NOTES
TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these accounts are set out below:

(a) Basis of preparation

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). They have been prepared under the historical cost convention except that, as disclosed in the accounting policies below, other investments are stated at fair value.

In the current year, the Group adopted revised Statements of Standard Accounting Practice ("SSAP") 12, "Income Taxes", issued by the HKICPA which is effective for accounting periods commencing on or after 1st January 2003. The change to the Group's accounting policy and the effect of adopting this new policy are set out in note 1(l) below.

(b) Group accounting

(i) Consolidation

The consolidated accounts include the accounts of the Company and its subsidiaries made up to 31st August. Subsidiaries are those entities in which the company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant inter-company transactions and balances within the Group are eliminated on consolidation.

The gain or loss on the disposal of a subsidiary represents the difference between the proceeds of the sale and the Group's share of its net assets together with any unamortised goodwill or negative goodwill or goodwill/negative goodwill taken to reserves and which was not previously charged or recognised in the consolidated profit and loss account.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

(ii) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases are dealt with in the profit and loss account.

For consolidation purposes, the balance sheets of subsidiaries expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss accounts are translated at an average rate for the year. Exchange differences are dealt with as a movement in reserves.

(c) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition.

Goodwill on acquisitions that occurred prior to 1st September 2001 was written off against reserves. Goodwill on acquisitions occurring on or after 1st September 2001 is separately shown on the consolidated balance sheet and is amortised using the straight-line method over its estimated useful life. Goodwill arising on major strategic acquisitions of the Group to expand its product or geographical market coverage is amortised over a period of not more than 20 years.

Where an indication of impairment exists, the carrying amount of goodwill, including goodwill previously written off against reserves, is assessed and written down immediately to its recoverable amount and any write-down is accounted for in the profit and loss account.

1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(d) Fixed assets

Fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses.

Leasehold land is depreciated over the period of the lease while other tangible fixed assets are depreciated at rates sufficient to write off their costs less accumulated impairment losses over their estimated useful lives on a straight-line basis. The principal annual rates are as follows:

Leasehold land	2%
Leasehold buildings	2%
Furniture, fixtures and fittings	25%
Telecommunications, computer and office equipment	7% - 25%
Auto-diallers	25%
Motor vehicles	25%

Depreciation of leasehold improvements is calculated to write off their cost less accumulated impairment losses over the unexpired periods of the leases or their expected useful lives to the Group whichever is shorter.

Major costs incurred in restoring fixed assets to their normal working condition are charged to the profit and loss account. Improvements are capitalised and depreciated over their expected useful lives to the Group.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

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

(e) Assets held under leases

(i) Finance leases

Leases that substantially transfer to the Group all the risks and rewards of ownership of assets are accounted for as finance leases. Finance leases are capitalised at the inception of the leases at the lower of the fair value of the leased assets or the present value of the minimum lease payments. Each lease payment is allocated between capital and finance charges so as to achieve a constant rate on the capital balances outstanding. The corresponding rental obligations, net of finance charges, are included in long-term liabilities. The finance charges are charged to the profit and loss account over the lease periods.

Assets held under finance leases are depreciated over the shorter of lease periods or their estimated useful lives.

(ii) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases net of any incentives received from the leasing company are charged to the profit and loss account on a straight-line basis over the lease periods.

(f) Other investments

Other investments are carried at fair value. At each balance sheet date, the net unrealised gains or losses arising from the changes in fair value of other investments are recognised in the profit and loss account. Profits or losses on disposal of other investments, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the profit and loss account as they arise.

1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(g) Deferred expenditure

Customer acquisition costs incurred to obtain long term service agreements with customers are deferred and amortised on a straight line basis over the period of the underlying service subscription agreements executed with the customers. All other related advertising and marketing costs are charged to the profit and loss account as incurred.

(h) Accounts receivable

Provision is made against accounts receivable to the extent they are considered to be doubtful. Accounts receivable in the balance sheets are stated net of such provision.

(i) Cash and cash equivalents

Cash equivalents are stated at cost, which approximates fair value because of the short-term maturity of these instruments. For the proposes of the cash flow statement, cash and cash equivalents are short-term highly liquid investments, which are readily convertible into cash and have original maturity of three months or less at the date of acquisition, and short-term loans and overdrafts repayable within three months.

(j) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

(k) Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long-service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity or paternity leave are not recognised until the time of leave.

(ii) Profit sharing and bonus plans

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

(iii) Retirement benefit costs

The Group contributes to defined contribution retirement schemes which are available to all employees. Contributions to the schemes by the Group and employees are calculated as a percentage of employees' basic salaries. The retirement benefit scheme cost charged to the profit and loss account represents contributions payable by the Group to the fund. The Group's contributions are reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

The assets of the scheme are held separately from those of the Group in an independently administered fund.

(l) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

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

1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(l) Deferred taxation (CONTINUED)

Deferred taxation is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not be reversed in the foreseeable future.

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 the revised SSAP 12 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.

As detailed in Note 23 to the accounts, opening retained profits at 1st September 2002 and 2003 have been reduced by HK$5,195,000 and HK$5,274,000, respectively, which represents the unprovided net deferred tax liabilities as at the two dates, as a result of the change in accounting policy. In addition, the profit for the year ended 31st August 2003 has been reduced by HK$79,000.

(m) Contingent liabilities and assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.

(n) Revenue recognition

(i) Revenue for the provision of international telecommunications and fixed telecommunications network services is recognised, net of discounts, when the services are rendered.

(ii) Revenue received in advance for the provision of international telecommunications services using calling cards is deferred and included under deferred services income, which is amortised based on the estimated actual usage by customers.

(iii) Revenue received in advance for the provision of fixed telecommunications network services is deferred and included under deferred services income, which is amortised on a straight-line basis over the agreed period of time in accordance with the terms of the subscriber agreement.

(iv) Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(o) Research and development costs

Research and development costs of new services and enhancements to existing services are charged to the profit and loss account as incurred.

(p) Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other borrowing costs are charged to the profit and loss account in the year in which they are incurred.

1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(q) Segment reporting

In accordance with the Group's internal financial reporting, the Group has determined that business segment be presented as the primary reporting format and geographical segment as the secondary reporting format.

Segment assets consist primarily of goodwill, fixed assets, receivables and operating cash. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate borrowings. Capital expenditure comprises additions to fixed assets.

In respect of geographical segment reporting, sales are reported based on the country in which the customer is located. Total assets and capital expenditure are reported based on where the assets are located.

(r) Barter transactions

When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

(s) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates.

2. TURNOVER, REVENUES AND SEGMENTAL INFORMATION

The Group is principally engaged in the provision of international telecommunications services and fixed telecommunications network services to customers in Hong Kong and Canada. Revenues recognised during the year are as follows:

	2004	2003
	HK$'000	HK$'000
Turnover		
International telecommunications services	627,978	875,802
Fixed telecommunications network services (note d)	541,902	423,107
	1,169,880	1,298,909
Other revenues		
Interest income	3,753	3,163
Other income	2,668	4,373
	6,421	7,536
Total revenues	1,176,301	1,306,445

2. TURNOVER, REVENUES AND SEGMENTAL INFORMATION (CONTINUED)

(a) Primary reporting format – business segments

The Group is organised on a worldwide basis into two business segments:

– International telecommunications – provision of international long distance call services

– Fixed telecommunications network – provision of dial up and broadband Internet access services, local voice-over-IP services and IP-TV services.

The Group's inter-segment transactions mainly consist of provision of leased lines services. These transactions were entered into on similar terms as those contracted with third parties.

	2004			
	International telecommuni-cations services HK$'000	Fixed telecommuni-cations network services HK$'000	Elimination HK$'000	Group HK$'000
Turnover				
External sales	627,978	541,902	–	1,169,880
Inter-segment sales	5,682	30,183	(35,865)	–
	633,660	572,085	(35,865)	1,169,880
Segment results	161,463	(109,695)		51,768
Finance costs				(175)
Profit before taxation				51,593
Taxation				(2,043)
Profit attributable to shareholders				49,550

2. TURNOVER, REVENUES AND SEGMENTAL INFORMATION (CONTINUED)

(a) Primary reporting format – business segments (CONTINUED)

	2003			
	International telecommuni-cations services	Fixed telecommuni-cations network services	Elimination	Group
	HK$'000	HK$'000	HK$'000	HK$'000
	As restated	As restated		As restated
Turnover				
External sales	875,802	423,107	–	1,298,909
Inter-segment sales	15,302	26,449	(41,751)	–
	891,104	449,556	(41,751)	1,298,909
Segment results	341,588	(62,692)		278,896
Loss on disposal of a subsidiary				(2,695)
Finance costs				(601)
Profit before taxation				275,600
Taxation				(17,857)
Profit attributable to shareholders				257,743

2. TURNOVER, REVENUES AND SEGMENTAL INFORMATION (CONTINUED)

(a) Primary reporting format – business segments (CONTINUED)

	2004		
	International telecommunications services HK$'000	Fixed telecommunications network services HK$'000	Group HK$'000
Segment assets	**532,161**	**1,151,018**	**1,683,179**
Unallocated assets			**229**
Total assets			**1,683,408**
Segment liabilities	**128,304**	**340,172**	**468,476**
Unallocated liabilities			**39,234**
Total liabilities			**507,710**
Capital expenditure	**17,164**	**392,882**	**410,046**
Depreciation	**29,023**	**166,929**	**195,952**
Goodwill amortisation charge	**–**	**–**	**1,065**

	2003		
	International telecommunications services HK$'000	Fixed telecommunications network services HK$'000	Group HK$'000
			As restated
Total segment assets	674,066	874,468	1,548,534
Segment liabilities	157,524	150,492	308,016
Unallocated liabilities			61,343
Total liabilities			369,359
Capital expenditure	20,749	229,460	250,209
Depreciation	36,043	138,912	174,955
Goodwill amortisation charge	–	–	1,065

2. TURNOVER, REVENUES AND SEGMENTAL INFORMATION (CONTINUED)

(b) Secondary reporting format – geographical segments

Although the Group's two business segments are managed on a worldwide basis, they operate in two main geographical areas:

– Hong Kong – international telecommunications and fixed telecommunications network services

– Canada – international telecommunications and fixed telecommunications network services

In presenting information on the basis of geographical segments, turnover and segment results are presented based on the geographical location of customers. Total assets and capital expenditure are presented based on the geographical location of the assets.

There were no sales between the geographical segments.

	2004			
	Turnover HK$'000	Segment results HK$'000	Total assets HK$'000	Capital expenditure HK$'000
Hong Kong	1,145,102	53,375	1,675,546	409,866
Canada	24,778	(1,607)	7,633	180
	1,169,880		1,683,179	410,046
Operating profit		51,768		
Unallocated assets			229	
Total assets			1,683,408	

	2003			
	Turnover HK$'000	Segment results HK$'000	Total assets HK$'000	Capital expenditure HK$'000
Hong Kong	1,263,160	275,126	1,539,212	250,093
Japan	7,790	269	–	–
Canada	27,959	3,501	9,322	116
	1,298,909	278,896	1,548,534	250,209
Loss on disposal of a subsidiary		(2,695)		
Operating profit		276,201		

2. TURNOVER, REVENUES AND SEGMENTAL INFORMATION (CONTINUED)

(c) During the year ended 31st August 2003, the Group's operation in Japan was discontinued following the disposal of its subsidiary operating in Japan to a company wholly-owned by a relative of a director of the subsidiary (the "Purchaser"). The subsidiary was sold for a consideration of JPY30,000,000 (equivalent to HK$1,950,000) to be satisfied by the Purchaser in thirty monthly instalments which commenced on 15th July 2003. The disposal resulted in a loss of HK$2,695,000. The revenue and operating profit up to the date of disposal relating to the Japanese segment are disclosed above and are included in the international telecommunications services reporting segment.

As at 31st August 2004, a receivable balance of HK$1,136,000 was due from the Purchaser, of which HK$780,000 included in other receivables, deposits and prepayments is expected to be received within one year. The remaining HK$356,000 is included in long term receivables and is expected to be received after one year.

(d) Revenue of fixed telecommunications network services for the year includes interconnection charges of HK$38,676,000 (2003: HK$6,090,000) receivable from several mobile operators for the usage of the fixed telecommunications network of the Group. The charges were determined using the available rates under the existing calculation model (fully distributed cost model) for interconnection charges between fixed and mobile operators, which are based on historical cost data of PCCW-HKT Telephone Limited ("PCCW-HKT"). In May 2004, the Office of the Telecommunications Authority ("OFTA") confirmed to Hong Kong Broadband Network Limited ("HKBN"), a wholly-owned subsidiary of the Group that mobile operators should pay interconnection charges to fixed network operators in accordance with the existing charging principles under the relevant statements issued by OFTA. In August, 2004, OFTA agreed to make a determination under section 36A of the Telecommunications Ordinance to cover the level of mobile and fixed interconnection charges payable by one of the mobile operators to HKBN; and the effective date of the determined interconnection charges. We believe, based on the application of the existing calculation model to our cost structure, we will obtain the same rates applied to PCCW-HKT and this rate will be applicable to all other mobile operators.

3. COST OF SERVICES PROVIDED

The Group estimates the Universal Services Contributions ("USC") payable to PCCW-HKT to fund the costs of network development in remote areas in Hong Kong and includes such estimated costs as part of the cost of its services. The OFTA periodically reviews the actual costs of such developments and revises the amounts owed to PCCW-HKT or to be refunded by it to the USC contributing parties.

Any sum received in advance from PCCW-HKT as an estimated refund of USC on a provisional basis, which is subject to the final confirmation and determination of the OFTA, is recorded in other payables and accrued charges in the Group's and the Company's balance sheet.

On 30th November 2002, the OFTA issued a statement (the "November 2002 Statement") on the USC which confirmed the actual USC payable by USC contributing parties for the calender year 2000. As a result of the release of the November 2002 Statement, in February 2003, the Group received a refund of USC paid for the period from 1st January 2000 to 31st December 2000 of HK$40,585,606 and the amount was set off against the cost of services of the Group for the year ended 31st August 2003.

3. COST OF SERVICES PROVIDED (CONTINUED)

On 8th March 2003, the Group received in advance a sum of HK$56,488,570 from PCCW-HKT as a provisional refund of the USC paid for the period from 1st January 2001 to 30th June 2002 ("the Provisional Refund"). On 20th October 2003, OFTA issued another statement on the USC and confirmed the contribution level for calendar year 2001. Accordingly, HK$40,276,440 out of the Provisional Refund and an additional refund of approximately HK$3 million payable by PCCW-HKT to the Group for the calendar year 2001 were set off against the costs of services of the Group. In aggregate, the Group had set off against the costs of services of HK$84,119,117 in respect of USC Refund for the year ended 31st August 2003. The remaining HK$16,212,130 of the Provisional Refund received by the Company, being the provisional refund of the USC for the period from 1st January 2002 to 30th June 2002 which was subject to confirmation of the OFTA ("2002 Provisional Refund") was included in other payables and accrued charges in the Group's and the Company's balance sheets as at 31st August 2003.

On 19th November 2004, the OFTA issued a statement on the USC and confirmed the actual contribution level for calendar year 2002. The 2002 Provisional Refund was confirmed. Additional refund payable by PCCW-HKT to the Group and related adjustments required to be made to the 2002 USC contribution charges were also determined. In aggregate, an amount of HK$31,688,696 was recorded as an off-set against the cost of services of the Group for the year ended 31st August 2004.

4. OTHER OPERATING EXPENSES

	2004	2003
	HK$'000	HK$'000
Advertising and marketing expenses	**228,169**	182,471
Amortisation of goodwill	**1,065**	1,065
Depreciation	**195,952**	174,955
Equipment rental	**31**	100
Loss on disposal of fixed assets	**–**	427
Office rental and utilities	**23,781**	19,792
Provision for doubtful debts	**11,502**	17,685
Staff costs (including directors' emoluments) (Note 11)	**226,650**	220,350
Others	**105,975**	87,951
	793,125	704,796

5. OPERATING PROFIT

The operating profit is stated after crediting and charging the following:

	2004	2003
	HK$'000	HK$'000
Crediting		
Net exchange gains	131	1,291
Gain on disposal of fixed assets	34	–
Reversal of costs of services accrued for in prior years	10,188	–
Charging		
Amortisation of goodwill (Note 14)	1,065	1,065
Amortisation of deferred expenditure (Note 19)	1,828	–
Auditors' remuneration	1,279	1,288
Depreciation of owned fixed assets	195,952	173,619
Depreciation of fixed assets held under finance leases	–	1,336
Loss on disposal of fixed assets	–	427
Operating lease charges in respect of land and buildings	8,084	6,481
Operating lease charges in respect of computer equipment	31	100
Provisions for doubtful debts	11,502	17,685
Research and development costs	5,962	2,622
Unrealised losses on other investments	1,696	–
Staff costs (including directors' emoluments) (Note 11)	244,944	236,653
Less: staff costs capitalised as fixed assets	(18,294)	(16,303)
	226,650	220,350

6. FINANCE COSTS

	2004	2003
	HK$'000	HK$'000
Interest on bank loans and overdrafts	3,228	210
Interest element of finance leases	–	42
Interest paid to third parties	–	349
Total borrowing cost incurred	3,228	601
Less: amount capitalised as fixed assets		
Interest capitalised	(2,553)	–
Other incidental borrowing costs	(500)	–
Total borrowing cost capitalised	(3,053)	–
	175	601

The entire sum of current year's interest from the long-term bank loan (Note 25) is capitalised as fixed assets.

7. TAXATION

Hong Kong profits tax has been provided at the rate of 17.5% (2003: 17.5%) on the estimated assessable profit for the year. Taxation on overseas profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the overseas countries in which the Group operates.

The amount of taxation charged to the consolidated profit and loss account represents:

	2004	2003
	HK$'000	HK$'000
		As restated
Current taxation:		
– Hong Kong profits tax	1,537	15,300
– Overseas taxation	596	2,478
– Underprovisions in prior years	1,221	–
Deferred taxation relating to the origination and reversal of temporary differences (Note 24)	(1,311)	(1,814)
Deferred taxation resulting from an increase in tax rate (Note 24)	–	1,893
Taxation charge	2,043	17,857

7. TAXATION (CONTINUED)

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

	2004	2003
	HK$'000	HK$'000
		As restated
Profit before taxation	**51,593**	275,600
Calculated at the prevailing taxation rate of respective countries	**9,696**	48,520
Income not subject to taxation	**(825)**	(5,151)
Expenses not deductible for taxation purposes	**730**	5,584
Recognition of deferred tax assets on prior year's tax losses, net of other temporary differences	**(9,066)**	(36,505)
Unrecognised tax losses	**27**	208
Underprovision in prior years	**1,221**	–
Increase in opening net deferred tax liabilities resulting from an increase in tax rate	**–**	1,893
Others	**260**	3,308
Taxation charge	**2,043**	17,857

8. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders is dealt with in the accounts of the Company to the extent of HK$241,000 (2003: HK$39,141,000).

9. DIVIDENDS

	2004	2003
	HK$'000	HK$'000
2003, Interim dividend, paid, of HK$0.05 per ordinary share	**–**	30,234
2003, Final dividend, paid, of HK$0.075 per ordinary share	**45,789**	–
2004, Interim dividend, paid, of HK$0.015 per ordinary share	**9,158**	–
	54,947	30,234

10. EARNINGS PER SHARE

	2004	2003
	HK$'000	HK$'000
		As restated
Profit attributable to shareholders	49,550	257,743

	No of shares in thousand	No of shares in thousand
Weighted average number of shares in issue	610,095	552,600
Incremental shares from assumed exercise of share options	604	7,112
Incremental shares from assumed exercise of warrants	3,666	55,390
Diluted weighted average number of shares	614,365	615,102
Basic earnings per share	HK$8.1 cents	HK$46.6 cents
Diluted earnings per share	HK$8.1 cents	HK$41.9 cents

11. STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

	2004	2003
	HK$'000	HK$'000
Wages and salaries	214,816	217,391
Unutilised annual leave	3,841	3,419
Retirement benefit costs – defined contribution plans (Note 12)	26,287	15,843
Less: staff costs capitalised as fixed assets	(18,294)	(16,303)
	226,650	220,350

Staff costs include directors' emoluments but exclude staff costs of HK$10,952,918 (2003: Nil) captured in cost of services and HK$83,953,378 (2003: HK$67,489,976) captured in advertising and marketing expenses.

12. RETIREMENT BENEFIT COSTS

The Group contributes to a defined contribution retirement scheme, an Occupational Retirement Scheme ("the ORSO Scheme"), which is available to some of its employees. Under the ORSO Scheme, the employees are required to contribute 5% of their monthly salaries, while the Group's contributions are calculated at 10% and 5% of the monthly salaries of senior management staff and all other staff respectively. The employees are entitled to 100% of the employer's contributions after 10 years of completed service, or at a reduced scale after completion of 3 to 9 years' service. Contributions to the ORSO Scheme are reduced by contributions forfeited by those employees who leave the ORSO Scheme prior to vesting fully in the Group's contributions.

A mandatory provident fund scheme (the "MPF Scheme") has been established under the Hong Kong Mandatory Provident Fund Scheme Ordinance in December 2000. The then existing employees of the Group in Hong Kong could elect to join the MPF Scheme, while all new employees joining the Group in Hong Kong from then onwards are required to join the MPF Scheme. Both the Group and the employees are required to contribute 5% of each individual's relevant income with a maximum amount of HK$1,000 per month as a mandatory contribution. Employer's mandatory contributions are 100% vested in the employees as soon as they are paid to the MPF Scheme. Employees may also elect to contribute more than the minimum as a voluntary contribution.

The retirement schemes for staff of the Group in other countries follow the local statutory requirements of the respective countries.

The aggregate employer's contributions, net of forfeited contributions, which have been dealt with in the profit and loss account during the year are as follows:

	2004	2003
	HK$'000	HK$'000
Gross contributions	**26,922**	16,340
Less: forfeited contributions utilised to offset the Group's contributions during the year	**(635)**	(497)
Net contributions charged to profit and loss account (Note 11)	**26,287**	15,843

At 31st August 2004, forfeited contribution available to offset future contributions by the Group to the schemes was HK$12,000 (2003: Nil).

13. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

(a) Directors' remuneration

The aggregate amounts of emoluments payable to directors of the Company during the year are as follows:

	2004	2003
	HK$'000	HK$'000
Executive		
Basic salaries, other allowances and benefits in kind	15,224	17,048
Discretionary bonuses	–	10,000
Allowances for directors' quarters	2,608	1,319
Retirement benefit costs – defined contribution plans	1,568	1,461
	19,400	29,828
Independent non-executive		
Fees	370	336
	19,770	30,164

During the year, the benefits arising from the exercise of share options granted to the directors amounted to Nil (2003: HK$17,655,000).

The emoluments of the directors fell within the following bands:

	Number of directors	
	2004	2003
Nil – HK$1,000,000	4[1]	3[1]
HK$1,000,001 – HK$1,500,000	1	1
HK$1,500,001 – HK$2,000,000	1	1
HK$2,000,001 – HK$2,500,000	1	–
HK$3,000,001 – HK$3,500,000	–	1
HK$3,500,001 – HK$4,000,000	–	1
HK$6,000,001 – HK$6,500,000	1	–
HK$6,500,001 – HK$7,000,000	1	–
HK$9,500,001 – HK$10,000,000	–	2

[1] Including three independent non-executive directors.

No director waived any emoluments in respect of the years ended 31st August 2003 and 2004.

13. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (CONTINUED)

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include four (2003: five) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining one (2003: Nil) individual during the year are as follows:

	2004	2003
	HK$'000	HK$'000
Basic salaries, other allowances and benefits in kind	1,114	–
Discretionary bonuses	232	–
Retirement benefit costs – defined contribution plans	111	–
	1,457	–

The emoluments fell within the following band:

	Number of individual	
	2004	2003
Emolument band		
HK$1,000,001 – HK$1,500,000	1	–

14. GOODWILL – GROUP

	HK$'000
Cost at 31st August 2003 and 31st August 2004	5,326
Accumulated amortisation:	
At 1st September 2003	2,130
Charge for the year (note 5)	1,065
At 31st August 2004	**3,195**
Net book amount:	
At 31st August 2004	**2,131**
At 31st August 2003	3,196

15. FIXED ASSETS

	Group						
	Leasehold land and buildings	Leasehold improvements	Furniture fixtures and fittings	Telecommunications, computer and office equipment	Auto-diallers	Motor vehicles	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Cost:							
At 1st September 2003	61,599	56,191	10,920	1,278,663	16,967	8,892	1,433,232
Additions	22,109	15,344	2,339	369,583	–	671	410,046
Disposals	–	(6,760)	–	(5,329)	–	(1,790)	(13,879)
Exchange adjustments	–	(76)	(21)	915	–	–	818
At 31st August 2004	**83,708**	**64,699**	**13,238**	**1,643,832**	**16,967**	**7,773**	**1,830,217**
Accumulated depreciation:							
At 1st September 2003	3,494	21,271	7,507	432,589	16,429	5,990	487,280
Charge for the year	1,530	7,067	1,530	184,018	371	1,436	195,952
Disposals	–	(6,757)	–	(4,220)	–	(1,790)	(12,767)
Exchange adjustments	–	22	15	840	–	–	877
At 31st August 2004	**5,024**	**21,603**	**9,052**	**613,227**	**16,800**	**5,636**	**671,342**
Net book value:							
At 31st August 2004	**78,684**	**43,096**	**4,186**	**1,030,605**	**167**	**2,137**	**1,158,875**
At 31st August 2003	58,105	34,920	3,413	846,074	538	2,902	945,952

15. FIXED ASSETS (CONTINUED)

	Company						
	Leasehold land and buildings	Leasehold improve-ments	Furniture, fixtures and fittings	Telecom-munications, computer and office equipment	Auto-diallers	Motor vehicles	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Cost:							
At 1st September 2003	5,197	14,604	6,612	294,221	16,968	6,465	344,067
Additions	–	–	408	5,778	–	330	6,516
Disposals	–	(6,759)	–	(1,863)	–	(1,790)	(10,412)
Transfer from a subsidiary	–	–	–	–	–	420	420
At 31st August 2004	**5,197**	**7,845**	**7,020**	**298,136**	**16,968**	**5,425**	**340,591**
Accumulated depreciation:							
At 1st September 2003	554	9,900	5,947	129,886	16,427	4,912	167,626
Charge for the year	104	1,012	584	22,898	371	820	25,789
Disposals	–	(6,756)	–	(1,852)	–	(1,789)	(10,397)
Transfer from a subsidiary	–	–	–	–	–	166	166
At 31st August 2004	**658**	**4,156**	**6,531**	**150,932**	**16,798**	**4,109**	**183,184**
Net book value:							
At 31st August 2004	**4,539**	**3,689**	**489**	**147,204**	**170**	**1,316**	**157,407**
At 31st August 2003	4,643	4,704	665	164,335	541	1,553	176,441

15. FIXED ASSETS (CONTINUED)

The interests in leasehold land and buildings situated in Hong Kong at their net book values are analysed as follows:

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
Leases of between 10 to 50 years	**78,684**	58,105	**4,539**	4,643

16. INVESTMENTS IN SUBSIDIARIES

	Company	
	2004	2003
	HK$'000	HK$'000
Unlisted investments, at cost (Note (a))	**51,791**	51,791
Amounts due from subsidiaries (Note (b))	**656,637**	568,199
	708,428	619,990

(a) The following is a list of the principal subsidiaries at 31st August 2004:

	Name	Place of incorporation	Principal activities and place of operations	Particulars of issued share capital	Percentage of interest held
	Attitude Holdings Limited	British Virgin Islands	Inactive	Ordinary US$1	100
	Automedia Holdings Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$1	[1]100
#	City Telecom (B.C.) Inc.	Canada	Provision of international telecommunications and dial-up internet access services in Canada	Common CAD501,000	100
#	City Telecom (Canada) Inc.	Canada	Maintenance of switching equipment and provision of operational services in Canada	Common CAD100	100

16. INVESTMENTS IN SUBSIDIARIES (CONTINUED)

	Name	Place of incorporation	Principal activities and place of operations	Particulars of issued share capital	Percentage of interest held
#	City Telecom Inc.	Canada	Provision of international telecommunications and dial-up internet access services in Canada	Common CAD1,000	100
	City Telecom International Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$5,294	[1]100
	Credibility Holdings Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$1	[1]100
#	CTI Guangzhou Customer Services Co. Ltd. (translated from the registered name in Chinese)	The People's Republic of China ("the PRC")	Provision of administrative support services in the PRC	Paid in capital of HK$8,000,000	[1]100
	CTI Marketing Company Limited	Hong Kong	Provision of media marketing services in Hong Kong	Ordinary HK$10,000	100
	Golden Trinity Holdings Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$1	[1]100
	Hong Kong Broadband Network Limited	Hong Kong	Provision of international telecommunications and fixed telecommunications network services in Hong Kong	Ordinary HK$383,049	100
	IDD 1600 Company Limited	Hong Kong	Provision of international telecommunications services in Hong Kong	Ordinary HK$2	100

1 Shares held directly by the Company.

\# Subsidiaries not audited by PricewaterhouseCoopers. The aggregate net liabilities of the subsidiaries not audited by PricewaterhouseCoopers amounted to approximately 0.6% (2003: 0.4%) of the Group's total assets.

(b) The amounts due from subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

17. OTHER INVESTMENTS

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
Debt securities, at fair value unlisted outside Hong Kong				
– secured (note 29(a)(ii))	**3,650**	–	**–**	–
– unsecured	**21,954**	23,370	**21,954**	23,370
	25,604	23,370	**21,954**	23,370

18. LONG TERM BANK DEPOSIT - GROUP AND COMPANY

The balance is a ten-year US$2 million (2003: US$2 million) (equivalent to HK$15,600,000) deposit placed with a bank in which the Group receives a floating rate deposit interest while the principal amount is fully protected. An interest rate of 10% per annum has been guaranteed for the first year of placement in 2003. The deposit will be terminated once the cumulative interest reaches the predetermined accrued interest cap at 13% of principal amount or an aggregate sum of US$260,000 (equivalent to HK$2,028,000), or otherwise, will reach maturity on 22nd August 2013 when interest will be paid out at the guaranteed accrued interest rate of 13% or the aggregate interest amount of US$260,000 (equivalent to HK$2,028,000).

19. DEFERRED EXPENDITURE

	Group	
	2004	2003
	HK$'000	HK$'000
Additions during the year	**23,391**	–
Less: Amortisation charge for the year (Note 5)	**(1,828)**	–
Balance at 31st August	**21,563**	–

Deferred expenditure represents costs incurred for premium given away to subscribers of the fixed line phone services offered by the Group, which is treated as customer acquisition costs and are amortised over the expected subscription period of the services.

20. ACCOUNTS RECEIVABLE

At 31st August 2004, the aging analysis of the accounts receivable balance was as follows:

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
Current – 30 days	**72,528**	82,138	**21,959**	30,615
31 – 60 days	**17,593**	7,870	**1,190**	885
61 – 90 days	**8,691**	4,072	**1,126**	511
Over 90 days	**36,037**	–	**–**	–
	134,849	94,080	**24,275**	32,011

The majority of the Group's turnover is on open account. Customers are generally required to pay deposits or provide their credit card or other credit information to the Group before they subscribe for the Group's services.

21. ACCOUNTS PAYABLE

At 31st August 2004, the aging analysis of the accounts payable was as follows:

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
Current – 30 days	**31,175**	25,446	**11,414**	14,082
31 – 60 days	**27,253**	26,786	**11,488**	10,491
61 – 90 days	**13,130**	11,254	**6,620**	10,077
Over 90 days	**50,901**	49,898	**43,055**	42,834
	122,459	113,384	**72,577**	77,484

22. SHARE CAPITAL

	Authorised (Ordinary shares of HK$0.10 each)			
	2004		2003	
	No. of shares	HK$'000	No. of shares	HK$'000
At 31st August 2003 and 31st August 2004	2,000,000,000	200,000	2,000,000,000	200,000

	Issued and fully paid (Ordinary shares of HK$0.10 each)			
	2004		2003	
	No. of shares	HK$'000	No. of shares	HK$'000
At 1st September	604,959,787	60,496	500,863,202	50,086
Exercise of share options (Note (a))	640,000	64	21,120,000	2,112
Exercise of warrants (Note (b))	4,973,574	497	82,976,585	8,298
At 31st August	610,573,361	61,057	604,959,787	60,496

(a) During the year ended 31st August 2004, 600,000 shares were issued at a price of HK$0.26 per share and 40,000 shares were issued at a price of HK$0.58 per share, respectively to share option holders who had exercised their subscription rights. These shares so issued rank pari passu with the then existing shares in issue.

(b) The Company effected a warrant issue at a price of HK$0.11 per warrant to certain qualifying shareholders (shareholders domiciled in Hong Kong) for cash during the year ended 31st August 2002. One warrant was offered for every five existing shares held on the date of record. The warrants entitle the holders to subscribe for ordinary shares of the Company (on a one to one basis) at a price of HK$0.40 per share (subject to adjustment), totalling HK$39,325,920 in cash at any time on or before 1st November 2004. If the warrants are fully exercised, the Company will be required to issue 98,314,800 additional shares. During the year, 4,973,574 (2003: 82,976,585) warrants were exercised for an equivalent number of shares and 3,635,439 (2003: 8,609,013) warrants were outstanding at year end. The shares so issued rank pari passu with the then existing shares in issue.

22. SHARE CAPITAL (CONTINUED)

(c) The movement of outstanding share options during the year was as follows:

Date of grant	3rd September 1998	10th September 1999	20th October 2000	3rd June 2004
Exercise price per share (HK$)	0.26	2.10	0.58	1.47
Number of Share Options outstanding at 1st September 2003	790,000	60,000	390,000	–
Granted	–	–	–	6,000,000
Exercised	(600,000)	–	(40,000)	–
Number of Share Options outstanding at 31st August 2004	190,000	60,000	350,000	6,000,000

All of the above share options (except the share options granted on 3rd June 2004) were granted under a share option scheme approved by the shareholders of the Company on 12th July 1997 (the "1997 Share Option Scheme") and are immediately exercisable. The share options granted on 3rd June 2004 were granted under the 2002 Share Option Scheme as described below.

Each option entitles the holder to subscribe for shares at nominal value of HK$0.10 each in the Company at a predetermined exercise price.

At an Extraordinary General Meeting held on 23rd December 2002, a new share option scheme (the "2002 Share Option Scheme") was approved by the shareholders of the Company and the 1997 Share Option Scheme was terminated on the same date. No further share option could be granted under the 1997 Share Option Scheme after the date of its termination, but all share options outstanding in respect of the 1997 Share Option Scheme as of 31st August 2004 shall continue to be exercisable in accordance with the terms of the 1997 Share Option Scheme.

During the year ended 31st August 2004, options were granted under the 2002 Share Option Scheme to an eligible participant for the subscription of 6,000,000 shares of the Company at an exercise price of HK$1.47 each.

23. RESERVES

	Group				
	Share premium	**Warrant reserve**	**Retained profits**	**Exchange reserve**	**Total reserves**
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
			As restated		As restated
At 1st September 2002, as previously reported	572,656	9,089	278,390	(38)	860,097
Changes in accounting policy – provision for net deferred tax liabilities (Note 1(l))	–	–	(5,195)	–	(5,195)
At 1st September 2002, as restated	572,656	9,089	273,195	(38)	854,902
2003 interim dividends paid (Note 9)	–	–	(30,234)	–	(30,234)
Profit attributable to shareholders	–	–	257,743	–	257,743
Exercise of warrants	–	(8,231)	–	–	(8,231)
Premium on shares issued upon exercise of share options	10,106	–	–	–	10,106
Premium on shares issued upon exercise of warrants	33,124	–	–	–	33,124
Exchange reserve realised upon disposal of a subsidiary (Note 26(c))	–	–	–	1,469	1,469
Exchange adjustments on translation of the accounts of overseas subsidiaries	–	–	–	(200)	(200)
At 31st August 2003	615,886	858	500,704	1,231	1,118,679

23. RESERVES (CONTINUED)

	Group				
	Share premium	Warrant reserve	Retained profits	Exchange reserve	Total reserves
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1st September 2003, as previous reported	615,886	858	505,978	1,231	1,123,953
Changes in accounting policy – provision for net deferred tax liabilities (Note 1(l))	–	–	(5,274)	–	(5,274)
At 1st September 2003, as restated	615,886	858	500,704	1,231	1,118,679
2003 final dividends paid (Note 9)	–	–	(45,789)	–	(45,789)
2004 interim dividends paid (Note 9)	–	–	(9,158)	–	(9,158)
Profit attributable to shareholders	–	–	49,550	–	49,550
Exercise of warrants	–	(493)	–	–	(493)
Premium on shares issued upon exercise of share options (Note 22(a))	115	–	–	–	115
Premium on shares issued upon exercise of warrants (Note 22(b))	1,985	–	–	–	1,985
Exchange adjustments on translation of the accounts of overseas subsidiaries	–	–	–	(248)	(248)
At 31st August 2004	**617,986**	**365**	**495,307**	**983**	**1,114,641**

23. RESERVES (CONTINUED)

	Company			
	Share premium	Warrant reserve	Retained profits	Total reserves
	HK$'000	HK$'000	HK$'000	HK$'000
			As restated	As restated
At 1st September 2002, as previously reported	572,656	9,089	346,442	928,187
Changes in accounting policy				
– provision for net deferred tax liabilities	–	–	(5,051)	(5,051)
At 1st September 2002, as restated	572,656	9,089	341,391	923,136
2003 interim dividends paid (Note 9)	–	–	(30,234)	(30,234)
Profit attributable to shareholders	–	–	39,141	39,141
Exercise of warrants	–	(8,231)	–	(8,231)
Premium on shares issued upon exercise of share options	10,106	–	–	10,106
Premium on shares issued upon exercise of warrants	33,124	–	–	33,124
At 31st August 2003	615,886	858	350,298	967,042
At 1st September 2003, as previously reported	615,886	858	355,488	972,232
Changes in accounting policy				
– provision for net deferred tax liabilities	–	–	(5,190)	(5,190)
At 1st September 2003, as restated	615,886	858	350,298	967,042
2003 final dividends paid (Note 9)	–	–	(45,789)	(45,789)
2004 interim dividends paid (Note 9)	–	–	(9,158)	(9,158)
Profit attributable to shareholders	–	–	241	241
Exercise of warrants	–	(493)	–	(493)
Premium on shares issued upon exercise of share options (Note 22(a))	115	–	–	115
Premium on shares issued upon exercise of warrants (Note 22(b))	1,985	–	–	1,985
At 31st August 2004	**617,986**	**365**	**295,592**	**913,943**

24. DEFERRED TAXATION

Deferred taxation is calculated in full on temporary differences under the liability method using the taxation rates prevailing in respective countries in which the Group operates.

The movement on the deferred tax liabilities/(assets) account is as follows:

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
		As restated		As restated
At 1st September	**20,274**	20,195	**20,190**	20,051
Exchange differences	**(301)**	–	**–**	–
Deferred taxation (credited)/charged to profit and loss account				
– relating to the origination and reversal of temporary differences (Note 7)	**(1,311)**	(1,814)	**(1,348)**	(1,741)
– resulting from an increase in tax rate (Note 7)	**–**	1,893	**–**	1,880
At 31st August	**18,662**	20,274	**18,842**	20,190

Deferred income tax assets are recognised for tax loss carry forwards to the extent that the related tax benefit through the utilisation of tax losses against the future taxable profits is probable. The Group has unrecognised tax losses of HK$40,573,000 at 31st August 2004 (2003: HK$80,577,000) to carry forward against future taxable income, these tax losses will expire in the following periods:

	Group	
	2004	2003
	HK$'000	HK$'000
After 5 years	**133**	–
From 2 to 5 years	**2,597**	4,600
No expiry date	**37,843**	75,977
	40,573	80,577

24. DEFERRED TAXATION (CONTINUED)

The movement in deferred tax assets and liabilities (prior to offsetting of balances within the same taxation jurisdiction) during the year is as follows:

Deferred tax liabilities – Group	Accelerated depreciation allowances		Others		Total	
	2004	2003	**2004**	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
		As restated		As restated		As restated
At 1st September	**110,925**	84,978	**–**	–	**110,925**	84,978
Charged to profit and loss account	**29,590**	25,947	**49**	–	**29,639**	25,947
Exchange differences	**(313)**	–	**–**	–	**(313)**	–
At 31st August	**140,202**	110,925	**49**	–	**140,251**	110,925

Deferred tax assets – Group	Tax losses	
	2004	2003
	HK$'000	HK$'000
		As restated
At 1st September	**(90,651)**	(64,783)
Credited to profit and loss account	**(30,950)**	(25,868)
Exchange differences	**12**	–
At 31st August	**(121,589)**	(90,651)

Deferred tax liabilities – Company	Accelerated depreciation allowances	
	2004	2003
	HK$'000	HK$'000
		As restated
At 1st September	**20,190**	20,051
(Credited)/charged to profit and loss account	**(1,348)**	139
At 31st August	**18,842**	20,190

24. DEFERRED TAXATION (CONTINUED)

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

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
		As restated		As restated
Deferred tax assets	**(229)**	–	**–**	–
Deferred tax liabilities	**18,891**	20,274	**18,842**	20,190
	18,662	20,274	**18,842**	20,190

25. LONG-TERM BANK LOAN – SECURED

At 31st August 2004, the Group's bank loan was repayable as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
Within one year	**13,333**	–
In the second year	**20,000**	–
In the third to fifth year	**60,000**	–
After the fifth year	**6,667**	–
	100,000	–
Less: current portion of long-term bank loan	**(13,333)**	–
	86,667	–

Please refer to Note 29(b) for details of the loan facility associated with this outstanding bank loan balance and securities given by the Group for it. In connection with the draw-down of this bank loan, the Group entered into an interest rate swap agreement with the bank, under which, the Group makes a monthly interest payment at a fixed rate of 2.675% per annum on a notional amount of HK$100 million, and receives monthly interest payments calculated at Hong Kong Interbank borrowing rate (HIBOR) during a period from March 2004 to December 2009.

26. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit before taxation to net cash inflow generated from operations

	2004	2003
	HK$'000	HK$'000
Profit before taxation	51,593	275,600
Amortisation of goodwill	1,065	1,065
Depreciation of owned fixed assets	195,952	173,619
Depreciation of fixed assets held under finance leases	–	1,336
Amortisation of deferred expenditure	1,828	–
Interest income	(3,753)	(3,163)
Interest expenses	175	559
Interest element of finance leases	–	42
(Gain)/loss on disposal of fixed assets	(34)	427
Unrealised losses on other investments	1,696	–
Loss on disposal of a subsidiary	–	2,695
Operating profit before working capital changes	248,522	452,180
Increase in long-term receivable	(6,206)	–
(Increase)/decrease in accounts receivable, other receivables, deposits and prepayments	(50,382)	6,455
Increase in deferred expenditure	(23,391)	–
Increase/(decrease) in accounts payable, other payables, accrued charges and deposits received	30,957	(28,678)
Increase in deferred services income	29,257	5,005
Net cash inflow generated from operations	228,757	434,962

26. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)

(b) Analysis of changes in financing during the year

	Share capital (including share premium and warrant reserve)	Obligations under finance leases	Bank loan
	HK$'000	HK$'000	HK$'000
Balance at 1st September 2002	631,831	2,949	–
Issue of new shares	45,409	–	–
Repayment of capital element of finance leases	–	(2,949)	–
Balance at 31st August 2003	677,240	–	–
Balance at 1st September 2003	677,240	–	–
Issue of new shares	2,168	–	–
Bank loan drawn down (note 25)	–	–	100,000
Balance at 31st August 2004	**679,408**	**–**	**100,000**

26. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)

(c) Disposal of a subsidiary

	2004	2003
	HK$'000	HK$'000
Fixed assets	–	1,354
Accounts receivable, other receivables, deposits and prepayments	–	1,914
Cash and bank balances	–	714
Accounts payable, other payables, accrued charges, deposits received and deferred service income	–	(805)
Taxation payable	–	(1)
Net assets disposed of	–	3,176
Exchange reserve transferred to profit and loss account (Note 23)	–	1,469
Net loss on disposal	–	(2,695)
Sale proceeds	–	1,950
Less: Cash and cash equivalents of the subsidiary disposed	–	(714)
Sale proceeds received and receivable	–	(1,818)
Net cash outflow in respect of the disposal of a subsidiary	–	(582)

27. CONTINGENT LIABILITIES

	Group		Company	
	2004	2003	2004	2003
	HK$'000	HK$'000	HK$'000	HK$'000
Bank guarantees provided to suppliers (Note 29(a)(i))	6,295	7,812	1,395	1,812
Bank guarantee in lieu of payment of utility deposits (Note 29(a)(ii))	3,622	3,622	–	–
Corporate guarantee provided to a subsidiary for banking facility granted (Note 29(b))	–	–	400,000	200,000
	9,917	11,434	401,395	201,812

28. COMMITMENTS

(a) Capital commitments

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
Purchase of telecommunications, computer and office equipment – contracted but not provided for	**213,310**	122,540	**–**	–

(b) Commitments under operating leases

At 31st August 2004, the Group and the Company had future aggregate minimum lease payments under non-cancellable operating leases as follows:

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000
Leases in respect of land and buildings which are payable:				
– Within one year	**10,419**	10,229	**1,012**	3,565
– Later than one year and not later than five years	**7,965**	3,268	**224**	438
	18,384	13,497	**1,236**	4,003
Leases in respect of telecommunications facilities and computer equipment which are payable:				
– Within one year	**36,479**	22,996	**6,132**	3,563
– Later than one year and not later than five years	**8,120**	8,368	**–**	–
– More than five years	**7,800**	–	**165**	–
	52,399	31,364	**6,297**	3,563
	70,783	44,861	**7,533**	7,566

28. COMMITMENTS (CONTINUED)

(c) Program fee commitments

The Group entered into several long-term agreements with program content providers for granting of program rights for use of certain program contents in the Group's IP-TV services. Minimum amounts of program fees are guaranteed to be paid by the Group which are analysed as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
Licence fee in respect of program rights which are payable:		
Within one year	**15,542**	–
Later than one year and not later than five years	**18,869**	–
	34,411	–

29. PLEDGE OF ASSETS

(a) As at 31st August 2004, the Group had:

(i) bank deposits of US$800,000 (equivalent to HK$6,240,000) (2003: HK$Nil) and HK$1,395,000 (2003: HK$11,434,000); and

(ii) a charge over an investment with market value as at 31st August 2004 of US$468,000 (equivalent to HK$3,650,000) (Note 17) (2003: HK$Nil).

as security for:

(i) bank guarantees of HK$6,295,000 (2003: HK$7,812,000) issued by the banks to third party suppliers of the Group for payment of certain products and services procured by the Group from these third party suppliers; and

(ii) bank guarantees of HK$3,622,000 (2003: HK$3,622,000) issued by a bank to certain utility vendors in lieu of payment of utility deposits.

As at 31st August 2004, the Group had pledged bank deposits of HK$7,635,000 (2003: HK$11,434,000).

(b) On 9th October 2002, the Group entered into a HK$200,000,000 long-term loan facility with The Hong Kong and Shanghai Banking Corporation Limited ("HSBC") to provide funding for further development of the fixed telecommunications network of Hong Kong Broadband Network Limited ("HKBN"), a wholly-owned subsidiary of the Company. According to the agreement, all amounts under the facility should be drawn by 31st December 2004. The principal balance drawn down is to be repaid in 60 equal monthly instalments beginning in January 2005. As at 31st August 2004, the amount drawn down and outstanding was HK$100,000,000 (see note 25).

On 27th July 2004, the Group entered into an additional HK$200,000,000 long term loan facility with HSBC to provide funding for the same purpose. All amounts under the facility should be drawn by 31st December 2006. The principal balance drawn down is to be repaid in 60 equal monthly instalments beginning in January 2007. As at 31st August 2004, the Company has not drawn any amount under this facility.

The Company is required to comply with certain covenants under the grant of both facilities. Both facilities are secured by a fixed and floating charge over all assets of HKBN.

(c) As at 31st August 2004, the short-term bank loan was secured by a bank deposit of HK$19,170,000 (2003: HK$18,174,000).

30. PENDING LITIGATIONS

(a) In July 1998, Cable & Wireless HKT, a Hong Kong company, commenced proceedings against the Company and served a statement of claim which alleged that the Company had breached the terms of a contract it had with Cable & Wireless HKT and committed an economic tort. The Company denied these allegations in a comprehensive defence which included a counterclaim lodged against the plaintiff seeking damages for anti-competitive practices conducted by Cable & Wireless HKT in Hong Kong. Neither the claim amount made by Cable & Wireless HKT nor the counterclaim amount made by the Company has been quantified. The directors believe that the allegations against the Company are without merit and intend to defend the litigation vigorously. The case is currently in its discovery phase and no provision against the claim has been made in the accounts as the directors do not consider provision is necessary.

(b) In January 1999, Jade Com Development Limited ("Jade Com") commenced proceedings against the Company and two directors of the Company, alleging repudiation of an international carrier service agreement executed between Jade Com and Attitude Holdings Limited, a wholly-owned subsidiary of the Company. Jade Com claimed damages for breach of contract and misrepresentation and alleged that the Company has a remaining commitment of approximately US$3.6 million under the agreement. The Company filed a defence in May 1999 on the basis that Jade Com had breached a condition of the agreement that they did not obtain the necessary legal approvals and licenses necessary for the provision of their services. In February 2001, the parties consented to adjourn the case indefinitely with liberty to restore, accordingly. No provision has been made in the accounts with respect to the litigation.

31. BARTER TRANSACTIONS

During the year ended 31st August 2004, Hong Kong Broadband Network Limited ("HKBN"), a wholly-owned subsidiary of the Group entered into two sets of agreements with a third party (the "Contract Party"). Pursuant to one agreement ("First Agreement"), the Contract Party agreed to sell to HKBN a set of un-activated telecommunications facility (the "Facility") at a cash consideration of approximately $42 million (the "Facility Considerations"). As at 31st August 2004, the full amount of the Facility Considerations had been paid by HKBN. In conjunction with the First Agreement, HKBN also entered into an operations and maintenance agreement with the Contract party for the provision of ongoing operations and maintenance services for the Facility at a fee of approximately HK$1 million per annum, commencing 1st September 2007 onwards.

Another agreement ("Second Agreement") was entered into on the same date between HKBN and the Contract Party whereby HKBN undertakes to provide certain telecommunication services to the Contract Party (the "Services") with fees computed based on unit service charges specified in the Second Agreement. However, the Contract Party is required to pay to HKBN a guarantee minimum service fee of approximately HK$42 million over a period of three years, commencing 1st September 2004. As at 31st August 2004, a prepayment of the service charges of HK$36.5 million (the "Prepaid Charges") was paid by the Contract Party to HKBN.

The Directors of the Company made an assessment of the fair values of the items under exchange and have drawn a conclusion that no fair values could be assigned to them. Accordingly, the Facility was not recognized as an asset and no revenue or deferred revenue was recognized in the financial statements of the Group as at and for the year ended 31 August 2004. The difference between the amounts paid for the Facility Considerations and the Prepaid Charges received, amounting to approximately HK$5.5 million, was recorded as a long-term receivable balance in the balance sheet.

32. SUBSEQUENT EVENT

In August 2004, HKBN launched its broadband phone services ("Broadband Phone Services") for customers in Hong Kong. In early October 2004, PCCW-HKT Telephone Limited and PCCW-IMS Limited (collectively, "Applicants") applied for leave to apply for judicial review of the decision of the OFTA by a letter dated 22nd September 2004 that there is no evidence to suggest that HKBN's Broadband Phone Services is outside the scope of its Fixed Telecommunications Network Services Licence. HKBN is being added by the Applicants as an interested party in these judicial review proceedings.

No revenue or cost had been recorded in the consolidated profit and loss accounts for the year ended 31st August 2004 in relation to the Broadband Phone Services. The cumulative capital expenditure incurred by the Group for the Broadband Phone Services as at 31 August 2004 was approximately HK$4.3 million. The Board of Directors of the Company presently have not formed any views as to any material adverse effect to the Group that may arise from this event.

33. APPROVAL OF ACCOUNTS

The accounts were approved by the board of directors on 23rd November 2004.