

The following is the text of a report, prepared for the purpose of incorporation in this prospectus, received from the Company's independent reporting accountants, KPMG, Certified Public Accountants, Hong Kong. As described in "Appendix X — Documents Delivered to the Registrar of Companies and Available for Inspection", a copy of the Accountants' Report is available for inspection.



8th Floor
Prince's Building
10 Chater Road
Central
Hong Kong

The Directors
China Construction Bank Corporation

October 14, 2005

China International Capital Corporation (Hong Kong) Limited
Morgan Stanley Dean Witter Asia Limited
CCB International Capital Limited

Dear Sirs

Introduction

We set out below our report on the financial information relating to China Construction Bank Corporation (the "Bank") and its subsidiaries (collectively the "Group"), in Sections I to VIII, including the consolidated balance sheets as at December 31, 2002, 2003 and 2004, and June 30, 2005, balance sheets of the Bank as at December 31, 2004 and June 30, 2005, and the related consolidated income statements, consolidated statements of changes in equity and consolidated statements of cash flows of the Group for each of the years ended December 31, 2002, 2003 and 2004, and for the six months ended June 30, 2005 (the "relevant periods"), and the notes thereto (collectively the "Financial Information"), together with the unaudited financial information of the Group including the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the six months ended June 30, 2004 and the notes thereto (the "June 30, 2004 Corresponding Information"), for inclusion in the prospectus of the Bank dated October 14, 2005.

The Bank was incorporated in the People's Republic of China (the "PRC"), excluding for the purpose of this report, the Hong Kong Special Administrative Region of the PRC, or Hong Kong, the Macau Special Administrative Region of the PRC, or Macau, and Taiwan, on September 17, 2004 as a joint stock company with limited liability pursuant to the restructuring (the "Restructuring") of China Construction Bank ("CCB") as described in Section V Note 1(a). The registered office of the Bank is located at No. 25, Finance Street, Xicheng District, Beijing, the PRC. Pursuant to the Restructuring, CCB was separated into the Bank and China Jianyin Investment Limited ("Jianyin") (the "Separation"). The Bank succeeded to CCB's commercial banking businesses and related operations, other than entrusted lending business (excluding the entrusted provident housing fund mortgage business), made on behalf of government agencies and corporations prior to October 20, 2000 (the "Pre-2000 entrusted lending"), together with the relevant assets and liabilities (the "Succeeding Business"), as at December 31, 2003. All CCB's businesses, assets and liabilities that were not succeeded by the Bank, including the Pre-2000 entrusted lending, property and

equipment with title documentation defects, certain equity investments in non-financial institution entities in the PRC, and other assets and liabilities not related to the commercial banking businesses (the “Non-core Business”), were transferred to Jianyin as a distribution to the owner. The Financial Information, prior to and including December 31, 2003, includes the income and expenses, and the cash flows of the Succeeding Business and the Non-core Business, while the consolidated balance sheet of the Group as at December 31, 2003 and the Financial Information since January 1, 2004 reflect only the assets and liabilities, income and expenses, and cash flows of the Succeeding Business.

All companies comprising the Group have adopted December 31 as their financial year end date.

As a state-owned financial institution, CCB prepared financial statements in accordance with the Accounting Standards for Business Enterprises (limited to standards applicable for all enterprises) issued by the Ministry of Finance of the PRC (the “MOF”), the *Accounting Regulations for Financial Enterprises* jointly issued by the MOF and the People’s Bank of China (the “PBOC”) in 1993, and other relevant regulations issued by the MOF (collectively “previous PRC GAAP”). The financial statements of CCB prepared in accordance with previous PRC GAAP for the years ended December 31, 2002 and 2003 were audited by Zhong Tian Yin Certified Public Accountants, a firm of professional accountants registered in the PRC. The financial statements of the Bank for the year ended December 31, 2004 and for the six months ended June 30, 2005, which were prepared in accordance with the Accounting Standards for Business Enterprises, the *Accounting Regulations for Financial Enterprises* (2001) and other relevant regulations issued by the MOF (collectively “PRC GAAP”), were audited by KPMG Huazhen, a firm of professional accountants registered in the PRC. The Group also prepared a set of its consolidated financial statements for the year ended December 31, 2004 and the comparatives for the year ended December 31, 2003 in accordance with International Financial Reporting Standards (“IFRS”) and its interpretations promulgated by the International Accounting Standards Board. These financial statements are the first consolidated financial statements of the Group under IFRS (the “first IFRS financial statements”) and were audited by us.

Jian Sing Bank Limited (“Jian Sing”) and Sino-German Bausparkasse Corporation Limited (“Sino-German”) are the principal subsidiaries of the Bank during the relevant periods. Throughout the relevant periods, we and KPMG Huazhen have acted as auditors of Jian Sing and Sino-German.

No financial statements of the Group have been prepared and audited subsequent to June 30, 2005.

Basis of preparation

The Financial Information, together with the June 30, 2004 Corresponding Information, has been prepared by the Directors of the Bank in accordance with IFRS and its interpretations promulgated by the International Accounting Standards Board based on the audited financial statements, or where appropriate, unaudited financial statements of the Bank and its subsidiaries. Adjustments have been made, for the purpose of this report, to restate the financial statements of the Bank and its subsidiaries in accordance with the basis set out in Section V to conform with IFRS and the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

Responsibility

The Directors are responsible for preparing the Financial Information which gives a true and fair view. In preparing the Financial Information which gives a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are

prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on the Financial Information.

Basis of opinion

As a basis for forming an opinion on the Financial Information of the Group, for the purpose of this report, we have carried out appropriate audit procedures in respect of the audited financial statements of CCB and its subsidiaries for each of the two years ended December 31, 2002 and 2003 and the audited financial statements, or where appropriate, unaudited financial statements of the Bank and its subsidiaries for the year ended December 31, 2004 and for the six months ended June 30, 2005 in accordance with Statements of Auditing Standards and Guidelines issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") and have carried out such additional procedures as we considered necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the HKICPA. We have not audited any financial statements of the Group in respect of any period subsequent to June 30, 2005.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Information. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Information, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the Financial Information is free from material misstatement. In forming our opinion, we also evaluated the overall adequacy of the presentation of the Financial Information. We believe that our audit provides a reasonable basis for our opinion.

Review work performed

For the purpose of this report, we have also reviewed the June 30, 2004 Corresponding Information, for which the Directors are responsible, in accordance with Statement of Auditing Standard 700 "Engagements to review interim financial reports" issued by the HKICPA.

A review consists principally of making enquiries of Directors and management, and applying analytical procedures to the June 30, 2004 Corresponding Information and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the June 30, 2004 Corresponding Information.

Opinion

In our opinion, for the purpose of this report, all adjustments considered necessary have been made and the Financial Information, on the basis of presentation set out in Section V, gives a true and fair view of the state of affairs of the Group as at December 31, 2002, 2003 and 2004, and June 30, 2005, of its consolidated results and consolidated cash flows for each of the three years ended December 31, 2002, 2003 and 2004, and for the six months ended June 30, 2005 and the state of affairs of the Bank as at December 31, 2004 and June 30, 2005, and have been properly prepared in accordance with IFRS.

Review conclusion

On the basis of our review of the June 30, 2004 Corresponding Information which does not constitute an audit, for the purpose of this report, we are not aware of any material modifications that should be made to the unaudited financial information presented for the six months ended June 30, 2004.

I CONSOLIDATED INCOME STATEMENTS

	Note	Years ended December 31,			Six months ended June 30,	
		2002	2003	2004	2004	2005
		(Expressed in millions of Renminbi)				
Interest income		116,554	132,471	147,196	71,096	82,655
Interest expense		(37,688)	(41,532)	(45,708)	(21,625)	(25,952)
Net interest income	3	<u>78,866</u>	<u>90,939</u>	<u>101,488</u>	<u>49,471</u>	<u>56,703</u>
Fee and commission income	4	4,129	5,159	7,352	3,230	4,315
Fee and commission expense		(467)	(578)	(881)	(244)	(409)
Net fee and commission income		<u>3,662</u>	<u>4,581</u>	<u>6,471</u>	<u>2,986</u>	<u>3,906</u>
Dividend income	5	1,049	952	777	160	217
Net gain/(loss) arising from dealing securities	6	71	300	306	(121)	67
Net gain arising from investment securities	7	320	479	2,701	222	709
Net gain arising from foreign currency dealing		301	392	509	217	582
Other income		930	961	1,724	650	738
Operating income		<u>85,199</u>	<u>98,604</u>	<u>113,976</u>	<u>53,585</u>	<u>62,922</u>
General and administrative expenses	8	(42,700)	(50,740)	(53,419)	(25,956)	(24,493)
Provisions for impairment losses on						
— loans and advances to customers ...	17(b)	(19,602)	(9,662)	(6,109)	(1,820)	(6,064)
— others	9	(495)	(500)	(3,249)	(1,323)	(622)
Operating expenses		<u>(62,797)</u>	<u>(60,902)</u>	<u>(62,777)</u>	<u>(29,099)</u>	<u>(31,179)</u>
Profit before tax		22,402	37,702	51,199	24,486	31,743
Income tax	13(a)	(11,068)	(15,169)	(2,159)	(209)	(3,394)
Net profit		<u>11,334</u>	<u>22,533</u>	<u>49,040</u>	<u>24,277</u>	<u>28,349</u>
Attributable to:						
Equity holders of the Bank		11,334	22,533	49,042	24,279	28,351
Minority interests		—	—	(2)	(2)	(2)
Net profit		<u>11,334</u>	<u>22,533</u>	<u>49,040</u>	<u>24,277</u>	<u>28,349</u>
Basic and diluted earnings per share (in RMB)	14	<u>0.06</u>	<u>0.12</u>	<u>0.26</u>	<u>0.13</u>	<u>0.15</u>

II(a) CONSOLIDATED BALANCE SHEETS

	Note	December 31,			June 30,
		2002	2003	2004	2005
(Expressed in millions of Renminbi)					
Assets					
Cash and balances with central banks	15	285,584	330,748	399,366	419,024
Amounts due from banks and other financial institutions	16	114,018	237,548	112,531	112,126
Loans and advances to customers	17	1,576,193	1,943,359	2,173,562	2,315,488
Investments	18	759,086	804,386	1,107,636	1,275,778
Property and equipment	19	55,387	51,736	48,444	46,120
Deferred tax assets	20	14,351	—	—	—
Other assets	21	53,317	189,289	68,381	55,552
Total assets		<u>2,857,936</u>	<u>3,557,066</u>	<u>3,909,920</u>	<u>4,224,088</u>
Liabilities					
Amounts due to central banks		2,448	5,696	2,247	2,222
Amounts due to banks and other financial institutions	22	106,461	109,174	112,039	125,064
Deposits from customers	23	2,822,744	3,195,673	3,491,121	3,781,295
Certificates of deposit issued		1,701	4,334	3,741	4,228
Current tax liabilities		305	52	1,750	2,816
Deferred tax liabilities	20	14	471	388	1,386
Other liabilities and provisions	24	57,469	54,461	63,187	66,235
Subordinated bonds issued	26	—	—	39,896	39,902
Total liabilities		<u>2,991,142</u>	<u>3,369,861</u>	<u>3,714,369</u>	<u>4,023,148</u>
Equity					
Share capital	27(a)	—	—	194,230	194,230
Reserves	27(b), 27(c)	—	—	1,286	6,677
Owner's equity	27(d)	(133,206)	187,168	—	—
Minority interests		—	37	35	33
Total equity		<u>(133,206)</u>	<u>187,205</u>	<u>195,551</u>	<u>200,940</u>
Total equity and liabilities		<u>2,857,936</u>	<u>3,557,066</u>	<u>3,909,920</u>	<u>4,224,088</u>

II(b) BALANCE SHEETS OF THE BANK

	Note	December 31, 2004	June 30, 2005
(Expressed in millions of Renminbi)			
Assets			
Cash and balances with central banks		399,366	419,024
Amounts due from banks and other financial institutions		112,531	112,126
Loans and advances to customers		2,171,781	2,313,336
Investments		1,105,673	1,273,885
Investments in subsidiaries	1 (d)	531	531
Property and equipment		48,377	46,052
Amounts due from subsidiaries		1,752	2,062
Other assets		68,049	55,170
Total assets		<u>3,908,060</u>	<u>4,222,186</u>
Liabilities			
Amounts due to central banks		2,247	2,222
Amounts due to banks and other financial institutions		112,015	124,978
Amounts due to subsidiaries		209	202
Deposits from customers		3,489,376	3,779,767
Certificates of deposit issued		3,741	4,228
Current tax liabilities		1,741	2,810
Deferred tax liabilities		377	1,374
Other liabilities and provisions		62,948	65,792
Subordinated bonds issued		39,896	39,902
Total liabilities		<u>3,712,550</u>	<u>4,021,275</u>
Equity			
Share capital		194,230	194,230
Reserves		1,280	6,681
Total equity		<u>195,510</u>	<u>200,911</u>
Total equity and liabilities		<u>3,908,060</u>	<u>4,222,186</u>

III CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Note	Share capital	Statutory surplus reserve	Statutory public welfare fund	Investment revaluation reserve	(Note (c)) (Accumulated losses)/retained earnings	(Note (d)) Others	Minority interests	Total equity
(Expressed in millions of Renminbi)									
As at January 1, 2002		—	—	—	581	(235,415)	93,549	111	(141,174)
Net profit		—	—	—	—	11,334	—	—	11,334
Net change in fair value of available-for-sale investments	27(c)	—	—	—	363	—	—	—	363
Realised on disposal of available-for-sale investments	27(c)	—	—	—	(76)	—	—	—	(76)
Acquisition of minority interests	30(c)	—	—	—	—	—	—	(111)	(111)
Profit distributions	29(a)	—	—	—	—	(3,542)	—	—	(3,542)
As at December 31, 2002		—	—	—	868	(227,623)	93,549	—	(133,206)
Net profit		—	—	—	—	22,533	—	—	22,533
Net change in fair value of available-for-sale investments	27(c)	—	—	—	(53)	—	—	—	(53)
Realised on disposal of available-for-sale investments	27(c)	—	—	—	(271)	—	—	—	(271)
Profit distributions	29(a)	—	—	—	—	(3,542)	—	—	(3,542)
Restructuring	1(a)	—	—	—	—	—	—	—	—
— Capital injection	27(d)	—	—	—	—	—	186,230	—	186,230
— Equity contribution from the disposal of impaired loans and advances	27(d)	—	—	—	—	—	35,818	—	35,818
— Surplus on valuation	27(d)	—	—	—	—	—	14,160	—	14,160
— Elimination of brought forward capital and reserves	1(a)	—	—	—	—	143,527	(143,527)	—	—
— Replenishment of accumulated losses	27(d)	—	—	—	—	65,499	—	—	65,499
Minority interests in a new subsidiary	30(d)	—	—	—	—	—	—	37	37
As at December 31, 2003		—	—	—	544	394	186,230	37	187,205
Shares issued upon incorporation of the Bank	27(a)	194,230	—	—	—	—	(186,230)	—	8,000
Net profit		—	—	—	—	49,042	—	(2)	49,040
Net change in fair value of available-for-sale investments	27(c)	—	—	—	(642)	—	—	—	(642)
Realised on disposal of available-for-sale investments	27(c)	—	—	—	(178)	—	—	—	(178)
Appropriations to statutory reserves	27(b)	—	343	171	—	(514)	—	—	—
Profit distributions	29(b)	—	—	—	—	(47,874)	—	—	(47,874)
As at December 31, 2004		194,230	343	171	(276)	1,048	—	35	195,551
As at January 1, 2004		—	—	—	544	394	186,230	37	187,205
Net profit (unaudited)		—	—	—	—	24,279	—	(2)	24,277
Net change in fair value of available-for-sale investments (unaudited)	27(c)	—	—	—	(646)	—	—	—	(646)
Realised on disposal of available-for-sale investments (unaudited)	27(c)	—	—	—	(100)	—	—	—	(100)
As at June 30, 2004 (unaudited)		—	—	—	(202)	24,673	186,230	35	210,736
As at January 1, 2005		194,230	343	171	(276)	1,048	—	35	195,551
Net profit		—	—	—	—	28,351	—	(2)	28,349
Net change in fair value of available-for-sale investments	27(c)	—	—	—	621	—	—	—	621
Realised on disposal of available-for-sale investments	27(c)	—	—	—	200	—	—	—	200
Appropriations to statutory reserves	27(b)	—	1,931	966	—	(2,897)	—	—	—
Profit distributions	29(c)	—	—	—	—	(23,781)	—	—	(23,781)
As at June 30, 2005		194,230	2,274	1,137	545	2,721	—	33	200,940

Notes:

- (a) Prior to the incorporation of the Bank on September 17, 2004, the Group's owner's equity as reflected in the consolidated balance sheet, which amount to RMB (133,206) million, RMB 187,168 million and RMB 210,701 million as at December 31, 2002 and 2003, and June 30, 2004 (unaudited) respectively, represent investment revaluation reserve, accumulated losses/retained earnings and others.

III CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (continued)

Notes: (continued)

- (b) Upon incorporation on September 17, 2004, the Bank issued a total of 186,230 million promoters' shares at par value of RMB 1 each as consideration for the Succeeding Business (Note 1(a)), and transferred the balance of others in equity to the Bank's share capital. The Group's reserves as reflected in the consolidated balance sheet, which amount to RMB 1,286 million and RMB 6,677 million as at December 31, 2004 and June 30, 2005 respectively, represent statutory surplus reserve, statutory public welfare fund, investment revaluation reserve and retained earnings.
- (c) At the extraordinary general meeting of the shareholders held on August 27, 2005, the shareholders approved a cash dividend, other than the profit distributions, to existing shareholders of RMB 168 million (Section VI(e)). This cash dividend was not reflected in the Financial Information for the six months ended 30 June 2005.
- (d) Others mainly represent contributions made by the owner and statutory reserve of CCB prior to the Restructuring.

IV CONSOLIDATED STATEMENTS OF CASH FLOWS

	Note	Years ended December 31,			Six months ended June 30,	
		2002	2003	2004	2004	2005
(Expressed in millions of Renminbi)						
Operating activities						
Net profit		11,334	22,533	49,040	24,277	28,349
Adjustments for:						
— Interest income from special government bond	29(a), 29(b)	(3,542)	(3,542)	(3,242)	(1,771)	—
— Dividend income		(1,049)	(952)	(777)	(160)	(217)
— Revaluation losses/(gains) of investments and derivatives		48	(60)	174	168	(55)
— Net (gains)/losses on disposal of investments, property and equipment, land use rights, and other assets		(196)	251	(2,491)	(266)	(734)
— Unrealised foreign exchange losses/(gains)		—	77	12	(70)	(14)
— Depreciation and amortisation ...		6,686	7,122	8,532	4,492	3,393
— Impairment losses		20,097	10,162	9,358	3,143	6,686
— Income tax	13(a)	11,068	15,169	2,159	209	3,394
— Interest expense on subordinated bonds issued		—	—	414	—	932
		<u>44,446</u>	<u>50,760</u>	<u>63,179</u>	<u>30,022</u>	<u>41,734</u>
Changes in operating assets and liabilities:						
Increase in balances with central banks (Increase)/decrease in amounts due from banks and other financial institutions		(34,335)	(43,909)	(42,707)	(38,763)	(36,278)
Increase in loans and advances to customers		(10,204)	41,359	(20,424)	3,810	7,779
Decrease/(increase) in other operating assets		(267,022)	(341,010)	(236,312)	(138,490)	(147,990)
(Decrease)/increase in amounts due to central banks		8,391	(57,276)	75,953	75,349	(11,466)
(Decrease)/increase in amounts due to banks and other financial institutions		(2,727)	3,248	(3,449)	(3,023)	(25)
Increase in deposits from customers ...		(22,738)	2,713	2,865	(1,075)	13,025
Increase/(decrease) in certificates of deposit issued		356,636	375,470	295,448	182,075	290,174
Income tax paid		1,181	2,556	(605)	(851)	501
(Decrease)/increase in other operating liabilities		(519)	(454)	(140)	(53)	(1,735)
		<u>(999)</u>	<u>249</u>	<u>(15,456)</u>	<u>(13,257)</u>	<u>6,123</u>
Cash flows from operating activities ...		<u>72,110</u>	<u>33,706</u>	<u>118,352</u>	<u>95,744</u>	<u>161,842</u>

IV CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

	Note	Years ended December 31,			Six months ended June 30,	
		2002	2003	2004	2004	2005
(Expressed in millions of Renminbi)						
Investing activities						
Proceeds from disposal and redemption of investments		97,535	281,238	542,163	246,023	245,337
Proceeds from disposal of property and equipment, land use rights, and other assets		1,727	3,174	2,701	1,709	878
Payments on acquisition of investments		(203,571)	(330,936)	(824,114)	(429,040)	(411,691)
Payments on acquisition of property and equipment, and land use rights		(7,524)	(8,163)	(7,099)	(3,527)	(2,764)
Payments on acquisition of minority interests	30(c)	(111)	—	—	—	—
Investment in a new subsidiary	30(d)	—	37	—	—	—
Dividend received		1,064	997	777	173	147
Cash flows from investing activities		<u>(110,880)</u>	<u>(53,653)</u>	<u>(285,572)</u>	<u>(184,662)</u>	<u>(168,093)</u>
Financing activities						
Proceeds from capital injection/shares issuance	27(a)	—	186,230	8,000	—	—
Proceeds from subordinated bonds issued	26	—	—	40,000	—	—
Transaction costs on bonds issued		—	—	(106)	—	—
Distribution to the owner in connection with the Restructuring	28	—	(60)	—	—	—
Interest paid on subordinated bonds issued		—	—	—	—	(119)
Dividend paid	29(b)	—	—	—	—	(2,914)
Cash flows from financing activities		<u>—</u>	<u>186,170</u>	<u>47,894</u>	<u>—</u>	<u>(3,033)</u>
Net (decrease)/increase in cash and cash equivalents		(38,770)	166,223	(119,326)	(88,918)	(9,284)
Cash and cash equivalents as at January 1, ...		211,975	173,211	339,435	339,435	220,106
Effect of exchange rate changes on cash held		6	1	(3)	(10)	3
Cash and cash equivalents as at December 31/June 30	30(a)	<u>173,211</u>	<u>339,435</u>	<u>220,106</u>	<u>250,507</u>	<u>210,825</u>
Cash flows from operating activities include:						
Interest received		<u>116,126</u>	<u>131,390</u>	<u>139,928</u>	<u>64,167</u>	<u>77,133</u>
Interest paid, excluding interest on subordinated bonds issued		<u>(39,944)</u>	<u>(40,112)</u>	<u>(43,948)</u>	<u>(23,019)</u>	<u>(25,490)</u>

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****1 ORGANISATION AND RESTRUCTURING, BASIS OF PREPARATION, PRINCIPAL ACTIVITIES AND DETAILS OF PRINCIPAL SUBSIDIARIES****(a) Organisation and Restructuring**

The Bank is a joint stock company with limited liability incorporated in the PRC on September 17, 2004 as part of the Restructuring of CCB.

CCB was a state-owned financial institution under the supervision of the PBOC and the China Banking Regulatory Commission (the "CBRC") empowered by the State Council of the PRC (the "State Council").

With the approval of the State Council on December 30, 2003, CCB underwent the Restructuring, whereby CCB received a capital injection of USD 22,500 million (equivalent to RMB 186,230 million) from China SAFE Investments Limited, previously known as Central Huijin Investment Co., Ltd ("Huijin"), a state-owned investment company under the direction of the State Council. In addition, CCB eliminated all brought forward capital and reserves together with the net profit for the year ended December 31, 2003, excluding the above-mentioned capital injection, against the then accumulated losses as at December 31, 2003. As a result, Huijin became the sole owner of CCB.

As part of the Restructuring, the State Council has also approved the following:

- the disposal of impaired loans and advances with a principal amount of RMB 128,900 million outstanding as at December 31, 2003 at 50% of the principal amount. The PBOC was designated by the State Council to receive these loans and advances. As such, CCB recognised the transaction immediately on the basis that substantially all the risks and rewards of the loans and advances had been transferred. Disposal proceeds of RMB 64,450 million were recognised as a receivable (Notes 18 and 21) and the difference of RMB 35,818 million between the disposal proceeds and the net carrying value of the loans and advances was credited to owner's equity in 2003 as an equity contribution by the owner (Note 27(d)).

In June 2004, China Cinda Asset Management Company ("Cinda") was selected by the PBOC to purchase these loans and advances. On June 28, 2004, Cinda entered into a transfer contract with CCB to purchase these loans and advances at the above-mentioned price. Disposal proceeds of RMB 64,450 million were fully settled on June 30, 2004 from Cinda, of which RMB 63,354 million was used to subscribe for a non-transferable bill issued by the PBOC at par value on the same day. The bill matures in June 2009 and bears a fixed interest rate of 1.89% per annum. The PBOC has an early redemption right on this bill (Note 18(a));

- the issue of a non-transferable bill by the PBOC with nominal value of RMB 21,000 million on June 30, 2004 to settle receivables arising from CCB acting as the receiver, appointed by the State Council and the PBOC, for the liquidation of a trust and investment company. The bill matures in June 2007 and bears a fixed interest rate of 1.89% per annum. The PBOC has an early redemption right on this bill subject to certain conditions (Notes 18(a) and 21(e));
- the replenishment of CCB's remaining accumulated losses of RMB 65,499 million. The amount is non-interest-bearing and is recorded as a receivable from the PRC government. The receivable was fully settled by June 30, 2005 (Notes 21(d) and 27(d));

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****1 ORGANISATION AND RESTRUCTURING, BASIS OF PREPARATION, PRINCIPAL ACTIVITIES AND DETAILS OF PRINCIPAL SUBSIDIARIES (continued)****(a) Organisation and Restructuring (continued)**

- the provision of financial support for the payment of interest and support for the repayment of principal by the MOF for a bond held by the Group with a nominal value of RMB 247,000 million issued by Cinda, effective from January 1, 2005. The bond matures in September 2009 and bears a fixed interest rate of 2.25% per annum (Note 18(a));
- the adjustment of the interest rate of a special government bond held by the Group with a nominal value of RMB 49,200 million to a fixed interest rate of 2.25% per annum effective December 1, 2004. Interest receivable on the bond is settled by cash on an annual basis from December 1, 2004 (Note 18(a)); and
- the issue of subordinated bonds with a total nominal value of RMB 40,000 million (Note 26) to strengthen the Bank's capital base.

In addition, pursuant to a notice issued by the PBOC on June 10, 2005, the PBOC has approved the Bank to use the bill with a nominal value of RMB 63,354 million issued by the PBOC and the special government bond with a nominal value of RMB 49,200 million as eligible assets equivalent to the surplus deposit reserve funds maintained with the PBOC for the purposes of clearing.

As part of the Restructuring, CCB was separated into the Bank and Jianyin, a limited liability company directly and wholly owned by Huijin. Pursuant to the separation agreement signed by Huijin, Jianyin and the Bank on September 15, 2004 (the "Separation Agreement"), the Bank succeeded to the Succeeding Business and the Non-core Business was transferred to Jianyin.

Huijin has also undertaken to the Bank that it will assume all the debts, obligations and liabilities relating to the Succeeding Business, which arose for any reason prior to December 31, 2003 and were not succeeded by the Bank.

The assets and liabilities of CCB succeeded by the Bank as at December 31, 2003 were valued at RMB 186,230 million, based on the revaluation report issued by an independent professional valuer in the PRC, China Consultants of Accounting and Financial Management Co. Ltd ("CCAFM").

The CBRC issued a financial services certificate to the Bank on September 15, 2004. The State Administration for Industry and Commerce of the PRC issued a business licence to the Bank on September 17, 2004.

Upon incorporation on September 17, 2004, the Bank issued 165,538 million and 20,692 million promoters' shares at par value of RMB 1 each to Huijin and Jianyin respectively as consideration for the Succeeding Business. On the same date, the Bank issued a total of 8,000 million promoters' shares at par value for cash to three other promoters. In total, the Bank issued 194,230 million of shares at par value of RMB 1 each. All shares rank pari passu.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****1 ORGANISATION AND RESTRUCTURING, BASIS OF PREPARATION, PRINCIPAL ACTIVITIES AND DETAILS OF PRINCIPAL SUBSIDIARIES (continued)****(b) Basis of preparation**

This Financial Information has been prepared to reflect the Restructuring of a business under common control in which all of the consolidated entities are ultimately controlled by the PRC government both before and after the Restructuring, and that control is not transitory.

The Group consistently applied the historical carrying values to all assets and liabilities to which it succeeded as a result of the Restructuring, except for certain assets (mainly property and equipment, and land use rights) that are recognised at deemed cost determined by an independent professional valuer upon the Restructuring (see Notes 19(b) and 21(a)).

The Financial Information for each of the years ended December 31, 2002, 2003 and 2004, and for the six months ended June 30, 2005 reflects the assets and liabilities, the income and expenses, and the cash flows of the Group or the Bank, as applicable, as if the Group or the Bank had been in existence throughout the period from January 1, 2002 to June 30, 2005 and as if the Group or the Bank had succeeded to the businesses of CCB as of the earliest date presented. In addition, the Financial Information, prior to and including December 31, 2003, includes the income and expenses, and the cash flows of the Succeeding Business and the Non-core Business. As a result of the Separation with effect from December 31, 2003 and separate management of the two business entities, the assets and liabilities transferred to Jianyin are not included in the consolidated balance sheet of the Group as at December 31, 2003 and have been reflected as a distribution to the owner as at December 31, 2003. The consolidated balance sheet of the Group as at December 31, 2003 and the Financial Information since January 1, 2004 reflects only the assets and liabilities, the income and expenses, and the cash flows of the Succeeding Business.

Although the Non-core Business was not transferred to the Bank, it has been included in the Financial Information for the years ended December 31, 2002 and 2003, other than the Group's consolidated balance sheet as at December 31, 2003, as the Non-core Business to which Jianyin succeeded was under the same management of CCB prior to the Restructuring. Accordingly, all relevant activities that have been a part of the history of the business operations of CCB are included in the historical financial information.

Details of the assets and liabilities transferred to Jianyin as at December 31, 2003 are set out in Note 28.

(c) Principal activities

The principal activities of the Group are the provision of corporate and personal banking services, conducting treasury business and corresponding banking business, and the provision of asset management and trustee services.

As at June 30, 2005, the Bank had established branches and sub-branches in 31 provinces, autonomous regions and municipalities directly under the central government. In addition, the Bank has five overseas branches in Hong Kong, Singapore, Frankfurt, Johannesburg and Seoul, and two overseas representative offices in London and New York.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****1 ORGANISATION AND RESTRUCTURING, BASIS OF PREPARATION, PRINCIPAL ACTIVITIES AND DETAILS OF PRINCIPAL SUBSIDIARIES (continued)****(c) Principal activities (continued)**

The Bank also has a branch in Tokyo which has temporarily suspended its business operations in accordance with Japanese Law after incorporation of the Bank. The Bank has already submitted an application for resuming its business to the Financial Services Agency of Japan.

(d) Details of principal subsidiaries consolidated

The particulars of the Bank's principal subsidiaries as at June 30, 2005 are set out below.

All of these are controlled subsidiaries and have been consolidated into the Financial Information of the Group.

<u>Name of company</u>	<u>Place of incorporation and operation</u>	<u>Particulars of the issued and paid up capital</u>	<u>% of ownership directly held by the Bank</u>	<u>Principal activities</u>
Jian Sing	Hong Kong	300 million shares of HK \$1 each	100%	Commercial banking and related financial services
Sino-German	PRC, limited liability company	150 million shares of RMB 1 each	75.1%	Home mortgage loan and deposit taking business

On February 19, 2002, the Bank acquired the minority interest of 30% in Jian Sing which then became a wholly owned subsidiary of the Bank (Note 30(c)).

Capital was contributed to Sino-German in April 2003. This subsidiary commenced operations in February 2004 (Note 30(d)).

2 SIGNIFICANT ACCOUNTING POLICIES**(a) Statement of compliance**

The Financial Information has been prepared in accordance with IFRS and its interpretations promulgated by the International Accounting Standards Board, and the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

All IFRS in issue which are relevant to the Group have been applied for the relevant periods presented, except for IFRS 7 Financial Instruments: Disclosures ("IFRS 7"), which was issued in August 2005 and is effective for the period beginning January 1, 2007. IFRS 7 requires more detailed qualitative and quantitative disclosure primarily on fair value information and risk management. The Group has assessed the impact of IFRS 7 and concluded that IFRS 7 would only affect the level of details in the disclosure of the Financial Information, and would not have financial impact nor result in a change in the Group's accounting policies.

The accounting policies set out below have been applied consistently by group entities and to the relevant periods presented in the Financial Information.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(b) Basis of measurement**

The Financial Information is presented in Renminbi (“RMB”), which is the Group’s functional and presentation currency, rounded to the nearest million.

The Financial Information is prepared using the historical cost basis except that the following assets and liabilities are stated at their fair value: financial assets and liabilities at fair value through profit or loss and available-for-sale assets, except those for which a reliable measure of fair value is not available; and certain non-financial assets are stated at deemed cost.

The preparation of the Financial Information in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances. The results of such estimates and assumptions form the basis of judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Judgements made by management in the application of IFRS that have significant effect on the Financial Information and estimates with a significant risk of material adjustment in the subsequent period are discussed in Note 36.

(c) Basis of consolidation

The Financial Information includes the financial statements of the Bank and its subsidiaries. Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operational policies of an enterprise so as to obtain benefits from its activities. The results and affairs of subsidiaries are included from the date that control commences until the date that control ceases.

The results of subsidiaries are included in the consolidated results of the Group and the share attributable to minority interests is treated as a movement in equity. All significant inter company transactions and balances, and any unrealised gains or losses arising from inter company transactions, have been eliminated on consolidation.

(d) Foreign currency translations

Transactions in foreign currencies are translated into Renminbi at the foreign exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the foreign exchange rates ruling at that date. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated using the exchange rates at the date the fair value is determined. When the gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(d) Foreign currency translations (continued)**

directly in equity, all other foreign exchange differences arising on settlement and translation of monetary and non-monetary assets and liabilities are recognised in the consolidated income statement.

The assets and liabilities of foreign operations are translated into Renminbi at the foreign exchange rates ruling at the balance sheet date. The revenue and expenses and cash flows of foreign operations are translated into Renminbi at rates approximating the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on translation are recognised directly in equity.

(e) Financial instruments**(i) Recognition and measurement**

All financial assets and financial liabilities are recognised in the consolidated balance sheet when and only when, the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised on the date when the contractual rights to the cash flows expire or substantially all the risks and rewards of ownership are transferred. Financial liabilities are derecognised on the date when the obligations specified in the contracts are discharged, cancelled or expire.

At initial recognition, all financial assets and liabilities are measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include observable market data.

Financial assets and financial liabilities are categorised as follows:

- financial assets and financial liabilities at fair value through profit or loss include those financial assets and financial liabilities held principally for the purpose of short term profit taking and those financial assets and liabilities that are designated by the Group upon recognition as at fair value through profit or loss.

All derivatives not qualified for hedging purposes are included in this category and are carried as assets when their fair value is positive and as liabilities when their fair value is negative;

- held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity;
- loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, other than those that the Group intends to sell immediately or in the near term, and those that are designated as available for sale upon initial recognition; and
- available-for-sale assets are non-derivative financial assets that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity assets.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(e) Financial instruments (continued)****(i) Recognition and measurement (continued)**

Subsequent to initial recognition, financial assets and financial liabilities are measured at fair value, without any deduction for transaction costs that may occur on sale or other disposal except for loans and receivables, held-to-maturity financial assets and financial liabilities not designated at fair value through profit or loss, which are measured at amortised cost using the effective interest rate method. Financial assets and financial liabilities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost.

Gains and losses from changes in the fair value of financial instruments at fair value through profit or loss are included in the consolidated income statement when they arise. Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised at which time the cumulative gains or losses previously recognised in equity will be recognised in the consolidated income statement. For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in the consolidated income statement when the financial asset or liability is derecognised or impaired, and through the amortisation process.

(ii) Impairment

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

Losses expected as a result of future events, no matter how likely, are not recognised because the necessary loss event has not yet occurred.

Loans and receivables and held-to-maturity assets

The Group uses two methods of assessing impairment losses: those assessed individually and those assessed on a collective basis.

(i) Individually assessed financial assets

Loans and receivables and held-to-maturity assets, which are considered individually significant, are assessed individually for impairment. This includes all loans and advances in the corporate lending portfolios.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity assets carried at amortised cost has been incurred on an individual basis, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of the allowances for impairment losses. Impairment losses are recognised in the consolidated income

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(e) Financial instruments (continued)****(ii) Impairment (continued)**

statement. Individually impaired loans and advances are graded at a minimum at doubtful (see Note 35(a) for the core definition of the loan classification).

Loans and advances which are assessed individually for impairment are assessed in the light of the objective evidence of loss events, for example:

- Significant financial difficulty of the borrower
- A breach of contract, such as default or delinquency in interest or principal payments
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the Group would not otherwise consider
- It becoming probable that the borrower will enter bankrupt or other financial reorganisations

It may not be possible to identify a single, discrete event that caused the impairment but it may be possible to identify impairment through the combined effect of several events.

Cash flows relating to short term loans and receivables are not discounted if the effect of discounting is immaterial.

The calculation of the present value of the estimated future cash flows of a collateralised loan or receivable reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

(ii) Collectively assessed financial assets

Loans and receivables and held-to-maturity assets, which include the following, are assessed for impairment losses on a collective basis:

- Homogeneous groups of loans not considered individually significant
- Individually assessed loans with no objective evidence of impairment on an individual basis

For the purpose of collective assessment, assets are grouped on the basis of historical loss experience for similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms.

Loans and advances which are assessed collectively for impairment are assessed in the light of the objective evidence of impairment that there is observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition of those assets including:

- adverse changes in the payment status of borrowers in the group; or
- national or local economic conditions that correlate with defaults on the assets in the group.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(e) Financial instruments (continued)****(ii) Impairment (continued)***Homogeneous groups of loans not considered individually significant*

For homogeneous groups of loans, including all of the retail lending portfolio, that are not considered individually significant, the Group adopts a flow rate methodology to assess impairment losses on a collective basis. This methodology utilises a statistical analysis of historical trends of probability of default and amount of consequential loss. As well as an evaluation of current economic conditions that may have a consequential impact on inherent losses in the portfolio.

Individually assessed loans with no objective evidence of impairment on an individual basis

Where loans are individually significant and therefore have been individually assessed but for which no impairment can be identified individually, either due to the absence of any loss events or due to an inability to measure reliably the impact of potential loss events on future cash flows, these loans are grouped together in portfolios of similar credit risk characteristics for the purpose of assessing a collective impairment loss. These loans include all the corporate loans and advances which are graded at normal, special mention or substandard (see Note 35(a) for the core definition of the loan classification). This loss covers those loans that were impaired at the balance sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is assessed after taking into account:

- Historical loss experience in portfolios of similar risk characteristics;
- The emergence period between a loss occurring and that loss being identified; and
- The current economic and credit environments and whether in management's experience these indicate that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The emergence period between a loss occurring and its identification is determined by management based on the historical experience of the markets where the Group operates.

Impairment losses recognised on a collective basis represent an interim step pending the identification of impairment losses on individual assets (which are subject to individual assessment) in the pool of financial assets that are collectively assessed for impairment.

As soon as information is available that specifically identifies objective evidence of impairment on individual assets in a pool, those assets are removed from the pool of financial assets. 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 for impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The reversal shall not result in a carrying amount of the financial asset that exceeds the

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(e) Financial instruments (continued)****(ii) Impairment (continued)**

amortised cost at the date of the reversal had the impairment not been recognised. The amount of the reversal is recognised in the consolidated income statement, except for the reversal as a result of the Restructuring.

When the borrower or the guarantor fails to repay the loan principal and interest, and repossessed assets are received by the Group for recovery of the impaired loans, the carrying value of the impaired loans is adjusted, if necessary, to the estimated fair value of the repossessed assets through impairment allowances. The adjusted carrying value of the impaired loans is transferred to repossessed assets, net of impairment allowances.

When management determine that a loan has no reasonable prospect of recovery after the Group has completed all the necessary legal or other proceedings, the loan is written off against the impairment losses for loan. If in a subsequent period the loan written off is recovered, the amount recovered will be recognised in the consolidated income statement through impairment allowances.

Available-for-sale assets

When a decline in the fair value of an available-for-sale asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in the consolidated income statement even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from equity and recognised in the consolidated income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that financial asset previously recognised in the consolidated income statement. For an available-for-sale asset that is not carried at fair value because its fair value cannot be reliably measured, such as an unquoted equity instrument, the amount of any impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

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

(iii) Fair value measurement

The fair value of financial assets is based on their quoted market price in an active market at the valuation date without any deduction for transaction costs. A quoted market price is from an active market where price information is readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and that price information represents actual and regularly occurring

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(e) Financial instruments (continued)****(iii) Fair value measurement (continued)**

market transactions on an arm's length basis. If a quoted market price is not available, the fair value of the financial assets is established using valuation techniques.

Valuation techniques applied include recent arm's length market transactions between knowledgeable and willing parties referenced to the fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. Periodically the Group calibrates the valuation techniques and tests them for validity.

In estimating the fair value of a financial asset and financial liability, the Group considers all factors, including but not limited to, interest rate, credit risk, foreign currency exchange price and market volatility, that are likely to affect the fair value of the financial asset and financial liability.

The Group obtains market data in the same market where the financial instrument was originated or purchased.

(iv) Derivative financial instruments

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from its investment activities. In accordance with its treasury policy, the Group generally does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as financial assets and financial liabilities at fair value through profit or loss.

Derivative financial instruments are recognised at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the consolidated income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

(v) Hedge accounting

It is the Group's policy to document the relationship between the hedging instruments and hedged items, as well as the risk management objective and strategy for undertaking the hedge, upon the inception of that relationship qualified for hedge accounting. Such policies also require documentation of the assessment, both at hedge inception and on any ongoing basis, of whether the derivatives are highly effective in offsetting changes in fair values attributed to the hedged risks.

Fair value hedges

A fair value hedge seeks to offset risks of changes in the fair value of an existing asset or liability that will give rise to a gain or loss being recognised in the consolidated income statement.

The hedging instrument is measured at fair value, with fair value changes recognised in the consolidated income statement. Changes in the fair value of the hedged item which are attributable to the risks hedged with the hedging instrument are reflected as adjustments to the carrying value of the hedged

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(e) Financial instruments (continued)****(v) Hedge accounting (continued)**

item. This adjustment is recognised in the consolidated income statement to offset the effect of the gain or loss on the hedging instrument.

(f) Repurchase and resale agreements

Assets purchased subject to commitments to resell them at future dates are not recognised. The amounts paid are accounted for as balances with central banks, amounts due from banks and other financial institutions or loans and advances to customers depending on the identity of the counterparty.

Assets sold under repurchase agreements continue to be recognised in the consolidated balance sheet and are measured in accordance with the accounting policy for these assets. The proceeds from the sale of the assets are reported as amounts due to central banks, banks or other financial institutions.

The difference between the purchase and resale consideration or sale and repurchase consideration is amortised over the period of the transaction and is included in interest income or expense, as appropriate.

(g) Property and equipment**(i) Cost**

Items of property and equipment (including construction in progress) are stated at cost, or deemed cost, less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of attributable indirect costs.

Construction in progress represents property under construction and is stated at cost less impairment losses. Cost comprises the direct cost of construction. Capitalisation of these costs ceases and the construction in progress is transferred to an appropriate class of property and equipment when the asset is substantially ready for its intended use.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

Pursuant to the Restructuring, all property and equipment have been revalued to fair value on December 31, 2003 by CCAF. The revalued amount was adopted as the deemed cost of the property and equipment on December 31, 2003.

(ii) Subsequent costs

The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the consolidated income statement as an expense when incurred.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Property and equipment (continued)

(iii) Depreciation

Depreciation is calculated to write off the cost or deemed cost, less residual value if applicable, of property and equipment and is charged to the consolidated income statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

	<u>Estimated useful lives</u>
Bank premises	30 - 35 years
Computer equipment	3 - 8 years
Others	4 - 11 years

No depreciation is provided in respect of construction in progress.

The residual value, if not insignificant, is reassessed annually.

(iv) Impairment

The carrying amount of property and equipment is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised in the consolidated income statement. The recoverable amount is the greater of the net selling price and value in use.

If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down or allowances are reversed through the consolidated income statement to the extent that it was previously recognised in the consolidated income statement.

(v) Disposal and retirement

Gains or losses arising from the retirement or disposal of property and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the consolidated income statement on the date of disposal or retirement.

(h) Land use rights

Land use rights are stated at cost or deemed cost, being the fair value on December 31, 2003 determined by CCAF, using the comparable market basis.

Land use rights are amortised on a straight-line basis over the respective periods of grant of 30 - 50 years.

(i) Repossessed assets

Repossessed assets are initially recognised at the carrying value of the loan principal and interest receivable, net of respective allowances for impairment losses, upon the seizure of these assets in lieu of the

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(i) Repossessed assets (continued)**

rights on the loans and advances and interest receivable. An impairment loss is recognised in the consolidated income statement whenever the carrying amount of such an asset exceeds its recoverable amount.

(j) Fiduciary activities

The Group acts in a fiduciary capacity as a custodian or an agent for customers. Assets held by the Group and the related undertakings to return such assets to customers are excluded from the Financial Information as the risks and rewards of the assets reside with the customers.

Entrusted lending is one of the principal fiduciary activities of the Group. The Group enters into entrusted loan agreements with a number of customers, whereby the customers provide funding (the "entrusted funds") to the Group, and the Group grants loans to third parties (the "entrusted loans") at the instruction of the customers. As the Group does not assume the risks and rewards of the entrusted loans and the corresponding entrusted funds, entrusted loans and funds are recorded as off-balance sheet items at their principal amounts and no impairment assessments are made for these entrusted loans.

(k) Provisions and contingent liabilities

A provision is recognised in the consolidated balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(l) Employee benefits**(i) Employment benefits**

Salaries and bonuses, housing benefits and costs for social security benefits are accrued in the year in which the services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) Post employment benefits

Post employment benefits of the Group mainly include retirement benefits, and supplementary retirement benefits to the employees who retired on or before December 31, 2003.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(l) Employee benefits (continued)****(ii) Post employment benefits (continued)***Defined contribution retirement schemes*

Obligations for contributions to defined contribution retirement schemes are recognised as an expense in the consolidated income statement as incurred for current employees.

Supplementary retirement benefits

The Group's obligations in respect of supplementary retirement benefits were calculated by estimating the amount of future benefits that the Group committed to pay to the staff after their retirement using actuarial techniques. Such benefits are discounted to determine their present values. The discount rate is the yield on the PRC government bonds at the balance sheet date, the maturity dates of which approximate to the terms of the Group's obligations. In calculating the Group's obligations, to the extent that any cumulative unrecognised gains or losses exceed 10% of the present value of the obligation at the balance sheet date, that portion is recognised in the consolidated income statement. Otherwise, the gain or loss is not recognised.

(m) Income recognition**(i) Interest income**

Interest income is recognised in the consolidated income statement as it accrues, taking into account the effective interest rate of the instrument or an applicable floating rate. Interest income includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

The accrual of interest income of a loan where principal or interest of which is overdue over 90 days based on the original terms of the claim is discontinued. Instead, interest will continue to be recognised on the impaired financial assets using the rate of interest used to discount future cash flows ("unwinding of discount") for the purpose of measuring the related impairment loss.

(ii) Fee and commission income

Fee and commission income is recognised in the consolidated income statement when the corresponding service is provided.

(iii) Dividend income

Dividend income is recognised in the consolidated income statement on the date when the Group's right to receive payment is established.

(n) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated balance sheet when the Group has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(o) Cash and cash equivalents**

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise cash, non-restricted balances with central banks, banks and other financial institutions, and short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(p) Operating lease payments

Payments made under operating leases are recognised in the consolidated income statement on a straight-line basis over the terms of the leases.

(q) Income tax

Income tax in the consolidated income statement comprises current and deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(r) Dividends or profit distributions

Dividends or profit distributions are recognised as a liability in the year in which they are approved and declared.

(s) Related parties

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

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(t) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

3 NET INTEREST INCOME

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
<i>Interest income arises from:</i>					
Balances with central banks	6,542	5,409	6,119	2,815	3,221
Amounts due from banks and other financial institutions	2,169	2,235	2,027	851	1,152
Loans and advances to customers					
— corporate loans (note)	72,395	83,076	86,540	42,707	47,058
— personal loans	12,533	15,855	19,224	9,482	11,383
— discounted bills	839	2,624	4,839	2,124	2,663
Investments in debt securities	21,428	22,793	28,196	12,866	17,178
Others	648	479	251	251	—
	<u>116,554</u>	<u>132,471</u>	<u>147,196</u>	<u>71,096</u>	<u>82,655</u>
<i>Interest expense arises from:</i>					
Amounts due to banks and other financial institutions	(3,002)	(2,045)	(1,805)	(863)	(1,067)
Deposits from customers	(34,511)	(39,103)	(43,051)	(20,547)	(23,869)
Subordinated bonds issued	—	—	(414)	—	(932)
Others	(175)	(384)	(438)	(215)	(84)
	<u>(37,688)</u>	<u>(41,532)</u>	<u>(45,708)</u>	<u>(21,625)</u>	<u>(25,952)</u>
Net interest income	<u>78,866</u>	<u>90,939</u>	<u>101,488</u>	<u>49,471</u>	<u>56,703</u>

Note:

The amount includes interest income of RMB 367 million for the six months ended June 30, 2005 (2004: RMB 520 million; 2003: RMB 1,991 million; 2002: RMB 2,286 million; six months ended June 30, 2004 (unaudited): RMB 289 million) with respect to unwinding of discount on impaired financial assets (Note 17(b)).

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

4 FEE AND COMMISSION INCOME

	Years ended December 31,			Six months ended June 30,	
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>	<u>2005</u>
				(unaudited)	
Bank card fees	665	1,023	2,316	857	1,333
Agency fee for securities, foreign currency dealing and insurance services fees	660	1,003	1,472	593	880
Remittance and settlement fees	1,009	1,204	1,486	705	776
Consultancy and advisory fees	456	548	732	322	528
Commission on trust business	844	850	702	417	432
Guarantee fees	126	180	233	117	166
Payment and collection services fees	127	161	192	72	100
Others	<u>242</u>	<u>190</u>	<u>219</u>	<u>147</u>	<u>100</u>
	<u>4,129</u>	<u>5,159</u>	<u>7,352</u>	<u>3,230</u>	<u>4,315</u>

5 DIVIDEND INCOME

The Group's dividend income was mainly derived from unlisted equity investments during the relevant periods.

6 NET GAIN/(LOSS) ARISING FROM DEALING SECURITIES

	Years ended December 31,			Six months ended June 30,	
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>	<u>2005</u>
				(unaudited)	
Dealing of debt securities	7	89	110	27	12
Revaluation (losses)/gains of investments and derivatives . .	(48)	60	(174)	(168)	55
Others	<u>112</u>	<u>151</u>	<u>370</u>	<u>20</u>	<u>—</u>
	<u>71</u>	<u>300</u>	<u>306</u>	<u>(121)</u>	<u>67</u>

7 NET GAIN ARISING FROM INVESTMENT SECURITIES

	Years ended December 31,			Six months ended June 30,	
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>	<u>2005</u>
				(unaudited)	
Net gain on disposal	207	75	2,436	73	1,008
Net revaluation gain/ (loss) transferred from equity on disposal	<u>113</u>	<u>404</u>	<u>265</u>	<u>149</u>	<u>(299)</u>
	<u>320</u>	<u>479</u>	<u>2,701</u>	<u>222</u>	<u>709</u>

Net gain on disposal primarily relates to available-for-sale securities.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

8 GENERAL AND ADMINISTRATIVE EXPENSES

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
Staff costs					
— salaries, bonuses and staff welfare expenses	12,815	14,991	16,091	8,146	8,254
— contributions to defined contribution retirement schemes	1,362	1,792	1,700	959	1,005
— housing allowance	445	444	455	207	217
— supplementary retirement benefits	227	150	—	15	119
— staff termination costs	649	3,726	1,457	517	87
— others	<u>1,602</u>	<u>2,102</u>	<u>2,468</u>	<u>1,204</u>	<u>1,416</u>
	17,100	23,205	22,171	11,048	11,098
Property and equipment expense					
— depreciation	5,849	6,262	7,497	3,994	2,832
— rent and property management expenses	2,008	1,896	2,104	1,047	1,061
— utilities	894	944	942	408	440
— maintenance	1,054	987	937	469	262
— others	<u>674</u>	<u>593</u>	<u>614</u>	<u>225</u>	<u>266</u>
	10,479	10,682	12,094	6,143	4,861
Other general and administrative expenses					
(note (i))	8,826	9,747	11,450	5,136	4,392
Business tax and surcharges (note (ii))	5,334	5,516	6,459	3,131	3,581
Amortisation expense	837	860	1,035	498	561
Loss on disposal of property and equipment, land use rights, and other assets	<u>124</u>	<u>730</u>	<u>210</u>	<u>—</u>	<u>—</u>
	<u>42,700</u>	<u>50,740</u>	<u>53,419</u>	<u>25,956</u>	<u>24,493</u>

Notes:

- (i) The amount includes auditors' remuneration of RMB 66 million for the six months ended June 30, 2005 (2004: RMB 113 million; 2003: RMB 1 million; 2002: RMB 1 million; six months ended June 30, 2004 (unaudited): RMB 57 million).
- (ii) Business tax is levied primarily on interest income from loans and advances to customers, and fee and commission income. The business tax rate was 6% in 2002 and reduced to 5% in 2003 and subsequent periods. The surcharges which include education surcharges and city construction tax are charged at 3% and 1% to 7% of local business tax paid respectively.

9 PROVISIONS FOR IMPAIRMENT LOSSES ON ASSETS OTHER THAN LOANS AND ADVANCES TO CUSTOMERS

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
Available-for-sale securities	74	126	1,876	975	331
Property and equipment	146	86	406	—	177
Others	<u>275</u>	<u>288</u>	<u>967</u>	<u>348</u>	<u>114</u>
	<u>495</u>	<u>500</u>	<u>3,249</u>	<u>1,323</u>	<u>622</u>

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

10 DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The aggregate of the emoluments in respect of the Directors and Supervisors during the relevant periods is as follows:

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Fees	—	—	133	—	490
Salaries and other emoluments	671	767	942	392	855
Discretionary bonuses	299	1,256	2,027	600	1,100
Contributions to defined contribution retirement schemes	34	46	66	27	64
	<u>1,004</u>	<u>2,069</u>	<u>3,168</u>	<u>1,019</u>	<u>2,509</u>

The number of the Directors and Supervisors whose emoluments are within the following band is set out as below. For the six months ended June 30, 2005 and 2004 (unaudited), the corresponding emoluments of each band represent only the amounts attributable to the six month period.

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
RMB Nil — RMB 1,000,000	<u>5</u>	<u>7</u>	<u>18</u>	<u>7</u>	<u>22</u>

None of the Directors and Supervisors received any inducements, or compensation for loss of office, or waived any emoluments during the relevant periods.

11 INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments, none of them are Directors or Supervisors whose emoluments are disclosed in Note 10 above. The aggregate of the emoluments in respect of the five highest paid individuals during the relevant periods is as follows:

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Salaries and other emoluments	9,900	9,361	9,099	4,550	5,897
Discretionary bonuses	1,939	2,141	2,471	1,236	1,200
Contributions to defined contribution retirement schemes	745	862	797	398	352
	<u>12,584</u>	<u>12,364</u>	<u>12,367</u>	<u>6,184</u>	<u>7,449</u>

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

11 INDIVIDUALS WITH HIGHEST EMOLUMENTS (continued)

The number of these individuals whose emoluments are within the following bands is set out below. For the six months ended June 30, 2005 and 2004 (unaudited), the corresponding emoluments of each band represent only the amounts attributable to the six month period.

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
RMB Nil — RMB 1,000,000	—	—	—	1	—
RMB 1,000,001 — RMB 1,500,000	—	—	—	4	2
RMB 1,500,001 — RMB 2,000,000	—	—	1	—	3
RMB 2,000,001 — RMB 2,500,000	2	3	2	—	—
RMB 2,500,001 — RMB 3,000,000	3	2	2	—	—

None of these individuals received any inducements, or compensation for loss of office, or waived any emoluments during the relevant periods.

12 LOANS TO DIRECTORS, SUPERVISORS AND OFFICERS

There were no loans to the Directors, Supervisors and Officers (and their affiliates) of the Bank as defined under section 161B of the Hong Kong Companies Ordinance during the relevant periods.

13 INCOME TAX

(a) Recognised in the consolidated income statement

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
Current tax					
— PRC	263	168	1,771	41	2,767
— Hong Kong	31	29	63	28	32
— Overseas	4	4	4	—	2
	298	201	1,838	69	2,801
Deferred tax (Note 20(b))	10,770	14,968	321	140	593
Income tax	11,068	15,169	2,159	209	3,394

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

13 INCOME TAX (continued)

(b) Reconciliation of profit before tax to income tax

	Years ended December 31,			Six months ended June 30,	
	2002	2003	2004	2004	2005
Profit before tax.....	<u>22,402</u>	<u>37,702</u>	<u>51,199</u>	<u>24,486</u>	<u>31,743</u>
Expected PRC income tax charged at statutory tax rate of 33% (note (i))	<u>7,393</u>	<u>12,442</u>	<u>16,896</u>	<u>8,080</u>	<u>10,475</u>
Non-deductible expenses (note (ii))					
— Staff costs	2,621	3,361	3,906	1,963	2,061
— Impairment losses	6,633	3,354	802	361	26
— Others	<u>183</u>	<u>1,311</u>	<u>1,334</u>	<u>1,017</u>	<u>114</u>
	<u>9,437</u>	<u>8,026</u>	<u>6,042</u>	<u>3,341</u>	<u>2,201</u>
Non-taxable income (note (iii))					
— Interest income from PRC government bonds ..	(3,200)	(3,104)	(3,162)	(1,531)	(1,345)
— Interest income from bond issued by Cinda	(1,834)	(1,834)	(1,834)	(917)	—
— Others	<u>(728)</u>	<u>(361)</u>	<u>(310)</u>	<u>(85)</u>	<u>(89)</u>
	<u>(5,762)</u>	<u>(5,299)</u>	<u>(5,306)</u>	<u>(2,533)</u>	<u>(1,434)</u>
	11,068	15,169	17,632	8,888	11,242
Less: Tax exemption (note (iv))	<u>—</u>	<u>—</u>	<u>(15,473)</u>	<u>(8,679)</u>	<u>(7,848)</u>
Income tax	<u>11,068</u>	<u>15,169</u>	<u>2,159</u>	<u>209</u>	<u>3,394</u>

Notes:

- (i) The provision for PRC income tax of the Group is calculated based on the statutory tax rate of 33% in accordance with the relevant PRC income tax rules and regulations.
- (ii) Amounts primarily represent staff costs in excess of the statutory deductible threshold, impairment losses on assets (such as loans and advances to customers, and property and equipment) in excess of the deductible amount, and entertainment expenses, depreciation and amortization charges which are not tax deductible.
- (iii) Amounts primarily comprise interest income from the PRC government bonds and the bond issued by Cinda for the purpose of acquiring CCB's impaired loans and advances in 1999.
According to the notice issued by the MOF, interest income from the bond issued by Cinda is subject to income tax from January 1, 2005 onwards.
- (iv) According to an approval notice issued by the MOF and the State Administration of Taxation of the PRC in June 2005, substantial amounts of the Group's income tax for the year ended December 31, 2004 and for the six months ended June 30, 2005 were exempted. The amounts of income tax exempted for the year ended December 31, 2004 and for the six months ended June 30, 2005 were RMB 15,473 million and RMB 7,848 million respectively.

14 EARNINGS PER SHARE

As part of the Restructuring, CCB received a capital injection of RMB 186,230 million from Huijin on December 30, 2003. Upon incorporation on September 17, 2004, the Bank issued a total of 186,230 million promoters' shares at par value of RMB 1 each to Huijin and Jianyin as consideration for the Succeeding Business, and 8,000 million promoters' shares at par value of RMB 1 each to three promoters for cash received.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

14 EARNINGS PER SHARE (continued)

Basic earnings per share for each of the years ended December 31, 2002 and 2003, and for the six months ended June 30, 2004 (unaudited) have been computed by dividing the net profits attributable to equity holders of the Bank by 186,230 million shares at par value RMB 1 each as if these shares had been issued as at January 1, 2002 as consideration for the Succeeding Business. Basic earnings per share for the year ended December 31, 2004 have been computed by dividing the net profits attributable to equity holders of the Bank by 188,547 million shares, the weighted average number of shares calculated on the basis that 186,230 million shares were issued and outstanding up to September 16, 2004 and 194,230 million shares were issued and outstanding since September 17, 2004. Basic earnings per share for the six months ended June 30, 2005 have been computed by dividing the net profits attributable to equity holders of the Bank by 194,230 million shares that were in issue during the six months ended June 30, 2005.

There was no difference between basic and diluted earnings per share as there were no dilutive potential shares outstanding for all periods presented.

15 CASH AND BALANCES WITH CENTRAL BANKS

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Cash	21,390	24,410	27,080	26,120
Balances with central banks				
— Statutory deposit reserve funds (note (i))	149,878	199,709	245,208	263,069
— Surplus deposit reserve funds (note (ii))	102,064	100,299	123,540	107,880
— Fiscal deposits	2,982	6,330	3,538	5,665
— Balances under resale agreement	9,270	—	—	16,290
	<u>264,194</u>	<u>306,338</u>	<u>372,286</u>	<u>392,904</u>
Total	<u>285,584</u>	<u>330,748</u>	<u>399,366</u>	<u>419,024</u>

Notes:

- (i) The Group places statutory deposit reserve funds with the PBOC and the central banks of overseas countries where it has operations. The statutory deposit reserve funds are not available for the Group's daily business.

Statutory deposit reserve funds placed with the PBOC were calculated at 6% of eligible Renminbi deposits for domestic branches of the Bank prior to September 21, 2003. This was increased to 7% with effect from September 21, 2003 and has been further increased to 7.5% since April 25, 2004. The Group is also required to deposit 2% of its foreign currency deposits from customers of domestic branches as statutory deposit reserve funds prior to January 15, 2005. This has been increased to 3% since January 15, 2005.

The amounts of statutory deposit reserve funds placed with the central banks of overseas countries are determined by local jurisdiction.

- (ii) The surplus deposit reserve funds were maintained with the PBOC for the purposes of clearing.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

16 AMOUNTS DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

(a) Analysed by nature

	December 31,			June 30,
	2002	2003	2004	2005
Money market placements	69,969	208,289	71,262	72,886
Balances under resale agreements	43,735	21,625	37,033	30,272
Deposits	6,813	11,481	6,886	11,545
Gross balances (Note 16(b))	120,517	241,395	115,181	114,703
Less: Allowances for impairment losses (Note 16(d))	(6,499)	(3,847)	(2,650)	(2,577)
Net balances	<u>114,018</u>	<u>237,548</u>	<u>112,531</u>	<u>112,126</u>

(b) Analysed by geographical location

	December 31,			June 30,
	2002	2003	2004	2005
Balances with				
— Banks in the PRC	44,297	23,188	34,861	27,581
— Other financial institutions in the PRC (note)	22,863	202,910	17,220	21,211
	<u>67,160</u>	<u>226,098</u>	<u>52,081</u>	<u>48,792</u>
Balances with				
— Banks outside the PRC	53,357	15,297	63,100	65,911
Gross balances	<u>120,517</u>	<u>241,395</u>	<u>115,181</u>	<u>114,703</u>
Of which money market placements maturing within one month				
from the balance sheet date	<u>34,359</u>	<u>202,461</u>	<u>40,130</u>	<u>67,776</u>

Note:

Other financial institutions in the PRC represent financial institutions, registered with and under the supervision of the CBRC, other than banks in the PRC.

The balances with other financial institutions in the PRC as at December 31, 2003 include a placement with a non-bank financial institution of USD 22,500 million (equivalent to RMB 186,230 million), being the capital injection by Huijin.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

16 AMOUNTS DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS (continued)

(c) Analysed by legal form of counterparty

	December 31,			June 30,
	2002	2003	2004	2005
Balances with				
— PRC government agency	—	186,230	—	—
— Policy banks in the PRC	4,000	—	—	2,100
— State-owned banks and other financial institutions	38,705	22,165	22,468	20,160
— Joint-stock banks and other financial institutions	24,455	17,703	29,613	26,572
— Foreign-invested banks and other financial institutions	53,357	15,297	63,100	65,871
Gross balances	<u>120,517</u>	<u>241,395</u>	<u>115,181</u>	<u>114,703</u>
Less: Allowances for impairment losses on balances with				
— State-owned banks and other financial institutions	(4,466)	(3,657)	(1,143)	(1,984)
— Joint-stock banks and other financial institutions	(2,033)	(190)	(1,507)	(593)
Total allowances for impairment losses	<u>(6,499)</u>	<u>(3,847)</u>	<u>(2,650)</u>	<u>(2,577)</u>
Net balances	<u>114,018</u>	<u>237,548</u>	<u>112,531</u>	<u>112,126</u>

(d) Movements of allowances for impairment losses

	Years ended December 31,			Six months ended June 30,
	2002	2003	2004	2005
As at January 1	6,505	6,499	3,847	2,650
(Release)/charge for the year/period	(1)	81	203	(37)
Write-offs	(5)	(2,733)	(1,400)	(36)
As at December 31/June 30	<u>6,499</u>	<u>3,847</u>	<u>2,650</u>	<u>2,577</u>

17 LOANS AND ADVANCES TO CUSTOMERS

(a) Analysed by nature

	December 31,			June 30,
	2002	2003	2004	2005
Corporate loans	1,463,100	1,538,802	1,657,460	1,776,568
Personal loans	271,485	355,089	412,647	429,503
Discounted bills	48,897	103,863	157,319	168,371
Gross loans and advances to customers	1,783,482	1,997,754	2,227,426	2,374,442
Less: Allowances for impairment losses (Note 17(b))	(207,289)	(54,395)	(53,864)	(58,954)
Net loans and advances to customers	<u>1,576,193</u>	<u>1,943,359</u>	<u>2,173,562</u>	<u>2,315,488</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(b) Movements of allowances for impairment losses

	Years ended December 31,			Six months ended June 30,
	2002	2003	2004	2005
As at January 1	199,325	207,289	54,395	53,864
Charge for the year/period	19,602	9,662	6,109	6,064
Unwinding of discount (Note 3)	(2,286)	(1,991)	(520)	(367)
Transfers out (note (i))	(3,713)	(3,492)	(432)	(15)
Write-offs	(8,042)	(58,558)	(6,342)	(632)
Recoveries of loans and advances previously written off	2,403	2,119	654	40
Releases				
— on disposal of impaired loans and advances (note (ii))	—	(100,268)	—	—
— on disposal of loans and advances made to an investee company (note (iii))	—	(366)	—	—
As at December 31/June 30	<u>207,289</u>	<u>54,395</u>	<u>53,864</u>	<u>58,954</u>

Notes:

- (i) Transfers out include the net transfer of provision to/from repossessed assets and debt equity swap investments.
- (ii) Upon the disposal of impaired loans and advances with a principal amount of RMB 128,900 million as described in Note 1 (a), the allowances for impairment losses of RMB 100,268 million previously made against these loans and advances were derecognised in 2003.
- (iii) This amount refers to the allowances for impairment losses associated with the loans to an investee company that were considered to be of investment nature, and were transferred as part of the Non-core Business to Jianyin under the Separation Agreement.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(c) Loans and advances to customers and allowances

	December 31, 2002				Gross impaired loans and advances as a % of gross total loans and advances
	(note (i)) Loans and advances for which allowances are collectively assessed	(note (ii)) Impaired loans and advances		Total	
		for which allowances are collectively assessed	for which allowances are individually assessed		
Gross loans and advances to:					
— financial institutions	2,735	—	—	2,735	—
— non-financial institution customers	<u>1,478,099</u>	<u>84,584</u>	<u>218,064</u>	<u>1,780,747</u>	17.00%
	<u>1,480,834</u>	<u>84,584</u>	<u>218,064</u>	<u>1,783,482</u>	<u>16.97%</u>
Less:					
Allowances for impairment losses on loans and advances to:					
— financial institutions	(26)	—	—	(26)	
— non-financial institution customers	<u>(16,774)</u>	<u>(22,187)</u>	<u>(168,302)</u>	<u>(207,263)</u>	
	<u>(16,800)</u>	<u>(22,187)</u>	<u>(168,302)</u>	<u>(207,289)</u>	
Net loans and advances to:					
— financial institutions	2,709	—	—	2,709	
— non-financial institution customers	<u>1,461,325</u>	<u>62,397</u>	<u>49,762</u>	<u>1,573,484</u>	
	<u>1,464,034</u>	<u>62,397</u>	<u>49,762</u>	<u>1,576,193</u>	

Notes:

- (i) Loans and advances assessed on a collective basis for impairment bear relatively insignificant impairment losses as a proportion of the total portfolio. These loans and advances include those which are graded normal or special mention.
- (ii) Impaired loans and advances include loans for which objective evidence of impairment exists and which have been assessed as bearing significant impairment losses. These loans include loans for which objective evidence of impairment has been identified:
 - individually (including corporate loans and advances which are graded doubtful or loss); or
 - collectively; that is portfolios of homogeneous loans (including retail loans and advances which are graded substandard, doubtful or loss) and portfolios of loans which have been individually assessed but for which no impairment can be identified individually (including corporate loans and advances which are graded substandard).
- (iii) The core definition of the loan classification stated in (i) and (ii) above is described in Note 35(a).
- (iv) There were no impaired loans and advances to financial institutions as at December 31, 2002, 2003 and 2004, and June 30, 2005.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(c) Loans and advances to customers and allowances (continued)

	December 31, 2003				Gross impaired loans and advances as a % of gross total loans and advances
	(note (i)) Loans and advances for which allowances are collectively assessed	(note (ii)) Impaired loans and advances		Total	
		for which allowances are collectively assessed	for which allowances are individually assessed		
Gross loans and advances to:					
— financial institutions	1,976	—	—	1,976	—
— non-financial institution customers	<u>1,910,460</u>	<u>52,498</u>	<u>32,820</u>	<u>1,995,778</u>	<u>4.27%</u>
	<u>1,912,436</u>	<u>52,498</u>	<u>32,820</u>	<u>1,997,754</u>	<u>4.27%</u>
Less:					
Allowances for impairment losses on loans and advances to:					
— financial institutions	(18)	—	—	(18)	
— non-financial institution customers	<u>(19,528)</u>	<u>(13,157)</u>	<u>(21,692)</u>	<u>(54,377)</u>	
	<u>(19,546)</u>	<u>(13,157)</u>	<u>(21,692)</u>	<u>(54,395)</u>	
Net loans and advances to:					
— financial institutions	1,958	—	—	1,958	
— non-financial institution customers	<u>1,890,932</u>	<u>39,341</u>	<u>11,128</u>	<u>1,941,401</u>	
	<u>1,892,890</u>	<u>39,341</u>	<u>11,128</u>	<u>1,943,359</u>	

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(c) Loans and advances to customers and allowances (continued)

	December 31, 2004				Gross impaired loans and advances as a % of gross total loans and advances
	(note (i)) Loans and advances for which allowances are collectively assessed	(note (ii)) Impaired loans and advances		Total	
		for which allowances are collectively assessed	for which allowances are individually assessed		
		for which allowances are collectively assessed	for which allowances are individually assessed	Total	
Gross loans and advances to:					
— financial institutions	648	—	—	648	—
— non-financial institution customers	<u>2,139,398</u>	<u>53,847</u>	<u>33,533</u>	<u>2,226,778</u>	<u>3.92%</u>
	<u>2,140,046</u>	<u>53,847</u>	<u>33,533</u>	<u>2,227,426</u>	<u>3.92%</u>
Less:					
Allowances for impairment losses on loans and advances to:					
— financial institutions	(4)	—	—	(4)	
— non-financial institution customers	<u>(19,496)</u>	<u>(14,102)</u>	<u>(20,262)</u>	<u>(53,860)</u>	
	<u>(19,500)</u>	<u>(14,102)</u>	<u>(20,262)</u>	<u>(53,864)</u>	
Net loans and advances to:					
— financial institutions	644	—	—	644	
— non-financial institution customers	<u>2,119,902</u>	<u>39,745</u>	<u>13,271</u>	<u>2,172,918</u>	
	<u>2,120,546</u>	<u>39,745</u>	<u>13,271</u>	<u>2,173,562</u>	

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(c) Loans and advances to customers and allowances (continued)

	June 30, 2005				Gross impaired loans and advances as a % of gross total loans and advances
	(note (i)) Loan and advances for which allowances are collectively assessed	(note (ii)) Impaired loans and advances		Total	
		for which allowances are collectively assessed	for which allowances are individually assessed		
Gross loans and advances to:					
— financial institutions	763	—	—	763	—
— non-financial institution customers	<u>2,280,868</u>	<u>53,258</u>	<u>39,553</u>	<u>2,373,679</u>	<u>3.91%</u>
	<u>2,281,631</u>	<u>53,258</u>	<u>39,553</u>	<u>2,374,442</u>	<u>3.91%</u>
Less:					
Allowances for impairment losses on loans and advances to:					
— financial institutions	(4)	—	—	(4)	
— non-financial institution customers	<u>(18,274)</u>	<u>(15,574)</u>	<u>(25,102)</u>	<u>(58,950)</u>	
	<u>(18,278)</u>	<u>(15,574)</u>	<u>(25,102)</u>	<u>(58,954)</u>	
Net loans and advances to:					
— financial institutions	759	—	—	759	
— non-financial institution customers	<u>2,262,594</u>	<u>37,684</u>	<u>14,451</u>	<u>2,314,729</u>	
	<u>2,263,353</u>	<u>37,684</u>	<u>14,451</u>	<u>2,315,488</u>	

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(d) Analysed by legal form of borrowers

	December 31,			June 30,
	2002	2003	2004	2005
Corporate loans to:				
— State-owned enterprises	777,638	796,504	838,864	875,360
— Joint-stock enterprises	295,631	328,188	350,150	381,394
— Private enterprises	76,204	118,993	152,490	177,408
— Foreign invested enterprises	99,887	92,489	107,672	120,481
— Joint-venture enterprises	29,525	34,145	40,191	50,632
— Collectively-controlled enterprises	69,267	49,358	44,278	46,346
— Jointly-owned enterprises	10,651	11,303	14,204	16,522
— Others	104,297	107,822	109,611	108,425
Subtotal	<u>1,463,100</u>	<u>1,538,802</u>	<u>1,657,460</u>	<u>1,776,568</u>
Personal loans	271,485	355,089	412,647	429,503
Discounted bills	48,897	103,863	157,319	168,371
Gross loans and advances to customers	<u>1,783,482</u>	<u>1,997,754</u>	<u>2,227,426</u>	<u>2,374,442</u>
Less: Allowances for impairment losses on:				
Corporate loans to:				
— State-owned enterprises	(98,947)	(26,335)	(19,571)	(19,583)
— Joint-stock enterprises	(28,002)	(8,867)	(11,718)	(13,073)
— Private enterprises	(12,692)	(3,632)	(5,656)	(7,331)
— Foreign invested enterprises	(13,850)	(1,991)	(3,342)	(3,520)
— Joint-venture enterprises	(2,449)	(986)	(1,705)	(2,253)
— Collectively-controlled enterprises	(29,318)	(4,976)	(3,051)	(3,080)
— Jointly-owned enterprises	(2,805)	(560)	(633)	(715)
— Others	(11,629)	(2,891)	(2,583)	(2,555)
Subtotal	<u>(199,692)</u>	<u>(50,238)</u>	<u>(48,259)</u>	<u>(52,110)</u>
Personal loans	(7,323)	(3,867)	(5,465)	(6,687)
Discounted bills	(274)	(290)	(140)	(157)
Total allowances for impairment losses	<u>(207,289)</u>	<u>(54,395)</u>	<u>(53,864)</u>	<u>(58,954)</u>
Net balances	<u>1,576,193</u>	<u>1,943,359</u>	<u>2,173,562</u>	<u>2,315,488</u>

18 INVESTMENTS

	December 31,			June 30,
	2002	2003	2004	2005
Receivables (Note 18(a))	<u>360,306</u>	<u>352,593</u>	<u>433,858</u>	<u>435,676</u>
Held-to-maturity debt securities (Note 18(b))	<u>311,882</u>	<u>361,340</u>	<u>489,791</u>	<u>576,633</u>
Available-for-sale				
— debt securities (Note 18(c))	48,634	58,968	166,917	246,563
— equity investments (Note 18(d))	37,006	29,992	16,355	14,883
	<u>85,640</u>	<u>88,960</u>	<u>183,272</u>	<u>261,446</u>
Debt securities at fair value through profit or loss (Note 18(e))	<u>1,258</u>	<u>1,493</u>	<u>715</u>	<u>2,023</u>
Total	<u>759,086</u>	<u>804,386</u>	<u>1,107,636</u>	<u>1,275,778</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

The Group's investments held for trading purpose are classified as debt securities at fair value through profit or loss.

(a) Receivables

	December 31,			June 30,
	2002	2003	2004	2005
Due from PRC issuers:				
— Government				
— Special government bond (note (i))	49,200	49,200	49,200	49,200
— Others	4,219	1,767	563	530
— The PBOC (note (ii))	—	—	84,354	84,354
— Policy banks	59,887	54,556	52,671	52,692
— Cinda (note (iii))	247,000	247,000	247,000	247,000
— PRC banks	—	70	70	1,900
Total	360,306	352,593	433,858	435,676

Notes:

- (i) This represents a non-negotiable bond of nominal value of RMB 49,200 million issued by the MOF in 1998 to strengthen the capital base of CCB. The bond matures in 2028 and bears an original fixed interest rate of 7.2% per annum. The interest rate of the bond was revised to a fixed interest rate of 2.25% per annum with effect from December 1, 2004 as part of the Restructuring. This substantial modification of the terms of the special government bond has been accounted for as a derecognition of the original bond with an interest rate of 7.2% per annum and the recognition of a new bond that matures in 2028 and bears an interest rate of 2.25% per annum to reflect the substance of the Restructuring of CCB.
- Interest receivable on the bond from the date of issue to November 30, 2004 was settled by the CCB's or Bank's profit distribution as per a notice of the MOF. From December 1, 2004, interest receivable on the bond is settled by cash on an annual basis.
- (ii) Due from the PBOC is represented by:
- a non-transferable bill of nominal value of RMB 63,354 million issued specifically to CCB. As mentioned in Note 1(a), the majority of the proceeds paid by Cinda on the disposal of impaired loans and advances were used to subscribe for a PBOC bill of nominal value of RMB 63,354 million. The bill matures in June 2009 and bears a fixed interest rate of 1.89% per annum. The PBOC has the right to early settle the bill; and
 - a non-transferable bill of nominal value of RMB 21,000 million issued for settlement of CCB's receivables arising from its appointment by the State Council and the PBOC to act as the receiver in respect of the liquidation of a trust and investment company (Notes 21(e) and 24(b)). The bill matures in June 2007 and bears a fixed interest rate of 1.89% per annum. The PBOC has an early redemption right on this bill subject to certain conditions (Note 1(a)).
- (iii) Cinda issued a bond specifically to CCB in 1999 for the acquisition of CCB's impaired loans and advances at their original book value. The bond has a nominal value of RMB 247,000 million and matures in September 2009. It bears a fixed interest rate of 2.25% per annum. According to a notice issued by the MOF, starting from January 1, 2005, the MOF will provide financial support if Cinda is unable to repay the interest in full. The MOF will also provide support for the repayment of bond principal, if necessary.
- (iv) As described in Note 1(a), the PBOC has approved the Bank to use the special government bond and the bill of nominal value of RMB 63,354 million issued by the PBOC as eligible assets equivalent to the surplus deposit reserve funds for the purpose of clearing.
- (v) All debt securities included as Receivables are unlisted.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

(b) Held-to-maturity debt securities

	December 31,			June 30,
	2002	2003	2004	2005
Issued by:				
Government				
— of the PRC	159,923	177,584	202,436	196,512
— outside the PRC	—	453	165	165
The PBOC	48,878	58,931	105,589	187,674
Policy banks				
— in the PRC	81,937	100,780	118,473	126,606
— outside the PRC	—	—	82	1,671
Banks and other financial institutions				
— in the PRC	13	3	4,940	6,317
— outside the PRC	14,951	15,670	31,989	38,266
Public sector entities outside the PRC	4,546	5,085	23,120	18,716
Others				
— in the PRC	18	—	—	4
— outside the PRC	1,616	2,834	2,997	702
Total	<u>311,882</u>	<u>361,340</u>	<u>489,791</u>	<u>576,633</u>
Listed outside Hong Kong	12,041	13,110	30,744	30,705
Unlisted	<u>299,841</u>	<u>348,230</u>	<u>459,047</u>	<u>545,928</u>
Total	<u>311,882</u>	<u>361,340</u>	<u>489,791</u>	<u>576,633</u>
Market value of listed securities	<u>12,493</u>	<u>13,405</u>	<u>30,463</u>	<u>30,609</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

(c) Available-for-sale debt securities

	December 31,			June 30,
	2002	2003	2004	2005
At fair value and issued by:				
Government				
— of the PRC	11,457	7,618	8,073	11,626
— outside the PRC	7,251	8,690	45,344	28,566
The PBOC	—	9,938	14,339	84,629
Central banks outside the PRC	105	78	—	—
Policy banks				
— in the PRC	3,451	2,854	4,132	6,486
— outside the PRC	388	652	5,637	3,555
Banks and other financial institutions				
— in the PRC	746	446	529	400
— outside the PRC	11,563	16,330	28,883	61,938
Public sector entities outside the PRC	5,587	4,812	45,918	38,281
Others				
— in the PRC (note)	—	—	—	1,801
— outside the PRC	8,086	7,550	14,062	9,281
Total	<u>48,634</u>	<u>58,968</u>	<u>166,917</u>	<u>246,563</u>
Listed in Hong Kong	761	445	1,237	1,557
Listed outside Hong Kong	13,728	18,736	58,858	72,310
Unlisted	34,145	39,787	106,822	172,696
Total	<u>48,634</u>	<u>58,968</u>	<u>166,917</u>	<u>246,563</u>

Note:

Others in the PRC include debt securities issued by state-owned enterprises and joint-stock enterprises of RMB 1,375 million and RMB 426 million respectively as at June 30, 2005.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

(d) Available-for-sale equity investments

	December 31,			June 30, 2005
	2002	2003	2004	
At fair value:				
Debt equity swap investments (note)	34,949	29,066	15,421	13,915
Other equity investments	<u>2,057</u>	<u>926</u>	<u>934</u>	<u>968</u>
Total	<u>37,006</u>	<u>29,992</u>	<u>16,355</u>	<u>14,883</u>
Listed in Hong Kong	385	789	638	701
Listed outside Hong Kong	—	—	28	31
Unlisted	<u>36,621</u>	<u>29,203</u>	<u>15,689</u>	<u>14,151</u>
Total	<u>37,006</u>	<u>29,992</u>	<u>16,355</u>	<u>14,883</u>

Note:

Pursuant to the arrangement of the PRC government in 1999, the Group acquired unlisted legal person shares (“debt equity swap investments”) in certain corporate borrowers in lieu of repayments of loans granted to them. Pursuant to a notice (the “Notice”) jointly issued by the State Economic & Trade Commission of the PRC and the PBOC on July 5, 1999, commercial banks are prohibited from being involved in management of the operation of these corporate borrowers although the banks hold equity interests through the above debt equity swap arrangement.

Prior to April 30, 2005, the Group appointed Cinda to hold and manage these debt equity swap investments. The Group has ownership and right of disposal and retains the risks and rewards associated with them. These shares were registered under the name of Cinda which acted on behalf of the Group and earned a management fee in return. On April 30, 2005, the Group entered into an agreement (the “Termination Agreement”) with Cinda to terminate the appointment of Cinda to manage these investments on its behalf. Pursuant to the Termination Agreement, Cinda will complete the transfer of the legal titles of these investments to the Group by the end of October 2005. Notwithstanding this change, the Group is still required to comply with the Notice. Therefore, the Group will continue not to be involved in management of the operation of these corporate borrowers. The Group has been advised by its PRC legal counsel that such direct ownership in these investments does not violate any of the prevailing laws and regulations in the PRC.

(e) Debt securities at fair value through profit or loss

	December 31,			June 30, 2005
	2002	2003	2004	
Issued by:				
Government				
— of the PRC	250	522	88	231
— outside the PRC	1,008	—	248	341
The PBOC	—	956	196	103
Policy banks				
— in the PRC	—	15	—	—
— outside the PRC	—	—	—	234
Banks and other financial institutions outside the PRC	—	—	183	869
Others outside the PRC	—	—	—	245
Total	<u>1,258</u>	<u>1,493</u>	<u>715</u>	<u>2,023</u>
Listed outside Hong Kong	—	—	—	1,504
Unlisted	<u>1,258</u>	<u>1,493</u>	<u>715</u>	<u>519</u>
Total	<u>1,258</u>	<u>1,493</u>	<u>715</u>	<u>2,023</u>

All the above securities are held for trading purposes.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

19 PROPERTY AND EQUIPMENT

	Bank premises <small>(Note 19(a))</small>	Construction in progress	Computer equipment	Others	Total
Cost:					
As at January 1, 2002	51,023	3,665	11,118	16,748	82,554
Additions	1,200	273	2,473	2,431	6,377
Disposals	(1,449)	(148)	(1,031)	(1,058)	(3,686)
Transfers	1,247	(1,271)	—	24	—
As at December 31, 2002	<u>52,021</u>	<u>2,519</u>	<u>12,560</u>	<u>18,145</u>	<u>85,245</u>
Accumulated depreciation and impairment losses:					
As at January 1, 2002	(10,203)	(643)	(5,915)	(9,190)	(25,951)
Depreciation charge	(1,644)	—	(1,839)	(2,366)	(5,849)
Impairment losses	(140)	(2)	(1)	(3)	(146)
Disposals	302	4	917	865	2,088
As at December 31, 2002	<u>(11,685)</u>	<u>(641)</u>	<u>(6,838)</u>	<u>(10,694)</u>	<u>(29,858)</u>
Net carrying value:					
As at December 31, 2002	<u>40,336</u>	<u>1,878</u>	<u>5,722</u>	<u>7,451</u>	<u>55,387</u>
Cost or deemed cost:					
As at January 1, 2003	52,021	2,519	12,560	18,145	85,245
Additions	1,388	972	2,189	1,796	6,345
Disposals	(4,063)	(523)	(1,962)	(2,325)	(8,873)
Transfers	884	(1,186)	253	49	—
Distribution to the owner in connection with the Restructuring (Note 28)	(6,807)	(741)	—	(890)	(8,438)
Elimination of accumulated depreciation and impairment losses on valuation	(9,600)	(110)	(7,088)	(10,622)	(27,420)
Surplus/ (deficit) on valuation (Note 19(b))	4,385	33	596	(137)	4,877
As at December 31, 2003	<u>38,208</u>	<u>964</u>	<u>6,548</u>	<u>6,016</u>	<u>51,736</u>
Accumulated depreciation and impairment losses:					
As at January 1, 2003	(11,685)	(641)	(6,838)	(10,694)	(29,858)
Depreciation charge	(1,718)	—	(2,141)	(2,403)	(6,262)
Net impairment (losses)/reversal	(69)	1	—	(18)	(86)
Disposals	1,849	236	1,891	1,832	5,808
Distribution to the owner in connection with the Restructuring (Note 28)	2,023	294	—	661	2,978
Elimination of accumulated depreciation and impairment losses on valuation	9,600	110	7,088	10,622	27,420
As at December 31, 2003	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net carrying value:					
As at December 31, 2003	<u>38,208</u>	<u>964</u>	<u>6,548</u>	<u>6,016</u>	<u>51,736</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

19 PROPERTY AND EQUIPMENT (continued)

	Bank premises <small>(Note 19(a))</small>	Construction in progress	Computer equipment	Others	Total
<i>Cost or deemed cost:</i>					
As at January 1, 2004	38,208	964	6,548	6,016	51,736
Additions	973	719	2,689	1,733	6,114
Disposals	(941)	(72)	(387)	(2,758)	(4,158)
Transfers	112	(847)	726	9	—
As at December 31, 2004	<u>38,352</u>	<u>764</u>	<u>9,576</u>	<u>5,000</u>	<u>53,692</u>
<i>Accumulated depreciation and impairment losses:</i>					
As at January 1, 2004	—	—	—	—	—
Depreciation charge	(1,714)	—	(3,182)	(2,601)	(7,497)
Impairment losses	(388)	—	(9)	(9)	(406)
Disposals	78	—	244	2,333	2,655
As at December 31, 2004	<u>(2,024)</u>	<u>—</u>	<u>(2,947)</u>	<u>(277)</u>	<u>(5,248)</u>
<i>Net carrying value:</i>					
As at December 31, 2004	<u>36,328</u>	<u>764</u>	<u>6,629</u>	<u>4,723</u>	<u>48,444</u>
<i>Cost or deemed cost:</i>					
As at January 1, 2005	38,352	764	9,576	5,000	53,692
Additions	58	433	288	454	1,233
Disposals	(427)	(1)	(129)	(807)	(1,364)
Transfers	56	(68)	—	12	—
As at June 30, 2005	<u>38,039</u>	<u>1,128</u>	<u>9,735</u>	<u>4,659</u>	<u>53,561</u>
<i>Accumulated depreciation and impairment losses:</i>					
As at January 1, 2005	(2,024)	—	(2,947)	(277)	(5,248)
Depreciation charge	(795)	—	(1,225)	(812)	(2,832)
Impairment losses	(125)	(50)	—	(2)	(177)
Disposals	61	—	109	646	816
As at June 30, 2005	<u>(2,883)</u>	<u>(50)</u>	<u>(4,063)</u>	<u>(445)</u>	<u>(7,441)</u>
<i>Net carrying value:</i>					
As at June 30, 2005	<u>35,156</u>	<u>1,078</u>	<u>5,672</u>	<u>4,214</u>	<u>46,120</u>

Note:

As at June 30, 2005, ownership documentation for the Group's bank premises with a net carrying value of RMB 992 million (31 December 2004: RMB 1,112 million) was being finalised.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

19 PROPERTY AND EQUIPMENT (continued)

(a) Analysed by remaining terms of leases

The net carrying value of bank premises at the balance sheet date is analysed by the remaining terms of the leases as follows:

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Long term leases (over 50 years), held in Hong Kong	111	108	105	104
Medium term leases (10-50 years), held in the PRC	40,133	38,013	36,141	34,950
Short term leases (less than 10 years), held in the PRC	92	87	82	102
Total	<u>40,336</u>	<u>38,208</u>	<u>36,328</u>	<u>35,156</u>

(b) Valuation pursuant to the Restructuring

As required by the relevant PRC rules and regulations with respect to the Restructuring, the property and equipment of CCB as at December 31, 2003 were valued by CCAFMM on a depreciated replacement cost or a comparable market basis as appropriate. The surplus arising from the valuation of property and equipment of RMB 4,877 million has been credited to owner's equity as at December 31, 2003 (Note 27(d)).

The Group's bank premises were also valued separately by Chesterton Petty Limited, an independent qualified valuer in Hong Kong, as at December 31, 2003. The value arrived at by them was approximately the same as that arrived at by CCAFMM.

The effect of this valuation was to increase the depreciation charges of property and equipment by approximately RMB 394 million, RMB 197 million and RMB 142 million for the year ended December 31, 2004, and for the six months ended June 30, 2004 (unaudited) and 2005 respectively.

The valuation was a one-off event driven by the Restructuring. Other than this revaluation carried out in compliance with relevant PRC rules and regulations, the Group has no plans to revalue its property and equipment on a regular basis. Accordingly, the property and equipment are to be stated at cost or deemed cost, less accumulated depreciation and impairment losses.

20 DEFERRED TAX

(a) Analysed by nature

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Deferred tax assets	14,351	—	—	—
Deferred tax liabilities	(14)	(471)	(388)	(1,386)
Net balance	<u>14,337</u>	<u>(471)</u>	<u>(388)</u>	<u>(1,386)</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

20 DEFERRED TAX (continued)

(b) Movements of deferred tax

The components of deferred tax assets/(liabilities) recognised in the consolidated balance sheets and the movements during the relevant periods are as follows:

	In the PRC					Outside the PRC		Net amount
	Impairment losses on loans and advances to customers (note (i))	Impairment losses on other assets (note (i))	Provision for housing reform losses and against interest receivable (note (ii))	Interest recognition for short-term debt securities (note (iii))	Deferral or amortisation of subordinated bonds issue costs	Fair value adjustments for securities and derivatives (note (iv))	Fair value adjustments for securities and derivatives (note (iv))	
As at January 1, 2002	12,223	5,108	8,218	(3)	—	(277)	(21)	25,248
Recognised in consolidated income statement	(4,917)	(1,364)	(4,381)	(121)	—	(7)	20	(10,770)
Recognised in equity	—	—	—	—	—	(128)	(13)	(141)
As at December 31, 2002	7,306	3,744	3,837	(124)	—	(412)	(14)	14,337
Recognised in consolidated income statement	(7,306)	(3,744)	(3,837)	(55)	—	(1)	(25)	(14,968)
Recognised in equity	—	—	—	—	—	164	(4)	160
As at December 31, 2003	—	—	—	(179)	—	(249)	(43)	(471)
Recognised in consolidated income statement	—	—	—	(343)	(35)	60	(3)	(321)
Recognised in equity	—	—	—	—	—	420	(16)	404
As at December 31, 2004	—	—	—	(522)	(35)	231	(62)	(388)
Recognised in consolidated income statement	—	—	—	(148)	2	(450)	3	(593)
Recognised in equity	—	—	—	—	—	(371)	(34)	(405)
As at June 30, 2005	—	—	—	(670)	(33)	(590)	(93)	(1,386)

Notes:

(i) Allowances for impairment losses are determined based on the expected recoverable amount of the relevant assets at the balance sheet date for financial reporting purposes while the amounts deductible for tax purposes are calculated at 1% of the gross carrying amount of qualifying assets at the balance sheet date together with the write-offs which fulfill the specific write-off criteria as set out in the PRC tax rules and approved by the tax authorities.

Due to the Restructuring, it is uncertain as to whether the allowances for impairment losses that were not previously treated as deductible expenses of CCB for tax purposes as at December 31, 2003 will be treated as deductible expenses of the Bank for tax purposes in subsequent years. In view of this uncertainty, no deferred tax assets in respect of such allowances were recognised as at December 31, 2003.

The allowances for impairment losses made subsequent to December 31, 2003 and the write-offs not relating to the allowances for impairment losses as described above are deductible for tax purposes so long as they fulfill the criteria set out in the PRC tax law.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****20 DEFERRED TAX (continued)****(b) Movements of deferred tax (continued)**

Notes: (continued)

- (ii) Pursuant to the one-off housing reform policy in the PRC in 1998, the Group allocated certain staff quarters to eligible employees for nominal consideration. Losses arising from the allocation were recognised in the consolidated income statement prior to 2001 for financial reporting purpose. Such losses were deducted for tax purpose over 3 years from 2001 to 2003.
- Adjustment of interest income arising from the change of interest accrual policy in 2001 and 2002 was allowed to be deductible for tax purpose over 3 years from 2001. According to the Group's accounting policy, when the interest receivable or the corresponding loan principal become overdue over 90 days, the interest receivable is reversed in the consolidated income statement.
- (iii) Interest income for short term debt investments are taxed on disposal or maturity of these investments.
- (iv) Fair value adjustments for available-for-sale securities and derivatives are subject to tax when realised.
- (v) The Group did not have significant unprovided deferred taxation arising at the balance sheet date.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

21 OTHER ASSETS

	December 31,			June 30,
	2002	2003	2004	2005
Interest receivable				
— debt securities	7,706	5,130	8,695	13,163
— loans and advances to customers	3,205	3,385	3,612	4,720
— others	169	104	338	284
	11,080	8,619	12,645	18,167
Land use rights (Note 21(a))	11,597	20,139	18,986	18,752
Positive fair value of derivatives (Notes 21(b) and 35(f))	618	638	1,624	7,292
Repossessed assets (Note 21(c))	7,247	6,171	2,862	2,187
Intangible assets	701	1,020	969	867
Government receivable (Note 21(d))	—	65,499	23,781	—
Receivable on disposal of impaired loans and advances (Note 1(a))	—	64,450	—	—
Receivables on liquidation of a trust and investment company (Note 21(e))	15,692	15,917	—	—
Others	6,382	6,836	7,514	8,287
Total	<u>53,317</u>	<u>189,289</u>	<u>68,381</u>	<u>55,552</u>

(a) Land use rights**(i) Valuation surplus**

As required by the relevant PRC rules and regulations with respect to the Restructuring, the land use rights of CCB as at December 31, 2003 were valued by CCAFMM on a comparable market basis. The surplus arising from the one-off valuation of the land use rights of RMB 9,283 million has been credited to owner's equity as at December 31, 2003 (Note 27(d)).

The effect of this valuation was to increase the amortisation charges of land use rights by approximately RMB 230 million, RMB 115 million and RMB 112 million for the year ended December 31, 2004 and for the six months ended June 30, 2004 (unaudited) and 2005, respectively.

(ii) Contribution land use rights

According to an approval notice issued by the Ministry of Land and Resources of the PRC, the PRC government has granted CCB the right to operate on certain state-owned lands (the "Contribution Land") for their original purposes, or transfer or lease them to group companies without further payment for the land compensation fees. As part of the Restructuring, the Bank succeeded to the Contribution Land with an aggregate net carrying value of RMB 9,047 million from CCB as at December 31, 2003.

However, if the Group uses the Contribution Land for other purposes, or if the Group transfers any of the Contribution Land to a third party, the Group is required to pay land compensation fees to the local land administration authorities for the Contribution Land that is subject to the change of use or the transfer. The land compensation fees in respect of the Contribution Land amounted to RMB 3,619 million as at December 31, 2003 if the Group used all the Contribution Land for other purposes or transferred all the relevant land use rights to third parties.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

21 OTHER ASSETS (continued)

(a) Land use rights (continued)

(ii) Contribution land use rights (continued)

The above Contribution Land was mainly used by the Group for its operating activities. The Group considers that only very limited pieces of Contribution Land will be disposed to third parties or for which the purpose of use will be changed as a result of branch rationalisation. Accordingly, the Group did not accrue the land compensation fees. The Group recognises the land compensation fees when it changes the purpose of use or dispose the relevant land use rights to third parties.

(b) Positive fair value of derivatives

The balance as at June 30, 2005 includes the fair value of the foreign exchange option, amounting to RMB 5,690 million, which was purchased to hedge the currency risk arising from the separately managed U.S. dollar denominated investment portfolio (Note 35(d)).

The premium payable in respect of the above option purchased is stated at a discounted value of RMB 5,247 million and is included under other liabilities and provisions (Note 24).

(c) Repossessed assets

On June 30, 2004, CCB entered into sale and purchase agreements (the "S&P Agreements") to dispose of repossessed assets amounting to RMB 3,277 million (against which allowances for impairment losses of RMB 2,204 million were made as at December 31, 2003) for a consideration of RMB 1,098 million. The completion dates of these transactions, which were initially set on December 27, 2004, were deferred to and finalised on March 30, 2005 and May 30, 2005 respectively upon request from the buyers. As at December 31, 2004, the Group considered that the uncertainty on completion was insignificant and these repossessed assets were therefore derecognised. Pursuant to the S&P Agreements, all gains or losses arising from these repossessed assets after the date of the S&P Agreements belong to the buyers. However, the Group has an obligation to buy back those assets which are found to be with defects within nine months from the completion dates, or for assets whose titles fail to be transferred to the buyers, within three years from the completion dates. At the date of this prospectus, the Group considers that the potential buy-back amounts will be immaterial.

(d) Government receivable

As part of the Restructuring, the PRC government agreed to replenish the remaining accumulated losses of CCB as at December 31, 2003. The government receivable is non-interest-bearing. In 2004, RMB 41,718 million was settled by the Bank's profit distribution as approved by the shareholders in the general meeting on December 27, 2004 (Note 29(b)). The remaining balance was settled by the Bank's profit distribution as approved by the shareholders in the general meeting on June 6, 2005 (Note 29(c)).

(e) Receivables on liquidation of a trust and investment company

In 1997, CCB was appointed by the State Council and the PBOC to be the receiver of a trust and investment company. The receivables were related to the settlement of claims and liabilities for the winding up

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

21 OTHER ASSETS (continued)

(e) Receivables on liquidation of a trust and investment company (continued)

of the company. The receivables were fully settled in 2004, by a bill issued by the PBOC (Notes 18(a) and 24(b)).

22 AMOUNTS DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

(a) Analysed by nature

	December 31,			June 30,
	2002	2003	2004	2005
Balances under repurchase agreements	1,227	286	100	6,512
Money market takings	16,041	19,595	23,085	18,785
Deposits	<u>89,193</u>	<u>89,293</u>	<u>88,854</u>	<u>99,767</u>
Total	<u>106,461</u>	<u>109,174</u>	<u>112,039</u>	<u>125,064</u>

(b) Analysed by geographical location

	December 31,			June 30,
	2002	2003	2004	2005
Balances payable on demand				
— Banks in the PRC	6,683	7,698	6,615	8,269
— Other financial institutions in the PRC	<u>79,379</u>	<u>76,955</u>	<u>73,736</u>	<u>86,336</u>
	<u>86,062</u>	<u>84,653</u>	<u>80,351</u>	<u>94,605</u>
— Banks outside the PRC	<u>2,467</u>	<u>2,704</u>	<u>4,348</u>	<u>1,989</u>
Term deposits				
— Banks in the PRC	8,690	6,442	7,099	9,897
— Other financial institutions in the PRC	<u>333</u>	<u>1,667</u>	<u>2,614</u>	<u>2,420</u>
	<u>9,023</u>	<u>8,109</u>	<u>9,713</u>	<u>12,317</u>
— Banks outside the PRC	<u>8,909</u>	<u>13,708</u>	<u>17,627</u>	<u>16,153</u>
Total	<u>106,461</u>	<u>109,174</u>	<u>112,039</u>	<u>125,064</u>

(c) Analysed by legal form of counterparty

	December 31,			June 30,
	2002	2003	2004	2005
Balances with				
— Policy banks in the PRC	53	49	45	364
— State-owned banks and other financial institutions	72,524	71,350	69,773	79,894
— Joint-stock banks and other financial institutions	22,508	21,363	20,246	26,664
— Foreign-invested banks and other financial institutions	<u>11,376</u>	<u>16,412</u>	<u>21,975</u>	<u>18,142</u>
Total	<u>106,461</u>	<u>109,174</u>	<u>112,039</u>	<u>125,064</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

23 DEPOSITS FROM CUSTOMERS

(a) Analysed by nature

	December 31,			June 30,
	2002	2003	2004	2005
Demand deposits				
— Corporate customers	1,197,130	1,322,989	1,389,355	1,404,723
— Personal customers	491,161	582,048	633,765	668,679
	<u>1,688,291</u>	<u>1,905,037</u>	<u>2,023,120</u>	<u>2,073,402</u>
Time deposits				
— Corporate customers	337,024	380,225	452,689	565,684
— Personal customers	797,429	910,411	1,015,312	1,142,209
	<u>1,134,453</u>	<u>1,290,636</u>	<u>1,468,001</u>	<u>1,707,893</u>
Total	<u>2,822,744</u>	<u>3,195,673</u>	<u>3,491,121</u>	<u>3,781,295</u>

(b) Analysed by geographical segments

	December 31,			June 30,
	2002	2003	2004	2005
Yangtze River Delta	549,229	655,421	726,774	777,453
Pearl River Delta	479,951	526,078	544,452	600,242
Bohai Rim	527,265	622,427	698,108	767,190
Central	472,181	550,822	604,301	646,291
Western	471,736	547,316	597,300	634,645
Northeastern	232,730	258,153	280,177	305,356
Head Office	79,771	24,716	29,698	32,392
Overseas	9,881	10,740	10,311	17,726
Total	<u>2,822,744</u>	<u>3,195,673</u>	<u>3,491,121</u>	<u>3,781,295</u>

See Note 34(b) for the definitions of geographical segments.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

24 OTHER LIABILITIES AND PROVISIONS

	December 31,			June 30,
	2002	2003	2004	2005
Interest payable				
— deposits from customers	20,125	21,649	22,976	22,464
— others	726	71	504	1,359
	20,851	21,720	23,480	23,823
Salaries and welfare payables (Note 24(a))	6,276	6,808	7,209	8,169
Supplementary retirement benefit obligations (Note 25(b))	6,572	6,367	5,743	5,712
Foreign exchange option premium payable (Note 21(b))	—	—	—	5,247
Payables to Jianyin (Notes 24(b) and 37(b))	—	—	6,405	5,165
Business and other tax payables	1,877	2,213	2,705	2,610
Government bond redemption payable	2,091	1,874	1,717	2,217
Negative fair value of derivatives (Note 35(f))	772	838	1,816	1,910
Litigation provision (Note 24(c))	3,551	2,587	2,107	1,853
Settlement accounts	2,060	3,015	1,287	1,845
Payment and collection clearance account	1,574	1,694	1,358	901
Dividend payable (Note 29(b))	—	—	2,914	—
Others	11,845	7,345	6,446	6,783
Total	<u>57,469</u>	<u>54,461</u>	<u>63,187</u>	<u>66,235</u>

(a) Salaries and welfare payables

Included under salaries and welfare payables, the Group had the following payables to defined contribution retirement schemes at the balance sheet date:

	December 31,			June 30,
	2002	2003	2004	2005
As at December 31/June 30	<u>888</u>	<u>1,350</u>	<u>1,231</u>	<u>1,341</u>

(b) Payables to Jianyin

The balance as at June 30, 2005 included a payable of RMB 5,165 million (December 31, 2004: RMB 5,113 million) to Jianyin, arising from the receipt of a bill issued by the PBOC with a nominal value of RMB 21,000 million (Note 18(a)), which exceeded net advances made by CCB for the liquidation of a trust and investment company (Note 21(e)), plus the interest accrual on such excess portion.

The balance as at December 31, 2004 also included the proceeds from the disposal of assets owned by Jianyin collected by the Group on behalf of Jianyin.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

24 OTHER LIABILITIES AND PROVISIONS (continued)

(c) Litigation provision

	Years ended December 31,			Six months ended June 30,
	2002	2003	2004	2005
As at January 1	3,999	3,551	2,587	2,107
Expenses recognised in the consolidated income statement	545	676	707	16
Provision utilised	(993)	(1,640)	(1,187)	(270)
As at December 31/June 30	<u>3,551</u>	<u>2,587</u>	<u>2,107</u>	<u>1,853</u>

25 RETIREMENT BENEFIT OBLIGATIONS

(a) Statutory retirement schemes

In accordance with the labour regulations of the PRC, the Group participates in various defined contribution retirement schemes organised by the municipal and provincial governments for its staff in the PRC. The Group is required to make contributions to a separate entity which could be the government or publicly administered retirement schemes at certain rates of the salaries, bonuses and certain allowances of its staff. A member of the schemes is entitled to retirement benefit equal to a fixed proportion of the salary prevailing at his or her retirement date.

For its staff outside the PRC, the Group participates in various defined contribution retirement schemes at funding rates determined in accordance with the local practices and regulations.

The Group has no other material obligations for the payment of its staff's retirement and other post retirement benefits other than the contributions described above and in Note 25(b) below.

(b) Supplementary retirement benefits

The Group pays supplementary retirement benefits for its PRC employees who retired on or before December 31, 2003 ("Eligible Employees"). The amounts recognised in the consolidated balance sheet represent the present value of unfunded obligations.

The Group's obligations in respect of the supplementary retirement benefits at the balance sheet date were reviewed by an independent actuary, Towers, Perrin, Forster & Crosby, Inc., Hong Kong, using the projected unit credit actuarial cost method. They are members of the Society of Actuaries of the United States of America.

Net liabilities recognised in the consolidated balance sheet represent:

	December 31,			June 30,
	2002	2003	2004	2005
Present value of the obligations	6,771	6,440	5,221	5,553
Unrecognised actuarial (losses)/gains	(199)	(73)	522	159
As at December 31/June 30	<u>6,572</u>	<u>6,367</u>	<u>5,743</u>	<u>5,712</u>

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

25 RETIREMENT BENEFIT OBLIGATIONS (continued)

(b) Supplementary retirement benefits (continued)

Movements in the net liabilities recognised in the consolidated balance sheet are as follows:

	Years ended December 31,			Six months ended
				June 30,
	2002	2003	2004	2005
As at January 1	6,680	6,572	6,367	5,743
Payments made	(335)	(355)	(348)	(150)
Net expense/(net income) recognised in the consolidated income statement	<u>227</u>	<u>150</u>	<u>(276)</u>	<u>119</u>
As at December 31/June 30	<u>6,572</u>	<u>6,367</u>	<u>5,743</u>	<u>5,712</u>

Net expense/(net income) recognised as staff cost/(other income) in the consolidated income statement comprises:

	Years ended December 31,			Six months ended	
				June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
Interest cost	227	150	219	109	119
Actuarial gain recognised	—	—	(495)	(94)	—
Net expense/(net income)	<u>227</u>	<u>150</u>	<u>(276)</u>	<u>15</u>	<u>119</u>

Actuarial gain recognised in the year ended December 31, 2004 arose mainly from the change in the discount rate.

Principal actuarial assumptions at the balance sheet date are as follows:

	December 31,			June 30,
	2002	2003	2004	2005
Discount rate	3.25%	3.50%	4.75%	4.00%
Health care cost increases	7.00%	7.00%	7.00%	7.00%
Average expected future lifetime of Eligible Employees	<u>16.3 years</u>	<u>16.3 years</u>	<u>15.5 years</u>	<u>15.2 years</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

26 SUBORDINATED BONDS ISSUED

Upon the approval of the PBOC and the CBRC, the Group issued and had the following subordinated bonds at the balance sheet date:

	Note	December 31, 2004	June 30, 2005
4.87% subordinated fixed rate bonds maturing in August 2014	(i)	11,140	11,140
Subordinated floating rate bonds maturing in August 2014	(ii)	3,860	3,860
4.95% subordinated convertible fixed rate bonds maturing in September 2014	(iii)	8,300	8,300
Subordinated floating rate bonds maturing in December 2014	(iv)	6,078	6,078
4.95% subordinated convertible fixed rate bonds maturing in December 2014	(v)	<u>10,622</u>	<u>10,622</u>
Total nominal value		40,000	40,000
Less: Unamortised issue cost		<u>(104)</u>	<u>(98)</u>
Net carrying value		<u>39,896</u>	<u>39,902</u>

Notes:

- (i) The interest rate per annum on the subordinated fixed rate bonds is 4.87%. The Group has an option to redeem the bonds on August 1, 2009. If they are not redeemed early, the interest rate of the bonds will increase in August 2009 to 7.67% per annum for the next five years.
- (ii) The interest rate per annum on the subordinated floating rate bonds is the PBOC one-year fixed deposit rate, which is reset annually, plus an interest margin of 2.00%. The Group has an option to redeem the bonds on August 1, 2009. If they are not redeemed early, the interest margin of the bonds will increase to 2.75% from August 2009 for the next five years.
- (iii) The interest rate per annum on the subordinated convertible fixed rate bonds is 4.95%. The bondholders may convert the interest rate into a floating rate, being the PBOC one-year fixed deposit rate plus an interest margin of 1.80%, on September 22, 2006. The interest rate is reset annually. The Group has an option to redeem the bonds on September 22, 2009. Fixed rate bonds not redeemed early by the Group on September 22, 2009 will start to pay 7.95% per annum for the next five years. For floating rate bonds not redeemed early by the Group on September 22, 2009, the interest margin of the bonds will increase to 2.80% for the next five years.
- (iv) The interest rate per annum on the subordinated floating rate bonds is the benchmark rate plus an interest margin of 2.00%. The benchmark rate is the PRC interbank money market 7-days repo rate, which is reset and payable every six months. The Group has an option to redeem the bonds on December 27, 2009. If they are not redeemed early, the interest margin of the bonds will increase to 3.00% from December 2009 for the next five years.
- (v) The interest rate per annum on the subordinated convertible fixed rate bonds is 4.95%. The bondholders may convert the interest rate into a floating rate, being the PBOC one-year fixed deposit rate plus an interest margin of 1.80%, on December 27, 2006. The interest rate is reset annually. The Group has an option to redeem the bonds on December 27, 2009. Fixed rate bonds not redeemed early by the Group on December 27, 2009 will start to pay 7.95% per annum for the next five years. For floating rate bonds not redeemed by the Group on December 27, 2009, the interest margin of the bonds will increase to 2.80% for the next five years.

27 EQUITY

(a) Share capital

On September 17, 2004, the Bank was incorporated with a registered and paid up capital of RMB 194,230 million divided into 194,230 million shares with a par value of RMB 1 each. As described in Note 1, 186,230 million shares were issued as consideration for the Succeeding Business of CCB transferred to the Bank in accordance with the Separation Agreement. In addition, 8,000 million shares were issued to other promoters at RMB 1 per share for cash. All shares rank pari passu and are unlisted.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

27 EQUITY (continued)

(b) Surplus reserves

Surplus reserves consist of statutory surplus reserve, discretionary surplus reserve and statutory public welfare fund.

(i) *Statutory surplus reserve and discretionary surplus reserve*

The Bank is required to appropriate 10% of its net profit, as determined under PRC GAAP, to the statutory surplus reserve until the reserve balance reaches 50% of the registered capital. After making the appropriation to the statutory surplus reserve, the Bank may also appropriate its net profit to the discretionary surplus reserve upon approval by shareholders in general meeting.

Subject to the approval of shareholders, statutory and discretionary surplus reserves may be used to make good prior year losses, if any, and may be converted into capital, provided that the balance of statutory surplus reserve after such capitalisation is not less than 25% of the registered capital.

(ii) *Statutory public welfare fund*

The Bank is required to appropriate 5% to 10% of its net profit, as determined under PRC GAAP, to the statutory public welfare fund.

This fund can only be used to purchase capital items for the collective benefit of the Bank's employees such as the construction of dormitories, canteen and other staff welfare facilities.

The fund is non-distributable other than in liquidation.

(c) Investment revaluation reserve

Investment revaluation reserve has been accounted for in accordance with the accounting policies adopted for the measurement of the available-for-sale investments at fair value.

(d) Owner's equity

(i) As part of the Restructuring, the financial impact of the following events approved by the State Council has been reflected in the owner's equity in 2003:

- receipt of cash of USD 22,500 million (equivalent to RMB 186,230 million) as a capital injection from Huijin;
- replenishment of the remaining accumulated losses of CCB by the PRC government of RMB 65,499 million; and
- equity contribution of RMB 35,818 million from the disposal of impaired loans and advances to Cinda at 50% of the principal amount of RMB 128,900 million.

(ii) Pursuant to the Restructuring, the property and equipment, and land use rights of CCB have been restated at deemed cost on December 31, 2003, resulting in surplus on valuation of RMB 4,877 million and RMB 9,283 million respectively (Notes 19(b) and 21(a)).

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****28 DISTRIBUTION TO THE OWNER IN CONNECTION WITH THE RESTRUCTURING**

Pursuant to the Separation Agreement, the Non-core Business of CCB was transferred to Jianyin on December 31, 2003. The operating income or operating expenses in relation to the business, and the assets and liabilities transferred to Jianyin represented less than 1% of the total operating income and less than 1% of the total operating expenses of the Group in each of the years ended 31 December 2002 and 2003.

The net carrying value of assets and liabilities, together with off-balance sheet items, transferred to Jianyin as at December 31, 2003 are as follows:

Assets	
Cash	60
Investments	1,146
Property and equipment	5,460
Other assets (including land use rights)	521
	<u>7,187</u>
Liabilities	
Other liabilities	7,187
	<u>7,187</u>
Net assets	<u>—</u>
Off-balance sheet items	
Entrusted loans	146,073
Entrusted funds	146,073
	<u>146,073</u>

29 PROFIT DISTRIBUTIONS**(a) Profit distributions for the years ended December 31, 2002 and 2003**

Pursuant to a notice from the MOF, CCB has distributed profit in an amount equal to the interest income arising from its investments in the special government bond for each of the two years ended December 31, 2002 and 2003. No cash was received or paid.

(b) Profit distributions for the year ended December 31, 2004

At the general meeting of shareholders held on December 27, 2004, the shareholders approved the Bank's profit distribution policy for the year ended December 31, 2004. In June 2005, all the Bank's

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

29 PROFIT DISTRIBUTIONS (continued)

(b) Profit distributions for the year ended December 31, 2004 (continued)

shareholders confirmed the amounts of the Bank's profit appropriations for the year ended December 31, 2004 as follows:

	Year ended December 31, 2004
Net profit available for distribution for the year ended December 31, 2004, under PRC GAAP	48,388
Settlement of interest receivable on the special government bond (note (i))	(3,242)
Settlement of government receivable	(41,718)
Net profit available for appropriation	3,428
Appropriations to (note (ii))	
— statutory surplus reserve	(343)
— statutory public welfare fund	(171)
Dividend declared (note (iii))	(2,914)
Retained profit, under PRC GAAP	—

Notes:

- (i) The Bank distributed profit in an amount equal to the interest income arising from the Group's investments in the special government bond for the period from January 1, 2004 to November 30, 2004. No cash was received or paid.
- Effective from December 1, 2004, interest on the special government bond is settled by cash on an annual basis.
- (ii) The Bank appropriated 10% and 5% of its net profit available for appropriation to the statutory surplus reserve and statutory public welfare fund respectively. No appropriation was made to the discretionary surplus reserve.
- (iii) The Bank declared dividends to its shareholders of RMB 2,914 million, representing RMB 0.015 per share.

(c) Profit distributions for the six months ended June 30, 2005

At the general meeting of shareholders held on June 6, 2005, the shareholders approved the Bank's profit distribution policy for the six months ended June 30, 2005. On August 27, 2005, all the Bank's shareholders confirmed the amounts of the Bank's profit appropriations for the six months ended June 30, 2005 as follows:

	Six months ended June 30, 2005
Net profit available for distribution for the six months ended June 30, 2005, under PRC GAAP	27,158
Settlement of government receivable	(23,781)
Net profit available for appropriation	3,377
Appropriations to (note)	
— statutory surplus reserve	(1,931)
— statutory public welfare fund	(966)
Retained profit, under PRC GAAP	480

Note:

The Bank appropriated 10% and 5% of its adjusted net profit for the six months ended June 30, 2005, which is calculated as if no income tax exemption was granted to the Bank, to the statutory surplus reserve and statutory public welfare fund respectively. The Bank's external legal counsel has confirmed the appropriateness of such basis of calculation. No appropriation was made to the discretionary surplus reserve.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

30 NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS

(a) Cash and cash equivalents

	December 31,			June 30,	
	2002	2003	2004	2004	2005
				(unaudited)	
Cash	<u>21,390</u>	<u>24,410</u>	<u>27,080</u>	<u>26,186</u>	<u>26,120</u>
Surplus deposit reserve funds (Note 15)	<u>102,064</u>	<u>100,299</u>	<u>123,540</u>	<u>87,714</u>	<u>107,880</u>
Amounts due from banks and other financial institutions	114,018	237,548	112,531	155,618	112,126
Less:					
— amounts due over three months when acquired	<u>(20,556)</u>	<u>(1,219)</u>	<u>(6,023)</u>	<u>(2,042)</u>	<u>(5,040)</u>
— balances under resale agreements	<u>(43,705)</u>	<u>(21,603)</u>	<u>(37,022)</u>	<u>(16,969)</u>	<u>(30,261)</u>
	<u>49,757</u>	<u>214,726</u>	<u>69,486</u>	<u>136,607</u>	<u>76,825</u>
Total	<u><u>173,211</u></u>	<u><u>339,435</u></u>	<u><u>220,106</u></u>	<u><u>250,507</u></u>	<u><u>210,825</u></u>

(b) Significant non-cash transactions

- (i) Transfer of certain assets and liabilities to Jianyin in accordance with the Separation Agreement (Note 28).
- (ii) Settlement of the receivable arising from the liquidation of a trust and investment company by a bill of nominal value of RMB 21,000 million issued by the PBOC (Notes 18(a), 21(e) and 24(b)).
- (iii) Settlement of the interest receivable arising from the Group's investment in the special government bond (Notes 29(a) and 29(b)).
- (iv) Recognition and settlement of the government receivable (Notes 21(d), 29(b) and 29(c)).

(c) Acquisition of minority interest in 2002

On February 19, 2002, CCB acquired the remaining 30% equity interest in Jian Sing. The consideration was equivalent to RMB 111 million. Since then, Jian Sing became a wholly owned subsidiary of CCB.

(d) Investment in a new subsidiary

On April 17, 2003, CCB and Bausparkasse Schwäerbisch Hall paid cash of RMB 113 million and RMB 37 million respectively as the initial paid-in capital of Sino-German. The Bank owns 75.1% equity interest in Sino-German, the remaining 24.9% equity interest is held by Bausparkasse Schwäerbisch Hall. Sino-German provides home mortgage loan and deposit taking services. It commenced operations in February 2004.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

31 COMMITMENTS AND CONTINGENT LIABILITIES

(a) Credit commitments

At any given time the Group has outstanding commitments to extend credit. These commitments take the form of approved loans and credit card limits.

The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties.

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers.

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amount reflected in the table for guarantees and letters of credit represents the maximum potential loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Contractual amount				
Loan commitments				
— with an original maturity of under one year	33,595	28,475	24,397	28,042
— with an original maturity of one year or over	<u>125,546</u>	<u>129,951</u>	<u>140,471</u>	<u>140,240</u>
	159,141	158,426	164,868	168,282
Guarantees and letters of credit	67,039	108,503	136,481	158,265
Acceptances	89,679	127,711	113,073	133,545
Credit card commitments	7,883	15,567	25,044	32,268
Others	<u>1,876</u>	<u>482</u>	<u>771</u>	<u>4,789</u>
	<u><u>325,618</u></u>	<u><u>410,689</u></u>	<u><u>440,237</u></u>	<u><u>497,149</u></u>

These commitments and contingent liabilities have off-balance sheet credit risk. Before the commitments are fulfilled or expire, management assess and make allowances for any probable losses accordingly. As the facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows.

Credit risk weighted amount of contingent liabilities and commitments

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Contingent liabilities and commitments	<u><u>146,935</u></u>	<u><u>192,465</u></u>	<u><u>203,201</u></u>	<u><u>207,123</u></u>

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% of contingent liabilities and commitments.

There are no relevant standards prescribed by IFRS in calculating the above credit risk weighted amounts.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

31 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

(a) Credit commitments (continued)

The credit risk weighted amounts stated above have taken into account the effects of bilateral netting arrangements.

(b) Capital commitments

The Group had the following authorised capital commitments at the balance sheet date:

	December 31,			June 30, 2005
	2002	2003	2004	
Purchase of property and equipment				
— Contracted for	1,212	1,164	777	540
— Not contracted for	<u>1,489</u>	<u>1,010</u>	<u>1,528</u>	<u>1,555</u>
Total	<u>2,701</u>	<u>2,174</u>	<u>2,305</u>	<u>2,095</u>

(c) Operating lease commitments

At the balance sheet date, the Group's future minimum lease payments under non-cancellable operating leases for premises were as follows:

	December 31,			June 30, 2005
	2002	2003	2004	
Within one year	1,105	1,039	956	938
After one year but within five years	2,543	2,333	2,234	2,276
After five years	<u>1,165</u>	<u>1,279</u>	<u>942</u>	<u>874</u>
Total	<u>4,813</u>	<u>4,651</u>	<u>4,132</u>	<u>4,088</u>

(d) Outstanding litigation and disputes

As at June 30, 2005, the Group was the defendant in certain pending litigations and disputes with gross claims of RMB 2,923 million. Provision has been made for the estimated losses of these litigations based upon the opinions of the Group's internal and external legal counsel (Note 24(c)). The Group considers that the provisions made are reasonable and adequate.

(e) Underwriting obligations

At the balance sheet date, the unexpired underwriting commitments of PRC government bonds were as follows:

	December 31,			June 30, 2005
	2002	2003	2004	
Underwriting obligations	<u>—</u>	<u>1,250</u>	<u>6,870</u>	<u>—</u>

(f) Redemption obligations

As an underwriting agent of PRC government bonds, the Group has the responsibility to buy back those bonds sold by it should the holders decide to early redeem the bonds held. The redemption price for the

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

31 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

(f) Redemption obligations (continued)

bonds at any time before their maturity date is based on the coupon value plus any interest unpaid and accrued up to the redemption date. Accrued interest payables to the bond holders are calculated in accordance with relevant rules of the MOF and the PBOC. The redemption price may be different from the fair value of similar instruments traded at the redemption date.

The redemption obligations below represent the nominal value of government bonds underwritten and sold by the Group, but not yet matured at the balance sheet date:

	December 31,			June 30,
	2002	2003	2004	2005
Redemption obligations	<u>77,107</u>	<u>83,407</u>	<u>97,158</u>	<u>104,398</u>

The Group expects the amount of redemption before the maturity date of these government bonds through the Group will not be material.

(g) Provision against commitments and contingent liabilities

The Group has assessed and made provision for any probable outflow of economic benefits in relation to the above commitments and contingent liabilities in accordance with the Group's accounting policies. Except for the provisions made against outstanding litigation and disputes (Note 24(c)), the Group has not made other provisions in respect of the above commitments and contingent liabilities at the balance sheet date.

32 ASSETS PLEDGED AS SECURITY

The Group had pledged the following assets as security for bills rediscounting transactions and securities sold under repurchase agreements. The related secured liabilities are recorded as amounts due to central banks, banks and other financial institutions of approximately similar carrying value at the balance sheet date.

	December 31,			June 30,
	2002	2003	2004	2005
Available-for-sale debt securities	—	—	—	4,216
Discounted bills	<u>1,268</u>	<u>3,760</u>	<u>125</u>	<u>2,322</u>
Total	<u>1,268</u>	<u>3,760</u>	<u>125</u>	<u>6,538</u>

33 ENTRUSTED LENDING BUSINESS

The Group provides entrusted lending business services to government agencies and corporations. All entrusted loans are made under the instruction or at the direction of these entities and are funded by entrusted funds from them.

The Pre-2000 entrusted lending was principally conducted under the policy and instruction of government authorities prior to October 20, 2000, the date on which CCB began to implement policies on entrusted lending based on rules issued by the PBOC. Due to insufficient and unclear documentation at the

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

33 ENTRUSTED LENDING BUSINESS (continued)

time of loan initiation, it was uncertain as to whether the Group had the rights or obligations in relation to the Pre-2000 entrusted lending. However, the Group had paid immaterial amounts for claims arising from the obligations of the Pre-2000 entrusted lending business up to December 31, 2003.

In view of the above, entrusted loans and entrusted funds relating to the Pre-2000 entrusted lending of RMB 146,073 million, which represented 49% of entrusted loans of CCB before the Separation on December 31, 2003, were transferred to Jiayin as at December 31, 2003. Accordingly, the Group will have no further rights or obligations arising from the Pre-2000 entrusted lending after the Separation.

For the remaining entrusted assets and liabilities arising from transactions entered into subsequent to October 20, 2000 and entrusted provident housing fund mortgage business, the Group generally does not take on credit risk in relation to these transactions. It acts as an agent to hold and manage these assets and liabilities at the direction of the entrustor and receives fee income for the services provided.

Trust assets are not assets of the Group and are not recognised in the consolidated balance sheet. Surplus funding is accounted for as deposits from customers. Income received and receivable for providing these services is included in the consolidated income statement as fee income.

At the balance sheet date, the entrusted assets and liabilities were as follows:

	December 31,			June 30,
	2002	2003	2004	2005
Entrusted loans	272,476	149,387	194,418	216,980
Entrusted funds	272,476	149,387	194,418	216,980

34 SEGMENT REPORTING

Segment information is presented in respect of the Group's business and geographical segments. Historically, the Group managed its business primarily along geographical locations. In recent years, the Group began to reorganise the management structure along the business segments of corporate banking, personal banking and treasury business. This new management structure, upon full implementation, is expected to enhance the Group's ability to assess and monitor the financial performance of business segments. During the relevant periods, the Group entered into a transitional phase of reorganisation in which it managed its business both along business segments and geographical segments. Accordingly, both business segment information and geographical segment information are presented as the Group's primary segment reporting formats.

Measurement of segment assets and liabilities and segment revenues and results is based on the Group's accounting policies.

Transactions between segments are conducted under normal commercial terms and conditions. Internal charges and transfer pricing adjustments are determined with reference to market rates and have been reflected in the performance of each segment. Net interest income and expenses arising on internal charges and transfer pricing adjustments are referred to as "internal net interest income/expenses". Interest income and expenses earned from third parties are referred to as "external net interest income/expenses".

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

34 SEGMENT REPORTING (continued)

Segment revenues, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one year.

(a) Business segments

The Group comprises the following main business segments:

Corporate banking

This segment represents the provision of a range of financial products and services to corporations, government agencies and financial institutions. The products and services include corporate loans, trade financing, deposit taking activities, agency services, consulting and advisory services, cash management services, remittance and settlement services, custody services and guarantee services.

Personal banking

This segment represents the provision of a range of financial products and services to individual customers. The products and services comprise personal loans, deposit taking activities, card business, personal wealth management services, remittance services and securities agency services.

Treasury business

This segment covers the Group's treasury operations. The treasury enters into inter-bank money market transactions and repurchase transactions, and invests in debt instruments. It also trades in debt instruments, derivatives and foreign currency for its own account. The treasury carries out customer driven derivatives, foreign currency and precious metal trading. Its function also includes the management of the Group's overall liquidity position, including the issuance of subordinated bonds.

Others and unallocated

These represent equity investments, overseas operations and head office assets, liabilities, income and expenses that are not directly attributable to a segment or cannot be allocated on a reasonable basis.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

34 SEGMENT REPORTING (continued)

(a) Business segments (continued)

	Six months ended June 30, 2004 (unaudited)					Total
	Corporate banking	Personal banking	Treasury business	Others and unallocated	Elimination	
External net interest income/(expense) ..	37,688	(2,240)	13,652	371	—	49,471
Internal net interest (expense)/income...	(8,771)	16,319	(6,207)	(1,341)	—	—
Net interest income/(expense)	28,917	14,079	7,445	(970)	—	49,471
Net fee and commission income	1,411	1,303	242	30	—	2,986
Dividend income	—	—	—	160	—	160
Net (loss)/gain arising from dealing securities	—	—	(138)	17	—	(121)
Net gain arising from investment securities	—	—	222	—	—	222
Net gain arising from foreign currency dealing	—	—	216	1	—	217
Other income	33	—	—	617	—	650
Operating income/(loss)	30,361	15,382	7,987	(145)	—	53,585
General and administrative expenses						
— depreciation and amortisation	(1,072)	(1,735)	(126)	(1,559)	—	(4,492)
— others	(9,520)	(6,418)	(1,694)	(3,832)	—	(21,464)
	(10,592)	(8,153)	(1,820)	(5,391)	—	(25,956)
(Provisions for)/reversals of impairment losses	(1,303)	(707)	4	(1,137)	—	(3,143)
Operating expenses	(11,895)	(8,860)	(1,816)	(6,528)	—	(29,099)
Profit/(loss) before tax	18,466	6,522	6,171	(6,673)	—	24,486
Capital expenditure	561	908	66	822	—	2,357

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

34 SEGMENT REPORTING (continued)

(b) Geographical segments

The Group operates principally in the PRC with branches located in 31 provinces, autonomous regions and municipalities directly under the central government. The Group also has bank branch operations outside the PRC in Hong Kong, Singapore, Frankfurt, Johannesburg and Seoul. The Bank also has a branch in Tokyo which has temporarily suspended its business operations.

In presenting information on the basis of geographical segments, operating income is allocated based on the location of the branches that generated the revenue. Segment assets and capital expenditure are allocated based on the geographical location of the underlying assets.

Geographical segments, as defined for management reporting purposes, are as follows:

- “Yangtze River Delta” refers to the areas serviced by the following tier-1 branches of the Group: Shanghai Municipality, Jiangsu Province, Zhejiang Province, City of Ningbo and City of Suzhou;
- “Pearl River Delta” refers to the areas serviced by the following tier-1 branches of the Group: Guangdong Province, City of Shenzhen, Fujian Province and City of Xiamen;
- “Bohai Rim” refers to the areas serviced by the following tier-1 branches of the Group: Beijing Municipality, Shandong Province, Tianjin Municipality, Hebei Province and City of Qingdao;
- the “Central” region refers to the areas serviced by the following tier-1 branches of the Group: Shanxi Province, Guangxi Autonomous Region, Hubei Province, Henan Province, Hunan Province, Jiangxi Province, Hainan Province, Anhui Province and the Three Gorges area;
- the “Western” region refers to the areas serviced by the following tier-1 branches of the Group: Sichuan Province, Chongqing Municipality, Guizhou Province, Yunnan Province, Tibet Autonomous Region, Inner Mongolia Autonomous Region, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Autonomous Region and Xinjiang Autonomous Region; and
- the “Northeastern” region refers to the areas serviced by the following tier-1 branches of the Group: Liaoning Province, Jilin Province, Heilongjiang Province and City of Dalian.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

34 SEGMENT REPORTING (continued)

(b) Geographical segments (continued)

	Six months ended June 30, 2004 (unaudited)								Total	
	Yangtze River Delta	Pearl River Delta	Bohai Rim	Central	Western	Northeastern	Head Office	Overseas		Elimination
External net interest income	8,975	4,626	7,188	5,553	6,264	1,616	14,769	480	—	49,471
Internal net interest income/(expense)	2,258	2,825	2,922	2,490	2,421	1,423	(14,226)	(113)	—	—
Net interest income	<u>11,233</u>	<u>7,451</u>	<u>10,110</u>	<u>8,043</u>	<u>8,685</u>	<u>3,039</u>	<u>543</u>	<u>367</u>	<u>—</u>	<u>49,471</u>
Net fee and commission income	626	546	505	508	391	252	108	50	—	2,986
Dividend income	18	9	8	15	18	39	37	16	—	160
Net loss arising from dealing securities	—	—	—	—	—	—	(99)	(22)	—	(121)
Net gain arising from investment securities	1	6	1	17	4	9	184	—	—	222
Net gain arising from foreign currency dealing	29	78	42	21	14	7	24	2	—	217
Other income/(expense)	129	119	10	294	(15)	(37)	118	32	—	650
Operating income	<u>12,036</u>	<u>8,209</u>	<u>10,676</u>	<u>8,898</u>	<u>9,097</u>	<u>3,309</u>	<u>915</u>	<u>445</u>	<u>—</u>	<u>53,585</u>
General administrative expenses	(808)	(708)	(792)	(852)	(737)	(370)	(217)	(8)	—	(4,492)
— depreciation and amortisation	(3,879)	(3,017)	(3,714)	(4,248)	(3,855)	(1,825)	(668)	(258)	—	(21,464)
— others	(4,687)	(3,725)	(4,506)	(5,100)	(4,592)	(2,195)	(885)	(266)	—	(25,956)
(Provisions for)/reversals of impairment losses	(810)	(110)	22	(166)	(1,330)	(431)	(302)	(16)	—	(3,143)
Operating expenses	<u>(5,497)</u>	<u>(3,835)</u>	<u>(4,484)</u>	<u>(5,266)</u>	<u>(5,922)</u>	<u>(2,626)</u>	<u>(1,187)</u>	<u>(282)</u>	<u>—</u>	<u>(29,099)</u>
Profit/(loss) before tax	<u>6,539</u>	<u>4,374</u>	<u>6,192</u>	<u>3,632</u>	<u>3,175</u>	<u>683</u>	<u>(272)</u>	<u>163</u>	<u>—</u>	<u>24,486</u>
Capital expenditure	427	232	398	237	235	168	651	9	—	2,357

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT

(a) Credit risk

Credit risk represents the potential loss that may arise from the failure of a debtor to meet its obligation or commitment to the Group. It arises primarily from the Group's credit asset portfolios.

To identify, evaluate, monitor and manage credit risk, the Group designs the particular organisation framework, credit policies and processes required for effective credit risk management, which have been implemented in the whole Group upon approval of the Risk Management and Internal Control Committee and of the President. The Risk Management and Internal Control Committee are responsible for supervising and evaluating the set-up, organisational structure, work process and effectiveness of various risk management functions. To mitigate risk, the Group may obtain collaterals and guarantees where appropriate.

With respect to daily operations, the Risk Management Department, as directed by the Risk Management and Internal Control Committee, monitors, shares and coordinates the work of other risk management functions, including the Corporate Banking Department, the Housing Finance & Personal Lending Department, the Special Assets Resolution Department and the Legal Department.

In respect of the loans portfolios, the Group adopts a risk based loan classification methodology and classifies loans into five categories: normal, special mention, substandard, doubtful and loss. The last three categories are considered as impaired loans and advances for which objective evidence of impairment exists based on a loss event or several events and which bear significant impairment losses. The allowances for impairment losses for the impaired loans and advances are assessed collectively or individually as appropriate.

The core definition of the five categories in which the Group classifies its loans and advances is set out below:

<i>Normal</i>	Borrowers can honour the terms of their loans. There is no reason to doubt their ability to repay principal and interest in full on a timely basis.
<i>Special mention</i>	Borrowers are able to service their loans currently, although repayment may be adversely affected by specific factors.
<i>Substandard</i>	Borrowers' abilities to service their loans are in question as they cannot rely entirely on normal business revenues to repay principal and interest. Losses may ensue even when collateral or guarantees are invoked.
<i>Doubtful</i>	Borrowers cannot repay principal and interest in full and significant losses will need to be recognised even when collateral or guarantees are invoked.
<i>Loss</i>	Only a small portion or no principal and interest can be recovered after taking all possible measures and exhausting all legal remedies.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Loans and advances to customers analysed by economic sector concentrations at the balance sheet date are presented in the table below:

	2002		December 31, 2003		2004		June 30, 2005	
		%		%		%		%
Domestic operations:								
Corporate loans								
— Manufacturing	360,191	20.49	347,051	17.65	396,631	18.08	421,451	18.00
— Transportation, storage and postal services	192,268	10.93	207,821	10.57	236,033	10.76	271,633	11.60
— Production and supply of electric power, gas and water	191,411	10.88	206,434	10.50	231,590	10.56	260,043	11.11
— Property development	211,986	12.05	248,520	12.64	244,036	11.12	258,683	11.05
— Construction	79,151	4.50	77,841	3.95	82,139	3.74	87,473	3.74
— Telecommunications, computer services and software	86,895	4.94	86,765	4.41	72,163	3.29	75,068	3.21
— Water, environment and public utility management	41,669	2.37	50,981	2.59	54,814	2.50	67,822	2.90
— Wholesale and retail trade	82,030	4.66	62,664	3.18	56,863	2.59	60,768	2.60
— Education	20,968	1.19	36,794	1.87	51,309	2.34	59,639	2.55
— Mining	35,819	2.04	41,278	2.10	52,637	2.40	51,135	2.18
— Other customers	136,221	7.75	142,329	7.24	146,204	6.66	129,664	5.54
Subtotal	1,438,609		1,508,478		1,624,419		1,743,379	
Personal loans	271,068	15.42	354,727	18.04	412,275	18.79	429,159	18.34
Discounted bills	48,875	2.78	103,421	5.26	157,275	7.17	168,028	7.18
Gross loans and advances to customers	1,758,552	100.00	1,966,626	100.00	2,193,969	100.00	2,340,566	100.00
Less: Allowances for impairment losses	(207,054)		(54,091)		(53,643)		(58,758)	
Net loans and advances to customers	1,551,498		1,912,535		2,140,326		2,281,808	

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Loans and advances to customers analysed by geographical sector risk concentrations at the balance sheet date are presented in the table below:

	2002		December 31, 2003		2004		June 30, 2005	
		%		%		%		%
Yangtze River Delta.....	374,167	20.98	465,270	23.29	547,351	24.57	589,503	24.82
Pearl River Delta.....	257,208	14.42	276,470	13.84	288,515	12.95	310,417	13.07
Bohai Rim.....	359,534	20.16	407,694	20.41	457,796	20.55	475,059	20.01
Central.....	275,230	15.43	304,833	15.26	362,218	16.26	394,482	16.61
Western.....	300,099	16.83	330,957	16.57	357,460	16.05	385,830	16.25
Northeastern.....	124,439	6.97	120,941	6.05	136,689	6.15	145,007	6.11
Head Office.....	67,875	3.81	60,461	3.03	43,940	1.97	40,268	1.70
Overseas.....	24,930	1.40	31,128	1.55	33,457	1.50	33,876	1.43
Gross loans and advances to customers.....	1,783,482	100.00	1,997,754	100.00	2,227,426	100.00	2,374,442	100.00
Less: Allowances for impairment losses.....	(207,289)		(54,395)		(53,864)		(58,954)	
Net loans and advances to customers.....	1,576,193		1,943,359		2,173,562		2,315,488	

See Note 34(b) for the definitions of geographical segments.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(a) Credit risk (continued)

The table below shows a breakdown of total credit extended by the Group by type of collaterals:

	December 31,			June 30, 2005
	2002	2003	2004	
Loans secured by monetary assets	112,356	140,610	163,452	181,535
Loans secured by tangible assets, other than monetary assets	585,173	695,790	790,675	860,241
Guaranteed loans	692,527	643,929	662,237	674,948
Unsecured loans	<u>393,426</u>	<u>517,425</u>	<u>611,062</u>	<u>657,718</u>
Gross loans and advances to customers	1,783,482	1,997,754	2,227,426	2,374,442
Less: Allowances for impairment losses	<u>(207,289)</u>	<u>(54,395)</u>	<u>(53,864)</u>	<u>(58,954)</u>
Net loans and advances to customers	<u>1,576,193</u>	<u>1,943,359</u>	<u>2,173,562</u>	<u>2,315,488</u>

(b) Market risk

Market risk is the risk of loss arising from movements in observable market variables such as interest rates, exchange rates and equity markets. The Group is exposed to market risk primarily through its proprietary investments held (the “proprietary investment book”) and balance sheet assets and liabilities other than the proprietary investment book (the “banking book”).

Since May 2005, the Risk Management Department of the Group has been responsible for formulating market risk management policies, supervising implementation of the policies and performing independent assessments of the risk status. The Asset and Liability Management Department (“ALM”) of the Group is responsible for managing market risk and developing procedures in accordance with the market risk management policies. ALM also develops and applies models and control tools for identifying, quantifying and controlling market risks. The Treasury Department manages the Group’s investment portfolios, conducts proprietary and customer-driven trades, and performs daily identification, measurement, assessment and control of risks.

Prior to May 2005, Assets and Liability Committee (“ALCO”) was responsible for the review and approval of key market risk management matters in accordance with the Group risk management policies. ALM, which reported to ALCO, was responsible for day to day market risk management.

For the proprietary investment book, the principal risk measures and controls over market risk are Value at Risk (VaR) and stress testing. The Group mainly uses gap analysis and stress testing to monitor market risk in the banking book.

VaR is a technique which estimates the potential losses that could occur on risk positions taken, due to movements in market rates and prices over a specified time horizon and to a given level of confidence. The Treasury Department calculates interest rate VaR across its foreign currency debt investments. Currently, this technique is extending to debt investments denominated in RMB. It uses historical movements in market rates and prices, at 99% confidence level, with a 1-day holding period. VaR is calculated on a daily basis for foreign currency portfolios.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(b) Market risk (continued)

The results of stress testing are assessed against a set of forward-looking scenarios using stress moves in market variables, which are regularly reviewed.

Gap analysis is a technique to project future cash flows in order to quantify the differences, at all future dates, between assets and liabilities of the banking book.

The Group adopts a prudent approach to managing its proprietary investment book, and reduces any excessive market risk by executing offsetting transactions with market counterparties. The Group considers that any market risk arising from its proprietary investment book is not material.

(c) Interest rate risk

The Group's interest rate exposures mainly comprise those originating in its commercial banking structural interest rate exposure, and trading positions.

(i) Structural interest rate risk

Interest rate risk is inherent in many of the Group's businesses and arises from factors such as differences in timing between contractual maturities or repricing of assets and liabilities.

ALM regularly monitors such interest rate risk positions. In terms of measuring and managing the risk, the Group regularly calculates interest rate gap and market value effect of these interest rate positions in different interest scenarios. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income.

(ii) Trading interest rate risk

The major part of this risk arises from the treasury's investment portfolios. The interest rate risk is monitored using the VaR method described above. Complementary methods are also applied, to capture the sensitivities to interest rate movements, expressed as the fair value change due to one basis point (0.01%) change in interest rates.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(c) Interest rate risk (continued)

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

	Effective interest rate (note (i))	December 31, 2002					
		Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years	More than five years
Assets							
Cash and balances with central banks	1.91%	285,584	21,390	264,194	—	—	
Amounts due from banks and other financial institutions	1.61%	114,018	—	111,316	2,120	582	
Loans and advances to customers (note(ii))	5.28%	1,576,193	1,215	671,326	883,095	6,424	
Investments	3.28%	759,086	37,006	45,624	180,947	106,461	
Other	4.00%	123,055	107,363	—	—	15,692	
Total assets	4.20%	2,857,936	166,974	1,092,460	1,066,162	129,159	403,181
Liabilities							
Amounts due to central banks	2.03%	2,448	—	2,448	—	—	
Amounts due to banks and other financial institutions	2.02%	106,461	—	104,706	1,723	32	
Deposits from customers	1.31%	2,822,744	54,850	2,004,212	577,801	171,907	
Certificates of deposit issued	1.55%	1,701	—	1,701	—	—	
Other	—	57,788	57,788	—	—	—	
Total liabilities	1.35%	2,991,142	112,638	2,113,067	579,524	171,939	13,974
Asset-liability gap	2.85%	(133,206)	54,336	(1,020,607)	486,638	(42,780)	389,207

Notes:

(i) Effective interest rate represents the ratio of interest income/expense to average interest bearing assets/liabilities.

(ii) For loans and advances to customers, the above "Less than three months" category includes overdue amounts (net of allowances for impairment losses) of RMB 84,600 million as at June 30, 2005 (December 31, 2004, 2003 and 2002: RMB 73,999 million, RMB 58,680 million and RMB 100,840 million). Overdue amounts represent loans, of which the whole or part of the principals was overdue, or interest was overdue for more than 90 days but for which principal was not yet due.

V NOTES TO THE FINANCIAL INFORMATION
 (Expressed in millions of Renminbi unless otherwise stated)
 35 RISK MANAGEMENT (continued)
 (c) Interest rate risk (continued)

	Effective interest rate (note (i))	December 31, 2003					
		Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years	More than five years
Assets							
Cash and balances with central banks	1.87%	330,748	24,410	306,338	—	—	
Amounts due from banks and other financial institutions	1.66%	237,548	—	236,517	905	126	
Loans and advances to customers (note(ii))	5.03%	1,943,359	637	717,768	1,203,780	7,040	
Investments	3.08%	804,386	29,992	56,761	217,644	116,849	
Other	3.15%	241,025	225,108	—	—	15,917	
Total assets	4.14%	<u>3,557,066</u>	<u>280,147</u>	<u>1,317,384</u>	<u>1,422,329</u>	<u>139,932</u>	<u>397,274</u>
Liabilities							
Amounts due to central banks	2.11%	5,696	—	5,696	—	—	
Amounts due to banks and other financial institutions	1.76%	109,174	—	107,231	1,886	57	
Deposits from customers	1.28%	3,195,673	44,989	2,249,686	655,688	231,278	
Certificates of deposit issued	2.24%	4,334	—	3,580	—	754	
Other	—	54,984	54,984	—	—	—	
Total liabilities	1.30%	<u>3,369,861</u>	<u>99,973</u>	<u>2,366,193</u>	<u>657,574</u>	<u>232,089</u>	<u>14,032</u>
Asset-liability gap	2.84%	<u>187,205</u>	<u>180,174</u>	<u>(1,048,809)</u>	<u>764,755</u>	<u>(92,157)</u>	<u>383,242</u>

V NOTES TO THE FINANCIAL INFORMATION
 (Expressed in millions of Renminbi unless otherwise stated)
 35 RISK MANAGEMENT (continued)
 (c) Interest rate risk (continued)

	Effective interest rate (note (i))	December 31, 2004					
		Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years	More than five years
Assets							
Cash and balances with central banks	1.80%	399,366	27,080	372,286	—	—	—
Amounts due from banks and other financial institutions	1.64%	112,531	—	111,215	1,008	308	—
Loans and advances to customers (note(ii))	5.18%	2,173,562	193	852,554	1,287,709	18,555	14,551
Investments	2.84%	1,107,636	16,355	120,771	236,426	544,450	189,634
Other	—	116,825	116,825	—	—	—	—
Total assets	4.09%	<u>3,909,920</u>	<u>160,453</u>	<u>1,456,826</u>	<u>1,525,143</u>	<u>563,313</u>	<u>204,185</u>
Liabilities							
Amounts due to central banks	1.91%	2,247	—	2,247	—	—	—
Amounts due to banks and other financial institutions	1.63%	112,039	—	109,595	2,301	103	40
Deposits from customers	1.29%	3,491,121	42,004	2,565,071	631,210	236,133	16,703
Certificates of deposit issued	2.29%	3,741	—	2,715	644	382	—
Other	—	65,325	65,325	—	—	—	—
Subordinated bonds issued	4.73%	39,896	—	—	9,912	29,984	—
Total liabilities	1.32%	<u>3,714,369</u>	<u>107,329</u>	<u>2,679,628</u>	<u>644,067</u>	<u>266,602</u>	<u>16,743</u>
Asset-liability gap	2.77%	<u>195,551</u>	<u>53,124</u>	<u>(1,222,802)</u>	<u>881,076</u>	<u>296,711</u>	<u>187,442</u>

V NOTES TO THE FINANCIAL INFORMATION
 (Expressed in millions of Renminbi unless otherwise stated)
 35 RISK MANAGEMENT (continued)
 (c) Interest rate risk (continued)

	Effective interest rate (note (i))	June 30, 2005				
		Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years
Assets						
Cash and balances with central banks	1.68%	419,024	26,120	392,904	—	—
Amounts due from banks and other financial institutions	2.18%	112,126	—	108,784	3,188	154
Loans and advances to customers (note(ii))	5.29%	2,315,488	106	575,263	1,698,896	26,388
Investments	2.92%	1,275,778	14,883	265,830	184,165	14,835
Other	—	101,672	101,672	—	—	191,302
Total assets	4.16%	4,224,088	142,781	1,342,781	1,886,249	206,137
Liabilities						
Amounts due to central banks	1.92%	2,222	—	2,222	—	—
Amounts due to banks and other financial institutions	1.82%	125,064	—	123,393	1,671	—
Deposits from customers	1.31%	3,781,295	24,842	2,647,829	825,726	267,895
Certificates of deposit issued	2.47%	4,228	—	2,972	884	372
Other	—	70,437	70,437	—	—	—
Subordinated bonds issued	4.67%	39,902	—	3,850	6,064	29,988
Total liabilities	1.36%	4,023,148	95,279	2,780,266	834,345	298,255
Asset-liability gap	2.80%	200,940	47,502	(1,437,485)	1,051,904	347,885

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****35 RISK MANAGEMENT (continued)****(d) Currency risk**

The Group's foreign exchange exposure mainly comprises exposures that arise from foreign currency portfolio within the treasury and currency exposures originated by the Group's overseas branches.

The Group has invested the capital injection of USD22,500 million into debt investments and money market instruments denominated in U.S. dollars. This investment portfolio is managed separately from other investments held by the Group. On January 12, 2005, the Bank entered into an agreement with Huijin, pursuant to which the Bank purchased from Huijin an option to sell to Huijin a maximum of USD 22,500 million in exchange for Renminbi at a pre-determined exchange rate of USD 1 to RMB 8.2769. The option is exercisable in 2007 in twelve equal monthly instalments. The Group will pay a total option premium of RMB 5,587 million to Huijin in twelve equal monthly instalments in 2007.

The option was purchased to hedge currency risk arising from the separate fund mentioned above. This option is qualified as a fair value hedge in accordance with IFRS. The change in the fair value of the option and the change in the fair value of the assets in the separate fund due to foreign exchange fluctuation are recognised as net gain in foreign exchange.

The Bank values the option using the Garman Kohlhagen Option model, which is commonly used by market participants to value currency options. The parameters used for the valuation include relevant market interest rates of RMB and USD, the spot exchange rates of RMB against USD sourced from the PBOC, and the foreign exchange volatility, which is based on that of non-deliverable forwards of RMB against USD, adjusted for the fact that the PRC foreign exchange market is regulated.

The fair value of the option as at June 30, 2005 was RMB 5,690 million, which is included in other assets (Note 21(b)). The premium payable in respect of the option is stated at its discounted value of RMB 5,247 million as at June 30, 2005 and is included under other liabilities and provisions (Note 24).

The change in the fair value of the option recognised in the net gain in foreign exchange for the six months ended June 30, 2005 was RMB 518 million.

The Group manages other currency risk by spot and forward foreign exchange transactions and matching its foreign currency denominated assets with corresponding liabilities in the same currencies.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(d) Currency risk (continued)

The exposures at the balance sheet date were as follows:

	December 31, 2002			
	RMB	USD	Others	Total
Assets				
Cash and balances with central banks	281,254	3,194	1,136	285,584
Amounts due from banks and other financial institutions	59,785	43,810	10,423	114,018
Loans and advances to customers	1,495,530	53,646	27,017	1,576,193
Investments	700,563	41,521	17,002	759,086
Other	119,739	2,475	841	123,055
Total assets	<u>2,656,871</u>	<u>144,646</u>	<u>56,419</u>	<u>2,857,936</u>
Liabilities				
Amounts due to central banks	2,448	—	—	2,448
Amounts due to banks and other financial institutions . . .	82,943	16,151	7,367	106,461
Deposits from customers	2,687,756	107,859	27,129	2,822,744
Certificates of deposit issued	—	—	1,701	1,701
Other	53,262	3,568	958	57,788
Total liabilities	<u>2,826,409</u>	<u>127,578</u>	<u>37,155</u>	<u>2,991,142</u>
Net position	<u>(169,538)</u>	<u>17,068</u>	<u>19,264</u>	<u>(133,206)</u>
Off-balance sheet credit commitments	<u>284,414</u>	<u>31,885</u>	<u>9,319</u>	<u>325,618</u>
	December 31, 2003			
	RMB	USD	Others	Total
Assets				
Cash and balances with central banks	325,827	3,307	1,614	330,748
Amounts due from banks and other financial institutions	33,549	198,342	5,657	237,548
Loans and advances to customers	1,839,704	66,409	37,246	1,943,359
Investments	738,413	46,373	19,600	804,386
Other	239,714	551	760	241,025
Total assets	<u>3,177,207</u>	<u>314,982</u>	<u>64,877</u>	<u>3,557,066</u>
Liabilities				
Amounts due to central banks	5,696	—	—	5,696
Amounts due to banks and other financial institutions . . .	85,250	10,929	12,995	109,174
Deposits from customers	3,064,584	101,079	30,010	3,195,673
Certificates of deposit issued	—	—	4,334	4,334
Other	50,642	2,613	1,729	54,984
Total liabilities	<u>3,206,172</u>	<u>114,621</u>	<u>49,068</u>	<u>3,369,861</u>
Net position	<u>(28,965)</u>	<u>200,361</u>	<u>15,809</u>	<u>187,205</u>
Off-balance sheet credit commitments	<u>353,313</u>	<u>43,190</u>	<u>14,186</u>	<u>410,689</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(d) Currency risk (continued)

	December 31, 2004			
	RMB	USD	Others	Total
Assets				
Cash and balances with central banks	393,995	3,459	1,912	399,366
Amounts due from banks and other financial institutions	47,461	59,080	5,990	112,531
Loans and advances to customers	2,054,975	78,777	39,810	2,173,562
Investments	903,463	188,147	16,026	1,107,636
Other	113,449	2,486	890	116,825
Total assets	3,513,343	331,949	64,628	3,909,920
Liabilities				
Amounts due to central banks	2,247	—	—	2,247
Amounts due to banks and other financial institutions . . .	83,437	15,254	13,348	112,039
Deposits from customers	3,364,350	96,690	30,081	3,491,121
Certificates of deposit issued	—	—	3,741	3,741
Other	60,071	3,418	1,836	65,325
Subordinated bonds issued	39,896	—	—	39,896
Total liabilities	3,550,001	115,362	49,006	3,714,369
Net position	(36,658)	216,587	15,622	195,551
Off-balance sheet credit commitments	364,555	56,593	19,089	440,237
June 30, 2005				
	RMB	USD	Others	Total
Assets				
Cash and balances with central banks	412,579	4,338	2,107	419,024
Amounts due from banks and other financial institutions	42,063	60,829	9,234	112,126
Loans and advances to customers	2,195,991	81,302	38,195	2,315,488
Investments	1,066,491	192,815	16,472	1,275,778
Other	98,318	2,012	1,342	101,672
Total assets	3,815,442	341,296	67,350	4,224,088
Liabilities				
Amounts due to central banks	2,222	—	—	2,222
Amounts due to banks and other financial institutions . .	95,095	21,188	8,781	125,064
Deposits from customers	3,634,669	111,561	35,065	3,781,295
Certificates of deposit issued	—	—	4,228	4,228
Other	65,088	3,166	2,183	70,437
Subordinated bonds	39,902	—	—	39,902
Total liabilities	3,836,976	135,915	50,257	4,023,148
Net position	(21,534)	205,381	17,093	200,940
Off-balance sheet credit commitments	417,344	59,683	20,122	497,149
Notional amount of hedging currency options	186,230	(186,230)	—	—

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(e) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due, and it results from amount and maturity mismatches of assets and liabilities. At the local level, in line with policy, the day to day monitoring of future cash flows takes place and suitable levels of easily marketable assets are maintained by the businesses.

On the Group level, liquidity is managed through ALM. ALM is responsible for both regulatory and prudential liquidity. These are managed through the liquidity policies which are coordinated by ALM and include:

- optimising the Group's asset and liability structure with the principle of matching funding operations with its sources of income;
- maintenance of strong balance sheet liquidity ratios;
- projecting cash flows and assessing the level of liquid assets in relation thereto; and
- maintenance of sufficient surplus funds through internal transfer pricing.

A substantial portion of the Group's assets are funded by customer deposits made up of savings accounts and other short-term deposits. These customer deposits, which have been growing in recent years, are widely diversified by type and maturity and represent a stable source of funds.

In terms of measuring liquidity risk, the Group principally uses liquidity gap analysis, although currently such analysis is restricted to cash flow projections of within one year. Different scenarios are then applied to assess the impact on both trading and client businesses.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(e) **Liquidity risk (continued)**

The following tables provide an analysis of the assets and liabilities of the Group into relevant maturity groupings based on the remaining periods to repayment at the balance sheet date.

	December 31, 2002					Total
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	
Assets						
Cash and balances with central banks (note (i))	123,454	9,270	—	—	—	285,584
Amounts due from banks and other financial institutions	7,645	103,671	2,120	582	—	114,018
Loans and advances to customers (note (ii))	86,605	196,803	576,636	440,720	275,429	1,576,193
Investments						
— Receivables	—	—	14,452	28,757	317,097	360,306
— Held-to-maturity debt securities	—	35,447	31,942	99,174	145,319	311,882
— Available-for-sale investments	—	2,081	7,355	20,456	18,742	85,640
— Debt securities at fair value through profit or loss (note (iii))	—	—	—	—	1,258	1,258
Other	7,290	3,089	19,191	17,254	336	75,895
Total assets	224,994	350,361	651,696	606,943	758,181	2,857,936
Liabilities						
Amounts due to central banks	2,207	241	—	—	—	2,448
Amounts due to banks and other financial institutions	88,529	16,177	1,723	32	—	106,461
Deposits from customers	1,843,052	207,610	579,802	175,144	17,136	2,822,744
Certificates of deposit issued	—	—	1,147	554	—	1,701
Other	24,280	11,688	11,581	4,822	5,417	57,788
Total liabilities	1,958,068	235,716	594,253	180,552	22,553	2,991,142
Long/(short) position	(1,733,074)	114,645	57,443	426,391	735,628	(133,206)

Notes:

(i) For cash and balances with central banks, undated amount represents statutory deposit reserve funds and fiscal balances maintained with the PBOC.

(ii) For loans and advances to customers, overdue amount included in the above "overdue/ repayable on demand" category represents loans of which principals were overdue, and excludes loans of which interests were overdue but the principals were not yet due. The overdue amount is stated net of appropriate allowances for impairment losses.

(iii) For debt securities held for trading purposes, the remaining term to maturities does not represent the Group's intention to hold them to final maturity.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

	December 31, 2003						
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated	Total
Assets							
Cash and balances with central banks (note (i))	124,709	—	—	—	—	206,039	330,748
Amounts due from banks and other financial institutions	11,945	224,572	905	126	—	—	237,548
Loans and advances to customers (note (ii))	49,116	291,666	696,004	538,274	368,299	—	1,943,359
Investments	—	—	—	—	—	—	—
— Receivables	—	247	4,563	27,552	320,231	—	352,593
— Held-to-maturity debt securities	—	32,949	64,063	124,439	139,889	—	361,340
— Available-for-sale investments	—	3,030	14,470	24,021	17,447	29,992	88,960
— Debt securities at fair value through profit or loss	—	—	—	—	—	—	—
(note (iii))	—	201	901	66	325	—	1,493
Other	4,494	3,745	111,608	41,271	187	79,720	241,025
Total assets	190,264	556,410	892,514	755,749	846,378	315,751	3,557,066
Liabilities							
Amounts due to central banks	2,207	3,489	—	—	—	—	5,696
Amounts due to banks and other financial institutions	87,357	19,874	1,886	57	—	—	109,174
Deposits from customers	2,067,592	223,997	655,760	231,097	17,227	—	3,195,673
Certificates of deposit issued	—	—	2,739	1,595	—	—	4,334
Other	19,760	12,296	12,317	5,618	4,993	—	54,984
Total liabilities	2,176,916	259,656	672,702	238,367	22,220	—	3,369,861
Long/(short) position	(1,986,652)	296,754	219,812	517,382	824,158	315,751	187,205

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

	December 31, 2004					Total
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	
Assets						
Cash and balances with central banks (note (i))	150,620	—	—	—	—	248,746
Amounts due from banks and other financial institutions	6,821	104,394	1,008	308	—	—
Loans and advances to customers (note (ii))	69,733	294,498	756,263	589,055	464,013	—
Investments						
— Receivables	—	—	2,853	361,344	69,661	—
— Held-to-maturity debt securities	—	63,850	71,554	219,835	134,552	—
— Available-for-sale investments	—	18,508	27,708	58,608	62,093	16,355
— Debt securities at fair value through profit or loss (note (iii))	—	64	315	27	309	—
Other	4,696	7,528	31,901	877	93	71,730
Total assets	<u>231,870</u>	<u>488,842</u>	<u>891,602</u>	<u>1,230,054</u>	<u>730,721</u>	<u>336,831</u>
Liabilities						
Amounts due to central banks	2,222	25	—	—	—	—
Amounts due to banks and other financial institutions . .	84,699	24,896	2,301	103	40	—
Deposits from customers	2,238,796	364,976	633,002	234,428	19,919	—
Certificates of deposit issued	—	107	969	2,665	—	—
Other	25,049	14,438	16,050	5,560	4,228	—
Subordinated bonds issued	—	—	—	—	39,896	—
Total liabilities	<u>2,350,766</u>	<u>404,442</u>	<u>652,322</u>	<u>242,756</u>	<u>64,083</u>	<u>—</u>
Long/(short) position	<u>(2,118,896)</u>	<u>84,400</u>	<u>239,280</u>	<u>987,298</u>	<u>666,638</u>	<u>336,831</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

	June 30, 2005					Total
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	
Assets						
Cash and balances with central banks (note (i))	134,000	16,290	—	—	—	268,734
Amounts due from banks and other financial institutions	7,046	101,669	3,096	315	—	—
Loans and advances to customers (note (ii))	81,157	316,680	809,900	604,642	503,109	—
Investments	—	—	—	—	—	—
— Receivables	—	2,820	—	366,814	66,042	—
— Held-to-maturity debt securities	—	46,431	97,717	302,751	129,734	—
— Available-for-sale investments	—	71,498	48,285	69,526	57,254	14,883
— Debt securities at fair value through profit or loss (note (iii))	—	72	132	1,094	725	—
Other	8,142	17,269	6,960	969	—	68,332
Total assets	<u>230,345</u>	<u>572,729</u>	<u>966,090</u>	<u>1,346,111</u>	<u>756,864</u>	<u>351,949</u>
Liabilities						
Amounts due to central banks	2,222	—	—	—	—	—
Amounts due to banks and other financial institutions . .	96,594	26,799	1,671	—	—	—
Deposits from customers	2,115,636	555,342	824,241	268,168	17,908	—
Certificates of deposit issued	—	320	789	3,119	—	—
Other	24,649	18,780	14,945	7,882	4,181	—
Subordinated bonds issued	—	—	—	—	39,902	—
Total liabilities	<u>2,239,101</u>	<u>601,241</u>	<u>841,646</u>	<u>279,169</u>	<u>61,991</u>	<u>—</u>
Long/(short) position	<u>(2,008,756)</u>	<u>(28,512)</u>	<u>124,444</u>	<u>1,066,942</u>	<u>694,873</u>	<u>351,949</u>
						<u>4,023,148</u>
						<u>200,940</u>

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(f) Use of derivatives

Derivatives are off-balance sheet financial instruments which include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets. The Group, through the operations of its branch network, acts as an intermediary between a wide range of customers structuring deals to produce risk management products to suit individual customer needs. These positions are actively managed through entering offsetting deals with external parties to ensure the Group's net exposures are within acceptable risk levels. No significant proprietary positions are maintained by the Group at the balance sheet date. The Group also uses derivatives (principally foreign exchange options and interest rate swaps) in the management of its own asset and liability portfolios and structural positions.

The primary derivatives utilised by the Group are shown in the following table.

<i>Derivatives</i>	<i>Description</i>
Cross-currency, foreign exchange and interest rate swaps	Cross-currency, foreign exchange and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these for cross-currency swaps.
Foreign currency and interest rate options	Foreign currency and interest rate options are contractual agreements under which the seller grants the purchaser the right, but not the obligation, either to buy or sell at or by a predetermined date or during a predetermined period, a specific amount of a foreign currency or a financial instrument at a predetermined price. The seller receives a premium from the purchaser in consideration for the assumption of foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Group and a customer over the counter.
Currency forwards	Currency forwards represent commitments to purchase or sell foreign exchanges at the certain date in the future.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(f) Use of derivatives (continued)

The following tables provide an analysis of the notional amounts of derivatives of the Group by relevant maturity groupings based on the remaining periods to settlement and the corresponding fair values at the balance sheet date. The notional amounts of the derivatives indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

	December 31, 2002					Fair values	
	Notional amounts with remaining life of				Total	Assets	Liabilities
	less than three months	between three months and one year	between one year and five years	more than five years			
<i>Interest rate derivatives</i>							
Interest rate swaps	609	1,171	11,880	4,789	18,449	307	447
Cross-currency swaps	—	338	6,271	545	7,154	235	242
Interest rate options written	—	268	—	—	268	—	—
	<u>609</u>	<u>1,777</u>	<u>18,151</u>	<u>5,334</u>	<u>25,871</u>	<u>542</u>	<u>689</u>
<i>Currency derivatives</i>							
Spot	5,993	—	—	—	5,993	—	—
Forwards	1,594	1,106	1	—	2,701	62	70
Foreign exchange swaps	13,298	6,037	—	—	19,335	13	12
Currency options written	315	248	—	—	563	1	1
	<u>21,200</u>	<u>7,391</u>	<u>1</u>	<u>—</u>	<u>28,592</u>	<u>76</u>	<u>83</u>
Total						<u>618</u>	<u>772</u>
						(Note 21)	(Note 24)
	December 31, 2003					Fair values	
	Notional amounts with remaining life of				Total	Assets	Liabilities
	less than three months	between three months and one year	between one year and five years	more than five years			
<i>Interest rate derivatives</i>							
Interest rate swaps	369	720	18,244	10,993	30,326	386	502
Cross-currency swaps	—	1,067	4,659	349	6,075	109	108
Interest rate options purchased	—	—	6	—	6	—	—
Interest rate options written	—	—	4	—	4	—	—
	<u>369</u>	<u>1,787</u>	<u>22,913</u>	<u>11,342</u>	<u>36,411</u>	<u>495</u>	<u>610</u>
<i>Currency derivatives</i>							
Spot	7,917	—	—	—	7,917	—	—
Forwards	4,265	8,252	372	—	12,889	107	198
Foreign exchange swaps	20,583	6,780	1,024	—	28,387	26	20
Currency options purchased	565	348	—	—	913	5	5
Currency options written	567	348	—	—	915	5	5
	<u>33,897</u>	<u>15,728</u>	<u>1,396</u>	<u>—</u>	<u>51,021</u>	<u>143</u>	<u>228</u>
Total						<u>638</u>	<u>838</u>
						(Note 21)	(Note 24)

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(f) Use of derivatives (continued)

	December 31, 2004					Fair values	
	Notional amounts with remaining life of					Assets	Liabilities
	less than	between	between	more than	Total		
	three months	three months and one year	one year and five years	five years			
<i>Interest rate derivatives</i>							
Interest rate swaps	5,097	5,856	38,350	17,977	67,280	745	802
Cross-currency swaps	662	6,898	1,159	577	9,296	319	318
Interest rate options purchased	—	—	6	—	6	—	—
Interest rate options written	22,760	—	4	—	22,764	—	212
	<u>28,519</u>	<u>12,754</u>	<u>39,519</u>	<u>18,554</u>	<u>99,346</u>	<u>1,064</u>	<u>1,332</u>
<i>Currency derivatives</i>							
Spot	2,268	—	—	—	2,268	—	—
Forwards	7,933	9,124	616	—	17,673	113	401
Foreign exchange swaps	17,911	4,897	51	—	22,859	446	83
Currency options purchased	17	—	—	—	17	—	—
Currency options written	3	83	—	—	86	1	—
	<u>28,132</u>	<u>14,104</u>	<u>667</u>	<u>—</u>	<u>42,903</u>	<u>560</u>	<u>484</u>
Total						<u>1,624</u>	<u>1,816</u>
						(Note 21)	(Note 24)

	June 30, 2005					Fair values	
	Notional amounts with remaining life of					Assets	Liabilities
	less than	between	between	more than	Total		
	three months	three months and one year	one year and five years	five years			
<i>Interest rate derivatives</i>							
Interest rate swaps	3,372	23,006	41,347	20,182	87,907	828	1,010
Cross-currency swaps	3,733	3,811	866	575	8,985	86	89
Interest rate options purchased	—	—	6	—	6	—	—
Interest rate options written	21,602	—	4	—	21,606	—	388
	<u>28,707</u>	<u>26,817</u>	<u>42,223</u>	<u>20,757</u>	<u>118,504</u>	<u>914</u>	<u>1,487</u>
<i>Currency derivatives</i>							
Spot	2,411	—	—	—	2,411	—	—
Forwards	9,292	19,302	1,781	—	30,375	416	280
Foreign exchange swaps	11,337	10,126	721	—	22,184	259	132
Currency options purchased (Note 35(d))	614	527	186,221	—	187,362	5,697	6
Currency options written	621	527	—	—	1,148	6	5
	<u>24,275</u>	<u>30,482</u>	<u>188,723</u>	<u>—</u>	<u>243,480</u>	<u>6,378</u>	<u>423</u>
Total						<u>7,292</u>	<u>1,910</u>
						(Note 21)	(Note 24)

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(f) Use of derivatives (continued)

The replacement costs and credit risk weighted amounts in respect of these derivatives are as follows. These amounts have taken into account the effects of bilateral netting arrangements.

Replacement costs

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Interest rate derivatives	542	495	1,064	914
Currency derivatives	<u>76</u>	<u>143</u>	<u>560</u>	<u>6,378</u>
	<u>618</u>	<u>638</u>	<u>1,624</u>	<u>7,292</u>

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. Replacement cost is a close approximation of the credit risk for these derivative contracts as at the balance sheet date.

Credit risk weighted amounts

	<u>December 31,</u>			<u>June 30,</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Interest rate derivatives	1,031	1,021	1,702	1,585
Currency derivatives	<u>362</u>	<u>709</u>	<u>1,016</u>	<u>1,361</u>
	<u>1,393</u>	<u>1,730</u>	<u>2,718</u>	<u>2,946</u>

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics.

In accordance with the rules set out by the CBRC, the credit risk weight assigned to Huijin, which is a government agency, is zero. Therefore, the credit risk weighted amount of the currency option purchased from Huijin (Note 35(d)) is zero.

(g) Operational risk

Operational risk includes the risk of direct or indirect loss due to an event or action causing failure of technology, processes, infrastructure and personnel, and other risks having an operational impact.

The Group manages this risk through a controls-based environment by establishing a framework of policies and procedures in order to identify, assess, control, manage and report risks. The framework covers all business functions ranging from finance, credit, accounting, settlement, savings, treasury, intermediary business, computer applications and management, special assets resolution and legal affairs. This has allowed the Group to identify and address comprehensively the operational risk inherent in all key products, activities, processes and systems. Key controls include:

- authorisation limits for various business activities to branches are delegated after consideration of their respective business scope, risk management capabilities and credit approval procedures.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(g) Operational risk (continued)

Such authorities are revised on a timely basis to reflect changes in market conditions and business development and risk management needs;

- the use of the single legal responsibility framework and strict disciplinary measures in order to ensure accountability;
- systems and procedures to identify, control and report on the major risks: credit, market, liquidity and operational;
- promotion of a risk management culture throughout the organisation by building a team of risk management professionals, providing formal training and having an appraisal system in place, to raise the overall risk awareness among the Group's employees;
- a dedicated anti-money laundering division under the Compliance Department responsible for overseeing that cash management and account management are in compliance with the relevant regulations, and for improving training on anti-money laundering to ensure our staff are well-equipped with the necessary knowledge and basic skills to combat money laundering since May 2005. Prior to this, the Legal Department was responsible for this function;
- the review and approval by senior management of comprehensive financial and operating plans which are prepared by branches;
- the assessment of individual branches' financial performance against the comprehensive financial and operating plan; and
- the maintenance of contingent facilities (including backup systems and disaster recovery schemes) to support all major operations, especially back office operations, in the event of an unforeseen interruption. Insurance cover is arranged to mitigate potential losses associated with certain operational events.

(h) Fair value information

(i) Financial assets

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

Amounts due from central banks, banks and other financial institutions

Amounts due from central banks, banks and other financial institutions are mainly priced at market interest rates and mature within one year. Accordingly, the carrying values approximate the fair values.

Loans and advances to customers

Loans and advances to customers are mostly priced at floating rates close to the PBOC rates. Accordingly, their carrying values approximate the fair values.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

35 RISK MANAGEMENT (continued)

(h) Fair value information (continued)

(i) Financial assets (continued)

Investments

Available-for-sale investments and debt securities at fair value through profit or loss are stated at fair value in the financial statements. The following table summarises the carrying values and the fair values of receivables and held-to-maturity debt securities which are not presented on the Group's consolidated balance sheet at their fair values.

	Carrying values				Fair values			
	December 31,		June 30,		December 31,		June 30,	
	2002	2003	2004	2005	2002	2003	2004	2005
Receivables	<u>360,306</u>	<u>352,593</u>	<u>433,858</u>	<u>435,676</u>	<u>384,068</u>	<u>344,898</u>	<u>414,724</u>	<u>431,389</u>
Held-to-maturity debt securities	<u>311,882</u>	<u>361,340</u>	<u>489,791</u>	<u>576,633</u>	<u>315,718</u>	<u>364,126</u>	<u>483,866</u>	<u>585,687</u>

(ii) Financial liabilities

The Group's financial liabilities mainly include amounts due to central banks, banks and other financial institutions, deposits from customers, certificates of deposit issued and subordinated bonds issued. The carrying values of financial liabilities approximate their fair values at the balance sheet date of the relevant periods presented, except that the fair value of subordinated bonds issued as at June 30, 2005 was RMB 41,117 million, which is higher than their carrying value of RMB 39,902 million.

36 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

In determining the carrying amounts of some assets and liabilities, the Group makes assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. The Group's estimates and assumptions are based on historical experience and expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying the Group's accounting policies.

(a) Impairment losses on loans and advances

Loan portfolios are assessed periodically to assess whether impairment losses exist and if they exist, the amounts of impairment losses. Objective evidence for impairment includes observable data indicating that there is a measurable decrease in the estimated future cash flows identified with an individual loan. It also includes observable data indicating adverse changes in the repayment status of borrowers in the loan portfolio or national or local or economic conditions that correlate with defaults on the loans in the portfolio. The impairment loss for a loan that is individually evaluated for impairment is the decrease in the estimated future cash flow of that loan. When loans and advances are collectively evaluated for impairment, the estimate is based on historical loss experience for assets with credit risk characteristics similar to the loans and advances. Historical loss experience is adjusted on the basis of the relevant observable data that reflect current economic

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****36 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)****(a) Impairment losses on loans and advances (continued)**

conditions. Management review the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

(b) Impairment of available-for-sale equity investments

For available-for-sale equity investments, a significant or prolonged decline in fair value below cost is considered to be objective evidence of impairment. Judgement is required when determining whether a decline in fair value has been significant or prolonged. In making this judgement, the historical data on market volatility as well as in the share price of the specific equity investment are taken into account. The Group also takes into account other factors, such as industry and sector performance and financial information regarding the investee.

(c) Fair value of financial instruments

For a number of financial instruments, no quoted prices from an active market exist. The fair values for these financial instruments are established by using valuation techniques. These techniques include using recent arm's length market transactions, reference to the current fair value of similar instruments and discounted cash flow analysis and option pricing models. The Group has established a process to ensure that valuation techniques are constructed by qualified personnel and are validated and reviewed by personnel independent of the area that constructed the valuation techniques. Valuation techniques are certified before being implemented for valuation and are calibrated to ensure that outputs reflect actual market conditions. Valuation models established by the Group make the maximum use of market inputs and rely as little as possible on Group-specific data. However, it should be noted that some inputs, such as credit and counterparty risk, and risk correlations, require management estimates. Management estimates and assumptions are reviewed periodically and are adjusted if necessary.

(d) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management make significant judgements. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(e) Income taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations. Deferred tax assets are recognised for tax losses not yet used and temporary deductible differences. As those deferred tax assets can only be recognised to the extent that it is probable that future taxable profit will be available against which the unused tax credits can be utilised. Management's judgement is required to assess the probability of future taxable profits. Management's assessment is

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

36 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(e) Income taxes (continued)

constantly reviewed and additional deferred tax assets are recognised if it becomes probable that future taxable profits will allow the deferred tax asset to be recovered.

37 RELATED PARTIES

(a) Restructuring

The Bank has undergone a restructuring under the direction of the State Council as detailed in Note 1(a).

(b) Huijin and companies under Huijin

(i) Huijin

Huijin directly and indirectly owned 95.88% of the issued share capital of the Bank as at June 30, 2005. Huijin was incorporated on December 16, 2003 as a wholly state-owned investment company with the approval of the State Council. Huijin is a government agency, and was established to hold certain equity investments on behalf of the State Council. Huijin represents the PRC government in exercising its investors' rights and obligations in certain financial institutions such as the Bank. The Group did not carry out any transactions with Huijin, except for the following, which form part of the Restructuring:

- Huijin has undertaken to assume all the debts, obligations and liabilities relating to the Succeeding Business, which arose for any reason prior to December 31, 2003 and were not succeeded by the Bank; and
- Huijin entered into a foreign exchange option agreement with the Bank on January 12, 2005 (Note 35(d)). The purpose of the option is to hedge against the Bank's currency risk arising from capital contributed by Huijin of USD 22,500 million.

(ii) Jianyin

As part of the Restructuring, CCB was separated into the Bank and Jianyin, a limited liability company directly and wholly owned by Huijin. Jianyin directly owns 10.65% of the issued share capital of the Bank as at June 30, 2005. Its principal activities include the holding of equity investments, asset management and other business activities as approved by the relevant PRC government authorities.

Jianyin entered into certain services and operating lease agreements with the Group subsequent to the Restructuring. Transactions during the relevant periods and the corresponding balances outstanding at the balance sheet date with Jianyin are as follows:

	Year ended December 31, 2004	Six months ended June 30, 2004 2005 (unaudited)	
Interest expense	—	—	3
Other income (note (ii-1))	5	2	16
Operating expenses (note (ii-2))	190	95	91

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

37 RELATED PARTIES (continued)

(b) Huijin, and companies under Huijin (continued)

(ii) Jianyin (continued)

	December 31, 2004	June 30, 2005
Other assets	—	179
Other payables (Note 24(b))	6,405	5,165
Deposits from customers	—	441
Amounts due to banks and other financial institutions	—	274
	<u>6,405</u>	<u>5,880</u>

Notes:

- (ii-1) This mainly represents custody management fee income earned by the Group for managing assets on behalf of Jianyin.
- (ii-2) This mainly represents rental expenses paid by the Group for leasing assets, including properties and motor vehicles, owned by Jianyin, and fees for supporting services provided by Jianyin.
- (iii-3) Amounts due from/to Jianyin are unsecured and are repayable under normal commercial terms. No allowance for impairment losses was made in respect of amounts due from Jianyin during the relevant periods.

(iii) Other companies under Huijin

Huijin also has controlling equity interests in certain other banks in the PRC. The Group enters into banking transactions with these banks in the normal course of its banking business at market rates. These include sale and purchase of debt securities, conducting of money market transactions and inter-bank clearing. The Directors consider that these banks are competitors of the Group. Transactions during the relevant periods and corresponding balances outstanding at the balance sheet date with these banks are as follows:

	Year ended December 31, 2004	Six months ended June 30, 2004 2005 (unaudited)	
<i>Interest income arises from:</i>			
Debt securities issued by these banks	<u>68</u>	<u>—</u>	<u>130</u>
Amounts due from these banks	<u>30</u>	<u>17</u>	<u>13</u>
<i>Interest expense arises from:</i>			
Amounts due to these banks	<u>25</u>	<u>9</u>	<u>21</u>
		December 31, 2003	June 30, 2005
Debt securities issued by these banks		<u>—</u>	<u>6,620</u>
Amounts due from these banks		<u>2,082</u>	<u>1,817</u>
Amounts due to these banks		<u>1,457</u>	<u>4,269</u>

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

37 RELATED PARTIES (continued)

(b) Huijin, and companies under Huijin (continued)

(iii) Other companies under Huijin (continued)

The Group issued subordinated bonds with a nominal value of RMB 40,000 million during the year ended December 31, 2004. One of these banks underwrote the Group's subordinated bonds with a nominal value of RMB 3,320 million upon their issuance. These bonds are bearer bonds and are traded in the secondary market. Accordingly, the Group has no information in respect of the amount of bonds held by such bank at the balance sheet date.

(c) Transactions with other state-owned entities in the PRC

The Group operates in an economic regime currently predominated by entities directly or indirectly owned by the PRC government through its government authorities, agencies, affiliations and other organisations ("state-owned entities").

Transactions with other state-owned entities include but are not limited to the following:

- lending and deposit taking;
- taking and placing of inter-bank balances;
- entrusted lending and other custody services;
- insurance and securities agency, and other intermediary services;
- sale, purchase, underwriting and redemption of bonds issued by other state-owned entities;
- purchase, sale and leases of property and other assets; and
- rendering and receiving of utilities and other services.

These transactions are conducted in the ordinary course of the Group's banking business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services, such as loans, deposits and commission income. Such pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. Having due regard to the substance of the relationships, the Directors are of the opinion that none of these transactions are material related party transactions that require separate disclosure.

(d) Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including Directors, Supervisors and Executive Officers.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

37 RELATED PARTIES (continued)

(d) Key management personnel (continued)

The aggregate of the compensations in respect of Directors and Supervisors is disclosed in Note 10. The Executive Officers' compensations during the relevant periods are as follows:

	<u>Years ended December 31,</u>			<u>Six months ended June 30,</u>	
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>	<u>2005</u>
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Salaries and other emoluments	902	959	1,086	510	537
Discretionary bonuses	319	1,772	2,281	1,110	1,110
Contributions to defined contribution retirement schemes	<u>41</u>	<u>55</u>	<u>74</u>	<u>34</u>	<u>39</u>
	<u>1,262</u>	<u>2,786</u>	<u>3,441</u>	<u>1,654</u>	<u>1,686</u>

(e) Contributions to defined contribution retirement schemes

The Group participates in various defined contribution retirement schemes organised by municipal and provincial governments for its staff in the PRC. For its staff outside the PRC, the Group participates in various defined contribution retirement schemes at funding rates determined in accordance with the local practices and regulations. The details of the Group's defined contribution retirement schemes are described in Notes 24(a) and 25(a).

38 FIRST-TIME ADOPTION OF IFRS

As stated in Introduction, the Group prepared its first IFRS financial statements for the year ended December 31, 2004. IFRS 1 First-Time Adoption of International Financial Reporting Standards ("IFRS 1") was applied in preparing these first IFRS financial statements. The date of first adopting IFRS was January 1, 2003 in accordance with IFRS 1. In preparing the first IFRS financial statements, the Group has adjusted amounts reported previously in its statutory financial statements prepared under previous PRC GAAP for the years ended December 31, 2003 and 2002 or under PRC GAAP for the year ended December 31, 2004 (collectively, "PRC statutory financial statements").

In view of the above, IFRS 1 is not applicable to the Financial Information for inclusion in this report.

In accordance with IFRS 1, the first IFRS financial statements require a reconciliation to show how the transition from previous PRC GAAP or PRC GAAP to IFRS has affected the Group's financial position, financial performance and cash flows. The reconciliation and the relevant explanations are set out in Notes 38(a) and 38(b) below. For illustrative purposes, the reconciliation between the owners' equity, other

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

38 FIRST-TIME ADOPTION OF IFRS (continued)

than minority interest, as at January 1, 2002 shown in the PRC statutory financial statements and the Financial Information is also included in Note 38(a).

(a) Reconciliation of owners' equity other than minority interest and net profit attributable to equity holders of the Bank

	Note	Owners' equity other than minority interest as at			Net profit for the year ended December 31, 2004
		January 1, 2002	January 1, 2003	December 31, 2004	
Balance shown under PRC statutory financial statements		107,567	107,236	194,744	48,388
Adjustment for allowance on impairment losses	(i)	(234,099)	(235,428)	—	—
Recognition of provision for probable losses and obligations	(ii)	(18,034)	(17,003)	—	—
Recognition of deferred tax	(iii)	25,543	14,874	—	—
Adjustment on cut off differences of interest income		(11,570)	(3,297)	—	—
Adjustment on cut off differences of other operating income and expenses		(13,230)	(7,028)	—	—
Reversal of the reserve in relation to the interest income received from Cinda bond	(iv)	12,588	18,146	—	—
Others	(v)	(10,661)	(11,822)	—	—
Fair value adjustments for investments	(vi)	616	963	(190)	(14)
Fair value adjustments for derivatives	(vii)	(10)	(98)	(167)	(99)
Interest recognition for short term debt securities	(viii)	5	251	1,059	697
Deferral of subordinated bonds' issue cost		—	—	70	70
Balances shown under the first IFRS financial statements or the Financial Information		<u>(141,285)</u>	<u>(133,206)</u>	<u>195,516</u>	<u>49,042</u>

Notes:

(i) Adjustment for allowance on impairment losses

Previous PRC GAAP does not require recognition of impairment losses against the assets based on their estimated recoverable amounts. Only an allowance of 1% of the total gross amount of certain assets, including loans and investments, is required to be made.

Under PRC GAAP and IFRS, the Group is required to assess whether its assets are impaired and recognise impairment losses based on their estimated recoverable amounts.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

38 FIRST-TIME ADOPTION OF IFRS (continued)

(a) Reconciliation of owners' equity other than minority interest and net profit attributable to equity holders of the Bank (continued)

Notes: (continued)

(ii) Recognition of provisions for probable losses and obligations

Previous PRC GAAP does not require the recognition of a provision for probable losses that an entity may suffer.

Under PRC GAAP and IFRS, provisions are recognised for liabilities of uncertain timing or amount when an entity has an obligation arising as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation with the potential loss reliably estimated. Accordingly, adjustments have been made to provide for the probable losses, which primarily represent the provision for litigation loss, claims in relation to investments in entities and liability in respect of supplementary retirement benefits, in the period the losses incurred.

(iii) Recognition of deferred tax

CCB did not recognise deferred tax in the financial statements prepared under previous PRC GAAP.

Under IFRS, deferred tax is provided using the balance sheet liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

When it is not probable that the tax benefits of deferred tax assets will be realised, the deferred tax assets are reduced to the extent that the related tax benefits are expected to be realised.

There is no significant difference between PRC GAAP and IFRS in this respect.

(iv) Reversal of the reserve in relation to the interest income received from Cinda bond

CCB recorded the interest received on Cinda bond as interest income and, at the same time, made a reserve in the same amount of the interest received in the allowance for loan losses.

These journal entries were reversed in the preparation of the first IFRS financial statements as there was no recoverability issue in relation to the interest on Cinda bond.

(v) Others

Others represent rectification of certain differences that have been identified for the years ended December 31, 2002 and 2003, such as the recognition of a liability for the transfer of assets to Cinda and reclassification differences.

(vi) Fair value adjustments for investments

Under previous PRC GAAP and PRC GAAP, debt securities are categorised as short term and long term debt securities according to the intention in relation to the investments. Short term debt investments and equity investments are stated at the lower-of-cost and market value. Long term debt investments are carried at amortised cost less provision for diminution in value.

Under IFRS, debt securities and equity investments are classified as financial assets at fair value through profit and loss, available-for-sale, loans and receivables or held-to-maturity depending on the intention and the market activity in relation to the investments. Financial assets at fair value through profit and loss and available-for-sale investments are stated at their fair value subsequent to the initial recognition while loans and receivables and held-to-maturity instruments are stated at amortised cost less impairment losses.

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

38 FIRST-TIME ADOPTION OF IFRS (continued)

(a) Reconciliation of owners' equity other than minority interest and net profit attributable to equity holders of the Bank (continued)

Notes: (continued)

(vii) Fair value adjustments for derivatives

Under previous PRC GAAP and PRC GAAP, derivatives are recorded as an off-balance sheet item at the notional amount. Any gains and losses are recognised in the income statement upon the expiry of the derivative contracts.

Under IFRS, derivatives are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the consolidated income statement, except for the derivatives that qualify for hedge accounting. Where derivatives qualify for hedge accounting, the gain or loss on remeasurement to fair value are recognised in the consolidated income statement or in equity, depending on the nature of the hedged item.

(viii) Interest recognition for short term debt securities

Under IFRS, interest income from debt securities is recognised on an accruals basis while under previous PRC GAAP and PRC GAAP, interest income together with discount and premium for short term investment is recognised on disposal or maturity.

(ix) Consolidation of subsidiaries

Under previous PRC GAAP or PRC GAAP, the Bank's interests in subsidiaries are stated at the Bank's attributable share of net assets, and the Bank does not prepare consolidated financial statements. The result of the Bank includes the Bank's share of the result of its subsidiaries.

Under IFRS, all of the Bank's controlled, principal subsidiaries have been consolidated into the Financial Information of the Group.

However, there are no differences in net profit or net assets between IFRS and PRC GAAP in this regard.

(b) Consolidated cash flow statement

Under previous PRC GAAP, no cash flow statement is required. Therefore, the Bank did not prepare a cash flow statement in its statutory financial statements for the years ended December 31, 2002 and 2003.

The objectives and principles of PRC GAAP applicable for the preparation of cash flow statements are similar to those set out in IAS 7 Cash Flow Statements.

Under PRC GAAP, the Bank was required to report its cash flows from operating activities under both direct and indirect methods. Under IFRS, the Group chose to use indirect method to report its cash flows from operating activities.

There were no other significant differences between the consolidated cash flow statement prepared under IFRS and the cash flow statement prepared under PRC GAAP.

VI EVENTS THAT OCCURRED AFTER THE BALANCE SHEET DATE**(a) Strategic investors**

On June 17, 2005, Bank of America Corporation (“BOA”) entered into an investment agreement and a strategic assistance agreement with the Bank, and a share and option purchase agreement with Huijin. Pursuant to the agreements, BOA agreed to invest in the Bank and to develop a strategic relationship with the Bank in several areas. On August 29, 2005, BOA paid USD 2,500 million to Huijin for the purchase of 17,482,209,346 issued shares of the Bank, or approximately 9% of the Bank’s then issued shares and a call option to acquire the Bank’s shares from Huijin until BOA holds 19.9% of the Bank’s shares at the closing date of the initial public offering. In addition, BOA will purchase the Bank’s H share in the initial public offering at the offer price, in an aggregate of USD 500 million.

On July 1, 2005, Asia Financial Holdings Pte Ltd (“AFH”), a wholly-owned subsidiary of Temasek Holdings Pte. Ltd. entered into an investment agreement with the Bank, and a share purchase agreement with Huijin. Pursuant to the agreements, AFH agreed to purchase 5.1% of the Bank’s issued shares from Huijin, and the Bank’s H shares in the initial public offering at the offer price in an aggregate of USD 1,000 million. The acquisition of 9,905,742,750 issued shares of the Bank, or 5.1% of the Bank’s then issued shares, from Huijin at USD 1,466 million was completed on August 29, 2005.

(b) Securitisation of residential mortgage loans

In early 2005, the Bank was authorised by the PRC government to conduct mortgage-backed securitisation. The Bank expects to securitise a portfolio of residential mortgage loans with the total principal amount of approximately RMB 3 billion (the “securitised loan portfolio”) by the end of 2005. Under this securitisation, the Bank intends to sell the securitised loan portfolio at a value approximately the same as the carrying amount to a special purpose trust (the “SPT”). The SPT will issue beneficial certificates that are collateralised by the securitised loan portfolio, and utilise the proceeds from the certificates to settle the transfer price.

The Bank will consolidate the financial positions and the results of the trust, which operates as an auto-pilot program as described in Interpretation 12 of the Standard Interpretation Committee (SIC 12).

(c) Appropriation to general reserve

Pursuant to Cai Jin [2005] No. 49 and Cai Jin [2005] No. 90 issued by the MOF on May 17, 2005 and September 5, 2005 respectively (collectively named as the “MOF Notices”), which are effective on July 1, 2005, banks and certain other financial institutions in the PRC, including the Bank, should maintain adequate allowances for impairment losses against their assets. In addition to the allowances for impairment losses, financial institutions should also set up a general reserve through appropriation of profit after tax, to cover their potential losses that are not yet identified. The general reserve forms part of the equity of the financial institutions. Financial institutions are required to assess the risk profile of their assets in determining the general reserve level. According to the MOF Notices, the general reserve is made to cover the assets in respect of which the financial institutions bear risk, and is in principle not less than 1% of the aggregate amount of those assets before allowances for impairment losses as at the balance sheet date. Financial institutions are not allowed to make profit distribution to shareholders until adequate allowances for impairment losses and general reserve have been made.

If a financial institution cannot meet the requirement of maintaining adequate general reserve as stipulated in the MOF Notices as at July 1, 2005, the financial institution is required to take necessary steps to

VI EVENTS THAT OCCURRED AFTER THE BALANCE SHEET DATE**(c) Appropriation to general reserve (continued)**

ensure that such requirement can be met in approximately 3 years but not more than 5 years, from July 1, 2005.

Management consider that the Group has made adequate allowances for impairment losses against its assets in accordance with the accounting policies set out in Note 2 during the relevant periods. As at June 30, 2005, the Group is not required to maintain the general reserve according to the MOF Notices. Had the Bank been required to do so as at June 30, 2005, the estimated general reserve required to be maintained at that date would be approximately RMB 29.2 billion.

(d) Set up of an asset management company

The Bank has entered into an agreement (the "Agreement") with Principal Financial Services, Inc. and China Huadian Group Corporation on July 28, 2005 to establish CCB Principal Asset Management Co., Ltd. (the "Asset Management Company") with registered capital of RMB 200 million. The Asset Management Company was set up on September 19, 2005. Pursuant to the Agreement, the Bank owns 65% of the registered capital of the Asset Management Company.

(e) Profit appropriations approved by shareholders

In addition to the profit appropriations for the six months ended June 30, 2005 approved by the shareholders at the general meeting held on June 6, 2005 (Note 29(c)), the shareholders approved the following profit appropriations of the Bank for the year ending December 31, 2005 at the extraordinary general meeting held on August 27, 2005:

- (i) The Bank appropriated 65% of its retained earnings of RMB 480 million, which was determined under PRC GAAP, as at June 30, 2005 to the general reserve as described in Section VI(c) (the "general reserve"). The remaining 35% of the retained earnings, or RMB 168 million, was declared to the five promoters in the form of cash dividend;
- (ii) The Bank will appropriate 50%, 10% and 5% of its profit after tax under PRC GAAP for the six months ending December 31, 2005 to the general reserve, statutory surplus reserve and statutory public welfare fund respectively;
- (iii) The Bank plans to be listed on overseas exchange(s) during the second half of 2005. RMB 3.1 billion of the profit after tax for the period from and including July 1, 2005 to the date immediately preceding the first date when the Bank's shares are listed (the "listing date") will be distributed in the form of cash dividend (the "special dividend") to the shareholders on the register of shareholders at the date immediately preceding the listing date; and
- (iv) 35% of the profit after tax for the six months ending December 31, 2005, as determined under PRC GAAP or IFRS, whichever is lower, less the special dividend, will be distributed in the form of cash dividend to the holders of our shares as at the relevant record date.

VII ULTIMATE PARENT

The Group is owned and controlled by the PRC government. The majority of the Bank's shares are held by Huijin, a government agency.

VIII SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Group in respect of any period subsequent to June 30, 2005.

Yours faithfully,

KPMG

Certified Public Accountants

Hong Kong, China