

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**FINANCIAL STATEMENTS – 31 DECEMBER 2005**

**Domiciled in Malaysia.**  
**Registered Office:**  
**2, Leboh Ampang,**  
**50100 Kuala Lumpur**

**HSBC BANK MALAYSIA BERHAD**  
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**BOARD OF DIRECTORS**

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Michael Roger Pearson Smith, *non-executive Chairman*

Zarir Jal Cama, *Deputy Chairman and Chief Executive Officer*

Ian Douglas Francis Ogilvie, *executive Director and Deputy Chief Executive*

Douglas Jardine Flint, *non-independent non-executive Director*

Dato' Sulaiman bin Sujak, *non-independent non-executive Director*

Dato' Henry Sackville Barlow, *independent non-executive Director*

Datuk Ramli bin Ibrahim, *independent non-executive Director*

Datuk Dr Zainal Aznam bin Mohd Yusof, *independent non-executive Director*

Professor Emeritus Dr Mohamed Ariff bin Abdul Kareem, *independent non-executive Director*

Dato' Zuraidah binti Atan, *independent non-executive Director*

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**PROFILE OF DIRECTORS**

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**Michael Roger Pearson Smith**, non-executive Chairman

Age 49. Holds a BSc (Hons) from the London University. Joined HSBC in 1978 and, in 1991, following a number of appointments in the Asia-Pacific and the Middle East, moved to the Planning Department of Midland Bank (now HSBC Bank plc) in the UK. In 1993, appointed as Managing Director International at the bank.

From 1995-1997, he was executive Director and Deputy Chief Executive of Hongkong Bank Malaysia Berhad (now HSBC Bank Malaysia Berhad). In 1997, he was appointed Chief Executive Officer of HSBC Argentina Holdings SA assuming responsibility for the Group's operations in Argentina. He was appointed Chairman there in 2000 and, in the same year, was appointed a Group General Manager.

In March 2003, he returned to the UK as Group General Manager to review and restructure the Group Head Office.

Michael Smith was appointed President and Chief Executive Officer of The Hongkong and Shanghai Banking Corporation Limited and Chairman of HSBC Bank Malaysia Berhad on 1 January 2004. He has also been appointed as the Chairman of Hang Seng Bank Limited effective 22 April 2005.

**Zarir Jal Cama**, Deputy Chairman and Chief Executive Officer

Age 58. Mr Cama went to school at St. Paul's School, Darjeeling and graduated from St. Stephen's College, Delhi University. Joined the HSBC Group in London in 1968. After two years training in the London office, he returned to India and worked in various operational, credit and branch capacities. In 1982, he was posted to the International Corporate Accounts Division in Hong Kong. He returned to India in 1984 to head the Bank's Merchant Banking operations where he was responsible for its business strategy and development. He moved to Saudi British Bank Ltd in 1988 to head the Corporate Bank and was subsequently appointed its Deputy Managing Director. In 1992, he was assigned to Head Office in Hong Kong as Senior Manager Group Corporate Planning and Senior Manager International and went on to become Senior Executive Global Banking Services, HSBC Holdings plc in October 1993 based in the Group's new headquarters in London.

In mid-March 1998, he was transferred back to India as Deputy Chief Executive Officer and was appointed Chief Executive Officer of The Hongkong and Shanghai Banking Corporation in India in October 1999. As Country Head, he was also Chairman of HSBC Securities and Capital Markets India Private Limited and of the Group's Processing Company, HSBC Electronic Data Processing India Private Ltd.

He became a Group General Manager of HSBC Holdings plc in August 2001. Mr Cama was appointed Deputy Chairman and Chief Executive Officer for HSBC Bank Malaysia Berhad in November 2002 with responsibility for the Malaysian operations.

He is a Director of Cagamas Berhad and a Council Member of the Association of Banks in Malaysia. He is on the General Committee of the Malaysian International Chamber of Commerce and Industry. Mr Cama is also a member of Rotary Club of Kuala Lumpur DiRaja and an Honorary Member of Rotary Club Damansara. He is also a Trustee of WWF Malaysia and the Aged European Fund.

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*Profile of Directors (continued)*

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**Ian Douglas Francis Ogilvie**, executive Director and Deputy Chief Executive

Age 46. Mr Ogilvie obtained a MA Geography from Cambridge University. He joined the HSBC Group in 1981 as a Research and Planning Analyst and held the position of General Manager, Human Resources of HSBC Bank plc prior to his current appointment as executive Director and Deputy Chief Executive of HSBC Bank Malaysia Berhad.

During his career at HSBC he has held a wide variety of senior posts with the Group.

**Douglas Jardine Flint**, non-independent non-executive Director

Age 50. Douglas Flint is a Chartered Accountant from the Institute of Chartered Accountants of Scotland and participated in the Programme for Management Development (PMD) from Harvard Business School. Group Finance Director of HSBC Holdings plc. A non-executive Director since 1995. He is the Chairman of the Financial Reporting Council's review of the Turnbull Guidance on Internal Control; and served on The Accounting Standards Board in the UK and the Standards Advisory Council of the International Accounting Standards Board from 2001 to 2004. He was named 'Business Leader of the Year' by the Chartered Institute of Management Accountants in 2003 and best European Chief Financial Officer in the banking category of a survey carried out by Institutional Investor magazine in 2004. He was a former partner of KPMG, UK.

**Dato' Sulaiman bin Sujak**, non-independent non-executive Director

Age 71. Served as an executive Director and Adviser of HSBC Bank Malaysia Berhad for 15 years, before being appointed a non-executive Director in 2004. He graduated from the Royal Air Force College, Cranwell, England in 1958 and the Royal College of Defence Studies, London in 1973 and had served both with the Royal Air Force and the Royal Malaysian Air Force. He was the first Malaysian to be appointed as the Royal Malaysian Air Force Chief (1967-1976). He served as an Adviser of Bank Negara Malaysia (1977-1983), Commercial Director of Kumpulan Guthrie (1983-1989) and Deputy Chairman of Malaysia Airline System (1977-2001). Currently, he also sits on the board of FACB Industries Incorporated Berhad, Nationwide Express Courier Services Berhad and Cycle & Carriage Bintang Berhad.

**Dato' Henry Sackville Barlow**, independent non-executive Director

Age 61. He graduated from Eton College and obtained a MA from Cambridge University. He is a former Council Member of the Incorporated Society of Planters and Honorary Secretary of the Heritage Trust of Malaysia. He is a Director of Golden Hope Plantations Berhad and Guthrie Ropel Berhad. He was formerly Joint Managing Director of Highland and Lowlands Para Rubber Co. Ltd., being instrumental in the company's Malaysianisation process in the late 1970s and early 1980s. Dato' Barlow is a Fellow of The Institute of Chartered Accountants, England and Wales, and a keen environmentalist.

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*Profile of Directors (continued)*

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**Datuk Ramli bin Ibrahim**, independent non-executive Director

Age 65. Datuk Ramli is a Chartered Accountant from the Institute of Chartered Accountants of Australia. He is currently non-executive Director of several other public listed and unlisted companies. He was formerly Senior Partner of KPMG Peat Marwick Malaysia (now known as KPMG Malaysia) and executive Chairman of Kuala Lumpur Options and Financial Futures Exchange Berhad.

**Datuk Dr Zainal Aznam bin Mohd Yusof**, independent non-executive Director

Age 61. Datuk Dr Zainal holds a Bsc (Econ) from Queen's University, Belfast, Northern Ireland, MA (Development Economics) from University of Leicester, United Kingdom and Ph.D. (Economics) from Oxford University, United Kingdom. He was attached to the Economic Planning Unit of the Prime Minister's Department from 1969 to 1988. During the 1987-1988 academic year, he was a Visiting Scholar at the Harvard Institute for International Development (HIID), Harvard University (Fulbright Scholar). He has also served as a Deputy Executive Director of the Malaysian Institute of Economic Research (MIER) from 1988 to 1990. Prior to that, he was the South East Asia Regional Economist at Kleinwort Benson Research (Malaysia) Sdn Bhd.

From 1990-1994 he was the Adviser in Economics at Bank Negara Malaysia. In January 1998 he was appointed as a Member of the Working Committee of the National Economic Action Council (NEAC). He was a Commissioner of the Securities Commission from 1999 to 2004 and the Deputy Director-General of the Institute of Strategic and International Studies until 2002. Datuk Dr Zainal is a well-known economist in Malaysia.

**Professor Emeritus Dr Mohamed Ariff bin Abdul Kareem**, independent non-executive Director

Age 65. Prof. Emeritus Dr Mohamed Ariff obtained his B.A. First Class Honours and M.Ec. from the University of Malaya. He completed his Ph.D. program at the University of Lancaster, England in 1971, on a Commonwealth Scholarship.

Prof. Emeritus Dr Mohamed Ariff, a specialist in International Economics, is currently the executive Director of the Malaysian Institute of Economic Research (MIER). Previously he held the Chair of Analytical Economics at the University of Malaya where he had also served as the Dean of the Faculty of Economics and Administration. He was a Board Member of the Inland Revenue Board (IRB) and is a Board Member of National Productivity Centre (NPC) and Social Security Organisation (SOSCO). He had a brief stint in the private sector as the Chief Economist at the United Asian Bank in 1976.

**Dato' Zuraidah binti Atan**, independent non-executive Director

Age 46. Appointed on 18 October 2004. She is currently a Director of TH Hin Corporation Berhad. She was previously President and Chief Executive of Affin Merchant Bank Berhad for four years until September 2003. A lawyer by training, she obtained her LLB from the University of Buckingham, Britain in 1984. She is also a member of the Association of Bumiputra Business and Professional Women, Malaysia. Currently she serves as an adviser to the National Cancer Society of Malaysia.

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**BOARD RESPONSIBILITY AND OVERSIGHT**

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**BOARD OF DIRECTORS**

**Composition of the Board**

At the date of this report, the Board consists of ten (10) members; comprising two (2) non-independent executive Directors, three (3) non-independent non-executive Directors and five (5) independent non-executive Directors.

The concept of independence adopted by the Board is as defined in paragraph 2.26 of Bank Negara Malaysia's Guidelines on Corporate Governance for Licensed Institutions (Revised BNM/GP1). The key requirements for independent Directors are that they do not have a substantial shareholding interest in the Bank (5% equity interest, directly or indirectly), have not been employed or have an immediate family employed in an executive position in the Bank within the past two (2) years, have not engaged in any transaction worth more than RM1 million with the Bank within the past two (2) years and generally, are independent of management and free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interest of the Bank.

There is a clear division of responsibilities at the head of the Bank to ensure a balance of authority and power. The Board is led by Mr Michael Roger Pearson Smith as the non-executive Chairman and the executive management of the Bank is led by Mr Zarir Jal Cama, the Chief Executive Officer.

Revised BNM/GP1 prescribes a maximum of one (1) executive Director on the Board, preferably the Chief Executive Officer. However, as there are two (2) executive Directors on the Board, that is, the Chief Executive Officer and the Deputy Chief Executive, the Bank has, on 8 December 2005, obtained Bank Negara Malaysia's approval to retain both executive Directors on the Board.

**Roles and Responsibilities of the Board**

The Board is responsible for the overall corporate governance of the Bank, including its strategic direction, establishing goals for management and monitoring the achievement of these goals. The role and function of the Board are clearly documented in a Shareholder's Mandate.

The Board has a formal schedule of matters reserved to itself for approval, which includes annual plans and performance targets, procedures for monitoring and control of operations, specified senior appointments, acquisitions and disposals above pre-determined thresholds and any substantial changes in the balance sheet management policy.

The Board carries out various functions and responsibilities laid down by Bank Negara Malaysia in guidelines and directives that are issued by Bank Negara Malaysia from time to time.

Pending the implementation of the Remuneration Committee, Nominating Committee and Risk Management Committee as required under the revised BNM/GP1, the Board is currently carrying out the roles of these committees.

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*Board Responsibility and Oversight (continued)*

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**BOARD OF DIRECTORS (continued)**

**Frequency and Conduct of Board Meetings**

The Board ordinarily meets at least four (4) times a year, usually in the month following the closure of each financial quarter. During the financial year, the Board met on four (4) occasions.

As the revised BNM/GP1 requires the Board to meet preferably on a monthly basis, but in any event, no less than once every two (2) months, the Bank has sought Bank Negara Malaysia's approval to allow the Bank to continue its existing practice of meeting at least once every quarter.

The Board receives reports on the progress of the Bank's business operations and minutes of meetings of Board Committees for review at each of its meetings. At these meetings, the members also consider a variety of matters including the Bank's financial results, major investment and strategic decisions and corporate governance matters. The Board also receives a number of annual presentations from each key business area, and on any other topic as they request.

The agenda for every Board meeting, together with comprehensive management reports, proposal papers and supporting documents are distributed to the Directors in advance of all Board meetings, to allow time for appropriate review and to enable full discussion at the meetings. All proceedings from the Board meetings are minuted. Minutes of every Board meeting are circulated to all Directors for their perusal prior to confirmation of the minutes at the following Board meeting.

The revised BNM/GP1 requires non-executive Directors to have a minimum attendance of at least 75% of all Board meetings.

The attendance of Directors at the Board meetings held in the financial year ended 31 December 2005 was as follows:

Name of members	Independent/ Non-Independent	Number of meetings and attendance
Michael Roger Pearson Smith	Chairman, non-independent non-executive Director	4/4
Zarir Jal Cama	Deputy Chairman and Chief Executive Officer	4/4
Ian Douglas Francis Ogilvie	Executive Director and Deputy Chief Executive	4/4
Douglas Jardine Flint	Non-independent non-executive Director	4/4
Dato' Sulaiman bin Sujak	Non-independent non-executive Director	4/4
Dato' Henry Sackville Barlow	Independent non-executive Director	4/4
Datuk Ramli bin Ibrahim	Independent non-executive Director	4/4
Datuk Dr Zainal Aznam bin Mohd Yusof	Independent non-executive Director	4/4
Professor Emeritus Dr Mohamed Ariff bin Abdul Kareem	Independent non-executive Director	4/3
Dato' Zuraidah binti Atan	Independent non-executive Director	4/4



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*Board Responsibility and Oversight (continued)*

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**BOARD COMMITTEES**

The Board has established Board Committees as well as various Management Committees to assist the Board in the running of the Bank. The functions and Terms of Reference of the Board Committees and Management Committees, as well as authority delegated by the Board to these Committees, have been clearly defined by the Board.

The Board Committee and Management Committees in the Bank are as follows:

**Board Committee**

- Audit Committee

**Management Committees**

- Executive Committee
- Credit Committee
- Asset and Liability Management Committee
- Human Resource Steering Committee
- IT Steering Committee
- Operational Risk Management Committee
- Property Committee
- Senior Succession Planning Committee

Pursuant to the revised BNM/GP1, the Board is required to establish the following Committees:

- Nominating Committee
- Remuneration Committee
- Risk Management Committee

Bank Negara Malaysia has granted the Bank until 31 March 2006 to set up these Committees. The Bank is currently looking into the establishment of the Committees and will ensure adherence to this deadline.

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*Board Responsibility and Oversight (continued)*

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**AUDIT COMMITTEE**

**Membership**

The present members of the Audit Committee ('the Committee') comprise of:

Datuk Ramli bin Ibrahim (Chairman)  
Dato' Sulaiman bin Sujak  
Dato' Henry Sackville Barlow

**Meetings**

A total of four (4) Audit Committee meetings were held during the financial year, which were attended by all members.

**Terms of Reference**

The Terms of Reference were approved at the meetings of the Audit Committee and Board held on 19 July 2005.

Membership

The Committee shall comprise not less than three independent<sup>1</sup> non-executive Directors.

The appointment to the Committee of members and of the Chairman shall be subject to endorsement by the HSBC Group Audit Committee.

The Board may from time to time appoint additional members to the Committee from among the non-executive directors it has determined to be independent. In the absence of sufficient independent non-executive directors, the Board may appoint individuals from elsewhere in the HSBC Holdings plc Group ('HSBC Group') with no line or functional responsibility for the activities of the Bank or its subsidiaries.

The Chairman of the Committee shall be appointed by the Board following election by the members of the Committee.

The Committee may invite any director, executive, external auditor or other person to attend any meeting(s) of the Committee as it may from time to time consider desirable to assist the Committee in the attainment of its objective.

<sup>1</sup> *A member of an Audit Committee is considered independent when the Committee determines that the person is independent in character and judgement and there are no circumstances which could affect, or appear to affect, the person's judgement.*

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*Board Responsibility and Oversight (continued)*

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**AUDIT COMMITTEE (continued)**

Meetings and Quorum

The Committee shall meet with such frequency and at such times as it may determine. It is expected that the Committee shall meet at least four (4) times each year.

The quorum for meetings shall be two (2) Directors.

Objective

The Committee shall be accountable to the Board and shall assist the Board in meeting its responsibilities in ensuring an effective system of internal control and compliance and for meeting its external financial reporting obligations, including its obligations under applicable laws and regulations and shall be directly responsible on behalf of the Board for the selection, oversight and remuneration of the external auditor.

Responsibilities of the Committee

Without limiting the generality of the Committee's objective, the Committee shall have the following responsibilities, powers, authorities and discretion.

1. To monitor the integrity of the financial statements of the Bank, and any formal announcements relating to the Bank's financial performance, reviewing significant financial reporting judgements contained in them. In reviewing the Bank's financial statements before submission to the Board, the Committee shall focus particularly on:
  - (i) any changes in accounting policies and practices;
  - (ii) major judgemental areas;
  - (iii) significant adjustments resulting from audit;
  - (iv) the going concern assumptions and any qualifications;
  - (v) compliance with accounting standards; and
  - (vi) compliance with applicable listing and other legal requirements in relation to financial reporting.

In regard to the above:

- (i) members of the Committee shall liaise with the Board, members of senior management and the principal financial officer and the Committee shall meet, at least once a year, with the external auditor and head of internal audit; and
- (ii) the Committee shall consider any significant or unusual items that are, or may need to be, reflected in the annual report and accounts and shall give due consideration to any matters raised by the principal financial officer, head of internal audit, head of compliance or external auditor.
- (iii) the Committee shall ensure that the accounts are prepared in a timely and accurate manner with frequent reviews of the adequacy of provisions against contingencies and bad and doubtful debts.

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*Board Responsibility and Oversight (continued)*

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**AUDIT COMMITTEE (continued)**

Responsibilities of the Committee (continued)

2. To review the Bank's financial and accounting policies and practices.
3. To review the Bank's internal financial controls and its internal control and risk management systems.
4. To monitor and review the internal audit plan, the effectiveness of the internal audit function and co-ordination between the internal and external auditors, consider the major findings of internal investigations and management's response, obtain assurances that the internal audit function is adequately resourced and has appropriate standing and is free from constraint by management or other restrictions. The Committee shall approve the appointment and removal of the head of internal audit.
5. To make recommendations to the Board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor.
6. To review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements and reports from the external auditors on their own policies and procedures regarding independence and quality control and to oversee the appropriate rotation of audit partners with the external auditor.
7. To implement the HSBC Group policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; where required under that policy to approve in advance any non-audit services provided by the external auditor that are not prohibited by the Sarbanes-Oxley Act of 2002 (in amounts to be pre-determined by the HSBC Group Audit Committee) and the fees for any such services; to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and make recommendations as to the steps to be taken. For this purpose "external auditor" shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally.
8. To review the external auditor's management letter and management's response, any material queries raised by the external auditor to management in respect of the accounting records, financial accounts or systems of control and management's response, the external auditors' annual report on the progress of the audit and management's annual internal control report.
9. To ensure a timely response is provided to the issues raised in the external auditor's management letter.

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*Board Responsibility and Oversight (continued)*

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**AUDIT COMMITTEE (continued)**

Responsibilities of the Committee (continued)

10. To discuss with the external auditor their general approach, nature and scope of their audit and reporting obligations before the audit commences including, in particular, the nature of any significant unresolved accounting and auditing problems and reservations arising from their interim reviews and final audits, major judgmental areas (including all critical accounting policies and practices used by the Bank and changes thereto), all alternative accounting treatments that have been discussed with management together with the potential ramifications of using those alternatives, the nature of any significant adjustments, the going concern assumption, compliance with accounting standards and legal requirements, reclassifications or additional disclosures proposed by the external auditor which are significant or which may in the future become material, the nature and impact of any material changes in accounting policies and practices, any written communications provided by the external auditor to management and any other matters the external auditor may wish to discuss (in the absence of management where necessary).
11. To review and discuss management's statement on internal control systems prior to endorsement by the Board, the effectiveness of the Bank's internal control systems and procedures for compliance with the HSBC Group compliance policy and the relevant regulatory and legal requirements in each of the markets where the Company is represented and whether management has discharged its duty to have an effective internal control system.
12. To consider any findings of major investigations of internal control matters as delegated by the Board or on the Committee's initiative and management's response.
13. To receive an annual report, and other reports from time to time as may be required by applicable laws and regulations, from the principal executive officer and principal financial officer to the effect that such persons have disclosed to the Committee and to the external auditor all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which could adversely affect the Bank's ability to record and report financial data and any fraud, whether material or not, that involves management or other employees who have a significant role in the Bank's internal controls over financial reporting.
14. To review such information as the Disclosure Committee (if any) may request (including reports and minutes of the Disclosure Committee) from time to time.
15. To provide to the Board such assurances as it may reasonably require regarding compliance by the Bank, its subsidiaries and those of its associates for which it provides management services with all supervisory and other regulations to which they are subject.
16. To provide to the Board such additional assurance as it may reasonably require regarding the reliability of financial information submitted to it.

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*Board Responsibility and Oversight (continued)*

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**AUDIT COMMITTEE (continued)**

Responsibilities of the Committee (continued)

17. To receive from the Compliance function reports on the treatment of substantiated complaints regarding accounting, internal accounting controls or auditing matters received through the HSBC Group Disclosure Line (or such other system as the HSBC Group Audit Committee may approve) for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.
18. To review regular risk management reports setting out the risks involved in the Bank's business and how they are controlled and monitored by management and to review the effectiveness of the risk management framework.
19. To agree the Bank's policy for the employment of former employees of the external auditor, within the terms of the HSBC Group's policy.
20. Where applicable to review the composition, powers, duties and responsibilities of subsidiary companies' Audit Committees.
21. To undertake or consider on behalf of the Chairman or the Board such other related tasks or topics as the Chairman or the Board may from to time entrust to it.
22. The Committee alone shall meet with the external auditor and with the head of internal audit at least once each year to ensure that there are no unresolved issues or concerns.
23. The Committee may appoint, employ or retain such professional advisors as the Committee may consider appropriate. Any such appointment shall be made through the secretary to the Committee, who shall be responsible for the contractual arrangements and payment of fees by the Company on behalf of the Committee.
24. The Committee shall review annually the Committee's terms of reference and its own effectiveness and recommend to the Board and HSBC Group Audit Committee any necessary changes.
25. To report to the Board on the matters set out in these terms of reference.
26. To provide half-yearly certificates to the HSBC Group Audit Committee, or to any audit committee of an intermediate holding company in the form required by the HSBC Group Audit Committee. Such certificates to include a statement that the members of the Committee are independent.
27. To review any related party transactions that may arise within the Bank and the HSBC Group.

Where the Committee's monitoring and review activities reveal cause for concern or scope for improvement, it shall make recommendations to the Board on action needed to address the issue or to make improvements and shall report any such concerns to the HSBC Group Audit Committee or to any audit committee of an intermediate holding company.

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**MANAGEMENT REPORTS**

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Board meetings are structured around a pre-set agenda and reports for discussion, notation and approvals are circulated in advance of the meeting dates. To enable directors to keep abreast with the performance of the Bank, reports submitted to the Board include:

- Quarterly business progress report
- Quarterly assets and liabilities summary
- Quarterly profit and loss statement
- Quarterly key financial ratios and statistics
- Quarterly significant Bank Negara Malaysia and HSBC Group's requirements
- Quarterly Bank Negara Malaysia's benchmarking statistics
- Quarterly derivatives outstanding
- Quarterly update on Basel II and Sarbanes-Oxley projects
- Quarterly risk management reports on sub-standard accounts and bad and doubtful debts
- Quarterly credit advances reports
- Minutes of the monthly Executive Committee meetings held
- Minutes of the monthly Asset and Liability Management Committee meetings held
- Minutes of the Audit Committee meetings held
- Human resource update
- Environmental issues update
- Comparative analysis of competitor banks

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**INTERNAL AUDIT AND INTERNAL CONTROL ACTIVITIES**

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The Board of Directors is responsible for internal control and for reviewing its effectiveness. Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material errors, losses or fraud.

Systems and procedures are in place to identify, control and report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error, breaches of law or regulations, unauthorised activities and fraud. Exposure to these risks is monitored by the Asset and Liability Management Committee (ALCO), Executive Committee (EXCO), Operational Risk Committee, Audit Committee and Board of Directors.

Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. Functional management in HSBC Group Head Office has been given responsibility to set policies, procedures and standards in the areas of finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for certain global product lines. The Bank operates within these policies, procedures and standards set by the HSBC Group Head Office functions.

The Bank's internal audit function monitors compliance with policies and standards and the effectiveness of internal control structures across the whole Bank in conjunction with other HSBC Group Internal Audit units. The work of the internal audit function is focused on areas of greatest risk to the Bank as determined by a risk-based approach. The head of the internal audit function reports to the Audit Committee and the Head of HSBC Group Audit function for the Asia Pacific region.

The Audit Committee has kept under review the effectiveness of this system of internal control and has reported regularly to the Board of Directors. The key processes used by the Committee in carrying out its reviews include regular reports from the heads of key risk functions; the production annually of reviews of the internal control framework (RICF – a self certification process) against HSBC Group benchmarks, which cover all internal controls, both financial and non-financial; annual confirmations from the Chief Executive Officer that there have been no material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

The Audit Committee has also reviewed the annual internal audit plan to ensure adequate scope and comprehensive coverage on the audit activities, effectiveness of the audit process, adequate resource deployment for the year and satisfactory performance of the Bank's Internal Audit Unit. The Committee has reviewed the internal audit reports, audit recommendations made and management's response to these recommendations. Where appropriate, the Committee has directed action to be taken by the Bank's management team to rectify any deficiencies identified by internal audit and improve the system of internal controls based on the internal auditors' recommendations for improvements.

The Directors, through the Audit Committee, have conducted an annual review of the effectiveness of the Bank's system of internal control covering all controls, including financial, operational and compliance controls and risk management.



**HSBC BANK MALAYSIA BERHAD**  
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**RISK MANAGEMENT**

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All of the Bank's activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The key business risks are credit risk, liquidity risk, market risk and operational risk. Market risk includes foreign exchange, interest rate and equity price risk.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and limits continually by means of reliable and up-to-date administrative and information systems. The Bank continually modifies and enhances its risk management policies and systems to reflect changes in markets, products and best practice risk management processes. Training, individual responsibility and accountability, together with a disciplined, conservative and constructive culture of control, lie at the heart of the Bank's management of risk.

The Executive Committee, Operational Risk Management Committee and Asset and Liability Management Committee, appointed by the Board of Directors, formulate risk management policy, monitors risk and regularly reviews the effectiveness of the Bank's risk management policies.

**Credit risk management**

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance and treasury activities. The Bank has dedicated standards, policies and procedures to control and monitor all such risks.

A Credit and Risk Management structure under the Chief Credit Officer who reports to the Chief Executive Officer, is in place to ensure a more coordinated management of credit risk and a more independent evaluation of credit proposals. The Chief Credit Officer has a functional reporting line to the HSBC Group General Manager, Group Credit and Risk.

The Bank has established a credit process involving credit policies, procedures and lending guidelines which are regularly updated and credit approval authorities delegated from the Board of Directors to the Credit Committee. Excesses or deterioration in credit risk grade are monitored on a regular and ongoing basis and at the periodic, normally annual, review of the facility. The objective is to build and maintain risk assets of high quality where risk and return are commensurate. Reports are produced for Executive Committee and the Board, covering:

- risk concentrations and exposures to industry sectors;
- large customer group exposures; and
- large non-performing accounts and impairment allowances.

The Bank has systems in place to control and monitor its exposure at the customer and counterparty level. Regular audits of credit processes are undertaken by the Internal Audit function. Such audits include consideration of the completeness and adequacy of credit manuals and lending guidelines, together with an in-depth analysis of a representative sample of accounts, an overview of homogeneous portfolios of similar assets to assess the quality of the loan book and other exposures, and adherence to HSBC Group standards and policies in the extension of credit facilities.

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*Risk Management (continued)*

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**Credit risk management (continued)**

Individual accounts are reviewed to ensure that risk grades are appropriate, that credit and collection procedures have been properly followed and that, where an account evidences deterioration, impairment allowances are raised in accordance with the HSBC Group's established processes. Internal Audit will discuss with management risk ratings they consider to be inappropriate, and their subsequent recommendations for revised grades must then be assigned to the facilities concerned.

At balance sheet date, exposure to the purchase of residential property accounted for 38% (2004: 39%) of total loans, advances and financing. Other concentrations of credit risk by economic purposes are disclosed in Note 6(iv).

**Liquidity and funding management**

The Bank maintains a diversified and stable funding base of core retail and corporate customer deposits as well as portfolios of highly liquid assets. The objective of the Bank's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due.

The management of liquidity and funding is primarily carried out in accordance with the Bank Negara Malaysia New Liquidity Framework; and practice and limits set by the HSBC Group Management Board. The HSBC Group Management Board ('GMB') operates as a general management committee under the direct authority of the HSBC Group Board of Directors. The HSBC GMB exercises the powers, authorities and discretions of the HSBC Group Board of Directors in so far as they concern the management and day to day running of the HSBC Group in accordance with such policies and directions as the HSBC Group Board of Directors may from time to time determine. These limits vary to take account of the depth and liquidity of the local market in which we operate. The Bank maintains a strong liquidity position and manages the liquidity profile of assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are met when due.

The Bank's liquidity and funding management process includes:

- projecting cash flows and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises while minimising adverse long-term implications for the business.

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*Risk Management (continued)*

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**Market risk management**

The objective of the Bank's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the HSBC Group's status as a premier provider of financial products and services.

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce the Bank's income or the value of its portfolios.

The Bank separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market making and proprietary position taking. Non-trading portfolios primarily arise from the management of the commercial banking assets and liabilities.

The management of market risk is principally undertaken using risk limit mandates approved by the HSBC Group Traded Markets Development and Risk Unit ('TMR') (an independent unit which develops HSBC Group's market risk management policies and measurement techniques). Market risks which arise on each product is transferred to the Bank's Global Markets unit and ALCO portfolio for management as the Global Markets unit has the necessary skills and tools to professionally manage such risks. Limits are set for each portfolio, product currency and risk type, with market liquidity being the principal factor in determining the level of limits set. The Bank has an independent market risk control function that is responsible for measuring market risk exposures in accordance with the policies defined by TMR and monitoring and reporting these exposures against the prescribed limits on a daily basis. Positions are monitored daily and excesses are reported immediately to local senior management and HSBC Group Treasury.

Market risk in the trading portfolio is monitored and controlled at both portfolio and position levels using a complimentary set of techniques such as value at risk ('VAR') and present value of a basis point, together with stress and sensitivity testing and concentration limits. Other controls to contain trading portfolio market risk at an acceptable level include rigorous new product approval procedures and a list of permissible instruments to be traded.

Market risk in non-trading portfolios arises principally from mismatches between the future yields on assets and their funding cost as a result of interest rate changes. This market risk is transferred to Global Markets and ALCO portfolio, taking into account both the contractual and behavioural characteristics of each product to enable the risk to be managed effectively. Behavioural assumptions for products with no contractual maturity are normally based on two-year historical trend. These assumptions are important as they reflect the underlying interest rate risk of the products and hence are subject to scrutiny from ALCO, the regional head office and TMR. The net exposure is monitored against the limits granted by TMR for the respective portfolios and, depending on the view on future market movement, economically hedged with the use of interest rate swaps.

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*Risk Management (continued)*

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**Market risk management (continued)**

*Value at risk ('VAR')*

One of the principal tools used by the Bank to monitor and limit market risk exposure is VAR. VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a 99 per cent level of confidence. The Bank calculates VAR daily. The VAR model used by the Bank is predominantly based on historical simulation. The historical simulation model derives plausible future scenarios from historical market rates time series, taking account of inter-relationships between different markets and rates, for example between interest rates and foreign exchange rates. Potential movements in market prices are calculated with reference to market data from the last two years and these rate changes are applied to current positions to create a profit and loss distribution for the portfolio. The 99 per cent confidence interval for this distribution represents the Bank's one-day VAR.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a 1-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Bank recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Stress tests are produced on a monthly basis based on the HSBC Group's stress-testing parameters, and on a quarterly basis based on Bank Negara Malaysia's parameters to determine the impact of changes in interest rates, exchange rates and other main economic indicators on the Bank's profitability and capital adequacy. The stress-testing provides ALCO with an assessment of the financial impact of identified extreme events on the market risk exposures of the Bank.

Derivative financial instruments (principally interest rate swaps) are used for hedging purposes in the management of asset and liability portfolios and structured positions. This enables the Bank to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of the assets and liabilities.

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*Risk Management (continued)*

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**Operational risk management**

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent to every business organisation and covers a wide spectrum of issues.

The Bank manages this risk through a control-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by Internal Audit, and by monitoring external operational risk events, which ensure that the Bank stays in line with best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

The Bank adheres to the HSBC Group standard on operational risk. This standard explains how HSBC manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events and implementing any additional procedures required for compliance with local statutory requirements. The standard covers the following:

- operational risk management responsibility is assigned at senior management level within the business operation;
- information systems are used to record the identification and assessment of operational risks and generate appropriate, regular management reporting;
- operational risks are identified by assessments covering operational risks facing each business and risk inherent in processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;
- operational risk loss data is collected and reported to senior management. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the Audit Committee; and
- risk mitigation, including insurance, is considered where this is cost-effective.

The Bank maintains and tests contingency facilities to support operations in the event of disasters. Additional reviews and tests are conducted in the event that the Bank is affected by a business disruption event to incorporate lessons learned in the operational recovery from those circumstances.

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**RATINGS STATEMENT**

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Rating Agency Malaysia Berhad (RAM) has on 29 September 2005 upgraded the Bank's long-term general bank rating, from AA<sub>1</sub> to AAA with a stable outlook; and reaffirmed the short-term rating at P<sub>1</sub>.

*Bank Rating Symbols and Definitions*

<i>Rating</i>	<i>Definition</i>
AAA	<i>Financial Institutions rated in this category are adjudged to offer the highest safety for timely payments of financial obligations. This level of rating indicates corporate entities with strong balance sheets, favourable credit profiles and consistent records of above-average profitability. Their capacities for timely payments of contractual financial obligations are unlikely to be impacted seriously by any foreseeable changes in economic conditions.</i>
P <sub>1</sub>	<i>Financial institutions in this category have superior capacities for timely payments of obligations.</i>

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**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2005**

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The directors have pleasure in submitting their report and the audited financial statements of the Bank and of the group for the year ended 31 December 2005.

**Principal Activities**

The principal activities of the Bank are banking and related financial services which also include Islamic banking business.

The principal activities of the subsidiary companies are as disclosed in Note 10 to the financial statements.

There have been no significant changes in these activities during the year.

**Results**

	<i>Group and Bank</i>
	<b>RM'000</b>
Profit before taxation and zakat	<b>747,156</b>
Taxation and zakat	<b>(213,471)</b>
Profit after taxation and zakat	<b>533,685</b>

**Dividends**

Since the end of the previous financial year, the Bank paid a final dividend of 121.3% less tax totalling RM100 million as proposed in the previous year's directors' report. The Bank also paid an interim dividend of 145.6% less tax amounting to RM120 million in respect of financial year 2005.

The directors now recommend a final dividend of 182.0% less tax totalling RM150 million in respect of the current financial year on the fully issued and paid-up ordinary shares of the Bank.

**Reserves and Provisions**

There were no material transfers to or from reserves or provisions during the year other than those disclosed in the financial statements.

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*Directors' Report (continued)*

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**Bad and Doubtful Debts and Financing**

Before the financial statements of the Bank and of the group were made out, the directors took reasonable steps to ascertain that action had been taken in relation to the writing off of bad debts and the making of allowance for doubtful debts and financing, and satisfied themselves that all known bad debts had been written off and adequate allowance made for doubtful debts and financing.

At the date of this report, the directors are not aware of any circumstances which would render the amount written off for bad debts, or the amount of the allowance for doubtful debts, in the financial statements of the Bank and of the group inadequate to any substantial extent.

**Current Assets**

Before the financial statements of the Bank and of the group were made out, the directors took reasonable steps to ascertain that any current assets, other than debts and financing, which were unlikely to be realised in the ordinary course of business at their value as shown in the accounting records of the Bank and of the group have been written down to an amount which they might be expected to realise.

At the date of this report, the directors are not aware of any circumstances which would render the values attributed to the current assets in the financial statements of the Bank and of the group misleading.

**Valuation Methods**

At the date of this report, the directors are not aware of any circumstances which have arisen which would render adherence to the existing methods of valuation of assets or liabilities in the financial statements of the Bank and of the group misleading or inappropriate.

**Contingent and Other Liabilities**

At the date of this report there does not exist:

- a any charge on the assets of the Bank or of the group which has arisen since the end of the financial year which secures the liabilities of any other person, or
- b any contingent liability in respect of the Bank or of the group that has arisen since the end of the financial year other than in the ordinary course of business.

No contingent or other liability of the Bank or of the group has become enforceable, or is likely to become enforceable within the period of twelve months after the end of the financial year which, in the opinion of the directors, will or may affect the ability of the Bank or of the group to meet its obligations as and when they fall due.



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*Directors' Report (continued)*

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**Change of Circumstances**

At the date of this report, the directors are not aware of any circumstances, not otherwise dealt with in this report or the financial statements of the Bank and of the group, that would render any amount stated in the financial statements misleading.

**Items of an Unusual Nature**

Except as disclosed in the financial statements, the results of the operations of the Bank and of the group for the financial year were not, in the opinion of the directors, substantially affected by any item, transaction or event of a material and unusual nature.

There has not arisen in the interval between the end of the financial year and the date of this report, any item, transaction or event of a material and unusual nature likely to affect substantially the results of the operations of the Bank and of the group for the current financial year in which this report is made.

**Business Strategy During the Year**

In a market which continues to be characterised by high liquidity, intense competition for quality lending against the backdrop of mixed economic performance of the country, the Bank continues its ongoing initiatives to balance profitable growth with market share aspirations. We strive to maintain a much more balanced business especially in our corporate and personal financial services portfolios.

Our general long-term rating was upgraded from AA<sub>1</sub> to AAA by Rating Agency Malaysia – this is the highest it has been since our local incorporation in 1994 – reflecting our overall financial standing. We were also awarded the Best Foreign Commercial Bank in Malaysia by FinanceAsia magazine for the second year running.

During 2005 we continued to invest in our brand and our people to generate further differentiation in our market position and maintain a high quality of service. Our 'brand consideration', the number of people who will consider buying from HSBC, increased significantly, particularly in our Personal Financial Services business. We continued to recruit and develop our employees, who are the key determinant of our success; this was reflected in being the runner-up in the Malaysian National HR Excellence Awards.

In the household sector, the strong growth in cards receivables and consumer credit was driven by our personal lending strategy of promoting high margin loan products targeted at the mass market under a strong risk management umbrella. The year saw another quantum growth in our cards business not only in terms of card base but also in terms of usage/ spending as well as receivables. This was made possible through an integrated approach towards creating value for existing and potential card customers.

Mortgage portfolio grew moderately in very difficult market conditions. The relaunch of the enhanced innovative product, HomeSmart, which gives flexibility to customers in terms of repayment and potential interest savings, mitigated partly the narrowing of margins. While we continue to drive growth in consumer lending, we remain selective of the segments to achieve quality growth.

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*Directors' Report (continued)*

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**Business Strategy During the Year (continued)**

Our unit trust sales and bancassurance business continued to grow strongly aided by the liberalisation of foreign investment whereby several unit trust funds with foreign flavour were launched by the suppliers. We remain the leading independent unit trust agent among banks in the country.

Similarly, total facilities approved for corporate and commercial banking customers also saw significant growth despite keen competition. We made good progress in our strategy to grow liabilities by growing our non-borrowing customer base. Our global presence positions us well to take advantage of effective cross border co-ordination and collaboration for clients venturing offshore and large multinational companies, capitalising on Global Relationship Management and Cash Management services.

The removal of the ringgit peg in July 2005 resulted in increased volatility and business opportunities in the spot and forward USD/MYR. Trading flows for spot and forward improved substantially, coupled with significant profitability contribution from the corporate client base.

The Debt Finance team, in active collaboration with Corporate and Institutional Banking, remained a leader in innovative debt and Islamic securities in Malaysia. The Bank acted as Joint Principal Adviser and Joint Lead Manager for the world's first rated Islamic residential mortgage-backed securities for Cagamas MBS Berhad's RM2.05 billion offering in July 2005. This deal was awarded the Best Domestic Securitisation, Best Islamic Finance Deal and Best Malaysia Deal by FinanceAsia. Since the release of Guidelines on Real Estate Investment Trust (REIT) in January 2005, HSBC has completed the largest REIT in Malaysia for the YTL Group.

We had also lead arranged the largest debt programme for the water industry with the successful completion of Syarikat Bekalan Air Selangor Sendirian Berhad's (SYABAS) RM3 billion Islamic Debt Programme. HSBC continued to be a leader in USD syndicated finance for Malaysian corporates, with the biggest deal for plantation companies in Malaysia i.e. Kumpulan Guthrie Berhad's USD480 million syndicated loan.

2005 was another exciting year for HSBC Amanah with the relaunching of Amanah Personal Financing-I, an unsecured personal installment loan product; the use of our Amanah Statement Savings Account-I as the default option for new customers and the promotion of Amanah General Investment Account to retail customers.

We continued to develop our call-centre and Internet services with continued growth in the take-up of Internet banking. In online banking, we are the first bank in Malaysia to implement a two-factor authentication mechanism using the One Time Password 'OTP' security device to provide online protection from various threats, investing about RM3 million in the device and support system.

We also expanded the range of payment options available to customers with the launch on September 26, 2005 of the link up with the Malaysian Electronic Payment System (MEPS) to provide customers with access to the interbank GIRO (IBG) and financial process exchange (FPX) services.

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*Directors' Report (continued)*

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**Business Strategy During the Year (continued)**

The Bank became an Executive Board member of the Roundtable on Sustainable Palm Oil (RSPO), a palm oil alliance pact whose members cover the entire spectrum of the industry, from oil palm growers to consumer goods manufacturers, processors and traders, retailers, manufacturers, banks and non-governmental organisations, and co-funded RSPO's development work.

We increased our involvement in our CSR educational and environmental projects and launched 'HSBC in the Arts', a platform to provide the Malaysian arts industry with much needed funding.

**Outlook For 2006**

The general world economic growth is expected to remain resilient at 4.3% in 2006, with further expansion in economic activities led by China and the United States (US) amidst higher oil prices and tighter monetary policy. On the home front, Malaysia's domestic economy has displayed excellent resilience this year and is expected to grow 5% for 2005 and 2006 is forecast to expand by 5.5%.

The outlook for 2006 is expected to be mixed and is likely to depend crucially on how exports behave, mainly driven by China and the US growth. Corporate balance sheets are healthy, but that is not translating into higher fixed investments largely due to the presence of spare capacity. The Government continues to consolidate on the fiscal side. Despite the rise in the overnight policy rate (OPR) to 3.00% on November 30, 2005, monetary policy remains accommodative given the current ample liquidity and availability of credit facilities at reasonable rates, and therefore should not impact future growth prospects of the country.

In this scenario, we believe HSBC's business continues to be placed exceptionally well to take advantage of any potential opportunities arising from further growth in the economy. On the banking front, the market is changing swiftly and competition will continue to get tougher. HSBC's focus will be on its key businesses - corporate and commercial banking and personal financial services, namely mortgage products, credit cards, unit trusts and bancassurance. The opening of four additional branches will provide a further platform for growth. Small and medium-scale enterprises (SMEs) are a very important focus for us and we will invest more in this area.

Having started our on-shore private banking last year, wealth management is also a key which we will take to the next level as the local market liberalises and more investment products will be offered to our high net worth customers.

At the same time, we will build on our Islamic banking capabilities where we are a global leader, locally having achieved approximately 14% of our book to be Islamic, in line with the Government's accelerated efforts to establish Malaysia as an Islamic financial hub with the granting of full-fledged Islamic banking and takaful licences. More products are due to be launched in 2006 to ensure that HSBC Amanah provides a total financial solution to the customers.

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*Directors' Report (continued)*

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**Outlook For 2006 (continued)**

The progressive liberalisation by the regulators is encouraging more dynamism in the risk management area as well as investment abroad. We aim to deliver sophistication to the local market by bringing onshore more investment alternatives that are of international standards. We will move towards introducing innovative hedging ideas and new products that capture value from market trends.

Malaysia is a key market for the HSBC Group and will continue to play an important role as we continue to invest in our people, technology, product innovation and branding.

**Directors and Their Interests in Shares**

The names of the directors of the Bank in office since the date of the last report and at the date of this report are:

Michael Roger Pearson Smith  
Zarir Jal Cama  
John Edward Coverdale (resigned with effect from 1/7/2005)  
Ian Douglas Francis Ogilvie (appointed with effect from 1/7/2005)  
Douglas Jardine Flint  
Dato' Sulaiman bin Sujak  
Dato' Henry Sackville Barlow  
Datuk Ramli bin Ibrahim  
Datuk Dr Zainal Aznam bin Mohd Yusof  
Professor Emeritus Dr Mohamed Ariff bin Abdul Kareem  
Dato' Zuraidah binti Atan

In accordance with the Articles of Association, Dato' Henry Sackville Barlow and Professor Emeritus Dr Mohamed Ariff bin Abdul Kareem retire from the Board at the Annual General Meeting and, being eligible, offer themselves for re-election.

In accordance with Article 84 of the Articles of Association, Mr. Ian Douglas Francis Ogilvie who was appointed since the last Annual General Meeting now retires and, being eligible, offers himself for re-election.

In accordance with Section 129(2) of the Companies Act, 1965, Dato' Sulaiman bin Sujak being over seventy years (70) of age, retires at the Annual General Meeting, and being eligible, offers himself for reappointment in accordance with Section 129(6) of the Companies Act, 1965.

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*Directors' Report (continued)*

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**Directors and Their Interests in Shares (continued)**

According to the register of directors' shareholdings maintained by the Bank in accordance with Section 134 of the Companies Act, 1965, the directors holding office at year end who have beneficial interests in the shares of related corporations are as follows:

Name	Balance at 1.1.2005 (or at date of appointment)	Number of Shares		Balance at 31.12.2005
		Bought	(Sold)	
<b>HSBC Holdings plc</b>				
<b>Ordinary shares of USD0.50</b>				
Michael Roger Pearson Smith	39,392	47,481 (A)	-	86,873
Zarir Jal Cama	206,220	26,575 (B)	(33,724)	199,071
Ian Douglas Francis Ogilvie	2,356	1,155 (C)	-	3,511
Douglas Jardine Flint	81,271	2,426 (D)	(1,998)	81,699
Dato' Sulaiman bin Sujak	43,094	1,245 (E)	-	44,339
Dato' Henry Sackville Barlow	990,000 *	-	-	990,000 *

(A) Shares were acquired through exercise of rights over options, scrip dividends and share plan awards vested.

(B) Shares were acquired through purchases, scrip dividends and share plan awards vested.

(C) Shares were acquired through exercise of rights over options and scrip dividends.

(D) Shares were acquired through reinvestment of dividend/tax credit/scrip dividend and scrip dividends.

(E) Shares were acquired through scrip dividends.

\* Indirect interest held through Majedie Investments plc

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*Directors' Report (continued)*

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**Directors and Their Interests in Shares (continued)**

Name	Number of Shares				
	Awards held at 1.1.2005 (or at date of appointment)	Awards made during year *	Awards forfeited during the year	(Awards vested during the year)	Awards held at 31.12.2005
<b>HSBC Holdings plc</b>					
<b>Restricted Share Plan/ HSBC Share Plan</b>					
Michael Roger Pearson Smith	228,248	91,321	-	(41,531)	278,038
Zarir Jal Cama	114,045	47,303	-	(17,453)	143,895
Ian Douglas Francis Ogilvie	57,192	992	-	-	58,184
Douglas Jardine Flint	427,974	194,833	-	(38,503)	584,304
Dato' Sulaiman bin Sujak	6,118	-	-	-	6,118

*\* Includes scrip dividends*

Name	Number of Shares				Balance at 31.12.2005
	Balance at 1.1.2005 (or at date of appointment)	Granted	(Exercised)	(Lapsed)	
<b>Options over HSBC Holdings plc Shares</b>					
Michael Roger Pearson Smith	73,298	-	(2,798)	-	70,500
Zarir Jal Cama	1,766	-	-	-	1,766
Ian Douglas Francis Ogilvie	42,102	989	(1,119)	-	41,972
Douglas Jardine Flint	2,617	-	-	-	2,617

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*Directors' Report (continued)*

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**Directors' Benefits**

Since the end of the previous financial year, no Director of the Bank has received or become entitled to receive any benefit (other than a benefit included in the aggregate amount of emoluments received or due and receivable by Directors shown in the financial statements or the fixed salary of a full-time employee of the Bank or of a related company) by reason of a contract made by the Bank or a related corporation with the Director or with a firm of which the Director is a member, or with a company in which the Director has a substantial financial interest.

Neither at the end of the financial year, nor at any time during that year, did there subsist any arrangements to which the Bank is a party whereby Directors might acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate, except for:

- i Directors who were granted the option to subscribe for shares in the ultimate holding company, HSBC Holdings plc, under Executive/Savings-Related Share Option Schemes at prices and terms as determined by the schemes, and
- ii Directors who were conditionally awarded shares of the ultimate holding company, HSBC Holdings plc, under its Restricted Share Plan.

**Ultimate Holding Company**

The Directors regard HSBC Holdings BV, a company incorporated in the Netherlands, and HSBC Holdings plc, a company incorporated in England, as the immediate and ultimate holding companies of the Bank, respectively.

**Auditors**

The auditors, Messrs KPMG, have indicated their willingness to accept re-appointment.

Signed in accordance with a resolution of the directors:

.....Director  
**ZARIR JAL CAMA**

.....Director  
**IAN DOUGLAS FRANCIS OGILVIE**

Kuala Lumpur, Malaysia  
9 February 2006

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**DIRECTORS' STATEMENT**

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In the opinion of the directors:

We, Zarir Jal Cama and Ian Douglas Francis Ogilvie, being two of the directors of HSBC Bank Malaysia Berhad, do hereby state on behalf of the directors that, in our opinion, the financial statements set out on pages 34 to 92 are drawn up in accordance with applicable approved accounting standards in Malaysia as modified by Bank Negara Malaysia's guidelines so as to give a true and fair view of the state of affairs of the Bank and of the group as at 31 December 2005 and of the results and cash flows of the Bank and of the group for the year ended on that date.

Signed at Kuala Lumpur, Malaysia this 9th February 2006.

In accordance with a resolution of the directors:

.....Director  
**ZARIR JAL CAMA**

.....Director  
**IAN DOUGLAS FRANCIS OGILVIE**



**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**STATUTORY DECLARATION**

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I, Baldev Singh s/o Gurdial Singh, being the officer primarily responsible for the financial management of HSBC Bank Malaysia Berhad, do solemnly and sincerely declare that, to the best of my knowledge and belief, the financial statements set out on pages 34 to 92 are correct, and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared by the abovenamed

BALDEV SINGH s/o GURDIAL SINGH at KUALA LUMPUR

in WILAYAH PERSEKUTUAN, MALAYSIA this 9th day of February 2006.

.....

BEFORE ME:

.....

Signature of Commissioner for Oaths

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**REPORT OF THE AUDITORS**  
**TO THE MEMBERS OF HSBC BANK MALAYSIA BERHAD**

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We have audited the financial statements set out on pages 34 to 92. The preparation of the financial statements is the responsibility of the HSBC Bank Malaysia Berhad's directors.

It is our responsibility to form an independent opinion, based on our audit, on the financial statements and to report our opinion to you, as a body, in accordance with Section 174 of the Companies Act, 1965 and for no other purpose. We do not assume responsibility to any other person for the content of this report.

We conducted our audit in accordance with approved Standards on Auditing in Malaysia. These standards require that we plan and perform the audit to obtain all the information and explanations which we consider necessary to provide us with evidence to give reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. An audit also includes an assessment of the accounting principles used and significant estimates made by the directors as well as evaluating the overall adequacy of the presentation of information in the financial statements. We believe our audit provides a reasonable basis for our opinion.

In our opinion:

- (a) the financial statements are properly drawn up in accordance with the provisions of the Companies Act, 1965 and applicable approved accounting standards in Malaysia as modified by Bank Negara Malaysia's guidelines so as to give a true and fair view of:
  - i) the state of affairs of the Bank and of the group at 31 December 2005 and the results of their operations and cash flows for the year ended on that date; and
  - ii) the matters required by Section 169 of the Companies Act, 1965 to be dealt with in the financial statements of the Bank and the group;

and

- (b) the accounting and other records and the registers required by the Companies Act, 1965 to be kept by the Bank and its subsidiaries have been properly kept in accordance with the provisions of the said Act.

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

*Report of the Auditors (continued)*

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We are satisfied that the financial statements of the subsidiary companies that have been consolidated with the Bank's financial statements are in form and content appropriate and proper for the purposes of the preparation of the consolidated financial statements and we have received satisfactory information and explanations required by us for those purposes.

Our audit reports on the financial statements of the subsidiary companies were not subject to any qualification and did not include any comment made under Sub-section (3) of Section 174 of the Act.

**KPMG**  
Firm Number: AF 0758  
Chartered Accountants

**AMPALAVANAR S/O SEGARAJAH**  
Partner  
Approval Number: 1293/10/06(J)

Kuala Lumpur, Malaysia  
9 February 2006

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**BALANCE SHEET AS AT 31 DECEMBER 2005**

	<i>Note</i>	<i>Group</i>		<i>Bank</i>	
		<b>2005</b>	2004	<b>2005</b>	2004
		<b>RM'000</b>	RM'000	<b>RM'000</b>	RM'000
<b>Assets</b>					
Cash and short term funds	2	<b>7,710,602</b>	5,767,418	<b>7,710,602</b>	5,767,418
Securities purchased under resale agreements		<b>1,449,760</b>	1,661,681	<b>1,449,760</b>	1,661,681
Deposits and placements with banks and other financial institutions	3	<b>479,942</b>	106,179	<b>479,942</b>	106,179
Securities:					
- Held for trading	4	<b>703,727</b>	871,201	<b>703,727</b>	871,201
- Available-for-sale	5	<b>3,277,490</b>	4,809,856	<b>3,277,490</b>	4,809,856
Loans, advances and financing	6	<b>21,476,706</b>	18,963,791	<b>21,476,706</b>	18,963,791
Other assets	8	<b>376,829</b>	303,861	<b>376,829</b>	303,861
Statutory deposits with Bank Negara Malaysia	9	<b>698,948</b>	762,948	<b>698,948</b>	762,948
Investments in subsidiary companies	10	-	-	<b>21</b>	21
Property, plant and equipment	11	<b>310,144</b>	299,721	<b>310,144</b>	299,721
Deferred tax assets	12	<b>53,547</b>	54,045	<b>53,547</b>	54,045
Total Assets		<b>36,537,695</b>	33,600,701	<b>36,537,716</b>	33,600,722
<b>Liabilities</b>					
Deposits from customers	13	<b>28,317,351</b>	26,556,685	<b>28,317,372</b>	26,556,706
Deposits and placements of banks and other financial institutions	14	<b>1,954,799</b>	1,432,336	<b>1,954,799</b>	1,432,336
Obligations on securities sold under repurchase agreements		<b>1,617,617</b>	1,812,105	<b>1,617,617</b>	1,812,105
Bills and acceptances payable		<b>475,940</b>	332,902	<b>475,940</b>	332,902
Other liabilities	15	<b>917,761</b>	613,012	<b>917,761</b>	613,012
Recourse obligation on loans sold to Cagamas Berhad		<b>787,931</b>	630,188	<b>787,931</b>	630,188
Provision for taxation and zakat	16	<b>29,716</b>	59,306	<b>29,716</b>	59,306
Total liabilities		<b>34,101,115</b>	31,436,534	<b>34,101,136</b>	31,436,555
<b>Shareholders' Fund</b>					
Share capital	17	<b>114,500</b>	114,500	<b>114,500</b>	114,500
Reserves	18	<b>2,172,080</b>	1,949,667	<b>2,172,080</b>	1,949,667
Proposed dividend		<b>150,000</b>	100,000	<b>150,000</b>	100,000
Shareholders' funds		<b>2,436,580</b>	2,164,167	<b>2,436,580</b>	2,164,167
Total Liabilities and Shareholders' Funds		<b>36,537,695</b>	33,600,701	<b>36,537,716</b>	33,600,722
Commitments and Contingencies	29	<b>47,716,860</b>	48,896,046	<b>47,716,860</b>	48,896,046

*The financial statements were approved and authorised for issue by the Board of Directors on 9 February 2006.*

*The accompanying Notes form an integral part of the Financial Statements.*

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005**

	<i>Note</i>	<i>Group and Bank</i>	
		<b>2005</b>	2004
		<b>RM'000</b>	RM'000
Revenue		<b>2,235,580</b>	1,909,802
Interest income	19	<b>1,443,345</b>	1,287,296
Interest expense	20	<b>(636,281)</b>	(595,539)
Net interest income		<b>807,064</b>	691,757
Other operating income	21	<b>623,263</b>	518,612
Income from Islamic banking operations	38 (t)	<b>107,888</b>	76,621
Operating income		<b>1,538,215</b>	1,286,990
Other operating expenses	22	<b>(780,777)</b>	(676,499)
Profit before allowance		<b>757,438</b>	610,491
(Allowance for)/ Write back of losses on loans and financing	24	<b>(9,822)</b>	8,323
(Allowance)/ Write back of allowance for commitments and contingencies	15	<b>(460)</b>	8,364
Profit before taxation and zakat		<b>747,156</b>	627,178
Taxation and zakat	25	<b>(213,471)</b>	(161,249)
Profit attributable to shareholders		<b>533,685</b>	465,929
Earnings per RM0.50 share	26	<b>233.1 sen</b>	203.5 sen
Dividends per RM0.50 ordinary share (net)		<b>117.9 sen</b>	87.3 sen

*The accompanying Notes form an integral part of the Financial Statements.*

**HSBC BANK MALAYSIA BERHAD**  
(Company No. 127776-V)  
**AND ITS SUBSIDIARY COMPANIES**  
(Incorporated in Malaysia)

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2005**

Note	<i>Group and Bank</i>									
	← Non-distributable				→ Distributable					
	<i>Share capital</i>	<i>Share premium</i>	<i>Statutory reserve</i>	<i>Revaluation reserve</i>	<i>Capital redemption reserve</i>	<i>Available-for-sale reserve</i>	<i>Retained profits</i>	<i>Total reserves</i>	<i>Proposed dividend</i>	<i>Total</i>
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Balance as at 1 January 2004										
- as previously reported	114,500	741,375	114,500	110,264	190,000	-	423,359	1,579,498	200,000	1,893,998
- prior year adjustment	36	-	-	-	-	6,820	35,813	42,633	-	42,633
	114,500	741,375	114,500	110,264	190,000	6,820	459,172	1,622,131	200,000	1,936,631
Net profit for the year										
- as previously reported	-	-	-	-	-	-	473,277	473,277	-	473,277
- prior year adjustment	36	-	-	-	-	-	(7,348)	(7,348)	-	(7,348)
Net unrealised gains on revaluation	-	-	-	-	-	50,809	-	50,809	-	50,809
Transfer to retained profit on realisation of assets	-	-	-	(3,054)	-	-	3,054	-	-	-
Surplus on revaluation of properties	-	-	-	11,756	-	-	-	11,756	-	11,756
Net gains and losses not recognised in the income statement	-	-	-	8,702	-	50,809	3,054	62,565	-	62,565
Net gains reclassified to income statement	-	-	-	-	-	(958)	-	(958)	-	(958)
Dividend paid - 2003 final	-	-	-	-	-	-	-	-	(200,000)	(200,000)
Dividend paid - 2004 interim	-	-	-	-	-	-	(100,000)	(100,000)	-	(100,000)
Proposed dividend - 2004 final	-	-	-	-	-	-	(100,000)	(100,000)	100,000	-
Balance as at 31 December 2004	114,500	741,375	114,500	118,966	190,000	56,671	728,155	1,949,667	100,000	2,164,167
Balance as at 1 January 2005	114,500	741,375	114,500	118,966	190,000	56,671	728,155	1,949,667	100,000	2,164,167
Net profit for the year	-	-	-	-	-	-	533,685	533,685	-	533,685
Net gains and losses not recognised in the income statement										
- Net unrealised losses on revaluation	-	-	-	-	-	(23,635)	-	(23,635)	-	(23,635)
Net gains reclassified to income statement	-	-	-	-	-	(17,637)	-	(17,637)	-	(17,637)
Dividend paid - 2004 final	-	-	-	-	-	-	-	-	(100,000)	(100,000)
Dividend paid - 2005 interim	-	-	-	-	-	-	(120,000)	(120,000)	-	(120,000)
Proposed dividend - 2005 final	-	-	-	-	-	-	(150,000)	(150,000)	150,000	-
Balance as at 31 December 2005	114,500	741,375	114,500	118,966	190,000	15,399	991,840	2,172,080	150,000	2,436,580

The accompanying Notes form an integral part of the Financial Statements.

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005**

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
<b>Cash Flows from Operating Activities</b>		
Profit before taxation and zakat	747,156	627,178
Adjustments for :		
Property, plant and equipment written off	445	84
Depreciation of property, plant and equipment	30,922	31,499
Net (gain)/ loss on disposal of property, plant and equipment	(696)	473
Reversal of downward revaluation of property	-	(2,252)
Dividend income	(2,991)	(1,929)
Operating profit before changes in operating assets	<u>774,836</u>	<u>655,053</u>
(Increase) / Decrease in operating assets		
Securities purchased under resale agreements	211,921	(1,661,681)
Deposits and placements with banks and other financial institutions	(373,763)	144,421
Held for trading securities	167,474	581,866
Loans, advances and financing	(2,512,915)	(1,653,378)
Other assets	(72,968)	124,084
Statutory deposits with Bank Negara Malaysia	64,000	(248,100)
Increase / (Decrease) in operating liabilities		
Deposits from customers	1,760,666	3,690,949
Deposits and placements of banks and other financial institutions	522,463	23,996
Bills and acceptances payable	143,038	(73,773)
Obligations on securities sold under repurchase agreements	(194,488)	662,584
Other liabilities	304,749	(112,019)
Recourse obligation on loans sold to Cagamas Berhad	157,743	239,044
Net cash generated from operating activities before income tax	<u>952,756</u>	<u>2,373,046</u>
Taxes and zakat paid	(226,513)	(187,109)
Net cash generated from operating activities	<u>726,243</u>	<u>2,185,937</u>
<b>Cash Flows from Investing Activities</b>		
Purchase of property, plant and equipment	(43,055)	(24,790)
Proceeds from disposal of property, plant and equipment	1,961	6,138
Available-for-sale securities	1,475,044	(173,290)
Dividend received	2,991	1,929
Net cash generated from/ (used in) investing activities	<u>1,436,941</u>	<u>(190,013)</u>
<b>Cash Flows from Financing Activities</b>		
Dividends paid	(220,000)	(300,000)
Net cash used in financing activities	<u>(220,000)</u>	<u>(300,000)</u>
<b>Net increase in Cash and Cash Equivalents</b>	<b>1,943,184</b>	<b>1,695,924</b>
<b>Cash and Cash Equivalents at beginning of year</b>	<b>5,767,418</b>	<b>4,071,494</b>
<b>Cash and Cash Equivalents at end of year</b>	<b><u>7,710,602</u></b>	<b><u>5,767,418</u></b>
<b>Analysis of Cash and Cash Equivalents</b>		
Cash and short-term funds	<u>7,710,602</u>	<u>5,767,418</u>

*The accompanying Notes form an integral part of the Financial Statements.*

**HSBC BANK MALAYSIA BERHAD**  
**(Company No. 127776-V)**  
**AND ITS SUBSIDIARY COMPANIES**  
**(Incorporated in Malaysia)**

**Notes to the Financial Statements as at 31 December 2005**

**1 Summary of Significant Accounting Policies**

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The following accounting policies are adopted by the Bank and the group and are consistent with those adopted in previous years except for the adoption of the Revised Guidelines on Financial Reporting for Licensed Institutions (BNM/GP8) issued by Bank Negara Malaysia which became effective for the current financial year.

In addition to the new policies and extended disclosures required by the revised BNM/GP8, the effects of the changes in the accounting policies are disclosed in Note 36 of these financial statements.

**(a) Basis of Preparation of the Financial Statements**

The financial statements of the Bank have been prepared under the historical cost basis unless otherwise indicated; and in accordance with the provisions of the Companies Act, 1965 and applicable approved accounting standards in Malaysia as modified by Bank Negara Malaysia's guidelines.

The financial statements incorporate those activities relating to Islamic Banking which have been undertaken by the Bank. Islamic Banking refers generally to the acceptance of deposits and granting of financing under the Shariah principles.

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**(b) Basis of Consolidation**

The group financial statements include the financial statements of the Bank and its subsidiary companies.

The results of subsidiary companies acquired or incorporated during the financial year are included in the group income statement from the dates of acquisition or incorporation.

All significant intercompany transactions and balances have been eliminated on consolidation.

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**(c) Revenue**

Revenue comprises gross interest income, fee income, investment income and other income derived from banking operations.

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## **1 Summary of Significant Accounting Policies (continued)**

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### ***(d) Recognition of Interest and Expense / Islamic Financing Income and Expense***

Interest income and expense for all interest-bearing financial instruments except those classified as held-for-trading are recognised in 'interest income' and 'interest expense' in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability, or where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Where an amount is classified as non-performing, interest accrued and recognised as income prior to the date the loan is classified as non-performing shall be reversed out of income by debiting the interest income in the income statement and crediting the accrued interest receivable account in the balance sheet. Subsequently, interest earned on non-performing loans shall be recognised as income on a cash basis. Customers' accounts are classified as non-performing where repayments are in arrears for more than three months for all loans, advances and financing.

Income from Islamic banking operations and attributable profits on deposits and borrowings on activities relating to Islamic banking operations are recognised on an accrual basis in accordance with the principles of Shariah.

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### ***(e) Recognition of Fees and Other Income***

The Bank earns fee income from a diverse range of services it provides to its customers. Fee income is accounted for as follows:

- if the income is earned on the execution of a significant act, it is recognised as revenue when the significant act has been completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of shares or other securities);
- if the income is earned as services are provided, it is recognised as revenue as the services are provided (for example, portfolio and other management advisory and service fee); and
- if the income is an integral part of the effective interest rate of a financial instrument, it is recognised as an adjustment to the effective interest rate (for example, loan commitment fees) and recorded in 'interest income' (see Note 1 (d)).

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

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## **1 Summary of Significant Accounting Policies (continued)**

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### **(f) Cash and Cash Equivalents**

For the purpose of the cash flow statement, cash and cash equivalents comprise cash and bank balances, and short term deposits and placements maturing within one month that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

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### **(g) Resale and Repurchase Agreements**

Securities purchased under resale agreements are securities which the Bank had purchased with a commitment to resell at future date. The commitment to resell the securities is reflected as an asset on the balance sheet.

Conversely, obligation on securities sold under repurchase agreements are securities which the Bank had sold from its portfolio, with a commitment to repurchase at future dates. Such financing transactions and the obligation to repurchase the securities are reflected as a liability on the balance sheet.

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### **(h) Securities**

The holdings of securities portfolio of the Bank are classified based on the following categories and valuation methods:

#### **i Held for trading**

Securities are classified as held for trading if acquired principally for the purpose of selling or repurchasing it in the near term or are part of a portfolio of identified securities that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Securities classified as held for trading are stated at fair value and any gains or losses from a change in the fair value, together with related interest income, are recognised within 'Other operating income' in the income statement.

#### **ii Held-to-maturity**

Held-to-maturity investments are securities with fixed or determinable payments and fixed maturities that the Bank has the positive intention and ability to hold until maturity. These investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

## **1 Summary of Significant Accounting Policies (continued)**

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### **(h) Securities (continued)**

#### **iii Available-for-sale**

Available-for-sale securities are securities that are not classified as held for trading or held-to-maturity investments; and measured at fair value. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost. Changes in the fair value are recognised directly in equity, net of applicable taxes, until the securities are either sold or impaired. On the sale of available-for-sale securities, cumulative gains or losses previously recognised in equity are recognised through income statement. Interest income is recognised on such securities using the effective interest method, calculated over the asset's expected life. Where dated available-for-sale securities have been purchased at a premium or discount, these premiums and discounts are included in the calculation of the effective interest rate. Dividends on available-for-sale equity instruments are recognised in the income statement when the right to receive payment is established.

An assessment is made at each balance sheet date as to whether there is any objective evidence of impairment, being circumstances where an adverse impact on estimated future cash flows of the securities or group of securities can be reliably measured.

If an available-for-sale security is determined to be impaired, the cumulative loss that had been recognised directly in equity shall be removed from equity and recognised in the income statement. The amount of cumulative loss is measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that security previously recognised in the income statement. If, in 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 income statement, that portion of impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

For loans converted into debt or equity instruments classified as available-for-sale, these instruments are measured at fair value. The difference between the net book value of the restructured loans (outstanding amount of loans net of specific allowance) and the fair value of the debt or equity instruments will be gain or loss from the conversion scheme.

- Where the net book value of the restructured loans is higher than the fair value of the debt or equity instruments, the loss shall be recognised in income statement in the current reporting period.
- Where the fair value of the debt or equity instruments is higher than the net book value of the restructured loans, the gain from the conversion exercise is transferred to the "impairment loss" account, which would be netted off from the "Securities" account in the balance sheet.

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### **(i) Loans, Advances and Financing**

Loans, advances and financing include loans and advances originated from the Bank, which are not intended to be sold in the short term and have not been classified as held for trading. Loans, advances and financing are recognised when cash is advanced to borrowers. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses.

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## **1 Summary of Significant Accounting Policies (continued)**

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### ***(j) Allowance for Losses on Loans and Financing/ Loan Impairment***

The Bank's allowance for non-performing loans and financing is in conformity with the requirements of Bank Negara Malaysia's "Guidelines on the Suspension of Interest on Non-Performing Loans and Provision for Bad and Doubtful Debts, BNM/GP3". Accounts are classified as non-performing when interest or principal is in arrears for more than ninety (90) days.

Specific allowances are made for doubtful debts and financing which have been individually reviewed and specifically identified as bad or doubtful.

A general allowance based on a percentage of the loan and financing portfolio is also made to cover possible losses which are not specifically identified.

Loans (and related allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

Impaired loans are measured at their estimated recoverable amount based on the discounted cash flow methodology. Specific allowances are provided if the recoverable amount (present value of estimated future cash flows discounted at original effective interest rate) is lower than the net book value of the loans (outstanding amount of loans, advances and financing, net of specific allowance). The expected cash flows are based on projections of liquidation proceeds, realisation of assets or estimates of future operating cash flows.

If, in a subsequent period, the amount of an 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 to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the income statement.

In addition, the Bank makes additional specific allowance as follows:

- i fifty per cent (50%) of the secured portion of non-performing loans which are in arrears for more than five (5) years but less than seven (7) years; and
- ii hundred per cent (100%) of the secured portion of non-performing loans which are in arrears for more than seven (7) years.

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### ***(k) Investment in Subsidiary Companies***

A subsidiary company is a company in which the Bank controls the composition of its board of directors or holds more than half of its voting power, or holds more than half of its issued ordinary share capital.

Investment in subsidiary companies are stated at cost, less impairment losses if any.

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## **1 Summary of Significant Accounting Policies (continued)**

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### **(l) Property, Plant and Equipment**

Property plant and equipment are stated at cost/valuation less accumulated depreciation and accumulated impairment losses except for freehold land which is stated at cost and directors' valuation.

#### **i Revaluation**

Land and buildings are revalued once every five years and at shorter intervals whenever the fair value of the revalued assets is expected to differ materially from their carrying value.

Surpluses arising from revaluation are dealt with in the property revaluation reserve account. Any deficit arising is offset against the revaluation reserve to the extent of a previous increase for the same property. In all other cases, a decrease in carrying amount is charged to the income statement.

#### **ii Depreciation**

Freehold land is not depreciated. Depreciation of other property, plant and equipment is calculated to write off the cost of the property, plant and equipment on a straight line basis over the expected useful lives of the assets concerned. The principal annual rates are:

Buildings on freehold land	2% per annum
Leasehold land with more than fifty (50) years to expiry and buildings thereon	2% per annum
Leasehold land with less than fifty (50) years to expiry and buildings thereon	Over the unexpired period of the lease
Office equipment, fixtures and fittings	10% and 20%
Computer equipment and software	20%
Motor vehicles	20%

With the exception of properties, additions to property, plant and equipment costing RM500 and under are fully depreciated in the year of purchase; for those assets costing more than RM500, depreciation is provided at the above rates.

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### **(m) Bills and Acceptances Payable**

Bills and acceptances payable represent the Bank's own bills and acceptances rediscounted and outstanding in the market.

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### **(n) Recourse Obligation on Loans Sold to Cagamas Berhad**

In the normal course of banking operations, the Bank sells loans to Cagamas Berhad. The Bank is liable in respect of the loans sold directly to Cagamas Berhad under the condition that the Bank undertakes to administer the loans on behalf of Cagamas Berhad and to buy back any loans which are regarded as defective based on prudence. Such financing transactions and the obligation to buy back the loans is reflected as a liability on the balance sheet.

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## **1 Summary of Significant Accounting Policies (continued)**

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### **(o) Taxation and Deferred Taxation**

Tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the 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 expense is the expected tax payable on the taxable income for the year, calculated using tax rates enacted or substantially enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Temporary differences are not recognised for the initial recognition of assets or liabilities that at the time of the transaction affects neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner or realisation of settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted by 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 relating to fair value re-measurement of available-for-sale investments, which is charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

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### **(p) Derivatives and Hedge Accounting**

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values are obtained from quoted market prices in active markets, or by using valuation techniques, including recent market transactions, where an active market does not exist. Valuation techniques include discounted cash flow models and option pricing models as appropriate. All derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement.

The accounting for changes (i.e. gains and losses) in the fair value of a derivative which qualifies for hedge accounting depends on the intended use of the derivative and the resulting designation as described below:

#### **i Fair value hedge**

For a derivative designated as hedging the exposures in the fair value of a recognised asset or liability or a firm commitment, the gain or loss is recognised in the income statement, together with the associated loss or gain on the hedged item attributable to the hedged risk.

#### **ii Cash flow hedge**

For a derivative designated as hedging the exposure to variable cash flows of a recognised asset or liability, or of a highly probable forecast transaction, the gain or loss on the derivative associated with the effective portion of the hedged is recognised in equity. Any gain or loss relating to an ineffective portion is recognised immediately in the income statement.

## **1 Summary of Significant Accounting Policies (continued)**

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### **(q) Currency Translations**

Individual foreign currency assets and liabilities are stated in the balance sheet at spot rates of exchange which closely approximate those ruling at the balance sheet date. Income statement items are translated at rates prevailing on transaction dates. Exchange gains and losses are recognised in the income statement in the year they arise.

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### **(r) Provisions**

A provision is recognised when it is probable that an outflow of resources embodying economic benefits will be required to settle a present legal or constructive obligation as a result of a past event and a reliable estimate can be made of the amount of the obligation.

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### **(s) Profit Equalisation Reserves ('PER')**

PER refers to the amount appropriated out of the total Islamic Banking gross income in order to maintain an acceptable level of return to depositors as stipulated by Bank Negara Malaysia's "The Framework of Rate of Return". PER is a provision shared by both the depositors and the Bank, and is deducted from the total gross income. Maximum monthly provision of PER is up to 15% of the gross income and can be accumulated up to a maximum of 30% of Islamic Banking Capital Funds.

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### **(t) Employee Benefits**

#### **i Short term employee benefits**

Wages, salaries, bonuses, paid annual and sick leave, social security contributions and non-monetary benefits are accrued in the period in which the associated services are rendered by the employees of the Bank.

#### **ii Post-employment benefits**

As required by law, the Bank makes contributions to the Employees Provident Fund ('EPF'), the national defined contribution plan and recognises such contributions as an expense in the income statement as incurred. Once the contributions have been paid, the Bank has no further payment obligations in future.

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## 2 Cash and Short Term Funds

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Cash and balances with banks and other financial institutions	414,406	395,506
Money at call and deposit placements maturing within one month	7,296,196	5,371,912
	<b>7,710,602</b>	<b>5,767,418</b>

## 3 Deposits and Placements with Banks and Other Financial Institutions

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Licensed banks	-	17,100
Licensed merchant banks	22,147	22,579
Bank Negara Malaysia	420,000	-
Other financial institutions	37,795	66,500
	<b>479,942</b>	<b>106,179</b>

## 4 Held For Trading Securities

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Money market instruments:		
Malaysian Government treasury bills	39,256	34,578
Bank Negara Malaysia bills	231,566	-
Bank Negara Malaysia Islamic bills	7,875	14,938
Malaysian Government securities	222,765	164,715
Negotiable instruments of deposit	-	365,066
Khazanah bonds	2,021	-
Cagamas bonds and notes	31,513	122,643
	<b>534,996</b>	<b>701,940</b>
Unquoted securities:		
Private debt securities (including commercial paper)	168,731	169,261
	<b>703,727</b>	<b>871,201</b>



## 5 Available-for-Sale Securities

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Money market instruments:		
Malaysian Government treasury bills	-	14,400
Bank Negara Malaysia bills	49,309	-
Bank Negara Malaysia Islamic bills	308,442	-
Malaysian Government securities	467,581	1,341,902
Malaysian Government Islamic bonds	21,811	245,783
Khazanah bonds	243,958	198,556
Cagamas bonds and notes	691,864	1,060,284
Negotiable instruments of deposit	554,847	438,485
Bankers' acceptance and Islamic accepted bills	143,326	470,678
	<b>2,481,138</b>	<b>3,770,088</b>
Quoted securities in Malaysia:		
Shares	29,519	55,413
Warrants	148	209
Loan stock	15,173	20,122
	<b>44,840</b>	<b>75,744</b>
Unquoted securities:		
Shares	17,392	37,526
Private and Islamic debt securities	754,322	947,661
	<b>771,714</b>	<b>985,187</b>
Impairment loss:		
Quoted securities in Malaysia:		
Shares	(11,291)	(12,252)
Warrants	(7)	(7)
Loan stock	(8,904)	(8,904)
	<b>(20,202)</b>	<b>(21,163)</b>
	<b>3,277,490</b>	<b>4,809,856</b>

The maturity structure of money market instruments held as available-for-sale securities is as follows

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Maturing within one year	1,452,480	2,229,196
One year to three years	952,869	1,209,362
Three years to five years	75,709	331,451
Over five years	80	79
	<b>2,481,138</b>	<b>3,770,088</b>

## 6 Loans, Advances and Financing

### (i) By type

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Overdrafts	2,236,412	1,733,322
Term loans/ financing		
Housing loans/ financing	7,267,122	7,485,443
Syndicated term loans/ financing	19,695	32,099
Hire purchase receivables	111,690	126,994
Lease receivables	49,740	62,845
Other term loans/ financing	5,515,035	4,193,675
Bills receivable	772,852	449,465
Trust receipts	180,166	639,016
Claims on customers under acceptance credits	3,109,050	2,440,514
Staff loans/ financing (of which loans to directors - Nil for 2005 and 2004)	307,157	301,017
Credit/ charge cards	1,616,357	1,202,785
Revolving credit	1,072,172	1,179,794
Other loans/ financing	10,722	8,193
Less: Unearned interest and income	(141,321)	(124,737)
	<b>22,126,849</b>	<b>19,730,425</b>
Less: Allowance for bad and doubtful debts and financing:		
- General	(327,200)	(289,300)
- Specific	(322,943)	(477,334)
Total net loans, advances and financing	<b>21,476,706</b>	<b>18,963,791</b>

### (ii) By type of customer

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Domestic non-bank financial institutions		
- Stockbroking companies	5,238	2,545
- Others	141,425	165,216
Domestic business enterprises		
- Small medium enterprises	2,655,201	2,416,355
- Others	7,584,366	6,808,053
Government and statutory bodies	64	82
Individuals	11,144,011	10,122,427
Other domestic entities	2,754	4,862
Foreign entities	593,790	210,885
	<b>22,126,849</b>	<b>19,730,425</b>

### (iii) By interest/ profit rate sensitivity

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Fixed rate		
Housing loans/ financing	328,417	326,339
Hire purchase receivables	102,190	116,371
Other fixed rate loans/ financing	3,711,654	2,348,061
Variable rate		
BLR plus	13,978,020	13,289,098
Cost-plus	1,073,903	1,179,793
Other variable rates	2,932,665	2,470,763
	<b>22,126,849</b>	<b>19,730,425</b>

## 6 Loans, Advances and Financing (continued)

### (iv) By sector

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Agricultural, hunting, forestry and fishing	893,313	823,888
Mining and quarrying	99,672	89,952
Manufacturing	3,739,427	3,441,364
Electricity, gas and water	81,383	128,603
Construction	428,685	457,594
Real estate	545,809	364,586
Purchase of landed property:		
- Residential	8,384,960	7,731,230
- Non-residential	970,920	791,009
Wholesale & retail trade and restaurants & hotels	2,164,107	1,899,937
Transport, storage and communication	190,842	125,731
Finance, insurance and business services	1,347,020	1,208,512
Purchase of securities	173,523	274,707
Purchase of transport vehicles	17,560	2,461
Consumption credit	2,894,133	2,249,058
Others	195,495	141,793
	<b>22,126,849</b>	<b>19,730,425</b>

### (v) By maturity structure

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Maturing within one year	9,843,898	8,487,274
One year to three years	1,596,418	1,436,272
Three years to five years	1,732,472	1,372,533
Over five years	8,954,061	8,434,346
	<b>22,126,849</b>	<b>19,730,425</b>

## 7 Non-Performing Loans/ Financing (NPL/ NPF)

### (i) Movements in non-performing loans, advances and financing

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
At beginning of year	1,055,888	1,170,239
Classified as non-performing during the year	314,067	507,930
Reclassified as performing	(199,467)	(121,081)
Loans/ financing converted to securities	-	(487)
Amount recovered	(275,478)	(353,267)
Amount written off	(207,031)	(147,446)
Other movements	647	-
At end of year	688,626	1,055,888
Specific allowance	(322,943)	(477,334)
Net non-performing loans, advances and financing	<b>365,683</b>	<b>578,554</b>
Ratio of net non-performing loans, advances and financing to net loans, advances and financing	1.7%	3.0%

## 7 Non-Performing Loans/ Financing (NPL/ NPF) (continued)

### (ii) Movements in allowance for bad and doubtful debts

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
<b>General allowance</b>		
At beginning of year	289,300	275,000
Allowance made during the year	37,900	14,300
At end of year	<b>327,200</b>	<b>289,300</b>
As % of gross loans, advances and financing less specific allowance	1.5%	1.5%
<b>Specific allowance</b>		
At beginning of year	477,334	576,236
Allowance made during the year	192,822	233,789
Transferred to accumulated impairment loss in value of securities	-	(487)
Amount recovered	(144,029)	(186,857)
Amount written off	(203,831)	(145,347)
Other movements	647	-
At end of year	<b>322,943</b>	<b>477,334</b>

### (iii) By sector

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Agricultural, hunting, forestry and fishing	2,202	2,153
Mining and quarrying	631	775
Manufacturing	185,029	370,082
Construction	31,718	57,149
Real estate	17,589	32,454
Purchase of landed property:		
- Residential	255,725	356,473
- Non-residential	23,088	32,784
Wholesale & retail trade and restaurants & hotels	53,291	61,237
Transport, storage and communication	4,628	2,875
Finance, insurance and business services	28,300	61,840
Purchase of securities	17,806	2,496
Purchase of transport vehicles	177	262
Consumption credit	65,210	61,580
Others	3,232	13,728
	<b>688,626</b>	<b>1,055,888</b>

## 8 Other Assets

	<i>Group and Bank</i>	
	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked to market	<b>203,871</b>	134,873
Interest/ income receivable	<b>34,082</b>	48,725
Other receivables, deposits and prepayments	<b>138,876</b>	120,263
	<b>376,829</b>	303,861

## 9 Statutory Deposits with Bank Negara Malaysia

The non-interest bearing statutory deposits are maintained with Bank Negara Malaysia in compliance with Section 37(1)(c) of the Central Bank of Malaysia Act, 1958 (revised 1994), the amounts of which are determined at set percentages of total eligible liabilities.

## 10 Investments in Subsidiary Companies

	<i>Bank</i>	
	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
Unquoted shares, at cost - in Malaysia	<b>21</b>	21

The subsidiary companies of the Bank are as follows:

<i>Name</i>	<i>Principal activities</i>	<i>Country of incorporation</i>	<i>Percentage of equity held</i>	
			<b>2005</b>	2004
HSBC (Kuala Lumpur) Nominees Sdn Bhd	Nominee company	Malaysia	<b>100%</b>	100%
HSBC Nominees (Tempatan) Sdn Bhd	Nominee company	Malaysia	<b>100%</b>	100%
HSBC Nominees (Asing) Sdn Bhd	Nominee company	Malaysia	<b>100%</b>	100%

All income and expenditure arising from the nominee activities of the subsidiary companies have been recognised in the Bank's results.

## 11 Property, Plant and Equipment

2005	Group and Bank									Total
	Freehold land	Short term leasehold land	Long term leasehold land	Building on freehold land	Building on short term leasehold land	Building on long term leasehold land	Office equipment, fixtures and fittings	Computer equipment and software	Motor vehicles	
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
<b>Cost or valuation</b>										
Balance as at 1 January 2005	76,500	8,261	14,204	126,911	6,139	9,810	130,015	148,138	8,058	528,036
Additions	-	-	-	782	-	-	15,277	24,680	2,316	43,055
Disposals	-	-	-	-	-	-	(1,510)	(1,011)	(2,281)	(4,802)
Written off	-	-	-	-	-	-	(7,855)	(6,804)	(59)	(14,718)
Balance as at 31 December 2005	76,500	8,261	14,204	127,693	6,139	9,810	135,927	165,003	8,034	551,571
Representing items at:										
Cost	-	-	-	782	-	-	135,927	165,003	8,034	309,746
Valuation - 2004	76,500	8,261	14,204	126,911	6,139	9,810	-	-	-	241,825
	76,500	8,261	14,204	127,693	6,139	9,810	135,927	165,003	8,034	551,571
<b>Accumulated depreciation</b>										
Balance as at 1 January 2005	-	-	-	-	-	-	110,149	115,262	2,904	228,315
Charge for the year	-	199	287	2,595	201	200	9,700	16,086	1,654	30,922
Disposals	-	-	-	-	-	-	(663)	(935)	(1,939)	(3,537)
Written off	-	-	-	-	-	-	(7,726)	(6,488)	(59)	(14,273)
Balance as at 31 December 2005	-	199	287	2,595	201	200	111,460	123,925	2,560	241,427
<b>Net book value at 31 December 2005</b>	<b>76,500</b>	<b>8,062</b>	<b>13,917</b>	<b>125,098</b>	<b>5,938</b>	<b>9,610</b>	<b>24,467</b>	<b>41,078</b>	<b>5,474</b>	<b>310,144</b>
Net book value at 31 December 2004	76,500	8,261	14,204	126,911	6,139	9,810	19,866	32,876	5,154	299,721
Depreciation charge for the year ended 31 December 2004	-	201	282	3,241	234	271	10,397	15,458	1,415	31,499
Had the land and building been carried at historical cost less accumulated depreciation, the carrying amount of the revalued assets that would have been included in the financial statements at the end of the year would be as follows:										
2005	18,003	318	2,597	74,417	4,912	7,633	-	-	-	107,880
2004	18,003	329	2,655	75,667	5,103	7,856	-	-	-	109,613

The land and buildings of the Bank were revalued by directors on the open market value basis as of 31 December 2004 based on professional valuations.

## 12 Deferred Tax

The amounts, determined after appropriate offsetting, are as follows:

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Deferred tax liabilities	(40,351)	(56,331)
Deferred tax assets	93,898	110,376
	<b>53,547</b>	<b>54,045</b>

Deferred tax liabilities and assets are offset above where there is a legally enforceable right to set off current tax assets against current tax liabilities.

The recognised deferred tax assets and liabilities (before offsetting) are as follows:

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Property, plant and equipment		
- capital allowances	(9,443)	(9,085)
- revaluation	(24,919)	(25,207)
Available-for-sale reserve	(5,989)	(22,039)
Allowances		
- general allowance	91,616	81,004
- others	1,074	1,183
Interest-in-suspense	-	26,514
Lease receivables	1,208	1,675
	<b>53,547</b>	<b>54,045</b>

## 13 Deposits from Customers

### (i) By type of deposit

	<i>Group</i>		<i>Bank</i>	
	2005	2004	2005	2004
	RM'000	RM'000	RM'000	RM'000
Demand deposits	5,689,273	6,178,442	5,689,294	6,178,463
Savings deposits	4,243,692	4,154,461	4,243,692	4,154,461
Fixed / Investment deposits	16,400,684	14,614,959	16,400,684	14,614,959
Negotiable instruments of deposit	1,702,320	1,443,697	1,702,320	1,443,697
Others	281,382	165,126	281,382	165,126
	<b>28,317,351</b>	<b>26,556,685</b>	<b>28,317,372</b>	<b>26,556,706</b>

The maturity structure of fixed / investment deposits and negotiable instruments of deposit is as follows:

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Due within six months	14,544,092	12,782,779
Six months to one year	3,135,727	3,080,490
One year to three years	248,841	28,944
Three years to five years	26,957	3,716
Over five years	147,387	162,727
	<b>18,103,004</b>	<b>16,058,656</b>

### 13 Deposits from Customers (continued)

#### (ii) By type of customer

	<i>Group</i>		<i>Bank</i>	
	2005 RM'000	2004 RM'000	2005 RM'000	2004 RM'000
Government and statutory bodies	15,780	3,288	15,780	3,288
Business enterprises	9,532,602	7,286,845	9,532,623	7,286,866
Individuals	14,185,641	13,776,773	14,185,641	13,776,773
Others	4,583,328	5,489,779	4,583,328	5,489,779
	<b>28,317,351</b>	<b>26,556,685</b>	<b>28,317,372</b>	<b>26,556,706</b>

### 14 Deposits and Placements of Banks and Other Financial Institutions

	<i>Group and Bank</i>	
	2005 RM'000	2004 RM'000
Licensed banks	120,000	-
Bank Negara Malaysia	38,247	15,533
Other financial institutions	1,796,552	1,416,803
	<b>1,954,799</b>	<b>1,432,336</b>

### 15 Other Liabilities

	<i>Group and Bank</i>	
	2005 RM'000	2004 RM'000
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked to market	183,219	124,435
Interest/ profit payable	144,243	127,346
Allowance for commitments and contingencies	3,030	2,793
Profit equalisation reserve	1,700	1,240
Other creditors and accruals	585,569	357,198
	<b>917,761</b>	<b>613,012</b>

Movement in allowance for commitments and contingencies is as follows:

	<i>Group and Bank</i>	
	2005 RM'000	2004 RM'000
At beginning of year	2,793	11,223
Allowance made during the year	1,075	269
Amount released	(615)	(8,633)
	460	(8,364)
Other movements	(223)	(66)
At end of year	<b>3,030</b>	<b>2,793</b>



## 16 Provision for Taxation and Zakat

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Taxation	29,667	59,306
Zakat	49	-
	<b>29,716</b>	<b>59,306</b>

## 17 Share Capital

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
<b>Authorised</b>		
Ordinary shares of RM0.50 each	500,000	500,000
Preference shares of RM0.50 each	500,000	500,000
	<b>1,000,000</b>	<b>1,000,000</b>
<b>Issued and Fully Paid</b>		
Ordinary shares of RM0.50 each	114,500	114,500

## 18 Reserves

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Share premium	741,375	741,375
Statutory reserve	114,500	114,500
Revaluation reserve	118,966	118,966
Capital redemption reserve	190,000	190,000
Available-for-sale reserve	15,399	56,671
Retained profits	991,840	728,155
	<b>2,172,080</b>	<b>1,949,667</b>

The statutory reserve is maintained in compliance with Section 36 of the Banking and Financial Institutions Act, 1989 and is not distributable as cash dividends.

The capital redemption reserve is maintained in compliance with Section 61 of the Companies Act, 1965 arising from the full redemption of RM190 million cumulative redeemable preference shares.

The Bank has sufficient tax credit under Section 108 of the Income Tax Act, 1967 to frank the payment of dividend out of all its retained profits.

## 19 Interest Income

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Loans and advances		
- Interest income other than recoveries from NPL	1,062,576	950,132
- Recoveries from NPLs	66,219	88,232
Money at call and deposit placement with financial institutions	208,391	142,756
Available-for-sale securities	119,577	131,438
	<b>1,456,763</b>	<b>1,312,558</b>
Amortisation of premium less accretion of discount	(1,829)	(13,166)
Interest suspended	(11,589)	(12,096)
Total interest income	<b>1,443,345</b>	<b>1,287,296</b>

## 20 Interest Expense

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Deposits and placements of banks and other financial institutions	36,925	22,370
Deposits from customers	517,936	498,025
Loans sold to Cagamas	29,730	23,882
Others	51,690	51,262
	<b>636,281</b>	<b>595,539</b>

## 21 Other Operating Income

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Fees and commissions	349,573	334,929
Net gains/ (losses) arising from sale of securities		
- Held for trading	15,733	14,040
- Available-for-sale	29,309	(21)
Net interest trading income	16,328	17,487
Net gains arising from dealing in foreign currency	181,692	126,549
Net gains arising from trading in derivatives	5,249	5,757
Dividend income from available-for-sale securities		
- Quoted in Malaysia	1,497	1,022
- Unquoted in Malaysia	1,494	907
Net unrealised gains/ (losses) on revaluation of trading securities (including derivatives)	7,409	(2,762)
Unrealised gains from foreign exchange translations	5,585	12,811
Rental income	6,147	5,834
Net gains/ (losses) on disposal of property, plant and equipment	696	(473)
Reversal of downward revaluation of property	-	2,252
Other operating income	2,551	280
	<b>623,263</b>	<b>518,612</b>

The above fees and commissions were derived from the following major contributors:

Cards	173,381	137,700
Trade facilities	44,031	49,595
Unit trust	26,277	22,230
Account services	23,119	29,455
Global custody	22,832	27,728
Credit facilities	18,567	25,442

## 22 Other Operating Expenses

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Personnel expenses	345,919	295,836
Promotion and marketing related expenses	81,741	78,091
Establishment related expenses	84,509	78,430
General administrative expenses	268,608	224,142
	<b>780,777</b>	<b>676,499</b>

The above expenditure includes the following major items / statutory disclosures:

Personnel expenses		
Salaries and bonuses	273,972	234,762
Employees Provident Fund contributions	40,617	34,762
Directors' remuneration (Note 23)	7,629	7,438
Promotion and marketing related expenses		
Advertising and promotion	46,700	42,837
Commercial sponsorships	6,748	5,901
Establishment related expenses		
Depreciation of property, plant and equipment	30,922	31,499
Information technology costs	19,388	18,639
Hire of equipment	8,679	4,845
Rental of premises	8,072	7,753
Property, plant and equipment written off	445	84
General administrative expenses		
Intercompany expenses	115,229	61,498
Fees and commissions paid	52,630	49,120
Auditors' remuneration	325	285

The number of employees of the Bank as at 31 December 2005 was 4,715 (31 December 2004: 4,009).

## 23 CEO and Directors' Remuneration

	<i>Group and Bank</i>	
	2005	2004
	RM'000	RM'000
Executive Directors and CEO		
Salary and other remuneration	4,464	4,392
Bonuses	1,266	1,525
Benefits-in-kind	1,573	1,192
	<b>7,303</b>	<b>7,109</b>
Non-Executive Directors		
Fees	315	318
Other remuneration	11	11
	<b>326</b>	<b>329</b>

### 23 CEO and Directors' Remuneration (continued)

The number of directors of the Bank whose remuneration including benefits-in-kind for the financial year falls into the following bands:

	<i>Number of Directors</i>	
	<b>2005</b>	2004
Executive Directors		
RM4,350,001 - RM4,400,000	-	1
RM4,200,001 - RM4,250,000	<b>1</b>	-
RM2,500,001 - RM2,550,000	-	1
RM2,050,001 - RM2,100,000	<b>1</b>	-
RM1,000,001 - RM1,050,000	<b>1</b>	-
RM250,001 - RM300,000	-	1
	<b>3</b>	<b>3</b>
Non-Executive Directors		
RM50,001 - RM100,000	<b>6</b>	4
RM50,000 and below	-	2
	<b>6</b>	<b>6</b>

### 24 Allowance for/ (Write Back of) Losses on Loans and Financing

	<i>Group and Bank</i>	
	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
Allowance for bad and doubtful debts on loans and financing		
(a) Specific allowance		
- Made in the financial year	<b>192,822</b>	233,789
- Written back	<b>(144,029)</b>	(186,857)
(b) General allowance		
- Made in the financial year	<b>37,900</b>	14,300
Bad debts on loans and financing		
- Recovered	<b>(82,924)</b>	(76,618)
- Written off	<b>6,053</b>	7,063
	<b>9,822</b>	<b>(8,323)</b>

## 25 Taxation and Zakat

	<i>Group and Bank</i>	
	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
Malaysian income tax	<b>227,000</b>	185,000
Deferred tax		
Origination and reversal of temporary differences	<b>(9,966)</b>	(7,020)
Over provision in respect of prior years	<b>(30,126)</b>	(16,731)
Reversal of deductible temporary differences in respect of prior years	<b>26,514</b>	-
	<b>213,422</b>	161,249
Zakat	<b>49</b>	-
	<b>213,471</b>	161,249

*A numerical reconciliation between tax expense and the product of accounting profit multiplied by the applicable tax rate is as follows:*

	<i>Group and Bank</i>	
	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
Profit before taxation	<b>747,156</b>	627,178
Income tax using Malaysian tax rates (28%)	<b>209,204</b>	175,610
Non-deductible expenses	<b>7,949</b>	2,443
Tax exempt income	<b>(119)</b>	(73)
Over provision in respect of prior years	<b>(30,126)</b>	(16,731)
Reversal of deductible temporary differences in respect of prior years	<b>26,514</b>	-
Tax expense	<b>213,422</b>	161,249

## 26 Earnings per Share

The earnings per ordinary share have been calculated based on the net profit and 229,000,000 (2004: 229,000,000) ordinary shares of RM0.50 each in issue during the year.

## 27 Significant Related Party Transactions and Balances

	2005		2004	
	<i>Parent companies</i> RM'000	<i>Other related companies</i> RM'000	<i>Parent companies</i> RM'000	<i>Other related companies</i> RM'000
<b>Income</b>				
Interest on intercompany placements	-	24,982	-	9,025
Interest on current accounts	-	7,185	-	1,702
Fees and commission	-	8,218	-	6,919
Other income	-	2,267	-	270
	-	42,652	-	17,916
<b>Expenditure</b>				
Interest on intercompany deposits	-	13,658	-	10,065
Interest on current accounts	-	20	-	14
Fees and commission	-	1,975	-	1,868
Operating expenses	6,513	108,716	7,676	53,822
	6,513	124,369	7,676	65,769
<b>Amount due from</b>				
Intercompany placements	-	742,698	-	1,858,684
Current account balances	-	165,697	-	181,901
Other assets	-	5,200	-	345
	-	913,595	-	2,040,930
<b>Amount due to</b>				
Intercompany deposits	-	518,738	-	364,232
Current account balances	-	121,721	-	117,946
Other liabilities	2,894	57,895	20,541	26,657
	2,894	698,354	20,541	508,835

## 28 Capital Adequacy

	<i>Bank</i>	
	2005 RM'000	2004 RM'000
<b>Tier 1 capital</b>		
Paid-up ordinary share capital	114,500	114,500
Share premium	741,375	741,375
Capital redemption reserve	190,000	190,000
Retained profit	1,141,840	828,155
Other reserves	114,500	114,500
	<u>2,302,215</u>	<u>1,988,530</u>
Less: Deferred tax adjustments	(85,583)	(102,131)
Total Tier 1 capital	<u>2,216,632</u>	<u>1,886,399</u>
<b>Tier 2 capital</b>		
Revaluation reserve	72,507	72,507
General allowance for bad and doubtful debts and financing	327,200	289,300
Total Tier 2 capital	<u>399,707</u>	<u>361,807</u>
Total capital	2,616,339	2,248,206
Less: Investment in subsidiaries	(21)	(21)
Holdings of other banking institutions' capital instruments	-	(20,134)
<b>Capital base</b>	<u>2,616,318</u>	<u>2,228,051</u>
Core capital ratio	9.9%	9.3%
Risk-weighted capital ratio	11.7%	11.0%
Core capital ratio (net of proposed dividend)	9.2%	8.8%
Risk-weighted capital ratio (net of proposed dividend)	11.0%	10.5%

Breakdown of gross risk-weighted assets in the various categories of risk-weights:

	<i>Bank</i>			
	2005		2004	
	Principal RM'000	Risk-weighted RM'000	Principal RM'000	Risk-weighted RM'000
0%	10,475,706	-	7,722,709	-
10%	399,528	39,953	1,148,902	114,890
20%	3,158,802	631,760	5,220,831	1,044,166
50%	7,715,056	3,857,528	6,736,695	3,368,348
100%	17,342,260	17,342,260	15,723,321	15,723,321
Total risk-weighted assets				
equivalent for market risk	-	553,272	-	-
	<u>39,091,352</u>	<u>22,424,773</u>	<u>36,552,458</u>	<u>20,250,725</u>

## 29 Commitments and Contingencies

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers. No material losses are anticipated as a result of these transactions.

The table below shows the contract or underlying principal amounts, credit equivalents amounts and risk weighted amounts of unmatured off-balance sheet transactions as at balance sheet date. The contract or underlying principal amounts indicate the volume of business outstanding and do not represent amount at risk.

	<i>Group and Bank</i>					
	2005			2004		
	Principal amount RM'000	Credit equivalent amount * RM'000	Risk weighted amount RM'000	Principal amount RM'000	Credit equivalent amount * RM'000	Risk weighted amount RM'000
Direct credit substitutes	610,872	610,872	571,773	394,407	394,407	353,049
Transaction-related contingent items	1,883,990	941,995	916,181	1,351,320	675,660	655,519
Short-term self-liquidating trade-related contingencies	259,019	51,804	46,555	275,510	55,102	49,653
Irrevocable commitments to extend credit:						
- Maturity not exceeding one year	15,131,142	-	-	10,428,332	-	-
- Maturity exceeding one year	1,298,798	649,399	649,399	2,112,154	1,056,077	1,056,077
Foreign exchange related contracts:						
- Less than one year	11,751,863	228,029	88,034	21,684,272	310,835	99,290
- One year to less than 5 years	1,818,966	137,126	54,254	942,497	69,698	15,835
- 5 years and above	-	-	-	30,000	3,293	1,646
Interest rate related contracts:						
- Less than one year	2,768,837	7,667	2,341	3,374,150	6,311	1,631
- One year to less than 5 years	11,166,070	289,349	124,080	7,314,346	217,870	71,203
- 5 years and above	976,309	60,427	28,417	943,900	54,044	16,746
Others	50,994	12,166	8,835	45,158	-	-
	<b>47,716,860</b>	<b>2,988,834</b>	<b>2,489,869</b>	<b>48,896,046</b>	<b>2,843,297</b>	<b>2,320,649</b>

\* The credit equivalent amount is arrived at using the credit conversion factors as per Bank Negara Malaysia guidelines.



**29 Commitments and Contingencies (continued)**

	<i>Group and Bank</i>			
	2005		2004	
	<b>Contracted amount RM'000</b>	<b>Fair value RM'000</b>	Contracted amount RM'000	Fair value RM'000
Foreign exchange related contracts				
- forward and future contracts	<b>11,526,475</b>	<b>13,158</b>	21,205,375	9,288
- options purchased	<b>431,202</b>	<b>17,834</b>	324,297	(383)
- options written	<b>428,368</b>	<b>(17,827)</b>	324,297	383
- swaps	<b>1,184,784</b>	<b>6,704</b>	802,800	3,069
Interest rate related contracts				
- forward and future contracts	<b>2,037,078</b>	<b>(895)</b>	3,179,600	(1,463)
- options	<b>2,334,158</b>	<b>(3,122)</b>	1,206,000	(8,798)
- swaps	<b>10,539,980</b>	<b>4,799</b>	7,246,796	5,910

**Credit risk**

Credit risk arises from the possibility that a counterparty may be unable to meet the terms of a contract in which the Bank has a gain position. As at 31 December 2005, the amount of credit risk, measured in terms of the cost to replace the profitable contracts, was RM203 million (As at 31 December 2004: RM135 million). This amount will increase or decrease over the life of the contracts, mainly as a function of maturity dates and market rates or prices.

### 30 Interest/ Profit Rate Risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing level of market interest rates on its financial position and cash flows. The following table summarises the Bank's exposure to interest rate risk. The assets and liabilities at carrying amount are allocated to time bands by reference to the earlier of the next contractual repricing dates and maturity dates.

Bank 2005	Non-trading book					Non-interest sensitive RM'000	Trading book RM'000	Effective interest rate %	
	Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years RM'000	Over 5 years RM'000				Total RM'000
<b>ASSETS</b>									
Cash and short term funds	7,364,991	-	-	-	-	345,611	-	7,710,602	3.20
Securities purchased under resale agreements	1,123,087	160,613	166,060	-	-	-	-	1,449,760	3.00
Deposits and placements with banks and other financial institutions	-	479,942	-	-	-	-	-	479,942	3.22
Securities:									
- Held for trading	-	-	-	-	-	-	703,727	703,727	3.57
- Available-for-sale	331,223	816,071	642,419	1,431,880	20,135	35,762	-	3,277,490	3.53
Loans, advances and financing									
- performing	16,368,497	1,642,167	514,933	1,177,644	760,572	647,210	-	21,111,023	6.02
- non-performing *	-	-	-	-	-	365,683	-	365,683	-
Others	-	-	-	-	-	1,208,056	231,433	1,439,489	-
<b>TOTAL ASSETS</b>	<b>25,187,798</b>	<b>3,098,793</b>	<b>1,323,412</b>	<b>2,609,524</b>	<b>780,707</b>	<b>2,602,322</b>	<b>935,160</b>	<b>36,537,716</b>	
<b>LIABILITIES AND SHAREHOLDERS' FUNDS</b>									
Deposits from customers	12,929,993	4,521,310	5,691,566	325,798	167,934	4,680,771	-	28,317,372	2.63
Deposits and placements of banks and other financial institutions	1,013,316	179,499	358,641	6,562	2,422	394,359	-	1,954,799	2.80
Obligation on securities sold under repurchase agreements	1,617,617	-	-	-	-	-	-	1,617,617	2.50
Bills and acceptances payable	40,079	88,972	7,269	-	-	339,620	-	475,940	2.71
Recourse obligation on loans sold to Cagamas Berhad	-	-	-	439,904	348,027	-	-	787,931	4.57
Others	-	-	-	-	-	637,403	310,074	947,477	-
<b>Total Liabilities</b>	<b>15,601,005</b>	<b>4,789,781</b>	<b>6,057,476</b>	<b>772,264</b>	<b>518,383</b>	<b>6,052,153</b>	<b>310,074</b>	<b>34,101,136</b>	
Shareholders' funds	-	-	-	-	-	2,436,580	-	2,436,580	-
<b>Total Liabilities and Shareholders' funds</b>	<b>15,601,005</b>	<b>4,789,781</b>	<b>6,057,476</b>	<b>772,264</b>	<b>518,383</b>	<b>8,488,733</b>	<b>310,074</b>	<b>36,537,716</b>	
On-balance sheet interest sensitivity gap	9,586,793	(1,690,988)	(4,734,064)	1,837,260	262,324	(5,886,411)	625,086	-	
Off-balance sheet interest sensitivity gap									
Interest rate contracts									
- futures	-	150,267	(228,267)	78,000	-	-	-	-	
- options	(243,130)	8,100	-	454,330	(219,300)	-	-	-	
- swaps	(715,538)	288,501	5,967	432,121	(9,800)	-	-	1,251	
<b>Total interest sensitivity gap</b>	<b>8,628,125</b>	<b>(1,244,120)</b>	<b>(4,956,364)</b>	<b>2,801,711</b>	<b>33,224</b>	<b>(5,886,411)</b>	<b>625,086</b>	<b>1,251</b>	

### 30 Interest/ Profit Rate Risk (continued)

Bank 2004	Non-trading book						Non-interest sensitive RM'000	Trading book RM'000	Effective interest rate %
	Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years RM'000	Over 5 years RM'000	<b>Total</b> RM'000			
<b>ASSETS</b>									
Cash and short term funds	5,476,492	-	-	-	-	290,926	-	5,767,418	2.58
Securities purchased under resale agreements	129,250	711,244	-	-	-	-	821,187	1,661,681	2.77
Deposits and placements with banks and other financial institutions	-	83,600	-	22,579	-	-	-	106,179	2.57
Securities:									
- Held for trading	-	-	-	-	-	-	871,201	871,201	3.21
- Available-for-sale	374,711	560,091	1,482,087	2,203,613	97,247	92,107	-	4,809,856	3.45
Loans, advances and financing									
- performing	14,802,812	1,202,265	505,813	810,691	605,832	457,824	-	18,385,237	5.49
- non-performing *	-	-	-	-	-	578,554	-	578,554	-
Others	-	-	-	-	-	1,278,323	142,273	1,420,596	-
<b>TOTAL ASSETS</b>	<b>20,783,265</b>	<b>2,557,200</b>	<b>1,987,900</b>	<b>3,036,883</b>	<b>703,079</b>	<b>2,697,734</b>	<b>1,834,661</b>	<b>33,600,722</b>	
<b>LIABILITIES AND SHAREHOLDERS' FUNDS</b>									
Deposits from customers	13,359,000	3,594,490	5,074,666	177,239	183,274	4,168,037	-	26,556,706	2.48
Deposits and placements of banks and other financial institutions	722,234	211,874	132,287	7,871	155	357,915	-	1,432,336	2.15
Obligation on securities sold under repurchase agreements	1,812,105	-	-	-	-	-	-	1,812,105	2.35
Bills and acceptances payable	54,394	67,584	7,360	-	-	203,564	-	332,902	2.72
Recourse obligation on loans sold to Cagamas Berhad	-	-	-	215,921	414,267	-	-	630,188	4.68
Others	-	-	-	-	-	547,883	124,435	672,318	-
<b>Total Liabilities</b>	<b>15,947,733</b>	<b>3,873,948</b>	<b>5,214,313</b>	<b>401,031</b>	<b>597,696</b>	<b>5,277,399</b>	<b>124,435</b>	<b>31,436,555</b>	
Shareholders' funds	-	-	-	-	-	2,164,167	-	2,164,167	-
<b>Total Liabilities and Shareholders' funds</b>	<b>15,947,733</b>	<b>3,873,948</b>	<b>5,214,313</b>	<b>401,031</b>	<b>597,696</b>	<b>7,441,566</b>	<b>124,435</b>	<b>33,600,722</b>	
On-balance sheet interest sensitivity gap	4,835,532	(1,316,748)	(3,226,413)	2,635,852	105,383	(4,743,832)	1,710,226	-	
Off-balance sheet interest sensitivity gap									
Interest rate contracts									
- futures	-	(201,200)	316,400	(115,200)	-	-	-	-	-
- options	(196,000)	(8,000)	110,000	94,000	-	-	-	-	-
- swaps	(136,950)	(383,848)	29,911	481,887	9,000	-	-	-	-
<b>Total interest sensitivity gap</b>	<b>4,502,582</b>	<b>(1,909,796)</b>	<b>(2,770,102)</b>	<b>3,096,539</b>	<b>114,383</b>	<b>(4,743,832)</b>	<b>1,710,226</b>	<b>-</b>	

\* This is arrived at after deducting specific allowance from non-performing loans.

### 31 Collateral

In the normal course of business, the Bank pledges assets to raise liabilities and accepts assets as collateral that are permitted for resale or repledge. Collateral pledged and received are mainly via repurchase agreements and reverse repurchase agreements.

	<i>Bank</i>	
	2005 RM'000	2004 RM'000
<b>Carrying amount of assets pledged as collateral</b>		
- Collateral pledged for repurchase agreements	<b>1,617,617</b>	1,812,105
<b>Fair value of assets accepted as collateral and collateral sold/ repledged</b>		
- Collateral accepted for reverse repurchase agreement	<b>1,517,383</b>	1,714,966
- Collateral sold	<b>123,955</b>	-

### 32 Fair Values of Financial Assets and Liabilities

The following table summarises the fair value of the financial assets and liabilities carried on the balance sheet as at 31 December.

	2005 Carrying amount RM'000	2005 Fair Value RM'000	2004 Carrying amount RM'000	2004 Fair Value RM'000
<b>Financial Assets</b>				
Cash and short term funds	<b>7,710,602</b>	<b>7,710,602</b>	5,767,418	5,767,418
Securities purchased under resale agreements	<b>1,449,760</b>	<b>1,449,760</b>	1,661,681	1,661,681
Deposits and placements with banks and other financial institutions	<b>479,942</b>	<b>479,942</b>	106,179	106,179
Securities:				
- Held for trading	<b>703,727</b>	<b>703,727</b>	871,201	871,201
- Available-for-sale	<b>3,277,490</b>	<b>3,297,692</b>	4,809,856	4,831,019
Loans, advances and financing	<b>21,476,706</b>	<b>21,443,719</b>	18,963,791	18,956,921
<b>Financial Liabilities</b>				
Deposits from customers	<b>28,317,372</b>	<b>28,311,164</b>	26,556,706	26,549,575
Deposits and placements of banks and other financial institutions	<b>1,954,799</b>	<b>1,954,786</b>	1,432,336	1,432,323
Obligations on securities sold under repurchase agreements	<b>1,617,617</b>	<b>1,617,617</b>	1,812,105	1,812,105
Bills and acceptances payable	<b>475,940</b>	<b>475,940</b>	332,902	332,902
Recourse obligation on loans sold to Cagamas Berhad	<b>787,931</b>	<b>801,336</b>	630,188	639,055

### **32 Fair Values of Financial Assets and Liabilities (continued)**

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The methods and assumptions used in estimating the fair values of financial instruments are as follows:

#### **Cash and short term funds**

#### **Securities purchased under resale agreements**

#### **Deposits and placements with banks and other financial institutions**

#### **Obligations on securities sold under repurchase agreements**

#### **Bills and acceptances payable**

The carrying amounts approximate fair value due to their relatively short-term nature.

#### **Securities**

Listed equity shares are valued at the quoted market price whilst unlisted equity shares are stated at cost. Fair values for other securities are estimated using market prices for these financial instruments. Where market prices are not available, fair values have been estimated using prices for financial instruments with similar characteristics, or otherwise using a suitable valuation technique where practicable to do so.

#### **Loans, advances and financing**

For personal and commercial loans and advances which mature or reprice after six months, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates). Performing loans are grouped to the extent possible, into homogenous pools segregated by maturity within each pool. In general, cash flows are discounted using current market rates for instruments with similar maturity, repricing and credit risk characteristics. For non-performing loans, the fair value is the carrying value of the loans, net of specific allowances. General allowances are deducted from the fair value of loans, advances and financing.

#### **Deposits from customers**

#### **Deposits and placements of banks and other financial institutions**

#### **Recourse obligation on loans sold to Cagamas Berhad**

Deposits, placements and obligations which mature or reprice after six months are grouped by residual maturity. Fair value is estimated using discounted cash flows, applying either market rates, where applicable, or current rates offered for deposits of similar remaining maturities.

#### **Unrecognised financial instruments**

The valuation of financial instruments not recognised in the balance sheet reflects their current market rates at the balance sheet date. The contracted amount and fair value of financial instruments not recognised in the balance sheet as at 31 December are disclosed in Note 29.

### 33 Lease Commitments

The Bank and the group have lease commitments in respect of rented premises and hired equipment, all of which are classified as operating leases. A summary of the non-cancellable long term commitments net of sub-leases are as follows:

<b>Year</b>	<i>Group and Bank</i>	
	<b>RM'000</b>	
Less than one year		<b>10,807</b>
Between one and five years		<b>17,205</b>
More than five years		<b>1,120</b>

### 34 Capital Commitments

	<i>Group and Bank</i>	
	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
Capital expenditure:		
- Authorised and contracted for	<b>9,037</b>	13,481
- Authorised but not contracted for	<b>4,002</b>	3,796
	<b>13,039</b>	<b>17,277</b>

### 35 Equity-based Compensation

The Bank participated in the following share compensation plans operated by the HSBC Group for the acquisition of HSBC Holdings plc shares.

#### a. Executive Share Option Scheme/Group Share Option Plan

The HSBC Holdings Group Share Option Plan, and previously the HSBC Holdings Executive Share Option Scheme, are discretionary share incentive plans under which HSBC employees, based on performance criteria and potential, are granted options to acquire HSBC Holdings ordinary shares. Options are granted at market value and subject to achievement of the performance condition, are normally exercisable between the third and tenth anniversary of the date of grant. No compensation cost is recognised.

Movements in the number of share options held by employees are as follows:

Year	2005		2004	
	Number (‘000)	Weighted average exercise price £	Number (‘000)	Weighted average exercise price £
Outstanding at 1 January	2,471	7.85	2,036	7.57
Granted in the year	-	-	690	8.28
Exercised in the year	(1,071)	7.87	(205)	7.14
Lapsed in the year	(522)	7.89	(50)	7.93
Outstanding at 31 December	<u>878</u>	<u>7.85</u>	<u>2,471</u>	<u>7.85</u>
Options vested at 31 December	<u>1,047</u>		<u>817</u>	

The Group Share Option Plan was terminated in 2005 and replaced by the Achievement Shares Award.

#### b. Savings-Related Share Option Schemes

The Savings-Related Share Option Schemes are all-employee share plans under which eligible HSBC employees are granted options to acquire HSBC Holdings ordinary shares. Employees may make monthly contributions up to £250 over a period of three or five years which may be used, on the third or fifth anniversary of the commencement of the relevant savings contract, to exercise the options; alternatively the employee may elect to have the savings (plus interest) repaid in cash. The options are exercisable within six months following the third or fifth anniversary of the commencement of the relevant savings contract. The exercise price is set at a discount of up to 20 per cent to the market value of the ordinary shares at the date of grant. No compensation cost is recognised.

Movements in the number of share options held by employees are as follows:

Year	2005		2004	
	Number (‘000)	Weighted average exercise price £	Number (‘000)	Weighted average exercise price £
Outstanding at 1 January	2,544	6.00	2,758	5.86
Granted in the year	553	6.68	323	6.47
Exercised in the year	(17)	5.93	(428)	5.55
Lapsed in the year	(1,284)	6.06	(96)	5.80
Transfers	(10)	6.08	(13)	5.67
Outstanding at 31 December	<u>1,786</u>	<u>6.19</u>	<u>2,544</u>	<u>6.00</u>
Options vested at 31 December	<u>12</u>		<u>383</u>	

### 35 Equity-based Compensation (continued)

#### c. Restricted Share Plan

The HSBC Holdings Restricted Share Plan is intended to align the interests of executives with those of shareholders by linking executive awards to the creation of superior shareholder value. This is achieved by focusing on predetermined targets. The cost of the conditional awards is recognised through an annual charge based on the likely level of vesting of shares, apportioned over the period of service to which the award relates.

Year	<b>2005</b> <b>Number</b> <b>('000)</b>	2004 Number (‘000)
Outstanding at 1 January	<b>184</b>	151
Additions during the year	<b>60</b>	67
Released in the year	<b>(27)</b>	(34)
Outstanding at 31 December	<u><b>217</b></u>	<u>184</u>
	<b>2005</b> <b>RM'000</b>	2004 RM'000
Compensation cost recognised during the year	<u><b>1,771</b></u>	<u>1,585</u>

The weighted average purchase price for all shares purchased by HSBC for awards under the Restricted Share Plan is £8.26 (2004: £8.21). The closing price of the HSBC share at 31 December 2005 was £9.33 (2004: £8.79). The weighted average remaining vesting period as at 31 December 2005 was 1.96 years (2004: 2.35 years).

#### d. Achievement Share Award

Achievement Share Award was introduced in 2005 to replace the Group Share Option Plan. HSBC Holdings ordinary shares are awarded to senior executives, without corporate performance conditions and will be released to the individual after three years, provided participants remain continuously employed within the HSBC Group. Additional awards are made during the three-year life of the award. These represent the equivalent value of dividends reinvested in shares. At the end of three years, the original Award together with the Additional Share Awards (added to the original award) will be released. The cost of the awards is recognised through an annual charge based on the cost of the shares purchased, apportioned over a period of three years to which the award relates.

Year	<b>2005</b> <b>Number</b> <b>('000)</b>
Outstanding at 1 January	-
Additions during the year	<b>88</b>
Released in the year	-
Outstanding at 31 December	<u><b>88</b></u>
	<b>2005</b> <b>RM'000</b>
Compensation cost recognised during the year	<u><b>1,336</b></u>

The weighted average purchase price for all shares purchased by HSBC for awards under the Achievement Shares Award is £8.43. The closing price of the HSBC share at 31 December 2005 was £9.33. The weighted average remaining vesting period as at 31 December 2005 was 2.17 years.



### **36 Change in Accounting Policies**

#### **Change in Accounting Policies**

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In the current financial year, the Bank adopted the revised Guidelines on Financial Reporting for Licensed Institutions (BNM/GP8) which has resulted in changes in accounting policies as disclosed in Note 2:

- (a) classification of securities into 'held for trading' and 'available-for-sale' categories (Note 2(h));
- (b) fair value of derivatives recognised in the income statement (Note 2(p));
- (c) application of effective interest methodology in calculating the amortised cost of financial instruments (Note 2 (d));
- (d) impaired loans being measured at their estimated recoverable amount based on discounted cash flow methodology (Note 2(j));
- (e) treatment on loan converted into debt or equity instruments (Note 2(h)(ii)); and
- (f) reversal of interest accrued and recognised as income prior to the date the loans are classified as non-performing (Note 2(d)).

The change in accounting policies due to the adoption of revised BNM/GP8 has been accounted for by restating comparatives and adjusting the opening balance of retained profit as at 1 January 2004 as disclosed in Note 37 and the Statement of Changes in Equity respectively.

#### **Prior Year Adjustments**

The changes in accounting policies as described above were applied retrospectively and have the following cumulative impact on the opening retained profit of the Bank:

	2004
	RM'000
At 31 December 2004, as previously stated	699,690
Effect of adopting fair value accounting for held-for-trading securities	2,081
Effect of adopting fair value accounting for available-for-sale securities	(3,057)
Effect of adopting fair value accounting for derivatives	(752)
Effect of adopting effective interest method on financial instruments	55,084
Effect of amortisation of credit card annual fees	<u>(12,502)</u>
	740,544
Additional provision for taxation	<u>(12,389)</u>
At 31 December 2004, as restated	<u>728,155</u>

### 37 Comparative Figures

The following comparatives have been restated to reflect the change in accounting policies as explained in Note 36.

	<i>Group</i>		<i>Bank</i>	
	As restated RM'000	As previously stated RM'000	As restated RM'000	As previously stated RM'000
<i>Balance Sheet</i>				
Dealing securities	-	869,119	-	869,119
Investment securities	-	4,733,868	-	4,733,868
Securities:				
- Held for trading	871,201	-	871,201	-
- Available-for-sale	4,809,856	-	4,809,856	-
Loans, advances and financing	18,963,791	18,908,629	18,963,791	18,908,629
Other assets	303,861	306,841	303,861	306,841
Deferred tax asset	54,045	79,473	54,045	79,473
Total assets	33,600,701	33,495,877	33,600,722	33,495,898
Deposits from customers	26,556,685	26,556,272	26,556,706	26,556,293
Other liabilities	613,012	602,737	613,012	602,737
Provision for taxation	59,306	50,306	59,306	50,306
Total liabilities	31,436,534	31,416,846	31,436,555	31,416,867
Reserves	1,949,667	1,864,531	1,949,667	1,864,531
Shareholders' funds	2,164,167	2,079,031	2,164,167	2,079,031
Total liabilities and shareholders' funds	33,600,701	33,495,877	33,600,722	33,495,898

	<i>Group and Bank</i>	
	As restated RM'000	As previously stated RM'000
<i>Income Statement</i>		
Revenue	1,909,802	1,917,159
Interest income	1,287,296	1,281,152
Interest expense	595,539	594,873
Net interest income	691,757	686,279
Other operating income	518,612	520,179
Income from Islamic banking operations	76,621	88,555
Operating income	1,286,990	1,295,013
Profit before allowance	610,491	618,514
Profit before taxation	627,178	635,201
Taxation	161,249	161,924
Profit attributable to shareholders	465,929	473,277
Earnings per RM0.50 share	203.5 sen	206.7 sen

### 38 Operations of Islamic Banking

#### Balance Sheet as at 31 December 2005 (29 Zulkaedah 1426)

		2005	2004
<b>Assets</b>	<i>Note</i>	<b>RM'000</b>	RM'000
Cash and short term funds	<i>(a)</i>	<b>1,157,855</b>	436,109
Deposits and placements with banks and other financial institutions	<i>(b)</i>	<b>90,000</b>	-
Available-for-sale securities	<i>(c)</i>	<b>1,026,595</b>	942,354
Financing, advances and other loans	<i>(d)</i>	<b>2,853,518</b>	1,778,087
Other assets	<i>(f)</i>	<b>13,666</b>	42,032
Statutory deposits with Bank Negara Malaysia		<b>98,500</b>	-
Equipment		<b>1,431</b>	1,665
Deferred tax asset	<i>(g)</i>	<b>13,737</b>	8,327
<b>Total Assets</b>		<b><u>5,255,302</u></b>	<b><u>3,208,574</u></b>
<b>Liabilities</b>			
Deposits from customers	<i>(h)</i>	<b>3,512,422</b>	2,014,358
Deposits and placements of banks and other financial institutions	<i>(i)</i>	<b>270,124</b>	44
Other liabilities	<i>(j)</i>	<b>946,987</b>	942,082
Provision for taxation and zakat	<i>(k)</i>	<b>20,680</b>	14,871
<b>Total liabilities</b>		<b><u>4,750,213</u></b>	<b><u>2,971,355</u></b>
<b>Islamic Banking Capital Funds</b>			
Funds allocated from Head Office		<b>430,000</b>	200,000
Reserves	<i>(l)</i>	<b>75,089</b>	37,219
<b>Islamic Banking Capital Funds</b>		<b><u>505,089</u></b>	<b><u>237,219</u></b>
<b>Total Liabilities and Islamic Banking Capital Funds</b>		<b><u>5,255,302</u></b>	<b><u>3,208,574</u></b>
Commitments and Contingencies	<i>(v)</i>	<b><u>241,408</u></b>	<b><u>262,286</u></b>

*The accompanying sub-notes form an integral part of the Financial Statements.*

### 38 Operations of Islamic Banking (continued)

#### Income Statement for the Year Ended 31 December 2005 (29 Zulkaedah 1426)

	<i>Note</i>	<b>2005</b> <b>RM'000</b>	2004 RM'000
Income derived from investment of depositors' funds and others	<i>(m)</i>	<b>138,540</b>	86,242
Allowance for losses on financing	<i>(n)</i>	<b>(19,193)</b>	(23,467)
Profit equalisation reserve	<i>(j)</i>	<b>(460)</b>	(1,240)
Total distributable income		<b>118,887</b>	61,535
Income attributable to depositors	<i>(o)</i>	<b>(86,415)</b>	(51,091)
Income attributable to the Bank		<b>32,472</b>	10,444
Income derived from investment of Islamic banking capital funds	<i>(p)</i>	<b>30,432</b>	17,652
Total net income		<b>62,904</b>	28,096
Other operating expenses	<i>(q)</i>	<b>(5,173)</b>	(5,213)
Profit before taxation and zakat		<b>57,731</b>	22,883
Taxation and zakat	<i>(s)</i>	<b>(16,555)</b>	(6,858)
Profit after taxation and zakat		<b>41,176</b>	16,025

*The accompanying sub-notes form an integral part of the Financial Statements.*

### 38 Operations of Islamic Banking (continued)

#### Statement of Changes in Equity for the Year Ended 31 December 2005 (29 Zulkaedah 1426)

	← Non-distributable →	Distributable			
	<i>Funds allocated from Head Office</i>	<i>Available- for-sale reserve</i>	<i>Retained profits</i>	<i>Total reserves</i>	<i>Total</i>
	<b>RM'000</b>	<b>RM'000</b>	<b>RM'000</b>	<b>RM'000</b>	<b>RM'000</b>
Balance as at 1 January 2004					
- as previously reported	200,000	-	10,818	10,818	210,818
- prior year adjustment	-	(6,762)	6,178	(584)	(584)
	<b>200,000</b>	<b>(6,762)</b>	<b>16,996</b>	<b>10,234</b>	<b>210,234</b>
Net profit for the year					
- as previously reported	-	-	24,676	24,676	24,676
- prior year adjustment	-	-	(8,651)	(8,651)	(8,651)
Net gains and losses not recognised in the income statement					
- Net unrealised gains on revaluation	-	10,960	-	10,960	10,960
Balance as at 31 December 2004	<b>200,000</b>	<b>4,198</b>	<b>33,021</b>	<b>37,219</b>	<b>237,219</b>
Balance as at 1 January 2005	200,000	4,198	33,021	37,219	237,219
Funds allocated	230,000	-	-	-	230,000
Net profit for the year	-	-	41,176	41,176	41,176
Net gains and losses not recognised in the income statement					
- Net unrealised gains on revaluation	-	(3,306)	-	(3,306)	(3,306)
Balance as at 31 December 2005	<b>430,000</b>	<b>892</b>	<b>74,197</b>	<b>75,089</b>	<b>505,089</b>

*The accompanying sub-notes form an integral part of the Financial Statements.*

### 38 Operations of Islamic Banking (continued)

#### Cash Flow Statement for the Year Ended 31 December 2005 (29 Zulkaedah 1426)

	2005 RM'000	2004 RM'000
<b>Cash Flows from Operating Activities</b>		
Profit before taxation and zakat	57,731	22,883
Adjustments for :		
Equipment written off	2	-
Depreciation of equipment	607	565
Net gain on disposal of equipment	-	(65)
Operating profit before changes in operating assets	<u>58,340</u>	<u>23,383</u>
(Increase) / Decrease in operating assets		
Deposits and placements with banks and other financial institutions	(90,000)	15,000
Financing, advances and other loans	(1,075,431)	(1,060,950)
Other assets	28,366	(25,413)
Statutory deposits with Bank Negara Malaysia	(98,500)	-
Increase / (Decrease) in operating liabilities		
Deposits from customers	1,498,064	1,329,848
Deposits and placements of banks and other financial institutions	270,080	(37,977)
Other liabilities	(9,966)	24,330
Net cash generated from operating activities	<u>580,953</u>	<u>268,221</u>
<b>Cash Flows from Investing Activities</b>		
Purchase of equipment	(375)	(819)
Transfer of equipment to Head Office	-	133
Proceeds from disposal of equipment	-	83
Available-for-sale securities	(88,832)	168,200
Net cash (used in)/ generated from investing activities	<u>(89,207)</u>	<u>167,597</u>
<b>Cash Flows from Financing Activities</b>		
Funds allocated from Head Office	230,000	-
Net cash generated from financing activities	<u>230,000</u>	<u>-</u>
<b>Net increase in Cash and Cash Equivalents</b>	<b>721,746</b>	<b>435,818</b>
<b>Cash and Cash Equivalents at beginning of year</b>	<b>436,109</b>	<b>291</b>
<b>Cash and Cash Equivalents at end of year</b>	<b><u>1,157,855</u></b>	<b><u>436,109</u></b>
<b>Analysis of Cash and Cash Equivalents</b>		
Cash and short-term funds	<u>1,157,855</u>	<u>436,109</u>

*The accompanying sub-notes form an integral part of the Financial Statements.*

### 38 Operations of Islamic Banking (continued)

#### (a) Cash and Short Term Funds

	2005	2004
	RM'000	RM'000
Cash and balances with banks and other financial institutions	855	809
Money at call and deposit placements maturing within one month	<u>1,157,000</u>	<u>435,300</u>
	<u>1,157,855</u>	<u>436,109</u>

#### (b) Deposits and Placements with Banks and Other Financial Institutions

	2005	2004
	RM'000	RM'000
Bank Negara Malaysia	<u>90,000</u>	<u>-</u>

#### (c) Available-for-Sale Securities

	2005	2004
	RM'000	RM'000
Money market instruments:		
Bank Negara Malaysia Islamic bills	308,442	-
Malaysian Government Islamic bonds	-	118,264
Negotiable Islamic instruments of deposit	4,988	1,445
Bankers' acceptances and Islamic accepted bills	<u>55,830</u>	<u>-</u>
	<u>369,260</u>	<u>119,709</u>
Unquoted securities:		
Islamic debt securities	<u>657,335</u>	<u>822,645</u>
	<u>1,026,595</u>	<u>942,354</u>

The maturity structure of money market instruments held as available-for-sale securities is as follows:

	2005	2004
	RM'000	RM'000
Maturing within one year	<u>369,260</u>	<u>119,709</u>

### 38 Operations of Islamic Banking (continued)

#### (d) Financing, Advances and Other Loans

(i) By type	2005 RM'000	2004 RM'000
Term financing		
House financing	113,141	107,051
Hire purchase receivables	110,885	125,501
Lease receivables	49,224	62,008
Other term financing	843,590	481,402
Claims on customers under acceptance credits	1,927,977	1,161,517
Credit /charge cards	1,409	3,159
Less: Unearned income	(141,321)	(124,737)
	<u>2,904,905</u>	<u>1,815,901</u>
Less: Allowance for bad and doubtful financing :		
- General	(43,770)	(27,509)
- Specific	(7,617)	(10,305)
Total net financing, advances and other loans	<u>2,853,518</u>	<u>1,778,087</u>

#### (ii) By contract

	2005 RM'000	2004 RM'000
Bai' Bithaman Ajil ( <i>deferred payment sale</i> )	521,209	444,040
Ijarah ( <i>operating lease</i> )	45,875	56,251
Ijarah Thumma Al-Bai ( <i>hire purchase / finance lease</i> )	101,385	115,384
Murabahah ( <i>cost-plus</i> )	1,346,043	844,270
Others	890,393	355,956
	<u>2,904,905</u>	<u>1,815,901</u>

#### (iii) By type of customer

	2005 RM'000	2004 RM'000
Domestic business enterprises		
- Small medium enterprises	1,535	3,088
- Others	2,527,761	1,684,400
Individuals	369,256	128,323
Foreign entities	6,353	90
	<u>2,904,905</u>	<u>1,815,901</u>



### 38 Operations of Islamic Banking (continued)

#### (d) Financing, Advances and Other Loans (continued)

##### (iv) By profit rate sensitivity

	2005 RM'000	2004 RM'000
Fixed rate		
House financing	89,747	83,447
Hire purchase receivables	101,386	115,384
Other financing	2,712,363	1,613,911
Variable rate		
Other financing	1,409	3,159
	<u>2,904,905</u>	<u>1,815,901</u>

##### (v) By sector

	2005 RM'000	2004 RM'000
Agriculture, hunting, forestry and fishing	288,150	305,232
Mining and quarrying	4,786	3,896
Manufacturing	1,382,641	748,919
Electricity, gas and water	6,031	1,469
Construction	80,901	49,055
Real estate	15,498	10,866
Purchase of landed property:		
- Residential	89,747	83,446
- Non-residential	7,788	4,526
Wholesale & retail trade and restaurants & hotels	545,386	463,835
Transport, storage and communication	41,779	31,036
Finance, insurance and business services	80,230	54,890
Consumption credit	283,966	43,574
Others	78,002	15,157
	<u>2,904,905</u>	<u>1,815,901</u>

##### (vi) By maturity structure

	2005 RM'000	2004 RM'000
Maturing within one year	1,965,726	1,183,182
One year to three years	196,852	176,377
Three years to five years	419,758	257,936
Over five years	322,569	198,406
	<u>2,904,905</u>	<u>1,815,901</u>

### 38 Operations of Islamic Banking (continued)

#### (e) Non-Performing Financing (NPF)

##### (i) Movements in non-performing financing, advances and other loans (including income receivables)

	2005 RM'000	2004 RM'000
At beginning of year	16,921	11,564
Classified as non-performing during the year	5,409	12,788
Reclassified as performing	(346)	-
Amount recovered	(2,520)	(3,842)
Amount written off	(6,659)	(3,589)
At end of year	<u>12,805</u>	<u>16,921</u>
Specific allowance	<u>(7,617)</u>	<u>(10,305)</u>
Net non-performing financing, advances and other loans	<u>5,188</u>	<u>6,616</u>
Ratio of net non-performing financing, advances and other loans to net financing, advances and other loans	<u>0.2%</u>	<u>0.4%</u>

##### (ii) Movements in allowance for bad and doubtful financing

	2005 RM'000	2004 RM'000
<b>General allowance</b>		
At beginning of year	27,509	10,921
Allowance made during the year	16,261	16,588
At end of year	<u>43,770</u>	<u>27,509</u>
As % of total financing less specific allowance	<u>1.5%</u>	<u>1.5%</u>

	2005 RM'000	2004 RM'000
<b>Specific allowance</b>		
At beginning of year	10,305	6,844
Allowance made during the year	4,870	8,699
Amount recovered	(936)	(1,558)
Amount written off	(6,622)	(3,680)
At end of year	<u>7,617</u>	<u>10,305</u>

##### (iii) Non-performing financing by sector

	2005 RM'000	2004 RM'000
Manufacturing	4,939	11,751
Purchase of landed property:		
- Residential	1,645	705
Wholesale & retail trade and restaurants & hotels	1,785	2,643
Transport, storage and communication	2,290	-
Consumption credit	601	249
Others	1,545	1,573
	<u>12,805</u>	<u>16,921</u>

### 38 Operations of Islamic Banking (continued)

#### (f) Other Assets

	2005 RM'000	2004 RM'000
Settlement due from Head Office	4,655	32,217
Income receivable	8,677	9,670
Other receivables, deposits and prepayments	334	145
	<u>13,666</u>	<u>42,032</u>

#### (g) Deferred Tax Asset

	2005 RM'000	2004 RM'000
Deferred tax assets	<u>13,737</u>	<u>8,327</u>

The recognised deferred tax assets are as follows:

	2005 RM'000	2004 RM'000
Lease receivables		
- capital allowance	1,353	1,910
Available-for-sale reserve	(347)	(1,633)
Allowances		
- general allowance	12,256	7,703
- others	475	347
	<u>13,737</u>	<u>8,327</u>

#### (h) Deposits from Customers

##### (i) By type of deposit

	2005 RM'000	2004 RM'000
Non-Mudharabah Fund		
Demand deposits	38,948	14,300
Savings deposits	157,048	51,933
	<u>195,996</u>	<u>66,233</u>
Mudharabah Fund		
General investment deposits	<u>3,316,426</u>	<u>1,948,125</u>
	<u>3,512,422</u>	<u>2,014,358</u>

The maturity structure of general investment deposits is as follows:

	2005 RM'000	2004 RM'000
Due within six months	3,142,528	1,885,770
Six months to one year	173,898	62,355
	<u>3,316,426</u>	<u>1,948,125</u>

##### (ii) By type of customer

	2005 RM'000	2004 RM'000
Government and statutory bodies	10,335	-
Business enterprises	2,481,328	1,309,596
Individuals	893,263	588,244
Others	127,496	116,518
	<u>3,512,422</u>	<u>2,014,358</u>

### 38 Operations of Islamic Banking (continued)

#### (i) Deposits and Placements of Banks and Other Financial Institutions

	2005 RM'000	2004 RM'000
Mudharabah Fund		
Licensed Islamic banks	70,000	-
Licensed banks	50,000	-
Bank Negara Malaysia	124	44
Other financial institutions	150,000	-
	<u>270,124</u>	<u>44</u>

#### (j) Other Liabilities

	2005 RM'000	2004 RM'000
Special placement deposits by Head Office	921,294	922,488
Profit equalisation reserve	1,700	1,240
Profit payable	9,675	4,803
Other creditors and accruals	14,318	13,551
	<u>946,987</u>	<u>942,082</u>

Movement in profit equalisation reserve is as follows:

	2005 RM'000	2004 RM'000
At beginning of year	1,240	-
Provided in the financial year	460	1,240
At end of year	<u>1,700</u>	<u>1,240</u>

#### (k) Provision for Taxation and Zakat

	2005 RM'000	2004 RM'000
Taxation	20,631	14,871
Zakat	49	-
	<u>20,680</u>	<u>14,871</u>

#### (l) Reserves

	2005 RM'000	2004 RM'000
Retained profits	74,197	33,021
Available-for-sale reserve	892	4,198
	<u>75,089</u>	<u>37,219</u>

### 38 Operations of Islamic Banking (continued)

#### (m) Income Derived from Investment of Depositors' Funds and Others

	2005 RM'000	2004 RM'000
Income derived from investment of:		
(i) general investment deposits	90,262	61,767
(ii) specific investment deposits	35,913	22,752
(iii) other deposits	12,365	1,723
	<u>138,540</u>	<u>86,242</u>

#### (i) Income derived from investment of general investment deposits

	2005 RM'000	2004 RM'000
<u>Finance income and hibah:</u>		
Financing, advances and other loans	80,324	50,032
Available-for-sale securities	-	3,847
Money at call and deposit with financial institutions	9,583	2,775
	<u>89,907</u>	<u>56,654</u>
Accretion of discount less amortisation of premium	-	5,032
Total finance income and hibah	<u>89,907</u>	<u>61,686</u>
<u>Other operating income</u>		
Net gain from dealing in foreign currency	355	81
	<u>90,262</u>	<u>61,767</u>

#### (ii) Income derived from investment of specific investment deposits

	2005 RM'000	2004 RM'000
<u>Finance income and hibah:</u>		
Available-for-sale securities	36,964	29,570
Amortisation of premium less accretion of discount	(1,051)	(6,818)
Total finance income and hibah	<u>35,913</u>	<u>22,752</u>

### 38 Operations of Islamic Banking (continued)

#### (m) Income Derived from Investment of Depositors' Funds and Others (continued)

(iii) Income derived from investment of other deposits

	2005 RM'000	2004 RM'000
<u>Finance income and hibah:</u>		
Financing, advances and other loans	11,004	1,396
Available-for-sale securities	-	107
Money at call and deposit with financial institutions	1,313	78
	<u>12,317</u>	<u>1,581</u>
Accretion of discount less amortisation of premium	-	140
Total finance income and hibah	<u>12,317</u>	<u>1,721</u>
<u>Other operating income</u>		
Net gain from dealing in foreign currency	48	2
	<u>12,365</u>	<u>1,723</u>

#### (n) Allowance for Losses on Financing

	2005 RM'000	2004 RM'000
Allowance for bad and doubtful debts on financing:		
(a) Specific allowance		
- Made in the financial year	4,870	8,699
- Written back	(936)	(1,558)
(b) General allowance		
- Made in the financial year	16,261	16,588
Bad debts on loans and financing		
- Recovered	(1,287)	(262)
- Written off	285	-
	<u>19,193</u>	<u>23,467</u>

#### (o) Income Attributable to Depositors

	2005 RM'000	2004 RM'000
Deposits from customers		
- Mudharabah Fund	59,267	25,325
- Non-Mudharabah Fund	369	378
Deposits and placements of banks and other financial institutions		
- Mudarabah Fund	988	330
Special placement deposits by Head Office	25,791	25,058
	<u>86,415</u>	<u>51,091</u>

### 38 Operations of Islamic Banking (continued)

#### (p) Income Derived from the Investment of Islamic Banking Capital Funds

	2005 RM'000	2004 RM'000
<u>Financing income and hibah:</u>		
Financing, advances and other loans	10,695	4,465
Available-for-sale securities	-	343
Money at call and deposit with financial institutions	1,276	248
	<u>11,971</u>	<u>5,056</u>
Accretion of discount less amortisation of premium	-	449
Total finance income and hibah	<u>11,971</u>	<u>5,505</u>
<u>Other operating income</u>		
Fees and commission	18,414	12,075
Net gain from dealing in foreign currency	47	7
<u>Other income</u>		
Gain on disposal of equipment	-	65
	<u>30,432</u>	<u>17,652</u>

The above fees and commissions were derived from the following major contributors:

Trade facilities	11,228	4,869
Unit trust	2,430	2,513
Cards	1,563	1,884
Corporate finance	1,452	1,893

#### (q) Other operating expenses

	2005 RM'000	2004 RM'000
Personnel expenses	3,362	2,887
Promotion and marketing related expenses	401	965
Establishment related expenses	838	691
General administrative expenses	572	670
	<u>5,173</u>	<u>5,213</u>

#### (r) Shariah Committee's Remuneration

	2005 RM'000	2004 RM'000
Shariah Committee	<u>62</u>	<u>11</u>

### 38 Operations of Islamic Banking (continued)

#### (s) Taxation and Zakat

	2005 RM'000	2004 RM'000
Malaysian income tax	20,631	11,895
Deferred tax		
Origination and reversal of temporary differences	(4,125)	(5,037)
	<u>16,506</u>	<u>6,858</u>
Zakat	49	-
	<u>16,555</u>	<u>6,858</u>

*A numerical reconciliation between tax expense and the product of accounting profit multiplied by the applicable tax rate is as follows:*

	2005 RM'000	2004 RM'000
Profit before taxation	<u>57,731</u>	<u>22,883</u>
Income tax using Malaysian tax rates (28%)	16,165	6,407
Non-deductible expenses	341	451
	<u>16,506</u>	<u>6,858</u>

#### (t) Income from Islamic Banking Operations

For consolidation with the conventional operations, income from Islamic banking operations comprises the following items:

	2005 RM'000	2004 RM'000
Income derived from investment of depositors' funds and others	138,540	86,242
Profit equalisation reserves	(460)	(1,240)
Income attributable to the depositors	(86,415)	(51,091)
Income attributable to special placement deposits by Head Office	<u>25,791</u>	<u>25,058</u>
	<u>77,456</u>	<u>58,969</u>
Income derived from the investment of Islamic banking capital funds	30,432	17,652
<b>Income from Islamic banking operations</b>	<u>107,888</u>	<u>76,621</u>



### 38 Operations of Islamic Banking (continued)

#### (u) Capital Adequacy

The capital adequacy ratios of the Islamic Banking Operation are as follows:

	<b>2005</b>	2004
	<b>RM'000</b>	RM'000
<b><u>Tier 1 capital</u></b>		
Funds allocated from Head Office	<b>430,000</b>	200,000
Retained profits	<b>74,197</b>	33,021
	<b>504,197</b>	233,021
Less: Deferred tax adjustments	<b>(14,085)</b>	(9,960)
Total Tier 1 capital	<b>490,112</b>	223,061
<b><u>Tier 2 capital</u></b>		
General allowance for bad and doubtful debts and financing	<b>43,770</b>	27,509
Total Tier 2 capital	<b>43,770</b>	27,509
<b>Capital base</b>	<b>533,882</b>	250,570
Core capital ratio	<b>13.4%</b>	8.2%
Risk-weighted capital ratio	<b>14.6%</b>	9.2%

Breakdown of gross risk-weighted assets in the various categories of risk-weights:

	<b>2005</b>		2004	
	<b>Principal</b>	<b>Risk-weighted</b>	Principal	Risk-weighted
	<b>RM'000</b>	<b>RM'000</b>	RM'000	RM'000
0%	<b>1,534,433</b>		364,250	-
10%	-	-	-	-
20%	<b>188,240</b>	<b>37,648</b>	191,600	38,320
50%	<b>76,568</b>	<b>38,284</b>	69,909	34,955
100%	<b>3,580,919</b>	<b>3,580,919</b>	2,654,684	2,654,684
	<b>5,380,160</b>	<b>3,656,851</b>	3,280,443	2,727,959

### 38 Operations of Islamic Banking (continued)

#### (v) Commitments and Contingencies

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers. No material losses are anticipated as a result of these transactions.

The table below shows the contract or underlying principal amounts, credit equivalents amounts and risk weighted amounts of unmatured off-balance sheet transactions as at balance sheet date. The contract or underlying principal amounts indicate the volume of business outstanding and do not represent amount at risk.

	<b>2005</b>	<b>Risk</b>		<b>2004</b>	<b>Risk</b>
	<b>Credit</b>	<b>weighted</b>		<b>Credit</b>	<b>weighted</b>
	<b>equivalent</b>	<b>amount</b>	<b>Principal</b>	<b>equivalent</b>	<b>amount</b>
	<b>amount *</b>	<b>amount</b>	<b>amount</b>	<b>amount *</b>	<b>amount</b>
	<b>RM'000</b>	<b>RM'000</b>	<b>RM'000</b>	<b>RM'000</b>	<b>RM'000</b>
Irrevocable commitments to extend credit:					
- Maturity not exceeding one year	<b>63,262</b>	-	156,910	-	-
- Maturity exceeding one year	<b>171,446</b>	<b>85,723</b>	105,376	52,688	52,688
Others	<b>6,700</b>	<b>6,700</b>	-	-	-
	<b>241,408</b>	<b>92,423</b>	<b>262,286</b>	<b>52,688</b>	<b>52,688</b>

\* The credit equivalent amount is arrived at using the credit conversion factors as per Bank Negara Malaysia guidelines.

### 38 Operations of Islamic Banking (continued)

#### (w) Profit Rate Risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows of the Islamic banking operations. The following table indicates the effective profit rates at balance sheet date and the periods of repricing or maturity, whichever is earlier.

2005	Non-trading book						Trading book RM'000	Total RM'000	Effective profit rate %
	Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years RM'000	Over 5 years RM'000	Non-profit sensitive RM'000			
<b>ASSETS</b>									
Cash and short term funds	1,157,491	-	-	-	-	364	-	<b>1,157,855</b>	2.95
Deposits and placements with banks and other financial institutions	-	90,000	-	-	-	-	-	<b>90,000</b>	3.00
Available-for-sale securities	-	509,934	180,324	336,337	-	-	-	<b>1,026,595</b>	3.79
Financing, advances and other loans									
- performing	1,894,987	1,756	36,205	600,012	315,370	-	-	<b>2,848,330</b>	4.47
- non-performing *	-	-	-	-	-	5,188	-	<b>5,188</b>	-
Others	-	-	-	-	-	127,334	-	<b>127,334</b>	-
<b>TOTAL ASSETS</b>	<b>3,052,478</b>	<b>601,690</b>	<b>216,529</b>	<b>936,349</b>	<b>315,370</b>	<b>132,886</b>	-	<b>5,255,302</b>	
<b>LIABILITIES AND ISLAMIC BANKING CAPITAL FUNDS</b>									
Deposits from customers	1,503,233	968,594	1,001,647	-	-	38,948	-	<b>3,512,422</b>	2.74
Deposits and placements of banks and other financial institutions	270,124	-	-	-	-	-	-	<b>270,124</b>	2.96
Others	920,792	-	-	-	-	46,875	-	<b>967,667</b>	3.12
<b>Total Liabilities</b>	<b>2,694,149</b>	<b>968,594</b>	<b>1,001,647</b>	-	-	<b>85,823</b>	-	<b>4,750,213</b>	
Islamic Banking Capital Funds	-	-	-	-	-	505,089	-	<b>505,089</b>	
<b>Total Liabilities and Islamic Banking Capital Funds</b>	<b>2,694,149</b>	<b>968,594</b>	<b>1,001,647</b>	-	-	<b>590,912</b>	-	<b>5,255,302</b>	
On-balance sheet profit sensitivity gap	358,329	(366,904)	(785,118)	936,349	315,370	(458,026)	-	-	
<b>Total profit sensitivity gap</b>	<b>358,329</b>	<b>(366,904)</b>	<b>(785,118)</b>	<b>936,349</b>	<b>315,370</b>	<b>(458,026)</b>	-	-	

### 38 Operations of Islamic Banking (continued)

#### (w) Profit Rate Risk (continued)

2004	Non-trading book						Trading book RM'000	Total RM'000	Effective profit rate %
	Up to 1 month RM'000	>1 - 3 months RM'000	>3 - 12 months RM'000	1 - 5 years RM'000	Over 5 years RM'000	Non-profit sensitive RM'000			
<b>ASSETS</b>									
Cash and short term funds	435,954	-	-	-	-	155	-	436,109	2.70
Deposits and placements with banks and other financial institutions	-	-	-	-	-	-	-	-	-
Available-for-sale securities	26,644	20,246	229,922	584,409	81,133	-	-	942,354	4.05
Financing, advances and other loans									
- performing	1,141,896	534	19,778	418,228	191,035	-	-	1,771,471	4.38
- non-performing *						6,616	-	6,616	-
Others	-	-	-	-	-	52,024	-	52,024	-
<b>TOTAL ASSETS</b>	<b>1,604,494</b>	<b>20,780</b>	<b>249,700</b>	<b>1,002,637</b>	<b>272,168</b>	<b>58,795</b>	<b>-</b>	<b>3,208,574</b>	
<b>LIABILITIES AND ISLAMIC BANKING CAPITAL FUNDS</b>									
Deposits from customers	1,312,532	493,917	193,609	-	-	14,300	-	2,014,358	2.59
Deposits and placements of banks and other financial institutions	44	-	-	-	-	-	-	44	2.70
Others	921,858	-	-	-	-	35,095	-	956,953	2.79
<b>Total Liabilities</b>	<b>2,234,434</b>	<b>493,917</b>	<b>193,609</b>	<b>-</b>	<b>-</b>	<b>49,395</b>	<b>-</b>	<b>2,971,355</b>	
Islamic Banking Capital Funds	-	-	-	-	-	237,219	-	237,219	
<b>Total Liabilities and Islamic Banking Capital Funds</b>	<b>2,234,434</b>	<b>493,917</b>	<b>193,609</b>	<b>-</b>	<b>-</b>	<b>286,614</b>	<b>-</b>	<b>3,208,574</b>	
On-balance sheet profit sensitivity gap	(629,940)	(473,137)	56,091	1,002,637	272,168	(227,819)	-	-	
Total profit sensitivity gap	(629,940)	(473,137)	56,091	1,002,637	272,168	(227,819)	-	-	

\* This is arrived at after deducting the specific allowance from non-performing loans.

### 38 Operations of Islamic Banking (continued)

#### (x) Fair Values of Financial Assets and Liabilities

The following table summarises the fair value of the financial assets and liabilities carried on the balance sheet as at 31 December.

	2005 Carrying amount RM'000	2005 Fair Value RM'000	2004 Carrying amount RM'000	2004 Fair Value RM'000
<b>Financial Assets</b>				
Cash and short term funds	1,157,855	1,157,855	436,109	436,109
Deposits and placements with banks and other financial institutions	90,000	90,000	-	-
Available-for-sale securities	1,026,595	1,026,595	942,354	942,354
Financing, advances and other loans	2,853,518	2,824,925	1,778,087	1,769,207
<b>Financial Liabilities</b>				
Deposits from customers	3,512,422	3,512,023	2,014,358	2,014,138
Deposits and placements of banks and other financial institutions	270,124	270,124	44	44

The methods and assumptions used to estimate the fair values of the financial assets and financial liabilities of the operations of Islamic banking are as stated in Note 32.

#### (y) Comparative Figures

The following comparatives have been restated to reflect the change in accounting policies as explained in Note 36.

	As restated RM'000	As previously stated RM'000
<i>Balance Sheet</i>		
Investment securities	-	939,688
Available-for-sale securities	942,354	-
Deferred tax asset	8,327	11,480
Total Assets	3,208,574	3,209,061
Other liabilities	942,082	941,894
Provision for taxation	14,871	17,271
Total liabilities	2,971,355	2,973,567
Reserves	37,219	35,494
Islamic Banking Capital Funds	237,219	235,494
Total Liabilities and Islamic Banking Capital Funds	3,208,574	3,209,061

### **38 Operations of Islamic Banking (continued)**

#### **(y) Comparative Figures (continued)**

	As restated RM'000	As previously stated RM'000
<i>Income Statement</i>		
Income derived from investment of depositors' funds and others	86,242	98,177
Total distributable income	61,535	73,470
Income attributable to the Bank	10,444	22,379
Income derived from investment of Islamic banking capital funds	17,652	17,651
Total net income	28,096	40,030
Profit before taxation	22,883	34,816
Taxation	6,858	10,140
Profit after taxation	16,025	24,676

#### **(z) Shariah Committee**

In line with Bank Negara Malaysia's "Guidelines on the Governance of Shariah Committee for The Islamic Financial Institutions" known as BNM/GPS 1, the following Shariah scholars were appointed:

- 1) Dr. Mohamad Akram Laldin, Head of Fiqh and Usul Al-fiqh Department at International Islamic University of Malaysia. He is a graduate of University of Jordan, Shariah Department and a Ph.D holder in Islamic Law from the University of Edinburgh, Scotland.
- 2) Dr. Rusni Hassan, Assistant Professor of Law at International Islamic University of Malaysia. She holds a double degree, LLB and LLB (Shariah) as well as Ph.D in Law from the same university.
- 3) Khairul Anuar Ahmad, lecturer with Selangor Islamic College University. He holds a Bachelor and Master of Shariah from University of Malaya.

Monthly meetings are held to discuss Shariah issues complemented by ad-hoc meetings to resolve urgent Shariah matters. The Committee peruse all the documents from inception of a product, to documentation and marketing to ensure that the process flow complies with Shariah at all times. No major Shariah issues were raised and none remain unresolved.

A Shariah Compliance executive was employed during the year to support the Shariah function and the Committee. This role will expand to include Shariah review of operations and other relevant Shariah work.