BANK OF KAOHSIUNG CO. LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013
(Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Stated)

## 1. HISTORY AND ORGANIZATION

1.1 Bank of Kaohsiung Co., Ltd. is a commercial bank formed and registered in accordance with the provisions of the Banking Law of the Republic of China. The Bank obtained its registration approval in December 1981 and the Certificate of Business Registration in January the following year. The Bank's main business activities are as follows:

(1) Agent for the Kaohsiung City Treasury.

(2) Management of Kaohsiung Municipal Bond.

(3) Other relevant commercial bank businesses authorized under the Banking Law.

(4) Savings and trust operations.

(5) Other relevant businesses authorized by the Central Competent Authority.

The Bank operates with five departments under the Head Office namely, Business, Municipal Treasury, International Banking, Trust and Wealth Management departments with an additional of 35 local branches and mini- branches and an Offshore Banking Unit (OBU).

Taiwan Stock Exchange Corporation (TSE) approved the Bank's application to seek listing on the Taiwan Stock Exchange and issued the approval document (Tai Jeng (87) Shan No. 11281) on April 27, 1998. The Bank was officially listed on the Taiwan Stock Exchange on May 18, 1998.

The proposal for the privatization of the Bank was approved upon assessment by the Task Force for the Privatization of Public-Owned Enterprises in its 16th Meeting and the proposal was executed on August 3, 1999 in accordance with approval document (Kaohsiung City Government Tsai 3 No. 23963). The offering of the Bank's shares to the public as part of the privatization policy of government-owned banks came into effect on August 17, 1999 upon approval by the Securities and Futures Commission of the Ministry of Finance. The Bank was officially reorganized as a private enterprise on September 27, 1999.

1.2 Subsidiaries included in the consolidated financial statements as of December 31, 2014 and 2013 are listed as follows:

| Investor | Name of Subsidiary | Main Business Activities | Shareholding % | |
|---|---|---|---|---|
| | | | Dec. 31, 2014 | Dec. 31, 2013 |
| The Bank | Kaohsiung Bank Insurance Agency Co., Ltd. | Life insurance agency business | 100% | 100% |
| The Bank | Kaohsiung Bank General Insurance Agency Co., Ltd | Property insurance agency business | 100% | 100% |

1.3 Subsidiaries not included in the consolidated financial statements: None.

1.4 The functional currency and the presentation currency used in financial statements are both the New Taiwan Dollar.

## 2. APPROVAL OF FINANCIAL STATEMENTS

The consolidated financial statements were approved by the board of directors and authorized for issue on March 26, 2015.

## 3. APPLICATION OF NEW AND REVISED STANDARDS, AMENDMENTS AND INTERPRETATIONS

3.1 The effect of adopting the newly issued or revised International Financial Reporting Standards that are ratified by the Financial Supervisory Commission (referred to as the "FSC" hereafter): None.

3.2 The effect of not adopting newly issued or revised International Financial Reporting Standards that are ratified by the FSC:

Pursuant to Order No. 10310006010 Category Financial Supervisory Banking Law, Order No. 1030034680 Category Financial Supervisory Securities, and Order No. 1030010325 Audit Category Letters which are issued by the Financial Supervisory Commission (referred to as "FSC" hereafter), The bank and its subsidiaries must adopt the 2013 version of

International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), International Financial Reporting Interpretations Committee interpretations (IFRIC), and Standards Interpretation Committee interpretations (SIC) (referred to as "IFRSs" hereafter) that have been released by the International Accounting Standards Board (IASB) and ratified by the FSC, beginning from 2015.

| The new / amended/ revised standards and interpretations | IASB pronouncement effective date (Note) |
|---|---|
| The amendment to the IFRS "IFRSs amendment – Amendments to IAS 39 (2009)" | Jan. 1, 2009 or Jan. 1, 2010 |
| Amendments to the IAS 39 "Embedded Derivatives" | Effective in the years that end after June 30, 2009 |
| "IFRSs improvements (2010)" | July 1, 2010 or Jan 1, 2011 |
| "2009-2011 IFRSs improvements" | Jan. 1, 2013 |
| Amendments to IFRS 1 "Limited exemption from IFRS 7 comparative disclosures for first-time adopters" | July 1, 2010 |
| Amendments to IFRS 1 "Severe hyperinflation and remove of fixed dates for first-time adopters" | July 1, 2011 |
| Amendments to IFRS 1 "Government loans" | Jan. 1, 2013 |
| Amendments to IFRS 7 "Disclosures - Financial assets and financial liabilities offsetting" | Jan. 1, 2013 |
| Amendments to IFRS 7 "Disclosures - financial assets transfer" | July 1, 2011 |
| IFRS 10 "Consolidated Financial Statements" | Jan. 1, 2013 |
| IFRS 11 "Joint Arrangements" | Jan. 1, 2013 |
| IFRS 12 "Disclosure of interests in other entities" | Jan. 1, 2013 |
| Amendments to the IFRS 10, IFRS 11, and IFRS 12 "Consolidated Financial Statements, the collective agreement and disclosure of interests in other entities: the transitional provisions guidelines" | Jan. 1, 2013 |
| Amendments to the IFRS 10, IFRS 12, and IAS 27 "Investment Entity" | Jan. 1, 2014 |
| IFRS 13 "Fair Value Measurement" | Jan. 1, 2013 |
| Amendments to the IAS 1 "The expression of other comprehensive profit or loss" | July 1, 2012 |
| Amendments to the IAS 12 "Deferred income tax: Recovery of underlying assets" | Jan. 1, 2012 |
| Amendments to the IAS 19 "Employee Benefits" | Jan. 1, 2013 |
| Amendments to the IAS 27 "Individual Financial Statements" | Jan. 1, 2013 |
| Amendments to IAS 28 "Investments in Associates and Joint Ventures" | Jan. 1, 2013 |
| Amendments to IAS 32 "Disclosures - Financial assets and financial liabilities offsetting" | Jan. 1, 2014 |
| IFRIC 20 "Stripping Costs in the production stage of an open-pit mine" | Jan. 1, 2013 |

Note: Unless otherwise stated, the aforementioned new / amended / revised standards or interpretation are effective in the year that begins after the respective date.

Except for the following explanations, the application of these new / amended / revised standards or interpretations will not result in significant changes in the consolidated company's accounting policies:

(1) New/revised standards for mergers, joint arrangements, affiliated corporations, and applicable disclosures

A. IFRS 10 "Consolidated Financial Statements"

This standard will supersede IAS 27 "Consolidated and Separate Financial Statements". Additionally, it will also supersede SIC 12 "Consolidation: Special Purpose Entities." The bank and its subsidiaries consider whether they exercise control over investees to determine whether these entities should be incorporated in the consolidated financial statements. When The bank and its subsidiaries have (i) power over the investee, (ii) risk exposure or rights that produce variable returns due to the participation in the investee, and (iii) the power to influence the amount of such return by exercising the power over the investee, The bank and its subsidiaries have control over the investee. Additionally, the new standard provides more guidance on the determination as to whether the investor has control in more complicated situations. Based on our evaluation, that standard and its amendments do not have material effects on The bank and its subsidiaries.

B. IFRS 12 “Disclosure of interests in other entities”

The new standard requires broader disclosure on the equity of subsidiaries, joint agreements, and associates. Based on our evaluation, this standard will demand The bank and its subsidiaries to increase the disclosure on consolidating subsidiaries.

C. Amendments to IAS 28 “Investments in Associates and Joint Ventures”

According to the requirements of the revised standard, when an investment in a joint venture becomes an investment in an associate, The bank and its subsidiaries will continue to apply the equity method and do not perform further measurements on the remaining equity. Before adopting these amendments, when The bank and its subsidiaries lose joint control, The bank should measure the remaining investment on the consolidation under joint control at fair value. The difference between the fair value of the remaining investment plus the amount of disposal of consolidated income under joint control and the book value of the investment on the day when control is lost should be presented in the income statement. Based on our evaluation, these amendments do not have material effects on The bank and its subsidiaries.

(2) IFRS 13 “Fair Value Measurement”

IFRS 13 “Fair Value Measurement” offers guidance on fair value measurement. This standard defines fair value and the structure that measures fair value. It also requires the disclosure on the measurement of fair value. Additionally, the disclosure required by that standard is broader than the current standard. For example, the current standard only requires financial instruments measured at fair value to be disclosed at the three levels of fair value. Pursuant to the requirements of IFRS 13 “Fair Value Measurement,” the corporation must provide aforementioned disclosure on all assets and liabilities subject to that standard. The measurement requirement of IFRS 13 is applicable from 2015 in deferred application. Based on our evaluation, that standard will increase The bank’s information disclosure on levels of fair value for non-financial items.

(3) Amendments to IAS 1 “Presentation of Items of Other Comprehensive Income”

According to the revised standards, items of other comprehensive income must be classified according to their nature and grouped as “items that would not be reclassified as income statement items and (2) items that would be reclassified as income statement items (when conditions are met). Related income tax expenses should also be classified according to the same basis. Before adopting that amendment, there is no mandatory requirement for the classification mentioned above.

The bank and its subsidiaries adopted aforementioned amendments to prepare the consolidated statement of comprehensive income. Items that would not be reclassified as income statement items may include actuarial gains and losses of defined benefits, and the share of actuarial gains and losses for associates (and joint ventures) recognized under the equity method. Items that may be reclassified as income statement items may include exchange difference from the translation of financial statements of foreign operating institutions, unrealized gains (losses) of available-for-sale financial assets, and cash flow hedge and the share of actuarial gains and losses for associates (and joint ventures) recognized under the equity method (excluding the actuarial gains and losses of defined benefit plans).

(4) IAS 19 “Employees benefits”

”Net interest” will replace the interest cost and the expected return of plan assets before adopting the amended standard, and the company will determine net interest with net defined benefit liability (assets) times the discount rate.

The effect of retroactive application of the amended IAS 19 in 2015 is expected to be as follows:

| Effects on the balance sheet and income statement | Book amount | Adjustment for IAS 19 | After IAS 19 adjustment |
|---|---|---|---|
| December 31, 2014 | | | |
| Effect on assets – Deferred income tax assets | 170,903 | 1,983 | 172,886 |
| Effect on liabilities – Employee benefit liability reserve | 859,942 | 11,666 | 871,608 |
| Undistributed earnings | 494,005 | (9,683) | 484,322 |
| January 1, 2014 | | | |
| Effect on assets – Deferred income tax assets | 133,821 | 1,857 | 135,678 |
| Effect on liabilities – Employee benefit liability reserve | 788,335 | 10,921 | 799,256 |
| Undistributed earnings | 214,246 | (9,064) | 205,182 |

| Effect on comprehensive income | | | |
|---|---|---|---|
| January 1 to December 31, 2014 | | | |
| Employee benefit expense | (134,577) | (1,645) | (136,222) |
| Income tax expense | (8,021) | 280 | (7,741) |
| Net income after tax for this period | 509,891 | (1,366) | 508,525 |
| Total comprehensive income for this period | 81,131 | 745 | 81,876 |

(5) Article 10, Paragraph 3, Subparagraph 3, Regulations Governing the Preparation of Financial Reports by Securities Issuers

The new requirement demands corporations to designate the financial liabilities that they issued as financial instruments at fair value through income statement. If the amount of the change in their fair value is generated by the credit risk of issuers themselves, the issuer should recognize the amount in other comprehensive income. Based on our evaluation, the new requirement does not have a significant effect on The bank and its subsidiaries.

3.3 IFRSs that have been released by the IASB but not yet ratified by the FSC

The following table summarizes the new pronouncements, amendments, and revisions for standards and interpretations of the 2013 version of the International Financial Reporting Standards that have been released by the IASB but not yet ratified by the FSC:

| The newly pronounced / amended/ revised standards and interpretations | Effective date of the IASB pronouncement (Note 1) |
|---|---|
| 2010 ~ 2012 IFRSs improvements | July 1, 2014 (Note 2) |
| 2011 ~ 2013 IFRSs improvements | July 1, 2014 |
| 2012 ~ 2014 IFRSs improvements | Jan. 1, 2016 |
| IFRS 9 “Financial Instruments” | (Note 3) |
| Amendments to IFRS 9 and IFRS 7 “Mandatory Effective Date and Transitional Disclosures” | (Note 3) |
| Amendments to IFRS 11 “Acquisition of an interest in a joint operation” | Jan. 1, 2016 |
| IFRS 15 “Revenue from Contracts with Customers” | Jan. 1, 2017 |
| Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38) | Jan. 1, 2016 |
| Amendments to IAS 16 and IAS 41 “Agriculture: Bearer Plants” | Jan. 1, 2016 |
| IFRS 14 “Restricted Deferred Account” | Jan. 1, 2016 |
| Amendments to the IAS 19 “Defined benefit plans: employees contribution” | July 1, 2014 |
| Amendments to the IAS 36 “Disclosure of recoverable amount of non-financial assets” | Jan. 1, 2014 |
| Amendments to the IAS 39 “Derivatives contract replacement and hedge accounting continuity” | Jan. 1, 2014 |
| IFRIC 21 “Levies” | Jan. 1, 2014 |
| Amendments to IAS 27 “Equity method in separate financial statements” | Jan. 1, 2016 |
| Amendments to IFRS 10/IAS 28 — Sales or contributions of assets between an investor and its associate/joint venture | Jan. 1, 2016 |

Note 1：Unless otherwise stated, the aforementioned new / amended / revised standards or interpretations are effective in the year that begins after the respective date.

Note 2：The share-based payment transactions for payment dates after July 1, 2014 are subject to amendments of IFRS 2. Corporate acquisitions whose purchase dates are after July 1, 2014. IFRS 13 is effective upon revision. Other amendments will be adopted in the years that begin after July 1, 2014.

Note 3： IASB temporarily designates the effective date of IFRS 9 as the year that begins after January 1, 2018.

The bank and its subsidiaries are evaluating the effect on the financial condition and operating results by said standards and interpretations. The applicable effects will be disclosed after the evaluation is complete.

## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting polices applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the period presented, unless otherwise stated.

4.1 Statement of Compliance

These consolidated financial statements are prepared according to Regulations Governing the Preparation of Financial Reports by Public Banks and International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), International Financial Reporting Interpretations Committee interpretations (IFRIC), and Standards Interpretation Committee interpretations (SIC) (referred to as "IFRSs" hereafter) that have been ratified by the FSC.

4.2 Basis of Preparation

(1) Except for the following items, these consolidated statements have been prepared under the historical cost convention:

A.Financial assets and liabilities measured at fair value through profit or loss (including derivatives) measured at fair value.

B. Available-for-sale financial assets measured at fair value.

C. Liabilities of cash-settled share-based payment agreement measured at fair value.

D. Defined benefit liabilities recognized at the net value of pension fund assets less the present value of defined benefit obligations.

(2) Expenses incurred by the Bank and subsidiaries are analysed and classified by their nature.

(3)The economic activities of the Bank and subsidiaries are classified into operating activities, investing activities and financing activities based on judgement by the management. Changes in cash and cash equivalents in the current period are reported in the cash flow statements in the categories of operating, investing and financing activities. Please refer to Note 6.1 for composition of the items that make up the cash and cash equivalents account.

The cash flow information for operating activities is compiled using the indirect method. The indirect method adjusts accrual basis net profit (or loss) for the effects of non-cash transactions, deferrals or accruals arising from any past or future cash from or used in operating activities and revenues or expenses associated with investing or financing cash flows. Interest paid and received and dividend received are classified as operating cash flows. Dividends paid are financing costs and are thus classified as financing cash flows.

(4)The preparation of financial statements in conformity with IFRSs requires the use of certain critical estimates. It also requires management to exercise its judgement in the process of applying the accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumption and estimates are significant to the consolidated financial statements are disclosed in Note 5.

4.3 Foreign Currency Translation:

(1) Functional and Presentation Currency

Items included in the consolidated financial statements of the Bank and subsidiaries (including the Head Office, domestic branches, offices and the OBU) are measured using the currency of the primary economic environment in which the entity operates (the "functional currency").The consolidated financial statements are presented in "New Taiwan Dollars", which is the functional currency of the Bank's Head Office and domestic branches and offices.

(2) Foreign Currency Transactions and Balances

The transactions denominated in foreign currency or to be settled in foreign currency are translated into a functional currency at the spot exchange rate between the functional currency and the underlying foreign currency on the date of the transaction.

Foreign currency monetary items are reported using the closing rate (market exchange rate) at the date of each balance sheet. Foreign currency non-monetary items measured at historical cost are reported using the exchange rate at the date of the transaction. Foreign currency non-monetary items measured at fair value are reported at the rate that existed when the fair values were determined.

Exchange differences arising when foreign currency transactions are settled or when monetary items are translated at rates different from those at which they were translated when initially recognized or in previous financial statements are reported in profit or loss in the period, with one exception. The exception is that exchange differences associated with the gains or losses of the parts of effective hedges of cash flow hedges or hedges of net investments in foreign operations are recognized in other comprehensive income.

If a gain or loss on a non-monetary item measured at fair value is recognized in other comprehensive income, any

foreign exchange component of that gain or loss is also recognized in other comprehensive income. If a gain or loss on a non-monetary item measured at fair value is recognized in profit or loss, any foreign exchange component of that gain or loss is also recognized in profit or loss.

The operating results and financial position of the Bank's OBU in the consolidated financial statements that has a functional currency different from the presentation currency are translated into the presentation currency as follows:

A. Assets and liabilities presented are translated at the Company's and its subsidiaries ' closing exchange rate at the date of that balance sheet;

B. The profit and loss presented is translated by the average exchange rate in the period (except for the situation that the exchange rate on the trade date shall be adopted when the exchangerate fluctuate rapidly); and

C. All resulting exchange differences are recognized in other comprehensive income.

The translation differences arising from above processes are recognized as 'Exchange differences on translating the financial statements of foreign operations' under equity items.

When a foreign operation is disposed of in full or in part, the exchange differences recognised in other comprehensive income are reclassified as profit or loss from equity.

4.4 Cash and Cash Equivalents

"Cash and cash equivalents" in the consolidated balance sheet includes cash on hand, due from other banks, short-term highly liquid investments that are readily convertible to known amount of cash and subject to an insignificant risk of changes in value. In respect of the consolidated statements of cash flows, cash include cash and cash equivalents shown in the consolidated balance sheet and due from the Central Bank of China and other banks and bills and bonds purchased under agreements to resell satisfying the definition of cash and cash equivalents in IAS 7.

4.5 Bills and Bonds Under Repurchase or Resale Agreements

For transactions of bills and bonds with a condition of repurchase agreement or resell agreement, the interest expense and interest income are recognized as incurred at the date of sale and purchase and the agreed period of sale and purchase. The repo trade liabilities, bond liabilities, reverse repo trade bills and bond investments are recognized at the date of sale or purchase.

4.6 Financial Assets or Liabilities

The financial assets and liabilities of the Bank and subsidiaries including derivatives are recognized in the consolidated balance sheet and are properly classified in accordance with IFRSs as endorsed by FSC.

(1) Financial Assets

The IFRSs as endorsed by the FSC apply to the financial assets of the Bank and subsidiaries , which are classified into: loans and receivables, financial assets at fair value through profit or loss, held-to-maturity financial assets and available-for-sale financial assets.

A. A regular way purchase or sale

All the financial assets of the Bank and subsidiaries are accounted for using trade date accounting.

B. Loans and receivables

There are two types of loans and receivables: one is originated by an entity and the other is not. Loans and receivables originated by an entity refer to the direct provision by the Bank and subsidiaries of money, merchandise or services to debtors, and loans and receivables not originated by the Bank and subsidiaries are loans and receivables other than those originated by the Bank and its subsidiaries .

Loans and receivables are initially recognized at fair value, which includes the price of transaction, significant costs of transaction, significant handling fees paid or received, discount and premium, etc., and subsequently measured using the effective interest method. However if the effect of discount is insignificant, pursuant to paragraphs 7 and 10, Article 10 of the "Regulations Governing the Preparation of Financial Reports by Public Banks", loans and receivables can be measured at initial amount.

C. Financial assets at fair value through profit or loss

Financial assets are classified as financial assets at fair value through profit or loss if they are acquired by the Bank and subsidiaries principally for the purpose of selling or repurchasing or gaining profit in the short-term, or if they are derivative instruments. These financial assets are initially recognized at fair value.

Financial assets that meet one of the following criteria are designated as at fair value through profit or loss on initial recognition:

(A) They eliminate or significantly reduce a measurement or recognition inconsistency such as measurement of financial assets or liabilities or recognition of related gain or loss on different bases; or

(B) Their performance is evaluated on a fair value basis; or

(C) Hybrid (combined) instruments including embedded derivative instruments.

Financial assets designated at fair value through profit or loss and financial assets designated at fair value through profit or loss on initial recognition are recognized under the "financial assets at fair value through profit or loss" in the consolidated balance sheet and any changes in their fair value is recognized under the 'gain or loss on financial assets and liabilities at fair value through profit or loss' account in the consolidated statement of comprehensive income.

D. Held-to-maturity financial assets

Held-to-maturity financial assets are measured at fair value plus acquisition or issuance cost on initial recognition and subsequently at the amortized cost and the interest income using the effective interest rate.

E. Available-for-sale financial assets

Available-for-sale financial assets are measured at fair value plus acquisition or issuance cost on initial recognition and subsequently at fair value. Any subsequent change in fair value of available-for-sale financial assets is adjusted against equity. Cumulative valuation gain or loss of a financial asset is recognized as current income or loss when the asset is derecognized.

F. Other financial assets

(A) Financial assets carried at cost

Equity instruments with no quoted price in an active market are initially recognized at fair value plus acquisition or issuance cost. The fair value can be reasonably estimated when the following criteria are met at the balance sheet date: (a) the variability in the range of reasonable fair value estimate is not significant for that equity instrument; or (b) probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If the variability in the range of reasonable fair value estimate of the instruments is significant and that it is not possible to assess the probabilities of the various estimates, the instruments shall not be measured at fair value. Financial assets that cannot be measured at fair value shall be carried at cost.

(B) Debt investments with no active market

Investments in debt instruments without active market are initially recognized at fair value on the trade date plus transaction costs of acquisition or issuance. Disposal gain or loss is recognized when derecognized. Bond investments without active market are measured at amortized cost using the effective interest method.

(2) Financial Liabilities

Financial liabilities held by the Bank and subsidiaries comprise financial liabilities at fair value through profit or loss (including financial liabilities as at fair value through profit or loss on initial recognition), financial liabilities measured at amortized cost and hedging derivatives.

A. Financial liabilities at fair value through profit or loss

This category includes financial liabilities held for trading or financial liabilities measured at fair value through profit or loss on initial recognition.

A financial liability shall be classified as held for trading, if it is acquired or incurred principally for the purpose of repurchasing it in the near term; or on initial recognition is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. A derivative is also classified as held for trading, except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument.

Financial liabilities designated at fair value through profit or loss and financial liabilities designated at fair value through profit or loss on initial recognition are recognized under the "financial liabilities at fair value through profit or loss" in the consolidated balance sheet and any changes in their fair value is recognized under the 'gain or loss on financial assets and liabilities at fair value through profit or loss' account in the consolidated statement of comprehensive income.

B. Financial liabilities measured at amortized cost

Financial liabilities measured at amortized cost include financial liabilities which are not classified as financial liabilities measured at fair value through profit or loss, hedging derivative financial liabilities, financial guarantee contracts, and financial liabilities arising from transfer of financial assets that does not qualify for derecognition to the

extent of transferor's continuing involvement.

C. Determination of fair value

Fair value and level information of financial instruments are provided in Note 7.

D. Deferring recognition of first-day profit or loss

The fair value of a financial instrument with no active market held by the Bank and subsidiaries is not generated from a valuation model by inputting observable market prices or interest rates. As such, financial instruments with no active market are recognised at the cost of acquisition on initial recognition. However, the acquisition price may differ from the amount generated from the valuation model. The difference is commonly referred to as "first-day profit or loss" and is not immediately recognised in the consolidated statements of comprehensive income.

As such, recognition of first-day profit or loss may be deferred until all parameters used in the valuation model are observable in the market or until settlement.

E. Derecognition of financial assets and liabilities

A financial asset is derecognized when the contractual rights to receive the cash flows from the financial asset expire, or when all the risks and rewards of ownership of the financial assets are substantially transferred.

A financial liability is derecognized when the obligation under the liability specified in the contract is discharged or cancelled or expires.

In case of securities lending or borrowing by the Bank or subsidiaries or provision of bonds or stocks as security for Repo trading, the Bank and subsidiaries do not derecognize the financial asset, because substantially all risks and rewards of ownership of the financial asset are still retained in the Bank and subsidiaries .

4.7 Reclassification of Financial Assets

Reclassification of the non-derivative financial assets is in accordance with IAS 39 as endorsed by the FSC.

4.8 Offsetting Financial Instruments

Financial assets and liabilities are offset and reported in the net amount in the balance sheet when (1) there is a legally enforceable right to offset the recognized amounts and (2) there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

4.9 Interest Income and Expense

Other than those classified as financial assets and liabilities at fair value through profit and loss, all the interest income and interest expenses generated from interest-bearing financial assets are calculated by effective interest rate according to relevant regulations and recognized as "interest income" and "interest expense" in the consolidated statement of comprehensive income.

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

4.10 Service Fee and Commission Income

Service fee income and expense are recognized upon the completion of services of loans or other services; service fee income and expense of subsequent services of loans are amortized or included in the calculation of effective interest rate of loans and receivables during the service period.

4.11 Impairment of Financial Assets

(1) Financial assets carried at amortized cost

At each reporting date, a financial asset or a group of financial assets is assessed by the Bank and subsidiaries to determine whether there is objective evidence of impairment. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a single or serveral loss event(s) has (have) occurred after the initial recognition of the asset, and that the "loss event" has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that a financial asset or a group of financial assets is impaired includes:

A. significant financial difficulty of the issuer or obligor;

B. a breach of contract, such as a default or delinquency in interest or principal payments;

C. the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

D. it becoming probable that the borrower will enter bankruptcy or other financial reorganization;

E. the disappearance of an active market for that financial asset because of the issuer's financial difficulties; or

F. observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

(A) adverse changes in the payment status of borrowers in the group; or

(B) changes in national or local economic conditions that correlate with defaults on the assets in the group.

The Bank and subsidiaries consider the evidence of impairment for financial assets at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together financial assets with similar credit risk characteristics. Financial assets that are assessed individually with impairment recognized or continue to be recognized need not be included in the collective assessment.

Where there is objective evidence indicating impairment loss, The amount of the impairment loss is the difference between the financial assets' book value and the estimated future cash flow (excluding future credit loss not yet incurred) discounted using the original effective interest rate. The carrying amount of assets is adjusted in the allowance for credit loss and the amount of impairment loss is listed under "allowance for credit loss and loss on guarantees" or "loss on impairment of financial assets". The amout of impairment loss of financial assets with a floating interest rate is discounted using the prevailing interest rate as set out in the agreement.

Financial assets through group assessment are grouped based on similar credit risk characteristics, such as types of assets, industry and collaterals. Such credit risk characteristics represent the ability of the debtors to pay all the amounts at maturities according to the contract term (such as credit risk assessment or rating procedures that consider the type of asset, industry and security, the overdue status and other key factors), which is related to future cash flow estimates of each group of financial assets.

The future cash flows of group of financial assets for group assessment are estimated based on historical impairment experience of financial assets in the group with similar credit risk characteristics. The historical impairment experience is adjusted on the basis of observable data for each period in order to reflect the effect of current conditions that did not have an impact on historical impairment experience and to eliminate the impact of past conditions that no longer exist at present.

When a loan is unable to be recovered, the carrying amount of the loan is offset against the related allowance for credit loss. The amount of impairment loss is offset against the uncollectible loan with the consent of the Board of Directors after the Bank and subsidiaries complete all mandatory legal procedures and provided that the amount of impairment loss may be determined.

If, in a subsequent period, the amount of the impairment loss decreased and such decrease is objectively related to an event occurred after the impairment was recognized (such as an improvement in the credit rating of the borrower), the amount of impairment loss recognized previously shall be reserved by adjusting allowance for credit loss. The reversal shall not cause the carrying amount of the financial asset exceeding the amortized cost of the period before recognition of the impairment loss. The amount of the reversal shall be recognized in the current income statement.

The above process of evaluation follows the "Regulations Governing the Procedures for Banking Institutions to Evaluate Assets and Deal with Nonperforming/Non accrual Loans" (the "Regulations") issued by the FSC under which loan assets are classified into the following categories. Normal credit assets shall be classified as "Category One". The Bank and subsidiaries shall make an allowance for credit losses and guarantees equaling 1% of the balance of Category One assets less government claims. The remaining unsound assets shall be evaluated based on the status of the loan collaterals and the length of time overdue. Assets that require special mention shall be classified as "Category Two," assets that are substandard shall be classified as "Category Three," assets that are doubtful shall be classified as "Category Four," and assets for which there is loss shall be classified as "Category Five." The minimum allowance for credit losses and guarantees should be 2% for Category Two, 10% for Category Three, 50% for Category Four and 100% for Category Five, respectively.

(2) Available-for-sale financial assets

When the decrease in the fair value of an available-for-sale financial asset is recognized in other comprehensive income and where there is objective evidence indicating an impairment has occurred, the losses accumulated in the fair value reserve in equity are reclassified to profit or loss, even if the available-for-sale financial asset is not derecognized yet.

Impairment loss of an investment in an equity instrument recognized in profit or loss shall not be reversed through profit or loss. Any subsequent increases in fair value of an investment in an equity instrument are recognized in other comprehensive income. If the impairment loss of bond investments decreases with objective evidence indicating that an impairment loss has been incurred after the impairment is recognized, the impairment amount is reversed and recognized in current profit and loss.

(3) Financial assets carried at cost

When there is objective evidence that financial assets carried at cost are impaired, the loss amount is recognized in "loss on impairment of financial assets" and the impairment loss is non-reversible.

4.12 Derivative Financial Instruments

(1) Derivative financial instruments are measured at fair value at initial recognition and in the subsequent period. Fair value is determined using valuation techniques that consider using quoted prices in an active market, recent market price, discounted cash flow models and option pricing models. If the result of its valuation at fair value is positive, a derivative instrument is classified as a financial asset, otherwise, it is classified as a financial liability.

(2) Economic characteristics and risks of the embedded derivatives and the economic characteristics of the main contract should be examined for the embedded derivatives. If the two are not closely correlated and the main contract is not a financial asset or liability at fair value through profit and loss, the main contract and embedded derivatives should be respectively recognized unless the overall hybrid contract is designated as assets or liabilities at fair value through profit and loss. The embedded derivatives are the financial assets or liabilities at fair value through profit and loss.

(3) Non-qualifying hedging derivatives

When a derivative is not designated in a qualifying hedge relationship, all changes in its fair value are recognized immediately in profit or loss as "gain or loss on financial assets and liabilities at fair value through profit or loss".

4.13 Impairment of Non-financial Assets

In accordance with International Accounting Standards 36 Asset impairment ("IAS 36") endorsed by the FSC, at each reporting date or as circumstance changes, the Bank and its subsidiaries assess non-financial assets for any indication of impairment in which the recoverable amount of an asset is less than its carrying amount. If the recoverable amount of an asset is less than its carrying amount, the difference between the recoverable amount and carrying amount is recognized as impairment loss. Assets are grouped together into the smallest group of identifiable assets (cash-generating unit) that generates cash inflows. Impairment test is also applied to an individual asset when its fair value less selling cost or its value-in-use can be reliably measured. Impairment loss on non-financial assets (other than goodwill) recognized in prior periods is assessed at each reporting date for any indications that the loss has decreased.

4.14 Foreclosed Collaterals

Foreclosed collaterals are recognized at the foreclosure price. Foreclosed properties are stated at the lower of its carrying amount or fair value less costs to sell at the end of period.

4.15 Leases

All lease agreements of the Bank and its subsidiaries are operating leases. Expenses incurred under an operating lease is recognized in profit or loss on a straight-line basis over the lease term and recognized in "other business and administrative expenses" and "other net non-interest income".

4.16 Property and Equipment

The property and equipment of the Bank and subsidiaries are recognized on the basis of the historical cost less accumulated depreciation. Historical cost includes all costs directly attributable to the acquisition of the assets. Such assets are subsequently measured using the cost model.

When the future economic benefit related to subsequent expenditure related to the asset is highly likely to flow into the Bank and its subsidiaries and that the costs can be reliably measured, such expenditure may be included in the carrying amount of the asset or may be seperately recognized as assets. The carrying amount of the replaced part is derecognized. When the future economic benefit generated from subsequent costs is highly likely to flow into the entity and subsequent

major improvements or repair expenses shall be capitalized. On-going repairs and maintenance cost is expensed as incurred.

The Bank and its subsidiaries examine the residual value and useful lives of the property and equipment and make appropriate adjustments accordingly on an annual basis.

Land is not affected by depreciation. Depreciation for other assets is provided on a straight-line basis over the estimated useful lives of the assets until carrying amount of the assets reaches their residual value as follows:

| | |
|---|---|
| Building | 48-60 years |
| Leasehold improvement | 5 years, or the lease term if less than 5 years |
| Equipment and machinery | 3-20 years |

Gain or loss on disposal is the difference between the carrying amount and proceeds from disposal and is recognized in "other net non-interest income" in the consolidated statements of comprehensive income.

4.17 Intangible Assets

Intangible assets refer to computer software acquired by the Bank and its subsidiaries. The cost incurred on acquiring the software is capitalized and is amortised over the useful life of the software which is estimated to be 6 years.

4.18 Income Taxes

(1) Current income tax

Income tax payable (refundable) is calculated on the basis of the tax laws enacted in the countries where the Bank operates and generates taxable income. Except that the transactions or other matters are directly recognized in other comprehensive income or equity, and that related income taxes in the period are recognized in other comprehensive income or directly derecognized from equity, all the others should be recognized as income or expense as recorded as gain and loss in the period.

(2) Deferred income tax

Deferred income tax assets and liabilities are measured based on the tax rate of the anticipated period that the future assets realization or the liabilities settlement requires, which is based on the effective or existing tax rate at the consolidated balance sheet date. The carrying amount and temporary differences of assets and liabilities included in the consolidated balance sheet are calculated through liability method and recognized as deferred income tax. The temporary difference of the Bank and its subsidiaries mainly occurs due to the setting aside and transferring of depreciation of property and equipment, valuation of certain financial instruments (including derivatives), and reserve for pension and other post-employment benefits.

Deductible temporary difference within the scope that is probable to offset taxable income is recognized as deferred income tax.

Deferred income tax assets and liabilities are not offset if they relate to income taxes levied by different tax authorities.

4.19 Employee Benefits

(1) Short-term employee benefits

The Bank and its subsidiaries recognize the undiscounted amount of the short-term benefits expected to be paid in the future as expenses in the period when the employees render service.

(2) Post employment benefit

The pension plan of the Bank and its subsidaries includes both Defined Contribution Plan and Defined Benefit Plan.

Under the Defined Contribution Plan, the Bank and its subsidiaries make a certain amount of contribution to the Plan to fullfil the obligations. The Bank and its subsidiaries make pension fund contributions to a publicly managed pension fund on a compulsory, contractual or voluntary basis. Shall the assets under pension fund be insufficnet to cover employment benefits that employees are entitled to receive as a result of services they provide to the Bank in the past or in the current period, the Bank and subsidiaries are not under legal or constructive obligation to make additional contributions. The contributions are recognized as pension expenses when they are due on an accrual basis. Prepaid pension assets are recognized to the extent of a cash refund or a reduction in the future payments.

Under the defined benefit plan, the amount of pension payment is determined on the basis of the amount of benefit that an employee is entitled to receive upon his or her retirement. The amount is determined on the basis of age, year of service and salary supplement.

The liability recognized in the balance sheet in respect of defined benefit pension plans is the actuarial present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit net obligation is alculated annually by independent actuaries using the projected unit credit method. The rate used to discount is determined by using market yields at the balance sheet date on high-quality corporate bonds with a currency and term consistent with the currency and term of the related pension liability; when there is no deep market in high-quality corporate bonds, the Group uses market yields on government bonds (at the balance sheet date) instead.

Actuarial gains and losses arising on defined benefit plans due to actual experience or changes in actuarial assumptions are recognized in other comprehensive income in the period in which they arise. Past service costs are recognized immediately in profit or loss if vested immediately except where due to an amendment to the pension plan requires consideration of whether an employee continues to provide service during a specific period (vesting period), the past service costs are amortized on a straight-line basis over the vesting period.

(3) Employment benefit - preferential interest on employees' deposits

The Bank and its subsidiaries offer preferential interest rate to its current employees and retired employees for their deposits within a prescribed amount. The preferential interest rate in excess of market interest rate is treated as employee benefits.

Under Article 28 of the "Regulations Governing the Preparation of Financial Reports by Public Banks", if the Bank's preferential deposit interest rate for an employee as stated in the employment contract exceeds the market interest rate, the excess will be subject to IAS 19 "Defined Benefit Plan" as endorsed by the FSC upon the employee's retirement. The actuarial valuation assumptions and parameters are based on those announced by the authority, if any.

(4) Termination benefits

Termination benefit is paid to the employees of the Bank and its subsidiaries who are eligible for retirement and terminated or voluntarily dismiss in exchange of termination benefit. The Bank and its subsidiaries made promises in the formal detailed employment termination plan which is irrevocable, and shall recognize liabilities when providing termination benefit to employees who voluntarily resign as a result of encouragement. Termination benefit paid 12 months after the financial reporting date should be discounted.

4.20 Provision for Liabilities, Contingent Liabilities and Contingent Assets

When all the following criteria are met, the Bank and its subsidiaries shall make a provision for liabilities:

(1) A present obligation (legal or constructive) as a result of a past event;

(2) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(3) The amount of the obligation can be reliably estimated.

The Bank and its subsidiaries do not make a provision for liabilities for future operating losses.

If there are several similar obligations, the outflow of economic benefit as a result of settlement is determined based on the overall obligation. Provisions for liabilities should be recognized when the outflow of economic benefits is probable in order to settle the obligation as a whole even if the outflow of economic benefits from any one of the obligation is remote.

Provisions are measured by the present value of expense which is required for settling the anticipated obligation. The pre-tax discount rate is used with timely adjustment that reflects the current market assessments on the time value of money and the risks specific to the obligation.

Contingent liability is a possible obligation that arises from past event, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank and its subsidiaries. Or it could be a present obligation as a result of past event but the payment is not probable or the amount cannot be measured reliably. The Bank and subsidiaries did not recognize any contingent liabilities but made appropriate disclosure in compliance with relevant regulations.

Contingent asset is a possible obligation that arises from past event, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank and its subsidiaries. The Bank and its subsidiaries did not recognize any contingent assets and made appropriate disclosure in compliance with relevant regulations when the economic inflow is probable.

4.21 Financial Guarantee Contracts

The Bank and its subsidiaries initially recognize financial guarantee contracts at fair value on the date of issuance. The Bank and its subsidiaries charge a service fee when the contract is signed and therefore the service fee income charged is the

fair value at the date that the financial guarantee contract is signed. Service fee received in advance is recognized in deferred accounts and amortized through straight-line method during the contract term.

The best estimate of the liability amount of a financial guarantee contract requires management to exercise their judgment combined with historical loss data based on the similar transaction experiences.

The increase in liabilities due to financial guarantee contract is recognized in "Allowance for credit loss and loss on guarantees".

4.22 Bank Debentures

Bank debentures issued by the Bank and its subsidiaries are measured at amortised cost using the effective interest rate method.

4.23 Capital

(1) Cost of issuing shares

Incremental costs directly attributable to the issuance of new shares are removed from equity.

(2) Common share dividends

Stock dividends are not recognized and are only disclosed as subsequent event in the notes if the dividend declaration date is later than the consolidated balance sheet date.

4.24 Comparative Information

The Bank and its subsidiaries shall disclose the comparative information for the amounts reported in the current financial statements unless otherwise specifically provided by the IFRS or regulations endorsed by the FSC.

Comparative information was adjusted to reflect changes in accounting policies or account reclassification to ensure that such information is comparable to the financial information for the current year.

4.25 Operating Segments

Information of operating segments of the Bank and its subsidiaries is reported in the same method as the internal management report provided to the Chief Operating Decision-Maker (CODM). The CODM of the Bank refers to the Board of Directors of the Bank and its subsidiaries.

## 5. MAJOR SOURCES OF UNCERTAINTIES ASSOCIATED WITH SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the consolidated financial statements of the Bank and its subsidiaries requires management to make appropriate professional judgments, estimates and assumptions that affect the application of the accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The Bank and its subsidiaries made appropriate assumptions on and estimates of material risks associated with significant adjustments to be made to the carrying amount of assets and liabilities in the next financial year.

The assumptions and estimates made by the Bank and its subsidiaries are the best assumptions and estimates under the IFRSs. Assumptions and estimates are evaluated on an on-going basis and adjusted based on historical experience and other factors including projections of the future.

Management's critical judgements and the accounting policies applicable to some items had significant impact on the amounts reported in the financial statements of the Bank and its subsidiaries.

5.1 Impairment Loss on Loans

The Bank and its subsidiaries review loan portfolios to assess impairment periodically. In determining whether an impairment loss should be recorded in the income statement, the Bank and its subsidiaries make judgments to recognize impairment loss as to whether there is observable evidence indicating that an impairment has occurred. This evidence includes repayment status of debtor, event that would cause delinquency in payments, and any significantly unfavorable changes in national or local economic circumstances. The management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when estimating expected future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly by the Bank and its subsidiaries in order to decrease the difference between estimated loss and actual loss.

5.2 Financial Instruments

(1) The fair value of non-active market or non-quoted financial instruments is determined using valuation techniques. Such

fair value is based on observable data of similar financial instruments or valuation model. If there are no observable market parameters, the fair value of financial instruments is evaluated based on appropriate assumptions. If the fair value is determined by the valuation model, the model is calibrated to ensure that all output data and the results reflect the actual market price. This valuation model use only observable data as much as possible. The management is required to estimate the volatility and correlation of credit risks (own and counterparty risks).

(2) Financial assets－impairment on equity investment

The Bank and its subsidiaries determine whether impairment has occurred on individual financial assets-equity investment in accordance with IFRS 39. The decision requires the management to exercise important judgment. The Bank and its subsidiaries separately evaluate the time when the fair values of individual investments fall below their costs

(3) Financial assets carried at cost

The more recent information obtainable for equity instruments with no active market held by the Bank and its subsidiaries was insufficient to determine the fair value of such assets, and as such the fair value of the assets cannot be reliably measured. These investments were classified as “financial assets carried at cost”.

(4) Please refer to Note 8.5 for analysis on the risks of financial instruments.

5.3 Income Tax

The estimates of income taxes payable involve many transactions and calculations. The Bank and its subsidiaries may recognize additional income tax liabilities for some tax issues when necessary. Any difference between the final income tax payable and initially recognized income tax payable will affect the amounts of current income taxes and deferred income taxes.

Please see Note 6.8 for evaluation of deferred income tax items.

5.4 Post Employment Benefit

The present value of post-employment benefit obligations are estimated based on several actuarial assumptions. Any changes in those assumptions will affect the carrying amounts of post-employment benefit obligations.

The assumptions used to determine net pension cost (revenue) comprise the discount rate. The Bank and its subsidiaries determine the appropriate discount rate at the end of each year, and use the discount rate in calculating the present value of future cash out of post-employment benefit obligations. The discount rate is chosen by reference to the rate of high-quality corporate bonds where the currency and maturity date of high-quality corporate bonds are in agreement with those of post-employment benefit obligations.

Other significant assumptions associated with post-employment benefits are made on the basis of current market conditions.

## 6. DETAILS OF SIGNIFICANT ACCOUNTS

6.1 Cash and Cash Equivalents

| Item | Dec. 31, 2014 | Dec. 31, 2013 |
|---|---|---|
| Cash on hand and petty cash | $1,431,657 | $1,303,541 |
| Notes and checks for clearing | 592,723 | 505,160 |
| Due from banks | 2,083,536 | 1,520,440 |
| Total | $4,107,916 | $3,329,141 |

(1) For the purpose of preparing the consolidated cash flow statements, cash and cash equivalents comprise of the following amounts:

| Item | Dec. 31, 2014 | Dec. 31, 2013 |
|---|---|---|
| Cash and cash equivalents in consolidated balance sheets | $4,107,916 | $3,329,141 |
| Due from the Central Bank of China and other banks that meet the definition of cash and cash equivalents in IAS 7 | 16,275,436 | 16,247,872 |
| Bills and bonds purchased under agreements to resell that meet the definition of cash and cash equivalents in IAS 7 | 13,385,318 | 3,460,558 |
| Cash and cash equivalents in consolidated statement of cash flow | $33,768,670 | $23,037,571 |