Notes to the Financial Statements

December 31, 2002
(Amount expressed in Hong Kong dollars unless otherwise stated)

1 GROUP ORGANIZATION

PCCW Limited (formerly Pacific Century CyberWorks Limited) (the “Company”) was incorporated in Hong Kong and its securities have been listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) since October 18, 1994. The principal activities of the Company and its subsidiaries (the “Group”) are the provision of local and international telecommunications services, Internet and interactive multimedia services, the sale and rental of telecommunications equipment, and the provision of computer, engineering and other technical services, mainly in the Hong Kong Special Administrative Region (“Hong Kong”); investment in and development of systems integration and technology-related businesses; and investment in and development of infrastructure and properties in Hong Kong and elsewhere in mainland China.

The directors consider Pacific Century Group Holdings Limited (“PCG”), a company incorporated in the British Virgin Islands (“BVI”), to be the ultimate holding company.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES

a. Statement of compliance

The financial statements have been prepared in accordance with applicable Statements of Standard Accounting Practice (“SSAP”) issued by the Hong Kong Society of Accountants, accounting principles generally accepted in Hong Kong (“HK GAAP”) and the disclosure requirements of the Hong Kong Companies Ordinance. In particular, these financial statements reflect the adoption of the first time of SSAP 1 (revised) “Presentation of financial statements”, SSAP 11 (revised) “Foreign currency translation”, SSAP 15 (revised) “Cash flow statements”, SSAP 33 “Discontinuing operations” and SSAP 34 “Employee benefits” which became effective January 1, 2002, and have opted for adoption of SSAP 12 “Income taxes” which is effective for accounting periods commencing on or after January 1, 2003. The Group has followed the transitional arrangements and where appropriate has retrospectively adjusted its financial results for the year ended December 31, 2001, as required under SSAP 2 “Net profit or loss for the period, fundamental errors and changes in accounting polices”. Details of these adjustments are disclosed in note 38. These financial statements also comply with the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange. Apart from the new SSAP 34 and the revised SSAP 12, the adoption of these new and revised SSAPs has not had a material financial impact on the preparation of these financial statements, although some comparative disclosures have been amended or extended.

b. Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is historical cost modified by the revaluation of investment properties and the marking to market of certain investments in securities as further explained in the accounting policies set out below.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

c. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries. All significant intra-group transactions and balances are eliminated on consolidation.

Unless otherwise indicated, the results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from or up to their effective dates of acquisition or disposal, as appropriate.

The equity and net income attributable to minority shareholders' interests are shown separately in the balance sheet and income statement, respectively.

For subsidiaries having accounting year ends different from the Group, the subsidiaries prepare, for the purpose of consolidation, financial statements as at the same date as the Group.

d. Turnover

Turnover represents (i) telecommunications and other service revenues, (ii) the amounts received and receivable in respect of goods sold, or sales of properties, (iii) amounts received and receivable from the rental of investment properties, and (iv) revenues from construction contracts.

e. Revenue recognition

Provided it is probable that the economic benefits associated with a transaction will flow to the Group and the revenue and costs, if applicable, can be measured reliably, turnover and other revenue are recognized in the income statement on the following bases:

i. **Telecommunications and other services**

Telecommunications services comprise the fixed line telecommunications network services and equipment businesses in Hong Kong.

Telecommunications service revenue based on usage of the Group's network and facilities is recognized when the services are rendered. Telecommunications revenue for services provided for fixed periods is recognized on a straight-line basis over the respective periods.

Other service income is recognized when services are rendered to customers.

ii. **Sales of goods**

Sales of goods are recognized when the significant risks and rewards of ownership of the goods have been transferred to customers.

iii. **Sales of properties**

Income arising from sales of completed properties is recognized upon completion of the sale when title passes to the purchaser.

Income arising from the pre-sale of properties under development is recognized when legally binding unconditional sales contracts are signed and exchanged, provided that the construction work has progressed to a stage where the ultimate realization of profit can be reasonably determined and on the basis that the total estimated profit is apportioned over the entire period of construction to reflect the progress of the development.

iv. **Rental income**

Rental income from investment properties is recognized on a straight-line basis over the respective terms of the leases.

v. **Contract revenue**

Revenue from a fixed price contract is recognized using the percentage of completion method, measured by reference to the percentage of estimated value of work done to date to total contract revenue.

vi. **Interest income**

Interest income from bank deposits and interest bearing notes is recognized on a time apportioned basis on the principal outstanding and at the rate applicable. Any discount or premium from the interest bearing notes is amortized over the life of the notes.

vii. **Commission income**

Commission income is recognized when entitlement to the income is ascertained.

viii. **Dividend income**

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

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

f. Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rental income and expenses under operating leases are accounted for in the income statement on a straight-line basis over the period of the relevant leases.

g. Fixed assets and depreciation

Fixed assets, excluding investment properties, are stated in the balance sheet at cost less accumulated depreciation and impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after a fixed asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the subsequent expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset beyond its originally assessed standard of performance, the expenditure is capitalized as an additional cost of the fixed asset and is depreciated over the original remaining useful life of the asset.

Depreciation is calculated on the straight-line basis at annual rates estimated to write off the cost of fixed assets over their expected useful lives. The annual rates are as follows:

Land and buildings	Over the shorter of the lease term and the expected useful lives
Exchange equipment	5 to 15 years
Transmission plant	5 to 25 years
Other plant and equipment	Over the shorter of 2 to 16 years and term of lease

A write-down is made if the recoverable amount of a fixed asset is below its carrying amount. The write-down is charged to the income statement as an expense unless it reverses a previous revaluation increase, in which case it is charged directly against any related revaluation reserve to the extent that the reduction does not exceed the amount held in the revaluation reserve in respect of the same item.

When fixed assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the income statement.

h. Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are held for their investment potential and for the long term.

Investment properties are included in the balance sheet at their open market value, on the basis of an annual valuation by professionally qualified executives of the Group and by independent valuers at intervals of not more than three years. Changes in the value of investment properties are dealt with as movements in the property revaluation reserve. If the total of this reserve is insufficient to cover a reduction in the open market value on a portfolio basis, the excess is charged to the income statement. Where a deficit has previously been charged to the income statement and a revaluation surplus subsequently arises, this surplus is credited to the income statement to the extent of the deficit previously charged.

Upon the disposal of an investment property, the relevant portion of the revaluation reserve realized in respect of previous valuations is released from the property revaluation reserve to the income statement as part of the gain or loss on disposal of the investment property.

No depreciation is provided on investment properties unless the unexpired lease term is 20 years or less, in which case depreciation is provided on their carrying value over the unexpired leases term.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

i. Impairment of assets

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

- fixed assets;
- investment in subsidiaries, associates and jointly controlled companies;
- intangible assets; and
- goodwill (whether taken initially to reserves or recognized as an asset).

If any such indication exists, the asset's recoverable amount is estimated. For intangible assets that are not yet available for use, or are amortized over more than 20 years from the date when the asset is available for use or goodwill that is taken initially to reserves or amortized over 20 years from initial recognition, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognized in the income statement whenever the carrying amount of an asset exceeds its recoverable amount.

i. **Calculation of recoverable amount**

The recoverable amount of an asset is the greater of its net selling price and its value in use. Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

ii. **Reversals of impairment losses**

In respect of assets other than goodwill, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is reversed only if the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognized in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognized.

j. Properties held for development

Properties held for development represent interests in land where construction has not yet commenced. Properties held for development are stated at cost less any provision for impairment in value. Costs include original land acquisition costs, costs of land use rights, and any direct development costs incurred attributable to such properties.

k. Properties under development

Properties under development represent interests in land and buildings under construction. Properties under development for long-term purposes are stated at cost less any provision for impairment in value. Properties under development for sale, pre-sales of which have not yet commenced are carried at the lower of cost and net realizable value. Properties under development for sale for which pre-sales have commenced are stated at cost plus attributable profits less sale deposits, instalments received and receivable and any foreseeable losses.

Cost includes original land acquisition costs, costs of land use rights, construction expenditure incurred and other direct development costs attributable to such properties, including interest prior to the completion of construction.

Properties under development for long-term retention, on completion, are transferred to fixed assets or investment properties.

Properties under development for sale with occupancy permits expected to be granted within one year from the balance sheet date, which have either been pre-sold or are intended for sale, are classified under current assets.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

l. Trademarks

Trademarks are stated in the balance sheet within intangible assets at acquisition cost and are amortized on a straight-line basis over their expected future economic lives of 20 years. Where appropriate, provision is made for any impairment in value.

m. Goodwill

Goodwill arising on the acquisition of a subsidiary, jointly controlled company or associate represents the excess of the purchase consideration over the Group's share of the estimated fair value ascribed to the separable assets and liabilities of the subsidiary, jointly controlled company or associate at the date of acquisition.

Goodwill is capitalized and amortized on a straight-line basis over its estimated useful life ranging from 10 to 20 years. The amortization charge for each period is recognized as an expense.

Goodwill arising from transactions completed prior to January 1, 2001 was eliminated directly against reserves and is reduced by impairment losses. Any impairment loss identified is recognized as an expense.

On disposal of an interest in a subsidiary, a jointly controlled company or an associate, the attributable amount of goodwill not previously amortized through the consolidated income statement or which has previously been dealt with as a movement on group reserves is included in the calculation of the profit or loss on disposal.

n. Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the composition of the board of directors. A subsidiary is considered to be controlled if the Company has the power, directly or indirectly, to govern its financial and operating policies. Investments in subsidiaries are carried at cost in the Company's balance sheet less provision for impairment in value, on an individual entity basis. The results of subsidiaries are included in the income statement of the Company only to the extent of dividends declared.

o. Associates

An associate is a company over which the Group has significant influence, but not control or joint control, and thereby has the ability to participate in its financial and operating policy decisions.

In the consolidated financial statements, investments in associates are accounted for using the equity method of accounting, whereby investments are initially recorded at cost and the carrying amounts are adjusted to recognize the Group's share of post-acquisition profits or losses of the associates, distributions received from associates and other necessary alterations in the Group's proportionate interests in the net assets of the associates arising from changes in the equity of associates that have not been included in the consolidated income statement.

In the Company's balance sheet, investment in associates is carried at cost less provision for impairment in value, on an individual entity basis. The results of associates are included in the income statement of the Company only to the extent of dividends declared.

p. Joint ventures and jointly controlled companies

A jointly controlled company or a joint venture is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control and over which none of the participating parties has unilateral control. The Group has made investments in joint ventures in the People's Republic of China (the "PRC") in respect of which the partners' profit-sharing ratios during the joint venture period and share of net assets upon the expiration of the joint venture period may not be in proportion to their equity ratios, but are as defined in the respective joint venture contracts.

Investments in jointly controlled companies or joint ventures are accounted for using the equity method of accounting, as described in note 2(o) above, in the Group's consolidated financial statements.

p. Joint ventures and jointly controlled companies (continued)

Investments made by means of joint venture structures where the Group controls the board of directors or equivalent governing body and/or is in a position to exercise control over the financial and operating policies of the joint ventures are accounted for as subsidiaries.

The Company's interests in joint ventures and jointly controlled companies are carried at cost in the Company's balance sheet less provisions for impairment in value, on an individual entity basis. The results of joint ventures and jointly controlled companies are included in the income statement of the Company only to the extent of dividends declared.

q. Unconsolidated subsidiaries

An unconsolidated subsidiary is a subsidiary that is excluded from consolidation. This arises when control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future. To the extent the investments in unconsolidated subsidiaries are intended to be temporary, they are accounted for using the cost method of accounting and are recorded as current assets on the consolidated balance sheet. In respect of investments in unconsolidated subsidiaries intended to be held for the long term, they are accounted for using the equity method of accounting.

r. Investments

Held-to-maturity securities

Held-to-maturity securities are investments which the Group has the expressed intention and ability to hold to maturity. They are carried at amortized cost less any provision for impairment in value. Any discount or premium is amortized over the period to maturity and is included in the income statement.

The carrying amounts of held-to-maturity securities are reviewed at each balance sheet date to assess the credit risk and whether the carrying amounts are expected to be recovered. Provisions are made when the carrying amounts are not expected to be recovered and are recognized as an expense in the income statement.

Investment securities

Investments, which include both debt and equity securities, intended to be held on a continuing basis, are classified as investment securities and are included in the balance sheet at cost less any provision for impairment in value.

The carrying amounts of investment securities are reviewed at each balance sheet date to assess whether fair values have declined below the carrying amounts. When such a decline has occurred, the carrying amount is reduced and the reduction is recognized as an expense in the income statement unless there is evidence that the decline is temporary.

Provisions against the carrying values of held-to-maturity securities and investment securities are reversed to the income statement when the circumstances and events that led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Upon disposal of held-to-maturity securities and investment securities, any profit or loss thereon is accounted for in the income statement.

Other investments

Investments other than held-to-maturity securities and investment securities are classified as other investments and are carried at fair value in the balance sheet. Any unrealized holding gain or loss on other investments is recognized in the income statement in the period when it arises. Upon disposal of other investments, any profit or loss representing the difference between the carrying value of the investment and net sales proceeds is accounted for in the income statement.

The transfer of investments between categories is accounted for at fair value. For an investment transferred into the other investment category, the unrealized holding gain or loss at the date of transfer is recognized in the income statement immediately. Previously recognized unrealized holding gains or losses on investments transferred from other investment category are not reversed.

s. Properties held for sale

Properties held for sale are stated at the lower of cost and net realizable value. Cost includes development and construction expenditure incurred, interest incurred during the construction period and other direct costs attributable to such properties. Net realizable value is estimated by the directors based on prevailing market prices, on an individual property basis, less any further costs expected to be incurred on disposal.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

t. Inventories

Inventories consist of trading inventories, work in progress and consumable inventories.

Trading inventories are carried at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Work-in-progress is stated at cost, which comprises labor, materials and overheads where appropriate.

Consumable inventories, held for use in the maintenance and expansion of the Group's telecommunications systems, are stated at cost less provision for deterioration and obsolescence.

Cost is derived on the weighted average cost basis and comprises all costs of purchase, costs of conversion and other costs incurred in bringing inventories to their present location and condition.

u. Construction contracts

The accounting policy for contract revenues is set out in note 2(e)(v) above. When the outcome of a construction contract can be estimated reliably, contract costs are recognized as expenses by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the full expected loss is recognized as an expense immediately. When the outcome of a construction contract cannot be estimated reliably, contract costs are recognized as an expense in the period in which they are incurred.

Construction contracts in progress at the balance sheet date are recorded at the net amount of costs incurred plus recognized profits less recognized losses and estimated value of work performed, and are presented in the balance sheet as "Gross amounts due from customers for contract work" (an asset) or "Gross amounts due to customers for contract work" (a liability), as applicable. Amounts billed, but not yet paid by customers, for work performed on a contract are included in the balance sheet under "Accounts receivable".

v. Cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity when acquired, less bank overdrafts that are repayable on demand and form an integral part of the Group's cash management, and also advances from banks repayable within three months from the dates of advances.

w. Provisions and contingent liabilities

A provision is recognized when, and only when, a company has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate of amount required. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

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

x. Borrowing costs

Borrowing costs are expensed in the income statement in the period in which they are incurred, except to the extent that they are attributable to the acquisition, construction or production of an asset that necessarily involves a substantial period of time before the asset is ready for its intended use or sale, in which case the borrowing costs are capitalized as part of the cost of the asset.

Discounts or premiums relating to borrowings, ancillary costs incurred in connection with arranging borrowings and exchange differences arising from foreign currency borrowings to the extent that they are regarded as adjustments to interest costs, are recognized as expenses over the period of the borrowing.

y. Deferred taxation

Deferred taxation is provided using the liability method, on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The principal temporary differences arise from depreciation on fixed assets, revaluations of certain non-current assets, provisions for pensions, tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax liabilities are provided in full on all taxable temporary differences while deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Before the adoption of SSAP 12, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the financial statements to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. The adoption of SSAP 12 "Income taxes" represents a change in accounting policy, which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy (see note 38(b)).

z. Employee benefits

i. Salaries, annual bonuses, annual leave entitlements, leave passage and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, provisions are made for the estimated liability as a result of services rendered by employees up to the balance sheet date.

ii. The Group operates both defined benefit and defined contribution retirement schemes (including the Mandatory Provident Fund) for its employees, the assets of which are generally held in separate trustee – administered funds. The schemes are generally funded by payments from the relevant Group companies and, in some cases, employees themselves, taking account of the recommendations of independent qualified actuaries.

   The Group's contributions to the defined contribution schemes are charged to the income statement in the period to which the contributions relate.

   For defined benefit retirement schemes, retirement costs are assessed using the projected unit credit method. Under this method, the cost of providing retirement benefits is charged to the income statement so as to spread the regular cost over the service lives of employees in accordance with the advice of the actuaries who carry out a full valuation of the schemes on an annual basis. The retirement benefit obligation is measured as the present value of the estimated future cash outflows using market yields on Exchange Fund Notes which have terms to maturity approximating the terms of the related liability. Scheme assets are measured at fair value. Actuarial gains and losses, to the extent that the amount is in excess of 10 percent of the greater of the present value of the defined benefit obligations and the fair value of the scheme assets, are recognised over the expected average remaining service lives of the employees. Past service costs are recognised as an expense on a straight-line basis over the average period until the benefits become vested.

   In previous years, retirement costs in respect of the defined benefit retirement schemes were charged to the income statement based on actuarial determinations of contributions payable in that year, using the attained age method. The adoption of the SSAP 34 "Employee benefits" in 2002 represents a change in accounting policy. As a result of this change, the opening deficit at January 1, 2002 has been increased by HK$723 million. Comparatives have not been restated (see note 38(a)).

iii. The Group grants employees shares of the Company under its share award schemes at nil consideration. The cost of shares is recognized in the balance sheet as prepaid expenses at the date of grant and amortized over the respective vesting period and recognized in the income statement as staff costs.

   The Group also operates share option schemes where directors or employees are granted with options to acquire shares of the Company at specified exercise price. No compensation costs are recognized in the income statement.

iv. Termination benefits are recognized when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

aa. Foreign currencies

Companies comprising the Group maintain their books and records in the primary currencies of their operations (the "respective functional currencies").

In the financial statements of individual companies, transactions in other currencies during the year are translated into the respective functional currencies at the applicable rates of exchange prevailing at the time of the transactions. Monetary assets and liabilities denominated in other currencies are translated into the respective functional currencies at the applicable rates of exchange in effect at the balance sheet date. All exchange differences are dealt with in the income statement.

For the purpose of preparing consolidated financial statements, the financial statements of the individual companies with functional currencies other than Hong Kong dollars are translated into Hong Kong dollars using the net investment method. Under this method, assets and liabilities of these individual companies are translated into Hong Kong dollars at the applicable rates of exchange in effect at the balance sheet date. Income and expenses are translated at the average exchange rates for the year. Share capital and other reserves are translated into Hong Kong dollars at historical rates. Exchange differences arising on translation are dealt with as movements in reserves.

bb. Off balance sheet financial instruments and derivatives

Gains and losses on the revaluation and maturity of spot and forward foreign exchange contracts used for hedging purposes are recorded in the income statement and are offset against gains and losses arising from the foreign exchange transactions and revaluation of foreign currency denominated assets and liabilities which these contracts are hedging. Forward contracts undertaken for trading purposes are marked to market and the gain or loss arising is recognized in the income statement.

Interest rate swaps, forward interest rate agreements and interest rate options are used to manage exposure to interest rate fluctuations. The notional amounts are recorded off balance sheet. Interest flows are accounted for on an accrual basis. Interest income or expense arising from the interest rate swap contracts are netted off against the related interest income or expense applicable to the on-balance sheet items, which these financial instruments are hedging.

The notional amounts of equity and currency options are not reflected in the balance sheet.

Premiums received or paid on the respective written or purchased equity and currency options are amortized over the terms of these options (see note 33). Premium received or paid or unamortized balance of premium received or paid resulting from early termination of the financial instruments and derivatives are recognized in the income statement in the year of termination.

cc. Management estimates

The presentation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

dd. Segment reporting

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

Consistent with the Group's internal financial reporting, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format.

Segment revenues, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenues, segment expenses and segment performance include transactions between segments. Inter-segment pricing is based on similar terms as those available to unaffiliated customers for similar services. These transactions are eliminated upon consolidation.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (continued)

dd. Segment reporting (continued)

Segment capital expenditure represents the total cost incurred during the year to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets and liabilities, interest-bearing loans, borrowings, corporate and financing expenses and minority interests.

3 RELATED PARTY TRANSACTIONS

Companies are considered to be related if one company has the ability, directly or indirectly, to control the other company or exercise significant influence over the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence.

a. During the year, the Group had the following significant transactions with related companies:

In HK$ million	The Group **2002**	 2001
Convertible bond interest payable to the ultimate holding company	**293**	293
Telecommunication service fees, rental charges and subcontracting charges from an associate and a jointly controlled company	**848**	1,150
Purchase of telecommunications services from an associate and a jointly controlled company	**1,636**	1,826

The above transactions were carried out after negotiations between the Group and the related parties in the ordinary course of business and on the basis of estimated market value as determined by the directors. In respect of transactions for which the price or volume has not yet been agreed with the relevant related parties, the directors have determined the relevant amounts based on their best estimation.

b. Advances from customers include an amount of HK$107 million (2001: HK$150 million) which represents prepaid advertising fees received and receivable from investee companies for advertising space on the broadband Internet and television network operated by the Group.

c. A wholly-owned subsidiary of the Company and a jointly controlled company (“JV”) have entered into a Hong Kong Domestic Connectivity Agreement and an International Services Agreement for the provision of domestic and international connectivity services in Hong Kong and between Hong Kong and other countries. Pursuant to the International Services Agreement, for the first five years of operations subsequent to the formation of the JV, the Group is required to acquire 90 percent, 90 percent, 80 percent, 70 percent and 60 percent per annum, respectively, of its total annual purchases of “Committed Services” (being international public switched telephone network terminating access, international transmission capacity and Internet gateway access services) from the JV. The Hong Kong Domestic Connectivity Agreement contemplates a reciprocal arrangement, whereby the Group will provide local connectivity services to the JV under similar terms and conditions. Both agreements are subject to renegotiation when the agreements expire in 2006.

In addition, the Group entered into one year fixed price bulk purchase arrangements for international connectivity services from January 1, 2002 which committed the Group to aggregate purchase levels. The Group’s commitments under these arrangements had regard to its future capacity needs and opportunities for growth as well as the JV’s minimum earnings requirements under its financing arrangements. Regulated services in Hong Kong were acquired in accordance with tariffs approved by the relevant regulatory authority and unregulated services were acquired in accordance with market prices. Purchases made by the Group for the year ended December 31, 2002 were HK$1,443 million (2001: HK$1,700 million).

d. Balances with related parties other than as specified in this note are unsecured, non-interest bearing and have no fixed repayment terms.

4 SEGMENT INFORMATION

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more consistent with the Group's internal financial reporting.

a. Business segments

During the year, the Group transferred certain operations among business segments as a result of its operational re-organization. The Group comprises the following main business segments:

Telecommunications Services ("TSS") is the leading provider of telecommunications services, Internet access and multimedia services and related equipment in Hong Kong.

Business eSolutions offers IT solutions, business broadband Internet access, hosting and facilities management services and directories businesses within Hong Kong, Taiwan and mainland China.

Infrastructure and Property ("Infrastructure") covers the Group's property portfolio in Hong Kong and mainland China including the Cyberport development in Hong Kong.

Others include the Group's other businesses in mainland China, Pacific Century CyberWorks Japan Co., Ltd. ("PCCW Japan"), Internet Services and CyberWorks Ventures.

4 SEGMENT INFORMATION (continued)

a. Business segments (continued)

In HK$ million	TSS[1]		Business eSolutions[3]		Infrastructure		Others[2]		Eliminations		Consolidated	
	2002	2001*	**2002**	2001*	**2002**	2001	**2002**	2001*	**2002**	2001*	**2002**	2001 (Restated) (Note 38)
REVENUE												
External revenue	**17,248**	18,874	**1,661**	1,457	**503**	1,238	**700**	390	**–**	–	**20,112**	21,959
Inter-segment revenue	**759**	953	**573**	479	**182**	130	**93**	78	**(1,607)**	(1,640)	**–**	–
Total revenue	**18,007**	19,827	**2,234**	1,936	**685**	1,368	**793**	468	**(1,607)**	(1,640)	**20,112**	21,959
RESULT												
Segment result	**6,348**	7,243	**(102)**	(31)	**267**	309	**(1,930)**	(1,622)	**–**	–	**4,583**	5,899
Unallocated corporate expenses											**(203)**	(449)
Profit from operations											**4,380**	5,450
Finance costs, net											**(1,997)**	(3,056)
Share of results of associates, jointly controlled companies and unconsolidated subsidiaries	**1,060**	1,092	**(34)**	(72)	**1**	–	**(196)**	(187)	**–**	–	**831**	833
Impairment loss for goodwill attributable to the interest in REACH	**(8,263)**	–	**–**	–	**–**	–	**–**	–	**–**	–	**(8,263)**	–
Losses on disposal of interests in RWC and MobileOne, net	**(1,433)**	–	**–**	–	**–**	–	**–**	–	**–**	–	**(1,433)**	–
(Loss)/Profit before taxation											**(6,482)**	3,227
Taxation											**(1,406)**	(1,982)
(Loss)/Profit after taxation											**(7,888)**	1,245
Minority interests											**126**	98
(Loss)/Profit for the year attributable to shareholders											**(7,762)**	1,343

4 SEGMENT INFORMATION (continued)

a. Business segments (continued)

In HK$ million	TSS[1] 2002	TSS[1] 2001*	Business eSolutions[3] 2002	Business eSolutions[3] 2001*	Infrastructure 2002	Infrastructure 2001	Others[2] 2002	Others[2] 2001*	Eliminations 2002	Eliminations 2001*	Consolidated 2002	Consolidated 2001 (Restated) (Note 38)
OTHER INFORMATION												
Capital expenditure (including fixed assets, intangible assets and goodwill) incurred during the year	**1,353**	2,777	**117**	425	**19**	16	**718**	689				
Depreciation and amortization	**2,183**	2,002	**95**	77	**206**	201	**255**	270				
Impairment loss recognized in income statement	**8,263**	–	**147**	–	**–**	63	**387**	28				
Significant non-cash expenses (excluding depreciation, amortization and impairment loss)	**108**	126	**16**	–	**10**	–	**742**	457				
ASSETS												
Segment assets	**20,122**	17,542	**1,474**	1,334	**10,662**	11,451	**3,082**	3,513	**–**	–	**35,340**	33,840
Investment in associates and jointly controlled companies	**4,443**	5,870	**110**	202	**1**	4	**78**	160	**–**	–	**4,632**	6,236
Unallocated corporate assets											**9,791**	11,765
Consolidated total assets											**49,763**	51,841
LIABILITIES												
Segment liabilities	**5,593**	4,989	**734**	198	**977**	952	**736**	1,258	**–**	–	**8,040**	7,397
Unallocated corporate liabilities											**47,231**	54,941
Consolidated total liabilities											**55,271**	62,338

* Comparative figures have been restated to conform with current year's classification as follows:

1. Retail consumer broadband and narrowband Internet access services and related multimedia services were transferred to TSS from Internet Services in 2002.
2. The remainder of Internet Services, which primarily comprises costs associated with the production of English and Chinese Internet and broadband content, is included under Others in 2002.
3. The operations of Internet Data Centers were merged into and are reported under Business eSolutions in 2002.

4 SEGMENT INFORMATION (continued)

b. Geographical segments

The Group's businesses are managed on a worldwide basis, but operate in three principal economic environments. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets and capital expenditure are based on the geographical location of the assets.

In HK$ million	Revenue from external customers		Segment assets		Capital expenditure incurred during the year	
	2002	2001	**2002**	2001	**2002**	2001
Hong Kong	**19,063**	21,010	**29,000**	27,027	**1,550**	3,429
Mainland China and Taiwan	**701**	853	**4,708**	4,501	**62**	92
Others	**348**	96	**1,632**	2,312	**616**	400
	20,112	21,959	**35,340**	33,840	**2,228**	3,921

5 OPERATING PROFIT BEFORE NET GAINS ON INVESTMENTS, PROVISION FOR IMPAIRMENT LOSSES AND RESTRUCTURING COSTS

In HK$ million	The Group	
	2002	2001
Turnover	**20,112**	21,959
Cost of sales	**(5,295)**	(6,855)
General and administrative expenses	**(9,605)**	(10,369)
Other income	**–**	39
Operating profit before net gains on investments, provision for impairment losses and restructuring costs	**5,212**	4,774

6 GAINS ON INVESTMENTS, NET

In HK$ million	The Group	
	2002	2001
Net unrealized holding losses on other investments	**(142)**	(194)
Net realized (losses)/gains from disposals of investments in subsidiaries, investment securities and other investments	**(92)**	261
Provision for impairment of investments	**(581)**	(263)
Amortisation of premium received from equity options	**32**	361
Release of provision for an onerous contract	**464**	477
Gain on termination of cross currency swap contracts (note 33(c))	**332**	–
Dividend income *	**–**	125
	13	767

* Dividends received in respect of 60 percent of the Group's investment in the wireless communications business before February 2001 when the venture with Telstra Corporation Limited ("Telstra") was formed.

7 RESTRUCTURING COSTS

During the current year, the Group subcontracted a significant portion of its network maintenance function to 17 newly-established subcontracting companies owned by individuals previously employed by the Group. Approximately 1,600 former employees joined these subcontracting companies in November 2002 and approximately 3,000 of the Group's employees joined a new wholly-owned subsidiary, Cascade Limited ("Cascade"), on January 1, 2003. In addition, the Group reset staff levels for maximum efficiency during the year involving approximately 1,400 employees. Restructuring costs mainly represent the ex-gratia payments, curtailment losses on the related defined benefit retirement schemes, Cascade incentive bonuses on employment transfers and payments in lieu of notice for the above exercises.

8 (LOSS)/PROFIT BEFORE TAXATION

(Loss)/Profit before taxation is stated after crediting and charging the following:

In HK$ million	The Group 2002	2001
Crediting:		
Dividend income from an unconsolidated subsidiary	**–**	125
Contract revenue	**63**	495
Realized gain on disposal of investment in subsidiaries, a jointly controlled company and associates included in gains on investments, net	**34**	264
Realized gain on disposal of investment securities included in gains on investments, net	**56**	14
Release of provision for an onerous contract	**464**	477
Exchange gains/(losses), net	**9**	(22)
Gross rental income	**332**	251
Less: outgoings	**(11)**	(9)
Charging:		
Unrealized holding losses on other investments included in gains on investments, net	**142**	194
Realized losses on disposal of other investments included in gains on investments, net	**182**	2
Provision for impairment of investments	**581**	263
Impairment provision of goodwill attributable to REACH	**8,263**	–
Impairment provision of goodwill attributable to a subsidiary	**309**	–
Provision for impairment of fixed assets	**232**	27
Write-off of intangible assets	**8**	4
Provision for property held for development	**–**	60
Depreciation	**2,623**	2,437
Amortization of intangible assets (included in operating expenses)	**112**	76
Amortization of goodwill (included in operating expenses)	**85**	50
Staff costs (excluding directors' emoluments (note 12) and retirement costs for other staff)	**3,395**	4,069
Retirement costs for other staff		
– contributions to defined contribution retirement scheme	**47**	327
– increase in liability for defined benefit retirement schemes (note 27(a) (iii))	**197**	–
– curtailment loss for the defined benefit retirement schemes included in restructuring costs (note 27(a) (iii))	**108**	–
Cost of inventories	**1,431**	1,735
Loss on disposal of fixed assets	**76**	63
Auditors' remuneration		
– current year	**10**	8
– underprovision in previous year	**2**	4
Operating lease rental		
– land and buildings	**261**	310
– equipment	**145**	163
Provision for inventory obsolescence	**26**	38

9 FINANCE COSTS, NET

In HK$ million	The Group 2002	2001
Interest paid/payable for:		
Bank loans and overdrafts wholly repayable within 5 years	**10**	887
Bank loans not wholly repayable within 5 years	**842**	1,853
Other loans wholly repayable within 5 years	**811**	645
Other loans not wholly repayable within 5 years	**531**	359
	2,194	3,744
Interest capitalized in properties under development and fixed assets	**(33)**	(140)
Finance costs	**2,161**	3,604
Interest income on bank deposits	**(164)**	(548)
Finance costs, net	**1,997**	3,056

Finance costs of HK$2,161 million (2001: HK$3,604 million) include amortization of arrangement fees of approximately HK$241 million (2001: HK$517 million) incurred in respect of the bank loans and other long term borrowings of the Group.

During the year, the capitalization rates used to determine the amount of interest eligible for capitalization ranged from 3.0 percent to 3.5 percent (2001: 3.3 percent to 7.1 percent).

10 IMPAIRMENT LOSS FOR GOODWILL ATTRIBUTABLE TO THE INTEREST IN REACH LTD. ("REACH")

REACH is currently in negotiations with its bankers to restructure the terms of a syndicated bank loan of US$1,500 million. As at March 20, 2003, the date these financial statements were approved, it has been granted waivers for certain of its debt covenants until the end of March 2003. REACH continues to operate in difficult and volatile conditions and its ability to continue as a going concern is dependent on successful renegotiation of its existing bank loan or other forms of funding being made available. Discussions with the banks continue to be constructive.

In view of the above developments, the Group has also performed an assessment of the fair value of its interest in REACH, including the related goodwill that had previously been eliminated against reserves, as at December 31, 2002. As a result, based on the estimated value in use of REACH determined using a discount rate of 9 percent (2001: 9 percent), the Group has recognized an impairment loss for goodwill attributable to the interest in REACH of approximately HK$8,263 million in the income statement for the year ended December 31, 2002.

11 LOSSES ON DISPOSAL OF INTERESTS IN JOINT VENTURE (BERMUDA) NO. 2 LIMITED ("RWC") AND MOBILEONE LTD. ("MobileOne"), NET

In HK$ million	The Group 2002	2001
Loss on disposal of interest in RWC (note a)	**(1,771)**	–
Profit on disposal of partial interest in MobileOne (note b)	**338**	–
	(1,433)	–

a. Loss on disposal of interest in RWC

On June 28, 2002, the Company and Telstra entered into, and completed, an agreement relating to the following:

i. the sale by the Company of its entire 40 percent equity interest in RWC to Telstra for a consideration of approximately US$614 million (approximately HK$4,792 million);

ii. the redemption by the Company of the outstanding principal amount of the US$750 million (approximately HK$5,850 million) variable coupon subordinated convertible bond due 2007 ("Telstra Bond due 2007") together with accrued interest of approximately US$54.38 million (approximately HK$424 million); and

11 LOSSES ON DISPOSAL OF INTERESTS IN JOINT VENTURE (BERMUDA) NO. 2 LIMITED ("RWC") AND MOBILEONE LTD. ("MobileOne"), NET (continued)

a. Loss on disposal of interest in RWC (continued)

iii. the issue by the Company of a US$190 million (approximately HK$1,482 million) 5 percent mandatory convertible note due 2005 ("Telstra Note due 2005") to Telstra.

A summary of the loss on disposal of interest in RWC is set out below:

In HK$ million	The Group 2002	2001
Telstra Bond due 2007	**5,850**	–
Accrued interest on Telstra Bond due 2007	**424**	–
Less: Fair value of Telstra Note due 2005	**(1,482)**	–
Proceeds on disposal of interest in RWC	**4,792**	–
Less: Book carrying value of interest in RWC as at June 28, 2002, as previously stated	**(2,770)**	–
Surplus of proceeds on disposal of interest in RWC over its book carrying value	**2,022**	–
Less: Realization of related goodwill previously charged against reserves, as previously stated	**(3,831)**	–
Loss on disposal of interest in RWC, as previously stated	**(1,809)**	–
Add: Adjustment to book carrying value of interest in RWC as at June 28, 2002 upon adoption of SSAP 12 "Income taxes"	**288**	–
Adjustment to realization of related goodwill charged against reserves	**(250)**	–
Loss on disposal of interest in RWC, as restated	**(1,771)**	–

b. Profit on disposal of partial interest in MobileOne

Prior to the disposal of its partial interest in MobileOne, the Group owned an effective 14.7 percent interest in MobileOne, an associate of the Group. In December 2002, MobileOne was listed on the Singapore Exchange Securities Trading Limited through the sale of existing shares. This resulted in a disposal of an equivalent of 8.4 percent stake in MobileOne by the Group. The consideration, net of transaction costs, for the disposal was approximately HK$497 million, which generated a profit of approximately HK$338 million. Following completion of the disposal, the Group's effective interest in MobileOne was reduced from 14.7 percent to 6.3 percent as at December 31, 2002.

A summary of the profit on disposal of partial interest in MobileOne is set out below:

In HK$ million	The Group 2002	2001
Proceeds on disposal of partial interest in MobileOne, net of transaction costs	**497**	–
Less: Share of the book carrying value of partial interest in MobileOne	**(159)**	–
Profit on disposal of partial interest in MobileOne	**338**	–

12 DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Details of directors' emoluments are set out below:

In HK$ million	The Group 2002	2001
Non-executive directors		
Fees	**3**	2
Executive directors		
Fees	**–**	–
Salaries, allowances and other allowances and benefits in kind	**46**	68
Pension scheme contributions	**4**	5
Bonuses paid and payable	**38**	51
Payments as compensation for loss of office	**22**	–
Payment to a director as inducement to join the Company (note a)	**8**	–
	118	124
Total	**121**	126

a. In addition, 4,954,000 shares of the Company (the number of shares does not reflect the share consolidation as described in note 15) were transferred by the Chairman and Chief Executive personally to a director as an inducement to join the Company. No new share was issued by the Company and the Company did not bear any portion of the cost of the shares transferred by the Chairman and Chief Executive.

The emoluments of the directors analyzed by the number of directors and emolument ranges are as follows:

	Number of directors The Group 2002	2001
Up to HK$1,000,000	**7**	10
HK$1,000,001 – HK$1,500,000	**3**	–
HK$2,500,001 – HK$3,000,000	**–**	1
HK$4,000,001 – HK$4,500,000	**1**	1
HK$5,500,001 – HK$6,000,000	**1**	2
HK$6,500,001 – HK$7,000,000	**–**	1
HK$7,000,001 – HK$7,500,000	**–**	1
HK$8,000,001 – HK$8,500,000	**1**	–
HK$9,000,001 – HK$9,500,000	**–**	1
HK$10,000,001 – HK$10,500,000	**1**	1
HK$10,500,001 – HK$11,000,000	**2**	1
HK$11,000,001 – HK$11,500,000	**3**	–
HK$13,000,001 – HK$13,500,000	**–**	1
HK$13,500,001 – HK$14,000,000	**1**	–
HK$16,000,001 – HK$16,500,000	**1**	–
HK$21,000,001 – HK$21,500,000	**–**	1
HK$25,500,001 – HK$26,000,000	**–**	1
	21	22

No directors waived the right to receive emoluments during the year.

Of the five highest paid individuals in the Group, all (2001: all) are directors of the Company whose emoluments are included above.

13 TAXATION

Hong Kong profits tax has been provided at the rate of 16 percent (2001: 16 percent) on the estimated assessable profits for the year.

Overseas taxation has been calculated on the estimated assessable profits for the year at the rates prevailing in the respective jurisdictions.

In HK$ million	The Group 2002	2001 (Restated) (Note 38)
The Company and subsidiaries:		
Hong Kong profits tax		
– Provision for current year	**1,249**	1,227
– Underprovision in respect of prior years	**3**	–
Overseas tax		
– Provision for current year	**137**	28
(Recovery of)/Provision for deferred taxation (note 30(a))		
– Hong Kong	**(152)**	460
	1,237	1,715
A jointly controlled company:		
Hong Kong profits tax		
– Provision for current year	**175**	160
Overseas tax		
– Provision for current year	**–**	6
Recovery of deferred taxation	**(14)**	(3)
Associates:		
Hong Kong profits tax		
– Provision for current year	**36**	60
Recovery of deferred taxation	**(28)**	(12)
Unconsolidated subsidiaries:		
Hong Kong profits tax		
– Recovery for current year	**–**	(6)
Provision for deferred taxation	**–**	62
Total	**1,406**	1,982

13 TAXATION (continued)

The taxation on the Group's (loss)/profit before taxation differs from the theoretical amount that would arise using the taxation rate of the home country of the Company as follows:

In HK$ million	The Group 2002	2001 (Restated) (Note 38)
(Loss)/Profit before taxation	**(6,482)**	3,227
Calculated at a taxation rate of 16 percent (2001: 16 percent)	**(1,037)**	516
Income not subject to taxation	**(193)**	(211)
Expenses not deductible for taxation purposes	**2,100**	730
Tax losses not recognized	**304**	432
Underprovision in prior years	**3**	–
Income not subject to taxation and/or expenses not deductible for taxation purposes for jointly controlled companies, associates and unconsolidated subsidiaries, net	**36**	134
Provision for deferred tax on revaluation surplus of properties	**56**	353
Provision for tax of overseas operations	**137**	28
Taxation charge	**1,406**	1,982

14 (LOSS)/PROFIT ATTRIBUTABLE TO SHAREHOLDERS

Loss of HK$14,049 million (2001: profit of HK$867 million) attributable to shareholders was dealt with in the financial statements of the Company.

15 (LOSS)/EARNINGS PER SHARE

The calculation of basic and diluted (loss)/earnings per share is based on the following data:

	2002	2001 (Restated) (Note 38)
(Loss)/Earnings (in HK$ million)		
(Loss)/Earnings for the purposes of basic and diluted (loss)/earnings per share	**(7,762)**	1,343
Number of shares		
Weighted average number of ordinary shares for the purposes of basic (loss)/earnings per share	**4,605,653,512**	4,474,615,652
Effect of dilutive potential ordinary shares	**N/A**	138,787,281
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**N/A**	4,613,402,933

The diluted loss per share for the year ended December 31, 2002 is the same as the basic loss per share as all potential ordinary shares are anti-dilutive.

Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on January 7, 2003, every five issued and unissued ordinary shares of HK$0.05 each ("Shares") were consolidated into one new ordinary share of HK$0.25 ("New Share") in the capital of the Company with effect from January 8, 2003 (the "Share Consolidation"). Upon the Share Consolidation becoming effective on January 8, 2003, the authorized share capital of the Company became HK$1,600,000,000 divided into 6,400,000,000 New Shares, of which 4,653,754,074 New Shares are in issue and fully paid. The New Shares rank pari passu in all respects with each other. The weighted average number of ordinary shares in 2002 and 2001 for the purposes of calculating the basic and diluted (loss)/earnings per share have been retrospectively adjusted for the five-to-one Share Consolidation which took place in January 2003.

16 FIXED ASSETS

In HK$ million	Investment properties	Land and buildings	Exchange equipment	Transmission plant	Other plant and equipment	Projects under construction	Total
THE GROUP							
Cost or valuation							
Beginning of year	5,525	3,590	5,636	7,260	3,939	1,947	27,897
Additions	–	11	430	88	312	770	1,611
Transfers	124	(121)	818	374	376	(1,571)	–
Elimination of accumulated depreciation on transfer to investment properties	–	(22)	–	–	(9)	–	(31)
Disposals	–	(13)	(1)	–	(89)	–	(103)
Exchange differences	(14)	–	–	–	13	–	(1)
End of year	5,635	3,445	6,883	7,722	4,542	1,146	29,373
Representing:							
At cost	–	3,445	6,883	7,722	4,542	1,146	23,738
At valuation	5,635	–	–	–	–	–	5,635
	5,635	3,445	6,883	7,722	4,542	1,146	29,373
Accumulated depreciation							
Beginning of year	–	107	1,038	723	1,430	–	3,298
Charge for the year	–	93	842	669	1,019	–	2,623
Provision for impairment in value	–	14	–	–	218	–	232
Elimination of accumulated depreciation on transfer to investment properties	–	(22)	–	–	(9)	–	(31)
Disposals	–	–	–	–	(27)	–	(27)
Exchange differences	–	–	–	–	(2)	–	(2)
End of year	–	192	1,880	1,392	2,629	–	6,093
Net book value							
End of year	5,635	3,253	5,003	6,330	1,913	1,146	23,280
Beginning of year	5,525	3,483	4,598	6,537	2,509	1,947	24,599

Land and buildings with an aggregate carrying value of approximately HK$93 million (2001: HK$73 million) were pledged as security for certain bank borrowings of the Group.

The carrying amount of investment properties and land and buildings of the Group is analyzed as follows:

In HK$ million	Investment properties		Land and buildings	
	2002	2001	**2002**	2001
Held in Hong Kong				
On long lease (over 50 years)	**1,869**	1,542	**1,483**	1,646
On medium-term lease (10–50 years)	**10**	232	**1,563**	1,614
On short lease (less than 10 years)	**5**	–	**–**	4
Held outside Hong Kong				
Freehold	**–**	–	**122**	126
Leasehold				
On long lease (over 50 years)	**–**	–	**46**	58
On medium-term lease (10–50 years)	**3,751**	3,751	**39**	35
	5,635	5,525	**3,253**	3,483

16 FIXED ASSETS (continued)

Investment properties held in and outside Hong Kong were revalued as at December 31, 2002 by a professionally qualified surveyor of the Group who is an associate member of the Hong Kong Institute of Surveyors and by independent valuer, CB Richard Ellis Limited, respectively. The basis of valuation for investment properties was open market value.

Approximately HK$3,830 million (2001: HK$2,703 million) of the investment properties were mortgaged as collateral for banking facilities of the Group.

17 PROPERTIES HELD FOR/UNDER DEVELOPMENT

In HK$ million	The Group 2002	2001
Leasehold land, at cost:		
Located in Hong Kong	**3**	13
Properties held for development	**3**	13
Properties under development	**4,354**	2,034
Total	**4,357**	2,047

No properties held for/under development were pledged as security for banking facilities as at December 31, 2002 (2001: Nil).

18 GOODWILL

In HK$ million	The Group 2002 Goodwill carried on consolidated balance sheet	Goodwill carried in reserves
Cost		
Beginning of year, as previously stated	**1,368**	**47,899**
Effect of adoption of new accounting standard (note 38(b))	**–**	**2,777**
Opening balances, as restated	**1,368**	**50,676**
Addition arising on acquisitions of minority interests of subsidiaries	**186**	**–**
Realization of goodwill on disposal of an associate	**–**	**(4,081)**
Impairment provision of goodwill made during the year	**(125)**	**(8,457)**
End of year	**1,429**	**38,138**
Amortization		
Beginning of year	**50**	**–**
Charge for the year	**85**	**–**
Written back for the year	**(10)**	**–**
End of year	**125**	**–**
Carrying amount		
End of year	**1,304**	**38,138**
Beginning of year (Restated)	**1,318**	**50,676**

19 INTANGIBLE ASSETS

In HK$ million	The Group 2002			
	Trademarks	Content Licence (note 26(b))	Others	Total
Cost				
Beginning of year	**1,516**	**–**	**15**	**1,531**
Addition	**2**	**375**	**54**	**431**
Write-off	**–**	**–**	**(8)**	**(8)**
End of year	**1,518**	**375**	**61**	**1,954**
Amortization				
Beginning of year	**104**	**–**	**–**	**104**
Charge for the year	**76**	**36**	**–**	**112**
End of year	**180**	**36**	**–**	**216**
Net book value				
End of year	**1,338**	**339**	**61**	**1,738**
Beginning of year	**1,412**	**–**	**15**	**1,427**

20 INVESTMENT IN SUBSIDIARIES

In HK$ million	The Company 2002	2001
Unlisted shares, at cost	**24,599**	24,552
Amounts due from subsidiaries	**198,509**	192,069
	223,108	216,621
Less: Provision for impairment in value	**(141,738)**	(127,584)
	81,370	89,037
Amounts due to subsidiaries	**(55,053)**	(43,757)
	26,317	45,280

The provision for impairment in value of HK$141,738 million (2001: HK$127,584 million) relates to certain subsidiaries of the Company which hold the Group's investments in subsidiaries, associates, jointly controlled companies, investment securities and other investments.

Certain subsidiaries had borrowings at commercial rates throughout the terms of the borrowings to or from the Company. The interest bearing principal receivable from subsidiaries as at December 31, 2002 is HK$5,896 million (2001: HK$3,822 million) and the interest bearing principal payable to subsidiaries as at December 31, 2002 is HK$12,838 million (2001: HK$4,398 million). Other balances with subsidiaries are unsecured, non-interest bearing and have no fixed terms of repayment.

Dividends from the PRC joint ventures will be declared based on the profits in the statutory financial statements of these PRC joint ventures. Such profits will be different from the amounts reported under HK GAAP.

As at December 31, 2002, the Group has financed the operations of certain of its PRC joint ventures in the form of shareholders' loans amounting to approximately US$191 million (2001: US$191 million) which have not been registered with the State Administration of Foreign Exchange. As a result, remittances in foreign currency of these amounts outside the PRC may be restricted.

20 INVESTMENT IN SUBSIDIARIES (continued)

As at December 31, 2002, particulars of the principal subsidiaries of the Company are as follows:

Company name	Place of incorporation/ operations	Principal activities	Nominal value of issued capital/ registered capital	Equity interest attributable to the Group	
				Directly	Indirectly
Pacific Century Systems Limited	Hong Kong	Customer premises equipment related business	HK$1,000,000	100%	–
Carlyle International Limited	Hong Kong	Entrustment work	HK$2	–	100%
Corporate Access Limited	Cayman Islands/ Asia Pacific	Transponder leasing	US$10	–	100%
Cyber-Port Limited	Hong Kong	Property development	HK$2	–	100%
Cyber-Port Management Limited	Hong Kong	Management services	HK$2	–	100%
電訊盈科(北京)有限公司	The PRC	System integration, consulting and informatization project	US$6,750,000	–	100%
Beijing Jing Wei House and Land Estate Development Co., Ltd.	The PRC	Property development	US$50,000,000	–	100%
Partner Link Investments Limited	British Virgin Islands/ Hong Kong	Property investment	US$1	–	100%
Pacific Convergence Corporation, Ltd.	Cayman Islands/ Hong Kong	IT Management	US$1,180	–	100%
Pacific Century CyberWorks Japan Co., Ltd.	Japan	Software and game development, Internet content, e-commerce, broadband services and other businesses	Yen19,742,711,522	–	76.13%
PCCW Business eSolutions Limited	Hong Kong	Provision of IP/IT related, value-added services to business customers	HK$2	–	100%
PCCW Business eSolutions (HK) Limited	Hong Kong/ Asia Pacific	Computer services and provision of IP/IT related value-added services to business customers	HK$1,200	–	100%
PCCW-HKT Business Services Limited	Hong Kong	Provision of business customer premises equipment and ancillary business services	HK$2	–	100%
PCCW-HKT Consumer Services Limited	Hong Kong	Provision of consumer premises equipment and ancillary consumer services	HK$2	–	100%
PCCW-HKT Limited	Hong Kong	Investment holding	HK$6,092,100,052	–	100%
PCCW-HKT Network Services Limited	Hong Kong	Provision of retail international data and value-added services, and local value-added telecommunications services	HK$2	–	100%
PCCW-HKT Products & Services Limited*	Hong Kong	Management of a customer loyalty program "Number One partners" for members of the program	HK$8,437,500	–	100%
PCCW-HKT Telephone Limited*	Hong Kong	Telecommunications services	HK$2,163,783,209	–	100%
Power Logistics Limited	Hong Kong	Delivery services	HK$100,000	–	100%
PCCW Directories Limited*	Hong Kong	Sale of advertising in the Business White Pages, Yellow Pages for businesses and Yellow Pages for customers, publication of directories, provision of Internet directory services and sale of on-line advertising	HK$10,000	–	100%
Taiwan Telecommunication Network Services Co., Ltd.	Taiwan	Type II Telecommunications services provider	NT$1,087,000,000	–	56.56%
Integrated E-Commerce Development (Shenzhen) Limited	The PRC	Software and information systems development	HK$7,000,000	–	100%

20 INVESTMENT IN SUBSIDIARIES (continued)

Company name	Place of incorporation/ operations	Principal activities	Nominal value of issued capital/ registered capital	Equity interest attributable to the Group Directly	Indirectly
Netplus Telecommunications Taiwan Ltd.	Taiwan	Telecommunications services/ investment holding	NT$203,614,460	–	100%
PCCW IMS Limited	Hong Kong	Retail broadband and narrowband Internet access services (currently under the “Netvigator” brand)	HK$2	–	100%
PCCW Powerbase Data Center Services (HK) Limited	Hong Kong	Data Center services	HK$2	–	100%
PCCW Teleservices (Hong Kong) Limited	Hong Kong	Provision of customer relationship management and customer contact management solutions and services	HK$2	–	100%
PCCW Teleservices Operations (Hong Kong) Limited	Hong Kong	Provision of customer relationship management and customer contact management solutions and services	HK$2	–	100%
PCCA Pte Ltd	Singapore	Provision of satellite-based and network telecommunication systems and customer support services to the user groups	S$100,000	–	100%
Omnilink Technology Limited	British Virgin Islands	Investment holding	US$14,850	–	76.43%
Cascade Limited	Hong Kong	Group service company	HK$10,000	–	100%

Certain subsidiaries which do not materially affect the results or financial position of the Group are not included.

* The subsidiary has accounting year end date of March 31. These subsidiaries prepare, for the purpose of consolidation, financial statements as at the same date as the Group.

21 INVESTMENT IN JOINTLY CONTROLLED COMPANIES

In HK$ million	The Group 2002	2001 (Restated) (Note 38)
Share of net assets of jointly controlled companies	**3,806**	3,237
Provision for impairment	**(59)**	(36)
	3,747	3,201
Loans due from a jointly controlled company	**93**	93
Amounts due from jointly controlled companies	**39**	43
Amounts due to jointly controlled companies	**(374)**	(427)
	3,505	2,910
Investments at cost, unlisted shares	**3,581**	3,482

Balances with the jointly controlled companies are unsecured, non-interest bearing and have no fixed terms of repayment except for the loans due from a jointly controlled company, which bear interest at commercial rates, are secured by part of its movable properties and are repayable on demand or have fixed terms of repayment ranging up to three years from the date of drawdown in 2000.

21 INVESTMENT IN JOINTLY CONTROLLED COMPANIES (continued)

As at December 31, 2002, particulars of the principal jointly controlled company of the Group are as follows:

Company name	Place of incorporation/ operations	Principal activities	Nominal value of issued capital/ registered capital	Equity interest attributable to the Group Directly	Indirectly
Reach Ltd.	Bermuda/Asia	Provision of international telecommunication services	US$5,000,000,000	–	50%

Summarized unaudited financial information of the significant jointly controlled company, REACH, is as follows:

In HK$ million	2002	2001
Condensed consolidated balance sheet information as at December 31		
Non-current assets	**24,433**	24,316
Current assets	**3,982**	3,588
Total assets	**28,415**	27,904
Non-current liabilities	**(14,293)**	(13,817)
Current liabilities	**(3,854)**	(4,719)
Minority interests	**(159)**	(162)
Net assets	**10,109**	9,206
Condensed consolidated income statement information for the year ended December 31		
Turnover	**9,854**	9,978
Profit after taxation	**1,141**	411

REACH is currently in negotiations with its bankers to restructure the terms of a syndicated bank loan of US$1,500 million. As at March 20, 2003, the date these financial statements were approved, it has been granted waivers for certain of its debt covenants until the end of March 2003. REACH continues to operate in difficult and volatile conditions and its ability to continue as a going concern is dependent on successful renegotiation of its existing bank loan or other forms of funding being made available. Discussions with the banks continue to be constructive.

In view of the above developments, the Group has also performed an assessment of the fair value of its interest in REACH, including the related goodwill that had previously been eliminated against reserves, as at December 31, 2002. As a result, based on the estimated value in use of REACH determined using a discount rate of 9 percent (2001: 9 percent), the Group has recognized an impairment loss for goodwill attributable to the interest in REACH of approximately HK$8,263 million in the income statement for the year ended December 31, 2002.

An analysis of the Group's total investment cost in REACH as at December 31, 2002 is as follows:

In HK$ million	Book carrying value	Goodwill	Total investment cost
Balances as at December 31, 2002, as previously announced on February 20, 2003	**3,964**	**8,263**	**12,227**
Adjustment to goodwill as at January 1, 2002 arising from adoption of new accounting standard for deferred taxation (note 38(b))	**(349)**	**315**	**(34)**
Balances, as restated	**3,615**	**8,578**	**12,193**
Impairment loss for goodwill attributable to the interest in REACH	**–**	**(8,263)**	**(8,263)**
Balances as at December 31, 2002	**3,615**	**315**	**3,930**

22 INVESTMENT IN ASSOCIATES

In HK$ million	The Group 2002	2001 (Restated) (Note 38)
Share of net assets of associates	**1,203**	3,027
Provision for impairment	**(28)**	(5)
	1,175	3,022
Amounts due from associates	**67**	307
Amounts due to associates	**(115)**	(3)
	1,127	3,326
Investment at cost:		
Unlisted shares	**1,086**	3,550
Shares listed in Hong Kong	**72**	72
	1,158	3,622
Market value of listed shares	**68**	227

Balances with associates are unsecured, non-interest bearing and have no fixed terms of repayment.

As at December 31, 2002, particulars of the principal associates of the Company are as follows:

Company name	Place of incorporation/ operations	Principal activities	Nominal value of issued capital/ registered capital	Equity interest attributable to the Group Directly	Indirectly
iLink Holdings Limited	Cayman Islands/ Hong Kong and the PRC	Provision of data center services, including Internet connectivity, server hosting and co-location services, other value-added services and sales of equipment and software, and also the development, distribution and operation of network games	HK$105,347,492	–	47.90%
ChinaBig.com Limited	Hong Kong	Production and distribution of trade directory	HK$192,308	–	37.65%
Unicom Yellow Pages Information Co., Ltd.	The PRC	Production and distribution of trade directory	US$6,000,000	–	30.12%
Great Eastern Telecommunications Limited*	Cayman Islands	Investment holding	US$43,112,715	–	49%
SecureNet Asia Limited	Hong Kong	Provision of Internet security audit and consultancy services as well as a full range of smart card, security products and solutions for e-Commerce transactions	HK$72,462,299	–	49.99%
Abacus Distribution Systems (Hong Kong) Limited	Hong Kong	Provision of computer reservation systems and travel related services	HK$15,600,000	–	37.04%
Petro-CyberWorks Information Technology Company Limited	The PRC	Design and development of Enterprise Resource Planning systems, and customer relationship management systems	RMB50,000,000	–	45%

* The associate has accounting year end date of March 31. The associate prepares, for the purpose of consolidation, financial statements as at the same date as the Group.

23 INVESTMENTS

Investments are analyzed as follows:

In HK$ million	The Group 2002	2001
Held-to-maturity securities	**42**	62
Investment securities (note a)	**866**	1,630
Other investments – long-term portion (note b)	**–**	–
	908	1,692

a. Investment securities

In HK$ million	The Group 2002	2001
Unlisted, at cost	**1,764**	2,034
Less: Provision for impairment in value	**(1,027)**	(713)
	737	1,321
Listed, at cost		
Hong Kong	**72**	106
Overseas	**270**	1,360
	342	1,466
Less: Provision for impairment in value	**(213)**	(1,157)
	129	309
Total investment securities	**866**	1,630
Quoted market value of listed investment securities as at December 31	**81**	299

b. Other investments

In HK$ million	The Group 2002	2001
Unlisted		
Overseas	**62**	–
Listed, at quoted market value		
Hong Kong	**269**	526
Overseas	**63**	104
	332	630
	394	630
Less: Current portion classified as current assets	**(394)**	(630)
	–	–

During the year, certain listed securities were transferred from investment securities to other investments. These transfers were effected at fair value. The aggregate unrealized holding losses at the dates of transfer which had not been previously recognized of approximately HK$28 million (2001: HK$193 million) were recognized in the income statement at the dates of transfer.

c. During 2002, the Group entered into certain derivative contracts, in the form of equity swap and equity option contracts, with a third party with the effect of entering into forward sale of a portion of certain quoted other investments plus written call options for the remaining portion of those quoted other investments. The underlying quoted other investments with aggregate carrying value of approximately HK$237 million have been placed as collateral for the transaction. The equity swap and equity option contracts have terms of up to five years from the date of the contracts and will mature in 2007 (see note 33(a)).

23 INVESTMENTS (continued)

d. As at December 31, 2002, no investment securities and other investments are subject to restrictions on sale. As at December 31, 2001, certain investment securities and other investments with a carrying value of approximately HK$191 million are subject to restrictions on sale (i) for a period of six months to three years from the date of purchase, or (ii) unless the securities are registered with the Securities and Exchange Commission of the United States or exemption from registration is obtained.

24 CURRENT ASSETS AND LIABILITIES

a. Properties held for sale

In HK$ million	The Group	
	2002	2001
Properties held for sale:		
Located in Macau	**2**	–
	2	–

b. Inventories

In HK$ million	The Group	
	2002	2001
Raw materials	**10**	15
Work-in-progress	**235**	187
Finished goods	**218**	147
Consumable inventories	**18**	23
	481	372

c. Accounts receivable

An aging analysis of trade receivable is set out below:

In HK$ million	The Group	
	2002	2001
0 – 30 days	**1,197**	1,490
31 – 60 days	**279**	235
61 – 90 days	**81**	54
91 – 120 days	**61**	65
Over 120 days	**106**	99
	1,724	1,943

The normal credit period granted by the Group is on average 30 days from the date of invoice.

24 CURRENT ASSETS AND LIABILITIES (continued)

d. Gross amounts due to customers for contract work

In HK$ million	The Group 2002	2001
Contract costs incurred plus attributable profit less foreseeable losses	**801**	700
Less: estimated value of work performed	**(811)**	(748)
	(10)	(48)

The total amount of progress billings, included in the estimated value of work performed as at December 31, 2002, is approximately HK$753 million (2001: HK$591 million).

Included in non-current assets at December 31, 2002 is approximately HK$8 million (2001: HK$6 million) representing retentions receivable from customers in respect of construction contracts in progress.

e. Short-term borrowings

In HK$ million	The Group 2002	2001
Bank loans	**75**	167
Loan from a shareholder	**–**	10
Other loans	**–**	99
Current portion of long-term borrowings	**79**	2
	154	278
Secured	**145**	144
Unsecured	**9**	134

Please refer to note 36 to the financial statements for details of the Group's banking facilities.

As at December 31, 2002, the Company had no unsecured loans (2001: HK$10 million).

f. Accounts payable

An aging analysis of accounts payable is set out below:

In HK$ million	The Group 2002	2001
0 – 30 days	**534**	317
31 – 60 days	**56**	93
61 – 90 days	**120**	16
91 – 120 days	**37**	21
Over 120 days	**413**	244
	1,160	691

24 CURRENT ASSETS AND LIABILITIES (continued)

g. Provisions

In HK$ million	The Group Staff related costs	Onerous contract *(note i)*	Others	Total	The Company Onerous contract *(note i)*
Balances as at January 1, 2002	**230**	**1,004**	**140**	**1,374**	**1,004**
Release of provision during the year	**–**	**(464)**	**–**	**(464)**	**(464)**
Provisions used during the year	**(230)**	**(540)**	**(70)**	**(840)**	**(540)**
Balances as at December 31, 2002	**–**	**–**	**70**	**70**	**–**

i. Upon the adoption of SSAP 28 "Provisions, contingent liabilities and contingent assets" in 2001, the Group recorded a provision for onerous contract for a share option agreement entered between the Company and the minority shareholder of a subsidiary through an adjustment to the opening deficit as at January 1, 2001. The provision was made based on the estimated fair value of the Group's obligation under the share option agreement. In 2001, the minority shareholder exercised a portion of the options and the remaining portion has been exercised in 2002. The exercise of the said options in 2002 has resulted in a release of provision of approximately HK$464 million included in the net gains on investments (see note 26(d)).

Management considers all provisions to be current in nature.

25 LONG-TERM LIABILITIES

In HK$ million	The Group 2002	2001
Long-term borrowings (note a)	**27,757**	33,222
Convertible bonds (note b)	**13,609**	14,653
	41,366	47,875

a. Long-term borrowings

In HK$ million	The Group 2002	2001
Repayable within a period		
– not exceeding one year	**79**	2
– over one year, but not exceeding two years	**123**	2
– over two years, but not exceeding five years	**406**	16,523
– over five years	**27,228**	16,697
	27,836	33,224
Less: Amounts repayable within one year included under current liabilities	**(79)**	(2)
	27,757	33,222
Representing:		
US$4,700 million term loan (note i)	**6,094**	22,543
Yen 30,000 million guaranteed notes (note ii)	**1,950**	1,950
US$1,000 million guaranteed notes (note iii)	**7,799**	7,724
HK$5,000 million 6-year term loan (note iv)	**5,000**	–
HK$5,000 million 7-year term loan (note v)	**5,000**	–
Other bank loans	**1,914**	1,005
	27,757	33,222
Secured	**1,908**	1,009
Unsecured	**25,849**	32,213

25 LONG-TERM LIABILITIES (continued)

a. Long-term borrowings (continued)

Details of major long-term borrowings of HK$27,757 million are presented below:

i. **US$4,700 million term loan ("Term Loan")**

In February 2001, the Group arranged syndicated bank borrowings of US$4,700 million (approximately HK$36,660 million) through PCCW-HKT Telephone Limited ("HKTC"), an indirect wholly-owned subsidiary of the Company. Approximately US$2,377 million was denominated in US dollars and the rest was denominated in Hong Kong dollars. The Term Loan consists of three tranches (A, B & C) which are repayable in three to seven years. Each tranche carries interest at rates ranging from London Interbank Offered rates ("LIBOR") plus 0.85 percent to LIBOR plus 1.45 percent for the US dollar portion and Hong Kong Interbank Offered rates ("HIBOR") plus 0.95 percent to HIBOR plus 1.55 percent for the Hong Kong dollar portion. As of December 31, 2002, the Group had prepaid a total of approximately US$3,919 million (2001: US$1,809 million) of the principal amount.

In relation to the Term Loan, HKTC is required to comply with certain financial and general covenants. The financial covenants are as follows:

HKTC's EBITDA (i.e. Earnings before Interest, Tax, Depreciation and Amortization) to Interest ratio must not be less than 2 to 1 for the Relevant Period ended December 31, 2001 and any Relevant Periods ending in 2002 and 2003. For Relevant Periods ending in 2004 and thereafter, HKTC's EBITDA to Interest ratio must not be less than 2.5 to 1. A Relevant Period refers to the twelve-month period ended on December 31, 2001 and thereafter, each twelve month period ending on March 31 and each twelve month period ending on September 30.

HKTC's Total Debt to EBITDA ratio must not exceed 5.5 to 1 for the Relevant Period ended on December 31, 2001; 5 to 1 for the Relevant Periods ending in 2002 and 2003; and 3.5 to 1 for the Relevant Periods ending in 2004 and thereafter.

As of the date of the approval of these financial statements, management believes that HKTC has complied in all material respects with all the financial and general covenants as required by the Term Loan agreement.

ii. **Yen 30,000 million guaranteed notes**

On October 26, 2001, Profit Century Finance Limited ("PCF"), an indirect wholly-owned subsidiary of the Company, completed the placement of Yen 30,000 million (approximately HK$1,950 million) 3.65 percent guaranteed notes due 2031 (the "Yen Notes"). Interest is payable semi-annually in arrears. The Yen Notes are redeemable at the option of PCF on any interest payment date falling on or after October 27, 2006.

The Yen Notes are unconditionally and irrevocably guaranteed by HKTC and will rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTC.

iii. **US$1,000 million guaranteed notes**

In November 2001, PCCW-HKT Capital Limited ("PCL"), an indirect wholly-owned subsidiary of the Company, issued US$1,000 million (approximately HK$7,800 million) 7.75 percent guaranteed notes due 2011 (the "Notes due 2011"). Interest is payable semi-annually in arrears. The interest rate payable on the Notes due 2011 will be subject to adjustment from time to time if the relevant rating agencies downgrade the rating ascribed to the Notes due 2011 below a pre-agreed level.

The Notes due 2011 are unconditionally and irrevocably guaranteed by HKTC and will rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTC.

iv. **HK$5,000 million 6-year term loan**

On March 7, 2002, HKTC entered into an agreement for a six-year HK$5,000 million (approximately US$641 million) term loan facility. This loan is denominated in Hong Kong dollars and matures in March 2008. Interest is payable at HIBOR plus 0.55 percent per annum.

v. **HK$5,000 million 7-year term loan**

On April 17, 2002, HKTC entered into an agreement for a seven-year HK$5,000 million (approximately US$641 million) term loan facility. This loan is denominated in Hong Kong dollars and matures in April 2009. Interest is payable at HIBOR plus 0.65 percent per annum.

Please refer to note 36 to the financial statements for details of the Group's banking facilities.

Certain covenants in the documentation relating to the borrowings described in (ii), (iii), (iv) and (v) above are less onerous than similar covenants relating to the borrowing described in (i) above.

25 LONG-TERM LIABILITIES (continued)

b. Convertible bonds

In HK$ million	The Group 2002	The Group 2001	The Company 2002	The Company 2001
Beginning of year (notes iii & iv)	**14,653**	8,580	**6,073**	–
Issuance (notes i & ii)	**4,992**	5,850	**1,482**	5,850
Capitalization of interest on principal amount of US$750 million Telstra Bond due 2007 (note iii)	**201**	223	**201**	223
Capitalization of interest on principal amount of US$190 million Telstra Note due 2005 (note ii)	**37**	–	**37**	–
Redemption (note iii)	**(6,274)**	–	**(6,274)**	–
End of year	**13,609**	14,653	**1,519**	6,073

i. On January 29, 2002 (the "Issue Date"), PCCW Capital No. 2 Limited, an indirect wholly-owned subsidiary of the Company, issued US$450 million (approximately HK$3,510 million) 1 percent guaranteed convertible bonds due 2007, which are unconditionally and irrevocably guaranteed on a joint and several basis by the Company and HKTC. The convertible bonds due 2007 are listed on the Luxembourg Stock Exchange. They are convertible, at the option of their holders, into ordinary shares of the Company at an initial conversion price of HK$2.75* (approximately US$0.3526*) per share at any time up to and including the close of business on January 15, 2007. The bonds bear interest at 1 percent per annum, payable semi-annually in arrears on January 29 and July 29 in each year and at maturity, commencing on July 29, 2002. Unless previously redeemed, converted or purchased and cancelled, these bonds will be redeemed in US dollars at 119.383 percent of its principal amount, plus accrued interest on January 29, 2007. The redemption premium is being accrued on a straight-line basis from the date of issuance to the final redemption date of January 29, 2007.

* The conversion price of HK$2.75 (approximately US$0.3526) per share would be adjusted to HK$13.75 (approximately US$1.763) after the implementation of the Share Consolidation in January 2003.

ii. On June 28, 2002, the Company issued the Telstra Note due 2005 to Telstra as part of the disposal of the Group's 40 percent interest in RWC (see note 11(a)). Unless previously redeemed or converted or purchased and cancelled, the Telstra Note due 2005 will be convertible into ordinary shares of the Company on June 30, 2005 or the date which is 30 days after the holder of the Telstra Note due 2005 has given notice to the Company declaring that, amongst other things, an event of default or potential event of default has occurred under REACH's US$1.5 billion syndicated term loan facility or any financing agreement entered into for the purpose of refinancing all or a significant part of such facility; the Company has ceased to have a controlling interest in HKTC; or if HKTC and its subsidiaries have ceased to carry on as their principal business the provision of fixed line telecommunications services in Hong Kong ("Repayment Date"). Interest is payable at 5 percent per annum compounded on a quarterly basis.

On the Repayment Date, the Telstra Note due 2005, plus accrued interest thereon, will be redeemed through its mandatory conversion into ordinary shares of the Company at a conversion price determined by reference to the volume weighted average price of the ordinary shares of the Company as quoted on the Stock Exchange for the 20 dealing days immediately preceding the Repayment Date. The Company is entitled to early redeem the Telstra Note due 2005 in full by giving notice in writing to Telstra. The redemption amount would be the outstanding principal balance together with any unpaid interest accrued at the date of redemption. The Telstra Note due 2005 may be redeemed at the request of Telstra, if a resolution is passed or an order is made that the Company be wound up or dissolved. The Company's obligations to Telstra as the initial holder of the Telstra Note due 2005 are secured by the Group's equity interest in REACH.

25 LONG-TERM LIABILITIES (continued)

b. Convertible bonds (continued)

iii. On February 7, 2001, the Company issued a convertible bond due 2007 with the principal amount of US$750 million (approximately HK$5,850 million) to Telstra ("Telstra Bond due 2007"). The Telstra Bond due 2007 was convertible into ordinary shares of the Company at an initial conversion price of the US dollar equivalent of HK$6.886 per ordinary share at any time on or after the issue date and ends on the day which is 14 business days prior to the end of the sixth year from the issue date. At the end of the fourth year and the end of the sixth year from the issue date, the Company was entitled to require full but not partial conversion depending on the share price of the Company. The Telstra Bond due 2007 bore interest at 5 percent per annum compounding quarterly increasing to 7 percent per annum compounding quarterly in 2005, and interest was payable quarterly. Telstra irrevocably directed that interest be capitalized and added to the principal amount so as to become part of the principal amount and therefore capable of conversion which, accordingly, itself accrued interest quarterly. Unless previously cancelled, redeemed or converted, the Telstra Bond due 2007 was to be redeemed in US dollars at par together with accrued interest upon maturity. The Telstra Bond due 2007 was initially secured with 50 percent of the Group's interest in REACH, which was subject to adjustment in accordance with the terms of the Telstra Bond due 2007.

On June 28, 2002, the Company redeemed the Telstra Bond due 2007, with the outstanding principal amount of US$750 million (approximately HK$5,850 million), together with accrued interest of US$54.38 million (approximately HK$424 million) as part of the disposal of the interest in RWC (see note 11(a)).

iv. On December 5, 2000, convertible bonds due 2005 with the principal amount of US$1,100 million (approximately HK$8,580 million) were issued by PCCW Capital Limited, a wholly-owned subsidiary of the Company. These bonds are listed on the Luxembourg Stock Exchange. They are convertible into ordinary shares of the Company at US$1.0083* (approximately HK$7.865*) subject to adjustments, per share at any time on or after January 5, 2001 and up to the close of business on November 21, 2005 and bear interest at 3.5 percent per annum, payable annually in arrears. Unless previously cancelled, redeemed or converted, these bonds will be redeemed in US dollars at 120.12 percent of the principal amount together with accrued interest on December 5, 2005. If these bonds are fully converted, the Company will be required to issue approximately 1,091 million ordinary shares. The redemption premium is being accrued on a straight-line basis from the date of issuance to the final redemption date of December 5, 2005.

* The conversion price of US$1.0083 (approximately HK$7.865) per share would be adjusted to US$5.0415 (approximately HK$39.325) after the implementation of the Share Consolidation in January 2003.

As at December 31, 2002, none of the above-mentioned convertible bonds had been converted into ordinary shares of the Company.

26 SHARE CAPITAL

	2002		2001	
	Number of shares (note e)	Nominal value HK$million	Number of shares (note e)	Nominal value HK$million
Authorized:				
Ordinary shares of HK$0.05 each (note e)	**32,000,000,000**	**1,600**	32,000,000,000	1,600
Issued and fully paid ordinary shares of HK$0.05 each (note e):				
Beginning of year	**22,693,349,346**	**1,135**	21,880,913,125	1,094
Exercise of warrants	**–**	**–**	22,938	–
Exercise of staff share options	**–**	**–**	2,388,998	–
Exercise of other share options (note a)	**376,680,000**	**19**	626,390,000	32
Issued for acquisition of a licence (note b)	**175,000,000**	**9**	–	–
Issued for acquisition of 100% holding in Telecommunications Technology Investments Limited	**–**	**–**	183,634,285	9
Issued for cash (note c)	**23,741,024**	**1**	–	–
End of year	**23,268,770,370**	**1,164**	22,693,349,346	1,135

a. A total of 376,680,000 new ordinary shares of HK$0.05 each were issued to the minority shareholder of PCC Holdings Ltd. ("PCCH"), as a result of its conversion of its remaining interest in PCCH into ordinary shares of the Company pursuant to the options granted to the minority shareholder in September 1999 (note d).

26 SHARE CAPITAL (continued)

b. On January 24, 2002, 175,000,000 new ordinary shares of HK$0.05 each were issued at their estimated market value totaling approximately US$48 million (approximately HK$375 million) to a wholly-owned subsidiary of Trans World International, Inc. ("TWI") as the consideration for the acquisition of a licence to use its sports archive and programmes.

c. During the year, 23,741,024 new ordinary shares of HK$0.05 each were issued at par under the employee share award scheme approved on November 12, 2002 (note 28(b)).

All new ordinary shares issued during the year rank pari passu in all respects with the existing shares.

d. In September 1999, as part of the acquisition of Pacific Convergence Corporation, Ltd. ("PCC"), the Company entered into an agreement, as subsequently amended, with the minority shareholder of PCCH, under which the minority shareholder can exchange its effective 40 percent shareholding in PCCH, the holding company of PCC, for 1,003,070,000 new ordinary shares of the Company at no further consideration. The option is exercisable for 10 years. The Company has the right to require the minority shareholder to exercise the option at the end of the option period to the extent it has not already been exercised. As of December 31, 2001, the minority shareholder had exercised a portion of the options and the Company had issued 626,390,000 new ordinary shares to the minority shareholder. During the year ended December 31, 2002, the minority shareholder exercised the remaining portion of the options and the Company had issued 376,680,000 new ordinary shares to the minority shareholder.

Pursuant to the terms and conditions of a consulting agreement dated August 17, 1999 and approved by the Company's shareholders at an extraordinary general meeting held on December 5, 2000, 63,201,097 share options were granted to a non-executive director of the Company on January 10, 2001 at an exercise price of HK$2.356 per share (see note e). During the year, the director did not exercise any of his options to acquire shares in the Company. He resigned as a director of the Company on September 5, 2002.

e. Subsequent to the balance sheet date, an ordinary resolution was passed at an extraordinary general meeting of the Company held on January 7, 2003 pursuant to which every five issued and unissued Shares of HK$0.05 each were consolidated into one New Share of HK$0.25 with effect from January 8, 2003. Following the Share Consolidation becoming effective on January 8, 2003, the authorized share capital of the Company is HK$1,600,000,000 divided into 6,400,000,000 New Shares, of which 4,653,754,074 New Shares are in issue and fully paid. The New Shares rank pari passu in all respects with each other.

Except for the (loss)/earnings per share and its related note 15, the number of shares, issued share price, number of share options and exercise price of share options stated in the annual report are before adjustment made for the effect of Share Consolidation as illustrated above.

27 RETIREMENT BENEFIT LIABILITY

a. Defined benefit retirement schemes

The Group operates defined benefit retirement schemes ("DB Schemes") that provide lump sum benefits for employees upon resignation and retirement. The DB Schemes are final salary defined benefit schemes. The scheme assets are administered by independent trustees and are maintained independently of the Group's finances.

The DB Schemes are funded by contributions from the Group and employees in accordance with qualified independent actuaries' recommendation from time to time on the basis of periodic valuations.

The latest independent actuarial valuations of the DB Schemes, in accordance with SSAP 34, were carried out on December 31, 2002 and were prepared by Mr Aaron Wong of Watson Wyatt Hong Kong Limited, fellow of the Canadian Institute of Actuaries and also fellow of the Society of Actuaries, USA, using the projected unit credit method. The actuary was of the opinion that the fair value of the scheme assets was sufficient to cover 75.7 percent of the present value of the defined benefit obligations as at December 31, 2002.

27 RETIREMENT BENEFIT LIABILITY (continued)

a. Defined benefit retirement schemes (continued)

i. The net liability recognized in the balance sheet are as follows:

In HK$ million	The Group **2002**
Present value of the defined benefit obligations	**4,578**
Fair value of scheme assets	**(3,466)**
	1,112
Unrecognized actuarial losses	**(526)**
Defined benefit liability in the balance sheet	**586**

The scheme assets include ordinary shares issued by the Company with a fair value of approximately HK$2 million as at December 31, 2002.

ii. Movements in the net liability recognized in the balance sheet are as follows:

In HK$ million	The Group **2002**
Balance as at January 1, 2002	**–**
Transitional liability recognized upon adoption of SSAP 34 (note 38(a))	**521**
Balance as at January 1, 2002, as restated	**521**
Contributions paid for the year	**(240)**
Expense recognized in the income statement for the year	**305**
Balance as at end of year	**586**

iii. Expense recognized in the consolidated income statement is as follows:

In HK$ million	The Group **2002**
Current service cost	**235**
Interest cost	**401**
Expected return on scheme assets	**(428)**
Loss on curtailment and settlement	**97**
	305
The expense is recognized in the following line item in the consolidated income statement:	
General and administrative expenses – retirement costs for other staff (note 8)	**197**
Restructuring costs (notes 7 & 8)	**108**
	305
Actual return on scheme assets	**(341)**

iv. The principal actuarial assumptions used as at December 31, 2002 (expressed as weighted averages) are as follows:

	The Group **2002**
Discount rate	**5.5%**
Expected rate of return on scheme assets	**6.5%**
Future salary increases	**3.5%**

27 RETIREMENT BENEFIT LIABILITY (continued)

b. Defined contribution retirement scheme

The Group also operates defined contribution schemes, including the Mandatory Provident Fund Scheme ("the MPF scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees employed under the jurisdiction of the Hong Kong Employment Ordinance and not previously covered by the defined benefit retirement scheme. The schemes are administered by independent trustees.

Under the defined contribution scheme, the employer is required to make contributions to the scheme at rates specified under the rules of the scheme. Where employees leave the scheme prior to the full vesting of the employer's contributions, the amount of forfeited contributions is used to reduce the contributions payable by the Group.

Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5 percent of the employees' relevant income, subject to a cap of monthly relevant income of HK$20,000. Contributions to the scheme vest immediately upon the completion of the service in the relevant service period.

28 EQUITY COMPENSATION BENEFITS

a. Share option scheme

The Company has a share option scheme which was adopted in September 1994 and amended in May 2002 under which the board of directors (the "Board") of the Company may, at their discretion, invite employees of the Group, including directors of any company in the Group, and other eligible persons, to take up options to subscribe for shares of the Company. For options granted before May 23, 2002, the exercise price in relation to each option was determined by the Board in its absolute discretion, but in any event would not be less than the higher of the nominal value of the shares and 80 percent of the average of the closing prices of the shares on the Stock Exchange for the five trading days immediately preceding the relevant date of offer.

For options granted on or after May 23, 2002, the exercise price in relation to each option shall be determined by the Board in its absolute discretion, but in any event shall not be less than the highest of: (i) the nominal value of a share of the Company; (ii) the closing price of the shares of the Company as stated in the daily quotation sheet of the Stock Exchange on the date of grant; and (iii) the average closing price of the shares of the Company as stated in the daily quotation sheets of the Stock Exchange for the five trading days immediately preceding the date of grant.

The vesting period and exercisable period of the options are determined by the directors but in any case no options can be exercised later than ten years from the date of grant. Each option gives the holder the right to subscribe for one share.

i. Movements in share options

	Number of options	
	2002 (note 26(e))	2001 (note 26(e))
As at January 1	**596,214,416**	609,260,126
Issued (note iii)	**74,653,500**	297,777,200
Exercised (note iv)	**–**	(2,388,998)
Cancelled/lapsed (note v)	**(123,068,352)**	(308,433,912)
As at December 31 (note ii)	**547,799,564**	596,214,416
Options vested as at December 31	**272,701,628**	95,371,466

28 EQUITY COMPENSATION BENEFITS (continued)

a. Share option scheme (continued)

ii. Terms of unexpired and unexercised share options at balance sheet date

Date of grant	Exercise period	Exercise price HK$ (note 26(e))	Number of options 2002 (note 26(e))	Number of options 2001 (note 26(e))
August 17, 1999 to September 15, 1999	August 17, 2000 to August 17, 2009	2.3560	**123,741,352**	127,533,354
October 25, 1999 to November 23, 1999	August 17, 2000 to October 25, 2009	4.5520	**32,046,000**	36,803,000
December 20, 1999 to January 18, 2000	December 20, 2000 to December 20, 2009	6.7120	**1,080,000**	1,080,000
February 8, 2000 to March 8, 2000	February 8, 2001 to February 8, 2010	15.0480	**433,500**	433,500
August 26, 2000 to September 24, 2000	May 26, 2001 to August 26, 2010	12.0240	**57,168,000**	59,098,000
October 27, 2000 to November 25, 2000	March 15, 2001 to October 27, 2010	4.8720	**73,731,010**	106,863,160
January 22, 2001 to February 20, 2001	January 22, 2001 to January 22, 2011	3.3680	**138,357,902**	203,375,702
February 20, 2001	February 8, 2002 to February 8, 2011	3.7520	**433,500**	433,500
April 17, 2001 to May 16, 2001	May 26, 2001 to April 17, 2011	2.0600	**18,971,000**	20,928,200
May 18, 2001	May 7, 2002 to May 7, 2011	2.2320	**–**	12,000,000
July 16, 2001 to September 15, 2001	July 16, 2002 to July 16, 2011	1.8320	**3,723,800**	4,206,000
August 3, 2001	March 31, 2002 to August 1, 2011	3.3680	**4,000,000**	4,000,000
September 27, 2001	September 27, 2001 to September 7, 2011	1.3630	**18,000,000**	18,000,000
October 15, 2001 to November 13, 2001	October 15, 2002 to October 15, 2011	1.7280	**1,460,000**	1,460,000
May 10, 2002	April 11, 2003 to April 11, 2012	1.5830	**1,158,500**	–
May 28, 2002	April 29, 2003 to April 29, 2012	1.9900	**28,000,000**	–
June 19, 2002	June 19, 2002 to May 21, 2012	2.0180	**2,895,000**	–
August 1, 2002	August 1, 2003 to July 31, 2012	1.6120	**1,000,000**	–
October 11, 2002	October 11, 2002 to October 10, 2007	1.7233	**6,000,000**	–
November 13, 2002	November 13, 2003 to November 12, 2012	1.2300	**35,600,000**	–
			547,799,564	596,214,416

iii. Details of share options granted during the year

Exercise period	Exercise price HK$ (note 26(e))	2002 Consideration received HK$	2002 Number of options (note 26(e))	2001 Consideration received HK$	2001 Number of options (note 26(e))
January 22, 2001 to January 22, 2011	3.3680	**–**	**–**	1,024	232,466,300
February 8, 2002 to February 8, 2011	3.7520	**–**	**–**	1	433,500
May 26, 2001 to April 17, 2011	2.0600	**–**	**–**	371	24,858,600
May 7, 2002 to May 7, 2011	2.2320	**–**	**–**	1	12,000,000
July 16, 2002 to July 16, 2011	1.8320	**–**	**–**	426	4,558,800
March 31, 2002 to August 1, 2011	3.3680	**–**	**–**	1	4,000,000
September 27, 2001 to September 7, 2011	1.3630	**–**	**–**	1	18,000,000
October 15, 2002 to October 15, 2011	1.7280	**–**	**–**	3	1,460,000
April 11, 2003 to April 11, 2012	1.5830	**2**	**1,158,500**	–	–
April 29, 2003 to April 29, 2012	1.9900	**1**	**28,000,000**	–	–
June 19, 2002 to May 21, 2012	2.0180	**5**	**2,895,000**	–	–
August 1, 2003 to July 31, 2012	1.6120	**–**	**1,000,000**	–	–
October 11, 2002 to October 10, 2007	1.7233	**–**	**6,000,000**	–	–
November 13, 2003 to November 12, 2012	1.2300	**–**	**35,600,000**	–	–
		8	**74,653,500**	1,828	297,777,200

iv. Details of share options exercised during the year

Exercise date	Exercise price HK$ (note 26(e))	Market value per share at exercise date HK$ (note 26(e))	2002 Proceeds received HK$	2002 Number of options (note 26(e))	2001 Proceeds received HK$	2001 Number of options (note 26(e))
February 14, 2001	4.552	4.650	**–**	**–**	136,560	30,000
February 15, 2001 to February 23, 2001	3.368	4.375 to 4.900	**–**	**–**	7,810,385	2,318,998
February 20, 2001	2.356	4.650	**–**	**–**	94,240	40,000
			–	**–**	8,041,185	2,388,998

28 EQUITY COMPENSATION BENEFITS (continued)

a. Share option scheme (continued)

v. Details of share options cancelled or lapsed during the year

Exercise period	Exercise price HK$ (note 26(e))	Number of options 2002 (note 26(e))	2001 (note 26(e))
August 17, 2000 to August 17, 2009	2.3560	**3,792,002**	5,341,338
August 17, 2000 to October 25, 2009	4.5520	**4,757,000**	33,320,334
December 7, 2000 to December 7, 2009	5.3920	**–**	2,280,000
December 20, 2000 to December 20, 2009	6.7120	**–**	27,370,000
February 1, 2001 to February 1, 2010	14.4720	**–**	2,000,000
May 26, 2001 to August 26, 2010	12.0240	**1,930,000**	192,521,000
March 15, 2001 to October 27, 2010	4.8720	**33,132,150**	14,546,440
January 22, 2001 to January 22, 2011	3.3680	**65,017,800**	26,771,600
May 26, 2001 to April 17, 2011	2.0600	**1,957,200**	3,930,400
May 7, 2002 to May 7, 2011	2.2320	**12,000,000**	–
July 16, 2002 to July 16, 2011	1.8320	**482,200**	352,800
		123,068,352	308,433,912

b. Share award schemes

In 2002, the Company established two employee share incentive award schemes under which awards of shares may be granted to employees of participating subsidiaries. Directors of the Company are not eligible to participate in either scheme. On June 10, 2002, the Company approved the establishment of a scheme (the "Purchase Scheme") under which selected employees are awarded shares purchased in the market. On November 12, 2002, the Company approved the establishment of a scheme (the "Subscription Scheme") under which selected employees are awarded newly issued shares. The purpose of both the Purchase Scheme and the Subscription Scheme is to recognize the contributions of certain employees of the Group, to retain them for the continued operation and development of the Group, and to attract suitable personnel for the further development of the Group. Under both schemes, following the making of an award to an employee, the relevant shares are held on trust for that employee and then vest over a period of time provided that the employee remains an employee of the Group at the relevant time and satisfies any other conditions specified at the time the award is made. The maximum aggregate number of shares that can be awarded under the two schemes is limited to one percent of the issued share capital of the Company (excluding shares that have already been transferred to employees on vesting).

A summary of movements in shares held under the share award schemes during the year is as follows:

	Number of shares 2002 (note 26(e))	2001 (note 26(e))
As at January 1	**–**	–
Issue of the Company's shares under the share award scheme at par value of HK$0.05 per share (note 26(c))	**23,741,024**	–
Purchases from the market by the trustee at average market price of HK$1.648 per share	**15,935,000**	–
As at December 31	**39,676,024**	–

In HK$ million	2002	2001
Fair value of shares held as at December 31	**48,802**	–
Fair value, on issuance, of shares issued during the year	**33,949**	–
Fair value, on date of purchase, of share purchased from the market	**26,261**	–
Amounts recognized in the consolidated balance sheet as prepaid expenses	**24,841**	–
Amounts recognized in the consolidated income statement as staff costs	**2,609**	–

28 EQUITY COMPENSATION BENEFITS (continued)

c. Employees' rights to invest in shares of PCCW Japan

PCCW Japan is a company incorporated under the laws of Japan with shares registered on the Over the Counter market in Japan. In August 2000, the Group has established an incentive scheme under which certain employees of the Group are granted with options to acquire equity interests in PCCW Japan. The exercise price of the options to the employees was set at a price not less than the fair value of the shares at the time of issue. Shares of PCCW Japan have been trading below the cost of the options since the first exercisable date, and up to December 31, 2002. A total number of 4,021,000 PCCW Japan shares were held by the incentive scheme which is operated under a limited partnership arrangement. As at December 31, 2002, no options have been exercised by the employees.

29 RESERVES/(DEFICIT)

In HK$ million	2002				
	Share premium	Property revaluation reserve (Restated) (Note 38)	Currency translation reserve	Deficit (Restated) (Note 38)	Total (Restated) (Note 38)
THE GROUP					
Beginning of year, as previously stated	169,635	42	(224)	(178,229)	(8,776)
Prior period adjustment arising from adoption of new accounting standard for deferred taxation (note 38(b))	–	(42)	–	(3,358)	(3,400)
Opening balances, as restated	169,635	–	(224)	(181,587)	(12,176)
Adjustment in relation to the recognition of transitional liability of defined benefit retirement schemes arising from adoption of new accounting standard for employee benefits at January 1, 2002 (note 38(a))	–	–	–	(723)	(723)
	169,635	–	(224)	(182,310)	(12,899)
Issue of ordinary shares and exercise of options, net of issuing expenses	936	–	–	–	936
Realization of goodwill on disposal of RWC	–	–	–	4,081	4,081
Translation exchange differences	–	–	107	–	107
Impairment provision of goodwill attributable to REACH	–	–	–	8,263	8,263
Impairment provision of goodwill attributable to a subsidiary	–	–	–	194	194
Loss for the year	–	–	–	(7,762)	(7,762)
End of year	170,571	–	(117)	(177,534)	(7,080)
Attributable to:					
– The Company and subsidiaries	170,571	–	(117)	(178,531)	(8,077)
– Jointly controlled companies	–	–	–	964	964
– Associates	–	–	–	33	33
End of year	170,571	–	(117)	(177,534)	(7,080)
THE COMPANY					
Beginning of year	169,635	–	–	(129,257)	40,378
Issue of ordinary shares and exercise of options, net of issuing expenses	936	–	–	–	936
Loss for the year	–	–	–	(14,049)	(14,049)
End of year	170,571	–	–	(143,306)	27,265

29 RESERVES/(DEFICIT) (continued)

In HK$ million	2001 Share premium	Property revaluation reserve (Restated) (Note 38)	Currency translation reserve	Deficit (Restated) (Note 38)	Total (Restated) (Note 38)
THE GROUP					
Beginning of year, as previously stated	167,035	343	(65)	(186,497)	(19,184)
Prior period adjustment arising from adoption of new accounting standard for deferred taxation (note 38(b))	–	(138)	–	(3,078)	(3,216)
Opening balances, as restated	167,035	205	(65)	(189,575)	(22,400)
Issue of ordinary shares and exercise of options, net of issuing expenses	2,600	–	–	–	2,600
Realization of goodwill on disposal of subsidiaries	–	–	–	33	33
Deficit on revaluation of properties, as previously stated	–	(301)	–	–	(301)
Prior period adjustment arising from adoption of new accounting standard for deferred taxation (note 30(b))	–	96	–	–	96
Deficit on revaluation of properties, as restated	–	(205)	–	–	(205)
Translation exchange differences	–	–	(159)	–	(159)
Realization of goodwill on contribution of assets to a jointly controlled company, as previously stated	–	–	–	6,382	6,382
Prior period adjustment arising from adoption of new accounting standard for deferred taxation (note 38(b))	–	–	–	269	269
Realization of goodwill on contribution of assets to a jointly controlled company, as restated	–	–	–	6,651	6,651
Adjustment to goodwill arising from acquisition of an associate	–	–	–	(39)	(39)
Profit for the year, as previously stated	–	–	–	1,892	1,892
Prior period adjustment arising from adoption of new accounting standard for deferred taxation (note 38(b))	–	–	–	(549)	(549)
Profit for the year, as restated	–	–	–	1,343	1,343
End of year	169,635	–	(224)	(181,587)	(12,176)
Attributable to:					
– The Company and subsidiaries	169,635	–	(224)	(182,240)	(12,829)
– Jointly controlled companies	–	–	–	575	575
– Associates	–	–	–	78	78
End of year	169,635	–	(224)	(181,587)	(12,176)
THE COMPANY					
Beginning of year	167,035	–	–	(130,124)	36,911
Issue of ordinary shares and exercise of options, net of issuing expenses	2,600	–	–	–	2,600
Profit for the year	–	–	–	867	867
End of year	169,635	–	–	(129,257)	40,378

30 DEFERRED TAXATION

a. Movement in deferred tax liabilities during the year is as follows:

In HK$ million	Accelerated tax depreciation	Valuation adjustment resulted from acquisition of subsidiaries	Leasing partnership	Revaluation of properties	Others	Total
	2002					
THE GROUP						
Beginning of year, as previously stated	**180**	**–**	**520**	**–**	**(4)**	**696**
Effect of adoption of new accounting standard (note 38(b))	**1,856**	**506**	**–**	**395**	**(37)**	**2,720**
Opening balances, as restated	**2,036**	**506**	**520**	**395**	**(41)**	**3,416**
Effect of adoption of SSAP 34 (note 38(a))	**–**	**–**	**–**	**–**	**(96)**	**(96)**
	2,036	**506**	**520**	**395**	**(137)**	**3,320**
Deferred taxation (credited)/ charged to income statement during the year (note 13)	**(196)**	**(21)**	**(53)**	**56**	**62**	**(152)**
Exchange differences	**–**	**–**	**–**	**–**	**(3)**	**(3)**
End of year	**1,840**	**485**	**467**	**451**	**(78)**	**3,165**

In HK$ million	Accelerated tax depreciation	Valuation adjustment resulted from acquisition of subsidiaries	Leasing partnership	Revaluation of properties	Others	Total
	2001					
THE GROUP						
Beginning of year, as previously stated	187	–	555	–	(4)	738
Effect of adoption of new accounting standard (note 38(b))	1,655	521	–	138	–	2,314
Opening balances, as restated	1,842	521	555	138	(4)	3,052
Deferred taxation charged/ (credited) to income statement during the year (note 13)	194	(15)	(35)	353	(37)	460
Deferred taxation credited to equity during the year (note b)	–	–	–	(96)	–	(96)
End of year	2,036	506	520	395	(41)	3,416

30 DEFERRED TAXATION (continued)

b. Deferred taxation credited to equity during the year is as follows:

In HK$ million	The Group 2002	2001
Property revaluation reserve (note 29)	–	(96)

c. Deferred income tax assets are recognized for tax loss carry forwards to the extent that realization of the related tax benefit through the future taxable profits is probable. The Group has unutilized estimated tax losses of HK$11,240 million (2001: HK$9,992 million) to carry forward for deduction against future taxable income. Tax losses of HK$1,205 million (2001: approximately HK$811 million) will expire within 1–5 years from December 31, 2002. The remaining portion of the tax losses, mainly relating to Hong Kong companies, can be carried forward indefinitely.

31 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

a. Reconciliation of (loss)/profit before taxation to net cash inflow from operating activities

In HK$ million	The Group 2002	2001 (Restated) *(Note 39)*
(Loss)/Profit before taxation	**(6,482)**	3,227
Adjustment for:		
Losses on disposal of interests in RWC and MobileOne, net	**1,433**	–
Impairment provision for goodwill attributable to REACH	**8,263**	–
Impairment provision for goodwill attributable to a subsidiary	**309**	–
Provision for inventory obsolescence	**26**	38
Write-off of intangible assets	**8**	4
Interest income	**(164)**	(548)
Interest expense	**1,948**	3,108
Finance charges	**226**	545
Depreciation	**2,623**	2,437
Unrealized holding losses on other investments, net	**142**	194
Realized losses on disposal of other investments	**182**	2
Realized gain on disposal of investment in subsidiaries, a jointly controlled company and associates	**(34)**	(264)
Realized gain on disposal of investment securities	**(56)**	(14)
Provision for impairment of investments	**581**	263
Provision for impairment of fixed assets	**232**	27
Release of provision for an onerous contract	**(464)**	(477)
Loss on disposal of fixed assets	**76**	63
Provision for doubtful debts	**148**	57
Amortization of intangible assets	**112**	76
Amortization of goodwill	**85**	50
Amortization of business development costs	**12**	–
Amortization of premium received from equity options	**(32)**	(361)
Provision for property held for development	–	60
Dividend income	–	(125)
Share of results of associates and jointly controlled companies	**(831)**	(681)
Share of results of unconsolidated subsidiaries	–	(152)
Gain on termination of cross currency swap contracts	**(332)**	–
Unrealized exchange differences	–	1

31 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

a. Reconciliation of (loss)/profit before taxation to net cash inflow from operating activities (continued)

In HK$ million	The Group 2002	2001 (Restated) *(Note 39)*
OPERATING PROFIT BEFORE CHANGES IN WORKING CAPITAL	**8,011**	7,530
Decrease/(Increase) in operating assets:		
– properties under development	**(2,204)**	(1,260)
– inventories	**(135)**	64
– accounts receivable	**(32)**	(207)
– prepayments, deposits and other current assets	**54**	293
– gross amounts due from customers for contract work	**–**	53
– amount due from jointly controlled companies and associates	**–**	(1,238)
– amounts due from related companies	**204**	(33)
Increase/(Decrease) in operating liabilities:		
– accounts payable, provisions, accruals, other payables and deferred income	**159**	1,067
– amount due to minority shareholders of subsidiaries	**5**	(5)
– gross amounts due to customers for contract work	**(38)**	48
– amounts due to related companies	**(446)**	450
– advances from customers	**(277)**	(48)
CASH GENERATED FROM OPERATIONS	**5,301**	6,714
Interest paid	**(221)**	(231)
Interest received	**82**	549
Dividend received	**–**	8
Tax paid		
– Hong Kong profits tax paid	**(1,243)**	(1,296)
– Overseas tax paid	**(2)**	(28)
NET CASH INFLOW FROM OPERATING ACTIVITIES	**3,917**	5,716

b. Acquisitions of subsidiaries

In HK$ million	The Group 2002	2001
Net assets acquired:		
Fixed assets	**–**	138
Accounts receivable, prepayments, deposits and other assets	**–**	92
Cash and bank balances	**–**	27
Accounts payable, accruals and other payables	**–**	(115)
Other long-term liabilities	**–**	(26)
Minority interests	**–**	(13)
	–	103
Goodwill arising on acquisition	**–**	1,033
	–	1,136
Satisfied by:		
Issuance of ordinary shares	**–**	1,043
Cash from internal resources	**–**	93
	–	1,136
Analysis of the net outflow of cash and cash equivalents in respect of the purchase of subsidiaries:		
Cash	**–**	(93)
Cash and bank balances acquired	**–**	27
Net cash outflow in respect of acquisitions of subsidiaries	**–**	(66)

31 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

c. Analysis of cash and cash equivalents

In HK$ million	The Group 2002	2001
Cash and bank balances	**8,638**	8,923
Bank loans and overdrafts	**(37)**	(75)
Restricted cash (included in "prepayments, deposits and other current assets" on consolidated balance sheet (note 36))	**(720)**	(1,405)
Cash and cash equivalents as at December 31	**7,881**	7,443

d. Major non-cash transactions

A total of 376,680,000 ordinary shares of HK$0.05 each were issued to the minority shareholder of PCCH, as a result of its conversion of its remaining interest in PCCH into ordinary shares of the Company.

On January 24, 2002, the Company issued 175,000,000 ordinary shares of HK$0.05 each at their estimated market value totaling approximately US$48 million (approximately HK$375 million) to a wholly-owned subsidiary of TWI for the acquisition of a license to use its sports archive and programmes.

On June 28, 2002, the Company disposed of its entire 40 percent equity interest in RWC to Telstra for a consideration of HK$4,792 million that was satisfied by the redemption of the Telstra Bond due 2007 together with its accrued interest and the issuance of the Telstra Note due 2005 (see note 11(a)).

32 NET LEASE PAYMENTS RECEIVABLE

A company within the Group is a limited partner in a number of limited partnerships, which own and lease assets to third parties.

In HK$ million	The Group 2002	2001
The net investment in relation to these finance leases comprises:		
Net lease payments receivable	**475**	475
Less: Current portion of net lease payments receivable	**–**	–
	475	475

Non-recourse finance of HK$2,600 million (2001: HK$2,847 million) has been offset against net rentals receivable in arriving at the above net investment in finance leases.

33 FINANCIAL INSTRUMENTS

a. Equity options

During the year, the Group entered into certain derivative contracts, in the form of equity swap and equity option contracts, with a third party with the effect of entering into forward sale of a portion of certain quoted other investments plus written call options for the remaining portion of those quoted other investments. The deemed forward sale effectively eliminated the Group's exposure to market price fluctuation and accordingly, the underlying quoted other investments were carried at the deemed forward price as at December 31, 2002. The Group received advance receipt of approximately HK$187 million for the deemed forward sales and the amount was included in other long-term liabilities in the consolidated balance sheet and is interest bearing at commercial rate. The Group recognized a gain of approximately HK$10 million for marking the quoted other investments to the deemed forward price and the gain has been reflected in net gains on investments. The Group also received premiums of approximately HK$25 million for the written call options with notional amount of approximately HK$71 million. The premiums received were recorded as deferred income and are being amortized into income on a straight-line basis over the life of the call options. The underlying quoted other investments were carried at market value at each balance date and any unrealized holding gain or loss are recognized in the income statement in the period as it arises. The underlying quoted other investments for both the deemed forward sale and written call options have been placed as collateral for the above equity swap and equity option transactions (note 23(c)).

33 FINANCIAL INSTRUMENTS (continued)

a. Equity options (continued)

Apart from the above, as at December 31, 2002, the Group had other outstanding written equity call options with a total notional amount of approximately HK$157 million (2001: approximately HK$157 million). Other than the equity options as aforementioned in previous paragraph, the Group did not receive premiums on writing new equity options in 2002 (2001: approximately HK$53 million). The premiums received were recorded as deferred income and are being amortized into income on a straight-line basis over the life of the related contracts.

The notional amounts of the outstanding equity option contracts indicate the volume of transactions outstanding at balance sheet date and do not represent amounts at risk.

b. Interest rate options

The Group entered into interest rate options to manage its interest rate risk. As at December 31, 2002, the total notional amount of such instruments was HK$150 million (2001: HK$190 million).

The notional amounts of the outstanding interest rate options indicate the volume of transactions outstanding at the balance sheet date and do not represent amounts at risk.

c. Cross currency swap

As at December 31, 2002, the Group had outstanding cross currency swap contracts to buy US$2,740 million and Yen 30,000 million (2001: US$1,100 million and Yen 30,000 million) at various rates totaling approximately HK$21,372 million and HK$1,950 million (2001: HK$8,580 million and US$250 million), respectively, to hedge against the Group's exposure to foreign currencies and interest rate fluctuations.

During the year ended December 31, 2002, the Group closed out certain cross currency swap contracts and recognized a gain of approximately HK$332 million (2001: Nil). The gain is reflected under net gains on investments (see note 6).

34 COMMITMENTS

a. Capital

In HK$ million	The Group 2002	2001
Authorized and contracted for	**4,155**	4,045
Authorized but not contracted for	**7,436**	11,378
	11,591	15,423

An analysis of the above capital commitments by nature is as follows:

In HK$ million	The Group 2002	2001
Investments	**137**	419
Property development (note i)	**11,080**	13,974
Development of Internet business	**101**	524
Construction contracts	**24**	125
Acquisition of fixed assets	**247**	378
Others	**2**	3
	11,591	15,423

i. The Group has a project agreement with the Government of Hong Kong (the "Government") to design, build and market the Cyberport development at Telegraph Bay on the Hong Kong Island (the "Cyberport Project"). Pursuant to the Cyberport Project Agreement entered into on May 17, 2000, the total construction costs of the Cyberport Project are estimated to be approximately HK$15.8 billion. The total construction costs incurred for the Cyberport Project up to December 31, 2002 were approximately HK$4.4 billion (2001: HK$2 billion). Accordingly, the outstanding commitment for the Cyberport Project as at December 31, 2002 was approximately HK$11 billion (2001: HK$14 billion).

34 COMMITMENTS (continued)

b. Operating leases

As at December 31, 2002, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

Land and buildings

In HK$ million	The Group 2002	2001
Within 1 year	**188**	181
After 1 year but within 5 years	**288**	255
After 5 years	**123**	161
	599	597

Equipment

In HK$ million	The Group 2002	2001
Within 1 year	**35**	49
After 1 year but within 5 years	**29**	51
	64	100

c. Others

As at December 31, 2002, the Group had outstanding forward foreign exchange contracts to buy US$160 million (2001: US$290 million) at various rates totaling approximately HK$1,245 million (2001: HK$2,264 million). Further, the Group had outstanding forward foreign exchange contracts to buy approximately S$110 million (2001: Nil) totaling approximately US$63 million (2001: Nil).

35 CONTINGENT LIABILITIES

In HK$ million	The Group		The Company	
	2002	2001	**2002**	2001
Performance guarantee	**74**	48	**1**	7
Tender guarantee	**10**	–	**–**	–
Advance payment guarantee	**14**	–	**–**	–
Guarantees given to banks in respect of credit facilities granted to				
– subsidiaries	**–**	–	**14,112**	8,580
– jointly controlled company	**–**	4	**–**	4
Guarantee in lieu of cash deposit	**20**	3	**–**	2
Guarantee in respect of an investment commitment of an associate	**–**	104	**–**	–
Staff mortgage loan guarantee	**5**	–	**–**	–
Guarantee indemnity	**11**	–	**–**	–
	134	159	**14,113**	8,593

On April 23, 2002, a writ of summons was issued against PCCW-HKT Limited ("HKT"), an indirect wholly-owned subsidiary of the Company, by New Century Infocomm Tech Co., Ltd. for its failure to purchase 6,522,000 shares of Taiwan Telecommunication Network Services Co., Ltd. ("TTNS"), an indirect subsidiary of the Company, pursuant to an option agreement entered into on July 24, 2000. The total claim against HKT amounted to approximately HK$90 million (NT$418 million), being the purchase price of shares in TTNS, contractual interest for the period January 1, 2001 to January 2, 2002 at 6.725 percent per annum and interest on the due amount pursuant to Sections 48 and 49 of the High Court Ordinance, Cap. 4. However, this figure should be reduced by the current market value of the shares in TTNS which would be transferred to HKT in the event that the claimants were successful in their claim. A defence was filed by HKT on May 29, 2002. Based on legal advice received, the directors consider that HKT has valid defences, therefore no provision has been made.

36 BANKING FACILITIES

Aggregate banking facilities as at December 31, 2002 were HK$21,660 million (2001: HK$27,958 million) of which the unused facilities as at the same date amounted to HK$3,521 million (2001: HK$4,250 million).

A summary of major loan agreement terms is set out in note 25(a).

Security pledged for certain banking facilities includes:

In HK$ million	The Group 2002	2001
Investment properties	**3,830**	2,703
Land and buildings	**93**	73
Investments	**312**	–
Fixed deposit	**122**	–
	4,357	2,776

Cyber-Port Limited, an indirect wholly-owned subsidiary of the Company, was granted a standby letter of credit facility amounting to approximately HK$722 million (2001: HK$1,405 million) from a bank for the purpose of providing a cashflow guarantee covering an amount equal to the 6-month forecast net cashflow requirements of the Cyberport Project, defined in and pursuant to the terms of the Cyberport Project Agreement. Such facility is secured by a bank fixed deposit of approximately HK$720 million (2001: approximately HK$1,405 million) placed by the Company. The amount of restricted cash is included in “prepayments, deposits and other current assets” on the balance sheet.

37 POST BALANCE SHEET EVENTS

The following events occurred subsequent to December 31, 2002 up to the date of approval of these financial statements by the Board of Directors:

a. Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on January 7, 2003, every five issued and unissued Shares were consolidated into one New Share with effect from January 8, 2003. Following the Share Consolidation becoming effective on January 8, 2003, the authorized share capital of the Company is HK$1,600,000,000 divided into 6,400,000,000 New Shares, of which 4,653,754,074 New Shares are in issue and fully paid. The New Shares rank pari passu in all respects with each other.

In addition, the conversion prices of the outstanding convertible bonds issued by certain wholly-owned subsidiaries of the Company and which are convertible into Shares are adjusted by the same factor as the Share Consolidation, namely by five times the conversion prices prior to the Share Consolidation. Accordingly, the US$1,100 million guaranteed convertible bonds issued by PCCW Capital Limited, which were convertible into Shares at a conversion price of US$1.0083 (approximately HK$7.865) per Share, are convertible into New Shares at a conversion price of US$5.0415 (approximately HK$39.324) per New Share following the Share Consolidation. The US$450 million guaranteed convertible bonds issued by PCCW Capital No. 2 Limited, which were convertible into Shares at a conversion price of HK$2.75 (approximately US$0.3526) per Share, are convertible into New Shares at a conversion price of HK$13.75 (approximately US$1.763) per New Share following the Share Consolidation.

The relevant exercise prices applicable to all outstanding options granted by the Company pursuant to the Company’s share option scheme are adjusted as a result of the Share Consolidation by the same five-fold factor as applies to the conversion prices applicable to the convertible bonds.

b. On January 24, 2003, PCCW Capital No. 3 Limited, an indirect wholly-owned subsidiary of the Company, privately placed US$456 million Guaranteed Notes due 2013 to raise funds for general working capital purposes. The notes are unconditionally and irrevocably guaranteed by the Company.

37 POST BALANCE SHEET EVENTS (continued)

c. On February 26, 2003, PCC Investments Limited ("PCCI"), a wholly-owned subsidiary of the Company, Commercial Radio Productions Limited ("CRP") and PCC Skyhorse Holding Limited ("Skyhorse"), a joint venture company of which 60 percent of the share capital was held by PCCI and the remaining 40 percent was held by CRP, entered into an agreement. Pursuant to this agreement, Skyhorse repurchased CRP's entire 40 percent shareholding in Skyhorse on normal commercial terms for HK$80 million which was settled by a cash payment from Skyhorse's internal resources arising as a result of PCCI's original equity commitment in the joint venture.

d. On March 5, 2003, the Financial Secretary, Mr Antony Leung, proposed the profits tax rate to be increased from 16 percent to 17.5 percent with effect from the year of assessment 2003/04.

e. On March 14, 2003, the Company completed a five-year term loan facility for HK$3,003 million (approximately US$385 million) on an unsecured basis. The loan is repayable in 2008. The proceeds will be used for general corporate purposes.

38 ADJUSTMENTS RETROSPECTIVELY APPLIED UPON ADOPTION OF NEW ACCOUNTING STANDARDS IN HONG KONG

a. Adoption of SSAP 34 "Employee benefits"

SSAP 34 prescribes the accounting and disclosure for all forms of consideration given by an enterprise in exchange for services rendered by employees. The underlying principle is that the cost of providing employee benefits should be recognized in the period in which the benefits are earned by the employees, rather than when they are paid or payable.

The Group has been providing defined benefit retirement schemes to certain of its employees. Prior to the adoption of SSAP 34, contributions to the defined benefit retirement schemes were made in accordance with the advice of qualified independent actuaries and were recognized as costs of retirement benefits to the income statement in the relevant accounting period. Special contributions were made to the retirement schemes as recommended by the actuaries and were deferred and amortized to the income statement on a systematic basis over the employees' average expected service lives.

With effect from January 1, 2002, in order to comply with SSAP 34, the Group adopted a new policy for defined benefit retirement schemes as set out in note 2(z). As a result of the adoption of this accounting policy, the Group has chosen to recognize the entire transitional liability immediately under the transitional provision of SSAP 34. As at January 1, 2002, the transitional liability of the Group's defined benefit retirement schemes, which represented the excess of the defined benefit obligation over the fair value of the scheme assets, was HK$521 million. The amount was recognized retrospectively against the opening balance of the deficit as at January 1, 2002 and the defined benefit liability has been carried in the consolidated balance sheet as non-current liabilities. In addition, the Group wrote off the unamortized balance of special contribution of HK$298 million that was made to the defined benefit retirement schemes in 1998. A resultant adjustment of HK$723 million after netting of deferred tax impact of HK$96 million was made to the opening balance of the deficit of the Group as at January 1, 2002. Comparative financial statements have not been restated.

b. Adoption of SSAP 12 "Income taxes"

The Hong Kong Society of Accountants issued SSAP 12 "Income taxes" ("SSAP 12 (revised)") in August 2002, which supercedes the previous SSAP 12 "Accounting for deferred taxes". The new standard will be effective for accounting periods beginning on, or after January 1, 2003. The Group has elected to adopt the SSAP 12 (revised) in the consolidated financial statements as of and for the year ended December 31, 2002.

SSAP 12 (revised) requires deferred tax assets and liabilities to be provided in full using the liability method, on temporary differences arising between the tax base of an asset or a liability and its carrying amount in the financial statements at any point in time. Deferred tax assets or liabilities arising from temporary differences need to be measured at the tax rates enacted or substantially enacted by the balance sheet date. The principal temporary differences arise from depreciation of fixed assets, revaluation surplus of certain non-current assets, provision for pensions, tax losses carried forward, and, in relation to acquisitions, the difference between the fair values of the net assets acquired and their tax base.

38 ADJUSTMENTS RETROSPECTIVELY APPLIED UPON ADOPTION OF NEW ACCOUNTING STANDARDS IN HONG KONG (continued)

b. Adoption of SSAP 12 "Income taxes" (continued)

Deferred tax liabilities are provided in full on all taxable temporary differences while deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Movements of deferred tax assets and liabilities between balance sheet dates need to be reported either in the income statement or as an item of recognized gain or loss in reserve movements.

In prior years, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future.

The adoption of SSAP 12 (revised) represents a change in accounting policy, which has been applied retrospectively so that comparatives presented have been restated to conform to the changed policy. As a result of the new accounting policy, the Group's loss for the year and the amount charged to deficit has been decreased by HK$140 million (2001: the Group's profit decreased by HK$549 million) and the net liabilities as at year end have been increased by HK$3,009 million (2001: HK$3,400 million). The new accounting policy has been adopted retrospectively, with the opening balances of deficit and the comparative information adjusted for the amounts relating to prior periods. The opening deficit of the Group at January 1, 2001 and 2002 have been increased by HK$3,078 million and HK$3,358 million respectively representing the unprovided net deferred tax liabilities as at those dates. This change has resulted in an increase in deferred tax liabilities at December 31, 2001 by HK$2,720 million.

39 COMPARATIVE FIGURES

The presentation and classification of items in the consolidated cash flow statement have been changed due to the adoption of the requirements of SSAP 15 (revised) "Cash flow statements". As a result, cash flow items from taxation, returns on investments and servicing of finance have been classified into operating and financing activities as set out in note 31(a) and consolidated cash flow statement. Comparative figures have been reclassified to conform with the current year's presentation.

Certain comparative figures have also been adjusted as a result of (i) changes in accounting policies for employee benefits and deferred taxation, details of which are set out in note 38 and (ii) reclassification of certain operations among business segments, details of which are set out in note 4.

The financial statements as of and for the year ended December 31, 2001 were audited by another firm of certified public accountants who expressed an unqualified opinion on the financial statements in their report dated March 20, 2002. The financial statements audited by them did not reflect the effects of the adoption of SSAP 12 "Income taxes" as described in note 38(b).