Notes to the Financial Statements

December 31, 2004
(Amount expressed in Hong Kong dollars unless otherwise stated)

1 GROUP ORGANIZATION

PCCW Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("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 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.

a. Reverse acquisition of Dong Fang Gas Holdings Limited

On March 5, 2004, the Company and Dong Fang Gas Holdings Limited ("DFG"), a company incorporated in Bermuda and whose shares are listed on the Stock Exchange, entered into an agreement (the "Sale and Purchase Agreement"). Pursuant to the Sale and Purchase Agreement, DFG conditionally agreed to purchase the Company's interest in certain investment properties, the Cyberport project and related property and facilities management companies for an aggregate consideration of HK$6,557 million. Approximately HK$2,967 million of the aggregate consideration was satisfied by the allotment and issue of new shares of DFG, representing approximately 93.42% of the then increased share capital of DFG following such share issue to Asian Motion Limited ("Asian Motion"), a wholly-owned subsidiary of the Company. The remaining HK$3,590 million was satisfied by the issuance of convertible notes by DFG to the Company entitling the holder to convert the principal amount into new shares of DFG. The Sale and Purchase Agreement became unconditional on May 10, 2004 and DFG was subsequently renamed Pacific Century Premium Developments Limited ("PCPD"). As the Company became the controlling shareholder (as defined under the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules")) of DFG on completion of the transaction, the transaction has been accounted for as a reverse acquisition and the Company is treated as acquiring a 93.42% interest in DFG. In addition, goodwill arising on the acquisition of DFG of approximately HK$84 million was recorded, being the excess of the cost of acquisition over the sum of the fair values of the identifiable assets acquired less liabilities assumed of DFG. As at December 31, 2004, the Company had sold down its interest in PCPD to approximately 51.07% through various transactions, details of which are set out in notes 7(a) and 7(b). As set out in note 39(b), on March 1, 2005, the Company exercised some of the conversion rights and increased its interest in PCPD to approximately 61.66%.

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 Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong ("HK GAAP") and the disclosure requirements of the Hong Kong Companies Ordinance. In particular, SSAP 36 "Agriculture", which became effective for periods commencing on or after January 1, 2004, does not have a material financial impact on the preparation of these financial statements.

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 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 made up to December 31 each year, except for certain subsidiaries of PCPD, the accounting for which is set out in note 2(q). Intra-group balances and transactions, and any unrealized profits arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements.

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

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 unamortized goodwill or goodwill taken to reserves and which was not previously charged to the consolidated income statement.

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

For subsidiaries which have 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. Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognized in the income statement as follows:

i. Telecommunications and other services

Telecommunications services comprise the fixed line telecommunications network services and equipment businesses mainly 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 period.

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

ii. Sales of goods

Revenue is recognized when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue is recorded after deduction of any trade discounts.

iii. Sales of properties

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

Revenue and income arising from the pre-sale of properties under development is recognized on the percentage of construction completion basis 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.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

d. Revenue recognition *(continued)*

iv. Rental income from operating leases

Rental income receivable from investment properties under operating leases is recognized in the income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognized in the income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognized as income in the accounting period in which they are earned.

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 is accrued on a time-apportioned basis by reference to the principal outstanding and the rate applicable.

vii. Commission income

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

viii. Dividend income

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

e. Operating leases

Leases of assets under which the lessor has not transferred all the risks and benefits of ownership are classified as operating leases.

i. Assets held for use in operating leases

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies, as set out in note 2(f). Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(h). Revenue arising from operating leases is recognized in accordance with the Group's revenue recognition policies, as set out in note 2(d)(iv).

ii. Operating lease charges

Where the Group has the use of assets under operating leases, payments made under the leases are charged to the income statement in equal instalments over the accounting periods covered by the lease term. Lease incentives received are recognized in the income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement in the accounting period in which they are incurred.

f. Fixed assets and depreciation

Fixed assets, excluding investment properties, are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 2(h)). 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. Subsequent expenditure relating to a fixed asset that has already been recognized is added to the carrying amount of the asset and is depreciated over the original remaining useful life of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Group. All other subsequent expenditure, such as repairs and maintenance and overhaul costs, is recognized as an expense in the period in which it is incurred.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

f. Fixed assets and depreciation *(continued)*

Depreciation is calculated to write off the cost on a straight-line basis over their estimated useful lives as follows:

Land and buildings	Over the shorter of the lease term and the estimated 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 the term of lease

Gains or losses arising from the retirement or disposal of a fixed asset are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognized in the income statement on the date of retirement or disposal.

g. 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 with an unexpired lease term of more than 20 years are stated 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 arising on the revaluation of investment properties are generally dealt with in the property revaluation reserve unless the following circumstances arise:

– when a deficit arises on revaluation, it will be charged to the income statement, if and to the extent that it exceeds the amount held in the reserve in respect of the portfolio of investment properties, immediately prior to the revaluation; and

– when a surplus arises on revaluation, it will be credited to the income statement, if and to the extent that a deficit on revaluation in respect of the portfolio of investment properties, had previously been charged to the income statement.

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 lease term.

h. 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;
– investments 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 more than 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.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

h. Impairment of assets *(continued)*

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.

i. 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.

j. 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 the estimated 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 incurred on loans directly attributable to the development 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.

k. Goodwill

Goodwill arising on consolidation represents the excess of the cost of the acquisition over the Group's share of the fair value of the identifiable assets and liabilities acquired. In respect of controlled subsidiaries:

- for acquisitions before January 1, 2001, goodwill is eliminated against reserves and is reduced by impairment losses (see note 2(h)); and
- for acquisitions on or after January 1, 2001, goodwill is amortized to the consolidated income statement on a straight-line basis over its estimated useful life ranging from 10 to 20 years. Goodwill is stated in the consolidated balance sheet at cost less any accumulated amortization and any impairment losses (see note 2(h)).

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

k. Goodwill *(continued)*

In respect of acquisitions of jointly controlled companies and associates, goodwill is amortized to the consolidated income statement on a straight-line basis over its estimated useful life ranging from 10 to 20 years. The cost of goodwill less any accumulated amortization and any impairment losses (see note 2(h)) is included in the carrying amount of the interest in jointly controlled companies or associates.

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

l. Intangible assets (other than goodwill)

Intangible assets that are acquired by the Group are stated in the balance sheet at cost less accumulated amortization and impairment losses (see note 2(h)). Expenditure on internally generated goodwill and brands is recognized as an expense in the period in which it is incurred.

Subsequent expenditure on an intangible asset after its purchase or its completion is recognized as an expense when it is incurred unless it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure is added to the cost of the intangible assets.

Amortization of intangible assets is charged to the income statement on a straight-line basis over the assets' estimated useful lives as follows:

Trademarks	20 years
Content licence	10 years
Wireless broadband licence	Over the term of licence

m. 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 the voting power, or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern its financial and operating policies, so as to obtain benefits from their activities.

In the Company's balance sheet, investments in subsidiaries are stated at cost less any impairment losses (see note 2(h)). The results of subsidiaries are recognized by the Company to the extent of dividends received and receivable at the balance sheet date.

n. Associates

An associate is an entity in which the Group or the Company has significant influence, but not control or joint control, over its management, including participating in the financial and operating policy decisions.

In the consolidated financial statements, investments in associates are accounted for under the equity method and are initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the associates' net assets. The consolidated income statement reflects the Group's share of post-acquisition results of the associates for the year, including any amortization of goodwill charged during the year in accordance with note 2(k).

In the Company's balance sheet, investments in associates are stated at cost less any impairment losses (see note 2(h)), on an individual entity basis. The results of associates are recognized by the Company to the extent of dividends received and receivable at the balance sheet date.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

o. Joint ventures and jointly controlled companies

A jointly controlled company or a joint venture is an entity which operates under a contractual arrangement between the Group or the Company and other parties, where the contractual arrangement establishes that the Group or the Company and one or more of the other parties share joint control over the economic activity of the entity. 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 made by means of joint venture structures where the Group or the Company controls the composition of 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.

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

The Company's interests in joint ventures and jointly controlled companies are stated at cost in the Company's balance sheet less any impairment losses (see note 2(h)), on an individual entity basis. The results of joint ventures and jointly controlled companies are recognized by the Company to the extent of dividends received and receivable at the balance sheet date.

p. Investments in securities

The Group's policy for investments in securities other than investments in subsidiaries, associates, joint ventures and jointly controlled companies is as follows:

i. Held-to-maturity securities are investments which the Group has the ability and intention to hold to maturity. Held-to-maturity securities are stated in the balance sheet at amortized cost less any provisions for diminution 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 the balance sheet date in order to assess the credit risk and whether the carrying amounts are expected to be fully recovered. Provisions are made when the carrying amounts are not expected to be fully recovered and are recognized as an expense in the income statement, such provisions being determined for each investment individually.

ii. Investments, which include both debt and equity securities, held on a continuing basis for an identified long-term purpose are classified as investment securities. Investment securities are stated in the balance sheet at cost less any provisions for diminution in value.

   The carrying amounts of investment securities are reviewed at the balance sheet date in order to assess whether fair values have declined below the carrying amounts. Provisions are made when the fair values have declined below the carrying amounts, unless there is evidence that the decline is temporary, and are recognized as an expense in the income statement, such provisions being determined for each investment individually.

iii. Provisions against the carrying values of held-to-maturity securities and investment securities are written back 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.

iv. Investments other than held-to-maturity securities and investment securities are classified as other investments and are stated in the balance sheet at fair value. Any unrealized holding gains or losses on other investments arising from the changes in fair value are recognized in the income statement as they arise.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

p. Investments in securities *(continued)*

v. 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.

vi. Profits or losses on disposal of investments in securities are determined as the difference between the estimated net disposal proceeds and the carrying amount of the investments and are accounted for in the income statement as they arise.

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 the subsequent disposal in the near future. To the extent the investments in unconsolidated subsidiaries are intended to be temporary, they are accounted for as other investments and stated at fair value, as described in note 2(p)(iv) above, and are recorded as current assets in the consolidated balance sheet.

r. 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 calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

s. Construction contracts

The accounting policy for contract revenues is set out in note 2(d)(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 expected loss is recognized as an expense immediately. When the outcome of a construction contract cannot be estimated reliably, revenue is recognized only to the extent that it is probable that the contract costs incurred will be recoverable and 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 in the balance sheet 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 the "Gross amounts due from customers for contract work" (as an asset) or the "Gross amounts due to customers for contract work" (as a liability), as applicable. Progress billings for work performed on a contract not yet paid by customers are included in the balance sheet under "Accounts receivable".

t. 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 at acquisition, 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.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

u. Provisions and contingent liabilities

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

v. 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 capitalized as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalization of borrowing costs as part of the cost of a qualifying asset commences when expenditures for the asset are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or completed.

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.

w. Income tax

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

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

iii. Deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax bases respectively. Deferred tax assets also arise from unused tax losses and unused tax credits.

    All deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilized, are recognized.

    The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

x. 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 recognized as an expense in the income statement in the period to which the contributions relate.

Retirement costs under defined benefit retirement schemes are assessed using the projected unit credit method. Under this method, the cost of providing defined 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 defined benefit obligation is measured as the present value of the estimated future cash outflows using interest rates determined by reference to market yields at the balance sheet date based 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% of the greater of the present value of the defined benefit obligations and the fair value of the scheme assets, are recognized in the income statement over the expected average remaining service lives of the participating employees. Past service costs are recognized as an expense on a straight-line basis over the average period until the benefits become vested.

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 options to acquire shares of the Company at specified exercise prices. No compensation costs are recognized in the income statement in respect of such options.

iv. Employee termination benefits are recognized only after either an agreement is in place with the appropriate employee representatives specifying the terms of redundancy and the numbers of employees affected, or, after individual employees have been advised of the specific terms.

y. Foreign currencies

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

In the financial statements of individual companies, transactions in other currencies during the year are translated into the respective reporting currencies at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in other currencies are translated into the respective reporting currencies at the exchange rates ruling at the balance sheet date. Exchange gains and losses are dealt with in the income statement.

For the purpose of preparing consolidated financial statements, the financial statements of the individual companies with reporting 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 rates of exchange ruling 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.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES *(CONTINUED)*

z. 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 or currency swaps, forward interest rate agreements and interest rate options are used to manage exposure to interest rate and foreign currency exchange 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 or currency 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 35(a)). Premiums 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.

aa. 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.

bb. Segment reporting

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

In accordance 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 for the purposes of these financial statements.

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.

Segment capital expenditure is 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

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

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

In HK$ million	The Group	
	2004	2003
Convertible bond interest paid or payable to a substantial shareholder	**293**	293
Capital injection to a jointly controlled company	**–**	117
Loan to a jointly controlled company	**19**	–
Telecommunication service fees, rental charges and subcontracting charges received or receivable from a jointly controlled company	**135**	221
System integration charges received or receivable from a shareholder of a PRC subsidiary	**387**	59
Telecommunications service fees and rental charges paid or payable to a jointly controlled company	**905**	1,086

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. No prepaid advertising fees received and receivable from investee companies for advertising space on the broadband Internet and television network operated by the Group was included in advances from customers as at December 31, 2004 (2003: HK$24 million).

c. An indirect wholly-owned subsidiary of the Company and a wholly-owned subsidiary of 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%, 90%, 80%, 70% and 60% 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 wholly-owned subsidiary of the JV. The Hong Kong Domestic Connectivity Agreement contemplates a reciprocal arrangement, whereby the Group will provide local connectivity services in Hong Kong to the wholly-owned subsidiary of the JV under similar terms and conditions. These agreements were subsequently amended on January 31, 2001 and further amended on April 15, 2003 such that each of the Group and Telstra Corporation Limited ("Telstra") have agreed to purchase 90% per annum of the Group's and Telstra's respective Committed Services from the JV and its subsidiaries until repayment of the outstanding portion of US$1,200 million (approximately HK$9,360 million) of the debt under the amended US$1,500 million syndicated term loan facility (the "Reach Term Facility") to a wholly-owned subsidiary of JV on December 31, 2010 or earlier at rates benchmarked at least annually to prevailing market prices. The above obligation is still in force notwithstanding the purchase of the entire outstanding portion of the debt under the Reach Term Facility by the Company and Telstra in June 2004 as stated below. The wholly-owned subsidiary of the JV similarly must acquire 90% per annum of its local connectivity services from the Group under the amended agreement for domestic connectivity services, similarly extended for the same period.

3 RELATED PARTY TRANSACTIONS *(CONTINUED)*

On April 15, 2003, the Company, the indirect wholly-owned subsidiary of the Company, and Telstra entered into a capacity prepayment agreement with the JV and certain of its subsidiaries whereby each of the Company and Telstra agreed to make a prepayment of US$143 million (approximately HK$1,115 million) for the purchase of capacity as stated above. These prepayments (which will be compounded to reflect the time value of money) are to be applied against the cost of services and capacity supplied to Telstra and the Group by the JV and certain of its subsidiaries as and when the JV and certain of its subsidiaries have available surplus cash in accordance with a prescribed formula. The total balance of HK$1,139 million, comprising the prepayment of HK$1,115 million and the accrued interest receivable of HK$24 million as at December 31, 2003, was included in "Loan due from a jointly controlled company of a subsidiary" in the balance sheet of the Company and subsequently written down to zero as at December 31, 2003 and the total balance of prepayment remained zero as at December 31, 2004 (see note 22).

Purchases made by the Group from the JV for the year ended December 31, 2004 were HK$855 million (2003: HK$1,036 million).

On June 17, 2004, the Company and Telstra agreed to purchase from the syndicate of banks the entire outstanding portion of US$1,200 million of the debt under the Reach Term Facility for approximately US$310.9 million (approximately HK$2,425 million). The Company's share of the purchased debt was 50%, or approximately US$155.45 million (approximately HK$1,213 million). The purchase was completed on June 18, 2004. This loan receivable from the wholly-owned subsidiary of the JV is secured and will be repayable in a single payment on December 31, 2010. Interest on the loan receivable has been suspended for six months from June 18, 2004 and agreed to be at London Interbank Offered Rate ("LIBOR") plus 250 basis points following such period. As at December 31, 2004, the loan receivable from the wholly-owned subsidiary of the JV was approximately HK$1,214 million (2003: Nil) and has been included in "Loan due from a jointly controlled company of a subsidiary" in the balance sheet of the Company (see note 22).

In addition, on June 17, 2004, the Company and Telstra agreed to provide the JV with a revolving working capital loan facility with each of the Company and Telstra contributing up to US$25 million (approximately HK$195 million) to this facility. As at December 31, 2004, no draw down has been made by the JV under this facility. This amount has been disclosed as the Group's commitment as at December 31, 2004 with details set out in note 36(c).

d. Other than as specified in this note and notes 22 and 23, balances with related parties are unsecured, non-interest bearing and have no fixed repayment terms.

4 TURNOVER

In HK$ million	The Group	
	2004	2003
Telecommunications and other service revenues	**15,613**	16,535
Amounts received and receivable in respect of goods sold	**1,532**	1,626
Amounts received and receivable in respect of properties sold	**5,415**	4,111
Amounts received and receivable from the rental of investment properties	**335**	276
Revenues from construction contracts	**–**	2
	22,895	22,550

5 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 consistent with the Group's internal financial reporting.

a. Business segments

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, JALECO LTD. ("JALECO"), Internet Services and CyberWorks Ventures.

In HK$ million	TSS		Business eSolutions		Infrastructure		Others		Elimination		Consolidated	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
REVENUE												
External revenue	**14,591**	15,865	**2,174**	1,762	**5,767**	4,497	**363**	426	**–**	–	**22,895**	22,550
Inter-segment revenue	**636**	707	**527**	564	**96**	103	**9**	–	**(1,268)**	(1,374)	**–**	–
Total revenue	**15,227**	16,572	**2,701**	2,326	**5,863**	4,600	**372**	426	**(1,268)**	(1,374)	**22,895**	22,550
RESULT												
Segment results	**4,621**	5,156	**(63)**	(148)	**1,319**	102	**(635)**	(2,317)	**–**	–	**5,242**	2,793
Unallocated corporate expenses											**(806)**	(537)
Profit from operations											**4,436**	2,256
Finance costs, net											**(1,929)**	(2,117)
Share of results of jointly controlled companies and associates	**163**	(750)	**(4)**	(49)	**–**	(1)	**(11)**	(26)	**–**	–	**148**	(826)
Impairment losses on interests in jointly controlled companies and associates	**–**	(4,170)	**(16)**	–	**–**	–	**–**	(294)	**–**	–	**(16)**	(4,464)
Profit/(Loss) before taxation											**2,639**	(5,151)
Taxation											**(981)**	(1,165)
Profit/(Loss) after taxation											**1,658**	(6,316)
Minority interests											**(20)**	216
Profit/(Loss) for the year attributable to shareholders											**1,638**	(6,100)

5 SEGMENT INFORMATION *(CONTINUED)*

a. Business segments *(continued)*

In HK$ million	TSS		Business eSolutions		Infrastructure		Others		Elimination		Consolidated	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
OTHER INFORMATION												
Capital expenditure (including fixed assets, intangible assets and goodwill) incurred during the year	**1,532**	1,746	**42**	190	**104**	13	**366**	165				
Depreciation and amortization	**2,061**	2,228	**135**	136	**147**	151	**112**	176				
Impairment losses recognized in income statement	**28**	5,190	**16**	71	**5**	–	**7**	1,643				
Significant non-cash expenses (excluding depreciation, amortization and impairment losses)	**99**	82	**4**	8	**–**	9	**212**	328				
ASSETS												
Segment assets	**17,202**	17,685	**1,508**	1,495	**18,540**	16,474	**1,507**	1,569	**–**	–	**38,757**	37,223
Interests in jointly controlled companies and associates	**1,858**	487	**2**	20	**–**	1	**14**	13	**–**	–	**1,874**	521
Unallocated corporate assets											**4,337**	6,903
Consolidated total assets											**44,968**	44,647
LIABILITIES												
Segment liabilities	**3,541**	4,527	**904**	746	**8,496**	5,146	**693**	672	**–**	–	**13,634**	11,091
Unallocated corporate liabilities											**36,234**	41,092
Consolidated total liabilities											**49,868**	52,183

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	
	2004	2003	**2004**	2003	**2004**	2003
Hong Kong	**21,105**	21,172	**33,351**	31,611	**1,651**	1,894
Mainland China (excluding Hong Kong) and Taiwan	**1,468**	948	**4,780**	5,011	**46**	115
Others	**322**	430	**626**	601	**370**	150
	22,895	22,550	**38,757**	37,223	**2,067**	2,159

6 OPERATING PROFIT BEFORE NET GAINS ON INVESTMENTS, PROVISIONS FOR IMPAIRMENT LOSSES AND RESTRUCTURING COSTS

In HK$ million	The Group	
	2004	2003
Turnover	**22,895**	22,550
Cost of sales	**(10,531)**	(8,730)
General and administrative expenses	**(8,298)**	(9,481)
Operating profit before net gains on investments, provisions for impairment losses and restructuring costs	**4,066**	4,339

7 GAINS ON INVESTMENTS, NET

In HK$ million	The Group	
	2004	2003
Net unrealized holding (losses)/gains on other investments	**(25)**	8
Net realized gains from disposals of investments in jointly controlled companies and associates, investment securities and other investments	**22**	103
Provision for impairment of investments	**(187)**	(258)
Amortization of premium received from equity options	**5**	12
Gain on termination and amendment of the terms of cross currency swap contracts (note 35(c))	**–**	532
Gain on deemed disposal of interest in subsidiaries (note a)	**72**	–
Gain on disposal of PCPD shares, net of expenses (note b)	**563**	–
Dividend income	**11**	10
	461	407

a. In respect of the reverse acquisition of DFG effective May 10, 2004 as set out in note 1(a), the Group recorded a deemed disposal gain of approximately HK$36 million for the year ended December 31, 2004. In addition, on October 28, 2004, Asian Motion agreed to sell, through Lehman Brothers Asia Limited, 118,000,000 PCPD shares at a price of HK$2.18 per PCPD share. On the same date, Asian Motion also entered into a subscription agreement with PCPD for the subscription of 118,000,000 new PCPD shares at the price of HK$2.18 per PCPD share. The net proceeds from the subscription were used for general working capital purposes. As a result, the Group recorded another deemed disposal gain of approximately HK$36 million for the year ended December 31, 2004.

b. On April 30, 2004, the Company and Asian Motion agreed to sell, through Citigroup Global Markets Hong Kong Futures and Securities Limited, 237,000,000 PCPD share at a price of HK$2.65 per PCPD share. The Group's gain (net of expenses) from the share placing was approximately HK$252 million for the year ended December 31, 2004 and the net proceeds were used for the general working capital purposes of Asian Motion. In addition, on November 30, 2004, Asian Motion agreed to sell, through Deutsche Bank AG, Hong Kong Branch, 450,000,000 PCPD shares at a price of HK$2.48 per PCPD share. The Group's gain (net of expenses) from this disposal was approximately HK$311 million for the year ended December 31, 2004 and the net proceeds were used for general corporate purposes.

8 PROVISIONS FOR IMPAIRMENT LOSSES

In HK$ million	The Group	
	2004	2003
Provisions for impairment of:		
Fixed assets (note a)	**29**	1,167
Multimedia business related assets (note b)	**–**	301
Game business related assets (note c)	**–**	893
Others	**11**	91
	40	2,452

8 PROVISIONS FOR IMPAIRMENT LOSSES *(CONTINUED)*

a. Due to technology and market changes in the sectors in which the Group operates, certain of the Group's fixed assets became obsolete or impaired. Accordingly, the Group recognized an impairment loss of approximately HK$29 million (2003: HK$1,155 million) in the consolidated income statement for the year ended December 31, 2004. In 2003, an impairment loss of approximately HK$12 million on the fixed assets of the game business was recognized as described in note (c) below.

b. Following the launch of certain new value-added services in 2003, the Group reviewed the recoverable amount of its multimedia business related assets and identified that the usage of certain content archive was diminishing. The income to be generated from such assets was expected to be insignificant. Accordingly, the Group fully wrote down the remaining carrying value of a content licence as at December 31, 2003 to zero and recognized an impairment loss of approximately HK$301 million for the year ended December 31, 2003.

c. In 2003, JALECO, a subsidiary incorporated under the laws of Japan with shares registered on the Over the Counter market in Japan, restructured its on-line game and game development businesses and exited certain legacy businesses. In view of the continual losses incurred by JALECO, management performed an assessment of the fair value of its interest in JALECO, including the related goodwill that was previously eliminated against reserves, as at December 31, 2003. As a result, based on the estimated value in use of JALECO determined using a discount rate of 12.5%, the Group recognized impairment losses for goodwill and other assets of HK$742 million and HK$151 million respectively in the consolidated income statement for the year ended December 31, 2003.

9 PROFIT/(LOSS) BEFORE TAXATION

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

In HK$ million	The Group	
	2004	2003
Crediting:		
Dividend income from		
– listed other investments	**–**	2
– unlisted investment securities	**11**	8
Realized gains on disposal of investments in jointly controlled companies and associates included in gains on investments, net	**3**	8
Realized gains on disposal of investment securities included in gains on investments, net	**19**	87
Realized gains on disposal of other investments included in gains on investments, net	**–**	8
Gain on disposal of fixed assets	**56**	–
Retirement costs for other staff		
– pension income for defined benefit retirement schemes (note 29(a)(iii))	**129**	–
Exchange gains, net	**34**	7
Gross rental income	**335**	276
Less: Outgoings	**(54)**	(21)
Charging:		
Provision for impairment of goodwill attributable to REACH	**–**	315
Provision for impairment of goodwill attributable to subsidiaries	**–**	742
Provision for impairment of goodwill attributable to another jointly controlled company	**–**	122
Provision for impairment of fixed assets	**29**	1,167
Provision for impairment of intangible assets	**–**	351
Provision for inventory obsolescence	**9**	70
Depreciation	**2,379**	2,674
Amortization of intangible assets	**97**	132
Amortization of goodwill	**63**	82
Staff costs (excluding directors' emoluments (note 12) and retirement costs for other staff)	**2,732**	2,813
Retirement costs for other staff		
– contributions to defined contribution retirement scheme	**174**	112
– pension expense for defined benefit retirement schemes (note 29(a)(iii))	**–**	103
Cost of inventories	**1,473**	1,528
Cost of properties sold	**4,665**	3,951
Loss on disposal of fixed assets	**–**	145
Auditors' remuneration	**14**	12
Operating lease rental		
– land and buildings	**231**	223
– equipment	**86**	99

10 FINANCE COSTS, NET

In HK$ million	The Group	
	2004	2003
Interest paid/payable for:		
Overdrafts and bank loans wholly repayable within 5 years	**113**	501
Bank loans not wholly repayable within 5 years	**5**	4
Other loans wholly repayable within 5 years	**895**	908
Other loans not wholly repayable within 5 years	**993**	853
	2,006	2,266
Interest capitalized in fixed assets	**(20)**	(17)
Finance costs	**1,986**	2,249
Interest income on bank deposits and other loan	**(57)**	(132)
Finance costs, net	**1,929**	2,117

Finance costs of HK$1,986 million (2003: HK$2,249 million) include arrangement fees and facility fees expensed of approximately HK$154 million (2003: HK$246 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 3.9% to 5.5% (2003: 2.7% to 4.9%).

11 IMPAIRMENT LOSSES ON INTERESTS IN JOINTLY CONTROLLED COMPANIES AND ASSOCIATES

In HK$ million	The Group	
	2004	2003
Impairment losses on interests in:		
REACH (note a)	**–**	4,159
Another jointly controlled company (note b)	**–**	227
Other jointly controlled company and associates	**16**	78
	16	4,464

a. On April 15, 2003, REACH and its bankers amended the terms of the Reach Term Facility, the outstanding balance of which was subsequently reduced to US$1,200 million, with effect from April 25, 2003. The amendments to the Reach Term Facility were intended to provide REACH with greater financial flexibility and an improved capital structure. REACH continues to operate in a difficult environment and the industry is expected to remain challenging for a period of time due to aggressive pricing and over supply of capacity.

The Group performed an assessment of the fair value of its interest in REACH, including the related goodwill that was previously eliminated against reserves, as at December 31, 2003. As a result, based on the estimated value in use of REACH determined using a discount rate of 10%, the Group made full provision for impairment of its previously unimpaired interest in REACH, recognizing an impairment loss of approximately HK$4,159 million in the consolidated income statement for the year ended December 31, 2003. Accordingly, the Group's total interest in REACH had been written down to zero as at December 31, 2003.

b. Due to continual losses sustained, the Group performed an assessment of the carrying value of its interest in a jointly controlled company, which is engaged in the on-line game business, as at December 31, 2003. Based on the result of the assessment, the Group made a full provision for impairment of its interest in this jointly controlled company of approximately HK$227 million in the consolidated income statement for the year ended December 31, 2003.

12 DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Details of directors' emoluments are set out below:

In HK$ million	The Group	
	2004	2003
Non-executive directors		
Fees	**5**	4
Executive directors		
Fees	**–**	–
Salaries, allowances and other allowances and benefits in kind	**52**	62
Pension scheme contributions	**4**	4
Bonuses (note a)	**65**	50
Further payment as compensation for loss of office to a past director	**–**	2
	121	118
Total	**126**	122

a. The amount in 2004 reflects both the bonus paid and payable whereas the amount in 2003 only reflects the bonus paid in 2003.

b. Pursuant to an agreement made between the Chairman and a director in 2002, 387,600 shares (2003: 387,600 shares) of the Company were transferred by the Chairman personally to that director in April 2004, being the second of three annual installments of a total of 1,162,800 shares the Chairman agreed to transfer to that director. The transfer of the third (last) annual installment of 387,600 shares will not proceed as the director concerned has resigned from the Company in September 2004. In addition, pursuant to another agreement made between the Chairman and another director in 2003, 2,161,000 shares of the Company were transferred by the Chairman personally to that director in July 2004, being the first of three annual installments of a total of 6,483,000 shares the Chairman agreed to transfer to that director. No new shares were issued by the Company and the Company did not bear any portion of the cost of the shares transferred by the Chairman.

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

	Number of directors The Group	
	2004	2003
Up to HK$1,000,000	**6**	5
HK$1,000,001 – HK$1,500,000	**1**	–
HK$1,500,001 – HK$2,000,000	**–**	1
HK$2,000,001 – HK$2,500,000	**–**	3
HK$2,500,001 – HK$3,000,000	**1**	–
HK$4,000,001 – HK$4,500,000	**1**	–
HK$5,000,001 – HK$5,500,000	**–**	1
HK$6,500,001 – HK$7,000,000	**1**	–
HK$7,000,001 – HK$7,500,000	**–**	2
HK$8,000,001 – HK$8,500,000	**–**	1
HK$9,500,001 – HK$10,000,000	**1**	–
HK$10,000,001 – HK$10,500,000	**–**	1
HK$10,500,001 – HK$11,000,000	**–**	1
HK$16,500,001 – HK$17,000,000	**–**	1
HK$18,500,001 – HK$19,000,000	**4**	–
HK$23,500,001 – HK$24,000,000	**1**	–
HK$45,000,001 – HK$45,500,000	**–**	1
	16	17

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

Of the five highest paid individuals in the Group, all (2003: all) are directors of the Company whose emoluments are included above.

13 TAXATION

Hong Kong profits tax has been provided at the rate of 17.5% (2003: 17.5%, except for certain subsidiaries as mentioned in note (a) below) 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	
	2004	2003
The Company and subsidiaries:		
Hong Kong profits tax		
– provision for current year	**1,305**	1,300
– (over)/under provision in respect of prior years	**(76)**	57
Overseas tax		
– provision for current year	**10**	10
– overprovision in respect of prior years	**–**	(74)
Recovery of deferred taxation (note 32(a))	**(259)**	(145)
	980	1,148
A jointly controlled company:		
Hong Kong profits tax		
– provision for current year	**–**	24
Recovery of deferred taxation	**–**	(8)
Associates:		
Hong Kong profits tax		
– provision for current year	**1**	1
Total	**981**	1,165

PCCW-HKT Telephone Limited ("HKTC"), an indirect wholly-owned subsidiary of the Company, has been in dispute with Hong Kong's Inland Revenue Department (the "IRD") regarding the deductibility of certain interest payments totalling HK$1,708 million in the current and previous year's tax computations. Subsequent to the balance sheet date, HKTC received official notification from the IRD in respect of its intention to disallow the deduction of interest payments in dispute and to issue additional assessments. The directors consider that their grounds for claiming the deduction are reasonable and will lodge a formal objection to the IRD against the additional assessments and accordingly no provision for taxation has been made in the financial statements of the Group.

Reconciliation between taxation charge and the Group's accounting profit/(loss) at applicable tax rates is set out below:

In HK$ million	The Group	
	2004	2003
Profit/(Loss) before taxation	**2,639**	(5,151)
Calculated at applicable taxation rates (note a)	**462**	(922)
Income not subject to taxation	**(86)**	(48)
Expenses not deductible for taxation purposes	**333**	1,340
Tax losses not recognized	**456**	453
(Over)/Under provision in prior years	**(142)**	57
Utilization of tax losses	**(27)**	–
(Income not subject to taxation)/Expenses not deductible for taxation purposes for jointly controlled companies, associates and unconsolidated subsidiaries, net	**(25)**	161
Recovery of deferred tax on revaluation surplus of properties	**–**	(56)
Tax provision of overseas operations	**10**	10
Effect on opening balance of deferred tax resulting from an increase in tax rate during the year	**–**	170
Taxation charge	**981**	1,165

13 TAXATION *(CONTINUED)*

a. For certain subsidiaries having an accounting year end date of March 31, the applicable tax rate of 16% was used on the estimated assessable profits for the first three months of 2003 while 17.5% was used on the estimated assessable profits for the rest of 2003.

14 LOSS ATTRIBUTABLE TO SHAREHOLDERS

Loss of HK$548 million (2003: HK$8,660 million) attributable to shareholders was dealt with in the financial statements of the Company.

15 DIVIDENDS

In HK$ million	2004	2003
Interim dividend declared and paid of 5.5 HK cents per ordinary share (2003: Nil)	**295**	–
Final dividend proposed after the balance sheet date of 9.6 HK cents per ordinary share (2003: Nil)	**645**	–
	940	–

The final dividend proposed after the balance sheet date has already taken into account 1,343,571,766 new shares to be issued pursuant to the subscription agreement on January 19, 2005 with China Network Communications Group Corporation (“China Netcom Group”), a state-owned enterprise established under the laws of the PRC, and China Netcom Group Corporation (BVI) Limited (“CNC(BVI)”), a company incorporated in the British Virgin Islands which is a wholly-owned subsidiary of China Netcom Group and this has not been recognized as a liability as at the balance sheet date. Please refer to note 39(a) for details of the subscription agreement.

16 EARNINGS/(LOSS) PER SHARE

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

	2004	2003
Earnings/(Loss) (in HK$ million)		
Earnings/(Loss) for the purpose of basic earnings/(loss) per share	**1,638**	(6,100)
Interest on convertible bonds	**23**	–
Earnings/(Loss) for the purpose of diluted earnings/(loss) per share	**1,661**	(6,100)
Number of shares		
Weighted average number of ordinary shares for the purpose of basic earnings/(loss) per share	**5,369,998,643**	4,967,178,732
Effect of dilutive potential ordinary shares	**118,793,037**	–
Weighted average number of ordinary shares for the purpose of diluted earnings/(loss) per share	**5,488,791,680**	4,967,178,732

The weighted average number of ordinary shares in 2003 for the purposes of calculating the basic and diluted loss per share has been retrospectively adjusted for the five-to-one share consolidation which took place in January 2003.

17 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	5,880	3,365	7,398	8,304	5,374	1,141	31,462
Additions	–	13	418	337	575	629	1,972
Transfers	(182)	177	656	(757)	1,234	(1,128)	–
Disposals	(179)	(108)	(141)	–	(180)	–	(608)
Exchange differences	(13)	–	–	–	37	–	24
Valuation adjustment	–	(247)	–	–	–	–	(247)
Deficit on revaluation	(322)	–	–	–	–	–	(322)
End of year	5,184	3,200	8,331	7,884	7,040	642	32,281
Representing:							
At cost	–	3,200	8,331	7,884	7,040	642	27,097
At valuation	5,184	–	–	–	–	–	5,184
	5,184	3,200	8,331	7,884	7,040	642	32,281
Accumulated depreciation and impairment							
Beginning of year	–	278	3,268	2,490	3,886	–	9,922
Charge for the year	–	82	898	500	899	–	2,379
Provision for impairment in value	–	–	–	29	–	–	29
Disposals	–	(19)	(141)	–	(166)	–	(326)
Exchange differences	–	–	–	–	31	–	31
End of year	–	341	4,025	3,019	4,650	–	12,035
Net book value							
End of year	5,184	2,859	4,306	4,865	2,390	642	20,246
Beginning of year	5,880	3,087	4,130	5,814	1,488	1,141	21,540

Land and buildings with an aggregate carrying value of approximately HK$33 million were pledged as security for certain bank borrowings of the Group as at December 31, 2004 (2003: Nil).

In HK$ million	Other plant and equipment	Total
THE COMPANY		
Cost		
Beginning of year	2	2
Additions	3	3
End of year	5	5
Accumulated depreciation and impairment		
Beginning of year	2	2
Charge for the year	–	–
End of year	2	2
Net book value		
End of year	3	3
Beginning of year	–	–

17 FIXED ASSETS *(CONTINUED)*

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	
	2004	2003	**2004**	2003
Held in Hong Kong				
On long lease (over 50 years)	**1,875**	2,117	**1,289**	1,447
On medium-term lease (10-50 years)	**–**	4	**1,471**	1,559
On short lease (less than 10 years)	**–**	4	**–**	–
Held outside Hong Kong				
Freehold	**–**	–	**41**	44
Leasehold				
On medium-term lease (10-50 years)	**3,309**	3,755	**58**	37
	5,184	5,880	**2,859**	3,087

Investment properties held in and outside Hong Kong were revalued as at December 31, 2004 by an independent valuer, CB Richard Ellis Limited. The basis of valuation for investment properties was open market value.

No investment properties were mortgaged as collateral for banking facilities of the Group as at December 31, 2004 (2003: HK$3,737 million).

As at December 31, 2004, the total future minimum lease payments under non-cancellable operating leases are receivable as follows:

Land and buildings

In HK$ million	The Group	
	2004	2003
Within 1 year	**191**	215
After 1 year but within 5 years	**333**	413
After 5 years	**96**	146
	620	774

Total future minimum lease payments receivable under non-cancellable operating leases as at December 31, 2004 included minimum lease receipts from the tenants of PCCW Tower, the Group's headquarters in Hong Kong, up to February 7, 2005, i.e. the completion date of the disposal of PCCW Tower as set out in note 39(c). Under the property sale and purchase agreement dated December 21, 2004 between Partner Link Investments Limited ("Partner Link"), an indirect wholly-owned subsidiary of PCPD, and an independent third party purchaser ("Property Sale and Purchase Agreement"), on completion of the disposal of PCCW Tower, there is a rental guarantee pursuant to which Partner Link will undertake to the purchaser that it will pay the sum of approximately HK$13.3 million to the purchaser by way of guaranteed net monthly rental for a period of five years. In return, the lease receipts from the tenants of PCCW Tower for the same five year period will be collected by Partner Link.

18 PROPERTIES HELD FOR/UNDER DEVELOPMENT

In HK$ million	The Group	
	2004	2003
Leasehold land, at cost: Located in Hong Kong	**3**	3
Properties held for development	**3**	3
Properties under development (note b) Less: Properties under development classified as current assets	**6,548** **(469)**	4,068 (297)
	6,079	3,771
Total	**6,082**	3,774

a. No properties held for/under development were pledged as security for banking facilities as at December 31, 2004 (2003: Nil).

b. Pursuant to an agreement dated May 17, 2000 entered into with The Government of Hong Kong (the "Government") ("Cyberport Project Agreement"), the Group was granted an exclusive right and obligation to design, develop, construct and market the Cyberport project at Telegraph Bay on the Hong Kong Island. The Cyberport project consists of commercial and residential portions. The completed commercial portion was transferred to the Government at no consideration. The associated costs incurred have formed part of the development costs of the residential portion. Pre-sales of the residential portion of the Cyberport project commenced in February 2003.

19 GOODWILL

In HK$ million	The Group **2004**	
	Goodwill carried on consolidated balance sheet	Goodwill carried in reserves
Cost		
Beginning of year	**1,535**	**166,177**
Additions	**90**	**–**
Realization of negative goodwill on disposal of interest in a subsidiary	**–**	**16**
End of year	**1,625**	**166,193**
Accumulated amortization and impairment		
Beginning of year	**602**	**128,823**
Charge for the year	**63**	**–**
End of year	**665**	**128,823**
Carrying amount		
End of year	**960**	**37,370**
Beginning of year	**933**	**37,354**

20 INTANGIBLE ASSETS

In HK$ million	The Group 2004				
	Trademarks	Content Licence	Wireless Broadband Licence	Others	Total
Cost					
Beginning of year	**1,518**	**375**	**93**	**63**	**2,049**
Additions	**–**	**–**	**5**	**–**	**5**
Exchange differences	**–**	**–**	**8**	**–**	**8**
End of year	**1,518**	**375**	**106**	**63**	**2,062**
Accumulated amortization and impairment					
Beginning of year	**256**	**375**	**11**	**57**	**699**
Charge for the year	**76**	**–**	**20**	**1**	**97**
End of year	**332**	**375**	**31**	**58**	**796**
Net book value					
End of year	**1,186**	**–**	**75**	**5**	**1,266**
Beginning of year	**1,262**	**–**	**82**	**6**	**1,350**

21 INVESTMENT IN SUBSIDIARIES

In HK$ million	The Company	
	2004	2003
Unlisted shares, at cost	**146,463**	25,549
Amounts due from subsidiaries	**84,739**	203,323
Convertible note due from a subsidiary	**3,621**	–
	234,823	228,872
Less: Provision for impairment in value	**(147,512)**	(148,179)
	87,311	80,693
Amounts due to subsidiaries	**(66,590)**	(56,639)
	20,721	24,054

The provision for impairment in value of HK$147,512 million (2003: HK$148,179 million) relates to certain subsidiaries of the Company which hold the Group's investments in subsidiaries, jointly controlled companies, associates, investment securities and other investments.

Certain subsidiaries had borrowings to or from the Company bearing interest at commercial rates throughout the terms of the borrowings. The interest bearing principal receivable from subsidiaries as at December 31, 2004 is HK$2,564 million (2003: HK$503 million) and the interest bearing principal payable to subsidiaries as at December 31, 2004 is HK$5,056 million (2003: HK$16,327 million). Other balances with subsidiaries are unsecured, non-interest bearing and have no fixed terms of repayment except for the HK$1,170 million convertible note due 2011 due from a subsidiary.

Dividends from the PRC joint ventures accounted for as subsidiaries 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, 2004, the Group has financed the operations of certain of its PRC joint ventures accounted for as subsidiaries in the form of shareholder's loans amounting to approximately US$198 million (2003: US$198 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.

Notes to the Financial Statements *(continued)*
December 31, 2004
(Amount expressed in Hong Kong dollars unless otherwise stated)

21 INVESTMENT IN SUBSIDIARIES *(CONTINUED)*

As at December 31, 2004, 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
PCCW-HKT Limited	Hong Kong	Investment holding	HK$6,092,100,052	–	100%
PCCW-HKT Telephone Limited*	Hong Kong	Telecommunications services	HK$2,163,783,209	–	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, computer products and ancillary services	HK$2	–	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 customer loyalty programs "No.1 Club" and "**Partners**" for members of the programs	HK$8,437,500	–	100%
PCCW Teleservices (Hong Kong) Limited	Hong Kong	Provision of customer relationship management and customer contact management solutions and services	HK$2	–	100%
PCCW-HKT Technical Services Limited	Hong Kong	Provision of technical support and maintenance services	HK$2	–	100%
PCCW VOD Limited (now known as PCCW Media Limited)	Hong Kong	Provision of pay television programme services	HK$3,500,000,100 (HK$3,500,000,095 ordinary shares, HK$1 "A" Class share and HK$4 "B" Class shares)	–	100%
PCCW Teleservices Operations (Hong Kong) Limited	Hong Kong	Provision of customer relationship management and customer contact management solutions and services	HK$2	–	100%
Cascade Limited	Hong Kong	Design, build and operate network infrastructures including technical consultancy and operation outsourcing	HK$10,000	–	100%
PCCW IMS Limited	Hong Kong	Provision of retail broadband and narrowband Internet access services under the "NETVIGATOR" brandname, interactive multimedia services, international telecommunication services and the provision of support services to a fellow subsidiary	HK$2	–	100%
Pacific Century Systems Limited	Hong Kong	Customer premises equipment related business	HK$1,000,000	100%	–
Corporate Access Limited	Cayman Islands/ Asia Pacific	Transponder leasing	US$10	–	100%

21 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
BtN Access (HK) Limited	Hong Kong	Provision of satellite based telecommunication services to third parties and satellite transponder capacity to a fellow subsidiary	HK$10	–	100%
Beyond The Network Limited	Hong Kong	Global Internet Protocol based communication service	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%
Omnilink Technology Limited	British Virgin Islands	Investment holding	US$14,850	–	76.43%
Unihub China Information Technology Company Limited 中盈優創資訊科技有限公司	The PRC	Selling of hardware and software and information system consulting services	RMB200,000,000	–	38.2%
Unihub Limited	Hong Kong/ Asia Pacific	Computer services and provision of IP/IT related value-added services to business customers	HK$1,200	–	100%
PCCW Business eSolutions Limited	Hong Kong	Provision of IP/IT related value-added services to business customers	HK$2	–	100%
PCCW Powerbase Data Center Services (HK) Limited	Hong Kong	Data Center services	HK$2	–	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%
ChinaBiG Limited	Hong Kong	Production and distribution of trade directory	HK$359,189	–	62.31%
Pacific Century Premium Developments Limited	Bermuda/ Hong Kong	Investment holding	HK$188,245,987	–	51.07%
Cyber-Port Limited	Hong Kong	Property development	HK$2	–	51.07%
JALECO LTD.	Japan	Games developing, publishing and distribution and certain content businesses	Yen19,742,711,522	–	79.80%
Taiwan Telecommunication Network Services Co., Ltd.	Taiwan	Type II Telecommunications services provider	NT$1,087,000,000	–	56.56%
UK Broadband Limited	United Kingdom	Public Fixed Wireless Access Licence Business	GBP1	–	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.

22 INTEREST IN JOINTLY CONTROLLED COMPANIES

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Share of net assets of jointly controlled companies	**2,815**	2,821	**–**	–
Loans due from jointly controlled companies	**2,361**	1,147	**2,353**	1,139
Amounts due from jointly controlled companies	**27**	27	**–**	–
Amounts due to jointly controlled companies	**–**	(1)	**–**	–
	5,203	3,994	**2,353**	1,139
Provision for impairment	**(3,976)**	(3,961)	**(1,139)**	(1,139)
	1,227	33	**1,214**	–
Investments at cost, unlisted shares	**3,130**	3,130	**–**	–

Balances with jointly controlled companies are unsecured, non-interest bearing and have no fixed terms of repayment except for the capacity prepayment to REACH of HK$1,139 million (2003: HK$1,139 million) and the loan receivable from the wholly-owned subsidiary of REACH of HK$1,214 million (2003: Nil) (see note 3(c)) as included in "Loans due from jointly controlled companies" above.

As at December 31, 2004, 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	**2004**	2003
Condensed consolidated balance sheet information as at December 31		
Non-current assets	**3,202**	3,737
Current assets	**2,122**	2,346
Total assets	**5,324**	6,083
Non-current liabilities	**(13,257)**	(13,969)
Current liabilities	**(3,721)**	(3,651)
Minority interests	**(78)**	(158)
Net liabilities	**(11,732)**	(11,695)
Condensed consolidated income statement information for the year ended December 31		
Turnover	**6,300**	7,036
Loss after taxation	**(275)**	(22,069)

22 INTEREST IN JOINTLY CONTROLLED COMPANIES *(CONTINUED)*

On April 15, 2003, REACH and its bankers amended the terms of Reach Term Facility, the outstanding balance of which was subsequently reduced to US$1,200 million, with effect from April 25, 2003. The amendments to the Reach Term Facility were intended to provide REACH with greater financial flexibility and an improved capital structure. REACH continues to operate in a difficult environment and the industry is expected to remain challenging for a period of time due to aggressive pricing and over supply of capacity.

The Group had written down its interest in REACH to zero as at December 31, 2003 (see note 11(a)).

An analysis of the Group's total interest in REACH as at December 31, 2004 is as follows:

In HK$ million	**2004**	2003
Share of net assets	**2,705**	2,705
Capacity prepayment to REACH (note 3(c))	**1,139**	1,139
Loan receivable from a wholly-owned subsidiary of REACH (note 3(c))	**1,214**	–
Goodwill previously eliminated against reserves	**8,578**	8,578
Total interest in REACH before provision for impairment	**13,636**	12,422
Provision for impairment	**(12,422)**	(12,422)
Total interest in REACH after provision for impairment	**1,214**	–

23 INTEREST IN ASSOCIATES

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Share of net assets of associates	**708**	547	**–**	–
Loans due from an associate	**78**	78	**–**	–
Amounts due from an associate	**39**	34	**4**	–
	825	659	**4**	–
Provision for impairment	**(178)**	(171)	**–**	–
	647	488	**4**	–
Investments at cost, unlisted shares	**1,000**	991	**–**	–

Balances with associates are unsecured, non-interest bearing and have no fixed terms of repayment except for the loans due from an associate, which bear interest at commercial rates, are secured by part of its movable properties and have fixed terms of repayment ranging up to three years from the date of drawdown in 2000.

23 INTEREST IN ASSOCIATES *(CONTINUED)*

As at December 31, 2004, particulars of the principal associates 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
Great Eastern Telecommunications Limited*	Cayman Islands	Investment holding	US$43,112,715	–	49%
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.

24 INVESTMENTS

Investments are analyzed as follows:

In HK$ million	The Group	
	2004	2003
Held-to-maturity securities	**31**	37
Investment securities (note a)	**388**	601
	419	638

a. Investment securities

In HK$ million	The Group	
	2004	2003
Unlisted, at cost	**1,765**	1,751
Less: Provision for impairment in value	**(1,377)**	(1,222)
	388	529
Listed, at cost		
Hong Kong	**–**	51
Overseas	**–**	63
	–	114
Less: Provision for impairment in value	**–**	(42)
	–	72
Total investment securities	**388**	601
Quoted market value of listed investment securities as at December 31	**–**	83

24 INVESTMENTS *(CONTINUED)*

During the year, a listed security was transferred from investment securities to other investments. This transfer was effected at fair value. The aggregate unrealized holding loss at the date of transfer which had not been previously recognized of approximately HK$0.5 million (2003: HK$1 million) was recognized in the income statement at the date of transfer.

Investment securities with an aggregate carrying value of approximately HK$19 million (2003: HK$20 million) were pledged as security for certain bank borrowings of the Group.

25 CURRENT ASSETS AND LIABILITIES

a. Sales proceeds held in stakeholders' accounts

The balance represents proceeds from the sale of the residential portion of the Cyberport project retained in bank accounts opened and maintained by stakeholders which will be transferred to specific bank accounts, which are restricted in use as described in note (b) below, pursuant to certain conditions and procedures as stated in the Cyberport Project Agreement.

b. Restricted cash

Pursuant to the Cyberport Project Agreement, the Group has a restricted cash balance of approximately HK$903 million as at December 31, 2004 (2003: HK$2,701 million) held in specific bank accounts. The uses of the funds are specified in the Cyberport Project Agreement. The remaining HK$1 million as at December 31, 2004 (2003: Nil) represented a bank deposit placed by an indirect subsidiary of the Company as a security for a banking facility granted to that subsidiary of the Company (see note 38).

c. Inventories

In HK$ million	The Group	
	2004	2003
Work-in-progress	**351**	218
Finished goods	**86**	298
Consumable inventories	**33**	21
	470	537

d. Other investments

In HK$ million	The Group	
	2004	2003
Unlisted		
Overseas	**71**	73
Listed, at quoted market value		
Hong Kong	**242**	250
	313	323

In 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 sales of a portion of certain quoted other investments plus written call options held by the counterparty for the remaining portion of those quoted other investments. As at December 31, 2004, the underlying quoted other investments with aggregate carrying value of approximately HK$224 million (2003: HK$246 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 35(a)). No new derivative contract of this nature was entered into by the Group in 2004 and 2003.

25 CURRENT ASSETS AND LIABILITIES *(CONTINUED)*

e. Investment in unconsolidated subsidiaries

In respect of the reverse acquisition of DFG as set out in note 1(a), considering that certain subsidiaries of DFG are acquired and held exclusively with a view to the subsequent disposal in the near future, the investment in certain subsidiaries of PCPD is accounted for as other investments and stated at a fair value of approximately HK$51 million as at December 31, 2004 (2003: Nil).

f. Accounts receivable, net

An aging analysis of accounts receivable is set out below:

In HK$ million	The Group	
	2004	2003
0 – 30 days	**1,055**	1,125
31 – 60 days	**253**	206
61 – 90 days	**108**	88
91 – 120 days	**88**	64
Over 120 days	**327**	276
	1,831	1,759
Less: Provision for doubtful debts	**(192)**	(188)
	1,639	1,571

The normal credit period granted by the Group ranges from 18 days to 30 days from the date of invoice.

g. Short-term borrowings

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Bank loans	**2**	54	**–**	–
Current portion of long-term borrowings (note 26(a))	**12**	106	**–**	–
Convertible note and bonds (note 26(b))	**9,017**	–	**461**	–
	9,031	160	**461**	–
Secured	**473**	154	**461**	–
Unsecured	**8,558**	6	**–**	–

Please refer to note 38 for details of the Group's banking facilities.

h. Accounts payable

An aging analysis of accounts payable is set out below:

In HK$ million	The Group	
	2004	2003
0 – 30 days	**636**	886
31 – 60 days	**67**	130
61 – 90 days	**22**	88
91 – 120 days	**41**	44
Over 120 days	**166**	229
	932	1,377

25 CURRENT ASSETS AND LIABILITIES *(CONTINUED)*

i. Gross amounts due to customers for contract work

In HK$ million	The Group	
	2004	2003
Contract costs incurred plus attributable profits less foreseeable losses	**794**	809
Less: Estimated value of work performed	**(799)**	(809)
	(5)	–

The total amount of progress billings, included in the estimated value of work performed as at December 31, 2004, is approximately HK$782 million (2003: HK$776 million).

No retentions receivable from customers in respect of construction contracts in progress was included in non-current assets at December 31, 2004 (2003: HK$8 million).

26 LONG-TERM LIABILITIES

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Long-term borrowings (note a)	**17,163**	22,029	**–**	3,003
Convertible note and bonds (note b)	**3,500**	12,477	**–**	440
	20,663	34,506	**–**	3,443

a. Long-term borrowings

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Repayable within a period				
– not exceeding one year	**12**	106	**–**	–
– over one year, but not exceeding two years	**–**	133	**–**	–
– over two years, but not exceeding five years	**–**	4,704	**–**	3,003
– over five years	**17,163**	17,192	**–**	–
	17,175	22,135	**–**	3,003
Less: Amounts repayable within one year included under current liabilities (note 25(g))	**(12)**	(106)	**–**	–
	17,163	22,029	**–**	3,003
Representing:				
US$456 million guaranteed notes (note i)	**3,547**	3,541	**–**	–
HK$3,003 million 5-year term loan (note ii)	**–**	3,003	**–**	3,003
US$500 million guaranteed notes (note iii)	**3,900**	3,900	**–**	–
Yen 30,000 million guaranteed notes (note iv)	**1,950**	1,950	**–**	–
US$1,000 million guaranteed notes (note v)	**7,766**	7,801	**–**	–
Other bank loans	**–**	1,834	**–**	–
	17,163	22,029	**–**	3,003
Secured	**–**	1,819	**–**	–
Unsecured	**17,163**	20,210	**–**	3,003

26 LONG-TERM LIABILITIES *(CONTINUED)*

a. Long-term borrowings *(continued)*

Details of major long-term borrowings of HK$17,163 million of the Group are presented below:

i. US$456 million guaranteed notes

On January 24, 2003, PCCW Capital No. 3 Limited, an indirect wholly-owned subsidiary of the Company, privately placed US$456 million 7.88% guaranteed notes due 2013 to raise funds for general corporate purposes. The notes are listed on the Luxembourg Stock Exchange and were unconditionally and irrevocably guaranteed by the Company until May 12, 2004. On May 12, 2004, the noteholders approved the novation of the guarantee to HKTC and amendments to certain terms of the notes.

ii. HK$3,003 million 5-year term loan

On March 14, 2003, the Company entered into a five-year term loan facility for HK$3,003 million on an unsecured basis. The loan was repayable in 2008. The proceeds were used for general corporate purposes. This term loan has been fully prepaid as at December 31, 2004.

iii. US$500 million guaranteed notes

On July 17, 2003, PCCW-HKT Capital No.2 Limited, an indirect wholly-owned subsidiary of the Company, issued US$500 million 6% guaranteed notes due 2013 which are listed on the Luxembourg Stock Exchange. The notes are irrevocable and unconditionally guaranteed by HKTC and will rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTC. The proceeds are used for general corporate purposes.

iv. 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 3.65% 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.

v. US$1,000 million guaranteed notes

In November 2001, PCCW-HKT Capital Limited, an indirect wholly-owned subsidiary of the Company, issued US$1,000 million 7.75% 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 interest rate payable on the Notes due 2011 has been adjusted to 8% based on the current ratings.

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.

Please refer to note 38 for details of the Group's banking facilities.

26 LONG-TERM LIABILITIES *(CONTINUED)*

b. Convertible note and bonds

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Repayable within a period				
– not exceeding one year	**9,017**	–	**461**	–
– over one year, but not exceeding two years	**–**	8,983	**–**	440
– over two years, but not exceeding five years	**3,500**	3,494	**–**	–
	12,517	12,477	**461**	440
Less: Amounts repayable within one year included under current liabilities (note 25(g))				
US$54 million 5% mandatory convertible note due 2005 (note ii)	**(461)**	–	**(461)**	–
US$1,100 million 3.5% guaranteed convertible bonds due 2005 (note iii)	**(8,556)**	–	**–**	–
	(9,017)	–	**(461)**	–
	3,500	12,477	**–**	440
Representing:				
US$450 million 1% guaranteed convertible bonds due 2007 (note i)	**3,500**	3,494	**–**	–
US$54 million 5% mandatory convertible note due 2005 (note ii)	**–**	440	**–**	440
US$1,100 million 3.5% guaranteed convertible bonds due 2005 (note iii)	**–**	8,543	**–**	–
	3,500	12,477	**–**	440
Secured	**–**	440	**–**	440
Unsecured	**3,500**	12,037	**–**	–

Details of convertible note and bonds of HK$12,517 million of the Group are presented below:

i. **US$450 million 1% guaranteed convertible bonds due 2007**

On January 29, 2002, PCCW Capital No. 2 Limited, an indirect wholly-owned subsidiary of the Company, issued US$450 million 1% 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$13.5836 (approximately US$1.7415) per share at any time up to and including the close of business on January 15, 2007. The bonds bear interest at 1% 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% of their 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.

26 LONG-TERM LIABILITIES *(CONTINUED)*

b. Convertible note and bonds *(continued)*

ii. US$54 million 5% mandatory convertible note due 2005

On June 28, 2002, the Company issued a US$190 million 5% mandatory convertible note due 2005 (the "Telstra Note due 2005") to Telstra as part of the disposal of the Group's 40% interest in Joint Venture (Bermuda) No. 2 Limited. 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 the Reach Term 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% 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.

On April 15, 2003, the Company redeemed US$143 million (approximately HK$1,115 million) of the Telstra Note due 2005 and issued an amended note in the principal amount of approximately US$54 million ("Amended Telstra Note due 2005") to Telstra. The principal amount of the Amended Telstra Note due 2005 is equal to US$190 million, being the initial principal amount of the Telstra Note due 2005, plus its accrued and capitalized interest until March 31, 2003 of approximately US$7 million less US$143 million. The terms of the Amended Telstra Note due 2005 are substantially the same as those of the Telstra Note due 2005.

As at December 31, 2004, the balance of Telstra Note due 2005 was HK$461 million and has been included in "Short-term borrowings" in the balance sheets of the Group and the Company respectively.

iii. US$1,100 million 3.5% guaranteed convertible bonds due 2005

On December 5, 2000, guaranteed convertible bonds due 2005 with the principal amount of US$1,100 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$4.9804 (approximately HK$38.8471) 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% per annum, payable annually in arrears. Unless previously cancelled, redeemed or converted, these bonds will be redeemed in US dollars at 120.12% 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 221 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. As at December 31, 2004, the balance of these bonds was HK$8,556 million and has been included in "Short-term borrowings" in the consolidated balance sheet.

26 LONG-TERM LIABILITIES *(CONTINUED)*

b. Convertible note and bonds *(continued)*

As at December 31, 2004, the total redemption premiums for the convertible bonds described in (i) and (iii) above were HK$1,808 million (2003: HK$1,326 million), of which HK$398 million (2003: HK$1,326 million) and HK$1,410 million (2003: Nil) have been included in "Other long-term liabilities" and "Accruals, other payables and deferred income" respectively in the consolidated balance sheet.

As at December 31, 2004, none of the above-mentioned convertible note and bonds had been converted into ordinary shares of the Company.

27 PROVISIONS

In HK$ million	The Group 2004		
	Payment to the Government (note a)	Others	Total
Beginning of year	**3,680**	**131**	**3,811**
Additional provisions made	**–**	**11**	**11**
Additional provisions included within properties under development	**4,375**	**–**	**4,375**
Provisions settled	**(1,675)**	**(54)**	**(1,729)**
End of year	**6,380**	**88**	**6,468**
Less: Amounts classified as current liabilities	**(1,496)**	**(88)**	**(1,584)**
	4,884	**–**	**4,884**

a. Pursuant to the Cyberport Project Agreement, the Government shall be entitled to receive payments of surplus cashflow arising from the sales of the residential portion of the Cyberport project, net of certain allowable costs incurred on the project, as stipulated under certain terms and conditions of the Cyberport Project Agreement. Provision for payment to the Government is included within properties under development as the amount is considered as part of the development costs of the Cyberport project. The provision is based on estimated sales proceeds of the residential portion and the estimated development costs of the Cyberport project. The estimated amount to be paid to the Government during the forthcoming year is classified as current liabilities.

28 SHARE CAPITAL

	2004		2003	
	Number of shares	Nominal value HK$ million	Number of shares	Nominal value HK$ million
Authorized:				
Ordinary shares of HK$0.05 each				
Beginning of year	**–**	**–**	32,000,000,000	1,600
Ordinary shares of HK$0.25 each				
Beginning of year	**6,400,000,000**	**1,600**	–	–
Effect of increase in nominal value of shares from HK$0.05 each to HK$0.25 each (note b)	**–**	**–**	(25,600,000,000)	–
End of year	**6,400,000,000**	**1,600**	6,400,000,000	1,600
Issued and fully paid:				
Ordinary shares of HK$0.05 each				
Beginning of year	**–**	**–**	23,268,770,370	1,164
Ordinary shares of HK$0.25 each				
Beginning of year	**5,368,754,074**	**1,343**	–	–
Effect of increase in nominal value of shares from HK$0.05 each to HK$0.25 each (note b)	**–**	**–**	(18,615,016,296)	–
	5,368,754,074	**1,343**	4,653,754,074	1,164
Exercise of staff share options (note a)	**5,508,987**	**1**	–	–
Issued for cash (note c)	**–**	**–**	715,000,000	179
End of year	**5,374,263,061**	**1,344**	5,368,754,074	1,343

a. During the year, 5,508,987 staff share options were exercised by the eligible optionholders at their respective subscription prices of HK$4.35 for a total cash consideration of HK$23,964,093 resulting in the issue of 5,508,987 new ordinary shares of HK$0.25 each.

b. 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 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 shares of HK$0.25 each, of which 4,653,754,074 shares were in issue and fully paid. The shares after the share consolidation rank pari passu in all respects with each other.

c. On July 17, 2003, the Company and Pacific Century Regional Developments Limited ("PCRD"), a substantial shareholder of the Company, entered into a subscription agreement, pursuant to which PCRD conditionally agreed to subscribe for 715,000,000 new shares of HK$0.25 each at a price of HK$4.40 per share. The net proceeds from the subscription were approximately HK$3,068 million, of which HK$3,060 million was used for debt repayment purpose. The subscription was completed on July 25, 2003.

d. Subsequent to the balance sheet date, an ordinary resolution was passed at an extraordinary general meeting of the Company held on March 16, 2005, pursuant to which the authorized share capital of the Company was increased to HK$2,500,000,000 divided into 10,000,000,000 shares of HK$0.25 each.

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

29 EMPLOYEE RETIREMENT BENEFITS

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.

On July 1, 2003 ("the Transfer Date"), all former members of the DB Schemes were transferred to defined contribution schemes operated by the Group for future services to be rendered by them to the Group and the benefit in respect of services rendered before the Transfer Date remained unchanged. In other words, scheme service in determining the level of benefit was frozen as of June 30, 2003 whereas the scheme salary and multiple will continue to grow. This freezing of scheme services was considered as a curtailment event under SSAP 34 "Employee benefits" but did not result in any accounting impact on the Group's financial statements for the year ended December 31, 2003.

In December 2004, members of certain DB Schemes were offered an option to receive a commuted lump sum payment in respect of their future monthly pension benefit and 382 members elected this option. This pension buy-out event was considered as a settlement event under SSAP 34. A gain of HK$131 million was recognized in the consolidated income statement for the year ended December 31, 2004.

The latest independent actuarial valuation of the DB Schemes, in accordance with SSAP 34, was carried out on December 31, 2004 and was 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 92.6% (2003: 90.6%) of the present value of the defined benefit obligations as at December 31, 2004.

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

In HK$ million	The Group	
	2004	2003
Present value of the defined benefit obligations	**3,984**	4,567
Fair value of scheme assets	**(3,691)**	(4,137)
	293	430
Unrecognized actuarial gains	**24**	16
Defined benefit liability in the consolidated balance sheet	**317**	446

As at December 31, 2004, the scheme assets do not include any ordinary shares issued by the Company (2003: fair value of HK$5 million).

29 EMPLOYEE RETIREMENT BENEFITS *(CONTINUED)*

a. Defined benefit retirement schemes *(continued)*

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

In HK$ million	The Group	
	2004	2003
Beginning of year	**446**	586
Contributions paid	**–**	(243)
(Income)/Expense recognized in the consolidated income statement	**(129)**	103
End of year	**317**	446

iii. (Income)/Expense recognized in the consolidated income statement is as follows:

In HK$ million	The Group	
	2004	2003
Current service cost	**–**	89
Interest cost	**235**	234
Expected return on scheme assets	**(233)**	(222)
Net actuarial losses recognized	**–**	2
Gain on settlement	**(131)**	–
	(129)	103
The (income)/expense is recognized in the following line item in the consolidated income statement:		
General and administrative expenses – retirement costs for other staff (note 9)	**(129)**	103
Actual return on scheme assets	**296**	700

iv. The principal actuarial assumptions used (expressed as weighted averages) are as follows:

In HK$ million	The Group	
	2004	2003
Discount rate	**4.00%**	5.25%
Expected rate of return on scheme assets	**5.75%**	5.75%
Future salary increases	**3.50%**	3.50%

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. 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% 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.

30 EQUITY COMPENSATION BENEFITS

a. Share option schemes of the Company

The Company has a share option scheme (the "1994 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 its 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. The vesting period and exercise period of the options are determined by the Board 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. The 1994 Scheme was due to expire in September 2004.

At the Company's annual general meeting held on May 19, 2004, the shareholders of the Company approved the termination of the 1994 Scheme and the adoption of a new share option scheme (the "2004 Scheme"). Since May 19, 2004, the Board may, at its discretion, grant share options to any eligible person to subscribe for shares in the Company subject to the terms and conditions stipulated in the 2004 Scheme. The overall limit on the number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the 2004 Scheme and any other share option schemes including the 1994 Scheme must not exceed 30% of the shares in issue from time to time. In addition, the maximum number of shares which may be granted under the 2004 Scheme must not exceed 10% of the Company's issued share capital as at May 19, 2004 (or some other date if renewal of this limit is approved by shareholders). The exercise price of the options under the 2004 Scheme shall be determined by the Board in its absolute discretion but in any event shall not be less than the highest of (i) the closing price of the shares as stated in the daily quotation sheet of the Stock Exchange on the date of grant, (ii) the average closing price of the shares as stated in the daily quotation sheet of the Stock Exchange for the five days last preceding the date of grant on which days it has been possible to trade shares on the Stock Exchange, and (iii) the nominal value of a share on the date of grant. The vesting period and exercise period of the options are determined by the Board, but no option can be exercised later than the day last preceding the tenth anniversary of the date of grant in respect of such option. In general, the subscription price is determined by reference to the closing prices of the shares as stated in the daily quotation sheet of the Stock Exchange. The basis for determination of the subscription price and the total number of shares that can be granted to eligible persons are precisely specified in the rules of the 2004 Scheme. The 2004 Scheme does not specify a minimum period for which an option must be held nor a performance target which must be achieved before an option can be exercised.

i. Movements in share options

	Number of options	
	2004	2003
Beginning of year	**222,177,528**	109,559,896
Issued (note iii)	**–**	132,856,200
Exercised (note iv)	**(5,508,987)**	–
Cancelled/Lapsed (note v)	**(37,925,825)**	(20,238,568)
End of year (note ii)	**178,742,716**	222,177,528
Options vested as at end of year	**93,379,227**	66,869,490

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30 EQUITY COMPENSATION BENEFITS *(CONTINUED)*

a. Share option schemes of the Company *(continued)*

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

Date of grant	Exercise period	Exercise price HK$	Number of options 2004	Number of options 2003
August 17, 1999 to September 15, 1999	August 17, 2000 to August 17, 2009	11.7800	**18,872,390**	19,525,188
October 25, 1999 to November 23, 1999	August 17, 2000 to October 25, 2009	22.7600	**3,432,400**	4,509,200
February 8, 2000 to March 8, 2000	February 8, 2001 to February 8, 2010	75.2400	**86,700**	86,700
August 26, 2000 to September 24, 2000	May 26, 2001 to August 26, 2010	60.1200	**9,946,600**	10,308,600
October 27, 2000 to November 25, 2000	March 15, 2001 to October 27, 2010	24.3600	**11,085,070**	12,966,082
January 22, 2001 to February 20, 2001	January 22, 2001 to January 22, 2011	16.8400	**17,195,318**	23,278,438
February 20, 2001	February 8, 2002 to February 8, 2011	18.7600	**86,700**	86,700
April 17, 2001 to May 16, 2001	May 26, 2001 to April 17, 2011	10.3000	**1,324,360**	3,542,960
July 16, 2001 to September 15, 2001	July 16, 2002 to July 16, 2011	9.1600	**648,600**	689,760
September 27, 2001	September 27, 2001 to September 7, 2011	6.8150	**–**	3,600,000
October 15, 2001 to November 13, 2001	October 15, 2002 to October 15, 2011	8.6400	**292,000**	292,000
May 10, 2002	April 11, 2003 to April 11, 2012	7.9150	**231,700**	231,700
May 28, 2002	April 29, 2003 to April 29, 2012	9.9500	**–**	5,600,000
June 19, 2002	June 19, 2002 to May 21, 2012	10.0900	**179,000**	279,000
August 1, 2002	August 1, 2003 to July 31, 2012	8.0600	**200,000**	200,000
October 11, 2002	October 11, 2002 to October 10, 2007	8.6165	**1,200,000**	1,200,000
November 13, 2002	November 13, 2003 to November 12, 2012	6.1500	**6,860,000**	7,040,000
July 25, 2003	July 25, 2004 to July 23, 2013	4.3500	**105,911,878**	127,551,200
September 16, 2003	September 16, 2004 to September 14, 2013	4.9000	**1,190,000**	1,190,000
			178,742,716	222,177,528

iii. Details of share options granted during the year

		2004		2003	
Exercise period	Exercise price HK$	Consideration received HK$	Number of options	Consideration received HK$	Number of options
July 25, 2004 to July 23, 2013	4.3500	**–**	**–**	–	131,666,200
September 16, 2004 to September 14, 2013	4.9000	**–**	**–**	–	1,190,000
		–	**–**	–	132,856,200

iv. Details of share options exercised during the year

			2004		2003	
Exercise date	Exercise price HK$	Market value per share at exercise date HK$	Proceeds received HK$	Number of options	Proceeds received HK$	Number of options
July 26, 2004 to December 31, 2004	4.3500	4.75 to 5.50	**23,964,093**	**5,508,987**	–	–
			23,964,093	**5,508,987**	–	–

30 EQUITY COMPENSATION BENEFITS *(CONTINUED)*

a. Share option schemes of the Company *(continued)*

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

		Number of options	
Exercise period	Exercise price HK$	**2004**	2003
August 17, 2000 to August 17, 2009	11.7800	**652,798**	5,223,068
August 17, 2000 to October 25, 2009	22.7600	**1,076,800**	1,900,000
December 20, 2000 to December 20, 2009	33.5600	**–**	216,000
May 26, 2001 to August 26, 2010	60.1200	**362,000**	1,125,000
March 15, 2001 to October 27, 2010	24.3600	**1,881,012**	1,780,120
January 22, 2001 to January 22, 2011	16.8400	**6,083,120**	4,393,140
May 26, 2001 to April 17, 2011	10.3000	**2,218,600**	251,240
July 16, 2002 to July 16, 2011	9.1600	**41,160**	55,000
September 27, 2001 to September 7, 2011	6.8150	**3,600,000**	–
March 31, 2002 to August 1, 2011	16.8400	**–**	800,000
April 29, 2003 to April 29, 2012	9.9500	**5,600,000**	–
June 19, 2002 to May 21, 2012	10.0900	**100,000**	300,000
November 13, 2003 to November 12, 2012	6.1500	**180,000**	80,000
July 25, 2004 to July 23, 2013	4.3500	**16,130,335**	4,115,000
		37,925,825	20,238,568

b. Share award schemes of the Company

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 1% of the issued share capital of the Company (excluding shares that have already been transferred to employees on vesting).

30 EQUITY COMPENSATION BENEFITS *(CONTINUED)*

b. Share award schemes of the Company *(continued)*

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

	Number of shares	
	2004	2003
Beginning of year	**5,771,000**	7,935,205
Purchases from the market by the trustee at average market price of HK$4.35 per share	**–**	834,800
Awards of vested shares to employees	**(2,078,600)**	(2,999,005)
End of year	**3,692,400**	5,771,000

In HK$ million	**2004**	2003
Fair value of shares held as at December 31	**18**	29
Fair value, on date of purchase, of shares purchased from the market	**–**	4
Fair value of shares awarded to employees during the year	**10**	16
Amounts recognized in the consolidated balance sheet as prepaid expenses	**7**	17
Amounts recognized in the consolidated income statement as staff costs	**10**	12

c. Employees’ rights to invest in shares of JALECO

In August 2000, the Group established an incentive scheme under which certain employees of the Group were granted options to acquire equity interests in JALECO. 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 JALECO have been trading below the cost of the options since the first exercise date. As at December 31, 2003 and up to November 8, 2004, a total number of 4,021,000 shares of JALECO were held by the incentive scheme which was operated under a limited partnership arrangement and no options were exercised by the employees. On November 8, 2004, the limited partnership was dissolved and the 4,021,000 shares of JALECO were transferred to Pacific Century CyberWorks Japan Limited, a wholly-owned subsidiary of the Company.

d. Share option scheme of PCPD

A new share option scheme (“2003 Scheme”) was approved and adopted on March 17, 2003 by PCPD. The 2003 Scheme is valid and effective for a period of ten years after the date of adoption.

The purpose of the 2003 Scheme is to enable PCPD to grant options to any directors (including executive directors, non-executive directors and independent non-executive directors) of PCPD and its subsidiaries (the “PCPD Group”) and full-time or part-time employees (including executives or officers) of the PCPD Group and any advisors and consultants providing advisory, consultancy or other services to the PCPD Group, distributors, contractors, suppliers, agents, customers, business partners, joint venture business partners, promoters, service providers of any member of the PCPD Group and those staff under secondment to the PCPD Group who the Board of PCPD considers, in its sole discretion, have contributed or will contribute to the PCPD Group (“Participant”) as incentives or rewards for their contribution to the PCPD Group and to encourage Participants to work towards enhancing the value of PCPD and its shares for the benefit of PCPD and its shareholders as a whole.

The maximum number of shares of PCPD in respect of which options may be granted under the 2003 Scheme and any other share option schemes of PCPD is not permitted to exceed 30% in nominal amount of the issued share capital of PCPD from time to time. The maximum number of shares in respect of which options may be granted to a specifically identified single grantee under the 2003 Scheme shall not (when aggregated with any shares subject to any other share option schemes of PCPD) in any twelve month period exceed 1% of the shares in issue.

30 EQUITY COMPENSATION BENEFITS *(CONTINUED)*

d. Share option scheme of PCPD *(continued)*

Where any grant of options to a substantial shareholder or an independent non-executive director of PCPD, or any of their respective associates, would result in the shares issued and to be issued upon exercise of all options already granted and to be granted (including options exercised, cancelled or outstanding) to such person in the twelve month period up to and including the date of grant:

(i) representing in aggregate over 0.1% of the shares in issue; and

(ii) having an aggregate value, based on the closing price of the shares as stated in the daily quotation sheets issued by the Stock Exchange on the date of grant, in excess of HK$5 million,

such grant of options shall be subject to prior approval by resolution of the shareholders who are not connected persons of PCPD pursuant to the Listing Rules.

Consideration to be paid on each grant of option is HK$1 and an offer remains open for the acceptance by Participant concerned for a period of 28 days from date of grant or otherwise stated in the offer letter. The option period is a period to be notified by the Board of PCPD to each grantee at the time of making an offer which shall not expire later than ten years from the date of grant. The exercise price is determined by the Board of PCPD, and shall not be less than the greatest of (i) the closing price of the shares as stated in the daily quotation sheets issued by the Stock Exchange on the date of grant; (ii) the average closing price of the shares of PCPD for the five business days immediately preceding the date of grant; and (iii) the nominal value of the share of PCPD.

Details of share options granted by PCPD pursuant to the 2003 Scheme and the share options outstanding at December 31, 2004, are as follows:

i. Movements in share options

	Number of options	
	2004	2003
Beginning of year	**–**	–
Issued (note ii)	**10,000,000**	–
End of year (note ii)	**10,000,000**	–
Options vested as at end of year	**10,000,000**	–

ii. Details of share options granted during the year

			2004		2003	
Date of grant	Exercise period	Exercise price HK$	**Consideration received HK$**	**Number of options**	Consideration received HK$	Number of options
December 20, 2004	December 20, 2004 to December 19, 2014	2.375	**2**	**10,000,000**	–	–
			2	**10,000,000**	–	–

All of the share options granted during the year remained unexpired and unexercised as at December 31, 2004.

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31 RESERVES/(DEFICIT)

In HK$ million	2004					
	Share premium	Special capital reserve	Property revaluation reserve	Currency translation reserve	Deficit	Total
THE GROUP						
Beginning of year	173,460	–	305	(97)	(182,850)	(9,182)
Exercise of staff share options	22	–	–	–	–	22
Elimination of accumulated deficit as at June 30, 2004 against share premium account (note a)	(152,932)	–	–	–	152,932	–
Transfer to special capital account (note a)	(20,532)	20,532	–	–	–	–
Reversal of excess provision for impairment loss as at June 30, 2004 to special capital reserve (note c)	–	14	–	–	(14)	–
Elimination of losses for the period from July 1, 2004 to December 30, 2004 against special capital reserve (note b)	–	(566)	–	–	566	–
Valuation adjustment	–	–	(254)	–	–	(254)
Deficit on revaluation of investment properties, net of deferred taxation	–	–	(26)	–	–	(26)
Translation exchange differences	–	–	–	53	–	53
Realization of negative goodwill on disposal of interest in subsidiaries	–	–	–	–	(16)	(16)
Profit for the year	–	–	–	–	1,638	1,638
Dividend declared and paid in respect of the current year	–	–	–	–	(295)	(295)
End of year	18	19,980	25	(44)	(28,039)	(8,060)
Attributable to:						
The Company and subsidiaries	18	19,980	25	(44)	(28,341)	(8,362)
Jointly controlled companies	–	–	–	–	53	53
Associates	–	–	–	–	249	249
End of year	18	19,980	25	(44)	(28,039)	(8,060)
THE COMPANY						
Beginning of year	173,460	–	–	–	(151,966)	21,494
Exercise of staff share options	22	–	–	–	–	22
Elimination of accumulated deficit as at June 30, 2004 against share premium account (note a)	(152,932)	–	–	–	152,932	–
Transfer to special capital account (note a)	(20,532)	20,532	–	–	–	–
Reversal of excess provision for impairment loss as at June 30, 2004 to special capital reserve (note c)	–	14	–	–	(14)	–
Elimination of losses for the period from July 1, 2004 to December 30, 2004 against special capital reserve (note b)	–	(566)	–	–	566	–
Loss for the year	–	–	–	–	(548)	(548)
Dividend declared and paid in respect of the current year	–	–	–	–	(295)	(295)
End of year	18	19,980	–	–	675	20,673

31 RESERVES/(DEFICIT) *(CONTINUED)*

In HK$ million	2003					
	Share premium	Special capital reserve	Property revaluation reserve	Currency translation reserve	Deficit	Total
THE GROUP						
Beginning of year	170,571	–	–	(117)	(177,534)	(7,080)
Issue of ordinary shares, net of issuing expenses	2,889	–	–	–	–	2,889
Surplus on revaluation of investment properties	–	–	305	–	–	305
Translation exchange differences	–	–	–	20	–	20
Provision for impairment of goodwill attributable to REACH	–	–	–	–	315	315
Provision for impairment of goodwill attributable to subsidiaries	–	–	–	–	469	469
Loss for the year	–	–	–	–	(6,100)	(6,100)
End of year	173,460	–	305	(97)	(182,850)	(9,182)
Attributable to:						
The Company and subsidiaries	173,460	–	305	(97)	(183,004)	(9,336)
Jointly controlled companies	–	–	–	–	57	57
Associates	–	–	–	–	97	97
End of year	173,460	–	305	(97)	(182,850)	(9,182)
THE COMPANY						
Beginning of year	170,571	–	–	–	(143,306)	27,265
Issue of ordinary shares, net of issuing expenses	2,889	–	–	–	–	2,889
Loss for the year	–	–	–	–	(8,660)	(8,660)
End of year	173,460	–	–	–	(151,966)	21,494

31 RESERVES/(DEFICIT) *(CONTINUED)*

a. Pursuant to a special resolution passed at an extraordinary general meeting of the Company held on May 19, 2004 and the subsequent order of the High Court of Hong Kong (the "High Court") made on August 3, 2004, the entire amount of HK$173,464,615,915 then standing to the credit of the share premium account of the Company was cancelled in accordance with the provisions of the Hong Kong Companies Ordinance (the "Capital Reduction").

Out of the credit arising from the Capital Reduction, HK$152,932,345,321 was applied to eliminate the accumulated losses of the Company as at June 30, 2004. An undertaking was given by the Company in connection with the Capital Reduction. Pursuant to the undertaking, the balance of HK$20,532,270,594 of the credit arising from the Capital Reduction and any sum received by the Company in respect of its investments against which provision for impairment loss or diminution in value had been made up to June 30, 2004 (or, in the case of a revaluation or disposal of any of such investment, sums revalued or realized in excess of the written down value of the relevant investment as at June 30, 2004) up to an aggregate amount of HK$152,932,345,321 shall be credited to a special capital reserve in the accounting records of the Company. While any debt or liability of, or claim against, the Company at the date of the Capital Reduction remains outstanding and the person entitled to the benefit thereof has not agreed otherwise, the special capital reserve shall not be treated as realized profit and (for so long as the Company remains a listed company) shall be treated as an undistributable reserve for the purposes of section 79C of the Hong Kong Companies Ordinance. The undertaking, however, is subject to the following provisos:–

(i) the amount standing to the credit of the special capital reserve may be applied for the same purposes as a share premium account may be applied or may be reduced or extinguished by the aggregate of any increase in the Company's issued share capital or share premium account resulting from an issue of shares for cash or other new consideration or upon a capitalization of distributable reserves after the date of the Capital Reduction;

(ii) an amount of up to HK$20,532,270,594 of the special capital reserve may be applied by the Company for the purpose of eliminating any loss sustained after June 30, 2004, provided that if subsequent to the elimination any of the Company's investments against which provision for impairment loss or diminution in value has been made for the period respecting the loss shall be revalued in excess of their written down value at the end of that period or realized for a sum in excess of such written down value, or any sum is received by the Company in respect of such investment, then a sum equal to the amount of the revaluation or the sum realized in excess of the written down value or the sum received by the Company in respect of such investment as aforesaid up to an aggregate amount of HK$20,532,270,594 or the total amount of the non-permanent losses sought to be eliminated (whichever is less) shall be re-credited to the special capital reserve; and

(iii) upon the coming into force of one or more guarantees to be issued by Standard Chartered Bank (HK) Limited in the form scheduled to the undertaking, the Company will be released from the undertaking to the extent of an amount equal to the sum so guaranteed less the fees and expenses incurred in issuing the relevant guarantee(s), with the result that such amount of the special capital reserve would thereby become distributable.

b. Pursuant to resolutions of the Board of the Company passed on September 29, 2004 and December 30, 2004, losses for the periods from July 1, 2004 to September 29, 2004 and from September 30, 2004 to December 30, 2004 in the amount of HK$284,227,183 and HK$281,932,052 respectively was eliminated against the special capital reserve by the Company.

c. During the year, a subsidiary of the Company, against which provision for impairment loss for diminution in value had been made in prior years, was liquidated. The amount realized from the liquidation exceeded the written down value by HK$13,681,249. In accordance with the undertaking given by the Company to the High Court, as summarized in note (a) above, the Company is required to credit such amount to the special capital reserve.

32 DEFERRED TAXATION

a. Movement in deferred tax liabilities/(assets) during the year is as follows:

In HK$ million	2004					
	Accelerated tax depreciation	Valuation adjustment resulting from acquisition of subsidiaries	Leasing partnership	Revaluation of properties	Others	Total
THE GROUP						
Beginning of year	**1,725**	**490**	**469**	**471**	**(129)**	**3,026**
(Credited)/Charged to consolidated income statement (note 13)	**(171)**	**(30)**	**(152)**	**42**	**52**	**(259)**
Credited to property revaluation reserve	**–**	**–**	**–**	**(188)**	**–**	**(188)**
Exchange differences	**–**	**–**	**–**	**–**	**(4)**	**(4)**
End of year	**1,554**	**460**	**317**	**325**	**(81)**	**2,575**

In HK$ million	2003					
	Accelerated tax depreciation	Valuation adjustment resulting from acquisition of subsidiaries	Leasing partnership	Revaluation of properties	Others	Total
THE GROUP						
Beginning of year	1,840	485	467	451	(78)	3,165
(Credited)/Charged to consolidated income statement (note 13)	(115)	5	2	20	(57)	(145)
Exchange differences	–	–	–	–	6	6
End of year	1,725	490	469	471	(129)	3,026

In HK$ million	The Group	
	2004	2003
Net deferred tax assets recognized in the consolidated balance sheet	**(38)**	–
Net deferred tax liabilities recognized in the consolidated balance sheet	**2,613**	3,026
	2,575	3,026

b. Deferred income tax assets are recognized for tax loss carry forwards to the extent that realization of the related tax benefit through utilization against future taxable profits is probable. The Group has unutilized estimated tax losses of HK$14,846 million (2003: HK$12,643 million) to carry forward for deduction against future taxable income. Estimated tax losses of HK$1,916 million (2003: HK$1,818 million) will expire within 1-5 years from December 31, 2004. The remaining portion of the tax losses, mainly relating to Hong Kong companies, can be carried forward indefinitely.

Notes to the Financial Statements *(continued)*
December 31, 2004
(Amount expressed in Hong Kong dollars unless otherwise stated)

33 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

In HK$ million	The Group	
	2004	2003
Profit/(Loss) before taxation	**2,639**	(5,151)
Adjustment for:		
Impairment loss on interest in REACH	**–**	4,159
Impairment loss on interest in another jointly controlled company	**–**	227
Impairment loss on interest in other jointly controlled companies and associates	**16**	78
Provision for inventory obsolescence	**9**	70
Interest income	**(57)**	(132)
Interest expense	**1,852**	2,020
Finance charges	**124**	217
Depreciation	**2,379**	2,674
Net unrealized holding losses/(gains) on other investments	**25**	(8)
Realized gains on disposal of other investments	**–**	(8)
Realized gains on disposal of investments in jointly controlled companies and associates	**(3)**	(8)
Realized gains on disposal of investment securities	**(19)**	(87)
Gain on deemed disposal of interest in subsidiaries	**(72)**	–
Gain on disposal of shares of a subsidiary, net of expenses	**(563)**	–
Provision for impairment of investments	**187**	258
Provision for impairment of fixed assets	**29**	1,167
Provision for impairment of multimedia business related assets	**–**	301
Provision for impairment of game business related assets	**–**	893
Provision for impairment of other non-current assets	**11**	91
(Gain)/Loss on disposal of fixed assets	**(56)**	145
Provision for doubtful debts	**45**	115
Dividend income	**(11)**	–
Amortization of intangible assets	**97**	132
Amortization of goodwill	**63**	82
Amortization of business development costs	**3**	–
Amortization of premium received from equity options	**(5)**	(12)
Share of results of jointly controlled companies and associates	**(148)**	826
Gain on termination and amendment of the terms of cross currency swap contracts	**–**	(532)
OPERATING PROFIT BEFORE CHANGES IN WORKING CAPITAL	**6,545**	7,517
Decrease/(Increase) in operating assets		
– properties under development	**(2,480)**	286
– inventories	**58**	(123)
– accounts receivable	**(113)**	54
– prepayments, deposits and other current assets	**72**	(245)
– sales proceeds held in stakeholders' accounts	**(2,016)**	(2,402)
– restricted cash	**1,797**	(2,701)
– amounts due from related companies	**94**	(25)
Increase/(Decrease) in operating liabilities		
– accruals, accounts payable, provisions, other payables and deferred income	**2,488**	3,448
– gross amounts due to customers for contract work	**5**	(10)
– amounts due to related companies	**(49)**	(322)
– advances from customers	**(106)**	(63)
CASH GENERATED FROM OPERATIONS	**6,295**	5,414
Interest paid	**(338)**	(294)
Interest received	**41**	93
Tax paid		
– Hong Kong profits tax paid	**(1,233)**	(1,371)
– overseas tax paid	**–**	(26)
NET CASH INFLOW FROM OPERATING ACTIVITIES	**4,765**	3,816

33 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT *(CONTINUED)*

b. Acquisition of subsidiaries

In HK$ million	The Group	
	2004	2003
Net assets acquired:		
Fixed assets	**–**	25
Intangible assets	**5**	–
Investment in unconsolidated subsidiaries	**55**	–
Inventories	**–**	3
Accounts receivable, prepayments, deposits and other assets	**70**	161
Cash and bank balances	**–**	304
Accounts payable, accruals and other payables	**–**	(135)
Minority interests	**–**	4
	130	362
Goodwill arising on acquisition	**89**	55
	219	417
Satisfied by:		
Interest in jointly controlled companies	**–**	130
Interest in associates	**–**	112
Interest in certain subsidiaries	**209**	–
Setting off shareholder's loan	**–**	23
Cash from internal resources	**10**	152
	219	417
Analysis of the net (outflow)/inflow of cash and cash equivalents in respect of the acquisition of subsidiaries:		
Cash	**(10)**	(152)
Cash and bank balances acquired	**–**	304
Net cash (outflow)/inflow in respect of acquisition of subsidiaries	**(10)**	152

c. Analysis of cash and cash equivalents

In HK$ million	The Group	
	2004	2003
Cash and bank balances	**4,413**	8,248
Bank loans and overdrafts	**(15)**	(12)
Restricted cash	**(904)**	(2,701)
Cash and cash equivalents as at December 31	**3,494**	5,535

d. Major non-cash transaction

During the year, the Group disposed of its interest in certain investment properties, the Cyberport project and related property and facilities management companies to DFG for an aggregate consideration of HK$6,557 million. Such consideration was satisfied by the issuance of the then 93.42% of the increased share capital of DFG of approximately HK$2,967 million and convertible notes of HK$3,590 million respectively. Details of this transaction are set out in note 1(a).

34 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	
	2004	2003
The net investment in relation to these finance leases comprises:		
Net lease payments receivable	**377**	454
Less: Current portion of net lease payments receivable (included in "Prepayments, deposits and other current assets" in the consolidated balance sheet)	**(90)**	(77)
	287	377

Non-recourse finance of HK$1,573 million (2003: HK$2,302 million) has been offset against net rentals receivable in arriving at the above net investment in finance leases.

35 FINANCIAL INSTRUMENTS

a. Equity options

In 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 sales of a portion of certain quoted other investments plus written call options held by the counterparty for the remaining portion of those quoted other investments. The deemed forward sales 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. An advance receipt of approximately HK$187 million for the deemed forward sales was received in 2002. 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 was reflected in "Net gains on investments" in the consolidated income statement for the year ended December 31, 2002. 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 are carried at market value at each balance sheet date and any unrealized holding gains or losses are recognized in the consolidated income statement in the period as it arises. The underlying quoted other investments for both the deemed forward sales and written call options have been placed as collateral for the above equity swap and equity option transactions (note 25(d)). No new derivative contract of this nature was entered into by the Group in 2004 and 2003.

Apart from the above, the Group had no other outstanding written equity call options as at December 31, 2004 and 2003. Other than the equity options as mentioned in the previous paragraph, the Group did not receive premiums on writing new equity options in 2004 and 2003.

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 enters into interest rate options to manage its interest rate risk. As at December 31, 2004, the total notional amount of such instruments was HK$53 million (2003: HK$68 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. Swaps

As at December 31, 2004, the Group had outstanding cross currency swap contracts of US$5,956 million and Yen 30,000 million (2003: US$2,756 million and Yen 30,000 million) at various rates totaling approximately HK$46,457 million and HK$1,950 million (2003: HK$21,497 million and HK$1,950 million), respectively, to manage the Group's exposure to foreign currencies and interest rate fluctuations.

In 2003, the Group recognized a gain of approximately HK$532 million from the termination of certain cross currency swap contracts and the amendment of the terms of another cross currency swap contract. The gain was reflected under "Net gains on investments" in the consolidated income statement (see note 7).

36 COMMITMENTS

a. Capital

In HK$ million	The Group	
	2004	2003
Authorized and contracted for	**1,909**	3,025
Authorized but not contracted for	**3,077**	3,480
	4,986	6,505

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

In HK$ million	The Group	
	2004	2003
Investments	**236**	274
Investment properties	**85**	82
Property development (note i)	**3,954**	5,637
Acquisition of fixed assets	**707**	512
Others	**4**	–
	4,986	6,505

i. The capital commitment as disclosed above represented management's best estimate of total construction costs of the Cyberport Project, which has been revised from the total construction costs since the Cyberport Project Agreement was entered into on May 17, 2000.

b. Operating leases

As at December 31, 2004, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

Land and buildings

In HK$ million	The Group	
	2004	2003
Within 1 year	**143**	148
After 1 year but within 5 years	**209**	259
After 5 years	**76**	198
	428	605

Equipment

In HK$ million	The Group	
	2004	2003
Within 1 year	**144**	44
After 1 year but within 5 years	**56**	–
After 5 years	**10**	–
	210	44

36 COMMITMENTS *(CONTINUED)*

c. Others

As at December 31, 2004, the Group had outstanding forward foreign exchange contracts to buy US$141 million (2003: US$910 million) at various rates totaling approximately HK$1,090 million (2003: HK$7,100 million).

As set out in note 3(c) above, on June 17, 2004, the Company agreed to provide REACH with a revolving working capital loan facility up to US$25 million (approximately HK$195 million). The facility is secured and will be repayable in full by REACH on December 31, 2007. The interest receivable under this facility is LIBOR plus 250 basis points. As at December 31, 2004, none of this working capital loan facility has been drawn down by REACH.

In addition, the Group has outstanding commitment of HK$586 million as at December 31, 2004 (2003: Nil) in relation to the rights to broadcast certain TV contents.

37 CONTINGENT LIABILITIES

In HK$ million	The Group		The Company	
	2004	2003	**2004**	2003
Performance guarantee	**129**	130	**–**	–
Tender guarantee	**1**	2	**–**	–
Advance payment guarantee	**6**	9	**–**	–
Guarantees given for bonds/notes issued by subsidiaries	**–**	–	**12,056**	15,582
Guarantees given to banks in respect of credit facilities granted to				
– subsidiaries	**–**	–	**–**	2,050
– an associate	**–**	85	**–**	–
Guarantee in lieu of cash deposit	**5**	16	**–**	–
Staff mortgage loan guarantee	**1**	1	**–**	–
Employee compensation	**3**	–	**3**	–
Guarantee indemnity	**11**	12	**–**	–
Corporate guarantee	**92**	–	**–**	–
	248	255	**12,059**	17,632

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 HKT’s 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$103 million (NT$418 million), being the purchase price of shares in TTNS, contractual interest for the period from January 1, 2001 to January 2, 2002 at 6.725% 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 are successful in their claim. A defence was filed by HKT on May 29, 2002 and proceedings are ongoing. Based on legal advice received, the directors consider that HKT has valid defences and therefore no provision has been made.

The Company is subject to certain parent company guarantee obligations to guarantee performance of its wholly-owned subsidiaries in the normal course of their businesses. The amount of liabilities arising from such obligations, if any, cannot be ascertained but the directors are of the opinion that any resulting liability would not materially affect the financial position of the Company.

38 BANKING FACILITIES

Aggregate banking facilities as at December 31, 2004 were HK$11,300 million (2003: HK$17,714 million) of which the unused facilities amounted to HK$11,286 million (2003: HK$12,745 million).

A summary of major borrowings is set out in note 26(a).

38 BANKING FACILITIES *(CONTINUED)*

Security pledged for certain banking facilities includes:

In HK$ million	The Group	
	2004	2003
Investment properties	–	3,737
Interest in a subsidiary	–	312
Land and buildings	**33**	–
Bank deposit	**15**	119
Investment securities	**19**	20
	67	4,188

As at December 31, 2004, an indirect subsidiary of the Company has been granted a banking facility amounting to approximately HK$20 million (2003: Nil) from a bank for the purpose of providing guarantee to the Government. Such facility was secured by bank deposit placed by the subsidiary from time to time to secure the amount of guarantee issued by the bank. The bank deposit was included in "Restricted cash" in the consolidated balance sheet (see note 25(b)) as at December 31, 2004.

39 POST BALANCE SHEET EVENTS

The following events occurred subsequent to December 31, 2004 up to the date of approval of these financial statements by the Board:

a. On January 19, 2005, China Netcom Group and CNC(BVI) entered into a conditional subscription agreement (the "Subscription Agreement") with the Company. Pursuant to the Subscription Agreement, CNC(BVI) conditionally agreed to subscribe for 1,343,571,766 new ordinary shares of the Company of HK$0.25 each at a price of HK$5.90 per share (the "Subscription"), representing approximately 20% of the Company's issued share capital as enlarged by the allotment and issue of the subscription shares. Under the terms of the Subscription Agreement, China Netcom Group has been granted certain rights, including the right to nominate three directors and China Netcom Group's anti-dilution rights. The proceeds of the Subscription are approximately HK$7,927 million (before deduction of expenses). Subject to the Group's capital investment procedures and the identification of appropriate investment opportunities, the Company intends to invest up to HK$5,000 million of these proceeds in telecommunications opportunities in the PRC. The remainder will be used for reducing the Group's debt and general corporate purposes. The Subscription Agreement and related matters were approved by the Company's shareholders pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on March 16, 2005.

b. On February 24, 2005, the Company elected to convert Tranche A of the convertible note with the principal amount of HK$1,170 million, which was issued by PCPD to the Company on May 10, 2004 as set out in note 1(a), into new shares of PCPD of HK$0.10 each at HK$2.25 per PCPD share. Upon the exercise of conversion rights by the Company effective March 1, 2005, PCPD alloted and issued 520,000,000 new PCPD shares to Asian Motion (as directed by the Company), which rank pari passu in all respects with the existing shares of PCPD. Immediately after the conversion and as at the date of approval of these financial statements by the Board, the Company holds an equity interest of approximately 61.66% in the issued share capital of PCPD.

c. Pursuant to the Property Sale and Purchase Agreement as set out in note 17, the disposal by Partner Link of PCCW Tower was completed on February 7, 2005 such that the entire cash consideration of HK$2,808 million was all received by Partner Link and the assignment of PCCW Tower to the purchaser was completed on February 7, 2005. Taking into account the adoption of Hong Kong Accounting Standard ("HKAS") 40 "Investment Property", which is effective for accounting periods beginning on or after January 1, 2005, and the related transitional provisions, the disposal is estimated to realize a gain of approximately HK$17 million to the Group.

d. Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on March 16, 2005, the authorized share capital of the Company was increased to HK$2,500,000,000 divided into 10,000,000,000 shares of HK$0.25 each.

40 RECENTLY ISSUED ACCOUNTING STANDARDS

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards and HKASs ("new HKFRSs") which are effective for accounting periods beginning on or after January 1, 2005.

The Group has not early adopted these new HKFRSs in the financial statements for the year ended December 31, 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.