

DBS BANK (HONG KONG) LIMITED

Financial Highlights of 2006 Final Results and Key Ratios

- Profit attributable to shareholders up by 48.6% (HK\$1,020 million) from 2005 to HK\$3,121 million
- Profit before impairment allowances up 42.0% (HK\$1,213 million) from 2005 to HK\$4,099 million. Excluding net gain of HK\$267 million from the sale of Queen's Road Central office premises, profit before impairment allowances would be up 32.8% (HK\$946 million) to HK\$3,832 million
- Net interest margin up 35 basis points from 2005 to 2.74%
- Net interest income up 24.6% (HK\$1,040 million) from 2005 to HK\$5,267 million
- Non-interest income up 35.8% (HK\$462 million) from 2005 to HK\$1,750 million, or up 15.1% (HK\$ 195 million) to HK\$1,483 million excluding profit from sale of Queen's Road Central office premises
- Total expenses up 11.0% (HK\$289 million) from 2005 to HK\$2,918 million
- Impairment allowances up 0.5% (HK\$2 million) from 2005 to HK\$405 million
- Gross advances to customers increased 6.0% (HK\$7 billion) from end of 2005 to HK\$119 billion
- Deposits from customers (included financial liabilities designated at fair value through profit or loss) increased 17.9% (HK\$25 billion) from end of 2005 to HK\$167 billion
- Cost-to-income ratio improved from 47.7% in 2005 to 41.6%, or 43.2% excluding profit from sale of Queen's Road Central office premises
- Return on average total assets increased from 1.1% in 2005 to 1.5%, or 1.4% excluding profit from sale of Queen's Road Central office premises
- Return on average shareholders' fund increased from 11.6% in 2005 to 17.0%, or 15.6% excluding profit from sale of Queen's Road Central office premises
- Loans to deposits ratio declined from 78.0% at the end of 2005 to 70.1%
- Ratio of impaired advances to gross advances to customers declined from 1.7% at the end of 2005 to 1.5%
- Adjusted capital adequacy ratio declined from 17.7% at the end of 2005 to 15.9%

DBS BANK (HONG KONG) LIMITED

***DBS Bank (Hong Kong) Limited
reported attributable profit of HK\$3,121 million
(up 48.6%) for 2006***

HONG KONG, 15 February 2007 - DBS Bank (Hong Kong) Limited (the 'Bank') today announced its 2006 final results. The Bank recorded a consolidated profit attributable to shareholders of HK\$3,121 million, an increase of 48.6% from 2005.

The growth in the Bank's profit was mainly attributable to higher total income, including a one-off disposal gain on an office building. Return on average total assets rose from 1.1% to 1.5 % on a year-on-year basis, and return on average shareholders' funds rose from 11.6% to 17.0%.

REVIEW OF ACTIVITIES

Hong Kong's economy continued to perform well in 2006. This is supported by buoyant external trade flows with China and robust intra-regional trade. The unemployment rate also fell to 4.4% in December, the lowest level since 2001. With improved employment outlook and continued strong inbound tourism, consumer spending and retail sales have grown. Average Prime-HIBOR spread widened in 2006 mainly due to excess liquidity. Equity market was buoyant providing banks with more opportunities to sell wealth management products. Competition in Hong Kong banking industry has been intensified, particularly in residential mortgages.

With increasing interdependence of the economies of the Mainland China and Hong Kong, the Bank continued its strategy to further expand its Mainland China

business. It opened a branch in Suzhou in April 2006 following the opening of a representative office in Hangzhou in second half of 2005. Corporate and Investment Banking Division continued to achieve good loan growth especially in the SME business in Pearl River Delta area. On retail side, the Bank expanded and diversified its customer base by continuously launching new products to the market.

KEY FINANCIAL PERFORMANCE

During the year, the Bank achieved growth in both total income and profit. Profit before impairment allowances was HK\$4,099 million, up 42.0% from 2005.

Total income increased by 27.2% to HK\$7,016 million. Net interest income grew by 24.6% to HK\$5,267 million mainly due to widening of interest spread and increased volumes.

Non-interest income grew by 35.8% to HK\$1,750 million. Excluding a net gain of HK\$267 million from the sale of its office premises at 139 Queen's Road Central, non-interest income would increase by 15.1% to HK\$1,483 million. Net fee and commission income increased by 19.9% to HK\$1,311 million.

Total expenses rose by 11.0% to HK\$2,918 million, with staff costs increased by 10.4% mainly due to upward wage pressure, while non-staff costs rising by 11.7%. Excluding the net gain from sale of Queen's Road Central office premises, the cost-to-income ratio was at 43.2% compared to 47.7% in 2005.

As at 31 December 2006, the level of impaired loans decreased to HK\$1.8 billion, or 1.5% of total gross loans, compared to HK\$1.9 billion and 1.7% as at 31 December 2005.

Total gross advances to customers increased 6.0% from 31 December 2005 to HK\$118.8 billion as at 31 December 2006 mainly due to growth in trade finance, property investment loans and loans for use outside Hong Kong. Customer deposits increased 17.9% to HK\$167 billion.

The Bank's financial strength remains good. Capital adequacy ratio adjusted for market risk was 15.9% as at 31 December 2006. Dividend payments of HK\$6,067 million were made during the year. Average liquidity ratio was 42.7% for 2006, compared to 49.0% for 2005.

– End –

DBS BANK (HONG KONG) LIMITED

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DBS BANK (HONG KONG) LIMITED

REPORT OF THE DIRECTORS

The directors of DBS Bank (Hong Kong) Limited (the 'Bank') submit their report together with the audited financial statements of the Bank and its subsidiaries (the 'Group') for the year ended 31st December 2006.

Principal activities

The principal activity of the Bank is the provision of banking and related financial services. The principal activities of the subsidiaries are shown in Note 22 to the financial statements.

Results and appropriations

The results of the Group for the year ended 31st December 2006 are set out in the consolidated income statement on page 5.

Three interim dividends were paid for the year ended 31st December 2006. The first and second interim dividends each amounting to HK\$1,400,000,000 at approximately HK\$0.2692 per share were paid on 29th May 2006 and 6th June 2006 respectively. The third interim dividend of approximately HK\$0.6283 per share totalling HK\$3,267,000,000 was paid on 13th December 2006. (2005: an interim dividend of HK\$0.198 per share totalling HK\$1,029,600,000 was paid).

The directors do not recommend the payment of a final dividend for the year ended 31st December 2006 (2005: Nil).

Reserves

Details of the movements in the reserves of the Bank and the Group during the year are set out in Note 33 to the financial statements.

Fixed assets

Details of the movements in fixed assets during the year are set out in Note 23 to the financial statements.

Donations

Donations made by the Group during the year amounted to HK\$215,000 (2005: HK\$946,000).

Directors

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

Wong Kwong Shing, Frank – Chairman	
Yip Yok Tak, Amy – Chief Executive	(appointed on 1st October 2006)
Chan Tak Kin – Deputy Chief Executive	
Jackson Peter Tai	
Leung Chun Ying	
Cheng Wai Chee, Christopher	
Leung Ting Mow, Kenneth	
Lo Chung Wing, Victor	
Randolph Gordon Sullivan	(resigned on 1st October 2006)

In accordance with Article 90 of the Bank's Articles of Association, Ms. Yip Yok Tak, Amy retires from office at the forthcoming Annual General Meeting and, being eligible, offers herself for re-election.

In accordance with Article 98 of the Bank's Articles of Association, Mr. Lo Chung Wing, Victor retires from office at the forthcoming Annual General Meeting and, being eligible, offers himself for re-election.

DBS BANK (HONG KONG) LIMITED

REPORT OF THE DIRECTORS (CONTINUED)

Interests in contracts

No contract of significance, to which the Bank or any of its subsidiaries or its holding companies or any subsidiary of its holding companies 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.

Arrangements to acquire shares

The following were arrangements which subsisted at the end of the year or at any time during the year which enabled the directors of the Bank to acquire benefits by means of the acquisition of shares of DBS Group Holdings Ltd. ('DBSH'), the ultimate holding company of the Bank, or to be awarded shares of DBSH.

(a) *DBSH Share Option Plan*

The DBSH Share Option Plan (the 'Option Plan') was adopted by the shareholders of DBSH at an Extraordinary General Meeting held on 18th September 1999 under which options to subscribe for DBSH ordinary shares could be granted to DBSH Group executives.

At the beginning of the year, Messrs. Wong Kwong Shing, Frank, Jackson Peter Tai, Randolph Gordon Sullivan and Chan Tak Kin have outstanding options granted under the Option Plan.

During the year, no options were granted to directors of the Bank and Mr. Randolph Gordon Sullivan had acquired shares in DBSH by exercising options granted pursuant to the Option Plan.

(b) *DBSH Share Plan (formerly known as the DBSH Performance Share Plan)*

The DBSH Share Plan (the 'Share Plan'), as amended, was adopted by the shareholders of DBSH at an Extraordinary General Meeting held on 18th September 1999. The Share Plan is a stock-based plan where DBSH ordinary shares are given free to DBSH Group executives when certain criteria (such as job performance, level of responsibility, potential for future development and contribution to the success and development of DBSH Group) are met.

During the year, Messrs. Wong Kwong Shing, Frank, Jackson Peter Tai, Randolph Gordon Sullivan and Chan Tak Kin were eligible to receive DBSH shares under the Share Plan. A total of 20,195 DBSH shares were vested in Messrs. Wong Kwong Shing, Frank, Jackson Peter Tai, Randolph Gordon Sullivan and Chan Tak Kin under the Share Plan during the year.

Apart from the above, at no time during the year was the Bank or any of its subsidiaries or its holding companies or any subsidiary of its holding companies a party to any 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.

Management contracts

On 12th November 2002, an Information Technology Outsourcing Agreement (the 'IBM Agreement') was entered into between the Bank and IBM China/Hong Kong Limited ('IBM') in relation to the provision by IBM of certain information technology and related services to the Bank. The IBM Agreement was in line with the spirit of the Master Agreement (the 'IBM Master Agreement') dated 12th November 2002 entered into between DBS Bank Ltd., the Bank's holding company, and IBM Singapore Pte. Limited. The IBM Agreement commenced on 12th November 2002 and continues until 23:59 (Singapore Time) on 11th November 2012, unless terminated earlier pursuant to the terms of the IBM Master Agreement.

DBS BANK (HONG KONG) LIMITED

REPORT OF THE DIRECTORS (CONTINUED)

Management contracts (continued)

On 1st April 2004, a Management Country Agreement (the 'JLL Agreement') was entered into between the Bank and Jones Lang LaSalle Limited ('JLL') in relation to the provision by JLL of certain property management and related services to the Bank in Hong Kong. The JLL Agreement was in line with the spirit of the Master Agreement (the 'JLL Master Agreement') dated 1st April 2004 entered into between DBS Bank Ltd., and Jones Lang LaSalle Property Consultants Pte Ltd.. The initial term of the JLL Agreement covered the period from 1st April 2004 to 31st December 2006, or for so long as the JLL Master Agreement remains in effect, unless terminated earlier or extended under the terms of the JLL Agreement, whichever is earlier in time. The JLL Master Agreement has been renewed for a further period of two years and will expire until 31st December 2008.

Apart from the foregoing, no contract concerning the management and administration of the whole or any substantial part of the business of the Bank was entered into or existed during the year.

Compliance with the guideline on 'Financial Disclosure by Locally Incorporated Authorized Institutions'

The Group has fully complied with the requirements set out in the guideline on 'Financial Disclosure by Locally Incorporated Authorized Institutions' issued by the Hong Kong Monetary Authority.

Auditors

The financial statements have been audited by Ernst & Young who retire at the forthcoming annual general meeting and offer themselves for re-appointment.

On behalf of the Board

Wong Kwong Shing, Frank
Chairman

Hong Kong, 9th February 2007

DBS BANK (HONG KONG) LIMITED

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF DBS BANK (HONG KONG) LIMITED

(Incorporated in Hong Kong with limited liability)

We have audited the financial statements of DBS Bank (Hong Kong) Limited set out on pages 5 to 61, which comprise the consolidated and company balance sheets as at 31st December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Bank are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made 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.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit 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 Group as at 31st December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Ernst & Young

Certified Public Accountants

18th Floor
Two International Finance Centre
8 Finance Street, Central
Hong Kong

9th February 2007

DBS BANK (HONG KONG) LIMITED

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER 2006

	Note	2006 HK\$'000	As restated 2005 HK\$'000
Interest income	3	11,136,163	7,532,080
Interest expense	4	(5,869,590)	(3,305,806)
Net interest income		5,266,573	4,226,274
Fee and commission income		1,629,398	1,345,913
Fee and commission expense		(318,406)	(252,385)
Net fee and commission income		1,310,992	1,093,528
Net trading income	5	(10,717)	(7,121)
Net gain on disposal of available-for-sale financial investments		83,193	88,180
Net gain on disposal of fixed assets and lease premium for land	6	335,927	72,000
Other income	7	30,493	41,730
Total income		7,016,461	5,514,591
Total expenses	8	(2,917,720)	(2,628,755)
Profit before impairment allowances		4,098,741	2,885,836
Impairment allowances on advances to customers	9	(404,834)	(402,861)
Profit before income tax		3,693,907	2,482,975
Income tax expense	11	(573,183)	(382,346)
Profit attributable to shareholders	12	3,120,724	2,100,629
Dividends	13	6,067,000	1,029,600

DBS BANK (HONG KONG) LIMITED

CONSOLIDATED BALANCE SHEET

AS AT 31ST DECEMBER 2006

	Note	2006 HK\$'000	As restated 2005 HK\$'000
Assets			
Cash and balances with banks	14	17,896,241	16,118,220
Placements with banks maturing between one to twelve months		18,133,327	11,093,471
Trading securities	15	6,625,849	5,000,470
Positive replacement values	16	1,463,111	954,453
Advances to customers less impairment allowances	17	117,109,840	110,394,517
Available-for-sale financial investments	19	45,403,836	36,279,619
Other assets	20	2,224,659	1,694,774
Deferred income tax assets	29(b)	82,942	85,920
Fixed assets	23	1,072,253	1,203,602
Lease premium for land	24	2,086,721	2,344,011
		<u>212,098,779</u>	<u>185,169,057</u>
Liabilities			
Deposits and balances from banks		2,936,632	2,277,937
Negative replacement values	16	2,082,175	1,836,007
Trading liabilities	25	6,655,669	4,971,799
Financial liabilities designated at fair value through profit or loss	26	12,899,635	18,344,388
Deposits from customers	26	154,264,360	123,440,237
Certificates of deposit issued	27	3,260,239	6,269,719
Other liabilities	28	6,989,669	6,634,067
Current income tax liabilities	29(a)	306,413	84,808
Amount due to a jointly controlled entity	21	673,830	672,839
Subordinated liabilities	30	6,233,157	2,028,445
		<u>196,301,779</u>	<u>166,560,246</u>
Equity			
Share capital	32	5,200,000	5,200,000
Reserves	33	10,597,000	13,408,811
		<u>15,797,000</u>	<u>18,608,811</u>
Total liabilities and equity		<u>212,098,779</u>	<u>185,169,057</u>

Wong Kwong Shing, Frank
Director

Yip Yok Tak, Amy
Director

Chan Tak Kin
Director

Wong Wai Nar, Doris
Secretary

DBS BANK (HONG KONG) LIMITED

BALANCE SHEET

AS AT 31ST DECEMBER 2006

	Note	2006 HK\$'000	As restated 2005 HK\$'000
Assets			
Cash and balances with banks	14	17,893,512	16,116,601
Placements with banks maturing between one to twelve months		18,133,327	11,093,471
Trading securities	15	6,625,849	5,000,470
Positive replacement values	16	1,463,111	954,453
Advances to customers less impairment allowances	17	117,136,246	110,427,673
Available-for-sale financial investments	19	45,403,836	36,279,619
Other assets	20	2,221,422	1,693,350
Deferred income tax assets	29(b)	84,125	82,606
Interest in a jointly controlled entity	21	500	500
Subsidiaries	22	161,177	155,836
Fixed assets	23	1,047,327	1,191,755
Lease premium for land	24	2,086,721	2,344,011
Total assets		212,257,153	185,340,345
Liabilities			
Deposits and balances from banks		2,936,632	2,277,937
Negative replacement values	16	2,082,175	1,836,007
Trading liabilities	25	6,655,669	4,971,799
Financial liabilities designated at fair value through profit or loss	26	12,899,635	18,344,388
Deposits from customers	26	154,264,360	123,440,237
Certificates of deposit issued	27	3,260,239	6,269,719
Other liabilities	28	6,477,953	6,122,042
Current income tax liabilities	29(a)	307,600	83,665
Amount due to a jointly controlled entity	21	1,347,660	1,345,679
Amounts due to subsidiaries	22	219,280	207,677
Subordinated liabilities	30	6,233,157	2,028,445
Total liabilities		196,684,360	166,927,595
Equity			
Share capital	32	5,200,000	5,200,000
Reserves	33	10,372,793	13,212,750
Total equity		15,572,793	18,412,750
Total liabilities and equity		212,257,153	185,340,345
Wong Kwong Shing, Frank <i>Director</i>		Yip Yok Tak, Amy <i>Director</i>	
Chan Tak Kin <i>Director</i>		Wong Wai Nar, Doris <i>Secretary</i>	

DBS BANK (HONG KONG) LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER 2006

	Share Capital HK\$'000	Share Premium HK\$'000	Capital Reserve HK\$'000	Investments Revaluation Reserve HK\$'000	General Reserve HK\$'000	Retained Earnings HK\$'000	Total Equity HK\$'000
Balance as at 1st January 2005	5,200,000	595,503	11,636	146,836	2,398,792	9,599,835	17,952,602
Change in fair value of available-for-sale financial investments	-	-	-	(369,770)	-	-	(369,770)
Exchange differences arising from translation of net investments in overseas branches and subsidiaries	-	-	-	-	-	(57)	(57)
Profit attributable to shareholders	-	-	-	-	-	2,100,629	2,100,629
Reserve transferred to income statement upon disposal of available-for-sale financial investments	-	-	-	(69,321)	-	-	(69,321)
Deferred income tax	-	-	-	24,328	-	-	24,328
Dividends	-	-	-	-	-	(1,029,600)	(1,029,600)
Balance as at 31st December 2005	5,200,000	595,503	11,636	(267,927)	2,398,792	10,670,807	18,608,811
Change in fair value of available-for-sale financial investments	-	-	-	181,410	-	-	181,410
Exchange differences arising from translation of net investments in overseas branches and subsidiaries	-	-	-	-	-	(311)	(311)
Profit attributable to shareholders	-	-	-	-	-	3,120,724	3,120,724
Reserve transferred to income statement upon disposal of available-for-sale financial investments	-	-	-	(68,777)	-	-	(68,777)
Deferred income tax	-	-	-	22,143	-	-	22,143
Dividends	-	-	-	-	-	(6,067,000)	(6,067,000)
Balance as at 31st December 2006	5,200,000	595,503	11,636	(133,151)	2,398,792	7,724,220	15,797,000

DBS BANK (HONG KONG) LIMITED

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER 2006

	Note	2006 HK\$'000	As restated 2005 HK\$'000
Net cash inflow from operating activities	37(a)	2,775,263	5,960,346
Investing activities			
Purchase of fixed assets		(155,968)	(266,926)
Proceeds from disposal of fixed assets and lease premium for land		<u>800,286</u>	<u>136,155</u>
Net cash inflow/(outflow) from investing activities		<u>644,318</u>	<u>(130,771)</u>
Financing activities			
Dividends paid		(6,067,000)	(1,029,600)
Interest paid for certificates of deposit issued		(187,136)	(170,176)
Interest paid for subordinated liabilities		(157,314)	(157,837)
Issue of certificates of deposit	37(b)	13,000	2,686,696
Redemption of certificates of deposit	37(b)	(3,075,326)	(6,121,586)
Issue of subordinated liabilities	37(b)	<u>4,198,878</u>	<u>–</u>
Net cash outflow from financing activities		<u>(5,274,898)</u>	<u>(4,792,503)</u>
(Decrease)/increase in cash and cash equivalents		(1,855,317)	1,037,072
Cash and cash equivalents at 1st January		25,704,474	24,667,459
Effect of foreign exchange movements		<u>(311)</u>	<u>(57)</u>
Cash and cash equivalents at 31st December	37(c)	<u>23,848,846</u>	<u>25,704,474</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1 General information

The principal activities of the Bank and its subsidiaries (the 'Group') are the provision of banking and related financial services. The Bank is a limited company incorporated and domiciled in Hong Kong. The address of its registered office is 11th Floor, The Center, 99 Queen's Road Central, Central, Hong Kong.

The ultimate holding company is DBS Group Holdings Ltd. ('DBSH') which is listed, incorporated and domiciled in Singapore. The address of its registered office is 6 Shenton Way, DBS Building Tower One, Singapore 068809.

These consolidated financial statements are presented in thousands of units of HK dollars (HK\$'000), unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 9th February 2007.

2 Summary of significant accounting policies

The following is a summary of the significant accounting policies applied by the Group and, except where noted, are consistent with those applied in the previous financial year. The principal accounting policies adopted in the preparation of the financial statements are set out below:

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs which is a collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ('HKASs') and Interpretations) issued by Hong Kong Institute of Certified Public Accountants ('HKICPA'), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial investments, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss and investment properties. In addition, the carrying amounts of assets and liabilities that are designated as hedged items in a fair value hedge are adjusted for fair value changes attributable to the hedged risks.

The preparation of financial statements in conformity with HKFRSs requires management to exercise judgement, use estimates and make assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. Although these estimates are based on management's best knowledge of current events and actions, actual results may differ from these estimates. Critical accounting estimates and assumptions used that are significant to the financial statements, and areas involving a higher degree of judgement and complexity are disclosed in Note 40.

The adoption of new/revised HKFRSs

In 2006, the Group adopted the new/revised Standards and Interpretations of HKFRSs as set out below, which are relevant to its operations.

HKAS 19 (Amendment)	Employee Benefits
HKAS 21 (Amendment)	Net Investment in a Foreign Operation
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 (Amendment)	Financial Guarantee Contracts
HKFRS-Int 4	Determining whether an Arrangement contains a Lease

The adoption of the above Standards and Interpretations did not result in substantial changes to the Group's accounting policies, which are consistent with those used in the previous financial year.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(a) *Basis of preparation (continued)*

New and revised HKFRSs issued but not effective yet

The Group has not early adopted the following new Standards, Amendments and Interpretations:

HKAS 1 (Amendment): Presentation of Financial Statements – Capital Disclosures

The amendment to HKAS 1 becomes effective for financial years beginning on or after 1st January 2007. It introduces disclosures about the level of an entity's capital and how the capital is managed.

The amendment to HKAS 1 will create additional disclosure requirements for the Group's financial statements.

HKFRS 7: Financial Instruments: Disclosures

HKFRS 7 becomes effective for financial years beginning on or after 1st January 2007 and it introduces new disclosures to improve information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including minimum disclosures about credit risk, liquidity risk and market risk. It supersedes HKAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements currently in HKAS 32 Financial Instruments: Disclosure and Presentation.

The adoption of HKFRS 7 will create additional disclosure requirements for the Group's financial statements.

HK(IFRIC)-Int 8 : Scope of HKFRS 2

HK(IFRIC)-Int 8 becomes effective for financial years beginning on or after 1st May 2006. It clarifies the scope of HKFRS 2 to include transactions in which the entity cannot identify specifically some or all of the goods and services received.

There is no expected material impact on the Group's financial statements arising from this new interpretation.

HK(IFRIC)-Int 9 : Reassessment of Embedded Derivatives

HK(IFRIC)-Int 9 becomes effective for financial years beginning on or after 1st June 2006. It establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows.

There is no expected material impact on the Group's financial statements arising from this new interpretation.

HK(IFRIC)-Int 10 : Interim Financial Reporting and Impairment

HK(IFRIC)-Int 10 becomes effective for financial years beginning on or after 1st November 2006. It prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance date.

There is no expected material impact on the Group's financial statements arising from this new interpretation.

(b) *Basis of consolidation*

The consolidated financial statements incorporate the financial statements of the Bank and all its subsidiaries.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(c) *Subsidiaries*

Subsidiaries are companies in which the Group has the power to govern the financial and operating policies to obtain benefits from its activities and this is generally accompanied by a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Investments in subsidiaries are stated in the financial statements of the Bank at cost less impairment losses. The results of subsidiaries are accounted for by the Bank on the basis of dividend received or receivable.

(d) *Investment in jointly controlled entities*

A jointly controlled entity is an entity which is jointly controlled by the Group together with one or more parties through contractual arrangements.

The investment is accounted for by proportionate consolidation which involves combining the Group's share of jointly controlled entity's income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's financial statements.

In the Bank's balance sheet, the investment in a jointly controlled entity is stated at cost less impairment losses. The results of a jointly controlled entity are accounted for by the Bank on the basis of dividend received and receivable.

(e) *Financial instruments*

Financial instruments are classified according to the purpose for which the assets were acquired or the liabilities were incurred. Management determines the classification at initial recognition and re-evaluates the designation at every reporting date, with the exception that the designation of financial assets or financial liabilities at fair value through profit or loss is not revocable.

The classification of financial instruments is as follows:

(i) Financial instruments at fair value through profit or loss

This category has two sub-categories: financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss at initial recognition. Financial assets and financial liabilities are classified in this category if acquired or incurred principally for the purpose of short term selling or repurchasing (held for trading) or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges.

Financial instruments designated under the fair value option are financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, and which would otherwise be accounting for separately.

(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.

(iii) Available-for-sale financial investments

Available-for-sale financial investments are non-derivatives that are either designated in this category or not classified in any of the other categories.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(e) *Financial instruments (continued)*

(iv) Other financial liabilities

These are financial liabilities that are not measured at fair value through profit or loss (Note 2(e)(i)).

Recognition and derecognition

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset.

Financial assets are de-recognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. Financial liabilities are removed or derecognised from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

Initial measurement

Financial instruments are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability, except for financial instruments at fair value through profit or loss, for which transactions costs are expensed off immediately.

Subsequent measurement

Available-for-sale financial investments and financial instruments at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method, less impairment allowances. Unquoted investments classified as available-for-sale for which fair values cannot be reliably determined are carried at cost, less impairment allowances.

Realised and unrealised gains and losses arising from changes in the fair value of the financial instruments at fair value through profit or loss are recognised in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised in the investments revaluation reserve. When investments classified as available-for-sale are sold or impaired, the accumulated fair value adjustments in the investments revaluation reserve are included in the income statement.

Other financial liabilities, except for hedged item as mentioned in Note 2(1), are carried at amortised cost using the effective interest method.

Determination of fair value

The fair values of financial instruments traded in active markets are based on quoted market prices at the balance sheet date. The quoted market prices used for financial assets held by the Group are the current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models refined to reflect the issuer's specific circumstances. The fair value of financial liabilities is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(f) *Impairment allowances*

Financial assets carried at amortised cost

Impairment allowances are made when there is objective evidence of impairment as a result of the occurrence of loss events that will impact on the estimated future cash flows. The Group 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 Group determines that no objective evidence of impairment exists for 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.

Individual impairment allowances are assessed by a discounted cash flow method. The individual impairment allowances are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate.

Collective impairment allowances are assessed on the basis of contractual cash flows and historical loss experience adjusted for current conditions.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the allowance is recognised in the income statement.

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment allowances are reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related allowances 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 allowances for loan impairment in the income statement.

Available-for-sale financial investments

When there is objective evidence of an impairment to an available-for-sale financial investment, 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 the income statement – is removed from the investments revaluation reserve within equity and recognised in the income statement. Impairment losses recognised in the income statement on equity investments are not reversed through the income statement, until the equity investments are disposed of. A subsequent recovery in the value of an available-for-sale debt security whose value is impaired is reversed through the income statement if there has been an identifiable event that led to the recovery.

(g) *Leases*

(i) Hire purchase contracts and finance leases

Where the Group is a lessor under finance leases and hire purchase transactions, the amounts due under the leases, net of unearned finance income, are recognised as a receivable and are included in 'Advances to customers'. Finance income implicit in rentals receivable is credited to the income statement over the lease period so as to produce an approximately constant periodic rate of return on the net investment outstanding for each accounting period.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(g) Leases (continued)

(ii) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases. Rentals applicable to such operating leases net of any incentives received from the lessor are charged to the income statement on a straight-line basis over the lease term. The Group's interests in leasehold land are also accounted as operating leases.

Where the Group is a lessor under operating leases, rentals receivable under operating leases are credited to the income statement on a straight-line basis over the lease term.

(h) Sale and repurchase agreements

Repurchase agreements ('Repos') are treated as collateralised borrowing and the amount borrowed is shown as a liability and included in 'Deposits from customers' or 'Deposits and balances from banks'. The securities sold under repos are treated as pledged assets and remain on the balance sheet at amortised cost or fair value depending on their classification. Reverse repurchase agreements ('Reverse repos') are treated as collateralised lending and the amount lent is shown as an asset and included in 'Advances to customers' or 'Placements with banks'. The difference between the amount received and the amount paid under repos and reverse repos is amortised as interest expense and interest income respectively on an effective interest basis.

(i) Properties and other fixed assets

(i) Properties

Properties are stated at cost less accumulated impairment losses and accumulated depreciation. Depreciation is calculated to write off the assets over their estimated useful lives on a straight-line basis as follows:

Freehold land	Not depreciated
Buildings	Over the remaining lease period of the land on which it is situated or 50 years, whichever is shorter
Leasehold improvements	Over the lease term of the leased properties or 5 years, whichever is shorter

(ii) Investment properties

Investment properties are carried at fair value, representing estimated open market value determined by independent qualified valuers. The changes in fair value are recognised in the income statement. Deferred income tax is recognised for the change in fair value of investment properties and charged to the income statement.

Land held under operating leases are classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it were a finance lease.

(iii) Furniture, fixtures and equipment

Furniture, fixtures and equipment are stated at cost less accumulated impairment losses and accumulated depreciation. Depreciation on furniture, fixtures and equipment is calculated to write off the assets on a straight-line basis over their estimated useful lives of between 3 and 8 years.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(i) *Properties and other fixed assets (continued)*

(iv) Impairment

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that properties, furniture, fixtures and equipment are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell. Such impairment losses are recognised in the income statement.

(v) Gain or loss on disposal

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement.

(j) *Lease premium for land*

Leasehold properties held for own use should be split into a lease of land and building in proportion to the relative fair values of the leasehold interests in the land element and the building element of the lease at the inception of the lease. Leasehold land premium that is up-front payment to acquire long-term interest in leasehold land is stated at cost and amortised over the period of the lease.

(k) *Provisions and other liabilities*

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount can be made.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

(l) *Derivative financial instruments and hedge accounting*

Derivatives are initially recognised at fair value at the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. All derivatives are included in assets when fair value is positive ('Positive replacement values') and as liabilities when fair value is negative ('Negative replacement values'). Changes in the fair value of derivatives other than those designated as cash flow hedges or hedges of net investments in foreign operations are recognised in the income statement.

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.

For derivatives designated as hedging instruments, each entity within the Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective for undertaking various hedge transactions. Each entity within the Group also documents its assessment, both at the hedge inception and on an ongoing basis, of whether the derivative is highly effective in offsetting changes in fair values or cash flows of hedged item.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(l) *Derivative financial instruments and hedge accounting (continued)*

(i) Fair value hedge

For a qualifying fair value hedge, the changes in the fair value of the derivative are recorded in the income statement, together with any changes in the fair value of the hedged item attributable to the hedged risk. Gain or loss arising from hedge ineffectiveness is recognised in the income statement.

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 the income statement over the period to maturity of the hedged item.

(ii) Cash Flow Hedge

The effective portion of changes in the fair value of derivative designated and qualified as a hedge of future cash flows are recognised directly in equity, and taken to the income statement in the periods when the hedged item affects profit or loss. The ineffective portion of the gain or loss is recognised immediately in the income statement.

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 remains until 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 in equity is recognised immediately in the income statement.

(iii) Hedge of net investment in a foreign operation

Hedges of net investments in the Group's foreign operations are accounted for in a manner similar to cash flow hedges. The gain or loss from the derivative relating to the effective portion of the hedge is recognised in equity. Gain or loss relating to the ineffective portion of the hedge is recognised immediately in the income statement. On disposal of the foreign operations, the cumulative gain or loss in equity is taken to the income statement.

(m) *Offsetting financial instruments*

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(n) *Interest income and expenses*

Interest income and expenses are recognised on a time-proportion basis using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes significant fees and transaction costs that are an integral part of the effective interest rate, and premiums or discounts.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cashflow discounted at original effective interest rate of the instrument, and thereafter amortising the discount as interest income using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(o) *Fee and commission income*

Fee and commission income is recognised in the income statement as and when service is performed and when considered recoverable except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or are interest in nature. In these cases, the fee is recognised on an appropriate basis over the relevant period.

(p) *Dividend income*

Dividend income is recognised when the right to receive payment is established.

(q) *Employee benefits*

(i) Bonus plans

Liabilities for bonus plans due wholly within twelve months after the balance sheet date are recognised when the Group has a present or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(ii) Pension obligations

The Group offers a mandatory provident fund scheme and participates in a defined contribution plan, the assets of which are generally held in separate trustee-administered funds. These pension plans are generally funded by payments from employees and the Group.

The Group's contributions to the mandatory provident fund scheme and defined contribution plan are expensed as incurred and are reduced by contributions forfeited by those employees who leave the scheme or the plan prior to vesting fully in the contributions.

(iii) Share-based compensation

There is a Share Option Plan run by DBSH, the ultimate holding company of the Bank. Under this plan, share options are granted to eligible staff. There is also a Share Plan run by DBSH. Under this plan, ordinary shares in DBSH are given free of charge to eligible employees subject to DBSH Group meeting certain prescribed performance targets.

These share based payment expense which are measured at their fair value at grant date is amortised and recognised in the income statement over the relevant vesting periods. Non-market vesting conditions are taken into account in determining the number of shares to be granted or number of options that are expected to become exercisable on vesting dates. The impact of subsequent revision of original estimates, if any, is recognised in the income statement.

(r) *Taxation*

The current taxation charged to the income statement represents tax at the current rate based on taxable profits earned during the year. Deferred income 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 financial statements. Taxation rates enacted or substantively enacted by the balance sheet date are used in the determination of deferred income tax.

Deferred income tax liabilities are generally recognised for all taxable temporary differences. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(r) *Taxation (continued)*

Deferred income tax liabilities are provided on temporary differences arising on investments in subsidiaries and joint venture company, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are credited or charged in the income statement, except when they relate to items credited or charged directly to reserves, in which case the deferred income tax assets and liabilities are also dealt with in reserves.

(s) *Foreign currencies*

(i) Functional and presentation currency

Items in the financial statements of the Bank and each of the Group's subsidiaries are measured using their functional currency, being the currency of the primary economic environment in which the entity operates. The consolidated financial statements are presented in Hong Kong dollars, which is the functional and presentation currency of the Bank.

(ii) Foreign currency transactions

Transactions in foreign currencies are translated at foreign exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Hong Kong dollars at foreign exchange rate ruling at that date. Foreign exchange differences arising from translation are recognised in the income statement. Non-monetary assets and liabilities measured at cost in a foreign currency are translated using foreign exchange rates at the date of the transaction. Non-monetary assets and liabilities measured at fair value in foreign currencies are translated to Hong Kong dollars at foreign exchange rates ruling at the dates the fair value was determined.

(iii) Foreign operations

The results and financial position of the Group's operations whose functional currency is not Hong Kong dollars are translated into Hong Kong dollars in the following manner:

- Assets and liabilities are translated at the exchange rate ruling at the balance sheet date;
- Income and expenses for each income statement are translated at an average exchange rate approximating the exchange rates at the dates of the transactions; and
- All resulting exchange differences are dealt with as a movement in retained earnings.

(t) *Financial guarantees*

A financial guarantee is initially recognised at its fair value. Subsequently, the amount initially recognised is amortised to the income statement over the period of the financial guarantee.

The exposure to potential losses associated with financial guarantees is monitored periodically. When there is objective evidence indicating probability of losses occurring, a provision is recognised (Note 2(k)) for the financial guarantee.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(u) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition including cash, balances with banks and treasury bills.

(v) Related party transactions

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

(w) Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from the financial statements where the Group acts in a fiduciary capacity such as nominee, trustee or agent.

3 Interest income

	2006 HK\$'000	2005 HK\$'000
Interest income on listed investments	573,583	501,373
Interest income on unlisted investments	1,351,905	953,729
Other interest income	9,210,675	6,076,978
	<u>11,136,163</u>	<u>7,532,080</u>

Included in interest income is HK\$23,211,000 (2005: HK\$18,982,000) with respect to the time value of the impaired loans released from the impairment allowances (Note 18) and HK\$293,714,000 (2005: HK\$172,217,000) with respect to interest income recognised on trading securities.

4 Interest expense

	2006 HK\$'000	2005 HK\$'000
Interest expense on subordinated liabilities maturity after five years	13,310	–
Other interest expense	5,856,280	3,305,806
	<u>5,869,590</u>	<u>3,305,806</u>

Interest expense recognised on trading liabilities amounted to HK\$295,545,000 (2005: HK\$172,511,000).

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

5 Net trading income

	2006 HK\$'000	2005 HK\$'000
Net trading income		
– Foreign exchange	569,096	408,500
– Interest rates and equities	382,463	27,269
Net income from financial instruments designated at fair value		
– Financial liabilities designated at fair value (Note)	(962,276)	(442,890)
	<u>(10,717)</u>	<u>(7,121)</u>

Note: Net income from derivatives managed in conjunction with financial liabilities designated at fair value amounted to HK\$238,535,000 (2005: loss of HK\$52,504,000).

6 Net gain on disposal of fixed assets and lease premium for land

On 18th May 2006, the Bank sold its office premises at 139 Queen's Road Central for a cash consideration of HK\$655 million, and the premises were derecognised on the balance sheet as at that date. A net gain of HK\$267 million, being the excess of the consideration received over the net book value and after deducting expenses, has been recognised in the income statement.

7 Other income

	2006 HK\$'000	2005 HK\$'000
Fair value adjustment on investment properties	7,064	12,325
Dividend income from listed investments	3,533	8,653
Dividend income from unlisted investments	6,536	8,862
Others	13,360	11,890
	<u>30,493</u>	<u>41,730</u>

8 Total expenses

	2006 HK\$'000	2005 HK\$'000
Employee compensation		
– Salaries and other short term employee compensation	1,480,387	1,319,024
– Pensions	74,875	69,069
– Share based payments	12,594	32,201
Premises and equipment expenses excluding depreciation		
– Amortisation of lease premium for land	48,024	48,627
– Rental of premises	107,407	60,337
– Others	217,345	178,721
Depreciation	140,215	144,477
Impairment of fixed assets	–	2,529
Auditors' remuneration	8,704	7,983
Other expenses	828,169	765,787
	<u>2,917,720</u>	<u>2,628,755</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

11 Income tax expense (continued)

(b) *The deferred income tax charged/(credited) in the consolidated income statement comprises the following temporary differences:*

	2006 HK\$'000	2005 HK\$'000
Accelerated depreciation allowances	19,983	(11,334)
Impairment allowances	4,604	(9,445)
Fair value adjustment on investment properties	1,236	1,703
Tax losses	(702)	–
	<u>25,121</u>	<u>(19,076)</u>

(c) *The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the Hong Kong profit tax rate of 17.5% (2005: 17.5%) is as follows:*

	2006 HK\$'000	2005 HK\$'000
Profit before income tax	3,693,907	2,482,975
Calculated at a tax rate of 17.5%	646,434	434,521
Effect of different tax rates in other countries	(8,227)	(487)
Income not subject to tax	(141,587)	(61,426)
Expenses not deductible for tax purposes	78,170	24,567
Release of provision from prior years	(94)	(14,000)
Others	(1,513)	(829)
	<u>573,183</u>	<u>382,346</u>

12 Profit attributable to shareholders

The profit attributable to shareholders is dealt with in the financial statements of the Bank to the extent of HK\$3,092,388,000 (2005: HK\$2,101,952,000).

13 Dividends

	2006 HK\$'000	2005 HK\$'000
First interim dividend paid of HK\$0.2692 per share (2005: HK\$0.198)	1,400,000	1,029,600
Second interim dividend paid of HK\$0.2692 per share (2005: nil)	1,400,000	–
Third interim dividend paid of HK\$0.6283 per share (2005: nil)	3,267,000	–
	<u>6,067,000</u>	<u>1,029,600</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

14 Cash and balances with banks

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cash in hand	271,239	313,124	271,239	313,124
Balances with central banks	485,557	278,705	485,557	278,705
Balances with banks	15,927,210	14,647,865	15,924,481	14,646,246
Trade bills	1,212,235	878,526	1,212,235	878,526
	17,896,241	16,118,220	17,893,512	16,116,601

15 Trading securities

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Treasury bills	3,511,265	2,504,372
Other debt securities	3,114,584	2,496,098
	6,625,849	5,000,470
Of which:		
– Listed in Hong Kong, at fair value	2,606,729	1,999,061
– Unlisted, at fair value	4,019,120	3,001,409
	6,625,849	5,000,470

Trading securities are analysed by issuer as follows:

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
– Central governments and central banks	6,621,902	4,993,718
– Public sector entities	3,947	6,114
– Banks and other financial institutions	–	638
	6,625,849	5,000,470

16 Positive replacement values/negative replacement values

Positive replacement values and negative replacement values represent the fair values of derivative financial instruments.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

17 Advances to customers less impairment allowances

	Group		Bank	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Advances to customers				
– Corporate	71,213,188	63,420,508	71,213,188	63,420,508
– Individuals	47,551,866	48,598,800	47,551,866	48,598,800
	118,765,054	112,019,308	118,765,054	112,019,308
Impairment allowances (Note 18)				
– Collectively assessed	(913,124)	(931,493)	(886,718)	(898,337)
– Individually assessed	(742,090)	(693,298)	(742,090)	(693,298)
	117,109,840	110,394,517	117,136,246	110,427,673
Included in advances to customers are:				
Trade bills	1,231,404	1,052,765	1,231,404	1,052,765
Impairment allowances				
– Collectively assessed	(22,409)	(17,394)	(22,409)	(17,394)
– Individually assessed	(31,366)	(24,782)	(31,366)	(24,782)
	1,177,629	1,010,589	1,177,629	1,010,589

(a) Impaired advances

	Group and Bank			
	2006 HK\$'000	% of gross advances to customers	2005 HK\$'000	% of gross advances to customers
Gross impaired advances subject to individual impairment allowances assessment	1,777,225	1.50	1,860,457	1.66
Individual impairment allowances	(742,090)		(693,298)	
	1,035,135		1,167,159	

The individual impairment allowances were made after taking into account the value of collateral in respect of such advances.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

17 Advances to customers less impairment allowances (continued)

(b) *Advances to customers include finance lease receivables and hire purchase contracts and are analysed as follows:*

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Gross investment in finance leases and hire purchase contracts receivable:		
Not later than one year	2,364,692	2,186,791
Later than one year and not later than five years	3,545,805	3,601,499
Later than five years	7,494,498	7,248,619
	13,404,995	13,036,909
Unearned future finance income	(108,919)	(100,918)
Net investment in finance leases and hire purchase contracts	<u>13,296,076</u>	<u>12,935,991</u>

The net investment in finance leases and hire purchase contracts is analysed as follows:

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Not later than one year	2,299,129	2,126,777
Later than one year and not later than five years	3,502,961	3,561,500
Later than five years	7,493,986	7,247,714
	<u>13,296,076</u>	<u>12,935,991</u>

The unguaranteed residual values included in the gross investment in finance leases and hire purchase contracts as at 31st December 2006 and 2005 are not considered to be material.

The allowance for uncollectable finance lease receivables and hire purchase contracts included in the impairment allowances amounted to HK\$97,126,000 as at 31st December 2006 (2005: HK\$70,510,000).

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

18 Impairment allowances on advances to customers

	Group		
	Individually assessed HK\$'000	Collectively assessed HK\$'000	Total HK\$'000
As at 1st January 2006	693,298	931,493	1,624,791
Amounts written off	(242,543)	(174,447)	(416,990)
Recoveries of advances written off in previous years	22,880	41,197	64,077
Net charge to consolidated income statement (Note 9)	289,953	114,881	404,834
Discounting effect released from impairment allowances (Note 3)	(23,211)	–	(23,211)
Exchange differences	1,713	–	1,713
At 31st December 2006	<u>742,090</u>	<u>913,124</u>	<u>1,655,214</u>
At 1st January 2005	700,380	861,381	1,561,761
Amounts written off	(235,537)	(154,530)	(390,067)
Recoveries of advances written off in previous years	25,353	43,598	68,951
Net charge to consolidated income statement (Note 9)	221,817	181,044	402,861
Discounting effect released from impairment allowances (Note 3)	(18,982)	–	(18,982)
Exchange differences	267	–	267
At 31st December 2005	<u>693,298</u>	<u>931,493</u>	<u>1,624,791</u>
	Bank		
	Individually assessed HK\$'000	Collectively assessed HK\$'000	Total HK\$'000
As at 1st January 2006	693,298	898,337	1,591,635
Amounts written off	(242,543)	(141,682)	(384,225)
Recoveries of advances written off in previous years	22,880	34,729	57,609
Net charge to income statement	289,953	95,334	385,287
Discounting effect released from impairment allowances	(23,211)	–	(23,211)
Exchange differences	1,713	–	1,713
At 31st December 2006	<u>742,090</u>	<u>886,718</u>	<u>1,628,808</u>
As at 1st January 2005	700,380	830,635	1,531,015
Amounts written off	(235,537)	(125,945)	(361,482)
Recoveries of advances written off in previous years	25,353	37,053	62,406
Net charge to income statement	221,817	156,594	378,411
Discounting effect released from impairment allowances	(18,982)	–	(18,982)
Exchange differences	267	–	267
At 31st December 2005	<u>693,298</u>	<u>898,337</u>	<u>1,591,635</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

19 Available-for-sale financial investments

	Group and Bank	
	2006 HK\$'000	2005 HK\$'000
Treasury bills	3,155,013	1,205,936
Certificates of deposit held	3,316,964	2,195,972
Other debt securities	38,841,297	32,768,156
	<u>45,313,274</u>	<u>36,170,064</u>
Debt securities	45,313,274	36,170,064
Equity securities	90,562	109,555
	<u>45,403,836</u>	<u>36,279,619</u>
Debt securities		
– Listed in Hong Kong, at fair value	2,899,978	3,698,958
– Listed outside Hong Kong, at fair value	8,659,172	8,288,979
– Unlisted, at fair value	33,739,803	24,170,515
– Unlisted, at cost	14,321	11,612
	<u>45,313,274</u>	<u>36,170,064</u>
Equity securities		
– Listed in Hong Kong, at fair value	89,553	108,507
– Unlisted, at cost	1,009	1,048
	<u>90,562</u>	<u>109,555</u>
	<u>45,403,836</u>	<u>36,279,619</u>

Available-for-sale financial investments are analysed by issuer as follows:

– Central governments and central banks	5,613,574	4,537,915
– Public sector entities	837,788	741,266
– Banks and other financial institutions	38,007,769	29,694,642
– Corporate entities	930,384	1,294,184
– Others	14,321	11,612
	<u>45,403,836</u>	<u>36,279,619</u>

20 Other assets

	Group		Bank	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Accrued interest	988,701	684,202	988,701	684,202
Other accounts	1,235,958	1,010,572	1,232,721	1,009,148
	<u>2,224,659</u>	<u>1,694,774</u>	<u>2,221,422</u>	<u>1,693,350</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

21 Interest in a jointly controlled entity

	Group		Bank	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Unlisted investment, at cost			500	500
Amount due to a jointly controlled entity	673,830	672,839	1,347,660	1,345,679

The Group's interest in the jointly controlled entity is as follows:

	2006 HK\$'000	2005 HK\$'000
Non-current assets	24,926	15,162
Current assets	652,640	640,698
Current liabilities	503,348	504,027
Share of income	136,045	147,985
Share of expenses	114,843	115,251

Details of the jointly controlled entity are as follows:

Name of company	Country of incorporation	Place of operation	Particulars of issued shares held	Interest held	Principal activities
Hutchison DBS Card Limited	British Virgin Islands	Hong Kong	500,000 class A shares of HK\$1 each 500,000 class B shares of HK\$1 each	50%	Provision of credit card services

22 Subsidiaries

	Bank	
	2006 HK\$'000	2005 HK\$'000
Unlisted shares, at cost after impairment of HK\$2,215,000 (2005: HK\$2,215,000)	144,942	144,752
Amounts due from subsidiaries	16,235	11,084
	161,177	155,836
Amounts due to subsidiaries	219,280	207,677

During the year, the subsidiaries have maintained deposit accounts with the Bank under its normal course of business. The other amounts due from/to subsidiaries do not carry fixed terms of repayment and are interest free.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

22 Subsidiaries (continued)

Details of the principal subsidiaries which are wholly and directly owned by the Bank are as follows:

<u>Name of company</u>	<u>Place of operation and incorporation</u>	<u>Particulars of issued share capital</u>	<u>Principal activities</u>
DBS Corporate Services (Hong Kong) Limited	Hong Kong	500,000 shares of HK\$1 each	Provision of corporate services
Ting Hong Nominees Limited	Hong Kong	10,000 shares of HK\$1 each	Provision of nominee, trustee and agency services
Overseas Trust Bank Nominees Limited	Hong Kong	50,000 shares of HK\$1 each	Provision of nominee services
DBS Trustee H.K. (Jersey) Limited	Jersey	100,000 shares of £1 each	Provision of trustee and trust administration services

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23 Fixed assets

(a) Fixed assets

Group

	Freehold properties HK\$'000	Leasehold buildings HK\$'000	Investment properties HK\$'000	Furniture, fixtures and equipment HK\$'000	Total HK\$'000
Cost or valuation					
As at 1st January 2006	23,372	1,167,841	103,870	1,073,246	2,368,329
Additions	–	21,598	–	360,546	382,144
Disposals	–	(420,926)	–	(234,653)	(655,579)
Fair value adjustment	–	–	7,064	–	7,064
Exchange adjustments	2	–	–	3	5
	<u>23,374</u>	<u>768,513</u>	<u>110,934</u>	<u>1,199,142</u>	<u>2,101,963</u>
At 31st December 2006					
Accumulated depreciation and impairment					
As at 1st January 2006	16,829	434,917	–	712,981	1,164,727
Charge for the year	112	49,179	–	90,924	140,215
Disposals	–	(169,736)	–	(105,502)	(275,238)
Exchange adjustments	1	–	–	5	6
	<u>16,942</u>	<u>314,360</u>	<u>–</u>	<u>698,408</u>	<u>1,029,710</u>
At 31st December 2006					
Net book value					
At 31st December 2006	<u>6,432</u>	<u>454,153</u>	<u>110,934</u>	<u>500,734</u>	<u>1,072,253</u>

The analysis of cost or valuation at 31st December 2006 of the above assets is as follows:

At cost	23,374	768,513	–	1,199,142	1,991,029
At valuation	–	–	110,934	–	110,934
	<u>23,374</u>	<u>768,513</u>	<u>110,934</u>	<u>1,199,142</u>	<u>2,101,963</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23 Fixed assets (continued)

(a) Fixed assets (continued)

Group

	Freehold properties HK\$'000	Leasehold buildings HK\$'000	Investment properties HK\$'000	Furniture, fixtures and equipment HK\$'000	Total HK\$'000
Cost or valuation					
As at 1st January 2005	35,069	1,205,683	97,950	899,236	2,237,938
Additions	304	10,602	–	256,020	266,926
Disposals	(12,000)	(49,600)	(2,500)	(81,888)	(145,988)
Transfers	–	1,156	(3,905)	(107)	(2,856)
Fair value adjustment	–	–	12,325	–	12,325
Exchange adjustments	(1)	–	–	(15)	(16)
At 31st December 2005	23,372	1,167,841	103,870	1,073,246	2,368,329
Accumulated depreciation and impairment					
As at 1st January 2005	23,302	397,462	–	708,807	1,129,571
Charge for the year	106	62,334	–	82,037	144,477
Impairment losses recognised directly in the income statement	–	2,529	–	–	2,529
Disposals	(6,578)	(27,487)	–	(77,777)	(111,842)
Transfers	–	79	–	(79)	–
Exchange adjustments	(1)	–	–	(7)	(8)
At 31st December 2005	16,829	434,917	–	712,981	1,164,727
Net book value					
At 31st December 2005	<u>6,543</u>	<u>732,924</u>	<u>103,870</u>	<u>360,265</u>	<u>1,203,602</u>

The analysis of cost or valuation at 31st December 2005 of the above assets is as follows:

At cost	23,372	1,167,841	–	1,073,246	2,264,459
At valuation	–	–	103,870	–	103,870
	<u>23,372</u>	<u>1,167,841</u>	<u>103,870</u>	<u>1,073,246</u>	<u>2,368,329</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23 Fixed assets (continued)

(a) Fixed assets (continued)

Bank

	Freehold properties HK\$'000	Leasehold buildings HK\$'000	Investment properties HK\$'000	Furniture, fixtures and equipment HK\$'000	Total HK\$'000
Cost or valuation					
As at 1st January 2006	23,372	1,167,841	103,870	1,047,877	2,342,960
Additions	–	21,598	–	344,569	366,167
Disposals	–	(420,926)	–	(234,561)	(655,487)
Fair value adjustment	–	–	7,064	–	7,064
Exchange adjustments	2	–	–	3	5
	<u>23,374</u>	<u>768,513</u>	<u>110,934</u>	<u>1,157,888</u>	<u>2,060,709</u>
At 31st December 2006					
Accumulated depreciation and impairment					
As at 1st January 2006	16,829	434,917	–	699,459	1,151,205
Charge for the year	112	49,179	–	88,114	137,405
Disposals	–	(169,736)	–	(105,498)	(275,234)
Exchange adjustments	1	–	–	5	6
	<u>16,942</u>	<u>314,360</u>	<u>–</u>	<u>682,080</u>	<u>1,013,382</u>
At 31st December 2006					
Net book value					
At 31st December 2006	<u>6,432</u>	<u>454,153</u>	<u>110,934</u>	<u>475,808</u>	<u>1,047,327</u>

The analysis of cost or valuation at 31st December 2006 of the above assets is as follows:

At cost	23,374	768,513	–	1,157,888	1,949,775
At valuation	–	–	110,934	–	110,934
	<u>23,374</u>	<u>768,513</u>	<u>110,934</u>	<u>1,157,888</u>	<u>2,060,709</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23 Fixed assets (continued)

(a) Fixed assets (continued)

Bank

	Freehold properties HK\$'000	Leasehold buildings HK\$'000	Investment properties HK\$'000	Furniture, fixtures and equipment HK\$'000	Total HK\$'000
Cost or valuation					
As at 1st January 2005	35,069	1,203,671	97,950	885,200	2,221,890
Additions	304	11,269	–	244,687	256,260
Disposals	(12,000)	(48,255)	(2,500)	(81,888)	(144,643)
Transfers	–	1,156	(3,905)	(107)	(2,856)
Fair value adjustment	–	–	12,325	–	12,325
Exchange adjustments	(1)	–	–	(15)	(16)
	<u>23,372</u>	<u>1,167,841</u>	<u>103,870</u>	<u>1,047,877</u>	<u>2,342,960</u>
At 31st December 2005					
Accumulated depreciation and impairment					
As at 1st January 2005	23,302	396,134	–	695,895	1,115,331
Charge for the year	106	62,317	–	81,427	143,850
Impairment losses recognised directly in the income statement	–	2,529	–	–	2,529
Disposals	(6,578)	(26,142)	–	(77,777)	(110,497)
Transfers	–	79	–	(79)	–
Exchange adjustments	(1)	–	–	(7)	(8)
	<u>16,829</u>	<u>434,917</u>	<u>–</u>	<u>699,459</u>	<u>1,151,205</u>
At 31st December 2005					
Net book value					
At 31st December 2005	<u>6,543</u>	<u>732,924</u>	<u>103,870</u>	<u>348,418</u>	<u>1,191,755</u>

The analysis of cost or valuation at 31st December 2005 of the above assets is as follows:

At cost	23,372	1,167,841	–	1,047,877	2,239,090
At valuation	<u>–</u>	<u>–</u>	<u>103,870</u>	<u>–</u>	<u>103,870</u>
	<u>23,372</u>	<u>1,167,841</u>	<u>103,870</u>	<u>1,047,877</u>	<u>2,342,960</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23 Fixed assets (continued)

(b) Operating lease arrangements

The Group leases out investment properties under operating leases. The leases typically run for an initial period of one to five years, and may contain an option to renew the lease after that date at which time all terms will be renegotiated. None of the leases include contingent rentals.

During the year, HK\$3,919,000 (2005: HK\$3,947,000) was recognised as rental income in the income statement in respect of operating leases.

All of the investment properties held by the Group and the Bank are located in Hong Kong with lease of over 50 years.

At 31st December, the Group and the Bank had future aggregate minimum lease receipts under non-cancellable operating leases as follows:

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Not later than one year	3,053	3,919
Later than one year and not later than five years	–	3,053
	3,053	6,972

24 Lease premium for land

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Net book value at 1st January	2,344,011	2,421,895
Disposals	(209,266)	(32,113)
Transfers	–	2,856
Amortisation	(48,024)	(48,627)
Net book value at 31st December	2,086,721	2,344,011

The Group's interests in leasehold land represent prepaid operating lease payment and their net book value are analysed as follows:

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
In Hong Kong held on :		
– Lease of over 50 years	314,190	497,953
– Lease of between 10 to 50 years	1,772,531	1,846,058
	2,086,721	2,344,011

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

25 Trading liabilities

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Trading liabilities		
– Short positions in securities	6,655,669	4,971,799

26 Deposits from customers

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Deposits from customers		
– Reported in the balance sheets	154,264,360	123,440,237
– Structured investment deposits reported as financial liabilities designated at fair value through profit or loss (Note)	12,899,635	18,344,388
	167,163,995	141,784,625
Analysed by:		
– Demand deposits and current accounts	10,432,384	8,978,602
– Savings deposits	33,337,333	27,413,893
– Time, call and notice deposits	123,394,278	105,392,130
	167,163,995	141,784,625

Note: Changes in the fair value of the financial liabilities designated at fair value through profit or loss are attributable mainly to equity, interest and currency risk changes. The remaining change that is not attributable to changes in the benchmark interest rate is considered not significant.

27 Certificates of deposit issued

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Certificates of deposit issued		
– At amortised cost	448,880	1,553,940
– At fair value under fair value hedge	2,064,741	3,811,981
– Designated at fair value through profit or loss (Note)	746,618	903,798
	3,260,239	6,269,719

Note: Changes in the fair value of the financial liabilities designated at fair value through profit or loss are attributable mainly to equity, interest and currency risk changes. The remaining change that is not attributable to changes in the benchmark interest rate is considered not significant.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

28 Other liabilities

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Short positions in securities	2,222,284	3,165,844	2,222,284	3,165,844
Other liabilities and provisions	4,767,385	3,468,223	4,255,669	2,956,198
	6,989,669	6,634,067	6,477,953	6,122,042

29 Taxation

(a) Current income tax liabilities

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Hong Kong profits tax payable	299,997	80,911	302,048	80,592
Overseas tax payable	6,416	3,897	5,552	3,073
	306,413	84,808	307,600	83,665

(b) Deferred income tax

The movements on the deferred income tax assets/(liabilities) are as follows:

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January	85,920	42,516	82,606	39,567
Deferred income tax (charged)/credited to income statement (Note 11)	(25,121)	19,076	(20,624)	18,711
Deferred income tax credited to equity (Note 33(c))	22,143	24,328	22,143	24,328
At 31st December	82,942	85,920	84,125	82,606

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

29 Taxation (continued)

(b) Deferred income tax (continued)

Deferred income tax assets and liabilities are attributable to the following items:

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deferred income tax assets				
Impairment allowances	142,034	146,638	139,783	143,234
Revaluation of available-for-sale financial investments	22,143	–	22,143	–
Tax losses	702	–	–	–
	164,879	146,638	161,926	143,234
Deferred income tax liabilities				
Accelerated depreciation allowances	62,250	42,267	58,114	42,177
Fair value adjustment on investment properties	19,687	18,451	19,687	18,451
	81,937	60,718	77,801	60,628

Deferred income tax assets and liabilities are offset when there is a legally enforceable right of set off and when the deferred income taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheets:

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deferred income tax assets	164,879	146,638	161,926	143,234
Deferred income tax liabilities	(81,937)	(60,718)	(77,801)	(60,628)
	82,942	85,920	84,125	82,606

30 Subordinated liabilities

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
7.75% fixed rate subordinated notes	2,034,279	2,028,445
Floating rate subordinated loan	4,198,878	–
	6,233,157	2,028,445

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

30 Subordinated liabilities (continued)

The 7.75% fixed rate subordinated notes ('Notes') with an aggregate principal amount of US\$350,000,000 were issued by the Bank on 24th January 1997. Interest is payable semi-annually on 24th January and 24th July, commencing 24th July 1997. Subsequent to the issue, the Bank repurchased and cancelled part of the Notes. At 31st December 2006 and 2005, the outstanding principal amount of the Notes was US\$261,620,000. The Notes were redeemed by the Bank on its maturity date of 24th January 2007.

The subordinated loan ('Loan') with principal amount of US\$540,000,000 was obtained by the Bank from its intermediate holding company, DBS Bank Ltd., on 12th December 2006. The Loan will mature on 12th December 2016 with an optional repayment date on 13th December 2011. Interest is payable quarterly and is charged at LIBOR plus 0.35% per annum before the optional repayment date and subsequently at LIBOR plus 0.85%.

31 Derivative financial instruments

The following is a summary of the contract/notional amounts of each significant type of derivative financial instruments:

	Group and Bank					
	Trading HK\$'000	2006 Hedging HK\$'000	Total HK\$'000	Trading HK\$'000	2005 Hedging HK\$'000	Total HK\$'000
Exchange rate contracts						
– Forwards	93,283,171	–	93,283,171	14,307,710	–	14,307,710
– Swaps	55,620,748	–	55,620,748	30,540,720	–	30,540,720
– Options purchased	92,196,921	–	92,196,921	27,865,096	–	27,865,096
– Options written	91,331,150	–	91,331,150	27,820,794	–	27,820,794
	<u>332,431,990</u>	<u>–</u>	<u>332,431,990</u>	<u>100,534,320</u>	<u>–</u>	<u>100,534,320</u>
Interest rate contracts						
– Futures	13,889,315	–	13,889,315	4,127,006	–	4,127,006
– Swaps	92,690,324	2,415,720	95,106,044	83,907,279	4,849,184	88,756,463
– Options purchased	7,473,562	–	7,473,562	10,403,233	–	10,403,233
– Options written	7,473,562	–	7,473,562	10,396,944	–	10,396,944
	<u>121,526,763</u>	<u>2,415,720</u>	<u>123,942,483</u>	<u>108,834,462</u>	<u>4,849,184</u>	<u>113,683,646</u>
Equity contracts						
– Swaps	2,140,044	–	2,140,044	2,456,046	–	2,456,046
– Options purchased	4,539,409	–	4,539,409	2,991,188	–	2,991,188
– Options written	4,539,409	–	4,539,409	2,991,188	–	2,991,188
	<u>11,218,862</u>	<u>–</u>	<u>11,218,862</u>	<u>8,438,422</u>	<u>–</u>	<u>8,438,422</u>
Total	<u>465,177,615</u>	<u>2,415,720</u>	<u>467,593,335</u>	<u>217,807,204</u>	<u>4,849,184</u>	<u>222,656,388</u>

The above amounts are shown on a gross basis without taking into account the effect of bilateral netting arrangements and include all embedded derivatives.

The contract amounts of these instruments indicate the volume of transactions outstanding as at the balance sheet date; they do not represent amounts at risk.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

31 Derivative financial instruments (continued)

The credit risk weighted amounts and replacement costs of the above derivative financial instruments, which do not take into account the effects of bilateral netting arrangements are as follows:

	Group and Bank			
	Credit risk weighted amount		Replacement cost	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Exchange rate contracts	1,425,812	345,682	1,066,122	383,611
Interest rate contracts	158,517	91,359	1,229,112	1,452,920
Equity contracts	100,856	71,403	73,589	319,584
	<u>1,685,185</u>	<u>508,444</u>	<u>2,368,823</u>	<u>2,156,115</u>

The credit risk-weighted amount is the amount which has been calculated in accordance with the Third Schedule of the Hong Kong Banking Ordinance and guidelines issued by the Hong Kong Monetary Authority. The amount calculated is dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

Replacement cost is the cost of replacing all contracts which have a positive value when marked-to-market (should the counterparty default on its obligations) and is obtained by marking-to-market contracts with a positive value. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet date.

The following table summarises all of the unrealised gains or losses of each class of the above derivative financial instruments as at balance sheet date:

	Group and Bank					
	2006			2005		
	Trading	Hedging	Total	Trading	Hedging	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Fair value assets						
Exchange rate contracts	1,066,122	–	1,066,122	383,611	–	383,611
Interest rate contracts	1,213,490	15,622	1,229,112	1,440,195	12,725	1,452,920
Equity contracts	73,589	–	73,589	319,584	–	319,584
	<u>2,353,201</u>	<u>15,622</u>	<u>2,368,823</u>	<u>2,143,390</u>	<u>12,725</u>	<u>2,156,115</u>
Fair value liabilities						
Exchange rate contracts	1,071,545	–	1,071,545	374,697	–	374,697
Interest rate contracts	1,039,658	25,516	1,065,174	1,439,536	83,012	1,522,548
Equity contracts	73,514	–	73,514	319,356	–	319,356
	<u>2,184,717</u>	<u>25,516</u>	<u>2,210,233</u>	<u>2,133,589</u>	<u>83,012</u>	<u>2,216,601</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

32 Share capital

	Group and Bank	
	2006 HK\$'000	2005 HK\$'000
Authorised, issued and fully paid 5,200,000,000 shares of HK\$1.00 each	<u>5,200,000</u>	<u>5,200,000</u>

33 Reserves

	Group		Bank	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
(a) Share premium				
At 1st January and 31st December	<u>595,503</u>	<u>595,503</u>	<u>595,503</u>	<u>595,503</u>
(b) Capital reserve				
At 1st January and 31st December	<u>11,636</u>	<u>11,636</u>	<u>–</u>	<u>–</u>
(c) Investments revaluation reserve				
At 1st January	(267,927)	146,836	(267,927)	146,836
Change in fair value of available-for-sale financial investments	181,410	(369,770)	181,410	(369,770)
Reserve transferred to income statement upon disposal of available-for-sale financial investments	(68,777)	(69,321)	(68,777)	(69,321)
Deferred income tax (Note 29(b))	22,143	24,328	22,143	24,328
At 31st December	<u>(133,151)</u>	<u>(267,927)</u>	<u>(133,151)</u>	<u>(267,927)</u>
(d) General reserve				
At 1st January and 31st December	<u>2,398,792</u>	<u>2,398,792</u>	<u>2,283,928</u>	<u>2,283,928</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

33 Reserves (continued)

(e) Retained earnings

	Group		Bank	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
At 1st January	10,670,807	9,599,835	10,601,246	9,529,111
Profit attributable to shareholders	3,120,724	2,100,629	3,092,388	2,101,952
Dividends (Note 13)	(6,067,000)	(1,029,600)	(6,067,000)	(1,029,600)
Exchange differences arising from translation of net investments in overseas branches and subsidiaries	(311)	(57)	(121)	(217)
At 31st December	<u>7,724,220</u>	<u>10,670,807</u>	<u>7,626,513</u>	<u>10,601,246</u>
Total reserves	<u>10,597,000</u>	<u>13,408,811</u>	<u>10,372,793</u>	<u>13,212,750</u>

Note: The investments revaluation reserve does not represent realised profits and are not available for distribution.

The general reserve is comprised of transfers from the previous years' retained earnings and is distributable.

As at 31st December 2006, HK\$328,485,000 (2005: HK\$249,691,000) was earmarked as the regulatory reserve from the retained earnings. The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes. Movements in the reserve are made directly through retained earnings and in consultation with the Hong Kong Monetary Authority.

34 Material related party transactions

(a) Holding companies and fellow subsidiaries

The Group's immediate holding company is DHB Limited and the ultimate holding company is DBS Group Holdings Ltd. ('DBSH'), a listed company incorporated in Singapore. DBS Bank Ltd. is an intermediate holding company of the Group.

As part of the Bank and the Group's normal course of business, it enters into various transactions with holding companies and fellow subsidiaries on normal commercial terms. These transactions include interbank placements, taking of deposits, derivatives, contingent liabilities and commitments.

Information relating to income and expenses from these transactions during the year and balances outstanding at 31st December are set out below:

(i) Income and expenses with holding companies and fellow subsidiaries

	DBS Bank Ltd.		Fellow subsidiaries	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Interest income	484,710	65,451	–	–
Interest expense	(61,689)	(12,141)	(55,743)	(10,261)
Fee and commission income	(3,434)	(2,883)	(628)	–
Net trading income	588,646	(156,317)	(12,558)	(3,290)
Other income	8,379	1,519	1,001	–
Total expenses (charged)/recovered	(87,584)	(68,866)	21,897	12,038

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

34 Material related party transactions (continued)

(a) Holding companies and fellow subsidiaries (continued)

(ii) Balances with DBS Bank Ltd. as at 31st December

	Group		Bank	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cash and balances with banks	8,679,645	1,450,562	8,676,916	1,448,943
Placements with banks maturing between one to twelve months	4,866,678	1,575,773	4,866,678	1,575,773
Positive replacement values	765,406	635,990	765,406	635,990
Other assets	186,554	82,378	186,554	82,378
	14,498,283	3,744,703	14,495,554	3,743,084
Deposits and balances from banks	117,580	303,305	117,580	303,305
Negative replacement values	1,737,490	1,627,882	1,737,490	1,627,882
Subordinated liabilities	4,198,878	–	4,198,878	–
Other liabilities	67,717	96,573	67,717	96,573
	6,121,665	2,027,760	6,121,665	2,027,760

(iii) Contract/notional amount of derivative financial instruments with DBS Bank Ltd. as at 31st December

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Exchange rate contracts	187,657,716	61,611,393
Interest rate contracts	78,880,912	64,161,266
Equity contracts	5,452,189	4,219,211
	271,990,817	129,991,870

(iv) Contingent liabilities and commitments with DBS Bank Ltd.

As at 31st December 2006, the total contingent liabilities and commitments with DBS Bank Ltd. amounted to HK\$13,829,500,000 (2005: HK\$3,644,098,000).

(v) Balances with ultimate holding company and other intermediate holding companies as at 31st December

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Deposits from customers	316,205	561,536
Other liabilities	46	44
	316,251	561,580

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

34 Material related party transactions (continued)

(a) Holding companies and fellow subsidiaries (continued)

(vi) Balances with fellow subsidiaries as at 31st December

	Group and Bank	
	2006 HK\$'000	2005 HK\$'000
Other assets	<u>13,562</u>	<u>28,886</u>
Deposits and balances from banks	1,072,777	1,127,656
Other liabilities	<u>3,589</u>	<u>216</u>
	<u>1,076,366</u>	<u>1,127,872</u>

(b) Jointly controlled entity

Under the Joint Venture Agreement (the 'Agreement') between the Bank, Whampoa Limited and Hutchison DBS Card Limited ('HDCL'), the Bank issues and services credit cards under the Compass brand. The Compass credit card receivable balances are included under 'Advances to customers' in the Bank's balance sheet. Under the Agreement, all the revenue, expenses and loan impairment allowances on the Compass cards are recorded in the books of HDCL. The revenues and expenses; assets and liabilities of HDCL are recognised by the Group through proportionate consolidation on a line-by-line basis.

As at 31 December 2006, the amount due from the Bank to the jointly controlled entity is HK\$1,347,660,000 (2005: HK\$1,345,679,000), of which HK\$940,000,000 (2005: HK\$930,000,000) is interest bearing time deposit and the remaining balance is interest free and with no fixed repayment term. Interest expense on the time deposit for the year ended 31st December 2006 paid and payable to HDCL is HK\$68,017,000 (2005: HK\$52,995,000). Gross service fee income from HDCL to the Bank for the year ended 31st December 2006 is HK\$85,347,000 (2005: HK\$83,603,000).

(c) Directors and key management personnel

(i) Transactions and balances with directors and key management personnel

During the year, the Group has banking transactions with directors and key management personnel of the DBSH Group, including deposit taking, loans and credit card facilities. These transactions are made in the ordinary course of business and carried out at arms length commercial terms, and are not material.

(ii) Compensation of directors and key management personnel

	Group and Bank	
	2006 HK\$'000	2005 HK\$'000
Directors' fees, salaries and other short term employee compensation	73,378	73,570
Pensions	1,721	1,809
Share based payments	<u>4,790</u>	<u>8,721</u>
	<u>79,889</u>	<u>84,100</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

34 Material related party transactions (continued)

(d) DBSH Share Option Plan

Under the DBSH Share Option Plan (the 'Option Plan'), options to subscribe for DBSH ordinary shares could be granted to the Group executives who hold the rank of Vice President (or equivalent rank) and above and selected employees of the Group of a rank below the rank of Vice President (or equivalent rank).

The exercise price of the granted options is equal to the average of the last dealt prices ('Market Price') for the DBSH shares, as determined by reference to the daily official list published by the Singapore Exchange Securities Trading Limited ('SGX-ST'), for the three consecutive trading days immediately preceding the date of the grant.

The share options vest over a period of 3 years in accordance with a vesting schedule determined by the Compensation Committee of DBSH, and are exercisable after the first anniversary of the date of the grant up to the date of expiration of the options. The share options have a validity period of ten years from the date of grant, unless they have been forfeited or have lapsed prior to that date.

There were no options granted in 2006.

The following table sets out the movements of the unissued ordinary shares of DBSH of par value in Singaporean Dollars ('SG\$') 1.00 each under outstanding options for the years ended 31st December 2006 and 2005, their exercise prices and expiration dates.

	2006		2005	
	Unissued number of ordinary shares under outstanding options	Weighted average exercise price SG\$	Unissued number of ordinary shares under outstanding options	Weighted average exercise price SG\$
Balance at 1st January	5,747,105	13.69	7,435,970	13.37
Movements during the year:				
– Granted	–	–	451,400	15.07
– Exercised	1,451,838	12.51	1,554,755	12.12
– Forfeited	212,680	15.79	585,510	14.83
Balance at 31st December	4,082,587	14.00	5,747,105	13.69
Outstanding options exercisable at 31st December	3,369,817	13.84	3,510,555	14.02
Weighted average remaining contractual life of options outstanding at 31st December	6.0 years		7.0 years	
Range of exercise price of options outstanding at 31st December	SG\$10.40- SG\$22.33		SG\$10.40- SG\$22.33	

In 2006, 1,451,838 options (2005: 1,554,755) were exercised at their contractual exercise prices. During this year, the average market price of DBSH shares was SG\$18.24 (2005: SG\$15.68).

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

34 Material related party transactions (continued)

(e) DBSH Share Plan (formerly known as the DBSH Performance Share Plan)

Under the DBSH Share Plan (the 'Share Plan') DBSH ordinary shares ('PSP shares') could be granted to the Group executives who hold the rank of Vice President (or equivalent rank) and above and selected employees of the Group of rank below the rank of Vice President (or equivalent rank).

Participants are awarded ordinary shares of DBSH when the prescribed Group performance targets are met over a 3-year period (the 'performance period').

For the PSP shares granted in current year, the vesting period is 3 years from the date of grant and the shares are exercisable anytime upon vesting. The fair value of PSP shares awarded is computed based on the market price of DBSH shares at the time of the award and is amortised through the income statement over the three-year vesting period.

The following table sets out the movements of the PSP shares granted pursuant to the plan for the year ended 31st December 2006 and their fair values at grant date.

	Group and Bank	
	2006 grant	2005 grant
	Number of shares	
Balance as at 1st January 2006	–	406,040
Granted during the year	500,100	–
Forfeited during the year	46,620	44,210
	<u>453,480</u>	<u>361,830</u>
	SG\$	SG\$
Fair value per share at grant date	<u>16.20</u>	<u>14.70</u>

35 Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment:

	Group and Bank	
	2006	As restated 2005
	HK\$'000	HK\$'000
Direct credit substitutes	1,080,015	922,049
Transaction-related contingencies	323,871	294,791
Trade-related contingencies	5,851,039	5,190,623
Forward deposits placed	13,428,634	3,256,428
Other commitments with an original maturity of under one year or which are unconditionally cancellable	81,013,117	72,377,043
Other commitments with an original maturity of one year and over	1,519,686	73,380
	<u>103,216,362</u>	<u>82,114,314</u>
Credit risk weighted amount	<u>5,667,238</u>	<u>2,555,339</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

35 Contingent liabilities and commitments (continued)

In November 2002, the Group entered into a ten-year outsourcing agreement with IBM with respect to the provision of information technology and related support to the Group's operation in Hong Kong. There are various termination clauses contained within the agreement that under certain circumstances could require the Group to pay a penalty on early termination of the contract. The exact amount of any penalty amount cannot be reliably determined as it is dependent upon business volumes over the period of the contract and on the timing of the termination itself.

In February 2002, the Bank entered into a Life Insurance Bancassurance Distribution Agreement ('Agreement') with Aviva Life Insurance Company Limited. Under the Agreement, the Bank has to pay a termination fee if the Bank terminates the Agreement. The amount of termination fee payable as at 31st December 2006 is determined in accordance with the schedule of termination fees included in the Agreement, and ranges from HK\$38,000,000 to HK\$115,000,000, depending on when the Agreement is terminated.

36 Capital and lease commitments

(a) Capital commitments

Capital commitments outstanding at the balance sheet date but not yet incurred are as follows:

	Group and Bank	
	2006	2005
	HK\$'000	HK\$'000
Expenditure contracted but not provided for	36,741	25,476
Expenditure authorised but not contracted for	244,852	120,216
	281,593	145,692

(b) Lease commitments

At the balance sheet date, the total future minimum lease payments under non-cancellable operating leases were payable as follows:

	Group and Bank			
	2006		2005	
	Properties	Others	Properties	Others
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Within 1 year	150,032	11,060	94,338	20,791
After 1 year but within 5 years	194,504	16,217	130,657	26,548
Over 5 years	167	–	–	3,406
	344,703	27,277	224,995	50,745

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

37 Notes to consolidated cash flow statement

(a) Reconciliation of profit before income tax to net cash inflow from operating activities

	2006	2005
	HK\$'000	HK\$'000
Profit before income tax	3,693,907	2,482,975
Net gain on disposal of fixed assets and lease premium for land	(335,927)	(72,000)
Impairment of fixed assets	–	2,529
Fair value adjustment on investment properties	(7,064)	(12,325)
Impairment allowances on advances to customers	404,834	402,861
Discounting effect released from impairment allowances	(23,211)	(18,982)
Write-off of fixed assets	11,589	2,104
Depreciation	140,215	144,477
Amortisation of lease premium for land	48,024	48,627
Advances written off net of recoveries	(352,913)	(321,116)
Revaluation for certificates of deposit issued	52,659	(109,491)
Amortisation of (premium)/discount on certificates of deposit issued	(60)	2,091
Interest expense for certificates of deposit issued	163,730	186,563
Interest expense for subordinated liabilities	172,348	159,184
	<hr/>	<hr/>
Profit before changes in operating assets and liabilities	3,968,131	2,897,497
Net (increase)/decrease in cash and balances with banks	(564,737)	2,875,882
Net increase in placements with banks	(10,790,729)	(1,085,928)
Net increase in trading securities	(1,684,270)	(1,914,865)
Net increase in advances to customers	(6,745,746)	(6,796,068)
Net (increase)/decrease in available-for-sale financial investments	(8,270,732)	1,815,638
Net (increase)/decrease in other assets and positive replacement values	(1,038,543)	358,919
Net increase/(decrease) in deposits and balances from banks	658,695	(2,291,631)
Net increase in deposits from customers	25,379,370	11,241,167
Net increase in amount due to a jointly controlled entity	991	54,785
Net increase/(decrease) in other liabilities and negative replacement values	504,072	(5,546,752)
Net increase in trading liabilities	1,683,870	4,971,799
Exchange differences and other adjustments	(158)	(7,875)
	<hr/>	<hr/>
Cash inflow from operating activities before income tax	3,100,214	6,572,568
Hong Kong profits tax paid	(319,134)	(610,963)
Overseas tax paid	(5,879)	(1,259)
Hong Kong profits tax refund	62	–
	<hr/>	<hr/>
Net cash inflow from operating activities	<u>2,775,263</u>	<u>5,960,346</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

37 Notes to consolidated cash flow statement (continued)

(b) Analysis of changes in financing activities during the year

	Share capital and share premium HK\$'000	Certificates of deposit issued HK\$'000	Subordinated liabilities HK\$'000
Balance as at 1st January 2005	5,795,503	9,815,399	2,033,860
Cash inflow from financing activities	–	2,686,696	–
Cash outflow from financing activities	–	(6,121,586)	–
Revaluation	–	(109,491)	–
Amortisation of discount	–	2,091	–
Effect of foreign exchange movements	–	(3,390)	(5,415)
	<hr/>	<hr/>	<hr/>
Balance as at 31st December 2005	5,795,503	6,269,719	2,028,445
Cash inflow from financing activities	–	13,000	4,198,878
Cash outflow from financing activities	–	(3,075,326)	–
Revaluation	–	52,659	–
Amortisation of premium	–	(60)	–
Effect of foreign exchange movements	–	247	5,834
	<hr/>	<hr/>	<hr/>
Balance as at 31st December 2006	<u>5,795,503</u>	<u>3,260,239</u>	<u>6,233,157</u>

(c) Analysis of the balances of cash and cash equivalents

	2006 HK\$'000	2005 HK\$'000
Cash and balances with banks repayable with original maturity within three months	16,372,978	15,159,694
Placements with banks repayable with original maturity within three months	4,821,345	8,572,218
Treasury bills repayable with original maturity within three months	2,654,523	1,972,562
	<hr/>	<hr/>
	<u>23,848,846</u>	<u>25,704,474</u>

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management

As part of overall corporate governance, the Board Risk Management Committee has approved a comprehensive Risk Governance Framework covering risk governance for all risk types.

This framework defines authority levels, oversight responsibilities, policy structures and risk appetite limits to manage the risks that arise in connection with the use of financial instruments.

On a day-to-day basis, business units have primary responsibility for managing specific risk exposures while Risk Management exercises independent risk oversight on the Group as a whole.

(a) Market risk

Market risk arises from changes in market rates such as interest rates, foreign exchange rates and equity prices, as well as in their correlation and volatility levels.

The Group's trading and investment market risk appetite is determined by the Board Risk Management Committee, with detailed limit frameworks approved by senior management.

The principal market risk appetite measures are Value at Risk (VaR) and stress loss. VaR estimates the potential loss on the current portfolio assuming a 1-day holding period and a 99% level of confidence. Stress loss is assessed against a set of scenarios using stress moves in the market variables.

At the business unit level, trading exposures are measured and controlled by more granular risk and loss limits such as stop loss limits.

All trading activities are subject to marking-to-market valuation to reflect the current market value of the trading portfolio and their profit and loss. Investments are subject to limits by market risk type.

(b) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument or the interest income/expense of a portfolio will fluctuate due to changes in market interest rates. Examples of financial assets and liabilities which have fixed and floating interest rate exposures include debt securities, loans, deposits and derivatives.

The Group manages its interest rate risk by changing duration of on-balance-sheet items and by way of entering into off-balance sheet interest rate hedging instruments to hedge the interest rate exposure based on market and economic conditions. To monitor the interest rate risk, various tools are used including repricing gap reports, sensitivity analysis and income simulations under various scenarios. These measures take into account both economic value and earnings perspectives.

The following tables summarise the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. Actual dates may differ from contractual dates owing to prepayments and the exercise of options. It should also be noted that any representation of interest rate risk at a specific date offers only a snapshot of the risks taken by the Group, since the position is being actively managed and can vary significantly on a daily basis. As such, it may not be representative of the level of risk at other times.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(b) Interest rate risk (continued)

2006 HK\$'million	Group							Non-interest bearing	Total
	Less than 7 days	1 week to 1 month	1 month to 3 months	3 months to 12 months	1 year to 3 years	3 years to 5 years	Over 5 years		
Assets									
– Cash and balances with banks	6,632	9,223	-	-	-	-	-	2,041	17,896
– Placements with banks maturing between one to twelve months	-	-	10,385	7,748	-	-	-	-	18,133
– Trading securities	880	100	429	2,553	1,541	565	558	-	6,626
– Advances to customers (before impairment allowances)	44,587	59,930	6,120	2,336	1,557	358	314	3,563	118,765
– Available-for-sale financial investments	1,401	4,075	11,541	17,879	7,504	2,240	659	105	45,404
– Others	-	-	-	-	-	-	-	5,275	5,275
Total assets	53,500	73,328	28,475	30,516	10,602	3,163	1,531	10,984	212,099
Liabilities									
– Deposits and balances from banks	889	137	67	473	-	-	-	1,371	2,937
– Trading liabilities	-	124	775	3,982	847	397	531	-	6,656
– Financial liabilities designated at fair value through profit or loss	-	-	-	-	-	-	-	12,900	12,900
– Deposits from customers	65,464	46,383	24,615	8,712	93	956	-	8,041	154,264
– Certificates of deposit issued	50	641	741	1,218	610	-	-	-	3,260
– Subordinated liabilities	-	2,034	4,199	-	-	-	-	-	6,233
– Others	1,225	868	599	-	-	-	-	7,360	10,052
Total liabilities	67,628	50,187	30,996	14,385	1,550	1,353	531	29,672	196,302
Total interest sensitivity gap	(14,128)	23,141	(2,521)	16,131	9,052	1,810	1,000		

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(b) Interest rate risk (continued)

2005 HK\$'million	Group							Non-interest bearing	Total
	Less than 7 days	1 week to 1 month	1 month to 3 months	3 months to 12 months	1 year to 3 years	3 years to 5 years	Over 5 years		
Assets									
– Cash and balances with banks	4,976	9,072	–	–	–	–	–	2,070	16,118
– Placements with banks maturing between one to twelve months	–	–	10,084	1,009	–	–	–	–	11,093
– Trading securities	–	21	1,917	1,357	732	371	602	–	5,000
– Advances to customers (before impairment allowances)	40,465	59,188	5,199	2,299	1,018	162	137	3,551	112,019
– Available-for-sale financial investments	1,240	3,259	10,148	6,455	10,655	2,967	1,435	121	36,280
– Others	–	–	–	–	–	–	–	4,659	4,659
Total assets	46,681	71,540	27,348	11,120	12,405	3,500	2,174	10,401	185,169
Liabilities									
– Deposits and balances from banks	699	234	875	283	–	–	–	187	2,278
– Trading liabilities	1,130	50	150	2,380	732	320	210	–	4,972
– Financial liabilities designated at fair value through profit or loss	–	–	–	–	–	–	–	18,344	18,344
– Deposits from customers	50,243	35,228	26,480	3,880	254	–	–	7,355	123,440
– Certificates of deposit issued	39	1,008	1,175	2,018	2,030	–	–	–	6,270
– Subordinated liabilities	–	–	–	–	2,028	–	–	–	2,028
– Others	2,534	–	1,096	–	–	–	–	5,598	9,228
Total liabilities	54,645	36,520	29,776	8,561	5,044	320	210	31,484	166,560
Total interest sensitivity gap	(7,964)	35,020	(2,428)	2,559	7,361	3,180	1,964		

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(b) Interest rate risk (continued)

The table below summarises the range of effective average interest rates at 31st December by major currencies for monetary financial instruments:

	2006		2005	
	HK dollar %	US dollar %	HK dollar %	US dollar %
Assets				
Cash and balances with banks	0-8.37	0-7.11	0-7.49	0-6.77
Placements with banks maturing between one to twelve months	4.13	5.37	4.21	4.11
Trading securities	3.02-5.01	5.25	3.62-4.04	2.95
Advances to customers	4.81-30.00	4.33-7.96	5.21-30.00	5.16-10.73
Available-for-sale financial investments	3.00-4.58	4.00-5.75	3.66-4.34	4.07-5.02
Liabilities				
Deposits and balances from banks	0-4.29	0-5.35	0-4.44	0-4.28
Deposits from customers	0-3.68	0-4.79	0-4.13	0-4.13
Certificates of deposit issued and subordinated liabilities	3.46	5.01-7.75	3.25	4.22-7.75

Majority of the advances to customers carry floating rate interest, while majority of the deposits from customers carry fixed rate interest.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(c) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The table below summarises the Group's assets and liabilities at carrying amounts, categorised by currency:

HK\$' million	2006			2005		
	HK dollar	US dollar	Others	HK dollar	US dollar	Others
HK\$ equivalents						
Assets						
Cash and balances with banks	3,346	11,534	3,016	2,279	6,169	7,670
Placements with banks maturing between one to twelve months	3,489	14,560	84	4,054	5,755	1,284
Trading securities	6,626	–	–	5,000	–	–
Advances to customers (before impairment allowances)	103,825	9,984	4,956	100,387	8,760	2,872
Available-for-sale financial investments	16,312	20,574	8,518	7,835	21,894	6,551
Others	3,536	1,608	131	2,257	2,084	318
Total assets	137,134	58,260	16,705	121,812	44,662	18,695
Liabilities						
Deposits and balances from banks	1,659	554	724	744	756	778
Trading liabilities	6,656	–	–	4,972	–	–
Financial liabilities designated at fair value through profit or loss	6,909	5,991	–	9,568	8,569	207
Deposits from customers	101,598	38,180	14,486	77,725	29,465	16,250
Certificates of deposit issued	3,184	76	–	6,162	108	–
Subordinated liabilities	–	6,233	–	–	2,028	–
Others	6,670	2,553	829	6,710	1,882	636
Total liabilities	126,676	53,587	16,039	105,881	42,808	17,871
Equity	15,797	–	–	18,609	–	–
Total liabilities and equity	142,473	53,587	16,039	124,490	42,808	17,871
Net on-balance sheet position	(5,339)	4,673	666	(2,678)	1,854	824
Net off-balance sheet position	4,201	(2,965)	(1,236)	276	443	(719)

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(d) Credit Risk

Credit risk represents the loss which the Group would suffer if a client or counterparty failed to meet its contractual obligations. Senior management sets the overall direction and policy for managing credit risk at the enterprise level. In so doing, it directs the risk appetite and underwriting activities for various countries, industries and counterparties taking into account factors such as prevailing business and economic conditions. The Group is guided by a set of Group-wide credit principles and policies which have been developed with the objective of promoting best practices and consistent credit risk management standards throughout the organisation. These credit policies and limits are established taking into account factors such as prevailing business and economic conditions, the Group's risk appetite to a single customer, or particular industries or sectors and regulatory requirements.

Exposure to credit risk is managed through a sound, well-defined credit granting process which includes the assessment of repayment likelihood, the establishment of appropriate credit limits, and the employment of various credit risk mitigation techniques such as appropriate credit structuring, and posting of collateral and/or third party support. The Group also uses credit derivative instruments to manage its credit risk exposures through risk transfer to third parties.

The Group uses various internal and external risk rating systems (credit scorecards, customer risk grading and bureau score) to control the level of credit risk accepted by the Group. Business units and credit approvers have the responsibility to ensure that credits are properly assessed and classified. Business units also assume the responsibility to ensure all crucial information is included in the application for the purpose of assessment and approval.

The Group adopts a multi-level credit approval process requiring loan approval at successively higher levels and/or committees (as delegated) depending on, among other things, the size and nature of the proposed transactions.

Exposures are monitored against credit limits and other control limits (such as large exposures and concentration limits) by independent credit control units at both the transaction and portfolio levels.

The maximum exposure to credit risk is limited to the amounts on the balance sheet as well as commitments to extend credit, without taking into account the fair value of any collateral and master netting arrangements.

– Derivatives

At any one time, the credit exposure of derivatives transactions is limited to the positive marked-to-market value to the Group, which in general is only a fraction of the derivative contract or notional amount used to express the volume of instruments. This credit exposure, together with potential exposures from market movements, is managed as part of the overall lending limits to the counterparties. Credit exposures on these instruments are usually unsecured, except where the Group enters into collateralised margin transactions with counterparties.

– Master Netting Arrangements

The Group further manages its credit exposure by entering into master netting arrangements with counterparties where appropriate and feasible to do so. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities as transactions are usually accounted for individually 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 of default occurs, all amounts with the counterparty are settled on a net basis.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(d) Credit Risk (continued)

– Credit-Related Commitments

Financial guarantees and standby letters of credit, which represent undertakings that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans even though they are of contingent nature. Documentary and commercial letters of credit, which are undertakings by the Group on behalf of a customer, are usually collateralised by the underlying shipments of goods to which they relate and therefore exhibit different risk characteristics from direct borrowing.

Commitments to extend credit include unused portions of loan commitments, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is usually less than the total unused commitments since most commitments to extend credit are contingent upon customers observing or meeting certain credit terms and conditions.

(e) Liquidity risk

Liquidity risk is the potential earnings volatility arising from being unable to fund portfolio assets at reasonable rates over required maturities. Liquidity obligations arise from withdrawals of deposits, repayments of purchased funds at maturity, extensions of credit and working capital needs. The Group seeks to manage its liquidity to meet its obligations under normal as well as adverse circumstances, and take advantage of arising lending and investment opportunities. As part of its liquidity risk management, the Group focuses on a number of components, including tapping available sources of liquidity, preserving necessary funding capacity and contingency planning.

The primary tool for monitoring liquidity is the maturity mismatch analysis, which is monitored over successive time bands and across functional currencies. This analysis includes behavioral assumptions on, inter-alia, customer loans, customer deposits, and reserve assets. This is tested under normal and adverse market scenario conditions. Limits are established for the cumulative negative cash flow over successive time bands. Various liquidity ratios are additional tools employed by the Group to manage funding liquidity risk.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(e) Liquidity risk (continued)

The maturity profile of assets and liabilities analysed by the remaining period as at 31st December to the contractual maturity dates is as follows:

2006	Group						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	
HK\$'million							
Assets							
– Cash and balances with banks	2,757	14,784	355	–	–	–	17,896
– Placements with banks maturing between one to twelve months	–	10,385	7,748	–	–	–	18,133
– Trading securities	–	1,409	2,553	2,106	558	–	6,626
– Advances to customers (before impairment allowances)	8,062	26,465	12,361	23,619	45,980	2,278	118,765
– Available-for-sale financial investments							
– Debts	–	5,434	21,500	17,472	893	14	45,313
– Equities	–	–	–	–	–	91	91
– Others	544	409	139	10	–	4,173	5,275
Total assets	11,363	58,886	44,656	43,207	47,431	6,556	212,099
Liabilities							
– Deposits and balances from banks	1,392	1,072	473	–	–	–	2,937
– Trading liabilities	–	899	3,982	1,244	531	–	6,656
– Financial liabilities designated at fair value through profit or loss	–	2,433	4,706	3,138	2,623	–	12,900
– Deposits from customers	43,774	100,729	8,712	1,049	–	–	154,264
– Certificates of deposit issued	–	289	1,929	1,042	–	–	3,260
– Subordinated liabilities	–	2,034	–	–	4,199	–	6,233
– Others	3	5,652	1,034	32	3	3,328	10,052
Total liabilities	45,169	113,108	20,836	6,505	7,356	3,328	196,302

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(e) Liquidity risk (continued)

2005	Group						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
HK\$'million							
Assets							
– Cash and balances with banks	2,070	13,899	149	–	–	–	16,118
– Placements with banks maturing between one to twelve months	–	10,084	1,009	–	–	–	11,093
– Trading securities	–	1,938	1,357	1,103	602	–	5,000
– Advances to customers (before impairment allowances)	7,398	22,926	12,185	22,502	44,902	2,106	112,019
– Available-for-sale financial investments							
– Debts	–	4,712	8,467	21,545	1,435	12	36,171
– Equities	–	–	–	–	–	109	109
– Others	–	259	417	310	13	3,660	4,659
Total assets	9,468	53,818	23,584	45,460	46,952	5,887	185,169
Liabilities							
– Deposits and balances from banks	195	1,800	283	–	–	–	2,278
– Trading liabilities	–	1,329	2,380	1,052	211	–	4,972
– Financial liabilities designated at fair value through profit or loss	–	2,791	6,024	6,890	2,639	–	18,344
– Deposits from customers	36,559	82,747	3,880	254	–	–	123,440
– Certificates of deposit issued	–	400	2,501	3,369	–	–	6,270
– Subordinated liabilities	–	–	–	2,028	–	–	2,028
– Others	–	3,780	363	589	727	3,769	9,228
Total liabilities	36,754	92,847	15,431	14,182	3,577	3,769	166,560

(f) Use of derivatives

The Group uses financial instruments to hedge for the positions of the Group. It also trades in financial instruments where it takes positions in traded and over-the-counter instruments, including derivatives, to take advantage of short term market movements in bonds, currency and interest rate. The Group places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. With the exception of specific hedging arrangements, foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

(g) Hedging activities

At 31st December 2006, the Group had interest rate swap agreements in place with a notional amount of HK\$2,415,720,000 (2005: HK\$4,849,184,000) to hedge the exposure to changes in the fair value as a result of market interest rate fluctuation of certain available-for-sale financial investments and certificates of deposit issued. The hedging derivatives and hedged items have the same critical terms.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38 Financial risk management (continued)

(h) *Geographical concentrations*

Over 90% of the Group's total income, profit before income tax, total assets, total liabilities, contingent liabilities and commitments arise from or are booked in Hong Kong.

39 Fair value of financial assets and liabilities not carried at fair value

For financial assets and liabilities not carried at fair values on the financial statements, the Group has ascertained that their fair values were not materially different from the carrying amounts at year end. The basis of arriving at their fair values are as follows:

(a) *Placements with banks*

The estimated fair value of placements is based on the discounted cash flows using the prevailing money market interest rates for placements and remaining maturity.

(b) *Loans and advances to customers*

The fair value approximates their carrying amounts.

(c) *Deposits from banks and customers*

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings is based on discounted cash flows using prevailing interest rates with similar remaining maturity.

(d) *Certificates of deposit issued*

The fair value approximates their carrying amounts.

(e) *Subordinated liabilities*

The fair value approximates their carrying amounts.

40 Critical accounting estimates and judgements in applying accounting policies

The Group makes certain assumptions and estimates in the process of applying the Group's accounting policies. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) *Impairment allowances*

The Group establishes, through charges against profit, impairment allowances in respect of estimated loss in advances to customers. The allowances consist of individual impairment allowances and collective impairment allowances. The overall impairment allowances should represent the aggregate amount by which management considers it necessary to write down its loan portfolio in order to state it in the balance sheet at its estimated ultimate net realisable value.

In determining individual impairment allowances, management considers objective evidence of impairments. When a loan is impaired, an individual impairment allowance is assessed by a discounted cash flow method, measured at the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate. The quantum of the allowance is also impacted by the collateral value and this in turn, may be discounted in certain circumstances to recognise the impact of forced sale or quick liquidation.

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

40 Critical accounting estimates and judgements in applying accounting policies (continued)

(a) Impairment allowances (continued)

In determining collective impairment allowances, management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Fair value of financial instruments

Fair value is defined as the value at which positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty over a period of time consistent with Group's trading or investment strategy. The majority of Group's financial instruments reported at fair value are based on quoted market prices or on internally developed models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates. Management exercises judgement in determining the risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors used in the valuation process. Also, judgement may also be applied in estimating prices for less readily observable external parameters. Other factors such as model assumptions, market dislocations and unexpected correlations can also affect estimates of fair value.

41 Loans to officers

Particulars of loans made to officers and disclosed pursuant to Section 161B of the Hong Kong Companies Ordinance:

	Balance outstanding as at 31st December		Maximum balance during the year	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Aggregate amount outstanding in respect of principal and interest	6,821	–	7,000	200

42 Assets pledged as security

The Group has liabilities secured by assets deposited with central depositories to facilitate settlement operations. The aggregate amount of secured liabilities and the nature and carrying values of the assets pledged as security are as follows:

	Group and Bank	
	2006 HK\$'000	2005 HK\$'000
Secured liabilities – short positions in securities (Note 25 and 28)	8,877,953	8,137,643
Assets pledged as security		
– Treasury bills	6,308,026	3,339,881
– Other securities	4,795,921	5,739,862
	11,103,947	9,079,743

DBS BANK (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

43 Comparative figures

Certain comparative figures have been reclassified to conform with the financial statements presentation adopted in the current year.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION

The following information is disclosed as part of the accompanying information to the financial statements and does not form part of the audited financial statements.

1 Capital adequacy and liquidity ratios

	2006	2005
Capital adequacy ratio	<u>16.31%</u>	<u>17.93%</u>
Adjusted capital adequacy ratio	<u>15.90%</u>	<u>17.71%</u>
Average liquidity ratio	<u>42.65%</u>	<u>48.96%</u>

The capital adequacy ratio represents the combined ratio of the Bank as required by the Hong Kong Monetary Authority for its regulatory purposes, and is computed in accordance with the Third Schedule of the Hong Kong Banking Ordinance.

The adjusted capital adequacy ratio represents the capital adequacy ratio adjusted to take into account market risk as at the balance sheet date computed in accordance with the guideline 'Maintenance of Adequate Capital against Market Risks' issued by the Hong Kong Monetary Authority.

The average liquidity ratio is the simple average of each calendar month's average liquidity ratio for the relevant period calculated for Hong Kong offices of the Bank, and is in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance.

2 Components of capital base after deductions

The capital base after deductions used in the calculation of the above capital adequacy ratios as at 31st December and reported to the Hong Kong Monetary Authority is analysed as follows:

	2006 HK\$'000	2005 HK\$'000
Core capital		
Paid up ordinary share capital	5,200,000	5,200,000
Share premium	595,503	595,503
Reserves (eligible for inclusion in core capital)	<u>9,487,565</u>	<u>12,546,919</u>
	<u>15,283,068</u>	<u>18,342,422</u>
Eligible supplementary capital		
Reserve on revaluation of land and interests in land	64,967	60,887
Reserve on revaluation of holding of securities not held for trading purposes	(147,437)	(280,062)
Collective impairment allowances and regulatory reserve	1,215,202	1,148,028
Term subordinated debt	<u>4,605,734</u>	<u>811,378</u>
	<u>5,738,466</u>	<u>1,740,231</u>
Total capital base before deductions	<u>21,021,534</u>	<u>20,082,653</u>
Deductions from total capital base	<u>(240,244)</u>	<u>(258,941)</u>
Total capital base after deductions	<u>20,781,290</u>	<u>19,823,712</u>

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

2 Components of capital base after deductions (continued)

The capital base represents the capital base of the Bank as at 31st December computed in accordance with the Third Schedule of the Hong Kong Banking Ordinance.

3 Currency concentrations

HK\$' million	Group			Total
	EUR	USD	Others	
2006				
Hong Kong dollar equivalents				
Spot assets	1,965	58,260	14,510	74,735
Spot liabilities	(1,898)	(53,587)	(14,192)	(69,677)
Forward purchases	1,476	72,316	10,124	83,916
Forward sales	(1,639)	(77,029)	(10,080)	(88,748)
Net option position	35	579	(320)	294
Net (short)/long non-structural position	<u>(61)</u>	<u>539</u>	<u>42</u>	<u>520</u>
Net structural position	<u>–</u>	<u>–</u>	<u>288</u>	<u>288</u>
2005				
Hong Kong dollar equivalents				
Spot assets	2,322	44,191	16,410	62,923
Spot liabilities	(2,047)	(42,872)	(16,139)	(61,058)
Forward purchases	603	21,499	2,192	24,294
Forward sales	(884)	(21,847)	(2,403)	(25,134)
Net option position	9	(21)	(27)	(39)
Net long non-structural position	<u>3</u>	<u>950</u>	<u>33</u>	<u>986</u>
Net structural position	<u>–</u>	<u>–</u>	<u>343</u>	<u>343</u>

The net structural position for 2006 represented the Group's Renminbi investment of HK\$257,000,000 (2005: HK\$214,000,000) equivalent in China and Macau Pataca (MOP) investment of HK\$31,000,000 (2005: HK\$129,000,000) equivalent in Macau.

The net option position is calculated based on the worst-case approach set out in the prudential return 'Foreign Currency Position' issued by the Hong Kong Monetary Authority.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

4 Segmental information

(a) By class of business

	Group			Total HK\$'000
	Commercial and retail banking HK\$'000	Treasury HK\$'000	Subsidiaries, overseas branches and others HK\$'000	
2006				
Total income	<u>5,829,125</u>	<u>685,999</u>	<u>501,337</u>	<u>7,016,461</u>
Profit before impairment allowances	<u>3,227,942</u>	<u>503,031</u>	<u>367,768</u>	<u>4,098,741</u>
Profit before income tax	<u>2,820,830</u>	<u>502,615</u>	<u>370,462</u>	<u>3,693,907</u>
2005 as restated				
Total income	<u>4,550,211</u>	<u>742,862</u>	<u>221,518</u>	<u>5,514,591</u>
Profit before impairment allowances	<u>2,223,588</u>	<u>540,305</u>	<u>121,943</u>	<u>2,885,836</u>
Profit before income tax	<u>1,948,115</u>	<u>541,674</u>	<u>(6,814)</u>	<u>2,482,975</u>

Commercial and retail banking business mainly comprises deposit account services, residential mortgage and other consumer lending, credit card services, corporate lending, trade finance and international banking.

Treasury activities are mainly the provision of foreign exchange services and centralised cash management for deposit taking and lending, trading activities and management of investment securities and the overall funding of the Banking Group.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

4 Segmental information (continued)

(b) Advances to customers

(i) By industry sectors

The information concerning gross advances to customers by industry sectors has been classified according to the usage of the loan.

	Group	
	2006	2005
	HK\$'000	HK\$'000
Loans for use in Hong Kong		
Industrial, commercial and financial		
– Property development	197,691	219,388
– Property investment	16,173,180	14,075,278
– Financial concerns	565,549	523,921
– Stockbrokers	21,871	124,795
– Wholesale and retail trade	2,745,477	2,240,217
– Manufacturing	6,643,591	6,352,956
– Transport and transport equipment	10,433,389	9,653,793
– Others	5,137,032	4,358,549
Individuals		
– Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	2,208,130	2,500,998
– Loans for the purchase of other residential properties	33,844,221	35,844,169
– Credit card advances	5,496,428	5,513,423
– Others	5,760,894	4,534,312
	89,227,453	85,941,799
Trade finance	20,125,508	18,406,410
Loans for use outside Hong Kong	9,412,093	7,671,099
	118,765,054	112,019,308

(ii) By geographical areas

Over 90% of the gross advances to customers and the related impaired loans and overdue advances were located in Hong Kong after taking into account the transfer of risks. In general, transfer of risk applies when an advance is guaranteed by a party in a country which is different from that of the counterparty.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

4 Segmental information (continued)

(c) Cross-border claims

Cross-border claims which include financial claims on balances due from banks and other financial institutions, advances to customers, trade bills, certificates of deposit held, trading securities and available-for-sale financial investments by location and type of counterparty are as follows:

HK\$' million	Group			Total
	Banks and other financial institutions	Public sector entities	Others	
2006				
Asia Pacific excluding Hong Kong	30,372	748	6,409	37,529
North and South America	3,619	155	857	4,631
Europe	30,488	6	724	31,218
Others	9	–	1,104	1,113
	64,488	909	9,094	74,491
2005				
Asia Pacific excluding Hong Kong	17,286	653	4,350	22,289
North and South America	3,345	277	337	3,959
Europe	31,399	8	656	32,063
Others	23	–	449	472
	52,053	938	5,792	58,783

The above analysis by geographical areas is based on the location of the counterparty after taking into account the transfer of risks. In general, transfer of risks applies if the claims are guaranteed by a party in a country which is different from that of the counterparty.

5 Overdue and rescheduled advances

(a) Overdue advances to customers

The overdue advances are analysed as follows:

	Group			
	2006	% of gross advances to customers	2005	% of gross advances to customers
	HK\$'000		HK\$'000	
Six months or less but over three months	378,061	0.32	354,079	0.32
One year or less but over six months	318,390	0.27	267,211	0.24
Over one year	583,282	0.49	430,251	0.38
	1,279,733	1.08	1,051,541	0.94

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

5 Overdue and rescheduled advances (continued)

(b) Rescheduled advances

The rescheduled advances (net of those which have been overdue for over three months and reported in item (a) above) are analysed as follows:

	Group			
	2006	%	2005	%
	HK\$'000	of gross advances to customers	HK\$'000	of gross advances to customers
Rescheduled advances	<u>206,581</u>	0.17	<u>211,696</u>	0.19

(c) Repossessed assets

At 31st December 2006, the repossessed assets held by the Group and the Bank amounted to HK\$130,101,000 (2005: HK\$87,736,000).

6 Corporate governance

Under the corporate governance structure of the Bank, the role of the Board is to provide high-level guidance and effective oversight over management. To assist the Board in fulfilling its responsibilities and in accordance with the best corporate governance practice, the Board Audit Committee and Board Risk Management Committee were established and a number of specialised committees were formed to effectively contribute to the strategic and operational development of the Bank. The roles, functions and composition of these committees are listed below:

(a) Board Audit Committee

The Board Audit Committee is authorised by the Board to investigate any activity within its terms of reference. Its main duties include, inter alia, the review of the Bank's financial statements before submission to the Board, the nomination and appointment of the external auditor, audit fee and any questions of resignation or dismissal of external auditor, the review of the internal audit programme and consideration of any major findings of internal investigations and management's response. The Board Audit Committee comprises the four independent non-executive directors of the Bank.

(b) Board Risk Management Committee

The Board Risk Management Committee provides comprehensive and bank-wide oversight of all risks and their management. It sets the overall and specific risk governance frameworks and obtains assurance that risk management activities are effective and that risk management activities have sufficient independence, status and visibility. It sets risk appetite capital and limits for delegation to the relevant risk committees and units and reviews risk reporting on significant risks and risk capital adequacy. It is also responsible for obtaining assurance that the Bank is on track in meeting the Basel II requirements according to approved plans. The Board Risk Management Committee comprises the Chairman of the Bank, the Chief Executive Officer and two independent non executive directors.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

6 Corporate governance (continued)

(c) *Greater China Management Committee*

The Greater China Management Committee formulates a bank-wide strategy and is responsible for its implementation and results. It provides leadership to the various business and support units and is responsible for prioritising business development initiatives and capital allocation. It ensures policies and practices are in place to maintain high corporate governance, risk management and compliance standards. The Committee formulates, approves and implements the Bank's strategy, reviews financial and non-financial results, reviews and assesses control, compliance, reputation and risk issues, identifies any financial and/or non-financial areas of concern, and develops and implements action plans to address areas of weakness. It also ensures that human resources policies, compensation and benefit programs and succession plans are aligned with Group policies and practices. The Greater China Management Committee comprises the Chief Executive Officer and other members of senior management.

(d) *Greater China Credit Risk Committee*

The Greater China Credit Risk Committee serves as an executive forum for discussion and decisions on all aspects of credit risk and its management. It assesses credit risk taking and risk-return tradeoffs and facilitates communication among the different business units on credit issues and determines the suitability of credit risk management strategy and framework as well as Internal Ratings-based systems in meeting the standards under Basel II. The Committee identifies, measures and monitors credit risk portfolio and specific loan and asset review situations and identifies specific credit concentrations and credit trends affecting the portfolio. Formed under the Greater China Credit Risk Committee, the Approval Sub-Committee approves credit risk related limits and policies and the Regulatory Sub-Committee oversees compliance with credit related regulatory requirements. The members of the Greater China Credit Risk Committee are the Chief Credit Officer, representatives from relevant business units and support units and other members nominated by the Chief Executive Officer.

(e) *Greater China Market Risk Committee*

The Greater China Market Risk Committee provides comprehensive and enterprise-wide oversight, direction and counsel relating to the management of market risk. It serves as an executive forum for discussion and decisions on all aspects of market risk and its management and maintains oversight on effectiveness of market risk management infrastructure, including framework, policies, people, processes, information, methodologies and systems on market risk. The Greater China Market Risk Committee comprises the Chief Executive Officer, representatives from relevant business units and support units and others nominated by the Chief Executive Officer.

(f) *Greater China Operational Risk Committee*

The Greater China Operational Risk Committee provides comprehensive and enterprise-wide oversight, direction and counsel relating to the management of operational risks. It is responsible for monitoring and reviewing the effectiveness of operational risk management framework, policy, process, methodology and infrastructure. It performs top-down assessment and monitors critical operational risk exposures and provides direction for resolution of critical operational risk issues and monitors issue resolution. The Greater China Operational Risk Committee comprises the Head of Risk Management, representatives from the relevant support units and others nominated by the Chief Executive Officer.

(g) *Greater China Asset and Liability Committee*

The Greater China Asset and Liability Committee supervises the asset and liability management including the management of liquidity, structural interest rate risk and structural foreign exchange risk activities. It manages the net interest income and margin of the region against changing interest and the currency rate conditions, and maturities/duration. It oversees the structure and composition of the balance sheets in the region, as well as the significant off-balance-sheet assets and liabilities. The members of the Greater China Asset and Liability Committee are the Head of Central Treasury Unit, representatives from the relevant business units and support units and others nominated by the Chief Executive Officer.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

6 Corporate governance (continued)

(h) *Greater China Project Council*

The Greater China Project Council serves as the forum to provide perspective and oversight over the project portfolio of the Bank. It manages tactical project budget and ensures that there is sound business justification, project organization and resources, and alignment with the strategies of the business and DBS Group. It also prioritizes project portfolio and reviews the scheduling and resources capacity and status of key projects. The Greater China Project Council comprises the Chief Executive Officer, representatives from the relevant business units and support units and others nominated by the Chief Executive Officer.

(i) *Greater China Commitments and Conflicts Committee*

The Greater China Commitments and Conflicts Committee reviews proposed commitments, transactions and other actions proposed by DBS Group in the Greater China region which might have a possible impact on DBS's reputation and standing and resolves all actual/potential conflicts that may arise in the course of DBS Group's financial services activities whether in Singapore or in the Greater China region, including ensuring that DBS Group and its employees do not benefit (or appear to benefit) from the use of confidential information. The Greater China Commitments and Conflicts Committee comprises the Chief Executive Officer, the Country Head of China, representatives from the relevant business units and support units and others nominated by the Chief Executive Officer and the Country Head of China.

(j) *Greater China Anti Money Laundering Oversight Committee*

The Greater China Anti Money Laundering Oversight Committee is to define, communicate and coordinate anti-money laundering ('AML') and counter terrorist financing ('CTF') policies, procedures, issues, concerns and initiatives to all business units and support units and to promote full compliance with existing and developing AML/CTF laws, regulations, guidelines, directives and policies. It reviews notable issues resulting from financial crime transaction monitoring and provides guidance on issues arising therefrom and continually enhances guidelines for monitoring to ensure current practices reflect DBS Group standards and industry best practices. The Greater China Anti Money Laundering Oversight Committee comprises the Deputy Chief Executive, the AML Compliance Officer and representatives from relevant business units and support units.

7 Risk management

Approach to Risk Management

Strong risk management capabilities are critical to the financial soundness of the Group. The key components of the Group's risk management approach are: strong risk governance; sound capital assessment; robust and comprehensive processes to identify, measure, control, monitor and report risks; and a rigorous system of internal control reviews, involving internal and external auditors, as well as the relevant bank supervision authorities.

Risk Governance

The Group has implemented a framework to give greater clarity, focus and consistency across different risk areas in the governance of risks. Under the Risk Governance Framework, the Board of Directors, through the Board Risk Management Committee, oversees the establishment of a robust enterprise-wide risk management system and sets risk appetite limits to guide risk-taking within the Group. Management is accountable to the Board for ensuring effective risk management activities and adherence to the risk appetite limits. In this regard, various senior management risk committees provide oversight, and forums for discussions, on specific risk areas, including Credit Risk, Market Risk, Liquidity Risk and Operational Risk. Business units have primary responsibility for managing specific risk exposures. Risk Management is the central resource for quantifying and managing the portfolio of risks taken by the Group as a whole.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

7 Risk management (continued)

Risk Governance (continued)

The Group has implemented policies and procedures to identify, measure, analyse and control risk across the enterprise. A governance framework has been established to provide a disciplined, consistent and tiered approach in the approval of the various risk frameworks/policies/procedures throughout the Group. The framework comprises four levels: Level 1 policies are Board-level approved enterprise-wide risk frameworks; Level 2 policies are minimum corporate-level and subject-specific risk principles and standards; Level 3 policies are business-specific or location-specific in nature; and Level 4 procedures underlie and support the policy implementation. These policies and procedures rely on constant communication, judgement, knowledge of products and markets, and controls by business and support units.

Apart from the financial risk management disclosed in Note 38, the other risk management aspects are disclosed below:

(a) Group Audit

Group Audit is an independent function that reports directly to the Audit Committee and the Chief Executive Officer. Group Audit meets or exceeds the Standards for Professional Practice of the Institute of Internal Auditors in all key aspects. The professional competence of our internal auditors is maintained or upgraded through training programmes, conferences and seminars that provide updates on auditing techniques, regulations and banking products and services.

An annual audit plan is developed under a structured risk assessment approach that examines all of the Group's activities and entities, their inherent risks and internal controls. Audit assignments are identified based on this approach and audit resources are focused on the activities deemed to carry higher risks.

The progress of corrective actions on outstanding audit issues is monitored monthly through a centralised Group-wide tracking system. Information on outstanding issues is categorised according to severity and monthly reports are sent to the Chairman of Audit Committee, the Chairman of the Board, senior management and all Group heads.

All audit reports which are rated as requiring attention are copied to the Audit Committee, the external auditors and senior management. The regulators are also apprised of all relevant audit matters and may request for further information on audit matters at any time. The head of Group Audit has full access to the Audit Committee and senior management, and his appointment is approved by the Committee.

Group Audit works closely with the external auditors and meets regularly with them to discuss matters of mutual interest, to strengthen working relationships and to co-ordinate audit efforts. The external auditors review the effectiveness of the Group's internal controls and risk management during an annual statutory audit. Material non-compliances with established practices and procedures and regulations, as well as internal control weaknesses noted during the audit, together with recommendations, are reported to the Audit Committee, which ensures that high risk outstanding issues are dealt with in a timely manner.

The head of Group Audit Greater China in Hong Kong reports directly to the head of Group Audit in Singapore and the Audit Committee in Hong Kong with dotted reporting line to the Chief Executive Officer in Hong Kong.

(b) Capital management

It is the Group's policy to maintain a strong capital base to support the development of the Group's business and to meet the statutory capital adequacy ratio. Capital is allocated to various activities of the Group depending on the risk reward criteria and regulatory requirements.

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

7 Risk management (continued)

(c) Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. An Operational Risk Management Framework has been developed to ensure that operational risks within the Group are properly identified, monitored, managed and reported in a structured, systematic and consistent manner. Key elements of the framework include control self-assessment (CSA), risk event management and key risk indicator monitoring. To reinforce accountability and ownership of risk and control by the business units and support units, Unit Operational Risk Managers are appointed to assist the unit heads in driving the overall risk and control agenda and programmes at the units. As part of Group Audit's review process, the quality of the operational risk management programmes of the business and support units, including the quality of CSA performed, are also taken into account, in the assignment of a 'Management Control Awareness Rating' to the business and support units.

The Operational Risk Committee oversees operational risk management infrastructure, including framework, policies, processes, information, methodologies and systems. The Committee also performs regular review of the operational risk profiles of the Group, and approves corporate operational risk policies.

The day-to-day management of operational risk exposures is through the maintenance of a comprehensive system of internal controls, supported by an infrastructure of robust systems and procedures to monitor transaction positions and documentation. A set of Core Operational Risk Standards have been established to provide guidance to business units and support units on the baseline internal controls to be put in place to ensure the safety and soundness of their operating environment. Other major operational risk mitigation programmes include Business Continuity Management and the Global Insurance Programme that apply to all DBS entities and units in all locations.

Each new product or service introduced is subject to a rigorous risk review and signoff process where all relevant risks are identified and assessed by departments independent of the risk-taking unit proposing the product. Variations of existing products, as well as outsourcing and process centralisation initiatives, are also subject to a similar process.

(d) Trading Market Risk Management

The Group adopts a Value at Risk (VaR) methodology to estimate the Group's trading market risk (in Singaporean Dollars 'SG\$') on a daily basis. VaR was computed using a parametric (variance-covariance) approach until the end of August 2006. From 1st September 2006 onwards, VaR is computed using a historical simulation approach. It takes into account all pertinent risk factors and covers all financial instruments which expose the Group to market risk. On a monthly basis, the Group computes VaR (in SG\$) for each risk type such as foreign exchange and interest rate. The VaR figures are back-tested against profit and loss of the trading book to validate its robustness.

The tables below provide the year end, average, highest and lowest VaR for the trading risk exposure of the Group for the years of 2006 and 2005 respectively:

In SG\$'million	As at	2006		
	31st December 2006	Average	Highest	Lowest
Total	<u>0.7</u>	<u>1.3</u>	<u>2.3</u>	<u>0.6</u>
In SG\$'million	As at	2005		
	31st December 2005	Average	Highest	Lowest
Total	<u>1.5</u>	<u>1.6</u>	<u>4.8</u>	<u>0.8</u>

DBS BANK (HONG KONG) LIMITED

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

7 Risk management (continued)

(d) Trading Market Risk Management (continued)

The tables below provide the year end, average, highest and lowest month-end VaR by risk type for the trading risk exposure of the Group for the years of 2006 and 2005 respectively:

In SG\$'million	As at	2006		
	31st December 2006	Average	Highest	Lowest
Interest rate	0.6	1.0	1.4	0.6
Foreign exchange	0.5	0.6	1.2	0.3
Diversification	(0.4)	(0.5)	–	–
Total	0.7	1.1	1.5	0.6

In SG\$'million	As at	2005		
	31st December 2005	Average	Highest	Lowest
Interest rate	1.4	1.4	2.0	0.9
Foreign exchange	0.5	0.7	1.2	0.4
Diversification	(0.4)	(0.6)	–	–
Total	1.5	1.5	2.1	1.0

The highest (and lowest) month-end VaR figures reported for each risk class did not necessarily occur on the same day as the highest (and lowest) reported for the month-end total. A corresponding diversification effect cannot be calculated and is therefore omitted from the above tables.

The average daily revenue arising from the Group's market risk related treasury activities for the year ended 31st December 2006 was HK\$2,771,000 (2005: HK\$1,436,000) and the standard deviation for such daily revenue was HK\$2,460,000 (2005: HK\$1,877,000). The average daily revenue/(loss) and its standard deviation are analysed by principal trading activities as follows:

	Average daily revenue/(loss)		Standard deviation	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interest rate activities	194	18	846	1,585
Foreign exchange activities	2,319	1,153	2,078	1,272

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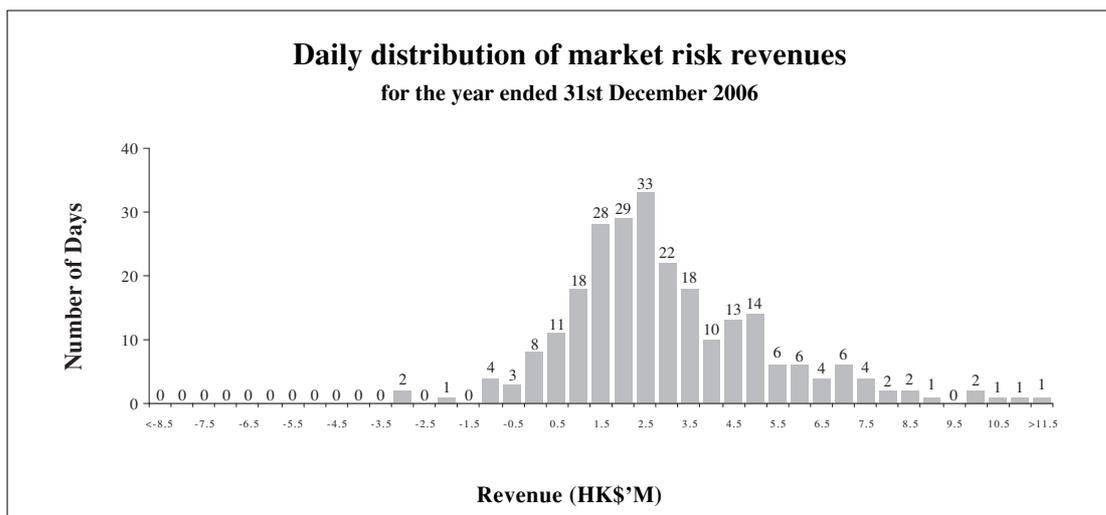
UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

7 Risk management (continued)

(d) Trading Market Risk Management (continued)

The following histograms show the frequency of daily revenues related to market risk trading activities:

2006



2005



(e) Basel II preparation

The DBS Group views Basel II as an enterprise-wide program that will ensure that our credit, market and operational risk management practices continue to meet international best practices. It is an initiative for us to further embed sound risk management practices and culture within our businesses, and ensure that the Group continues to expand our businesses across segments and markets with the right risk management discipline, practices and processes in place. To underscore the importance of this initiative and ensure a concerted effort towards the successful implementation of various aspects of the program, an integrated Basel II Governance and Program Management structure is put in place.

A Basel II Steering Committee ('Steering Committee') has been set up to oversee the implementation of all program work streams to ensure that the Bank is on track for Basel II qualification. The Steering Committee is supported by the respective work stream sponsors and dedicated project managers to drive the overall Basel II program.