<i>HK\$'M</i>	<i>No. of shares in million</i>	<i>HK\$'M</i>
<i>Authorised, issued and fully paid:</i>				
'A' ordinary shares of HK\$0.05 each	780	39	780	39
'B' ordinary shares of HK\$0.05 each	1,231	62	780	39
	<u>2,011</u>	<u>101</u>	<u>1,560</u>	<u>78</u>
Preference shares of HK\$1.00 each	3,800	3,800	3,800	3,800
	<u>5,811</u>	<u>3,901</u>	<u>5,360</u>	<u>3,878</u>

- (i) The Bank was incorporated with authorised share capital of HK\$1,000 which comprised 20,000 ordinary shares of HK\$0.05 each. On incorporation, the Bank issued share capital of HK\$0.10 which comprised 2 ordinary shares of HK\$0.05 each for cash consideration of HK\$2.
- (ii) On 13 February 2004, the authorised share capital was increased to HK\$1,000,000 by the creation of 19,980,000 additional ordinary shares of HK\$0.05 each in the capital of the Bank.
- (iii) On 18 February 2004, 18,781,740 ordinary shares of HK\$0.05 each were allotted to Standard Chartered Bank, the immediate holding company, for cash consideration of HK\$300,507,840.
- (iv) On 28 June 2004, the authorised share capital of the Bank increased from HK\$1,000,000 to HK\$3,878,000,000 and was reorganised into 780,000,000 class 'A' ordinary shares of HK\$0.05 each (including the conversion of the existing ordinary shares into 'A' ordinary shares), 780,000,000 class 'B' ordinary shares of HK\$0.05 each and 3,800,000,000 non-cumulative irredeemable preference shares of HK\$1.00 each.
- (v) On 28 June 2004, 761,218,258 'A' ordinary shares and 3,800,000,000 preference shares were allotted to Standard Chartered Bank at HK\$16.03 and HK\$1.00 each respectively. On 1 July 2004, 780,000,000 'B' ordinary shares were allotted at HK\$0.10 each as consideration for the transfer of the business of the Hong Kong SAR branch of Standard Chartered Bank.

- (vi) At the time of the acquisition by the Bank of the net assets of the Hong Kong SAR branch of Standard Chartered Bank, the precise valuation of these net assets had yet to be determined. The Bank agreed to issue further ordinary shares to reflect the amount of the final valuation. The Bank, therefore, issued, in accordance with the Articles of Association (Article 14(C)), an additional 451,315,097 'B' ordinary shares of HK\$0.05 each (an aggregate nominal value of HK\$22,565,754.85) to the existing holder of 'B' ordinary shares by capitalising the share premium account paid up on the ordinary shares in issue.

On 29 June 2005, the authorised share capital of the Bank was increased from HK\$3,878,000,000 to HK\$3,900,566,000 divided into 780,000,000 'A' ordinary shares of HK\$0.05 each, 1,231,320,000 'B' ordinary shares of HK\$0.05 each and 3,800,000,000 non-cumulative preference shares of HK\$1.00 each by the creation of an additional 451,320,000 new 'B' ordinary shares of HK\$0.05 each, ranking *pari passu* with the existing 'B' ordinary shares of the Bank.

On 29 June 2005, 451,315,097 'B' ordinary shares of HK\$0.05 each were allotted to Standard Chartered Sherwood (HK) Limited by capitalising HK\$22,565,754.85 from the share premium account paid up on the ordinary shares in issue.

- (vii) The preference shares bear a non-cumulative preferential dividend at a rate of 8.25% per annum on their nominal amount and rank in priority to the 'A' ordinary shares and the 'B' ordinary shares with respect to the payment of dividends and any return of capital. The 'B' ordinary shares rank in priority to the 'A' ordinary shares with respect to any return of capital.
- (viii) During the year, the Bank made no repurchase of its own shares.

32 Reserves**(a) Consolidated**

	Attributable to equity shareholders of the Bank						
	Share premium HK\$'M	Property revaluation reserve HK\$'M	Hedging reserve HK\$'M	Available- for-sale/ non-trading	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
				investment reserve HK\$'M			
At 1 January 2004	1,625	3	–	(110)	–	(412)	1,106
Changes in fair value of non-trading securities	–	–	–	98	–	–	98
Dividends declared in respect of the current year (restated)	–	–	–	–	–	(5)	(5)
Deferred tax charged (note 26)	–	–	–	(17)	–	–	(17)
Capital contribution from immediate holding company in respect of share option schemes (restated)	–	–	–	–	–	25	25
Actuarial losses on defined benefits plan (restated)	–	–	–	–	(93)	–	(93)
Issue of 'A' ordinary shares	12,461	–	–	–	–	–	12,461
Issue of 'B' ordinary shares	39	–	–	–	–	–	39
Movement of reserves arising from Hong Kong Incorporation	(1,625)	–	–	–	–	(1,252)	(2,877)
Profit for the year (restated)	–	–	–	–	–	3,695	3,695
At 31 December 2004 (restated)	<u>12,500</u>	<u>3</u>	<u>–</u>	<u>(29)</u>	<u>(93)</u>	<u>2,051</u>	<u>14,432</u>

	Attributable to equity shareholders of the Bank						
	Share premium HK\$'M	Property revaluation reserve HK\$'M	Hedging reserve HK\$'M	Available- for-sale/ non-trading	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
				investment reserve HK\$'M			
At 1 January 2005							
– as previously reported	12,500	3	–	(29)	–	2,051	14,525
– prior year adjustments in respect of HKAS 19	–	–	–	–	(93)	–	(93)
– as restated, before opening balance adjustments	12,500	3	–	(29)	(93)	2,051	14,432
– opening balance adjustments in respect of HKAS 39	–	–	(10)	37	–	599	626
At 1 January 2005 (restated)	<u>12,500</u>	<u>3</u>	<u>(10)</u>	<u>8</u>	<u>(93)</u>	<u>2,650</u>	<u>15,058</u>
Available-for-sale securities:							
– changes in fair value	–	–	–	(113)	–	–	(113)
– transfer to income statement on disposal (note 5)	–	–	–	6	–	–	6
– deferred tax released (note 26)	–	–	–	13	–	–	13
Cash flow hedge:							
– effective portion of changes in fair value	–	–	(41)	–	–	–	(41)
– deferred tax released (note 26)	–	–	7	–	–	–	7
Actuarial gains on defined benefits plan	–	–	–	–	62	–	62
Capitalisation of share premium	(23)	–	–	–	–	–	(23)
Profit for the year	–	–	–	–	–	4,536	4,536
At 31 December 2005	<u>12,477</u>	<u>3</u>	<u>(44)</u>	<u>(86)</u>	<u>(31)</u>	<u>7,186</u>	<u>19,505</u>

(b) Bank

	Attributable to equity shareholders of the Bank						
	Share premium	Property revaluation reserve	Hedging reserve	Available- for-sale/ non-trading	Pension reserve	Retained profits	Total
				investment reserve			
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Additions through business acquisitions	–	3	–	(139)	–	–	(136)
Premium on shares issued	12,500	–	–	–	–	–	12,500
Change in fair value of non-trading securities	–	–	–	81	–	–	81
Deferred tax released (note 26)	–	–	–	29	–	–	29
Capital contribution from immediate holding company in respect of share option schemes (restated)	–	–	–	–	–	25	25
Actuarial losses on defined benefits plan (restated)	–	–	–	–	(93)	–	(93)
Profit for the period	–	–	–	–	–	2,075	2,075
At 31 December 2004 (restated)	12,500	3	–	(29)	(93)	2,100	14,481

	Attributable to equity shareholders of the Bank						
	Share premium	Property revaluation reserve	Hedging reserve	Available- for-sale/ non-trading	Pension reserve	Retained profits	Total
				investment reserve			
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
At 1 January 2005							
– as previously reported	12,500	3	–	(29)	–	2,100	14,574
– prior period adjustments in respect of HKAS 19	–	–	–	–	(93)	–	(93)
– as restated, before opening balance adjustments	12,500	3	–	(29)	(93)	2,100	14,481
– opening balance adjustments in respect of HKAS 39	–	–	(10)	37	–	601	628
At 1 January 2005 (restated)	12,500	3	(10)	8	(93)	2,701	15,109
Available-for-sale securities:							
– changes in fair value	–	–	–	(113)	–	–	(113)
– transfer to income statement on disposal	–	–	–	6	–	–	6
– deferred tax released (note 26)	–	–	–	13	–	–	13
Cash flow hedge:							
– effective portion of changes in fair value	–	–	(41)	–	–	–	(41)
– deferred tax released (note 26)	–	–	7	–	–	–	7
Actuarial gains on defined benefits plan	–	–	–	–	62	–	62
Capitalisation of share premium	(23)	–	–	–	–	–	(23)
Profit for the year	–	–	–	–	–	4,492	4,492
At 31 December 2005	12,477	3	(44)	(86)	(31)	7,193	19,512

The consolidated profit attributable to equity shareholders of the Bank includes a profit of HK\$4,492 million (2004 (restated): HK\$2,070 million) which has been dealt with in the financial statements of the Bank.

(c) Nature and purpose of reserves

(i) Share premium

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

(ii) Property revaluation reserve

The revaluation reserves have been set up and are dealt with in accordance with the accounting policies adopted for buildings and are distributable.

(iii) Available-for-sale/non-trading investment reserve

The available-for-sale/non-trading investment reserve comprises the cumulative net change in the fair value of available-for-sale/non-trading securities held at the balance sheet date and is dealt with in accordance with the accounting policies in note 2(i).

(iv) Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2(j).

(v) Pension reserve

The pension reserve comprises the cumulative net effect of the actuarial gains and losses for the defined benefits plan.

The HKMA requires the Bank to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2005, an amount of HK\$355 million (2004: HK\$Nil) has been reserved for this purpose.

(d) Minority interests

	<i>Consolidated</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
At 1 January	48	48
Opening balance adjustment in respect of HKAS 39	(2)	–
	<hr/>	<hr/>
At 1 January (restated)	46	48
Profit for the year	5	4
Dividends paid to minority shareholders	–	(4)
	<hr/>	<hr/>
At 31 December	<u>51</u>	<u>48</u>

33 Cash and cash equivalents

	2005 HK\$'M	2004 HK\$'M
(a) Components of cash and cash equivalents in the cash flow statement		
Cash and balances with banks and other financial institutions	5,514	7,780
Placements with banks and other financial institutions with original maturity within three months	30,733	7,981
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	16,267	31,625
	<u>52,514</u>	<u>47,386</u>
	2005 HK\$'M	2004 HK\$'M
(b) Reconciliation with the consolidated balance sheet		
Cash and balances with banks and other financial institutions	5,764	7,857
Placements with banks and other financial institutions	39,625	18,860
Trading securities	16,064	9,934
Available-for-sale securities	39,866	–
Non-trading securities	–	34,315
Amounts due from immediate holding company and fellow subsidiaries	37,258	64,548
Overdraft included in “deposits and balances of banks and other financial institutions”	(250)	(77)
Overdraft included in “amounts due to immediate holding company”	(2,857)	(492)
	<u>135,470</u>	<u>134,945</u>
Less: amounts with an original maturity of beyond three months	(82,956)	(87,559)
	<u>52,514</u>	<u>47,386</u>
	2005 HK\$'M	2004 HK\$'M
(c) Investment in a subsidiary		
		2005 HK\$'M
Net assets acquired:		
– Cash and balances from banks and other financial institutions		3
– Advances to customers		1,369
– Available-for-sale securities		132
– Other assets		20
– Deposits and balances from banks and other financial institutions		(230)
– Amounts due to fellow subsidiaries		(962)
– Deposits from customers		(13)
– Current taxation		(6)
– Other liabilities		(23)
		<u>290</u>
Total		<u>290</u>
Satisfied by:		
– Cash consideration		<u>290</u>
Analysis of net cash outflow in respect of the purchase of a subsidiary:		
– Cash consideration paid		(290)
– Cash and balances with banks and other financial institutions acquired		3
		<u>(287)</u>

34 Derivatives

(a) Notional amounts of derivatives

Derivatives are contracts whose value depends on the value of one or more underlying financial instruments, interest or exchange rates or indices.

The following is a summary of the notional amounts of each significant type of derivative entered into by the Bank and its subsidiaries:

Consolidated

	2005			2004		
	Trading HK\$'M	Hedging HK\$'M	Total HK\$'M	Trading HK\$'M	Hedging HK\$'M	Total HK\$'M
Exchange rate contracts						
Forwards	405,327	–	405,327	549,390	–	549,390
Cross currency swaps	1,718	–	1,718	31	6,464	6,495
Options purchased	4,561	–	4,561	6,712	–	6,712
Options written	4,561	–	4,561	6,712	–	6,712
Interest rate contracts						
Forwards	178	–	178	651	–	651
Swaps	6,007	12,071	18,078	8,790	59,697	68,487
Options purchased	4,312	–	4,312	9,494	–	9,494
Options written	4,312	–	4,312	9,494	–	9,494
Other derivatives	54	–	54	26	–	26
	<u>431,030</u>	<u>12,071</u>	<u>443,101</u>	<u>591,300</u>	<u>66,161</u>	<u>657,461</u>

Bank

	2005			2004		
	Trading HK\$'M	Hedging HK\$'M	Total HK\$'M	Trading HK\$'M	Hedging HK\$'M	Total HK\$'M
Exchange rate contracts						
Forwards	405,327	–	405,327	549,390	–	549,390
Cross currency swaps	1,718	–	1,718	31	6,464	6,495
Options purchased	4,561	–	4,561	6,712	–	6,712
Options written	4,561	–	4,561	6,712	–	6,712
Interest rate contracts						
Forwards	178	–	178	651	–	651
Swaps	5,421	12,071	17,492	8,790	59,097	67,887
Options purchased	4,312	–	4,312	9,494	–	9,494
Options written	4,312	–	4,312	9,494	–	9,494
Other derivatives	54	–	54	26	–	26
	<u>430,444</u>	<u>12,071</u>	<u>442,515</u>	<u>591,300</u>	<u>65,561</u>	<u>656,861</u>

The notional amounts of these instruments indicate the volume of transactions outstanding and do not represent amounts at risk.

(b) Fair values and credit risk weighted amounts of derivatives

	Consolidated					
	2005			2004		
	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weight amount HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weight amount HK\$'M
Currency derivatives	2,894	3,037	1,312	5,933	5,332	2,267
Interest rate derivatives	125	342	104	343	654	110
Other derivatives	–	–	1	–	–	–
	<u>3,019</u>	<u>3,379</u>	<u>1,417</u>	<u>6,276</u>	<u>5,986</u>	<u>2,377</u>

	Bank					
	2005			2004		
	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weight amount HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weight amount HK\$'M
Currency derivatives	2,894	3,037	1,312	5,933	5,332	2,267
Interest rate derivatives	116	342	102	343	645	110
Other derivatives	–	–	1	–	–	–
	<u>3,010</u>	<u>3,379</u>	<u>1,415</u>	<u>6,276</u>	<u>5,977</u>	<u>2,377</u>

Credit risk-weighted amount refers to the amount as computed in accordance with the Third Schedule to the Hong Kong Banking Ordinance on capital adequacy and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 50% for exchange rate, interest rate and other derivatives contracts.

The above analysis did not take into account any bilateral netting arrangements entered into during the year and accordingly these amounts are shown on a gross basis.

(c) Fair value of derivative financial instruments designated at hedging instruments

The following is a summary of the fair values of derivatives held-for-hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2005:

	Consolidated and Bank	
	Assets (Included in other assets) HK\$'M	Liabilities (Included in other liabilities) HK\$'M
	Interest rate contracts	<u>15</u>
Fair value hedges		

The fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of certain fixed rate liabilities due to movements in market interest rates. At 31 December 2005, the net fair value of interest rate swaps held as fair value hedges was HK\$95 million which was all related to liabilities.

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps that are used to hedge against the variability in cash flows of certain floating rate assets or liabilities. At 31 December 2005, the net fair value held as cash flow hedges was HK\$55 million comprising assets of HK\$15 million and liabilities of HK\$70 million.

35 Contingent liabilities and commitments**(a) The following is a summary of the contractual amounts of each significant contingent liability and commitment:**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Direct credit substitutes	6,574	7,724	6,574	7,724
Transaction-related contingencies	8,463	3,408	8,463	3,408
Trade-related contingencies	16,503	18,937	16,503	18,937
Other commitments:				
– with an original maturity of under one year or which are unconditionally cancellable	127,105	134,303	127,092	134,303
– with an original maturity of one year and over	8,361	9,381	8,361	9,381
Others	1,802	16,364	1,802	16,364
	<u>168,808</u>	<u>190,117</u>	<u>168,795</u>	<u>190,117</u>
Credit risk weight amount	<u>15,804</u>	<u>19,329</u>	<u>15,804</u>	<u>19,329</u>

Contingent liabilities and commitments are credit-related instruments, which include acceptances, letters of credit, guarantees and commitments to extend credit. The risk involved is similar to the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. As the facilities may expire without being drawn upon, the contracted amounts do not represent expected future cash flows.

(b) Capital commitments

Capital commitments outstanding at 31 December not provided for in the financial statements were as follows:

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Contracted for	<u>23</u>	<u>41</u>

(c) Lease commitments

The Bank and its subsidiaries lease a number of properties under operating leases. The leases typically run for an initial period of two to ten years, with an option to renew the lease when all terms are renegotiated. At 31 December, total future minimum lease payments under non-cancellable operating leases are payable as follows:

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	288	282
After 1 year but within 5 years	424	411
After 5 years	95	136
	807	829
	807	829

(d) Contingencies

The Bank and its subsidiaries are named in and are defending a number of legal actions arising from its banking activities. Management of the Bank believes that the resolution of these actions and proceedings will not be material to the financial position of the Bank and its subsidiaries.

36 Financial risk management**(a) Credit risk management**

Credit risk arises from the possibility that the counterparty in a transaction may default. It arises from lending, trade finance, treasury and other activities. The Bank has dedicated standards, policies and procedures to monitor and control credit risk.

The Bank has put in place a credit control structure and effective credit risk management tools to ensure proper management of the quality of its credit portfolio. The Bank's credit policies and procedures define credit extension criteria, credit approval authorities delegated from the Board, credit monitoring processes, the loan grading system and provisioning policy. It also takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the HKMA with respect to large exposures and provisioning requirements. The Bank's policy is not to have significant concentrations of exposure to individual counterparties or individual overseas countries.

The Bank further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements generally do not result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if an event occurs, all amounts with the counterparty are settled on a net basis.

(b) Market risk management*Market risk*

The Bank recognises market risk as the exposure created by potential changes in market prices and rates. The Bank is exposed to market risk arising principally from customer driven transactions.

The Bank transacts in the money market, foreign exchange markets and capital markets giving rise to market risk exposures. Positions are taken as a result of the execution of customers' orders, market making and proprietary trading activities.

Other financial instruments transacted include debt and other securities and certain derivative financial instruments. Derivative instruments are contracts whose characteristics and value derive from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps, and options transactions in the foreign exchange and interest rate markets. The Bank only enters derivative positions to meet customer demand or for hedging purposes. Derivative contracts entered into by the Bank are primarily over-the-counter derivatives.

The Bank has established standards, principles, policies, and techniques for managing market risk. The Bank has established clear market risk management policies and framework, including limits setting, monitoring and reporting and control procedures, which are reviewed regularly by the Risk Committee. Market risk limits are proposed by the business within the terms of agreed policy. Market Risk department approves the limits within delegated authorities and monitors exposures against these limits.

(i) *Currency risk*

The Bank's foreign exchange positions arise from foreign exchange trading and commercial banking operations. Foreign exchange trading exposures are principally derived from customer driven transactions.

Foreign exchange exposures arising from trading, non-trading and structural positions, with an individual currency constituting 10% or more of the total net position in all foreign currencies, are shown as follows:

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
US dollar exposure		
Spot assets	95,852	94,579
Spot liabilities	(79,944)	(84,707)
Forward purchases	196,056	272,370
Forward sales	(210,890)	(281,566)
	<u>1,074</u>	<u>676</u>
Net long non-structural position		

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
JPY dollar exposure		
Spot assets	2,236	2,911
Spot liabilities	(2,732)	(1,274)
Forward purchases	13,254	20,249
Forward sales	(12,544)	(21,870)
	<u>214</u>	<u>16</u>
Net long non-structural position		

The Bank and its subsidiaries had the following structural foreign currency exposures which exceed 10% of the net structural foreign currency exposure in all currencies.

	<i>Consolidated and Bank</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Vietnamese Dong	<u>170</u>	<u>—</u>

(ii) Interest rate risk

The Bank's interest rate exposures comprise trading exposures and non-trading structural interest rate exposures. Structural interest rate risk generally arises from the differing re-pricing characteristics of commercial banking assets and liabilities.

The following tables indicate the effective interest rates for the relevant periods and the expected next repricing dates (or maturity dates whichever are earlier) for the assets and liabilities at the balance sheet date.

Consolidated

	Effective interest rate	2005					Non-interest bearing
		Total	Less than three months	Between three months and one year	Between one and five years	More than five years	
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		5,764	–	–	–	–	5,764
Placements with banks and other financial institutions	3.27%	39,625	38,545	1,078	–	–	2
Hong Kong SAR Government certificates of indebtedness		19,321	–	–	–	–	19,321
Trading assets	3.07%	19,773	8,693	4,254	2,824	293	3,709
Advances to customers	4.84%	168,876	159,199	6,426	1,932	1,319	–
Amounts due from group companies	2.88%	37,258	28,707	6,607	152	–	1,792
Available-for-sale securities	3.49%	39,866	15,220	20,818	3,053	322	453
Non-interest bearing assets		6,677	–	–	–	–	6,677
Total assets		<u>337,160</u>	<u>250,364</u>	<u>39,183</u>	<u>7,961</u>	<u>1,934</u>	<u>37,718</u>
Liabilities							
Hong Kong SAR currency notes in circulation		19,321	–	–	–	–	19,321
Deposits and balances of banks and other financial institutions	2.54%	8,723	1,178	–	–	–	7,545
Deposits from customers	1.89%	247,663	226,319	4,280	1,480	54	15,530
Trading liabilities	2.68%	14,587	6,618	2,828	893	152	4,096
Financial liabilities designated at fair value through profit or loss	2.84%	5,153	5,153	–	–	–	–
Certificates of deposit issued	2.18%	5,178	3,482	583	1,083	30	–
Amounts due to group companies	1.80%	5,136	970	590	195	–	3,381
Dated capital notes	3.56%	3,781	669	–	3,112	–	–
Non-interest bearing liabilities		4,161	–	–	–	–	4,161
Total liabilities		<u>313,703</u>	<u>244,389</u>	<u>8,281</u>	<u>6,763</u>	<u>236</u>	<u>54,034</u>
Interest rate sensitivity gap			<u>5,975</u>	<u>30,902</u>	<u>1,198</u>	<u>1,698</u>	<u>(16,316)</u>

Consolidated

	Effective interest rate	Total	Less than three months	2004 Between three months and one year	Between one and five years	More than five years	Non-interest bearing
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		7,857	–	–	–	–	7,857
Placements with banks and other financial institutions	1.44%	18,860	13,422	5,043	392	–	3
Hong Kong SAR Government certificates of indebtedness		19,681	–	–	–	–	19,681
Trading assets	2.04%	16,416	5,815	3,949	170	–	6,482
Advances to customers	3.85%	169,689	159,824	7,908	1,188	767	2
Amounts due from group companies	1.18%	64,549	49,853	8,921	1,299	62	4,414
Non-trading securities	2.91%	34,315	17,986	8,885	6,171	504	769
Non-interest bearing assets		4,395	–	–	–	–	4,395
Total assets		<u>335,762</u>	<u>246,900</u>	<u>34,706</u>	<u>9,220</u>	<u>1,333</u>	<u>43,603</u>
Liabilities							
Hong Kong SAR currency notes in circulation		19,681	–	–	–	–	19,681
Deposits and balances of banks and other financial institutions	1.21%	10,373	5,819	–	–	–	4,554
Deposits from customers	0.45%	238,922	210,748	3,687	974	63	23,450
Trading liabilities	1.98%	15,262	5,972	1,522	1,460	310	5,998
Debt securities issued	1.84%	931	724	–	85	122	–
Certificates of deposit issued	1.84%	10,525	–	4,558	5,967	–	–
Amounts due to group companies	0.29%	9,239	4,258	473	533	–	3,975
Dated capital notes	4.13%	8,383	669	–	7,714	–	–
Non-interest bearing liabilities		4,088	–	–	–	–	4,088
Total liabilities		<u>317,404</u>	<u>228,190</u>	<u>10,240</u>	<u>16,733</u>	<u>495</u>	<u>61,746</u>
Interest rate sensitivity gap			<u>18,710</u>	<u>24,466</u>	<u>(7,513)</u>	<u>838</u>	<u>(18,143)</u>

Bank

	Effective interest rate	Total	Less than three months	2005 Between three months and one year	Between one and five years	More than five years	Non-interest bearing
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		5,764	–	–	–	–	5,764
Placements with banks and other financial institutions	3.27%	39,623	38,545	1,078	–	–	–
Hong Kong SAR Government certificates of indebtedness		19,321	–	–	–	–	19,321
Trading assets	3.07%	19,764	8,693	4,254	2,824	293	3,700
Advances to customers	4.84%	168,262	159,129	6,235	1,579	1,319	–
Amounts due from group companies	2.88%	37,765	29,194	6,607	152	–	1,812
Available-for-sale securities	3.49%	39,696	15,220	20,818	3,053	322	283
Non-interest bearing assets		6,963	–	–	–	–	6,963
Total assets		<u>337,158</u>	<u>250,781</u>	<u>38,992</u>	<u>7,608</u>	<u>1,934</u>	<u>37,843</u>
Liabilities							
Hong Kong SAR currency notes in circulation		19,321	–	–	–	–	19,321
Deposits and balances of banks and other financial institutions	2.54%	8,723	1,178	–	–	–	7,545
Deposits from customers	1.89%	247,663	226,319	4,280	1,480	54	15,530
Trading liabilities	2.68%	14,587	6,618	2,828	893	152	4,096
Financial liabilities designated at fair value through profit or loss	2.84%	5,153	5,153	–	–	–	–
Certificates of deposit issued	2.18%	5,178	3,482	583	1,083	30	–
Amounts due to group companies	1.80%	5,250	1,091	590	195	–	3,374
Dated capital notes	3.56%	3,781	669	–	3,112	–	–
Non-interest bearing liabilities		4,089	–	–	–	–	4,089
Total liabilities		<u>313,745</u>	<u>244,510</u>	<u>8,281</u>	<u>6,763</u>	<u>236</u>	<u>53,955</u>
Interest rate sensitivity gap			<u>6,271</u>	<u>30,711</u>	<u>845</u>	<u>1,698</u>	<u>(16,112)</u>

Bank

	Effective interest rate	2004					Non-interest bearing
		Total	Less than three months	three months and one year	Between one and five years	More than five years	
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		7,850	–	–	–	–	7,850
Placements with banks and other financial institutions	1.44%	18,859	13,422	5,043	392	–	2
Hong Kong SAR Government certificates of indebtedness		19,681	–	–	–	–	19,681
Trading assets	2.04%	16,416	5,815	3,949	170	–	6,482
Advances to customers	3.85%	169,051	159,740	7,710	834	767	–
Amounts due from group companies	1.18%	65,063	50,368	8,921	1,298	62	4,414
Non-trading securities	2.91%	34,315	17,986	8,885	6,171	504	769
Non-interest bearing assets		4,460	–	–	–	–	4,460
Total assets		<u>335,695</u>	<u>247,331</u>	<u>34,508</u>	<u>8,865</u>	<u>1,333</u>	<u>43,658</u>
Liabilities							
Hong Kong SAR currency notes in circulation		19,681	–	–	–	–	19,681
Deposits and balances of banks and other financial institutions	1.21%	10,373	5,819	–	–	–	4,554
Deposits from customers	0.45%	238,922	210,748	3,687	974	63	23,450
Trading liabilities	1.98%	15,262	5,972	1,522	1,460	310	5,998
Debt securities issued	1.84%	931	724	–	85	122	–
Certificates of deposit issued	1.84%	10,525	–	4,558	5,967	–	–
Amounts due to group companies	0.29%	9,234	4,280	473	533	–	3,948
Dated capital notes	4.13%	8,383	669	–	7,714	–	–
Non-interest bearing liabilities		4,025	–	–	–	–	4,025
Total liabilities		<u>317,336</u>	<u>228,212</u>	<u>10,240</u>	<u>16,733</u>	<u>495</u>	<u>61,656</u>
Interest rate sensitivity gap			<u>19,119</u>	<u>24,268</u>	<u>(7,868)</u>	<u>838</u>	<u>(17,998)</u>

(c) Liquidity risk management

The Bank defines liquidity risk as the risk that it either does not have sufficient financial resources available to meet all its obligations and commitments as they fall due, or can only secure them at excessive cost.

The Bank has established standards, principles, policies and techniques for managing liquidity risk. Liquidity risk management is governed by the Asset and Liability Committee (“ALCO”). The tools used for the management of liquidity risk, range from key balance sheet ratios and medium-term funding requirements to ensure balance sheets are not developing structural imbalances, to short term cash flow limits and controls on borrowing in the wholesale markets. They are supplemented by the establishment of a liquidity crisis contingency plan and regular stress test on liquidity positions.

Global Markets is responsible for the day-to-day management of all the liquidity risk in the Bank, executing liquidity directives and operating within the liquidity policy and approved limits. Liquidity limits are regularly monitored by a Market Risk function that is independent from the business. Liquidity profiles are reviewed by ALCO on a regular basis.

Customer deposits form a significant part of the Bank's overall funding. Its composition has remained relatively diversified and stable. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

(i) Analysis of assets and liabilities by remaining maturity

The following maturity profile is based on the remaining period at the balance sheet date to the contractual maturity date. The disclosure does not imply that the assets will be held to maturity or that the liabilities will be withdrawn on maturity.

Consolidated

	2005						Total HK\$'M
	Repayable on demand HK\$'M	From 1 month to 3 months HK\$'M	From 3 months to 1 year HK\$'M	From 1 year to 5 years HK\$'M	After 5 years HK\$'M	Undated or overdue more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	5,764	–	–	–	–	–	5,764
Placements with banks and other financial institutions	9	37,173	2,443	–	–	–	39,625
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	19,321	19,321
Trading assets	–	7,491	4,987	3,293	293	3,709	19,773
Advances to customers	5,334	37,866	20,484	34,639	62,862	4,545	165,730
Trade bills	2,859	2,549	427	–	–	–	5,835
Available-for-sale securities	–	13,599	21,366	2,751	1,852	298	39,866
Amounts due from group companies	1,792	28,590	6,723	153	–	–	37,258
Undated assets	–	–	–	–	–	3,988	3,988
Total Assets	15,758	127,268	56,430	40,836	65,007	31,861	337,160
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	19,321	19,321
Deposits and balances of banks and other financial institutions	5,058	3,592	73	–	–	–	8,723
Deposits from customers	114,790	127,290	5,286	297	–	–	247,663
Trading liabilities	–	6,618	2,828	893	152	4,096	14,587
Financial liabilities designated at fair value through profit or loss	2,174	175	1,371	1,379	54	–	5,153
Certificates of deposit issued	–	240	1,121	3,725	92	–	5,178
Amounts due to group companies	3,381	710	850	195	–	–	5,136
Dated capital notes	–	–	–	–	3,781	–	3,781
Undated liabilities	–	–	–	–	–	4,161	4,161
Total Liabilities	125,403	138,625	11,529	6,489	4,079	27,578	313,703

Consolidated

	2004						Total HK\$'M
	Repayable on demand HK\$'M	From	From	From	After	Undated or overdue	
		1 month to 3 months HK\$'M	3 months to 1 year HK\$'M	1 year to 5 years HK\$'M	5 years HK\$'M	more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	7,857	–	–	–	–	–	7,857
Placements with banks and other financial institutions	2	14,216	4,642	–	–	–	18,860
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	19,681	19,681
Trading assets	–	5,846	1,834	1,440	814	6,482	16,416
Advances to customers	4,839	44,580	16,810	37,682	59,517	4,003	167,431
Trade bills	2,909	2,025	376	–	–	–	5,310
Non-trading securities	–	16,572	11,372	6,062	51	258	34,315
Amounts due from group companies	4,414	49,880	9,280	913	62	–	64,549
Undated assets	–	–	–	–	–	1,343	1,343
Total Assets	20,021	133,119	44,314	46,097	60,444	31,767	335,762
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	19,681	19,681
Deposits and balances of banks and other financial institutions	4,630	5,551	192	–	–	–	10,373
Deposits from customers	142,321	91,877	3,687	974	63	–	238,922
Trading liabilities	–	5,972	1,523	1,459	310	5,998	15,262
Debt securities issued	–	–	–	931	–	–	931
Certificates of deposit issued	–	770	4,558	5,075	122	–	10,525
Amounts due to group companies	3,975	4,258	473	533	–	–	9,239
Dated capital notes	–	–	–	–	8,383	–	8,383
Undated liabilities	–	–	–	–	–	4,088	4,088
Total Liabilities	150,926	108,428	10,433	8,972	8,878	29,767	317,404

Bank

	2005						Total HK\$'M
	Repayable on demand HK\$'M	From	From	From	After	Undated or overdue	
		1 month to 3 months HK\$'M	3 months to 1 year HK\$'M	1 year to 5 years HK\$'M	5 years HK\$'M	more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	5,764	–	–	–	–	–	5,764
Placements with banks and other financial institutions	7	37,173	2,443	–	–	–	39,623
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	19,321	19,321
Trading assets	–	7,491	4,987	3,293	293	3,700	19,764
Advances to customers	5,334	37,794	20,292	34,287	62,862	4,545	165,114
Trade bills	2,859	2,549	427	–	–	–	5,835
Available-for-sale securities	–	13,599	21,366	2,751	1,852	128	39,696
Amounts due from group companies	1,812	29,078	6,723	152	–	–	37,765
Undated assets	–	–	–	–	–	4,276	4,276
Total Assets	15,776	127,684	56,238	40,483	65,007	31,970	337,158
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	19,321	19,321
Deposits and balances of banks and other financial institutions	5,058	3,592	73	–	–	–	8,723
Deposits from customers	114,790	127,290	5,286	297	–	–	247,663
Trading liabilities	–	6,618	2,828	893	152	4,096	14,587
Financial liabilities designated at fair value through profit or loss	2,174	175	1,371	1,379	54	–	5,153
Certificates of deposit issued	–	240	1,121	3,725	92	–	5,178
Amounts due to group companies	3,374	831	850	195	–	–	5,250
Dated capital notes	–	–	–	–	3,781	–	3,781
Undated liabilities	–	–	–	–	–	4,089	4,089
Total Liabilities	125,396	138,746	11,529	6,489	4,079	27,506	313,745

Bank

	2004						Total HK\$'M
	Repayable on demand HK\$'M	From	From	From	After	Undated or	
		1 month to 3 months HK\$'M	3 months to 1 year HK\$'M	1 year to 5 years HK\$'M	5 years HK\$'M	more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	7,850	–	–	–	–	–	7,850
Placements with banks and other financial institutions	2	14,215	4,642	–	–	–	18,859
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	19,681	19,681
Trading assets	–	5,846	1,834	1,440	814	6,482	16,416
Advances to customers	4,839	44,504	16,613	37,315	59,517	4,003	166,791
Trade bills	2,909	2,025	376	–	–	–	5,310
Non-trading securities	–	16,572	11,372	6,062	51	258	34,315
Amounts due from group companies	4,414	50,394	9,280	913	62	–	65,063
Undated assets	–	–	–	–	–	1,410	1,410
Total Assets	20,014	133,556	44,117	45,730	60,444	31,834	335,695
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	19,681	19,681
Deposits and balances of banks and other financial institutions	4,630	5,551	192	–	–	–	10,373
Deposits from customers	142,321	91,877	3,687	974	63	–	238,922
Trading liabilities	–	5,972	1,523	1,459	310	5,998	15,262
Debt securities issued	–	–	–	931	–	–	931
Certificates of deposit issued	–	770	4,558	5,075	122	–	10,525
Amounts due to group companies	3,948	4,280	473	533	–	–	9,234
Dated capital notes	–	–	–	–	8,383	–	8,383
Undated liabilities	–	–	–	–	–	4,025	4,025
Total Liabilities	150,899	108,450	10,433	8,972	8,878	29,704	317,336

37 Fair value information**(a) Estimation of fair values**

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most financial instruments, and in particular for loans and deposits, direct market prices are not available. The fair value of such instruments was therefore calculated on the basis of valuation techniques using current market parameters. In particular, the fair value is a theoretical value applicable at a given reporting date, and hence can only be used as an indicator of the value realisable in a future sale.

These techniques involve uncertainties and are significantly affected by the assumptions used and judgements made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experiences and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realised in an immediate sale of the instruments.

(b) Fair value

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31 December 2005 and 2004 unless otherwise stated.

(i) Financial assets

The Bank's financial assets mainly include cash, amounts due from banks and other financial institutions, loans and advances to customers, and investments.

Amounts due from banks and other financial institutions, loans and advances to customers

Amounts due from banks and other financial institutions, loans and advances to customers are mainly priced at market interest rate or to be matured within one year. Accordingly, the carrying values approximate the fair values.

Investments

Available-for-sale securities and trading securities are stated at fair value in the financial statements.

(ii) Financial liabilities

The Bank's financial liabilities mainly include amounts due to banks and other financial institutions, deposits from customers and certificates of deposit issued.

38 Assets pledged as security for liabilities

The Bank maintains pledged cash and securities accounts with financial institutions to secure any borrowings or other obligations resulting from the Bank's use of clearing systems. As at 31 December 2005, the Bank did not have borrowings due to the financial institutions and the pledged cash and securities amounted to HK\$0.1 million (2004: HK\$86 million) and HK\$25,353 million (2004: HK\$9,401 million) respectively.

39 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as for the consolidated ones in 2005. The Bank had no operations in first half of 2004.

(a) Key management personnel remuneration

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 7 is as follows:

	<i>Consolidated</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short-term employee benefits	84	84
Post-employment benefits	8	7
Equity compensation benefits	5	3
	<u>97</u>	<u>94</u>

Total remuneration is included in staff costs (see note 3(f)).

(b) Credit facilities and loans to key management personnel

During the year, the Bank provided credit facilities to key management personnel of the Bank and its holding companies and their close family members and companies controlled or significantly influenced by them. The credit facilities were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees.

	<i>Consolidated</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Loan balances:		
At 1 January	<u>1,210</u>	<u>1,170</u>
At 31 December	<u>1,585</u>	<u>1,210</u>
Average balance during the year	<u>1,175</u>	<u>1,269</u>
Income earned	<u>28</u>	<u>8</u>

(c) Transaction with Korea First Bank Limited

On 15 April 2005, Standard Chartered PLC completed the acquisition of Korea First Bank, which has subsequently changed its name to SC First Bank Korea Limited ("SCFB"). SCFB then became a related party of the Bank. On 18 August 2005, the Bank acquired the Hong Kong subsidiary of SCFB, Korea First Finance Limited ("KFF") with a view of integrating the business into that of the Bank. KFF was acquired from SCFB at the fair value of the net assets, including funding, of KFF at HK\$290 million. There was no goodwill arising on the acquisition. The consideration was satisfied in cash. KFF was a Deposit Taking Company ("DTC") regulated by the HKMA. Subsequent to the acquisition, the DTC license of KFF was revoked, and certain individual assets and liabilities were sold to the Bank for cash. KFF then paid a dividend to the Bank amounting to HK\$233 million. KFF has been placed in liquidation by the Bank, and subject to the settlement of tax, there will be a return of capital and reserves to the Bank.

KFF was engaged in commercial lending and trade finance activities, and the net assets acquired by the Bank were:

	<i>HK\$'M</i>
Net assets acquired by the Bank (note 33(c))	290
Dividend paid to the Bank	<u>(233)</u>
Current carrying value of the investment	<u><u>57</u></u>

(d) Share based payments

The Standard Chartered PLC Group (the "Group") operates a number of share based payment schemes for its directors and employees in which the Bank's employees participate.

1997 Restricted Share Scheme

The Group operates a discretionary Restricted Share Scheme for high performing and high potential staff at any level of the organisation whom the Group wish to motivate and retain. Except upon appointment when an executive director may be granted an award of restricted shares, the Restricted Share Scheme is not applicable to executive directors, as it has no performance conditions attached to it. Fifty per cent of the award vests two years after the date of grant and the balance after three years. The value of shares awarded in any year to any individual may not exceed two times their base salary.

1997 Supplemental Share Option Scheme (closed)

No awards have been made under this scheme since February 2000 and it is anticipated that no future grants will be made under it except in exceptional circumstances. To be eligible for a grant under this scheme, participants had to retain a personal holding of at least 10,000 shares, purchased at their own expense. Options can only be exercised up to the fifth anniversary of the grant date if, during the performance period:

- The share price over 20 consecutive days exceeds the share price at the date of grant by at least 50 per cent plus RPI; and
- EPS increases by at least 25 per cent plus RPI.

Both conditions must be satisfied within five years of the date of grant. In the event of a change of control, the Committee may deem the EPS target to have been met.

1994 Executive Share Option Scheme (closed)

No awards have been made under this scheme since August 1999 as the scheme was replaced by the 2000 Executive Share Option Scheme. Executive share options to purchase ordinary shares in Standard Chartered PLC (the "Ultimate Holding Company") are exercisable after the third, but before the tenth anniversary of the date of grant. The exercise price is the share price at the date of grant and options can only be exercised if EPS increases by at least 15 per cent over three consecutive years.

2000 Executive Share Option Scheme

The 2000 scheme is designed to be internationally competitive and focus executive directors and their senior management teams on delivering long-term performance. An EPS performance criterion needs to be met before options can be exercised.

Executive share options to purchase ordinary shares in the Ultimate Holding Company are exercisable after the third, but before the tenth, anniversary of the date of grant. The exercise price per share is the share price at the date of grant and options can normally only be exercised if a performance condition is satisfied.

2001 Performance Share Plan

The Performance Share Plan is designed to be an intrinsic part of total remuneration for the Group's executive directors and for a small number of the group's most senior executives. It is an internationally competitive long-term incentive plan that focuses executives on meeting and exceeding the long-term performance targets of the Group. Awards of nil price options to acquire shares are granted to the individual and will normally be exercised between three and ten years after the date of grant if the individual is still employed by the Group. There is provision for earlier exercise in certain limited circumstances.

All Employee Sharesave Schemes

Under the Sharesave schemes, employees have the choice of opening a three-year or five-year savings contract. Within a period of six months after the third or fifth anniversary, employees may purchase ordinary shares in the Ultimate Holding Company. The price at which they may purchase shares is at a discount of up to 20 per cent on the share price at the date of invitation. There are no performance conditions attached to options granted under the all employee sharesave schemes.

2000 Executive Share Option Scheme

Valuation

Options are valued using a Binomial option-pricing model. The fair value per option granted and the assumptions used in the calculation are as follows:

<i>Grant Date</i>	<i>2005</i>		<i>2004</i>	
	<i>14 June</i>	<i>9 March</i>	<i>14 September</i>	<i>4 March</i>
Share price at grant date	£10.395	£9.71	£9.58	£9.355
Exercise price	£10.395	£9.71	£9.58	£9.355
Shares under option as at 31 December 2005	–	–	20,540	675,947
Vesting period (years)	3	3	3	3
Expected volatility (%)	30.9 - 31.6	30.9 - 32.3	30.9 - 35.6	30.9 - 35.8
Option life (years)	10	10	10	10
Risk free rate (%)	4.2 - 4.6	4.2 - 4.9	4.2 - 4.9	4.2 - 4.8
Expected dividends (yield) (%)	3.5	3.5	3.5	3.5 - 3.7
Fair value (%)	24.3 - 32.3	26.5 - 34.9	28.8 - 35.6	28.3 - 36.6

The expected volatility is based on historical volatility over the last five years or five years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the assumed option life.

A reconciliation of option movements over the year to 31 December 2005 is shown below:

	2005		2004	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	5,071,041	£8.00	4,684,686	£7.85
Granted	–	–	803,999	£9.36
Lapsed	(163,270)	£7.77	(68,659)	£9.36
Exercised	(1,006,134)	£7.95	(348,985)	£8.73
Outstanding at 31 December	3,901,637	£8.03	5,071,041	£8.00
Exercisable at 31 December	1,813,664	£8.36	1,024,492	£9.01

Range of exercise price	2005				2004			
	Weighted average exercise price	No. of shares	Weighted average remaining life:		Weighted average exercise price	No. of shares	Weighted average remaining life:	
			Expected years	Contractual years			Expected years	Contractual years
£6.905 – £10.395	£8.36	1,813,664	5	6.5	–	–	–	–
£6.905 – £9.88	–	–	–	–	£9.01	1,024,492	5	7.4

2001 Performance Share Plan

Valuation

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

Grant Date	2005		2004	
	20 September	9 March	9 June	4 March
Share price at grant date	£11.89	£9.71	£9.21	£9.355
Shares under option as at 31 December 2005	–	101,591	–	63,242
Vesting period (years)	3	3	3	3
Option life (years)	10	10	10	10
Expected dividends (yield) (%)	3.5	3.5	3.7 - 3.9	3.5 - 3.9
Fair value (EPS) (%)	90	90	90	90
Fair value (TSR) (%)	39	39	39	39

A reconciliation of option movements over the year to 31 December 2005 is shown below:

	2005		2004	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	295,034	–	287,165	–
Granted	101,591	–	63,242	–
Lapsed	(49,605)	–	(20,254)	–
Exercised	(4,052)	–	(35,119)	–
Outstanding at 31 December	342,968	–	295,034	–
Exercisable at 31 December	342,968	–	11,127	–

Range of exercise price	2005				2004			
	Weighted average exercise price	No. of shares	Weighted average remaining life:		Weighted average exercise price	No. of shares	Weighted average remaining life:	
			Expected years	Contractual years			Expected years	Contractual years
n/a	–	342,968	–	7.8	–	11,127	–	8.1

1997 Restricted Share Scheme

Valuation

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

Grant Date	2005			2004	
	20 September	14 June	9 March	14 September	4 March
Share price at grant date	£11.89	£10.395	£9.71	£9.58	£9.355
Shares under option					
as at 31 December 2005	43,747	7,929	349,614	24,588	214,030
Vesting period (years)	2/3	2/3	2/3	2/3	2/3
Option life (years)	7	7	7	7	7
Expected dividends (yield) (%)	3.5	3.5	3.5	3.5 - 4	3.5 - 3.9
Fair value (%)	90	90 - 92	90 - 92	90 - 91	90 - 91

A reconciliation of option movements over the year to 31 December 2005 is shown below:

	2005		2004	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	1,303,904	–	1,264,475	–
Granted	428,133	–	259,957	–
Lapsed	(56,416)	–	(454)	–
Exercised	(226,561)	–	(220,074)	–
Outstanding at 31 December	1,449,060	–	1,303,904	–
Exercisable at 31 December	694,570	–	415,652	–

Range of exercise price	2005				2004			
	Weighted average exercise price	No. of shares	Weighted average remaining life:		Weighted average exercise price	No. of shares	Weighted average remaining life:	
			Expected years	Contractual years			Expected years	Contractual years
n/a	–	694,570	–	4.0	–	415,652	–	4.3

2004 Sharesave

Valuation

Options are valued using a Binomial option-pricing model. The fair value per option granted and the assumptions used in the calculation are as follows:

Grant Date	2005		2004	
	20 September	8 September	14 September	8 September
Share price at grant date	£11.89	£12.25	£9.58	£9.70
Exercise price	£9.87	£9.87	£7.43	£7.43
Shares under option as at 31 December 2005	680,307	–	527,343	–
Vesting period (years)	3/5	3/5	3/5	3/5
Expected volatility (%)	21 - 31	25 - 31	17 - 36	33 - 36
Option life (years)	3.33 - 5.33	3.33 - 5.33	3.33 - 5.33	3.33 - 5.33
Risk free rate (%)	4.2	4.1	4.2 - 4.9	4.9
Expected dividends (yield) (%)	3.5 - 3.7	3.5 - 3.7	3.1 - 3.9	3.4 - 3.9
Fair value (%)	24 - 33	24 - 31	31 - 42	31 - 37

The expected volatility is based on historical volatility over the last three to five years or three to five years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the assumed option life.

A reconciliation of option movements over the year to 31 December 2005 is shown below:

	2005		2004	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	604,339	£7.43	–	–
Granted	688,678	£9.87	612,710	£7.43
Lapsed	(84,641)	£7.67	(8,371)	£7.43
Exercised	(726)	£7.43	–	–
Outstanding at 31 December	1,207,650	£8.80	604,339	£7.43
Exercisable at 31 December	–	–	–	–

Range of exercise price	2005				2004			
	Weighted average exercise price	No. of shares	Expected years	Contractual years	Weighted average exercise price	No. of shares	Expected years	Contractual years
£7.43 - £9.87	£8.82	–	3.33 - 5.33	3.6	£7.43	–	3.33 - 5.33	3.6

(e) Loans to officers

Loans to officers of the Bank disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2005 HK\$'M	2004 HK\$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	11	49
Maximum aggregate amount of relevant loans by the Bank outstanding during the year/period	14	50

40 Ultimate holding company

The Bank's ultimate holding company is Standard Chartered PLC, a company registered in England and Wales. Standard Chartered PLC has dual primary listings on the London Stock Exchange and the Stock Exchange of Hong Kong.

41 Comparative figures

Certain comparative figures have been restated to comply with current year presentation.

42 Changes in accounting policies**(a) Restatement of prior periods and opening balances**

The following tables disclose the adjustments that have been made in accordance with the transitional provisions of the respective HKFRS to each of the line items in the consolidated income statement and balance sheet and other significant related disclosure items as previously reported for the year ended 31 December 2004.

*(i) Effect on the consolidated financial statements***Consolidated income statement for the year ended 31 December 2004**

	<i>Effect of new policy (increase/(decrease) in profit for the year)</i>			<i>2004 (as restated) HK\$'M</i>
	<i>2004 (before restatement) HK\$'M</i>	<i>HKFRS2 note 2(p)(iii) HK\$'M</i>	<i>HKAS30 note 42(c) HK\$'M</i>	
Interest income	9,067	–	6	9,073
Interest expense	(2,105)	–	–	(2,105)
Net interest income	6,962	–	6	6,968
Fee and commission income	3,259	–	–	3,259
Fee and commission expense	(734)	–	–	(734)
Net fee and commission income	2,525	–	–	2,525
Net trading gains	585	–	–	585
Other operating income	83	–	(6)	77
	<u>3,193</u>	<u>–</u>	<u>(6)</u>	<u>3,187</u>
Total operating income	10,155	–	–	10,155
Staff costs	(2,288)	(25)	–	(2,313)
Premises and equipment expense	(1,084)	–	323	(761)
Others	(1,478)	–	(323)	(1,801)
Operating expense	<u>(4,850)</u>	<u>(25)</u>	<u>–</u>	<u>(4,875)</u>
Operating profit before impairment	5,305	(25)	–	5,280
Net charge for bad and doubtful debts	(856)	–	–	(856)
Profit before taxation	4,449	(25)	–	4,424
Taxation	(725)	–	–	(725)
Profit after taxation	3,724	(25)	–	3,699
Profit attributable to minority interests	(4)	–	–	(4)
Profit attributable to shareholders	3,720	(25)	–	3,695

Consolidated balance sheet as at 31 December 2004*Consolidated*

	<i>Effect of new policy (increase/(decrease) in net assets)</i>			
	<i>2004 (before restatement) HK\$'M</i>	<i>HKAS 19 (note 2(p)(ii)) HK\$'M</i>	<i>HKAS 30 (note 42(c)) HK\$'M</i>	
Assets				
Cash and short-term funds	40,912	–	(40,912)	–
Cash and balances with banks and other financial institutions	–	–	7,857	7,857
Placements with banks and other financial institutions	7,739	–	11,121	18,860
Certificates of deposit held	1,474	–	(1,474)	–
Hong Kong SAR Government certificates of indebtedness	19,681	–		19,681
Trading securities	2,581	–	(2,581)	–
Trading assets	–	–	16,416	16,416
Advances to customers	169,592	–	97	169,689
Amounts due from immediate holding company	64,521	–		64,521
Amounts due from fellow subsidiaries	28	–		28
Non-trading securities	18,357	–	15,958	34,315
Fixed assets	1,954	–	(413)	1,541
Intangible assets	611	–	413	1,024
Deferred tax assets	137	–		137
Other assets	8,175	–	(6,482)	1,693
	<u>335,762</u>	<u>–</u>	<u>–</u>	<u>335,762</u>
Liabilities				
Hong Kong SAR currency notes in circulation	19,681	–	–	19,681
Deposits and balances of banks and other financial institutions	10,373	–	–	10,373
Deposits from customers	238,922	–	–	238,922
Trading liabilities	–	–	15,262	15,262
Debt securities issued	931	–	–	931
Certificates of deposit issued	10,525	–	–	10,525
Amounts due to immediate holding company	8,978	–	–	8,978
Amounts due to fellow subsidiaries	261	–	–	261
Current taxation	114	–	–	114
Deferred tax liabilities	24	–	–	24
Other liabilities	19,119	93	(15,262)	3,950
Dated capital notes	8,383	–	–	8,383
	<u>317,311</u>	<u>93</u>	<u>–</u>	<u>317,404</u>
Equity				
Share capital	3,878	–	–	3,878
Reserves – Pension reserve	14,525	(93)	–	14,432
Shareholders' equity	18,403	(93)	–	18,310
Minority interests	48	–	–	48
	<u>18,451</u>	<u>(93)</u>	<u>–</u>	<u>18,358</u>
	<u>335,762</u>	<u>–</u>	<u>–</u>	<u>335,762</u>

(ii) *Effect on the Bank's financial statements*

The effects of new policy on Bank's balance sheet are materially the same as for the consolidated balance sheet, therefore this has not been separately disclosed.

(b) *Estimated effect of changes in accounting policies on the current period*

The following tables provide estimates of the extent to which each of the line items in the consolidated income statement and balance sheet and other significant related disclosure items for the year ended 31 December 2005 is higher or lower than it would have been had the previous policies still been applied in the year, where it is practicable to make such estimates.

(i) *Effect on the consolidated financial statements***Estimated effect on the consolidated income statement for the year ended 31 December 2005:**

	Estimate effect of new policy (increase/(decrease) in profit for the year)					Total HK\$'M
	HKAS 39 (note 42(d))	HKFRS 2 (note 2(p)(iii))	HKAS 38 (note 2(e)(i))	HKAS 30 (note 42(c))	Tax effect	
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Interest income	26	-	-	-	-	26
Interest expense	6	-	-	-	-	6
Net interest income	32	-	-	-	-	32
Fee and commission income	(92)	-	-	-	-	(92)
Fee and commission expense	156	-	-	-	-	156
Net fee and commission income	64	-	-	-	-	64
Net trading gains	6	-	-	30	-	36
Net income from financial instruments designated at fair value through profit or loss	6	-	-	(30)	-	(24)
	76	-	-	-	-	76
Total operating income	108	-	-	-	-	108
Staff costs	-	(25)	-	-	-	(25)
Others	3	-	39	-	-	42
Operating expenses	3	(25)	39	-	-	17
Operating profit before impairment	111	(25)	39	-	-	125
Impairment losses on loans and advances	(98)	-	-	(729)	-	(827)
Net charge for bad and doubtful debts	-	-	-	729	-	729
Profit before taxation	13	(25)	39	-	-	27
Taxation	-	-	-	-	3	3
Profit after taxation	13	(25)	39	-	3	30
Profit attributable to minority interests	-	-	-	-	-	-
Profit attributable to shareholders	13	(25)	39	-	3	30

Estimated effect on the consolidated balance sheet at 31 December 2005:

	Estimated effect of new policy (increase/(decrease) in total assets and liabilities)					Tax effect HK\$'M	Total HK\$'M
	HKFRS 2	HKAS 19	HKAS 38	HKAS 39	HKAS 30		
	(note 2(p)(iii)) HK\$'M	(note 2(p)(ii)) HK\$'M	(note 2(e)(i)) HK\$'M	(note 42(d)) HK\$'M	(note 42(c)) HK\$'M		
Assets							
Cash and short-term funds	–	–	–	–	(55,015)	–	(55,015)
Cash and balances with banks and other financial institutions	–	–	–	–	5,764	–	5,764
Placements with banks and other financial institutions	–	–	–	–	31,775	–	31,775
Certificates of deposit held	–	–	–	–	(3,717)	–	(3,717)
Trading assets	–	–	–	123	19,650	–	19,773
Trading securities	–	–	–	–	(4,186)	–	(4,186)
Advances to customers	–	–	–	847	155	–	1,002
Available-for-sale securities	–	–	–	–	39,866	–	39,866
Non-trading securities	–	–	–	–	(30,706)	–	(30,706)
Fixed assets	–	–	–	–	(234)	–	(234)
Intangible assets	–	–	39	–	234	–	273
Deferred tax assets	–	–	–	–	–	(77)	(77)
Other assets	–	–	–	6	(3,586)	–	(3,580)
	–	–	39	976	–	(77)	938
Liabilities							
Deposits from customers	–	–	–	14	(4,254)	–	(4,240)
Trading liabilities	–	–	–	200	14,387	–	14,587
Financial liabilities designated at fair value through profit or loss	–	–	–	–	5,153	–	5,153
Debt securities issued	–	–	–	–	(899)	–	(899)
Current taxation	–	–	–	–	–	36	36
Other liabilities	25	31	–	152	(14,387)	–	(14,179)
Dated capital notes	–	–	–	(95)	–	–	(95)
	25	31	–	271	–	36	363
Equity							
Share capital	–	–	–	–	–	–	–
Reserves							
– Hedging reserve	–	–	–	(53)	–	9	(44)
– Pension reserve	–	(31)	–	–	–	–	(31)
– Retained profits	(25)	–	39	758	–	(122)	650
	–	–	39	976	–	(77)	938

Estimated effect on net income recognised directly in consolidated equity for the year ended 31 December 2005:

	Effect of new policy (increase/(decrease) in equity)		Total HK\$'M
	HKAS 19 (note 2(p)(ii))	HKAS 39 (note 42(d)) HK\$'M	
Attributable to equity shareholders of the Bank	(31)	(53)	(84)
Minority interest	—	—	—
Total equity	<u>(31)</u>	<u>(53)</u>	<u>(84)</u>

(ii) *Effect on the Bank's balance sheet*

The effect of new policy on Bank's balance sheet are materially the same as for the consolidated balance sheet, therefore this has not been separately disclosed.

(c) Changes in presentation (HKAS 1, Presentation of financial statements and HKAS 30, Disclosures in financial statements of banks and similar financial institutions)

In prior years, there were no specific accounting standards governing the presentation of the financial statements of banks. Management, having regard to the overall clarity and the disclosure requirements of the HKMA, exercised its judgement in deciding on the relative prominence given to each item presented on the face of the income statement and balance sheets. As a result, certificates of deposits held were separately presented on the face of the balance sheets. Treasury bills (including Exchange Fund Bills) and money at call and short notice (representing placements with banks and other financial institutions maturing within one month) were included in cash and short term funds with treasury bills being presented separately as trading and non-trading according to the previous Statement of Standard Accounting Practice 24.

With effect from 1 January 2005, in order to comply with HKAS 30 and take into account the measurement basis that has been applied, the Bank and its subsidiaries have changed the presentation of certain items on the face of the income statement and balance sheets. Treasury bills (including Exchange Fund Bills) and certificates of deposit held are included in the two categories of financial instruments under HKAS 39. Placements with banks and other financial institutions maturing within one month are included in placements with banks and other financial institutions. These changes in presentation have been applied retrospectively with comparatives reclassified as shown in note 42(a) and (b).

(d) Financial instrument (HKAS 32, Financial instruments: Disclosure and presentation and HKAS 39, Financial Instruments: Recognition and measurement)

With effect from 1 January 2005, in order to comply with HKAS 32, the Bank and its subsidiaries have provided additional disclosures of terms, conditions, accounting policies, risk and fair values of financial instruments throughout the notes to this financial statements. In order to comply with HKAS 39, the Bank and its subsidiaries have changed their accounting policies relating to financial instruments accordingly. A summary of the changes as set out in note 2 are as follows:

- (i) Financial assets and liabilities (note 2(i))
- (ii) Derivative financial instruments and hedge accounting (note 2(j))
- (iii) Impairment of financial assets (note 2(k)(i))

The changes in accounting policies of the above items were adopted by way of opening balance adjustments to certain reserves and re-designation of financial instruments as at 1 January 2005 as disclosed in the respective notes. Comparative amounts have not been restated as HKAS 39 are applied prospectively.

43 Significant accounting estimates and judgements

In determining the carrying amounts of some assets and liabilities, the Bank and its subsidiaries make assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. The Bank and its subsidiaries' estimations and assumptions are based on historical experience and expectation of future events and are reviewed periodically. This disclosure excludes uncertainty over future events and judgments in respect of measuring financial instruments.

Pensions

Actuarial assumptions are made in valuing future pension obligations as set out in note 29. There is uncertainty that these assumptions will continue in the future. They are updated periodically.

Taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions.

Impairment of financial assets

Policies on impairment of financial assets are set out in note 2(k)(i).

44 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2005

Up to the date of issue of these financial statements, the HKICPA has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ending 31 December 2005 and which have not been adopted in these financial statements:

	<i>Effective for accounting periods beginning on or after</i>
HKFRS 6, Exploration for and evaluation of mineral resources	1 January 2006
HK(IFRIC) 4, Determining whether an arrangement contains a lease	1 January 2006
HK(IFRIC) 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds	1 January 2006
HK(IFRIC) 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005
Amendments to HKAS 39, Financial instruments:	
Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:	
– HKAS 1, Presentation of financial statements	1 January 2006
– HKAS 27, Consolidated and separate financial statements	1 January 2006
– HKFRS 3, Business combinations	1 January 2006
HKFRS 7, Financial instruments: disclosures	1 January 2007
Amendment to HKAS 1, Presentation of financial statements: capital disclosures	1 January 2007

In addition, the Hong Kong Companies (Amendment) Ordinance 2005 came into effect on 1 December 2005 and would be first applicable to the financial statements of the Bank and its subsidiaries for the period beginning 1 January 2006.

The Bank and its subsidiaries are in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application.

Unaudited supplementary financial information

(a) Capital adequacy ratios

	2005 %	2004 %
Capital adequacy ratio as at 31 December	<u>15.1%</u>	<u>15.9%</u>
Adjusted capital adequacy ratio as at 31 December	<u>14.8%</u>	<u>14.9%</u>

The capital adequacy ratio is computed on the consolidated basis of the Bank and certain of its financial subsidiaries as specified by the HKMA for its regulatory purposes, and is in accordance with the Third Schedule to the Hong Kong Banking Ordinance. The adjusted capital adequacy ratio incorporating market risk is computed on an unconsolidated basis as agreed with the HKMA, and is in accordance with the guideline on "Maintenance of Adequate Capital Against Market Risks" under the Supervisory Policy Manual issued by the HKMA.

	<i>Consolidated</i>	
	2005 HK\$'M	2004 HK\$'M
Components of capital base after deductions		
Core capital:		
Paid up ordinary share capital	101	78
Irredeemable non-cumulative preference shares	3,800	3,800
Share premium	12,477	12,500
Reserves (including retained profits)	6,794	2,821
Minority interest	51	48
Deduct: Goodwill	<u>(611)</u>	<u>(667)</u>
	<u>22,612</u>	<u>18,580</u>
Eligible supplementary capital:		
Properties revaluation reserves (at 70%)	2	2
Available-for-sale investment reserve	(86)	–
Non-trading investment reserves	–	(29)
Collective impairment allowances for impaired assets and regulatory reserve	769	–
General provisions for bad and doubtful debts	–	785
Dated capital notes	<u>3,781</u>	<u>8,383</u>
	<u>4,466</u>	<u>9,141</u>
Total capital base before deductions	27,078	27,721
Deductions from total capital base	<u>(1,400)</u>	<u>(23)</u>
Total capital base after deductions	<u>25,678</u>	<u>27,698</u>

(b) Liquidity ratios

	<i>Bank</i>	
	2005 %	2004 %
Average liquidity ratio for the year	<u>35.2%</u>	<u>34.8%</u>

The average liquidity ratio is computed as the simple average of each calendar month's average ratio and in accordance with the Fourth Schedule to the Hong Kong Banking Ordinance.

(c) Overdue and rescheduled assets*(i) Overdue advances to customers*

	<i>Consolidated</i>			
	2005		2004	
	<i>HK\$'M</i>	<i>% of advances</i>	<i>HK\$'M</i>	<i>% of advances</i>
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– 6 months or less but over 3 months	193	0.1%	168	0.1%
– 1 year or less but over 6 months	417	0.3%	188	0.1%
– over 1 year	<u>1,679</u>	<u>1.0%</u>	<u>2,140</u>	<u>1.3%</u>
	<u>2,289</u>	<u>1.4%</u>	<u>2,496</u>	<u>1.5%</u>
Breakdown by countries				
– Hong Kong	2,012		1,683	
– People's Republic of China (excluding Hong Kong)	266		791	
– Others	<u>11</u>		<u>22</u>	
	<u>2,289</u>		<u>2,496</u>	

(ii) Advances to customers – by geographical area

Advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when an advance is guaranteed by a party in an area which is different from that of the counterparty. At 31 December 2005 and 31 December 2004, over 90 per cent of the Bank and its subsidiaries' advances to customers were classified under the area of Hong Kong.

(iii) Rescheduled advances to customers

	<i>Consolidated</i>			
	2005		2004	
	<i>HK\$'M</i>	<i>% of advances</i>	<i>HK\$'M</i>	<i>% of advances</i>
Rescheduled advances	<u>591</u>	<u>0.4%</u>	<u>535</u>	<u>0.3%</u>

Rescheduled advances are those advances, which have been restructured or renegotiated because of deteriorations in the financial position of the borrowers, or the inability of the borrowers to meet the original repayment schedule and for which the revised repayment terms are non-commercial to the Bank. Rescheduled advances to customers are stated net of any advances that have subsequently become overdue for over 3 months and reported as overdue advances in note(c)(i) above.

There were no overdue advances and rescheduled advances to banks and other financial institutions as at 31 December 2005.

(d) Cross border claims

Cross border claims are on-balance sheet exposures of counterparties based on the location of those counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, risk will be transferred to the country of the guarantor. For a claim on the branch of a bank or other financial institution, the risk will be transferred to the country where its head office is situated. Claims on individual countries or area, after risk transfer, amounting to 10% or more of the aggregate cross border claims are shown as follows:

	<i>Consolidated 2005</i>			
	<i>Banks and other financial institutions HK\$'M</i>	<i>Public sector entities HK\$'M</i>	<i>Other HK\$'M</i>	<i>Total HK\$'M</i>
Asia Pacific excluding Hong Kong	16,741	–	4,522	21,263
Western Europe				
– United Kingdom	42,712	–	715	43,427
– Others	34,371	1,195	507	36,073
	<u>77,083</u>	<u>1,195</u>	<u>1,222</u>	<u>79,500</u>
	<i>Consolidated 2004</i>			
	<i>Banks and other financial institutions HK\$'M</i>	<i>Public sector entities HK\$'M</i>	<i>Other HK\$'M</i>	<i>Total HK\$'M</i>
Asia Pacific excluding Hong Kong	8,711	–	7,595	16,306
Western Europe				
– United Kingdom	65,163	–	322	65,485
– Others	12,809	1,114	885	14,808
	<u>77,972</u>	<u>1,114</u>	<u>1,207</u>	<u>80,293</u>

Geographical segments are identified based on the location of the principal operations of the subsidiaries or, in case of the Bank itself, on the location of branches responsible for reporting the results or booking the assets. For the years ended 31 December 2005 and 31 December 2004, all the Bank's operations and branches were located in Hong Kong. More than 90% of the Bank and its subsidiaries' assets were located in Hong Kong.

(e) Repossessed assets

	<i>Consolidated</i>	
	<i>2005</i>	<i>2004</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Repossessed assets	<u>39</u>	<u>112</u>

(f) Corporate governance

The Bank is committed to high standards of corporate governance, and has fully complied throughout the year with the guideline on “Corporate Governance of Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the HKMA.

Board committees

The Board has established various committees while reserving key strategic matters for its own approval. The major committees are detailed below:

(i) Executive Committee (“EXCO”)

The EXCO operates under the direct authority of the Board and meets regularly in relation to the day to day management, operation and control of the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The EXCO comprises the Chief Executive Officer, the Chief Financial Officer and the Heads of various business functions.

(ii) Risk Committee

The Risk Committee is responsible for assisting the Board to supervise and direct the management of credit, market, country, operational, compliance and reputational risk within the Bank. It also ensures that processes and procedures in place for monitoring and control of risk meet the standards set down in internal procedures and external regulatory requirements.

The Committee meets regularly and comprises of the Chief Risk Officer, the Chief Financial Officer, Heads of Credit and representatives from other relevant units. It has appointed various sub-committees to supervise and review specific areas of risk, including the Portfolio Management Committee, the Early Alert Committee, the Group Special Asset Management (“GSAM”) Committee, the Excess Approval Committee and the Country Operational Risk Group (“CORG”).

(iii) Asset and Liability Committee (“ALCO”)

The ALCO is appointed by the EXCO. It is chaired by the Chief Executive Officer, and with authority derived from the Board, is responsible for both statutory and prudential liquidity. It is also responsible to ensure that the balance sheet management is in compliance with regulatory requirements relating to management of liquidity, capital adequacy and structural market risks. These are managed through the provision of liquidity policies and guidelines agreed in ALCO. The members of the ALCO include the Chief Executive Officer, the Chief Financial Officer, key business and risk management heads.

(iv) *Audit Committee*

The Audit Committee meets regularly with the internal audit and the external auditors to review and discuss the Bank's internal financial control, internal control, compliance and risk management systems. The Committee also discusses matters raised by the internal and external auditors and ensures that audit recommendations are implemented appropriately. The Committee comprises of at least 3 non-executive directors, the majority of whom are independent.

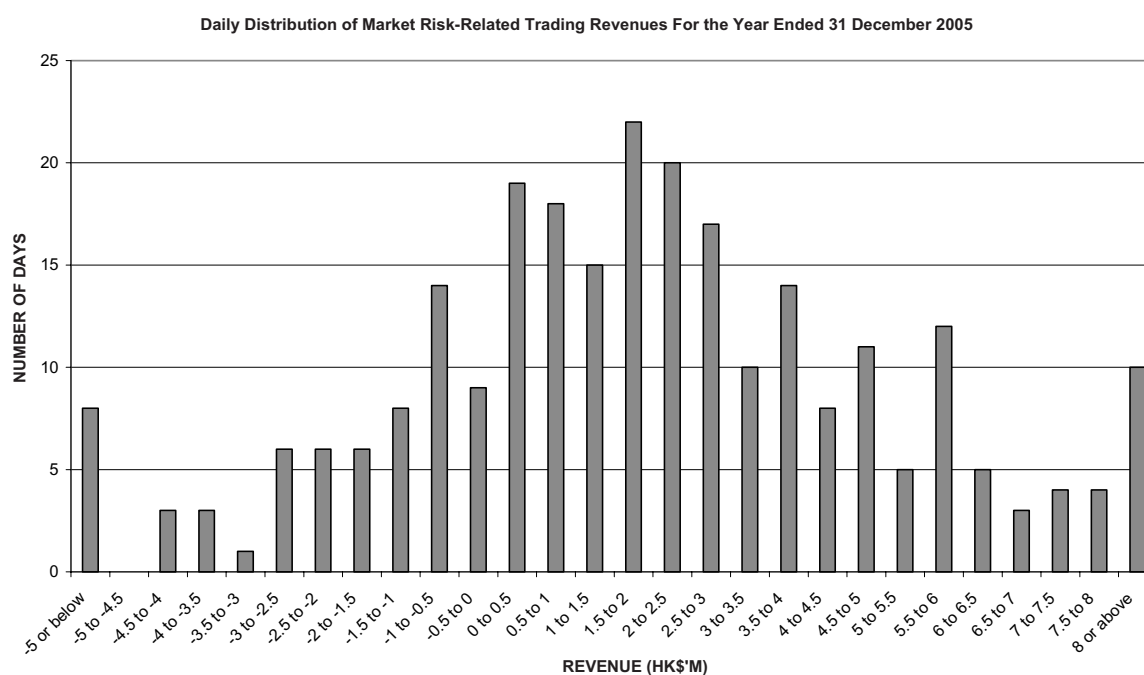
(v) *Country Operational Risk Group ("CORG")*

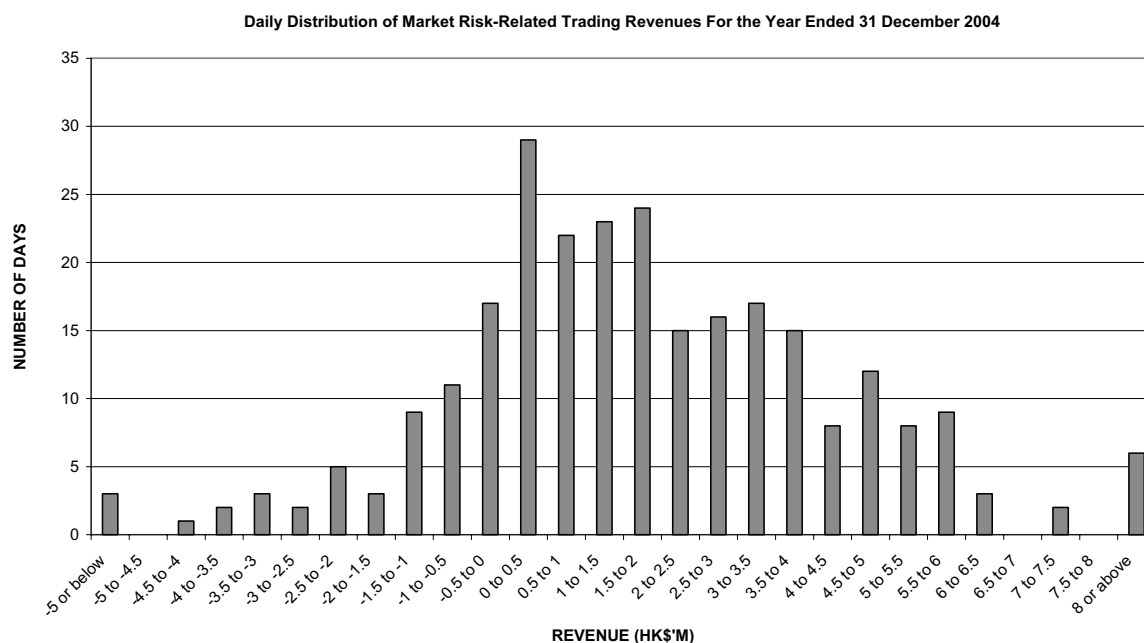
CORG is appointed by the Risk Committee to review all operational risks including key project risks, legal and compliance risks, reputational risks, e-commerce risks, outsourcing risks, internal financial control risks, front office risks, middle office risks and risks in support functions. The Committee comprises the Chief Executive Officer, Manager, Operational Risk and representatives from other relevant units.

(g) **Market risk management exposures**

Historical simulation is used to measure Value at Risk ("VaR") on trading exposure by applying actual historical market rate movements based on one-day holding period and a 97.5% confidence level. Additional limits are placed on specific instruments and currency concentrations where appropriate. Sensitivity measures are used in addition to VaR as part of the overall risk management tools. Market risk exposures are measured and monitored against approved limits or triggers to ensure the Bank's market risk exposures are within acceptable levels. Regular stress test on market risk exposures are also performed. The Risk Committee reviews stress test results on a regular basis.

For the year ended 31 December 2005, the average daily revenue of the Bank earned from market risk-related trading activities was HK\$2.0 million (2004: HK\$1.8 million). The standard deviation of these daily trading revenues was HK\$3.5 million (2004: HK\$2.7 million). An analysis on the daily distribution of market risk-related trading revenues is provided below.





(h) Foreign exchange exposure

The average daily foreign exchange dealing revenue for the year ended 31 December 2005 was HK\$1.3 million (2004: HK\$1.2 million).

Foreign Exchange related VaR as at 31 December 2005 was HK\$1.0 million (2004: HK\$0.8 million). The average VaR for the year ended 31 December 2005 was HK\$1.5 million (2004: HK\$1.7 million).

(i) Interest rate risk exposure

The average daily revenue earned from interest rate activities for the year ended 31 December 2005 was HK\$0.6 million (2004: HK\$0.3 million).

Interest rate trading related VaR as at 31 December 2005 was HK\$6.3 million (2004: HK\$0.7 million). The average VaR for the year end 31 December 2005 was HK\$5.5 million (2004: HK\$2.0 million).