notes to the financial statements

(Expressed in Hong Kong Dollars)

1. General Information

Hongkong Electric Holdings Limited (the "Company") is a limited company incorporated and domiciled in Hong Kong. The address of its registered office is 44 Kennedy Road, Hong Kong.

2. Significant Accounting Policies

(a) Statement of Compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1st January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRSs for the current and prior accounting periods reflected in these financial statements is provided in note 3.

(b) Basis of Preparation of the Financial Statements

The consolidated financial statements for the year ended 31st December 2005 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in associates.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

– financial instruments classified as available-for-sale securities (see note 2(g)); and

– derivative financial instruments (see note 2(h)).

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 38.

(c) Basis of Consolidation

The Group financial statements incorporate the financial statements of Hongkong Electric Holdings Limited and all its subsidiaries made up to 31st December each year, together with the Group's share of the results for the year and the relevant share of the post acquisition results of its associates.

(d) Subsidiaries

A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

In the Company's Balance Sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 2(l)).

(e) Associates

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

An investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's net assets. The Consolidated Profit and Loss Account includes the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment in associates recognised for the year (see notes 2(f) and 2(l)).

When the Group's share of losses exceeds its interest in the associate, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For this purpose, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

notes to the financial statements

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(f) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(l)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in the associate.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in profit or loss.

On disposal of a cash-generating unit or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

(g) Other Investments in Debt and Equity Securities

The Group's and the Company's policies for investments in debt and equity securities, other than investments in subsidiaries and associates, are as follows:

Investments in securities held for trading are classified as current assets and are initially stated at fair value. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised in profit or loss.

Dated debt securities that the Group and/or the Company have the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are initially recognised in the Balance Sheet at fair value plus transaction costs. Subsequently, they are stated in the Balance Sheet at amortised cost less impairment losses (see note 2(l)).

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the Balance Sheet at cost less impairment losses (see note 2(l)).

Other investments in securities are classified as available-for-sale securities and are initially recognised at fair value plus transaction costs. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except for impairment losses (see note 2(l)) and, in case of monetary items such as debt securities, foreign exchange gains and losses which are recognised directly in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss.

Investments are recognised/derecognised on the date the Group and/or the Company commits to purchase/sell the investments or they expire.

(h) Derivative Financial Instruments

Derivative financial instruments are recognised initially at fair value. At each balance sheet date the fair value is remeasured. The gain or loss on remeasurement to fair value is charged immediately to profit or loss, except where the derivatives qualify for cash flow hedge accounting or hedge the net investment in a foreign operation, in which case recognition of any resultant gain or loss depends on the nature of the item being hedged (see note 2(i)).

(i) Hedging

(i) *Cash Flow Hedges*

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability or a highly probable forecast transaction or the foreign currency risk of a committed future transaction, the effective portion of any gain or loss on remeasurement of the derivative financial instrument to fair value is recognised directly in equity. The ineffective portion of any gain or loss is recognised immediately in profit or loss.

If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gain or loss is removed from equity and recognised in profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss (such as when interest income or expense is recognised).

For cash flow hedges, other than those covered by the preceding two policy statements, the associated gain or loss is removed from equity and recognised in profit or loss in the same period or periods during which the hedged forecast transaction affects profit or loss.

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedge forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in profit or loss.

(ii) *Hedge of Net Investments in Foreign Operations*

The portion of the gain or loss on remeasurement to fair value of an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity until the disposal of the foreign operation, at which time the cumulative gain or loss recognised directly in equity is recognised in profit or loss. The ineffective portion is recognised immediately in profit or loss.

notes to the financial statements

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(j) Fixed Assets, Depreciation and Amortisation

(i) Fixed assets are stated in the Balance Sheet at cost less accumulated depreciation (see note 2(j)(vi)), amortisation (see note 2(k)) and impairment losses (see note 2(l)).

(ii) The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs (see note 2(w)).

(iii) Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount 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 enterprise. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

(iv) 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 recognised in the profit or loss on the date of retirement or disposal.

(v) Leasehold land held under operating leases is stated in the Balance Sheet at cost less accumulated amortisation and impairment losses (see note 2(l)).

(vi) Depreciation is provided on a straight-line basis and are calculated to write off the cost of fixed assets over their expected useful lives as set out below:

	Years
Cable tunnels	100
Ash lagoon	50
Buildings, generation plant and machinery, transmission and distribution equipment and overhead lines (132kV and above)	35
Overhead lines (below 132kV), cables and gas turbines	30
Meters, microwave and optical fibre equipment and trunk radio system	15
Furniture, fixtures, sundry plant and equipment	10
Workshop tools and office equipment	5
Computers	5 to 10
Motor vehicles and marine craft	5 to 6

(k) Operating Lease Charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss 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.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term except where the property is classified as an investment property.

(l) Impairment of Assets

(i) *Impairment of Investments in Debt and Equity Securities and Other Receivables*

Investments in debt and equity securities and other current and non-current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

– For unquoted equity securities and current receivables that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for current receivables are reversed if in a subsequent period the amount of the impairment loss decreases. Impairment losses for equity securities are not reversed.

– For financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets).

  If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

– For available-for-sale securities, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

  Impairment losses recognised in profit or loss in respect of available-for-sale equity securities are not reversed through profit or loss. Any subsequent increase in the fair value of such assets is recognised directly in equity.

  Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

notes to the financial statements

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(l) Impairment of Assets (continued)

(ii) *Impairment of Other Assets*

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

- fixed assets;
- pre-paid interests in leasehold land classified as being held under an operating lease;
- investments in subsidiaries and associates; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

- *Calculation of Recoverable Amount*

  The recoverable amount of an asset is the greater of its net selling price and value in use. 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).

- *Recognition of Impairment Losses*

  An impairment loss is recognised in profit or loss whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

- *Reversals of Impairment Losses*

  In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

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

(m) Inventories and Work In Progress

Coal, stores and fuel oil are valued at cost on a weighted average basis.

Cost comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Cost of inventory recognised as an expense includes the write-off and all losses of inventory.

(n) Trade and Other Receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 2(l)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 2(l)).

(o) Interest-bearing Borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in profit or loss over the period of the borrowings using the effective interest method or at fair value when accounting for fair value hedges applies.

(p) Trade and Other Payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(q) Cash and 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. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the Consolidated Cash Flow Statement.

(r) Employee Benefits

(i) *Short Term Employee Benefits*

Salaries, annual bonuses, paid annual leave and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

notes to the financial statements

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(r) Employee Benefits (continued)

(ii) *Defined Benefit Retirement Schemes Obligations*

The Group's net obligation in respect of defined benefit retirement schemes is calculated separately for each scheme by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value, and the fair value of any scheme assets is deducted. The discount rate is the yield at balance sheet date on high quality corporate bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the "Projected Unit Credit Method".

Any cumulative unrecognised actuarial gains or losses in respect of the defined benefit schemes are recognised in full in the period in which they occur, outside profit or loss, in equity.

(iii) *Contributions to Defined Contribution Retirement Schemes*

Obligations for contributions to defined contribution retirement schemes, including contributions payable under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the profit or loss as incurred.

(s) Income Tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

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 years.

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

Apart from certain limited exceptions, 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 utilised, are recognised.

The amount of deferred tax recognised is measured based on the expected manner of realisation 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.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset.

(t) Provisions and Contingent Liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. 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.

(u) Income Recognition

(i) *Regulation of Earnings under the Scheme of Control*

The earnings of The Hongkong Electric Company, Limited ("HEC") are regulated by the Hong Kong SAR Government under a Scheme of Control ("SOC") which provides for a permitted level of earnings based principally on a return on HEC's capital investment in electricity generation, transmission and distribution assets (the "Permitted Return"). HEC is required to submit detailed financial plans for approval by the Government which project the key determinants of the Permitted Return HEC will be entitled to over the Financial Plan period.

The Government has approved the current Financial Plan covering the period from 2004 to 2008. No further Government approval is required during this period unless a need for significant rate increases, over and above those set out in the Financial Plan, is identified during the Annual Review conducted with Government under the terms of the SOC.

(ii) *Fuel Clause Account*

Under the SOC, any difference between the standard cost of fuel and the actual cost of fuel consumed is debited (or credited) to the Fuel Clause Account ("Fuel Clause Transfer").

Fuel Clause Surcharges (or Rebates) are charged (or given) to customers by increasing (or reducing) the Basic Tariff rate to a Net Tariff rate payable by customers and are credited (or debited) to the Fuel Clause Account.

The balance on the Fuel Clause Account at the end of a financial year represents the difference between Fuel Clause Rebates (or Surcharges) and Fuel Clause Transfers during the year, together with any balance brought forward from the prior year. Any debit balance is carried forward as a deferred receivable to be recovered from Fuel Clause Transfers or Fuel Clause Surcharges and any credit balance is carried forward as a deferred payable to be cleared by Fuel Clause Transfers or Fuel Clause Rebates. The 2004-2008 Financial Plan was submitted and approved by Government on the basis that any deferred receivable would be recovered by the end of the Financial Plan period, i.e. by the end of 2008.

notes to the financial statements

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(u) Income Recognition (continued)

(iii) *Income Recognition*

Income is recognised based on units of electricity consumed by customers during the year at basic tariff rates, which is the unit charge agreed with the Government during the Annual Tariff Review for each financial year.

Fuel Clause Rebates included in the 1999-2004 Financial Plan include amounts in excess of Fuel Clause Transfers in certain financial years, which are utilised to smooth increases in Net Tariffs paid by customers during the Financial Plan period. The impact of tariff smoothing is to reduce the Net Tariffs payable by customers in certain years and increase the Net Tariffs in other years. However, the tariff smoothing has no impact on HEC's total earnings over the period to 2008 and the related balance on the Fuel Clause Account (see note 2(u)(ii)) is expected to be recovered by Fuel Clause Surcharge in the 2004-2008 Financial Plan in excess of Fuel Clause Transfers. In accounting for income, Fuel Clause Account debit balances are therefore treated as deferred receivables in the Balance Sheet and not accounted for in the Profit and Loss Account each year.

(v) Translation of Foreign Currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates, or at contract rates if foreign currencies are fixed in supplier agreements or hedged by forward foreign exchange contracts. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date.

Exchange gains and losses in respect of fixed assets under construction are, up to the date of commissioning, incorporated in the cost of the assets. All other exchange differences are dealt with in the Profit and Loss Account.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

The results of foreign operations are translated into Hong Kong dollars at the average exchange rates for the year. Balance sheet items, including goodwill arising on consolidation of foreign operations acquired on or after 1st January 2005, are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity. Goodwill arising on consolidation of a foreign operation acquired before 1st January 2005 is translated at the foreign exchange rate that applied at the date of acquisition of the foreign operation.

On disposal of a foreign operation, the cumulative amount of the exchange differences recognised in equity which relate to that foreign operation is included in the calculation of the profit or loss on disposal.

(w) Borrowing Costs

Borrowing costs are expensed in the profit or loss in the period in which they are incurred, except to the extent that they are capitalised 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 capitalisation 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. Capitalisation 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 complete.

(x) Related Parties

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 other 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 (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(y) Segment Reporting

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

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.

3. Changes in Accounting Policies

The HKICPA has issued a number of new and revised HKFRSs that are effective for the accounting periods beginning on or after 1st January 2005.

In 2005, the Group has adopted all the HKFRSs pertinent to its operations. The accounting policies of the Group after the adoption of these new and revised HKFRSs have been summarised in note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

Except for the early adoption of the Amendment to HKAS 19 Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures, the Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 40).

notes to the financial statements

(Expressed in Hong Kong Dollars)

3. Changes in Accounting Policies (continued)

(a) Restatement of Prior Periods and Opening Balances

The following tables disclose the adjustments that have been made in accordance with the transitional provisions of the respective HKFRSs to each of the line items in the Consolidated Profit and Loss Account and Consolidated Balance Sheet and other significant related disclosure items as previously reported for the year ended 31st December 2004. The effects of the changes in accounting policies on the balances at 1st January 2004 and 2005 are disclosed in the Consolidated Statement of Changes in Equity.

Effect on the Consolidated Profit and Loss Account for the year ended 31st December 2004

$ million	2004 (as previously reported)	Effect of New Policy (increase/(decrease) in profit for the year) HKAS 1 (note 3(c))	HKAS 17 (note 3(e))	HKAS 28 (note 3(f))	Sub-total	2004 (as restated)
Operating profit	7,017	–	–	–	–	7,017
Share of profits less losses of associates	314	129	–	(24)	105	419
Profit before taxation	7,331	129	–	(24)	105	7,436
Income tax:						
Current	(1,048)	–	–	–	–	(1,048)
Deferred	(3)	(129)	–	–	(129)	(132)
	(1,051)	(129)	–	–	(129)	(1,180)
Profit after taxation	6,280	–	–	(24)	(24)	6,256
Scheme of Control transfers	–	–	–	–	–	–
Profit attributable to equity shareholders						
Local activities	5,521	–	–	–	–	5,521
Overseas activities	759	–	–	(24)	(24)	735
Profit for the year	6,280	–	–	(24)	(24)	6,256
Earnings per share ($)	2.94	–	–	(0.01)	(0.01)	2.93
Other significant disclosure items:						
Depreciation	(1,805)	–	55	–	55	(1,750)
Amortisation of leasehold land	–	–	(55)	–	(55)	(55)

Effect on Consolidated Balance Sheet at 31st December 2004

$ million	2004 (as previously reported)	Effect of New Policy (increase/(decrease) in net assets) HKAS 17 (note 3(e))	HKAS 28 (note 3(f))	Sub-total	2004 (as restated)
Non-current assets					
Fixed assets					
– Property, plant and equipment	41,308	(2,326)	–	(2,326)	38,982
– Assets under construction	3,968	(158)	–	(158)	3,810
– Interests in leasehold land held for own use under operating leases	–	2,484	–	2,484	2,484
	45,276	–	–	–	45,276
Interest in associates	9,198	–	(284)	(284)	8,914
Other non-current assets	335	–	–	–	335
	54,809	–	(284)	(284)	54,525
Current assets	4,158	–	–	–	4,158
Current liabilities	(2,916)	–	–	–	(2,916)
Net current assets	1,242	–	–	–	1,242
Total assets less current liabilities	56,051	–	(284)	(284)	55,767
Non-current liabilities	(18,195)	–	–	–	(18,195)
Net Assets	37,856	–	(284)	(284)	37,572
Capital and Reserves					
Total equity attributable to equity shareholders of the Company					
Share capital	2,134	–	–	–	2,134
Share premium	4,476	–	–	–	4,476
Exchange reserve	428	–	(79)	(79)	349
Revenue reserve	28,278	–	(205)	(205)	28,073
Proposed dividend	2,540	–	–	–	2,540
	37,856	–	(284)	(284)	37,572

notes to the financial statements

(Expressed in Hong Kong Dollars)

3. Changes in Accounting Policies (continued)

(b) Estimated Effect of Changes in Accounting Policies on the Current Period

The following tables provide estimates of the extent to which each of the line items in the Consolidated Profit and Loss Account and Consolidated Balance Sheet and other significant related disclosure items for the year ended 31st December 2005 is higher or lower than it would have been had the previous policies still been applied in the year, where it is practicable to make such estimates.

Estimated effect on the Consolidated Profit and Loss Account for the year ended 31st December 2005

	Estimated Effect of New Policy (increase/(decrease) in profit for the year)					
$ million	HKAS 1 (note 3(c))	HKAS 17 (note 3(e))	HKAS 19 (note 3(i))	HKAS 28 (note 3(f))	HKAS 32 & 39 (note 3(g))	Total
Other operating costs	–	–	9	–	18	27
Finance costs	–	–	–	–	1	1
Operating profit	–	–	9	–	19	28
Share of profits less losses of associates	477	–	–	49	–	526
Profit before taxation	477	–	9	49	19	554
Income tax:						
Current	–	–	–	–	–	–
Deferred	(477)	–	(2)	–	–	(479)
	(477)	–	(2)	–	–	(479)
Profit after taxation	–	–	7	49	19	75
Scheme of Control transfers	–	–	–	–	–	–
Profit attributable to equity shareholders						
Local activities	–	–	7	–	–	7
Overseas activities	–	–	–	49	19	68
Profit for the year	–	–	7	49	19	75
Earnings per share ($)	–	–	–	0.02	0.01	0.03
Other significant disclosure items:						
Staff costs	–	–	9	–	–	9
Depreciation	–	54	–	–	–	54
Amortisation of leasehold land	–	(54)	–	–	–	(54)

Estimated effect on the Consolidated Balance Sheet at 31st December 2005

$ million	Estimated Effect of New Policy (increase/(decrease) in net assets) HKAS 17 (note 3(e))	HKAS 19 (note 3(i))	HKAS 28 (note 3(f))	HKAS 32 & 39 (note 3(g))	Total
Non-current assets					
Fixed assets					
– Property, plant and equipment	(2,266)	–	–	–	(2,266)
– Assets under construction	(174)	–	–	–	(174)
– Interests in leasehold land held for own use under operating leases	2,440	–	–	–	2,440
	–	–	–	–	–
Interest in associates	–	–	(220)	59	(161)
Derivative financial instruments	–	–	–	29	29
Employee retirement benefit assets	–	(204)	–	–	(204)
	–	(204)	(220)	88	(336)
Current assets					
Trade and other receivables	–	–	–	32	32
Current liabilities					
Trade and other payables	–	–	–	(4)	(4)
Current portion of bank loans and other borrowings	–	–	–	(2)	(2)
	–	–	–	(6)	(6)
Net current assets	–	–	–	26	26
Total assets less current liabilities	–	(204)	(220)	114	(310)
Non-current liabilities					
Interest-bearing borrowings	–	–	–	196	196
Derivative financial instruments	–	–	–	(287)	(287)
Deferred tax liabilities	–	75	–	–	75
Employee retirement benefit liabilities	–	(226)	–	–	(226)
	–	(151)	–	(91)	(242)
Net Assets	–	(355)	(220)	23	(552)
Capital and Reserves					
Total equity attributable to equity shareholders of the Company					
Exchange reserve	–	–	(41)	–	(41)
Hedging reserve	–	–	–	2	2
Revenue reserve	–	(355)	(179)	21	(513)
	–	(355)	(220)	23	(552)

(c) Changes in Presentation of Shares of Associates' Taxation (HKAS 1, Presentation of Financial Statements)

In prior years, the Group's share of taxation of associates accounted for using the equity method was included as part of the Group's income tax in the Consolidated Profit and Loss Account. With effect from 1st January 2005, in accordance with the implementation guidance in HKAS 1, the Group has changed the presentation and includes the share of taxation of associates accounted for using the equity method in the respective shares of profit or loss reported in the Consolidated Profit and Loss Account before arriving at the Group's profit or loss before tax. These changes in presentation have been applied retrospectively with comparatives restated as shown in note 3(a).

notes to the financial statements

(Expressed in Hong Kong Dollars)

3. Changes in Accounting Policies (continued)

(d) Amortisation of Positive and Negative Goodwill (HKFRS 3, Business Combinations and HKAS 36, Impairment of Assets)

In prior periods:

– positive or negative goodwill which arose prior to 1st January 2001 was taken directly to reserves at the time it arose, and was not recognised in the Profit and Loss Account until disposal or impairment of the acquired business;

– positive goodwill which arose on or after 1st January 2001 was amortised on a straight line basis over its useful life and was subject to impairment testing when there were indication of impairment; and

– negative goodwill which arose on or after 1st January 2001 was amortised over the weighted average useful life of the depreciable/amortisable non-monetary assets acquired, except to the extent it related to identified expected future losses as at the date of acquisition. In such cases it was recognised in the Profit and Loss Account as those expected losses were incurred.

With effect from 1st January 2005, in order to comply with HKFRS 3 and HKAS 36, the Group has changed its accounting policies relating to goodwill. Under the new policy, the Group no longer amortises positive goodwill but tests it at least annually for impairment. Also with effect from 1st January 2005 and in accordance with HKFRS 3, if the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognised immediately in the profit or loss as it arises. Further details of these new policies are set out in note 2(f).

The change in accounting policy relating to positive and negative goodwill had no effect to the Group's financial statements, as there were no positive or negative goodwill balances deferred as at 31st December 2004.

(e) Leasehold Land and Buildings (HKAS 17, Leases)

In prior years, leasehold land and buildings held for own use were stated at cost less accumulated depreciation and accumulated impairment losses.

With effect from 1st January 2005, in order to comply with HKAS 17, the Group has adopted a new policy for leasehold land held for own use. Under the new policy, the leasehold interest in the land held for own use is accounted for as being held under an operating lease where the fair value of the interest in any buildings situated on the leasehold land could be measured separately from the fair value of the leasehold interest in the land at the time the lease was first entered into by the Group, or taken over from the previous lessee, or at the date of construction of those buildings, if later.

Further details of the new policy are set out in notes 2(j) and 2(k). Any buildings held for own use which are situated on such land leases continue to be presented as part of property, plant and equipment.

The adjustments for each consolidated financial statement line affected for the years ended 31st December 2004 and 2005 are set out in notes 3(a) and 3(b).

(f) Share of Losses of Associates (HKAS 28, Investments in Associates)

In prior years, when the Group's share of losses exceeded its interest in the associate, the Group's interest was reported at nil and recognition of further losses was discontinued.

With effect from 1st January 2005, in order to comply with HKAS 28, recognition of the share of associate's losses under equity method is broadened by including other long-term non-equity interests, which in substance form part of the net investment of an associate. Further details of the new policy are set out in note 2(e).

HKAS 28 has been applied retrospectively. The adjustments for each consolidated financial statement line affected for the years ended 31st December 2004 and 2005 are set out in notes 3(a) and 3(b).

(g) Financial Instruments (HKAS 32, Financial Instruments: Disclosure and Presentation and HKAS 39, Financial Instruments: Recognition and measurement)

With effect from 1st January 2005, in order to comply with HKAS 32 and HKAS 39, the Group has changed its accounting policies relating to financial instruments to those as set out in notes 2(g), 2(h) and 2(i). Further details of the changes are as follows:

(i) *Investments in Debt and Equity Securities*

In prior years, equity investments held on a continuing basis for an identifiable long-term purpose were classified as investment securities and stated at cost less provision. Other investments in securities (including those held for trading and for non-trading purposes) were at fair value with changes in fair value recognised in profit or loss, with the exception of dated debt securities being held to maturity.

With effect from 1st January 2005 and in accordance with HKAS 39, all investments, with the exception of securities held for trading purposes, dated debt securities being held to maturity and certain unquoted equity investments, are classified as available-for-sale securities and carried at fair value. Changes in the fair value of available-for-sale securities are recognised in equity, unless there is objective evidence that an individual investment has been impaired. Further details of the new policies are set out in note 2(g).

(ii) *Derivative Financial Instruments*

In prior years, derivative financial instruments entered into by management to hedge the interest rate risk of a recognised asset or liability or the foreign currency risk of a committed future transaction were recognised on an "accrual basis" with reference to the timing of recognition of the hedged transaction.

With effect from 1st January 2005, and in accordance with HKAS 39, all derivative financial instruments entered into by the Group are stated at fair value. Changes in the fair value of derivatives held as hedging instruments in a cash flow hedge are recognised in equity to the extent that the hedge is effective and until the hedged transaction occurs. Any other changes in fair value of the derivatives is recognised in profit or loss. Further details of the new policies are set out in note 2(h).

notes to the financial statements

(Expressed in Hong Kong Dollars)

3. Changes in Accounting Policies (continued)

(g) Financial Instruments (HKAS 32, Financial Instruments: Disclosure and Presentation and HKAS 39, Financial Instruments: Recognition and measurement) (continued)

(iii) *Description of Transitional Provisions and Effect of Adjustments*

The changes in accounting policies relating to accounting for investments in debt and equity securities and derivatives were adopted by way of opening balance adjustments to certain reserves as at 1st January 2005. The adjustments included re-designation of other investments with a carrying value $39 million at 31st December 2004 as available-for-sale securities at 1st January 2005 (see Note 18). The effects of the changes in accounting policies on the balances at 1st January 2005 are disclosed in the Consolidated Statement of Changes in Equity. Comparative amounts have not been restated as this is prohibited by the transitional arrangements in HKAS 39.

The adjustments for each consolidated financial statement line affected for the year ended 31st December 2005 are set out in note 3(b).

(h) Definition of Related Parties (HKAS 24, Related Party Disclosures)

As a result of the adoption of HKAS 24, the definition of related parties as disclosed in note 2(x) has been expanded to clarify that related parties include entities that are under the significant influence of a related party that is an individual (i.e. key management personnel, significant shareholders and/or their close family members) and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group. The clarification of the definition of related parties has not resulted in any material changes to the previously reported disclosures made in the current period, as compared to those that would have been reported had SSAP 20, related party disclosures still been in effect.

(i) Actuarial Gains and Losses (Amendment to HKAS 19, Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures)

In prior years, cumulative unrecognised actuarial gains and losses, to the extent of the amount in excess of 10% of the greater of the present value of the defined benefit obligations and the fair value of scheme assets, were recognised in the profit or loss over the expected average remaining working lives of employees participating in the scheme. Otherwise, the actuarial gain or loss was not recognised.

The Group has early adopted the Amendment to HKAS 19 with effect from 1st January 2005. Amendment to HKAS 19 provides an option to recognising actuarial gains and losses in full in the period in which they occur, outside profit or loss, in equity. The Group has elected to take the option to recognise all actuarial gains and losses in equity.

This change in accounting policy has been applied prospectively. The main reason for not applying Amendment to HKAS 19 retrospectively is that the management considered the impact is immaterial and is not practical to do so. The adjustments for each consolidated financial statement line affected for the year ended 31st December 2005 are set out in note 3(b).

4. Turnover

The principal activities of the Group are the generation and supply of electricity.

Group turnover is analysed as follows:

	2005 $ million	2004 $ million
Sales of electricity	12,309	11,442
Special subsidy	(763)	(112)
Concessionary discount on sales of electricity	(4)	(3)
Electricity-related income	33	29
Technical service fees	47	51
	11,622	11,407

5. Other Revenue and Net Income

	2005 $ million	2004 $ million
Other Revenue		
Interest income	902	879
Dividend income from available-for-sale equity securities	66	–
Profit on disposal of available-for-sale equity securities	21	–
Sundry income	45	29
	1,034	908
Other Net Income		
Net profit on disposal of fixed assets	25	30
	1,059	938

6. Segment Information

(a) Business Segments

The Group's principal business segments are sales of electricity and infrastructure investments. Financial information about the Group's business segments is set out in Appendix 1(a) on page 98.

(b) Geographical Segments

The Group operates, through its subsidiaries and associates, in two major geographical regions – Hong Kong and Australia. Financial information about the Group's operations by geographical region is set out in Appendix 1(b) on page 99.

notes to the financial statements

(Expressed in Hong Kong Dollars)

7. Finance Costs

	2005 $ million	2004 $ million
Interest on overdrafts, bank loans and other borrowings repayable within 5 years	**730**	665
Interest on other borrowings	**34**	17
Less: Interest capitalised to fixed assets	**(167)**	(108)
Interest transferred to fuel cost	**(9)**	(5)
	588	569

Interest expenses have been capitalised at the average rate of approximately 3.9% p.a. (2004 : 2.9% p.a.) for assets under construction.

8. Profit on Disposal of Interest in Associates

Profit on disposal of interest in associates represents a profit on the disposal of approximately 22.07% attributable interest in each of ETSA Utilities and CKI/HEI Electricity Distribution Holdings (Australia) Pty Ltd. in 2005.

9. Profit Before Taxation

	2005 $ million	2004 $ million restated
Profit before taxation is shown after charging/(crediting):		
Depreciation	**1,773**	1,750
Amortisation of leasehold land	**54**	55
Costs of inventories	**1,887**	1,315
Write down of inventories	**4**	3
Staff costs	**525**	506
Operating lease charges – equipment	**62**	62
Fixed assets written off	**21**	20
Auditors' remuneration:		
Audit and audit related work		
– KPMG	**4**	4
Non audit work		
– Other auditors	**1**	2
Share of associates' taxation	**(477)**	(92)

The profit attributable to shareholders includes a profit of $8,315 million (2004 : $6,807 million) which has been dealt with in the financial statements of the Company.

10. Income Tax

(a) Taxation in the Consolidated Profit and Loss Account represents:

	2005 $ million	2004 $ million restated
Current Tax – Hong Kong Profits Tax		
Provision for the year	**1,006**	1,048
Current Tax – Overseas		
Provision for the year	**1**	–
Deferred Tax		
Origination and reversal of temporary differences (see note 27(a))	**208**	132
Total income tax expenses	**1,215**	1,180

Hong Kong Profits Tax has been provided for at the rate of 17.5% (2004 : 17.5%) based on the estimated assessable profit for the year. Overseas taxation has been provided for at the applicable rate on the estimated assessable profit.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2005 $ million	2004 $ million restated
Profit before taxation	**9,777**	7,436
Notional tax on profit before taxation, calculated at the rates applicable to profits in the tax jurisdictions concerned	**1,642**	1,228
Tax effect of non-deductible expenses	**74**	35
Tax effect of non-taxable revenue	**(496)**	(80)
Tax effect of temporary differences not recognised	**–**	(1)
Tax effect of recognition of previously unrecognised temporary differences	**(3)**	–
Tax effect of recognition of previously unrecognised tax losses	**(2)**	–
Tax effect of unused tax gains not recognised	**–**	(1)
Tax effect on rebated Rate Reduction Reserve	**–**	(1)
Total income tax expenses	**1,215**	1,180

notes to the financial statements

(Expressed in Hong Kong Dollars)

11. Directors' Emoluments and Senior Management Compensation

(a) Directors' Emoluments

Directors' emoluments comprise payments to Directors by the Company and its subsidiaries in connection with the management of the affairs of the Company and its subsidiaries. The emoluments of each of the Directors of the Company are as follows:

Name of Directors	Fees $ million	Basic Salaries, Allowances & Other Benefits $ million	Retirement Scheme Contributions $ million	Bonuses $ million	2005 Total Emoluments $ million	2004 Total Emoluments $ million
Executive Directors						
Canning Fok Kin-ning[(1) (7)]	0.08	0.26	–	–	**0.34**	0.31
Chairman						
Tso Kai-sum	0.07	6.07	–	7.98	**14.12**	13.28
Group Managing Director						
Andrew John Hunter[(2)]	0.07	4.20	0.14	3.62	**8.03**	7.93
Group Finance Director						
Kam Hing-lam	0.07	0.05	–	–	**0.12**	0.12
Francis Lee Lan-yee	0.07	4.41	0.01	3.51	**8.00**	7.68
Director & General Manager (Engineering)						
Victor Li Tzar-kuoi	0.07	0.18	–	–	**0.25**	0.25
Neil Douglas McGee[(3)]	–	0.57	0.02	–	**0.59**	–
Frank John Sixt	0.07	0.04	–	–	**0.11**	0.11
Wan Chi-tin[(3)]	–	3.25	0.44	1.50	**5.19**	–
Director & General Manager (Corporate Development)						
Non-executive Directors						
Ronald Joseph Arculli[(6)]	0.14	0.05	–	–	**0.19**	0.17
Susan Chow Woo Mo-fong	0.07	0.03	–	–	**0.10**	0.09
George Colin Magnus[(4)]	0.11	0.03	–	–	**0.14**	0.15
Holger Kluge[(5) (6)]	0.14	–	–	–	**0.14**	0.08
Ralph Raymond Shea[(5) (6) (7)]	0.16	0.03	–	–	**0.19**	0.15
Wong Chung-hin[(5) (6) (7)]	0.16	0.08	–	–	**0.24**	0.19
Ewan Yee Lup-yuen	0.07	0.03	–	–	**0.10**	0.10
Total for the year 2005	**1.35**	**19.28**	**0.61**	**16.61**	**37.85**	**30.61**
Total for the year 2004	1.19	15.81	0.45	13.16		30.61

Notes:

(1) Appointed as Chairman with effect from 1st November 2005.

(2) During the year, Mr. Andrew John Hunter received director's fees of THB255,000 from Ratchaburi Power Company, Limited, an associate of the Group. The director's fees were then paid back to the Company.

(3) Appointed to the Board on 12th December 2005.

(4) Retired from the office of Chairman and re-designated from an Executive Director to a Non-executive Director with effect from 1st November 2005.

(5) Independent non-executive directors.

(6) Members of the Audit Committee.

(7) Members of the Remuneration Committee.

(b) Senior Management Compensation

The five highest paid individuals in the Group included four directors (2004 : three) whose total emoluments are shown above. The emoluments of the other one individual (2004 : two individuals) who comprises the five are set out below:

	2005 $ million	2004 $ million
Salaries and other benefits	**3.73**	7.95
Retirement scheme contributions	**0.37**	1.05
	4.10	9.00

The total emoluments of the individual (2004 : two individuals) are within the following bands:

	2005 Number	2004 Number
$4,000,001 to $4,500,000	**1**	1
$4,500,001 to $5,000,000	**–**	1

12. Scheme of Control Transfers

The financial operations of The Hongkong Electric Company, Limited ("HEC"), a wholly-owned subsidiary of the Company, are governed by a Scheme of Control ("SOC") agreed with the Hong Kong SAR Government which provides for HEC to earn a Permitted Return (see note 2(u)(i)). Any difference between this Permitted Return and the SOC net revenue as calculated in accordance with the SOC must be transferred to/(from) a Development Fund from/(to) the Profit and Loss Account of HEC. Where the SOC net revenue is less than the Permitted Return, the amount transferred from the Development Fund to the Profit and Loss Account shall not exceed the balance of the Development Fund. In addition, 8% of the average balance of the Development Fund is transferred from the Profit and Loss Account of HEC to a Rate Reduction Reserve, which is subsequently rebated to customers. There is no transfer to and from both the Development Fund and Rate Reduction Reserve during the year.

13. Dividends Payable to Equity Shareholders of the Company Attributable to the Year

(a) Dividends payable to equity shareholders of the Company attributable to the year

	2005 $ million	2004 $ million
Interim dividend declared and paid of 58 cents per ordinary share (2004: 58 cents per ordinary share)	**1,238**	1,238
Final dividends proposed after the balance sheet date of:		
Ordinary – $1.01 per ordinary share (2004: $1.19 per ordinary share)	**2,156**	2,540
Special – $0.73 per ordinary share (2004: $nil)	**1,558**	–
	4,952	3,778

The final dividends proposed after the balance sheet date are based on 2,134,261,654 ordinary shares (2004 : 2,134,261,654 ordinary shares), being the total number of issued shares at the year end. The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends payable to equity shareholders of the Company attributable to the previous financial year, approved and paid during the year

	2005 $ million	2004 $ million
Final dividend in respect of the previous financial year, approved and paid during the year, of $1.19 per ordinary share (2004: $1.13 per ordinary share)	**2,540**	2,412

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(Expressed in Hong Kong Dollars)

14. Earnings Per Share

The calculation of earnings per share is based on the profit attributable to equity shareholders of the Company of $8,562 million (2004 restated : $6,256 million) and 2,134,261,654 ordinary shares (2004 : 2,134,261,654 ordinary shares) in issue throughout the year.

There were no dilutive potential ordinary shares in existence during the years ended 31st December 2005 and 2004.

15. Fixed Assets

$ million	Site Formation and Buildings	Plant, Machinery and Equipment	Assets Under Construction	Sub-total	Interests in Leasehold Land held for own use under Operating Leases	Total Fixed Assets
Group						
Cost:						
At 1st January 2004 (restated)	11,870	45,333	2,850	60,053	2,809	62,862
Additions	3	180	2,055	2,238	8	2,246
Transfers between categories	56	1,039	(1,095)	–	–	–
Disposals	(7)	(123)	–	(130)	(9)	(139)
At 31st December 2004 (restated)	11,922	46,429	3,810	62,161	2,808	64,969
At 1st January 2005 (restated)	**11,922**	**46,429**	**3,810**	**62,161**	**2,808**	**64,969**
Additions	**2**	**211**	**2,776**	**2,989**	**16**	**3,005**
Transfers between categories	**126**	**936**	**(1,062)**	**–**	**–**	**–**
Disposals	**(5)**	**(123)**	**–**	**(128)**	**(6)**	**(134)**
At 31st December 2005	**12,045**	**47,453**	**5,524**	**65,022**	**2,818**	**67,840**
Accumulated Depreciation and Amortisation:						
At 1st January 2004 (restated)	2,859	14,710	–	17,569	269	17,838
Written back on disposals	(4)	(89)	–	(93)	–	(93)
Charge for the year	321	1,572	–	1,893	55	1,948
At 31st December 2004 (restated)	3,176	16,193	–	19,369	324	19,693
At 1st January 2005 (restated)	**3,176**	**16,193**	**–**	**19,369**	**324**	**19,693**
Written back on disposals	**(3)**	**(72)**	**–**	**(75)**	**–**	**(75)**
Charge for the year	**323**	**1,587**	**–**	**1,910**	**54**	**1,964**
At 31st December 2005	**3,496**	**17,708**	**–**	**21,204**	**378**	**21,582**
Net Book Value:						
At 31st December 2005	**8,549**	**29,745**	**5,524**	**43,818**	**2,440**	**46,258**
At 31st December 2004 (restated)	8,746	30,236	3,810	42,792	2,484	45,276

The above are mainly electricity-related fixed assets in respect of which financing costs capitalised during the year amounted to $167 million (2004 : $108 million).

The Group's leasehold land at 31st December 2005 is held in Hong Kong and comprises $54 million (2004 restated : $60 million) and $2,386 million (2004 restated : $2,424 million) of long-term and medium-term leasehold land respectively.

Depreciation charges for the year included $137 million (2004 : $143 million), relating to assets utilised in development activities which have been capitalised.

16. Interest in Subsidiaries

	Company	
	2005	2004
	$ million	$ million
Unlisted shares, at cost	**2,417**	2,417
Loan capital (see note below)	**23,151**	21,324
Amounts due from subsidiaries	**6,434**	6,832
	32,002	30,573

Loan capital is paid to The Hongkong Electric Company, Limited. These interest free loans, defined as "Loan Capital" in the Scheme of Control Agreement effective 1st January 1994, are not repayable without the prior agreement of the Government.

Particulars of the principal subsidiaries are set out in Appendix 2 on page 100.

17. Interest in Associates

	Group	
	2005	2004
	$ million	$ million
		restated
Share of net assets	**1,333**	1,077
Loans to associates (see note below)	**4,087**	7,417
Amounts due from associates	**360**	420
	5,780	8,914

Included in the loans to associates, $3,913 million (2004 : $6,556 million) are subordinated loans. The rights in respect of these loans are subordinated to the rights of any other lenders to the associates.

Particulars of the principal associates are set out in Appendix 3 on page 101.

Summarised Financial Information based on the unaudited Management Accounts of the associates is as follows:

	2005	2004
	$ million	$ million
Assets	**55,725**	56,942
Liabilities	**(49,677)**	(54,436)
Equity	**6,048**	2,506
Revenues	**9,815**	9,494
Profit	**2,882**	1,055

notes to the financial statements

(Expressed in Hong Kong Dollars)

18. Other Non-current Financial Assets

	Group	
	2005	2004
	$ million	$ million
Unlisted available-for-sale equity securities (2004 : Other investments)	**1,682**	39

19. Inventories

	Group	
	2005	2004
	$ million	$ million
Work in progress	**–**	2
Coal and fuel oil	**164**	189
Stores and materials (see note below)	**281**	275
	445	466

Included in stores and materials is capital stock of $191 million (2004 : $176 million) which was purchased for the future maintenance of capital assets.

20. Trade and Other Receivables

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Demand Side Management account (see note (a) below)	**–**	46	**–**	–
Derivative financial instruments	**32**	–	**–**	–
Debtors (see note (b) below)	**1,058**	1,023	**12**	6
	1,090	1,069	**12**	6

All of the trade and other receivables are expected to be recovered within one year.

(a) The Hongkong Electric Company, Limited reached an agreement with Government in 2000 to carry out Demand Side Management ("DSM") programmes to promote energy and maximum demand savings among non-domestic customers. The DSM account was to be recovered from non-domestic customers by applying DSM surcharges in subsequent years. The DSM costs were written-off during the year as management decided not to levy additional DSM surcharges in subsequent years.

	Group	
	2005	2004
	$ million	$ million
At 1st January	**46**	45
Programme costs incurred	**–**	1
Written off to profit and loss	**(46)**	–
At 31st December	**–**	46

(b) Debtors' ageing is analysed as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Within 1 month	**555**	528	**–**	–
1 to 3 months overdue	**28**	25	**–**	–
More than 3 months overdue but less than 12 months overdue	**10**	10	**–**	–
Total trade debtors (see note below)	**593**	563	**–**	–
Deposits, prepayments and other receivables	**465**	460	**12**	6
	1,058	1,023	**12**	6

Electricity bills issued to domestic, small industrial, commercial and miscellaneous customers of electricity supplies are due upon presentation whereas maximum demand customers are allowed a credit period of 16 working days. If settlements by maximum demand customers are received after the credit period, The Hongkong Electric Company, Limited is entitled to add a surcharge of 5% to the respective bills.

21. Fuel Clause Account

The surcharge per unit of electricity sales was 2.2 cents from 1st January 2005 (2004 : The rebate per unit of electricity sales was 6.1 cents from January to March 2004 and 4.1 cents from April to December 2004). Movements on the Fuel Clause Account were as follows:

	Group	
	2005	2004
	$ million	$ million
At 1st January	**1,197**	1,147
Transfer to/(from) Profit and Loss Account	**119**	(443)
(Surcharge)/rebate during the year	**(237)**	493
At 31st December	**1,079**	1,197

This account, inclusive of interest, has been and will continue to be used to stabilise electricity tariffs (see note 2(u)).

22. Cash and Cash Equivalents

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Deposits with banks and other financial institutions	**4,548**	1,415	**4,512**	1,415
Cash at bank and on hand	**13**	11	**8**	1
	4,561	1,426	**4,520**	1,416

notes to the financial statements

(Expressed in Hong Kong Dollars)

22. Cash and Cash Equivalents (continued)

Included in cash and cash equivalents are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	Group		Company	
	2005	2004	**2005**	2004
	million	million	**million**	million
United States Dollars	**USD 4**	USD 139	**USD 4**	USD 139
Australian Dollars	**AUD 274**	AUD 57	**AUD 271**	AUD 57

23. Trade and Other Payables

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Creditors (see note below)	**1,042**	1,070	**39**	28
Current portion of deferred creditors (see note 25)	**22**	212	**–**	–
Derivative financial instruments	**4**	–	**–**	–
	1,068	1,282	**39**	28

All of the trade and other payables are expected to be settled within one year.

Creditors' ageing is analysed as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Due within 1 month	**358**	440	**13**	2
Due after 1 month but within 3 months	**170**	236	**–**	–
Due after 3 months but within 12 months	**485**	366	**1**	1
	1,013	1,042	**14**	3
Other payables	**29**	28	**25**	25
	1,042	1,070	**39**	28

Included in trade and other payables are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	Group		Company	
	2005	2004	**2005**	2004
	million	million	**million**	million
United States Dollars	**USD 31**	USD 24	**–**	–
Japanese Yen	**JPY 273**	JPY 437	**–**	–
Euros	**EUR 4**	EUR 1	**–**	–
Pound Sterling	**GBP 1**	–	**–**	–

24. Non-current Interest-bearing Borrowings

	Group 2005 $ million	Group 2004 $ million
Bank loans	8,043	9,232
Current portion	(354)	(400)
	7,689	8,832
Hong Kong dollar notes (see note below)	2,520	3,000
Current portion	–	(1,000)
	2,520	2,000
Total	10,209	10,832

Hong Kong dollar fixed rate notes bear interest at rates between 4.13% p.a. to 7.35% p.a. (2004 : 4.13% p.a. to 7.35% p.a.), while interest on floating rate notes are determined with reference to the Hong Kong Interbank Offered Rate. Details of issuers of Hong Kong dollar notes are set out in Appendix 2 on page 100. None of the non-current interest-bearing borrowings are expected to be settled within one year.

These borrowings have final maturities extending up to 2015 and are repayable as follows:

$ million	Bank Loans 2005	Bank Loans 2004	Hong Kong Dollar Notes 2005	Hong Kong Dollar Notes 2004	Total 2005	Total 2004
Within 1 year	354	400	–	1,000	354	1,400
After 1 year but within 2 years	115	2,520	520	–	635	2,520
After 2 years but within 5 years	7,574	6,312	1,000	500	8,574	6,812
After 5 years	–	–	1,000	1,500	1,000	1,500
	8,043	9,232	2,520	3,000	10,563	12,232

Included in interest-bearing borrowings are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	Group 2005 million	Group 2004 million
United States Dollars	USD 154	USD 154
Euros	EUR 4	EUR 7

notes to the financial statements

(Expressed in Hong Kong Dollars)

25. Deferred Creditors and Other Payables

	Group	
	2005	2004
	$ million	$ million
Deferred creditors	**74**	760
Current portion of deferred creditors (see note 23)	**(22)**	(212)
Other payables	**–**	21
	52	569

Deferred creditors are repayable as follows (see note below):

	Group	
	2005	2004
	$ million	$ million
Within 1 year	**22**	212
After 1 year but within 2 years	**22**	212
After 2 years but within 5 years	**26**	329
After 5 years but within 10 years	**4**	7
	74	760

Deferred creditors are unsecured and bear interest at a margin over Hong Kong Interbank Offered Rate with final maturities up to 2011. During the year, management decided to accelerate the repayment of deferred creditors of $474 million.

26. Derivative Financial Instruments

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Cross currency swaps	**198**	–	**–**	–
Interest rate swaps and caps	**41**	–	**–**	–
Foreign exchange forward contracts	**(9)**	–	**–**	–
Total	**230**	–	**–**	–
Current portion of derivative financial instruments (see notes 20 and 23)	**28**	–	**–**	–
	258	–	**–**	–
Represented by:				
Derivative financial instruments assets	**(29)**	–	**–**	–
Derivative financial instruments liabilities	**287**	–	**–**	–
	258	–	**–**	–

27. Deferred Taxation

(a) Movements in deferred taxation during the year are as follows:

	Group 2005 $ million	Group 2004 $ million	Company 2005 $ million	Company 2004 $ million
At 1st January	**5,237**	5,105	**–**	–
Charged/(credited) to Profit and Loss Account (see note 10)	**208**	132	**(4)**	–
Credited to reserves	**(77)**	–	**(9)**	–
At 31st December	**5,368**	5,237	**(13)**	–

	Group 2005 $ million	Group 2004 $ million	Company 2005 $ million	Company 2004 $ million
Net deferred tax assets recognised on the Balance Sheet	**(14)**	–	**(13)**	–
Net deferred tax liabilities recognised on the Balance Sheet	**5,382**	5,237	**–**	–
At 31st December	**5,368**	5,237	**(13)**	–

(b) Major components of deferred tax (assets)/liabilities are set out below:

	Group 2005 $ million	Group 2004 $ million	Company 2005 $ million	Company 2004 $ million
Tax effects of:				
Depreciation allowances in excess of related depreciation	**5,223**	5,009	**–**	–
Fuel clause rebates	**189**	209	**–**	–
Contributions to employee retirement schemes	**(41)**	19	**(11)**	–
Tax losses	**(2)**	–	**(2)**	–
Cash flow hedges	**(1)**	–	**–**	–
	5,368	5,237	**(13)**	–

(c) Deferred tax assets have not been recognised in respect of the following items:

	Group 2005 $ million	Group 2004 $ million	Company 2005 $ million	Company 2004 $ million
Deductible temporary differences	**–**	5	**–**	5
Tax losses	**–**	2	**–**	2
	–	7	**–**	7

notes to the financial statements

(Expressed in Hong Kong Dollars)

28. Employee Retirement Benefits

(a) Defined Benefit Retirement Scheme

The Company and its principal subsidiaries operate two Retirement Schemes which cover substantially all permanent staff in the Group. The Schemes are established under trust and are registered under the Hong Kong Occupational Retirement Schemes Ordinance. They are defined benefit in nature whereby the retirement benefits are based on the employee's final basic salary and length of service. The assets of the Schemes are held independently of the Group's assets in separate trustee administered funds.

The funding policy in respect of the Schemes is based on valuations prepared periodically by independent professionally qualified actuaries at Watson Wyatt Hong Kong Limited. The policy on employer's contributions is to fund the Schemes in accordance with the actuary's recommendations on an on-going basis, whereas employees' contributions, if applicable, are fixed at 5% of basic pay. The most recent actuarial valuations of both Schemes have been carried out by the appointed actuary, represented by Mr. A. Wong, FSA, FCIA as at 1st January 2004. The principal actuarial assumptions used include a long term yield gap, which is the long term expected rate of investment return net of salary increase, of 2% p.a., pension increase of 2.5% p.a., together with appropriate provisions for mortality rates, turnover and adjustments to reflect the short-term market expectation of salary increases. The valuations revealed that the Scheme assets in each case were sufficient to cover the respective discontinuance liabilities as at the valuation date.

Retirement scheme costs charged to the Profit and Loss Account for the year ended 31st December 2005 were determined in accordance with HKAS 19 "Employee Benefits", under which the Schemes are required to be valued using the "Projected Unit Credit Method".

(i) The amounts recognised in the Balance Sheet are as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Present value of funded obligations	**4,151**	3,701	**393**	354
Fair value of scheme assets	**(3,986)**	(3,639)	**(337)**	(312)
Net unrecognised actuarial losses	**–**	(256)	**–**	(32)
	165	(194)	**56**	10
Represented by:				
Employee retirement benefit assets	**(170)**	(296)	**(10)**	(14)
Employee retirement benefit liabilities	**335**	102	**66**	24
	165	(194)	**56**	10

The plan assets include ordinary shares issued by the Company with a fair value of $7 million (2004 : $7 million).

A portion of the above liability is expected to be settled after more than one year. However, it is not practicable to segregate this amount from the amounts payable in the next twelve months, as future contributions will also relate to future services rendered and future changes in actuarial assumptions and market conditions.

(ii) Changes in present value of funded obligations are as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Opening present value of funded obligations	**3,701**	3,427	**354**	321
Current service cost	**140**	134	**9**	8
Interest cost	**182**	185	**17**	18
Employee contributions paid to schemes	**28**	28	**2**	2
Actuarial loss	**251**	84	**32**	28
Benefits paid	**(151)**	(157)	**(21)**	(23)
Closing present value of funded obligations	**4,151**	3,701	**393**	354

(iii) Changes in fair value of scheme assets are as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Opening fair value of scheme assets	**3,639**	3,240	**312**	278
Expected return	**274**	245	**23**	21
Actuarial gain	**67**	148	**13**	14
Employer contributions paid to schemes	**129**	135	**8**	8
Employee contributions paid to schemes	**28**	28	**2**	2
Transfer of assets	**–**	–	**–**	12
Benefits paid	**(151)**	(157)	**(21)**	(23)
Closing fair value of scheme assets	**3,986**	3,639	**337**	312

The Group expects to contribute $84 million to its defined benefit schemes in 2006.

(iv) Expense recognised in the Profit and Loss Account, prior to any capitalisation of employment costs attributable to fixed assets additions, is as follows:

	2005	2004
	$ million	$ million
Current service cost	**140**	134
Interest cost	**182**	185
Expected return on scheme assets	**(274)**	(245)
Net actuarial losses recognised	**–**	11
	48	85

The expense is recognised in the following line items in the consolidated Profit and Loss Account:

	2005	2004
	$ million	$ million
Direct costs	**25**	45
Other operating costs	**23**	40
	48	85

The actual return on scheme assets (taking into account all changes in the fair value of the scheme assets excluding contributions paid and received) was net income of $341 million (2004 : $394 million).

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(Expressed in Hong Kong Dollars)

28. Employee Retirement Benefits (continued)

(a) Defined Benefit Retirement Scheme (continued)

(v) The cumulative amount of actuarial gains and losses recognised in the Statement of Recognised Income and Expense is as follows:

	2005 $ million	2004 $ million
At 1st January	**–**	–
Actuarial losses recognised in the Statement of Recognised Income and Expense during the year	**439**	–
At 31st December	**439**	–

(vi) The major categories of scheme assets as a percentage of total scheme assets are as follows:

	2005	2004
Hong Kong equities	**17.2%**	19.8%
Europe equities	**14.8%**	12.7%
North America equities	**14.7%**	17.8%
Other Asia Pacific equities	**17.7%**	14.6%
Global bonds	**31.3%**	32.6%
Deposits and Cash	**4.3%**	2.5%

(vii) The principal actuarial assumptions used at 31st December (expressed as weighted average) are as follows:

	Group and Company	
	2005	2004
Discount rate	**4.5%**	5.0%
Expected rate of return on scheme assets	**7.5%**	7.5%
Future salary increase rate	**5.0%**	5.0%
Future pension increase rate	**2.5%**	2.5%

(viii) The amounts of defined benefit schemes for the current and previous year are as follows:

	Group		**Company**	
	2005 $ million	2004 $ million	**2005 $ million**	2004 $ million
Present value of funded obligations	**(4,151)**	(3,701)	**(393)**	(354)
Fair value of scheme assets	**3,986**	3,639	**337**	312
Deficit	**(165)**	(62)	**(56)**	(42)
Experience adjustments on:				
Scheme liabilities	**(8)**	(26)	**(10)**	(18)
Scheme assets	**67**	148	**13**	14

(b) Defined Contribution Retirement Scheme

Since the introduction of the Hong Kong Mandatory Provident Fund Scheme in December 2000, all new recruits are enrolled in that Scheme instead of the existing retirement schemes.

	2005 **$ million**	2004 $ million
Expenses recognised in the Profit and Loss Account	**2**	2

29. Share Capital

		Company	
	Number of Shares	**2005** **$ million**	2004 $ million
Authorised:			
Ordinary shares of $1 each	3,300,000,000	**3,300**	3,300
Issued and fully paid:			
Ordinary shares of $1 each	2,134,261,654	**2,134**	2,134

30. Nature and Purpose of Reserves

Details of the composition of reserves and movements during the year are given in the Statement of Changes in Equity.

(a) Share Premium

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

(b) Exchange Reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations as well as the effective portion of any foreign exchange differences arising from hedges of the net investment in these foreign operations. The reserve is dealt with in accordance with the accounting policies set out in notes 2(i)(ii) and 2(v).

(c) Hedging Reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2(i)(i).

(d) Revenue Reserve

The revenue reserve is the accumulative profits retained by the Company and its subsidiaries and including share of the retained profits of its associates.

notes to the financial statements

(Expressed in Hong Kong Dollars)

31. Notes to the Consolidated Cash Flow Statement

Reconciliation of profit before taxation to cash generated from operations

	2005 **$ million**	2004 $ million
		restated
Profit before taxation	**9,777**	7,436
Adjustments for:		
Profit on disposal of interest in associates	**(1,560)**	–
Share of profits less losses of associates	**(1,050)**	(419)
Interest income	**(902)**	(879)
Dividend income from available-for-sale equity securities	**(66)**	–
Profit on disposal of available-for-sale equity securities	**(21)**	–
Finance costs	**597**	574
Depreciation	**1,773**	1,750
Amortisation of leasehold land	**54**	55
Fixed assets written off	**21**	20
Net profit on disposal of fixed assets	**(25)**	(30)
Exchange gain	**(14)**	(1)
Operating profit before changes in working capital	**8,584**	8,506
Decrease/(increase) in inventories	**36**	(116)
Increase in trade and other receivables	**(25)**	(30)
Decrease/(increase) in Fuel Clause Account	**118**	(50)
(Decrease)/increase in trade and other payables, excluding current portion of deferred creditors	**(137)**	27
Increase in net employee retirement benefits	**(81)**	(50)
Cash generated from operations	**8,495**	8,287

32. Financial Instruments

The Group is exposed to credit, liquidity, interest rate and currency risks in the normal course of its businesses. In accordance with the Group's treasury policy, derivative financial instruments are only used to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading or speculative purposes.

(a) Credit Risk

The Group's credit risk is primarily attributable to trade and other receivables of electricity charges, Fuel Clause Account, bank deposits and over-the-counter derivative financial instruments entered into for hedging purposes. The management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis.

In respect of trade and other receivables of electricity charges, The Hongkong Electric Company Limited, a wholly-owned subsidiary company, obtains sufficient collateral of security from customers in accordance with the Supply Rules. The outstanding amount of deposits received from customers at 31st December 2005 was $1,508 million. The credit policy is set out in note 20.

In respect of the Fuel Clause Account, the 2004-2008 Financial Plan was submitted and approved by the Government on the basis that the Fuel Clause Account receivable would be recovered by the end of the Financial Plan period, i.e. by the end of 2008.

The Group has a defined minimum credit rating requirement and transaction limit on counterparties for dealing in financial derivatives or placing of deposits to minimise credit exposure. The management does not expect any counterparty to fail to meet its obligations.

The Group has no significant concentrations of credit risk in respect of trade and other receivables of electricity charges, as the five largest customers combined did not exceed 30% of the Group's total turnover.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

(b) Liquidity Risk

The Group's policy is to regularly monitor current and expected liquidity requirements and its compliance with loan covenants, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term. The Group has undrawn committed bank facilities of $3,465 million at 31st December 2005.

(c) Interest Rate Risk

(i) *Hedging*

The Group's policy is to maintain a balanced combination of fixed and variable rate debt to reduce its interest rate exposure. The Group also uses interest rate derivatives to manage the exposure in accordance with the treasury policy. At 31st December 2005, the Group had interest rate swaps with a total notional amount of $5,893 million.

The Group classifies interest rate swaps as cash flow hedges and states them at fair value in accordance with the policy set out in note 2(h).

The net fair value of swaps entered into by the Group at 31st December 2005 was $41 million. These amounts are recognised as derivative financial instruments assets/liabilities.

notes to the financial statements

(Expressed in Hong Kong Dollars)

32. Financial Instruments (continued)

(c) Interest Rate Risk (continued)

(ii) *Effective Interest Rate and Repricing Analysis*

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice or the maturity dates, if earlier.

			2005			
$ million	**Weighted Average Interest Rate %**	**One Year or Less**	**1-2 Years**	**2-5 Years**	**More Than 5 Years**	**Total**
Group						
Repricing dates for assets/(liabilities) which reprice before maturity						
Cash at bank and on hand	–	13	–	–	–	13
Bank overdrafts	7.8	(8)	–	–	–	(8)
Bank loans and other borrowings	4.7	(6,104)	–	–	–	(6,104)
Deferred creditors	5.2	(74)	–	–	–	(74)
Customers' deposits	2.3	(1,508)	–	–	–	(1,508)
Effect of interest rate swaps	0.2	750	(500)	(250)	–	–
		(6,931)	(500)	(250)	–	(7,681)
Maturity dates for assets/(liabilities) which do not reprice before maturity						
Loans to associates	11.1	126	–	–	3,949	4,075
Deposits with banks and other financial institutions	4.6	4,548	–	–	–	4,548
Bank loans and other borrowings	5.9	(185)	–	(3,274)	(1,000)	(4,459)
		4,489	–	(3,274)	2,949	4,164

$ million	Weighted Average Interest Rate %	One Year or Less	1-2 Years	2-5 Years	More Than 5 Years	Total
			2005			
Company						
Repricing dates for assets which reprice before maturity						
Cash at bank and on hand	–	8	–	–	–	8
Maturity dates for assets which do not reprice before maturity						
Deposits with banks and other financial institutions	4.6	4,512	–	–	–	4,512

(d) Foreign Currency Risk

(i) *Committed and Forecast Transactions*

The Group is exposed to foreign currency risk primarily through purchases that are denominated in a currency other than the functional currency of the operations to which they relate. The currencies giving rise to this risk are primarily United States dollars, Sterling pounds, Euros, Japanese yen and Australian dollars.

The Group uses forward exchange contracts to hedge its foreign currency risk and classifies these as cash flow hedges. At 31st December 2005, the Group had forward exchange contracts hedging committed and forecast transactions with a net fair value of $8 million recognised as derivative financial instruments.

(ii) *Recognised Assets and Liabilities*

The net fair value of forward exchange contracts and currency swaps contracts used by the Group as economic hedges of monetary assets and liabilities in foreign currencies at 31st December 2005 was $1 million and $198 million recognised as derivative financial instruments assets and liabilities respectively.

Except for borrowings arising from overseas investments (see note 32(d)(iii)), 100% of the Group's borrowings are either hedged or denominated in Hong Kong dollars. Given this, the management does not expect that there will be any significant currency risk associated with the Group's borrowings.

(iii) *Overseas Investments*

Currency exposure arising from overseas investments is hedged by arranging a comparable level of external borrowings in the same currency as the underlying investments. The fair value of the loans at 31st December 2005 was $3,274 million.

notes to the financial statements

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32. Financial Instruments (continued)

(e) Fair Values

The carrying amounts of the financial instruments are estimated to approximate their fair values.

(f) Estimation of Fair Values

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments.

(i) *Securities*

Fair value is based on quoted market prices at the balance sheet date without any deduction for transaction costs. Unquoted equity investments do not have a quoted market price in an active market and are measured at cost as their fair value cannot be measured reliably.

(ii) *Derivatives*

The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

(iii) *Interest-bearing Bank Loans and Other Borrowings*

The carrying amounts of bank loans and other borrowings are estimated to approximate their fair values.

(g) Comparative Information

Corresponding figures for the last year were not shown, as comparative amounts have not been restated which is prohibited by the transitional arrangements in HKAS 39.

33. Operating Lease

At 31st December 2005, the total future minimum lease payments by the Group under a non-cancellable equipment operating lease are payable as follows:

	Group	
	2005	2004
	$ million	$ million
Within 1 year	**62**	62
After 1 year but within 5 years	**170**	232
	232	294

Under the non-cancellable equipment operating lease agreement, the lessee has an option to purchase all of the equipment at the fair market value as at the lease maturity date.

34. Commitments

The Group's commitments outstanding at 31st December and not provided for in the financial statements were as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Contracted for:				
Capital expenditure	**1,807**	2,961	**–**	–
Investment in associates	**234**	312	**–**	–
Available-for-sale equity securities	**–**	1,581	**–**	–
	2,041	4,854	**–**	–
Authorised but not contracted for:				
Capital expenditure	**7,400**	7,195	**–**	1

35. Contingent Liabilities

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Guarantees have been executed in respect of banking facilities available to the subsidiaries	**–**	–	**3,274**	6,270
Other guarantees given in respect of:				
Subsidiaries	**10**	5	**1,728**	4,866
Associate	**33**	35	**33**	35
Others	**210**	256	**–**	45
	253	296	**5,035**	11,216

36. Material Related Party Transactions

The Group had the following material transactions carried out with related parties during the year:

(a) Associates

Interest income received/receivable from associates in respect of the loans to associates amounted to $840 million (2004 : $848 million) for the year. At 31st December 2005, the total outstanding interest bearing loan balances due from associates were $4,075 million (2004 : $7,417 million). The outstanding balances with associates are disclosed in note 17.

(b) Key Management Personnel Compensation

Remuneration for key management personnel, including amounts paid to the company's directors as disclosed in note 11(a) and certain of the highest paid employees as disclosed in note 11(b), is as follows:

	Group		Company	
	2005	2004	**2005**	2004
	$ million	$ million	**$ million**	$ million
Short-term employee benefits	**61**	57	**35**	32
Post-employment benefits	**3**	4	**1**	1
	64	61	**36**	33

Total remuneration is included in "staff costs" (see note 9).

notes to the financial statements

(Expressed in Hong Kong Dollars)

36. Material Related Party Transactions (continued)

(c) Subsidiaries

Management fees and services fees recharged by the Company to subsidiaries amounted to $134 million (2004 : $130 million) for the year. At 31st December 2005, the outstanding balances with subsidiaries are disclosed in note 16. The transactions and balances with subsidiaries are eliminated on consolidation.

(d) Other Related Parties

(i) On 10th September 2004, Hongkong Electric Holdings Limited ("HEH") and Cheung Kong Infrastructure Holdings Limited ("CKI"), a substantial shareholder of the Company, entered into an agreement under which HEH agreed to purchase, or procure the purchase by its wholly-owned subsidiary, of the entire issued share capital of Alpha Central Profits Limited ("Alpha"). Alpha was a wholly-owned indirect subsidiary of CKI that owns 19.9% of the issued share capital of Gas Network Limited (currently known as Northern Gas Networks Holdings Limited). Gas Network Limited had agreed to acquire Blackwater F Limited ("Blackwater") (currently known as Northern Gas Networks Limited), a wholly-owned subsidiary of Transco plc that owned the North of England Gas Distribution Network business in the United Kingdom. The Blackwater acquisition was completed on 1st June 2005.

(ii) On 9th November 2005, CKI and HEH entered into an agreement, pursuant to which HEH agreed to procure the sale and CKI agreed, through its nominee(s), to purchase from HEH an approximately 22.07% attributable interest in each of ETSA Utilities ("ETSA") and CKI/HEI Electricity Distribution Holdings (Australia) Pty Ltd ("CHEDHA"). ETSA and CHEDHA are associates of the Company. The transaction was completed on 21st December 2005. Profit on disposal of the 22.07% interest in ETSA and CHEDHA was $1,560 million, as disclosed in note 8.

(iii) On 23rd December 2005, CKI/HEI Infrastructure Holdings Pty Ltd ("CHIP", formerly known as CKI/HEI Telecommunications Pty Limited), a wholly-owned subsidiary of CKI/HEI Electricity Holdings (Malaysian) Limited ("CHEM"), entered into a Share Sale Agreement with Powercor Australia Holdings Pty Limited ("Powercor Holdings") to acquire the entire issued share capital of Silk Telecom Pty Ltd. ("Silk", formerly known as Powercor Australia Telecommunications Pty Limited), and Silk had entered into agreements to acquire telecommunications assets from certain associated companies of the Company. The Company would provide financial assistance to CHEM for completion of the purchase and for Silk's future operations which is expected to be up to an aggregate amount of A$12.5 million (approximately HK$71 million). CHIP, CHEM and Powercor Holdings are associates of the Company. At 31st December 2005, the total amount lent to CHEM was HK$48 million.

37. Substantial Shareholder of the Company

The Company is a Hong Kong listed company and the shares are widely held by the public. Cheung Kong Infrastructure Holdings Limited currently holds approximately 38.87% of the issued share capital of the Company and is a substantial shareholder of the Company.

38. Critical Accounting Estimates and Judgements

There are no critical accounting estimates and judgements made by the Group concerning the future that cause a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

39. Comparative Figures

Certain comparative figures have been adjusted or re-classified as a result of the changes in accounting policies. Further details are disclosed in note 3.

40. Possible Impact of Amendments, New Standards and Interpretations Issued But Not Yet Effective for the Annual Accounting Period Ended 31st December 2005

Up to the date of issue of these financial statements, the HKICPA has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period end 31st December 2005 and which have not been adopted in these financial statements:

		Effective for accounting periods beginning on or after
HKFRS 6	Exploration for and evaluation of mineral resources	1st January 2006
HK(IFRIC) 4	Determining whether an arrangement contains a lease	1st January 2006
HK(IFRIC) 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds	1st January 2006
HK(IFRIC) 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment	1st December 2005
HK(IFRIC) 7	Applying the restatement approach under HKAS 29 – Financial reporting in hyperinflationary economies	1st March 2006
Amendments to HKAS 39	Financial instruments: recognition and measurement	1st January 2006
Amendments to, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005	HKAS 1 Presentation of financial statements;	1st January 2006
	HKAS 27 Consolidated and separate financial statements;	1st January 2006
	HKFRS 3 Business combinations	1st January 2006
HKFRS 7	Financial Instruments: Disclosures	1st January 2007
Amendments to HKAS 1	Presentation of Financial Statements: Capital Disclosures	1st January 2007

In addition, the Hong Kong Companies (Amendment) Ordinance 2005 came into effect on 1st December 2005 and would be first applicable to the Group's financial statements for the period beginning 1st January 2006.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that they are unlikely to have a significant impact on the Group's results of operations and financial position.

notes to the financial statements

(Expressed in Hong Kong Dollars)

Appendix 1

Segment Information

(a) **Business Segments**
For the year ended 31st December

$ million	Sales of Electricity 2005	Sales of Electricity 2004	Infrastructure Investments 2005	Infrastructure Investments 2004	Unallocated & Other Items 2005	Unallocated & Other Items 2004	Consolidated 2005	Consolidated 2004
				restated				restated
Revenue								
Group turnover	11,575	11,356	–	–	47	51	11,622	11,407
Other revenue	47	52	–	–	110	7	157	59
Segment revenue	11,622	11,408	–	–	157	58	11,779	11,466
Result								
Segment result	6,783	6,744	–	–	70	(37)	6,853	6,707
Interest income	–	–	840	848	62	31	902	879
Finance costs	(128)	(83)	(460)	(486)	–	–	(588)	(569)
Operating profit	6,655	6,661	380	362	132	(6)	7,167	7,017
Profit on disposal of interest in associates	–	–	1,560	–	–	–	1,560	–
Share of profits less losses of associates	–	–	1,049	417	1	2	1,050	419
Profit before taxation	6,655	6,661	2,989	779	133	(4)	9,777	7,436
Income tax	(1,218)	(1,180)	(1)	–	4	–	(1,215)	(1,180)
Profit after taxation	5,437	5,481	2,988	779	137	(4)	8,562	6,256
Scheme of Control transfers	–	–	–	–	–	–	–	–
Profit attributable to equity shareholders	5,437	5,481	2,988	779	137	(4)	8,562	6,256
At 31st December								
Assets								
Segment assets	49,056	48,340	1,738	45	(27)	(42)	50,767	48,343
Interest in associates	–	–	5,770	8,903	10	11	5,780	8,914
Cash and cash equivalent	–	–	–	–	4,561	1,426	4,561	1,426
Consolidated total assets	49,056	48,340	7,508	8,948	4,544	1,395	61,108	58,683
Liabilities								
Segment liabilities	2,601	2,332	458	255	117	61	3,176	2,648
Current and deferred taxation	5,602	5,465	–	–	–	1	5,602	5,466
Interest-bearing borrowings	7,372	6,441	3,273	6,556	–	–	10,645	12,997
Rate Reduction Reserve	–	–	–	–	–	–	–	–
Development Fund	–	–	–	–	–	–	–	–
Consolidated total liabilities	15,575	14,238	3,731	6,811	117	62	19,423	21,111
Other information								
Capital expenditure	3,005	2,246	–	–	–	–	3,005	2,246
Depreciation and amortisation	1,964	1,948	–	–	–	–	1,964	1,948

(b) **Geographical Segments**
For the year ended 31st December

$ million	Hong Kong 2005	Hong Kong 2004	Australia 2005	Australia 2004 restated	Unallocated & Other Items 2005	Unallocated & Other Items 2004	Consolidated 2005	Consolidated 2004 restated
Revenue								
Group turnover	11,607	11,394	–	2	15	11	11,622	11,407
Other revenue	53	56	–	–	104	3	157	59
Segment revenue	11,660	11,450	–	2	119	14	11,779	11,466
Result								
Segment result	6,787	6,751	13	1	53	(45)	6,853	6,707
Interest income	62	31	837	846	3	2	902	879
Finance costs	(128)	(83)	(460)	(486)	–	–	(588)	(569)
Operating profit	6,721	6,699	390	361	56	(43)	7,167	7,017
Profit on disposal of interest in associates	–	–	1,560	–	–	–	1,560	–
Share of profits less losses of associates	1	2	1,064	435	(15)	(18)	1,050	419
Profit before taxation	6,722	6,701	3,014	796	41	(61)	9,777	7,436
Income tax	(1,214)	(1,180)	–	–	(1)	–	(1,215)	(1,180)
Profit after taxation	5,508	5,521	3,014	796	40	(61)	8,562	6,256
Scheme of Control transfers	–	–	–	–	–	–	–	–
Profit attributable to equity shareholders	5,508	5,521	3,014	796	40	(61)	8,562	6,256
At 31st December								
Assets								
Segment assets	49,023	48,292	56	6	1,688	45	50,767	48,343
Interest in associates	10	11	5,548	8,794	222	109	5,780	8,914
Cash and cash equivalent	–	–	–	–	4,561	1,426	4,561	1,426
Consolidated total assets	49,033	48,303	5,604	8,800	6,471	1,580	61,108	58,683
Other information								
Capital expenditure	3,005	2,246	–	–	–	–	3,005	2,246
Depreciation and amortisation	1,964	1,948	–	–	–	–	1,964	1,948

notes to the financial statements

Appendix 2

Principal Subsidiaries

The following list contains only the particulars of subsidiaries as at 31st December 2005 which principally affected the results, assets or liabilities of the Group:

Name	Issued Share Capital and Debt Securities	Percentage of Equity Held by the Company	Place of Incorporation/ Operation	Principal Activity
The Hongkong Electric Company, Limited	HK$2,411,600,000	100	Hong Kong	Electricity generation and supply
Associated Technical Services Limited	HK$1,000,000	100	Hong Kong	Consulting
Cavendish Construction Limited	HK$4,200,000	100	Hong Kong	Contracting
Fortress Advertising Company Limited	HK$2	100	Hong Kong	Advertising
Hongkong Electric Fund Management Limited	HK$20	100	Hong Kong	Trustee
Gusbury Enterprises Incorporation	US$2	100	Panama/Hong Kong	Investment holding
HKE International Limited	US$1	100	British Virgin Islands/ Hong Kong	Investment holding
Hongkong Electric (Natural Gas) Limited	US$1	100	British Virgin Islands/ Hong Kong	Investment holding
Hongkong Electric (Cayman) Limited	US$1 and HK$1,000 million Hong Kong dollar notes (see note 24)	100	Cayman Islands/ Hong Kong	Financing
Hongkong Electric Finance (Cayman) Limited	US$1 and HK$500 million Hong Kong dollar notes (see note 24)	100	Cayman Islands/ Hong Kong	Financing
Fenning Limited	HK$20	100	Hong Kong	Contracting
Dunway Investment Limited	US$1	100	British Virgin Islands	Investment
Coty Limited	US$1	100	British Virgin Islands	Investment holding
Hongkong Electric International Limited	US$1	100	British Virgin Islands	Investment holding
Hongkong Electric Finance Limited	US$1 HK$1,000 million Hong Kong dollar notes (see note 24)	100*	British Virgin Islands/ Hong Kong	Financing
HEI Investment Holdings Limited	HK$2	100*	Hong Kong	Investment holding
Rayong Energy Developments Limited	US$1	100*	British Virgin Islands/ Hong Kong	Investment holding
Sigerson Business Corp.	US$1	100*	British Virgin Islands	Investment holding
HEI Utilities (Malaysian) Ltd	A$637,510	100*	British Virgin Islands	Investment holding
HEI Power (Malaysian) Ltd	A$52,510	100*	British Virgin Islands	Investment holding
Hong Kong Electric International Finance (Australia) Pty Limited	A$1	100*	Australia	Financing
HEI Transmission Finance (Australia) Pty Limited	A$12	100*	Australia	Financing
HEI Distribution Finance (Australia) Pty Limited	A$100	100*	Australia	Financing
Riverland Investment Limited	US$1	100*	British Virgin Islands	Investment holding
Hongkong Electric International Power (Mauritius) Limited	US$2	100*	Mauritius	Investment holding
HEI Electricity Distribution (Malaysian) Limited	US$100	100*	Malaysia	Investment holding
Kentson Limited	US$1	100*	British Virgin Islands	Investment holding
Alpha Central Profits Limited	US$1	100*	British Virgin Islands	Investment holding

* *Indirectly held*

Appendix 3

Principal Associates

The following list contains only the particulars of associates as at 31st December 2005 which principally affected the results or assets of the Group:

Name	Issued Share Capital	Percentage of Group's Effective Interest	Place of Incorporation/ Operation	Principal Activity
Secan Limited	HK$10	20%	Hong Kong	Property development
CKI Spark Holdings No. One Limited (see note (a) below)	AUD335,031,565	54.76%	Bahamas/ Australia	Electricity distribution
CKI Spark Holdings No. Two Limited (see note (b) below)	AUD498,038,537	54.76%	Bahamas/ Australia	Electricity distribution
CKI/HEI Electricity Holdings (Malaysian) Limited (see note (c) below)	AUD100	50%	Malaysia	Investment holding
Ratchaburi Power Company, Limited (see note (d) below)	THB1,665,000,000	25%	Thailand	Electricity generation and supply

Notes:

(a) *CKI Spark Holdings No. One Limited holds 51% attributable interest in CHEDHA Holdings Pty Limited ("CHEDHAH"). CHEDHAH is the holding company of Powercor and CitiPower. Powercor operates and manages an electricity distribution business in the State of Victoria, Australia. CitiPower, which is similar to Powercor, is one of five electricity distributors in the State of Victoria, Australia. The Group holds 54.76% of CKI Spark Holdings No. One Limited but the Group does not have effective control over it and therefore it has been accounted for as an associate.*

(b) *CKI Spark Holdings No. Two Limited holds 51% attributable interest in ETSA Utilities Partnership ("ETSA"). ETSA is an unincorporated body and operates and manages the electricity distribution business in the State of South Australia. The Group holds 54.76% of CKI Spark Holdings No. Two Limited but the Group does not have effective control over it and therefore it has been accounted for as an associate.*

(c) *CKI/HEI Electricity Holdings (Malaysian) Limited through its wholly-owned subsidiary holds certain telecommunication assets in Australia.*

(d) *Ratchaburi Power Company, Limited is incorporated in Thailand and is principally engaged in the development, financing, construction, installation, testing, operation and maintenance of a power generating station in Thailand.*