FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT (HK$m)

	Note	2005	2004 (restated)
		Year ended 31 December	
Turnover	3	**3,269**	3,112
Other revenue	4	**7**	8
		3,276	3,120
Cost of inventories		**(232)**	(222)
Staff costs and related expenses		**(1,028)**	(996)
Rent and utilities		**(261)**	(238)
Other operating expenses		**(663)**	(672)
Operating profit before depreciation and amortisation (EBITDA)		**1,092**	992
Depreciation and amortisation		**(238)**	(240)
Operating profit		**854**	752
Financing charges	5A	**(163)**	(243)
Share of losses of jointly controlled entity/associates		**(3)**	(14)
Profit before non-operating items	5	**688**	495
Increase in fair value of investment properties	15A	**1,089**	2,812
Net gain on disposal of The Kowloon Hotel	6	**953**	–
Other non-operating items	7	**199**	79
Profit before taxation		**2,929**	3,386
Taxation	8	**(208)**	(573)
Profit for the year		**2,721**	2,813
Attributable to:			
Equity shareholders of the company	28A	**2,664**	2,786
Minority interests	28A	**57**	27
Profit for the year		**2,721**	2,813
Earnings per share (HK cents)			
Basic	12A	**189**	199
*Adjusted**	12B	***45***	*28*
Dividends per share (HK cents)		**14**	12
Dividends payable to equity shareholders of the company attributable to the year:	13		
Interim dividend declared during the year		**57**	42
Final dividend proposed after the balance sheet date		**142**	126
		199	168

* *Adjusted for non-operating items, net of related tax and minority interests.*

The notes on pages 92 to 155 form part of these financial statements.

CONSOLIDATED BALANCE SHEET (HK$m)

	Note	At 31 December 2005	2004 *(restated)*
Non-current assets			
Fixed assets			
Properties, plant and equipment		**4,406**	4,338
Investment properties		**16,155**	15,478
Leasehold land		**–**	242
	15	**20,561**	20,058
Interests in associates	17	**–**	80
Interest in jointly controlled entity	18	**446**	137
Investment in hotel management contract		**168**	174
Interests in unlisted equity instruments	19	**52**	52
Derivative financial instruments	20A	**23**	–
Deferred tax assets	21B	**123**	–
		21,373	20,501
Current assets			
Inventories	22	**77**	74
Debtors and payments in advance	23	**216**	224
Taxation recoverable	21A	**3**	–
Derivative financial instruments	20A	**2**	–
Cash and cash equivalents	24	**301**	262
		599	560
Current liabilities			
Creditors and accruals	25	**(867)**	(1,128)
Interest-bearing borrowings	26	**(139)**	(354)
Derivative financial instruments	20A	**(5)**	–
Current taxation	21A	**(78)**	(45)
		(1,089)	(1,527)
Net current liabilities		**(490)**	(967)
Total assets less current liabilities		**20,883**	19,534
Non-current liabilities			
Interest-bearing borrowings	26	**(2,475)**	(4,182)
Net defined benefit retirement obligation	32A	**(21)**	(10)
Derivative financial instruments	20A	**(204)**	–
Deferred tax liabilities	21B	**(2,577)**	(2,386)
		(5,277)	(6,578)
Net assets		**15,606**	12,956
Capital and reserves			
Share capital	27	**709**	701
Reserves	28A	**14,187**	11,641
Total equity attributable to equity shareholders of the company		**14,896**	12,342
Minority interests	28A	**710**	614
Total equity		**15,606**	12,956

Approved by the Board of Directors on 16 March 2006 and signed on its behalf by:

The Hon. Sir Michael Kadoorie, Clement K M Kwok, C Mark Broadley, *directors*

The notes on pages 92 to 155 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT (HK$m)

	Note	Year ended 31 December 2005	2004 (restated)
Operating activities			
Profit before non-operating items		**688**	495
Adjustments for:			
Depreciation		**231**	228
Amortisation			
– land lease premium		**1**	7
– hotel management contract		**6**	5
Financing charges		**163**	243
Dividend income from unlisted equity instruments		**(3)**	(5)
Interest income		**(4)**	(3)
Share of losses of jointly controlled entity/associates		**3**	14
Loss on disposal of fixed assets		**9**	24
Foreign exchange gain		**(8)**	(6)
Operating profit before changes in working capital		**1,086**	1,002
Decrease/(increase) in inventories		**1**	(2)
(Increase)/decrease in debtors and payments in advance		**(2)**	68
Increase/(decrease) in creditors and accruals		**54**	(26)
Cash generated from operations		**1,139**	1,042
Net tax paid:			
Hong Kong profits tax paid		**(35)**	(44)
Overseas tax paid		**(46)**	(6)
Net cash from operating activities		**1,058**	992
Investing activities			
Purchase of fixed assets		**(344)**	(227)
Acquisition of subsidiary, net of cash acquired	30	**(2)**	–
Receipt in relation to the disposal of a subsidiary	30	**1,684**	193
Capital injected/loan granted to jointly controlled entity		**(308)**	(133)
Interest received		**4**	3
Dividend received from unlisted equity instruments		**3**	5
Proceeds from sale of fixed assets		**152**	1
Net cash generated from/(used in) investing activities		**1,189**	(158)
Financing activities			
Net decrease in bank borrowings		**(1,886)**	(387)
Dividends paid to equity shareholders of the company		**(104)**	(154)
Interest paid and other financing charges		**(210)**	(248)
Dividends paid to minority shareholders		**(5)**	(5)
Net cash used in financing activities		**(2,205)**	(794)
Net increase in cash and cash equivalents		**42**	40
Cash and cash equivalents at 1 January		**243**	203
Cash and cash equivalents at 31 December	24	**285**	243

The notes on pages 92 to 155 form part of these financial statements.

PARENT COMPANY BALANCE SHEET (HK$m)

	Note	At 31 December 2005	2004 (restated)
Non-current assets			
Investments in subsidiaries	16	**71**	–
Interests in associates	17	**–**	50
Derivative financial instruments	20B	**149**	–
Deferred tax asset	21B	**10**	–
		230	50
Current assets			
Debtors and payments in advance	23	**10,173**	9,576
Derivative financial instruments	20B	**3**	–
Cash and cash equivalents	24	**7**	23
		10,183	9,599
Current liabilities			
Creditors and accruals	25	**(20)**	(34)
Current taxation	21A	**(22)**	(4)
Derivative financial instruments	20B	**(5)**	–
		(47)	(38)
Net current assets		**10,136**	9,561
Non-current liability			
Derivative financial instruments	20B	**(203)**	–
Net assets		**10,163**	9,611
Capital and reserves			
Share capital	27	**709**	701
Reserves	28B	**9,454**	8,910
Total equity		**10,163**	9,611

Approved by the Board of Directors on 16 March 2006 and signed on its behalf by:

The Hon. Sir Michael Kadoorie, Clement K M Kwok, C Mark Broadley, *directors*

The notes on pages 92 to 155 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (HK$m)

	Year ended 31 December			
		2005		2004 *(restated)*
Total equity at 1 January				
As previously reported:				
– attributable to equity shareholders of the company	**17,384**		13,441	
– minority interests	**602**		579	
	17,986		14,020	
Prior period adjustments arising from changes in accounting policies (see note 2)	**(5,030)**		(3,722)	
As restated, before opening balance adjustments	**12,956**		10,298	
Opening balance adjustments arising from the initial adoption of HKAS 32 and 39	**(304)**		–	
At 1 January, after prior period and opening balance adjustments		**12,652**		10,298
Net income for the year recognised directly in equity:				
Exchange differences on translation of financial statements of foreign entities, net of deferred tax, as previously reported			–	
Prior period adjustments arising from changes in the accounting policies under:				
– HKAS 16			1	
– HKAS 40			3	
Exchange differences on translation of financial statements of foreign entities (2004: *as restated*)		**6**		4
Surplus on revaluation of investment properties, net of deferred tax:				
As previously reported:				
– attributable to equity shareholders of the company			2,782	
– minority interests			(5)	
			2,777	
Prior period adjustments arising from changes in the accounting policy under HKAS 40			(2,777)	
Surplus on revaluation of investment properties, net of deferred tax (2004: *as restated*)		**–**		–
Surplus on revaluation of land and buildings held for own use, net of deferred tax				
As previously reported:				
– attributable to equity shareholders of the company			741	
Prior period adjustments arising from changes in the accounting policy under HKAS 16			(741)	
Surplus on revaluation of land and buildings held for own use, net of deferred tax (2004: *as restated*)		**–**		–
Cash flow hedges: effective portion of changes in fair value, net of tax		**50**		–
Net income for the year recognised directly in equity (2004: *as restated*)		**56**		4
Cash flow hedges: transfer from equity to profit or loss, net of tax		**214**		–

The notes on pages 92 to 155 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (HK$m)

			Year ended 31 December	
continued		**2005**		2004 *(restated)*
Net profit for the year:				
As previously reported:				
– attributable to equity shareholders of the company			574	
– minority interests			32	
			606	
Prior period adjustments arising from changes in accounting policies			2,207	
Net profit for the year (2004: *as restated*)		**2,721**		2,813
Total recognised gains for the year (2004: *as restated*)		**2,991**		2,817
Attributable to:				
Equity shareholders of the company	**2,930**		2,790	
Minority interests	**61**		27	
	2,991		2,817	
Dividends				
Distributed to equity shareholders of the company:				
– by means of cash	**(104)**		(154)	
– by means of scrip	**(79)**		–	
Paid in cash to minority interests	**(5)**		(5)	
		(188)		(159)
Issuance of new shares		**111**		–
Minority interests arising from business combination		**40**		–
Total equity at 31 December		**15,606**		12,956
Restatement of total recognised income and expense for the year attributable to equity shareholders of the company				(1,311)
Arising from restatement of:				
Net income recognised directly in equity				(3,518)
Net profit for the year				2,207
				(1,311)

The notes on pages 92 to 155 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

A. Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (HKFRS), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (HKAS) 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 HKFRS that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRS for the current and prior accounting periods reflected in these financial statements is provided in note 2.

B. Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2005 comprise the company and its subsidiaries (together referred to as the "group") and the group's interest in associates and a jointly controlled entity.

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:

- investment property (see note 1J);
- other leasehold land and buildings, for which the fair values cannot be measured separately at the inception of the lease and the entire lease is classified as a finance lease (see notes 1I and 1L);
- financial instruments classified as available-for-sale securities (see note 1F); and
- derivative financial instruments (see note 1G).

The preparation of financial statements in conformity with HKFRS 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. Revision to accounting estimates is recognised in the period in which the estimates are 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 HKFRS that may have a significant effect on the financial statements and estimates are discussed in note 39.

C. Subsidiaries and controlled entities

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 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.

C. Subsidiaries and controlled entities *continued*

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.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the company. Minority interests in the results of the group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the group's interest is allocated all such profits until the minority's share of losses previously absorbed by the group has been recovered.

In the company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 1M).

D. Associated and jointly controlled entities

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.

A jointly controlled entity is an entity which operates under a contractual arrangement between the group or company and other parties, where the contractual arrangement establishes that the group or company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a jointly controlled entity 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 or the jointly controlled entity's net assets. The consolidated income statement includes the group's share of the post-acquisition, post-tax results of the associates and jointly controlled entities for the year, including any impairment loss on goodwill relating to the investment in associates and jointly controlled entities recognised for the year (see notes 1E and 1M).

When the group's share of losses exceeds its interest in the associate or the jointly controlled entity, 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 or the jointly controlled entity. For this purpose, the group's interest in the associate or the jointly controlled entity 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 or the jointly controlled entity.

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

In the company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 1M).

1. SIGNIFICANT ACCOUNTING POLICIES *continued*

E. Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate or a jointly controlled entity 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 1M). In respect of an associate or a jointly controlled entity, the carrying amount of goodwill is included in the carrying amount of the interest in the associate or jointly controlled entity.

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 or a jointly controlled entity is recognised immediately in profit or loss.

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

F. Equity instruments

The group's long term investments which are equity in nature (other than investments in subsidiaries, associates and jointly controlled entities) that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are classified as interests in equity instruments and recognised in the balance sheet at cost less impairment losses (see note 1M).

Interests in equity instruments are recognised/derecognised on the date the group commits to purchase/sell the investments.

G. 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 1H).

H. Hedging

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 hedged 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.

H. Hedging *continued*

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.

I. Properties, plant and equipment

Hotel and other properties held for own use, and plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 1M).

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 1X).

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

Depreciation is calculated to write off the carrying values of the assets on a straight line basis over the shorter of the unexpired period of the land lease and the anticipated remaining useful lives of the assets. The useful lives which have been adopted are summarised as follows:

• hotel buildings	75 to 150 years
• other buildings	50 years
• golf courses	100 years
• external wall finishes, windows, roofing and glazing works	10 to 40 years
• major plant and machinery	15 to 25 years
• furniture, fixtures and equipment	3 to 20 years
• operating equipment	3 to 5 years
• motor vehicles	5 to 10 years

No depreciation is provided on freehold land as it is deemed to have an indefinite life.

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

J. Investment properties

Investment properties are land and/or buildings which are owned or held under a leasehold interest (see note 1L) to earn rental income and/or for capital appreciation. These include land held for a currently undetermined future use.

Investment properties are stated in the balance sheet at fair value. Any gain or loss arising from a change in fair value or from the retirement or disposal of an investment property is recognised in profit or loss. Rental income from investment properties is accounted for as described in note 1V.

When the group holds a property interest under an operating lease to earn rental income and/or for capital appreciation, the interest is classified and accounted for as an investment property on a property-by-property basis. Any such property interest which has been classified as an investment property is accounted for as if it were held under a finance lease (see note 1L), and the same accounting policies are applied to that interest as are applied to other investment properties leased under finance leases. Lease payments are accounted for as described in note 1L.

Property that is being constructed or developed for future use as investment property is classified as property, plant and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property at fair value. Any difference between the fair value of the property at that date and its previous carrying amount is recognised in profit or loss.

1. SIGNIFICANT ACCOUNTING POLICIES *continued*

K. Investment in hotel management contract

Payments for acquiring hotel management contracts are capitalised and are stated in the balance sheet at cost less accumulated amortisation and impairment losses (see note 1M).

Amortisation of investment in hotel management contracts is charged to profit or loss on a straight-line basis over the term of the relevant agreements.

L. Leased assets

Classification of assets leased to the group

Assets that are held by the group under leases which transfer to the group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the group are classified as operating leases, with the following exceptions:

- property held under operating leases that would otherwise meet the definition of an investment property is classified as an investment property on a property-by-property basis and, if classified as investment property, is accounted for as if held under a finance lease (see note 1J); and
- land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease, unless the building is also clearly held under an operating lease. For these purposes, the inception of the lease is the time that 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.

Assets acquired under finance leases

Where the group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments, of such assets are included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the company or group will obtain ownership of the asset, the life of the asset, as set out in note 1I. Impairment losses are accounted for in accordance with the accounting policy as set out in note 1M. Finance charges implicit in the lease payments are charged to profit or loss over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are written off as an expense of the accounting period in which they are incurred.

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. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

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.

M. Impairment of assets

Impairment of financial assets

Financial assets include loans granted by the group or company other than those regarded as long-term interests that in substance form part of the group's net investments in the associates and the jointly controlled entities, interests in equity instruments, and debtors (including trade debtors and receivables from related parties).

Financial assets that are stated at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, an impairment loss is determined and recognised as follows:

- For unquoted equity instruments and current debtors 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 debtors are reversed if in a subsequent period the amount of the impairment loss decreases. Impairment losses for equity instruments are not reversed.
- For financial assets carried at amortised cost (such as loans), 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 the asset). 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.

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:

- hotel and other properties, plant and equipment;
- pre-paid interests in leasehold land classified as being held under an operating lease;
- investment in hotel management contracts;
- interests in subsidiaries, associates and jointly controlled entities; and
- goodwill.

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

1. SIGNIFICANT ACCOUNTING POLICIES *continued*

M. Impairment of assets *continued*

Impairment of other assets *continued*

- Calculation of recoverable amount
  The recoverable amount of an asset or a cash-generating unit 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 time value of money and the risks specific to the asset or the cash-generating unit.

- Recognition of impairment losses
  An impairment loss is recognised in profit or loss whenever the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. Impairment losses recognised in respect of a cash-generating unit 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 the recoverable amount of an asset, or the cash-generating unit to which it belongs, exceeds its carrying amount. An impairment loss in respect of goodwill is not reversed.
  A reversal of an impairment loss is limited to the asset's or the cash-generating unit's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

N. Inventories

Land lots for sale and other inventories are carried at the lower of cost and net realisable value.

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

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

O. Trade debtors and other receivables

Trade debtors 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 1M), except where they are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, they are stated at cost less impairment losses for bad and doubtful debts (see note 1M).

P. 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.

Q. Trade creditors and other payables

Trade creditors 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.

R. 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.

S. Employee benefits

Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution plans 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.

Defined benefit retirement plan obligations

The group's net obligation in respect of defined benefit retirement plans is calculated separately for each plan 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 plan assets is deducted. The discount rate is the yield at the 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.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in profit or loss on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately, the expense is recognised immediately in profit or loss.

In calculating the group's obligation in respect of a plan, if any cumulative unrecognised actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in profit or loss over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation of the group's net obligation results in a negative amount, the asset recognised is limited to the net total of any cumulative unrecognised net actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

Termination benefits

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

1. SIGNIFICANT ACCOUNTING POLICIES *continued*

T. Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised directly in equity, in which case they are 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 their 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 assets can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax losses or credits can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

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.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

T. Income tax *continued*

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the company or the group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the company or the group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
  - the same taxable entity; or
  - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

U. Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the group or 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 expenditure expected to settle the obligation.

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

V. Revenue recognition

Provided it is probable that the economic benefits will flow to the group or company and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

Hotel and golf club operations

Revenue is recognised on a basis that reflects the timing, nature and value when the relevant services are provided.

Sales of land lots

Revenue is recognised upon the transfer of legal title of the land lots. Deposits and instalments received on land lots sold prior to the date of revenue recognition are included in the balance sheet under creditors.

Sale of goods and wholesaling

Revenue is recognised when goods are delivered and the related risks and rewards of ownership of the goods have been transferred to the customers. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

1. SIGNIFICANT ACCOUNTING POLICIES *continued*

V. Revenue recognition *continued*

Rental income from operating leases

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

Dividends

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

Interest income

Interest income is recognised as it accrues using the effective interest method.

W. Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss, except those arising from foreign currency borrowings used to hedge a net investment in a foreign operation which are recognised directly in equity (see note 1H).

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 exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items, including goodwill arising on consolidation of foreign operations acquired on or after 1 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 1 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.

X. Borrowing costs

Borrowing costs are expensed in 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 expenditure for the asset is 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.

1. SIGNIFICANT ACCOUNTING POLICIES *continued*

Y. 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 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.

Z. 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 system, the group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade debtors and fixed assets. Segment revenue, expenses, assets, and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

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

Unallocated items mainly comprise financial and corporate assets, interest-bearing borrowings, tax balances, corporate and financing expenses.

2. CHANGES IN ACCOUNTING POLICIES

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

The accounting policies of the group and/or company after the adoption of these new and revised HKFRS have been summarised in note 1. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

The group and/or company has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 40).

2. CHANGES IN ACCOUNTING POLICIES *continued*

A. Restatement of prior year and opening balances

The following tables disclose the adjustments that have been made in accordance with the transitional provisions of the respective HKFRS to each of the line items in the consolidated income statement and consolidated balance sheet and other significant related disclosure items as previously reported for the year ended 31 December 2004. The effects of the changes in accounting policies on the balances at 1 January 2004 and 2005 are disclosed in note 28.

Effect on the consolidated financial statements

Consolidated income statement for the year ended 31 December 2004 (HK$m)

	2004	Increase/(decrease) in net profit					2004
	(as previously reported)	HKAS 16 (note 2E)	HKAS 17 (note 2F)	HKAS 40 (note 2H)	HK(SIC)-INT 21 (note 2H)	Sub-total	*(as restated)*
Turnover	3,112	–	–	–	–	–	3,112
Other revenue	8	–	–	–	–	–	8
	3,120	–	–	–	–	–	3,120
Cost of inventories	(222)	–	–	–	–	–	(222)
Staff costs and related expenses	(996)	–	–	–	–	–	(996)
Rent and utilities	(238)	–	–	–	–	–	(238)
Other operating expenses	(678)	6	–	–	–	6	(672)
Operating profit before depreciation and amortisation (EBITDA)	986	6	–	–	–	6	992
Depreciation and amortisation	(96)	(137)	(7)	–	–	(144)	(240)
Operating profit	890	(131)	(7)	–	–	(138)	752
Financing charges	(243)	–	–	–	–	–	(243)
Share of losses of associates	(14)	–	–	–	–	–	(14)
Profit before non-operating items	633	(131)	(7)	–	–	(138)	495
Increase in fair value of investment properties	–	–	–	2,812	–	2,812	2,812
Other non-operating items	67	(4)	–	16	–	12	79
Profit before taxation	700	(135)	(7)	2,828	–	2,686	3,386
Taxation	(94)	(42)	–	–	(437)	(479)	(573)
Profit for the year	606	(177)	(7)	2,828	(437)	2,207	2,813
Attributable to:							
Equity shareholders of the company	574	(177)	(7)	2,833	(437)	2,212	2,786
Minority interests	32	–	–	(5)	–	(5)	27
Profit for the year	606	(177)	(7)	2,828	(437)	2,207	2,813
Earnings per share (HK cents)							
Basic	41	(13)	–	202	(31)	158	199
*Adjusted**	*37*	*(12)*	–	*34*	*(31)*	*(9)*	*28*

* *Adjusted for non-operating items, net of related tax and minority interests.*

2. CHANGES IN ACCOUNTING POLICIES *continued*

A. Restatement of prior year and opening balances *continued*

***Effect on the consolidated financial statements** continued*

Consolidated balance sheet at 31 December 2004 (HK$m)

	2004	Increase/(decrease) in net assets							2004
	(as previously reported)	HKFRS 3 (note 2C)	HKAS 1 (note 2D)	HKAS 16 (note 2E)	HKAS 17 (note 2F)	HKAS 40 (note 2H)	HK(SIC)-INT 21 (note 2H)	Sub-total	*(as restated)*
Non-current assets									
Properties, plant and equipment	7,631	–	–	(2,484)	(375)	(434)	–	(3,293)	4,338
Investment properties	15,227	–	–	(237)	–	488	–	251	15,478
Leasehold land	–	–	–	–	242	–	–	242	242
	22,858	–	–	(2,721)	(133)	54	–	(2,800)	20,058
Interests in associates	84	–	–	(4)	–	–	–	(4)	80
Interest in jointly controlled entity	137	–	–	–	–	–	–	–	137
Investment in hotel management contract	174	–	–	–	–	–	–	–	174
Interests in unlisted equity instruments	52	–	–	–	–	–	–	–	52
Deferred tax assets	42	–	–	(31)	–	–	(11)	(42)	–
	23,347	–	–	(2,756)	(133)	54	(11)	(2,846)	20,501
Current assets									
Inventories	74	–	–	–	–	–	–	–	74
Debtors and payments in advance	224	–	–	–	–	–	–	–	224
Cash and cash equivalents	262	–	–	–	–	–	–	–	262
	560	–	–	–	–	–	–	–	560
Current liabilities									
Creditors and accruals	(1,128)	–	–	–	–	–	–	–	(1,128)
Interest-bearing borrowings	(354)	–	–	–	–	–	–	–	(354)
Current taxation	(45)	–	–	–	–	–	–	–	(45)
	(1,527)	–	–	–	–	–	–	–	(1,527)
Net current liabilities	(967)	–	–	–	–	–	–	–	(967)
Total assets less current liabilities	22,380	–	–	(2,756)	(133)	54	(11)	(2,846)	19,534
Non-current liabilities									
Interest-bearing borrowings	(4,182)	–	–	–	–	–	–	–	(4,182)
Net defined benefit retirement obligation	(10)	–	–	–	–	–	–	–	(10)
Deferred tax liabilities	(202)	–	–	(187)	–	–	(1,997)	(2,184)	(2,386)
Minority interests	(602)	–	602	–	–	–	–	602	–
	(4,996)	–	602	(187)	–	–	(1,997)	(1,582)	(6,578)
Net assets	17,384	–	602	(2,943)	(133)	54	(2,008)	(4,428)	12,956

2. CHANGES IN ACCOUNTING POLICIES *continued*

A. Restatement of prior year and opening balances *continued*

Effect on the consolidated financial statements *continued*

Consolidated balance sheet at 31 December 2004 (HK$m) *continued*

	2004 (as previously reported)	HKFRS 3 (note 2C)	HKAS 1 (note 2D)	HKAS 16 (note 2E)	HKAS 17 (note 2F)	HKAS 40 (note 2H)	HK(SIC)-INT 21 (note 2H)	Sub-total	2004 (as restated)
		Increase/(decrease) in net assets							
Capital and reserves									
Share capital	701	–	–	–	–	–	–	–	701
Share premium and capital reserve	2,595	(4)	–	–	–	–	–	(4)	2,591
Revaluation reserves									
– Investment properties	11,367	–	–	–	–	(11,367)	–	(11,367)	–
– Hotel properties	1,394	–	–	(1,394)	–	–	–	(1,394)	–
– Other properties	2	–	–	(2)	–	–	–	(2)	–
Exchange reserve	(634)	–	–	1	–	3	–	4	(630)
General reserve	1,098	–	–	–	–	–	–	–	1,098
Retained profits	861	4	–	(1,550)	(133)	11,408	(2,008)	7,721	8,582
Total equity attributable to equity shareholders of the company	17,384	–	–	(2,945)	(133)	44	(2,008)	(5,042)	12,342
Minority interests	–	–	602	2	–	10	–	614	614
Total equity	17,384	–	602	(2,943)	(133)	54	(2,008)	(4,428)	12,956

2. CHANGES IN ACCOUNTING POLICIES *continued*

B. Estimated effect of changes in accounting policies on the current year

The following tables provide estimates of the extent to which each of the line items in the consolidated income statement and consolidated balance sheet and the company's balance sheet and other significant related disclosure items for the year ended 31 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.

(i) Effect on the consolidated financial statements

Estimated effect on the consolidated income statement for the year ended 31 December 2005 (HK$m)

	Increase/(decrease) in net profit					
	HKAS 16 (note 2E)	HKAS 17 (note 2F)	HKAS 32 & 39 (note 2G)	HKAS 40 (note 2H)	HK(SIC)-INT 21 (note 2H)	Total
Depreciation and amortisation	(142)	–	–	–	–	(142)
Profit before non-operating items	(142)	–	–	–	–	(142)
Increase in fair value of investment properties	–	–	–	1,089	–	1,089
Net gain on disposal of The Kowloon Hotel	1,073	133	23	(199)	–	1,030
Profit before taxation	931	133	23	890	–	1,977
Taxation	(32)	–	(4)	–	(169)	(205)
Profit for the year	899	133	19	890	(169)	1,772
Attributable to:						
Equity shareholders of the company	904	133	19	889	(169)	1,776
Minority interests	(5)	–	–	1	–	(4)
Profit for the year	899	133	19	890	(169)	1,772
Earnings per share (HK cents)						
Basic	64	9	1	63	(12)	125
*Adjusted**	*(12)*	–	–	–	–	*(12)*

* *Adjusted for non-operating items, net of related tax and minority interests.*

2. CHANGES IN ACCOUNTING POLICIES *continued*

B. Estimated effect of changes in accounting policies on the current year *continued*

(i) Effect on the consolidated financial statements *continued*

Estimated effect on the consolidated balance sheet at 31 December 2005 (HK$m)

	Increase/(decrease) in net assets						
	HKFRS 3 (note 2C)	HKAS 1 (note 2D)	HKAS 16 (note 2E)	HKAS 32 & 39 (note 2G)	HKAS 40 (note 2H)	HK(SIC)-INT 21 (note 2H)	Total
Non-current assets							
Properties, plant and equipment*	–	–	(1,625)	–	(88)	–	(1,713)
Investment properties	–	–	88	–	156	–	244
Derivative financial instruments	–	–	–	23	–	–	23
Deferred tax assets	–	–	–	–	–	(16)	(16)
	–	–	(1,537)	23	68	(16)	(1,462)
Current assets							
Derivative financial instruments	–	–	–	2	–	–	2
	–	–	–	2	–	–	2
Current liabilities							
Creditors and accruals	–	–	–	189	–	–	189
Interest-bearing borrowings	–	–	–	1	–	–	1
Derivative financial instruments	–	–	–	(5)	–	–	(5)
	–	–	–	185	–	–	185
Net current liabilities	–	–	–	187	–	–	187
Total assets less current liabilities	–	–	(1,537)	210	68	(16)	(1,275)
Non-current liabilities							
Interest-bearing borrowings	–	–	–	6	–	–	6
Derivative financial instruments	–	–	–	(204)	–	–	(204)
Deferred tax liabilities	–	–	(282)	–	–	(2,161)	(2,443)
Minority interests	–	710	–	–	–	–	710
	–	710	(282)	(198)	–	(2,161)	(1,931)
Net assets	–	710	(1,819)	12	68	(2,177)	(3,206)
Capital and reserves							
Capital reserve	(4)	–	–	–	–	–	(4)
Revaluation reserves							
– Investment properties	–	–	–	–	(12,424)	–	(12,424)
– Hotel properties	–	–	(371)	–	–	–	(371)
– Other properties	–	–	(2)	–	–	–	(2)
Hedging reserve	–	–	–	(15)	–	–	(15)
Exchange reserve	–	–	1	–	2	–	3
Retained profits	4	–	(1,447)	25	12,480	(2,177)	8,885
Total equity attributable to equity shareholders of the company	–	–	(1,819)	10	58	(2,177)	(3,928)
Minority interests		710	–	2	10	–	722
Total equity	–	710	(1,819)	12	68	(2,177)	(3,206)

* *The estimated effect is based on the fair value as at 31 December 2004.*

B. Estimated effect of changes in accounting policies on the current year *continued*

(i) Effect on the consolidated financial statements continued

Estimated effect on net income recognised directly in consolidated equity for the year ended 31 December 2005 (HK$m)

	Increase/(decrease) in equity		
	HKAS 39 (note 2G)	HKAS 40 (note 2H)	Total
Attributable to equity shareholders of the company	262	(858)	(596)
Total equity	262	(858)	(596)

(ii) Effect on the company's balance sheet

Estimated effect on the company's balance sheet at 31 December 2005 (HK$m)

	Increase/(decrease) in net assets HKAS 32 & 39 (note 2(g))
Non-current assets	
Derivative financial instruments	149
Deferred taxation	10
	159
Current assets	
Derivative financial instruments	3
Current liabilities	
Derivative financial instruments	(5)
Net current assets	(2)
Non-current liability	
Derivative financial instruments	(203)
Net assets	(46)
Capital and reserves	
Reserves	(46)
Total equity	(46)

2. CHANGES IN ACCOUNTING POLICIES *continued*

C. Amortisation of positive and negative goodwill (HKFRS 3, Business combinations and HKAS 36, Impairment of assets)

Amortisation of goodwill

In prior years:

- positive or negative goodwill which arose prior to 1 January 2001 was taken directly to reserves at the time it arose, and was not recognised in the income statement until disposal or impairment of the acquired business;
- positive goodwill which arose on or after 1 January 2001 was amortised on a straight line basis over its useful life and was subject to impairment testing when there were indications of impairment; and
- negative goodwill which arose on or after 1 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 income statement as those expected losses were incurred.

With effect from 1 January 2005, in order to comply with HKFRS 3 and HKAS 36, the accounting policies relating to goodwill have been changed. Under the new policy, the group no longer amortises positive goodwill but tests it at least annually for impairment. Also with effect from 1 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 profit or loss as it arises. Further details of these new policies are set out in note 1E.

The new policy in respect of the amortisation of positive goodwill has been applied prospectively in accordance with the transitional arrangements under HKFRS 3. The adjustments for each consolidated financial statement line affected for the year ended 31 December 2005 are set out in note 2B.

Also in accordance with the transitional arrangements under HKFRS 3, goodwill which had previously been taken directly to reserves (i.e. goodwill which arose before 1 January 2001) will not be recognised in profit or loss on disposal or impairment of the acquired business, or under any other circumstances.

The change in policy relating to negative goodwill had no effect on the financial statements as there was no negative goodwill deferred as at 31 December 2004.

D. Changes in presentation (HKAS 1, Presentation of financial statements)

Minority interests (HKAS 1, Presentation of financial statements and HKAS 27, Consolidated and separate financial statements)

In prior years, minority interests at the balance sheet date were presented in the consolidated balance sheet separately from liabilities and as deduction from net assets. Minority interests in the results of the group for the year were also separately presented in the income statement as a deduction before arriving at the profit attributable to shareholders (the equity shareholders of the company).

With effect from 1 January 2005, in order to comply with HKAS 1 and HKAS 27, the group has changed its accounting policy relating to presentation of minority interests. Under the new policy, minority interests are presented as part of equity, separately from interests attributable to the equity shareholders of the company. Further details of the new policy are set out in note 1C. These changes in presentation have been applied retrospectively with comparatives restated as shown in note 2A.

E. Properties, plant and equipment (HKAS 16, Property, plant and equipment and HK-Int 2, The appropriate policies for hotel properties)

In prior years, hotel properties including their integral fixed plant with an unexpired lease term of more than 20 years were included in the balance sheet at their open market value, on the basis of an annual third party professional valuation. No depreciation was provided in respect of hotel properties and their integral fixed plant since it was the group's practice to maintain hotel properties such that the residual values result in depreciation being insignificant. The related maintenance expenditure was dealt with in the income statement in the year in which it was incurred.

Other properties held for own use were stated in the balance sheet at their revalued amounts, adjusted for accumulated depreciation subsequent to the date of revaluation.

Changes in the value of hotel and other properties were dealt with as movements on their respective reserves on an individual basis, except:

- when a deficit arose on revaluation, it was charged to the income statement, if and to the extent that it exceeded the amount held in the reserve in respect of that same asset; and
- when a surplus arose on revaluation, it was credited to the income statement, if and to the extent that a deficit on revaluation in respect of that same asset, had previously been charged to the income statement.

In addition, golf courses were classified as investment properties and included in the balance sheet at their open market value, on the basis of annual third party professional valuation. No depreciation was provided in respect of golf courses since the valuation took into account the state of the golf courses at the date of valuation.

With effect from 1 January 2005, the group has changed its policy for hotel (including the hotel's integral fixed plant) and other properties, and golf courses, which are now stated at cost less accumulated depreciation and impairment. Further details of the new policy are set out in notes 1I and 1M. The change in policy has been applied retrospectively with comparatives restated as shown in note 2A.

F. Leasehold land and buildings (HKAS 17, Leases)

Leasehold land and buildings held for own use

In prior years, leasehold land and buildings held for own use were stated at revalued amounts less accumulated depreciation and accumulated impairment losses. Movements of revaluation surpluses or deficits were normally taken to the properties revaluation reserve.

With effect from 1 January 2005, in order to comply with HKAS 17, the group has adopted a new policy for leasehold land and buildings 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 1I and 1L. Any buildings held for own use which are situated on such land leases continue to be presented as part of property, plant and equipment. However, as from 1 January 2005 the buildings are also stated at cost less accumulated depreciation, rather than at fair value, to be consistent with the new policy required to be adopted for the land element.

Description of transitional provisions and effect of adjustments

All the above new accounting policies relating to leases have been adopted retrospectively. The adjustments for each financial statement line item affected for 31 December 2004 and 2005 are set out in notes 2A and 2B.

2. CHANGES IN ACCOUNTING POLICIES *continued*

G. Financial instruments (HKAS 32, Financial instruments: Disclosure and presentation and HKAS 39, Financial instruments: Recognition and measurement)

With effect from 1 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 1F to 1H, 1M and 1O to 1Q. Further details of the changes are as follows:

Interests in unlisted equity instruments

In prior years, investments in equity securities, other than those in subsidiaries, associates and jointly controlled entities, held on a continuing basis for an identifiable long-term purpose were classified as other investments and stated at cost less provision.

With effect from 1 January 2005, and in accordance with HKAS 39, these investments are classified as available-for-sale securities and disclosed as interests in equity instruments. There are no material adjustments arising from the adoption of the new policy. Further details of the new policies are set out in note 1F.

Derivative financial instruments

In prior years, derivative financial instruments entered into to hedge the interest rate risk of recognised assets or liabilities or the foreign currency risk of committed future or highly probable forecast transactions were recognised on an accrual basis with reference to the timing of recognition of the hedged items.

With effect from 1 January 2005, and in accordance with HKAS 39, all derivative financial instruments are stated at fair value. Changes in the fair value of derivatives that qualify for cash flow hedge accounting or that hedge the net investments in foreign operations 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 are recognised in profit or loss. Further details of the new policies are set out in notes 1G and 1H.

The changes in accounting policy for derivative financial instruments were adopted by way of opening balance adjustments to certain reserves as at 1 January 2005. Comparative amounts have not been restated as this is prohibited by the transitional arrangements in HKAS 39. The adjustments for each financial statement line item affected for the year ended 31 December 2005 are set out in note 2B.

H. Investment properties (HKAS 40, Investment property and HK(SIC) Interpretation 21, Income taxes – Recovery of revalued non-depreciable assets)

Changes in accounting policies relating to investment properties are as follows:

Timing of recognition of movements in fair value in the income statement

In prior years, movements in the fair value of the group's investment properties were recognised directly in the investment properties revaluation reserve except when, on a portfolio basis, the reserve was insufficient to cover a deficit on the portfolio, or when a deficit previously recognised in the income statement had reversed, or when an individual investment property was disposed of. In these limited circumstances movements in the fair value were recognised in the income statement.

In addition, land (including leasehold land) which the group held for an undetermined future purpose was accounted for under the cost model in SSAP 17, *Property, plant and equipment*, whereby the land was carried at cost less impairment losses.

Furthermore, the group's golf courses were classified as investment properties and were included in the balance sheet at open market value (see note 2E).

2. CHANGES IN ACCOUNTING POLICIES *continued*

H. Investment properties (HKAS 40, Investment property and HK(SIC) Interpretation 21, Income taxes – Recovery of revalued non-depreciable assets) *continued*

Timing of recognition of movements in fair value in the income statement *continued*

Upon adoption of HKAS 40 as from 1 January 2005, the group has adopted a new policy for investment properties. Under this new policy:

- all changes in the fair value of investment properties are recognised directly in the income statement in accordance with the fair value model in HKAS 40;
- land held for an undetermined future purpose is recognised as investment property if the property is freehold or, if the property is leasehold, the group has chosen to recognise such land as investment property rather than as land held under an operating lease; and
- golf courses are classified as properties, plant and equipment and are stated at cost less accumulated depreciation and impairment losses (see note 2E).

Further details of the new policy for investment properties are set out in note 1J.

Measurement of deferred tax on movements in fair value

In prior years, the group was required to apply the tax rate that would be applicable to the sale of investment properties to determine whether any amounts of deferred tax should be recognised on the revaluation of investment properties. Consequently, deferred tax was only provided to the extent that tax allowances already given would be clawed back if the properties were disposed of at their carrying value, as there would be no additional tax payable on disposal.

As from 1 January 2005, in accordance with HK(SIC) Interpretation 21, the group recognises deferred tax on movements in the value of an investment property using tax rates that are applicable to the property's use, if the group has no intention to sell it and the property would have been depreciable had the group not adopted the fair value model. Further details of the policy for deferred tax are set out in note 1T.

Description of transitional provisions and effect of adjustments

All the above changes in accounting policies relating to investment properties have been adopted retrospectively. The adjustments for each financial statement line item affected for 31 December 2004 and 2005 are set out in notes 2A and 2B.

I. Definition of related parties (HKAS 24, Related party disclosure)

As a result of the adoption of HKAS 24, *Related party disclosures*, the definition of related parties as disclosed in note 1Y 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 of related party transactions nor has it had any material effect on the disclosures made in the current year, as compared to those that would have been reported had SSAP 20, *Related party disclosures*, still been in effect.

3. TURNOVER (HK$m)

The company is an investment holding company. The group is principally engaged in the ownership and management of prestigious hotel, commercial and residential properties.

Turnover represents the gross amount invoiced for services, inventories and facilities including management fees and rental income. The amount of each significant category of revenue recognised in turnover during the year is as follows:

	2005	2004
Hotels		
Rooms	**1,297**	1,191
Food and beverage	**735**	715
Commercial rentals	**377**	382
Others	**253**	236
	2,662	2,524
Rentals from non-hotel properties	**374**	364
Other businesses	**233**	224
	3,269	3,112

4. OTHER REVENUE (HK$m)

	2005	2004
Dividend income from unlisted equity instruments	**3**	5
Interest income	**4**	3
	7	8

5. PROFIT BEFORE NON-OPERATING ITEMS (HK$m)

Profit before non-operating items is arrived at after charging/(crediting):

A. **Financing charges**

	2005	2004 *(restated)*
Interest on bank borrowings wholly repayable within five years	**106**	231
Interest on bank borrowings repayable after five years	**7**	11
Derivative financial instruments:		
cash flow hedges, transfer from equity	**43**	–
Other borrowing costs	**15**	3
	171	245
Less: Amount capitalised into assets under development*	**(8)**	(2)
	163	243

* *The average rate used to determine the amount of financing charges eligible for capitalisation was **1.9%** (2004: 1.5%)*

5. PROFIT BEFORE NON-OPERATING ITEMS (HK$m) *continued*

B. Other items

	2005	2004 *(restated)*
Amortisation		
– land lease premium	**1**	7
– hotel management contract	**6**	5
Depreciation	**231**	228
Auditors' remuneration		
– audit services	**7**	5
– tax	**1**	1
Foreign exchange gains	**1**	–
Operating lease charges: minimum lease payments		
– hire of other assets (including property rentals)	**69**	62
Rental receivable from investment properties less direct outgoings of **HK$27 million*** (2004: HK$30 million)	**(645)**	(644)

* *Direct outgoings of investment properties included HK$1 million incurred by The Peak Tower which was closed for renovation with effect from mid April 2005.*

6. NET GAIN ON DISPOSAL OF THE KOWLOON HOTEL (HK$m)

	2005	2004
Gain on disposal of The Kowloon Hotel (note 30)	**1,171**	–
Fair value changes of related derivative financial instruments	**(218)**	–
	953	–

The disposal of The Kowloon Hotel has resulted in a reduction in bank borrowings. To maintain the group's interest rate risk hedging policy, the loan interest hedging ratio was re-adjusted by way of offsetting swap arrangements rendering some swaps ineffective, which gave rise to a one-off loss of HK$218 million.

7. OTHER NON-OPERATING ITEMS (HK$m)

	2005	2004 *(restated)*
Gain on disposal of investment property	**60**	–
Reversal of impairment losses, net	**117**	91
Impairment loss on interests in associates	**–**	(5)
Others	**22**	(7)
	199	79

8. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT (HK$m)

A. Taxation in the consolidated income statement represents:

	2005	2004 *(restated)*
Current tax – Hong Kong Profits Tax		
Provision for the year	**38**	49
Over-provision in respect of prior years	**–**	(1)
	38	48
Current tax – Overseas		
Provision for the year	**80**	14
Under-provision in respect of prior years	**–**	5
	80	19
Deferred tax		
Increase in net deferred tax liabilities	**119**	506
Transfer from hedging reserve	**(29)**	–
Origination and reversal of temporary differences	**90**	506
	208	573

The above tax expenses include **HK$173 million** (2004 *restated*: HK$480 million) in respect of non-operating items.

The provision for Hong Kong Profits Tax for 2005 is calculated at **17.5%** (2004: 17.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant jurisdictions.

The directors consider that the provision for deferred tax liabilities with regard to revaluation of the group's investment properties in Hong Kong for the year amounting to **HK$169 million** (2004: HK$437 million) will not be payable on the grounds set out in note 21B.

B. Reconciliation between tax expense and accounting profit at applicable tax rates:

	2005	2004 *(restated)*
Profit before taxation	**2,929**	3,386
Notional tax at the domestic income tax rate of 17.5%	**513**	593
Tax effect of non-deductible expenses	**3**	17
Tax effect of non-taxable income	**(207)**	(61)
Tax effect of utilisation of tax losses	**(54)**	(26)
Tax effect of unused tax losses not recognised	**5**	3
Write off of tax losses expired	**6**	–
Recognition of prior years' tax losses	**(110)**	–
Effect of different tax rates of subsidiaries operating in other jurisdictions	**61**	37
Others	**(9)**	10
Actual tax expense	**208**	573

9. DIRECTORS' AND SENIOR MANAGEMENT'S REMUNERATION

There are three components of remuneration paid to executive directors, as well as senior management and other staff.

Basic compensation
Basic compensation consists of base salary, housing and other allowances and benefits. Basic compensation is reviewed annually taking into account market conditions and individual performance.

Bonuses and incentives
Bonus payments depend on individual performance and the performance of the group. In addition, certain incentive payments have been defined in the individual employment contracts.

Retirement benefits
Retirement benefits relate to the group's contribution to retirement funds.

For non-executive directors, fees are set in line with market practice, taking account of comparable Hong Kong listed companies, and at present are fixed at HK$100,000 per annum. Non-executive directors who are also members of the Executive Committee or the Audit Committee are also entitled to a fixed fee of HK$100,000 per annum for each committee.

Remuneration for directors disclosed pursuant to section 161 of the Hong Kong Companies Ordinance and that for senior management disclosed pursuant to corporate governance best practice are as follows:

	Directors' fees (HK$'000)	Basic compensation (HK$'000)	Bonuses & incentives (HK$'000)	Retirement benefits (HK$'000)	Total (HK$'000)
2005					
*Executive directors**					
Mr Clement K M Kwok	–	4,289	5,189	651	10,129
Mr C Mark Broadley	–	3,579	2,001	540	6,120
Mr Peter C Borer	–	3,098	1,095	450	4,643
Non-executive directors					
The Hon. Sir Michael Kadoorie	200	–	–	–	200
Mr Ian D Boyce	300	–	–	–	300
Mr James S Dickson Leach	200	–	–	–	200
Sir Sidney Gordon	100	–	–	–	100
Mr Ronald J McAulay	100	–	–	–	100
Mr William E Mocatta	100	–	–	–	100
Mr Pierre R Boppe	100	–	–	–	100
Independent non-executive directors					
Dr The Hon. Sir David K P Li	100	–	–	–	100
Mr Robert C S Ng	200	–	–	–	200
Mr Robert W Miller	100	–	–	–	100
Mr Patrick B Paul	200	–	–	–	200
Senior management (other members of Group Management Committee)*					
Mr J Niklaus Leuenberger	–	3,394	502	187	4,083
Mr Martyn P A Sawyer	–	2,743	353	268	3,364
	1,700	**17,103**	**9,140**	**2,096**	**30,039**

9. DIRECTORS' AND SENIOR MANAGEMENT'S REMUNERATION *continued*

	Directors' fees (HK$'000)	Basic compensation (HK$'000)	Bonuses & incentives (HK$'000)	Retirement benefits (HK$'000)	Total (HK$'000)
2004					
*Executive directors**					
Mr Clement K M Kwok	–	4,261	3,580	651	8,492
Mr C Mark Broadley	–	3,587	1,549	540	5,676
Mr Peter C Borer#	–	2,984	650	405	4,039
Non-executive directors					
The Hon. Sir Michael Kadoorie	200	–	–	–	200
Mr Ian D Boyce	300	–	–	–	300
Mr James S Dickson Leach	200	–	–	–	200
Sir Sidney Gordon	100	–	–	–	100
Mr Ronald J McAulay	100	–	–	–	100
Mr William E Mocatta	100	–	–	–	100
Mr Pierre R Boppe	100	–	–	–	100
Independent non-executive directors					
Dr The Hon. Sir David K P Li	100	–	–	–	100
Mr Robert C S Ng	200	–	–	–	200
Mr Robert W Miller	100	–	–	–	100
Mr Patrick B Paul	169	–	–	–	169
Senior management (other members of Group Management Committee)*					
Mr J Niklaus Leuenberger	–	3,203	471	180	3,854
Mr Martyn P A Sawyer	–	2,695	286	283	3,264
	1,669	16,730	6,536	2,059	26,994

* *The Group Management Committee, the company's management and operations decision-making authority, is comprised of the three executive directors and two senior executives who represent the various key functions and operations of the company.*

Peter C Borer was a member of Group Management Committee throughout 2004 and was appointed as an executive director of the company on 15 April 2004.

10. INDIVIDUALS WITH HIGHEST EMOLUMENTS (HK$m)

Of the five individuals with the highest emoluments, **three** (2004: three) are directors whose emoluments are disclosed in note 9. The aggregate of the emoluments in respect of the other **two** (2004: two) individuals are as follows:

	2005	2004
Basic compensation	**6**	6
Bonuses & incentives	**1**	1
Retirement benefits	**–**	–
	7	7

10. INDIVIDUALS WITH HIGHEST EMOLUMENTS (HK$m) *continued*

The emoluments of the other **two** (2004: two) individuals with the highest emoluments are within the following bands:

	2005 Number	2004 Number
HK$3,000,001 – HK$3,500,000	**1**	1
HK$3,500,001 – HK$4,000,000	**–**	1
HK$4,000,001 – HK$4,500,000	**1**	–
	2	2

11. PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the company includes a profit of **HK$670 million** (2004: HK$225 million) which has been dealt with in the financial statements of the company.

12. EARNINGS PER SHARE

A. Earnings per share – basic

	2005	2004 *(restated)*
Profit attributable to equity shareholders of the company (HK$m)	**2,664**	2,786
Weighted average number of shares in issue (million shares)*	**1,411**	1,402
Earnings per share (HK cents)	**189**	199

B. Earnings per share – adjusted

	2005	2004 *(restated)*
Profit attributable to equity shareholders of the company (HK$m)	**2,664**	2,786
Less:		
Increase in fair value of investment properties (HK$m)	**(1,089)**	(2,812)
Net gain on disposal of The Kowloon Hotel (HK$m)	**(953)**	–
Other non-operating items (HK$m)	**(199)**	(79)
Add:		
Tax and minority interests attributable to non-operating items (HK$m)	**218**	491
Earnings excluding non-operating items and related tax and minority interests effects (HK$m)	**641**	386
Earnings per share – adjusted (HK cents)	***45***	*28*

* *Weighted average number of shares* (million)

	2005	2004
Issued shares at 1 January	**1,402**	1,402
Effect of new shares issued and allotted as part consideration to acquire a subsidiary (note 29)	**4**	–
Effect of new shares issued and allotted to shareholders who opted to take scrip as an alternative to cash in respect of the 2004 final and 2005 interim dividends	**5**	–
Weighted average number of shares at 31 December	**1,411**	1,402

13. DIVIDENDS (HK$m)

A. Dividends payable to equity shareholders of the company attributable to the year

	2005	2004
Interim dividend declared and paid of **4 cents** per share (2004: 3 cents per share)	**57**	42
Final dividend proposed after the balance sheet date of **10 cents** per share (2004: 9 cents per share)	**142**	126
	199	168

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	2004
Final dividend in respect of the previous financial year, approved and paid during the year, of **9 cents** per share (2004: 8 cents per share)	**126**	112

14. SEGMENT REPORTING (HK$m)

Segment information is presented in respect of the group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the group in making operating and financial decisions. The revenue and operating performance of the group's hotel business segment are subject to a higher degree of seasonal volatility by nature whilst those for the group's property leasing segment are subject to a relatively lower degree of seasonality.

A. Business segments

The group is comprised of the following main business segments:

Hotels	Hotel room accommodation, leasing of commercial shopping arcades and office premises, provision of food and beverage at restaurant outlets, operation of retail outlets and other minor departments such as spa, telephone, guest transportation and laundry within the hotel premises.
Rentals from non-hotel properties	Leasing of commercial and office premises (other than those in hotel properties) and residential apartments.
Other businesses	Various other businesses including operation of golf courses, the Peak Tramways, food and beverage outlets other than those in owned hotels, wholesaling of food and beverage products, laundry, and provision of management and consultancy services for clubs.

14. SEGMENT REPORTING (HK$m) *continued*

A. Business segments *continued*

	Hotels 2005	Hotels 2004 (restated)	Rentals from non-hotel properties 2005	Rentals from non-hotel properties 2004 (restated)	Other businesses 2005	Other businesses 2004 (restated)	Consolidated 2005	Consolidated 2004 (restated)
Segment turnover and results – for the year ended 31 December								
Turnover								
Total segment	**2,663**	2,532	**375**	364	**252**	244	**3,290**	3,140
Inter-segment	**(1)**	(8)	**(1)**	–	**(19)**	(20)	**(21)**	(28)
	2,662*	2,524	**374**	364	**233**	224	**3,269**	3,112
Segment operating profit before depreciation and amortisation	**769**	664	**263**	260	**60**	68	**1,092**	992
Depreciation and amortisation	**(213)**	(211)	**–**	–	**(25)**	(29)	**(238)**	(240)
Segment operating profit	**556**	453	**263**	260	**35**	39	**854**	752
Financing charges							**(163)**	(243)
Share of losses of jointly controlled entity/associates	**(3)**	(14)	**–**	–	**–**	–	**(3)**	(14)
Profit before non-operating items							**688**	495
Increase in fair value of investment properties							**1,089**	2,812
Net gain on disposal of The Kowloon Hotel							**953**	–
Other non-operating items							**199**	79
Profit before taxation							**2,929**	3,386
Taxation							**(208)**	(573)
Profit for the year							**2,721**	2,813
Segment balance sheet – as at 31 December								
Properties, plant and equipment	**4,086**	3,986	–	–	**320**	352	**4,406**	4,338
Investment properties	**6,142**	5,989	**9,646**	9,024	**367**	465	**16,155**	15,478
Leasehold land	**–**	242	**–**	–	**–**	–	**–**	242
Interests in associates	**–**	80	**–**	–	**–**	–	**–**	80
Interest in jointly controlled entity	**446**	137	**–**	–	**–**	–	**446**	137
Investment in hotel management contract	**168**	174	**–**	–	**–**	–	**168**	174
Interests in unlisted equity instruments	**43**	43	**–**	–	**9**	9	**52**	52
Other segment assets	**232**	225	**21**	14	**40**	59	**293**	298
Derivative financial instruments							**25**	–
Taxation recoverable							**3**	–
Deferred tax assets							**123**	–
Cash and cash equivalents							**301**	262
Total assets							**21,972**	21,061
Liabilities								
Segment liabilities	**639**	638	**185**	134	**64**	366	**888**	1,138
Bank loans and other liabilities							**5,478**	6,967
Total liabilities							**6,366**	8,105
Capital expenditure incurred during the year	**626**	207	**136**	55	**33**	12	**795**	274

14. SEGMENT REPORTING (HK$m) *continued*

A. Business segments *continued*

* *Analysis of hotels' turnover*

	2005	2004
Rooms	**1,297**	1,191
Food and beverage	**735**	715
Commercial rental	**377**	382
Others	**253**	236
	2,662	2,524

B. Geographical segments

The group's hotel operations and property rental businesses are principally located in Hong Kong, the People's Republic of China, Thailand, The Philippines, Vietnam and the United States of America. The golf course operations are located in Thailand and the United States of America. Other miscellaneous businesses are mostly conducted in Hong Kong.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location in which the business operation is conducted. Segment assets and capital expenditure are based on the geographical location of the assets.

	Hong Kong		Other Asia		United States of America	
	2005	2004 (restated)	2005	2004 (restated)	2005	2004 (restated)
For the year ended 31 December						
Revenue from external customers	**1,411**	1,566	**775**	567	**1,083**	979
Segment assets	**15,442**	15,003	**3,494**	3,153	**2,584**	2,643
Capital expenditure incurred during the year	**197**	94	**562**	145	**36**	35
Depreciation and amortisation	**54**	69	**77**	62	**107**	109

15. FIXED ASSETS

A. Movements of fixed assets (HK$m)

	Freehold land	Hotel and other buildings held for own use	Plant, machinery and other fixed assets	Sub-total	Investment properties	Interests in leasehold land held under operating leases	Total fixed assets
Cost or valuation:							
At 1 January 2004 *(restated)*	873	4,882	3,029	8,784	12,588	376	21,748
Exchange adjustments	8	19	12	39	16	–	55
Additions	–	79	132	211	63	–	274
Disposals	–	(2)	(65)	(67)	(1)	–	(68)
Fair value adjustment	–	–	–	–	2,812	–	2,812
At 31 December 2004 *(restated)*	881	4,978	3,108	8,967	15,478	376	24,821
Representing:							
Cost *(restated)*	881	4,978	3,108	8,967	–	376	9,343
Valuation – 2004	–	–	–	–	15,478	–	15,478
	881	4,978	3,108	8,967	15,478	376	24,821
At 1 January 2005 *(restated)*	881	4,978	3,108	8,967	15,478	376	24,821
Exchange adjustments	(29)	(52)	(29)	(110)	(8)	–	(118)
Additions							
– through acquisition of subsidiary	–	340	72	412	8	–	420
– others	–	50	191	241	134	–	375
Disposals							
– through disposal of subsidiary	–	(45)	(211)	(256)	(452)	(375)	(1,083)
– others	–	–	(86)	(86)	(94)	–	(180)
Fair value adjustment	–	–	–	–	1,089	–	1,089
At 31 December 2005	852	5,271	3,045	9,168	16,155	1	25,324
Representing:							
Cost	852	5,271	3,045	9,168	–	1	9,169
Valuation – 2005	–	–	–	–	16,155	–	16,155
	852	5,271	3,045	9,168	16,155	1	25,324
Accumulated depreciation:							
At 1 January 2004 *(restated)*	344	2,159	2,013	4,516	–	127	4,643
Exchange adjustments	5	12	2	19	–	–	19
Charge for the year	–	91	137	228	–	7	235
Reversal of impairment losses	(10)	(69)	(12)	(91)	–	–	(91)
Written back on disposals	–	(1)	(42)	(43)	–	–	(43)
At 31 December 2004 *(restated)*	339	2,192	2,098	4,629	–	134	4,763
At 1 January 2005 *(restated)*	339	2,192	2,098	4,629	–	134	4,763
Exchange adjustments	(14)	(34)	(4)	(52)	–	–	(52)
Through acquisition of subsidiary	–	173	63	236	–	–	236
Charge for the year	–	100	131	231	–	1	232
Provision for/(reversal of) impairment losses	19	(15)	18	22	–	–	22
Written back on disposals							
– through disposal of subsidiary	–	(37)	(196)	(233)	–	(134)	(367)
– others	–	–	(71)	(71)	–	–	(71)
At 31 December 2005	344	2,379	2,039	4,762	–	1	4,763
Net book value:							
At 31 December 2005	**508**	**2,892**	**1,006**	**4,406**	**16,155**	**–**	**20,561**
At 31 December 2004 *(restated)*	542	2,786	1,010	4,338	15,478	242	20,058

15. FIXED ASSETS *continued*

A. **Movements of fixed assets** (HK$m) *continued*

Impairment loss

The group assessed the recoverable amounts of its fixed assets (other than investment properties) at the balance sheet date in accordance with the policy as disclosed in note 1M. Based on the assessment, the directors considered that, due to the significant improvement in the operating performance of The Peninsula New York and in the New York hotel property market, the impairment provision previously made against this property should be fully reversed by **HK$62 million** to its original cost less accumulated depreciation that would have been determined had no impairment been recognised for the property in prior years (2004 *restated*: partially reversed by HK$52 million). The reversal of the impairment provision was determined based on the recoverable amount of the property, by reference to its estimated fair value less costs to sell which has been assessed with reference to prevailing market conditions.

However, the directors considered that Quail Lodge Resort and Golf Club was further impaired as at 31 December 2005, as a result of an adverse operating environment. On this basis, its carrying amount was written down by **HK$86 million** (2004 *restated*: HK$44 million) to its recoverable amount which is its estimated fair value less costs to sell which has been assessed with reference to prevailing market conditions.

As at 31 December 2004, the directors considered that, due to the improvement in the property market in Thailand, the impairment provisions previously made against The Peninsula Bangkok and the Thai Country Club should be reversed by HK$73 million and HK$10 million respectively. The reversal of the impairment provisions was determined based on the recoverable amounts of respective properties, by reference to the estimated fair value less costs to sell which was assessed with reference to prevailing market conditions.

B. All investment properties of the group were revalued as at 31 December 2005 on an open market value basis calculated by reference to net rental income allowing for reversionary income potential. The valuations were carried out by firms of surveyors independent of the group, details of which are as follows:

Description of investment properties	Name of valuer	Qualification of employees conducting the valuation
Hong Kong		
– Retail shops, office, and residential apartments	Savills (Hong Kong) Limited	Members of The Hong Kong Institute of Surveyors
Other Asia *		
– Retail shops, office, residential apartments and vacant land	Sallmanns (Far East) Limited Savills (Hong Kong) Limited	Members of Royal Institution of Chartered Surveyors and The Valuers Association of Thailand
United States of America		
– Retail shops and vacant land	HVS International Jones Lang LaSalle Hotels	Members of the Appraisal Institute, United States of America

* *Other Asia includes the People's Republic of China, Thailand, The Philippines and Vietnam.*

15. FIXED ASSETS *continued*

C. The analysis of net book value of land held by the group is as follows (HK$m):

		2005	2004 *(restated)*
Hong Kong	– long term leases	**12,819**	12,435
	– medium term leases	**231**	118
		13,050	12,553
Thailand	– freehold	**562**	685
Vietnam	– medium term lease	**48**	48
Other Asia		**610**	733
United States of America	– freehold	**333**	344
		13,993	13,630
Representing:			
Land classified as investment properties, at fair value		**13,485**	12,846
Leasehold land held for own use under operating leases, at cost less accumulated amortisation		**–**	242
Freehold land held for own use		**508**	542
		13,993	13,630

D. Fixed assets leased out under operating leases

The group leases out its investment properties under operating leases. The leases typically run for an initial period of one to five years, with or without options to renew the leases after that date at which time all terms are renegotiated. Contingent rentals of these leases were immaterial during 2005 and 2004. All properties held under operating lease that would otherwise meet the definition of investment property are classified as investment property. Future minimum rentals receivable under non-cancellable operating leases of these properties are disclosed in note 34B.

E. Major assets under development

Included under plant, machinery and other fixed assets are assets under development in relation to The Peninsula Tokyo project at 31 December 2005 amounting to **HK$216 million** (2004: HK$198 million), which was not subject to depreciation.

15. FIXED ASSETS *continued*

F. **Hotel and investment properties, all held through subsidiary companies, are as follows:**

	Usage
Held in Hong Kong:	
Long term leases (over 50 years):	
The Peninsula Hong Kong, Salisbury Road	Hotel and commercial rentals
The Peninsula Office Tower, 18 Middle Road	Office
The Repulse Bay, 109 Repulse Bay Road	Residential and commercial rentals
Repulse Bay Apartments, 101 Repulse Bay Road	Residential
Repulse Bay Garage, 60 Repulse Bay Road	Commercial rentals
St John's Building, 33 Garden Road	Office
Medium term leases (between 20 and 50 years):	
The Peak Tower, 128 Peak Road	Commercial rentals (under redevelopment at 31 December 2005)
Held in the People's Republic of China:	
Medium term lease (between 20 and 50 years):	
The Peninsula Palace Beijing, 8 Goldfish Lane, Wangfujing, Beijing	Hotel and commercial rentals
Held in Thailand:	
Freehold:	
The Peninsula Bangkok, 333 Charoennakorn Road, Klongsan, Bangkok 10600	Hotel
Thai Country Club, Bangna-Trad, Chachoengsao	Golf club
Land plots, Bangpakong District, Chachoengsao	Undetermined
Held in The Philippines:	
Medium term lease (between 20 and 50 years):	
The Peninsula Manila, Corner of Ayala and Makati Avenues, 1226 Makati City, Metro Manila	Hotel and commercial rentals
Held in Vietnam:	
Medium term lease (between 20 and 50 years):	
The Landmark, 5B Ton Duc Thang, District 1, Ho Chi Minh City	Residential and commercial rentals
Held in the United States of America:	
Freehold/leasehold:	
Quail Lodge Resort and Golf Club, 8205 Valley Greens Drive, Carmel, California	Hotel and golf club
Vacant land, near Quail Lodge	Undetermined
Freehold/long term leasehold to air rights (over 50 years):	
The Peninsula Chicago, 108 East Superior Street (at North Michigan Avenue), Chicago, Illinois	Hotel
Long term lease (over 50 years):	
The Peninsula New York, 700 Fifth Avenue at 55th Street, New York	Hotel and commercial rentals

16. INVESTMENTS IN SUBSIDIARIES (HK$m)

	Company 2005	Company 2004 (restated)
Unlisted shares, at cost	**94**	–
Provision for impairment	**(23)**	–
	71	–

Particulars of subsidiaries which principally contributed to the results, assets or liabilities of the group are presented on page 154. All of these are controlled subsidiaries as defined under note 1C and hence have been consolidated into the group financial statements.

17. INTERESTS IN ASSOCIATES (HK$m)

	Group 2005	Group 2004 (restated)	Company 2005	Company 2004
Unlisted shares, at cost	**–**	147	**–**	24
Less: Amounts written off against general reserve				
– Goodwill	**–**	(1)	**–**	–
– Exchange losses on translation	**–**	(37)	**–**	–
	–	109	**–**	24
Less: Share of post acquisition losses	**–**	(62)	**–**	–
Share of net assets	**–**	47	**–**	24
Loans to associates (note 17B)	**–**	38	**–**	26
	–	85	**–**	50
Impairment loss (note 7)	**–**	(5)	**–**	–
	–	80	**–**	50

A. Details of associates are as follows:

Company name	Form of business structure	Place of incorporation/ formation	Particulars of issued and paid up capital	Proportion of ownership interest: Group's effective interest	Held directly by company	Held indirectly by subsidiary	Principal activity
As at 31 December 2005:							
Valley Resort Management, LLC	Limited liability company	United States of America	Contributed capital of US$50,000	50%	–	50%	Resort management
As at 31 December 2004:							
Manila Peninsula Hotel, Inc. (MPHI) (see note 29)	Incorporated	The Philippines	94,420,107 shares of Pesos 10 each	40%	7.55%	32.45%	Hotel
RipBion! Limited ("RipBion!") (see note 17C)	Incorporated	Hong Kong	2 shares of HK$1 each	50%	–	50%	Museum operation
Valley Resort Management, LLC	Limited liability company	United States of America	Contributed capital of US$50,000	50%	–	50%	Resort management

17. INTERESTS IN ASSOCIATES (HK$m) *continued*

B. The balance as at 31 December 2004 comprises loans of HK$26 million and HK$12 million to MPHI and RipBion! respectively.

The loan to MPHI was unsecured, repayable on demand and bore interest at a rate related to London inter-bank lending rate. Pursuant to the Convertible Loan Memorandum dated 10 March 2002, the company had the right to convert the outstanding principal into shares in MPHI in the event of a rights issue or public offering of MPHI's shares at a price not higher than that of the shares offered to the stockholders or to the public. Following the completion of acquisition of an additional 31.68% equity interest in MPHI through a conditional offer on 3 March 2005, the company exercised its right under the Convertible Loan Memorandum and converted the loan into additional shares in MPHI. Details of this business combination and loan conversion are further disclosed in notes 29 and 30.

The loan to RipBion! was granted through The Peak Tower Limited, a wholly owned subsidiary of the company. The loan was unsecured, interest-free and repayable on demand. RipBion! ceased business on 21 March 2005 as a result of the renovation of The Peak Tower and has remained inactive since then.

C. **Summary financial information on associates:**

	Group	
	2005	2004
Total assets	**3**	228
Total liabilities	**(3)**	(107)
Net assets	**–**	121
Group's share of associates' net assets	**–**	47
Revenue	**30**	193
Loss	**–**	(36)
Group's share of associates' losses	**–**	(14)

18. INTEREST IN JOINTLY CONTROLLED ENTITY (HK$m)

	Group	
	2005	2004
Unlisted shares, at cost (note 18A)	**–**	–
Share of exchange difference	**4**	–
Share of losses	**(3)**	–
Share of net assets	**1**	–
Loan to jointly controlled entity (note 18B)	**445**	137
	446	137

A. Details of the jointly controlled entity are as follows:

				Proportion of ownership interest			
Company name	Form of business structure	Place of incorporation/ formation	Particulars of issued and paid up capital	Group's effective interest	Held directly by company	Held indirectly by subsidiary	Principal activity
The Peninsula Shanghai (BVI) Limited (TPS)*	Incorporated	British Virgin Islands	US$1,000	50%	–	50%	Investment holding

* *TPS holds a 100% direct interest in The Peninsula Shanghai Waitan Hotel Company Limited (PSW), a wholly foreign-owned enterprise incorporated in the People's Republic of China. PSW is engaged in the project for the development and construction of a hotel to be branded "The Peninsula Shanghai", a Peninsula apartment hotel, a retail arcade and ancillary facilities. At 31 December 2005, the paid up capital of PSW amounted to* ***US$70,000,000*** *(2004: US$35,174, 000)*

18. INTEREST IN JOINTLY CONTROLLED ENTITY (HK$m) *continued*

B. The loan to the jointly controlled entity is denominated in US dollars, unsecured and interest-free, and has no fixed repayment terms. The loan was on-lent to PSW on an interest-free basis for the purpose of funding the development of the project described in note 18A above.

C. Set out below is a summary of the financial information on the jointly controlled entity, of which the group has a 50% share.

	2005	2004
Non-current assets	**916**	263
Current assets	**21**	11
Current liabilities	**(42)**	–
Non-current liabilities	**(892)**	(274)
Net assets	**3**	–
Income	**–**	–
Expenses	**(6)**	–
Loss for the year	**(6)**	–

19. INTERESTS IN UNLISTED EQUITY INSTRUMENTS (HK$m)

	Group	
	2005	2004
Unlisted equity securities, at cost	**129**	129
Less: Impairment loss	**(77)**	(77)
	52	52

Unlisted equity securities include:

	Ownership interest held indirectly	Place of incorporation/ establishment
The Belvedere Hotel Partnership	20%	United States of America
PT Ciputra Adigraha	20%	Indonesia

The Belvedere Hotel Partnership (BHP) holds a 100% interest in The Peninsula Beverly Hills. PT Ciputra Adigraha remained inactive during the year. The group is not in a position to exercise significant influence over these investments.

BHP has pledged its hotel property and other assets to an independent financial institution as security for BHP's loan facility amounting to **US$76 million** (2004: US$78 million) and the net carrying amount of these pledged assets amounted to **US$65 million** (2004: US$62 million).

20. DERIVATIVE FINANCIAL INSTRUMENTS (HK$m)

A. Group

	31 December 2005		1 January 2005	
	Assets	Liabilities	Assets	Liabilities
Cash flow hedges				
Interest rate swaps	**6**	**(32)**	3	(310)
Forward foreign exchange contracts	**3**	**–**	–	(29)
Currency swap	**2**	**–**	17	–
	11	**(32)**	20	(339)
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**–**	**(166)**	–	–
Others	**14**	**(11)**	6	(37)
Total	**25**	**(209)**	26	(376)
Less: Current portion				
Cash flow hedges:				
Interest rate swaps	**–**	**–**	–	(5)
Forward foreign exchange contracts	**2**	**–**	–	–
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**–**	**(5)**	–	–
	2	**(5)**	–	(5)
Non-current portion	**23**	**(204)**	26	(371)

During the year, upon the completion of the sale of The Kowloon Hotel and the reduction of bank borrowings in this connection, offsetting interest rate swaps were entered into for the purposes of re-adjusting the loan interest fixing ratio. As a result, some outstanding cash flow hedges became ineffective and were reclassified as interest rate swaps held for trading.

B. Company

	31 December 2005		1 January 2005	
	Assets	Liabilities	Assets	Liabilities
Cash flow hedges				
Interest rate swaps	**–**	**(56)**	–	–
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**152**	**(152)**	318	(318)
Total	**152**	**(208)**	318	(318)
Less: Current portion				
Cash flow hedges:				
Interest rate swaps	**–**	**(2)**	–	–
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**3**	**(3)**	5	(5)
	3	**(5)**	5	(5)
Non-current portion	**149**	**(203)**	313	(313)

21. INCOME TAX IN THE BALANCE SHEET (HK$m)

A. Current taxation in the balance sheet represents:

	Group		Company	
	2005	2004	**2005**	2004
Provision for Hong Kong Profits Tax for the year	**38**	49	**20**	9
Provisional profits tax paid	**(18)**	(25)	**–**	(5)
	20	24	**20**	4
Balance of profits tax provision relating to prior years	**3**	3	**2**	–
Provision for overseas taxes	**52**	18	**–**	–
	75	45	**22**	4

Analysed as follows:

	Group		Company	
	2005	2004	**2005**	2004
Taxation recoverable	**(3)**	–	**–**	–
Current taxation	**78**	45	**22**	4
	75	45	**22**	4

B. Deferred tax assets and liabilities recognised

The components of deferred tax (assets)/liabilities of the group recognised in the consolidated balance sheet and the movements during the year are as follows:

	Group					
	Investment properties*	Tax allowances in excess of the related depreciation	Provisions and others	Tax losses	Cash flow hedges	Total
Deferred tax arising from:						
At 1 January 2004 *(restated)*	1,644	407	(21)	(150)	-	1,880
Charged/(credited) to profit or loss	490	8	(1)	9	-	506
At 31 December 2004 *(restated)*	2,134	415	(22)	(141)	-	2,386
At 1 January 2005 (restated before opening balance adjustments)	2,134	415	(22)	(141)	–	2,386
– opening balance adjustments	–	–	–	–	(53)	(53)
At 1 January 2005 (as restated and after opening balance adjustments)	2,134	415	(22)	(141)	(53)	2,333
Acquisition of a subsidiary	–	–	–	(6)	–	(6)
Disposal of a subsidiary	–	(7)	–	–	–	(7)
Charged/(credited) to profit or loss	164	85	(1)	(129)	–	119
Charged/(credited) to reserves	(3)	(1)	(1)	–	20	15
At 31 December 2005	2,295	492	(24)	(276)	(33)	2,454

* *In prior years, the deferred tax effects in respect of revalued investment properties were assessed on the basis of the tax consequence that would follow from recovery of the carrying amount of the properties through sale. HK(SIC)-Int 21 "Deferred taxes – Recovery of revalued non-depreciable assets" now removes the aforesaid presumption and requires deferred tax effects arising from the revaluation of investment properties be measured on the basis of tax consequences that would follow from recovery of the carrying amount through use, at the profits tax rate. The application of this new interpretation has necessitated a restatement of the opening deferred tax liabilities. Accordingly, within the group's overall deferred tax provisions, a provision for deferred tax liabilities with regard to revaluation of the group's investment properties in Hong Kong amounting to **HK$2,177 million** (2004: HK$2,008 million) has been made.*

However, it should be noted that the directors have no intention of selling these properties; and should any such sale eventuate, any gain would be regarded as capital in nature and would not be subject to any tax in Hong Kong.

21. INCOME TAX IN THE BALANCE SHEET (HK$m) *continued*

B. Deferred tax assets and liabilities recognised *continued*

	Group 2005	Group 2004 (restated)
Net deferred tax asset recognised on the balance sheet	**(123)**	–
Net deferred tax liability recognised on the balance sheet	**2,577**	2,386
	2,454	2,386

	Company 2005	Company 2004
Deferred tax asset arising from cash flow hedges	**10**	–

C. Deferred tax assets not recognised

The group has not recognised the following potential deferred tax assets:

	Group 2005	Group 2004 (restated)
Depreciation allowances in excess of book depreciation	**44**	(6)
Timing difference on amortisation	**–**	14
Future benefit of tax losses	**144**	673
Revaluation deficits	**11**	19
Provision and others	**8**	–
	207	700

In accordance with the accounting policy set out in note 1T, the group has not recognised deferred tax assets in respect of certain cumulative tax losses of **HK$556 million** (2004: HK$2,203 million) as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdiction and entity. Details of the expiry date of unused tax losses are as follows:

	Group 2005	Group 2004
Within 1 year	**238**	421
After 1 year but within 5 years	**69**	651
After 5 years but within 10 years	**8**	242
After 10 years but within 15 years	**–**	491
Without expiry date	**241**	398
	556	2,203

D. Deferred tax liabilities not recognised

At 31 December 2005, the group does not have any unrecognised deferred tax liabilities relating to undistributed profits of subsidiaries (2004: HK$3 million).

22. INVENTORIES (HK$m)

	Group	
	2005	2004
Land lots for sale	**4**	4
Food and beverage and others	**73**	70
	77	74

The cost of inventories recognised as expenses in the consolidated income statement amounted to **HK$232 million** (2004: HK$222 million).

23. DEBTORS AND PAYMENTS IN ADVANCE (HK$m)

	Group		Company	
	2005	2004	**2005**	2004 *(restated)*
Loans and other receivables from subsidiaries	**–**	–	**13,619**	13,168
Provision for impairment	**–**	–	**(3,458)**	(3,601)
	–	–	**10,161**	9,567
Trade debtors (ageing analysis is shown below)	**94**	104	**–**	–
Rental deposits and payments in advance	**122**	120	**12**	9
	216	224	**10,173**	9,576

The directors consider that the carrying amount of all debtors and payments in advance approximates their fair value.

The ageing analysis of trade debtors is as follows:

	Group		Company	
	2005	2004	**2005**	2004
Less than 3 months	**90**	101	**–**	–
More than 3 months but less than 6 months	**3**	2	**–**	–
More than 6 months	**1**	1	**–**	–
	94	104	**–**	–

The group's credit policy is set out in note 33D.

24. CASH AND CASH EQUIVALENTS (HK$m)

	Group		Company	
	2005	2004	**2005**	2004
Cash and cash equivalents in the balance sheet	**301**	262	**7**	23
Bank overdrafts (note 26)	**(16)**	(19)		
Cash and cash equivalents in the consolidated cash flow statement	**285**	243		

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

	Group		Company	
	2005 million	2004 million	**2005** million	2004 million
US dollars	**USD 5**	USD 3	**–**	–
Philippines pesos	**PHP 42**	PHP 74	**PHP 42**	PHP 74

25. CREDITORS AND ACCRUALS (HK$m)

	Group		Company	
	2005	2004	**2005**	2004
Trade creditors (ageing analysis is shown below)	**66**	68	**–**	–
Interest payable	**8**	12	**2**	–
Accruals of fixed assets	**43**	212	**–**	–
Tenants' deposits	**258**	234	**–**	–
Golf membership deposits	**43**	45	**–**	–
Receipt in advance	**–**	193	**–**	–
Other payables	**449**	364	**16**	10
Other payables to subsidiaries	**–**	–	**2**	24
	867	1,128	**20**	34

The ageing analysis of trade creditors is as follows:

	Group		Company	
	2005	2004	**2005**	2004
Less than 3 months	**65**	66	**–**	–
More than 3 months but less than 6 months	**1**	1	**–**	–
More than 6 months	**–**	1	**–**	–
	66	68	**–**	–

26. INTEREST-BEARING BORROWINGS (HK$m)

	Group	
	2005	2004
Total facilities available:		
Bank loans and revolving credits	**4,387**	5,908
Uncommitted facilities, including bank overdrafts	**1,086**	1,064
	5,473	6,972
Utilised at 31 December:		
Bank loans and revolving credits	**2,594**	4,389
Uncommitted facilities, including bank overdrafts	**20**	147
	2,614	4,536
Represented by:		
Short-term bank loans, repayable within one year or on demand	**88**	296
Current portion of long-term bank loans, repayable within one year	**35**	39
Bank overdrafts, repayable on demand (note 24)	**16**	19
	139	354
Long-term bank loans, repayable:		
Within 1 year	**35**	39
Between one and two years	**1,244**	231
Between two and five years	**1,164**	3,805
After five years	**67**	146
	2,510	4,221
Less: Current portion of long-term bank loans	**(35)**	(39)
Non-current portion of long-term bank loans	**2,475**	4,182
Total interest-bearing borrowings	**2,614**	4,536

The non-current portion of long-term bank loans, apart from bank loans totalling **HK$496 million** (2004: HK$1,761 million), are not expected to be settled within one year.

The total borrowings comprised the following variable rate bank loans and overdrafts that were:

	Group	
	2005	2004
Unsecured	**2,547**	4,390
Secured mortgages over investment and hotel properties of a PRC subsidiary	**67**	146
Total interest-bearing borrowings	**2,614**	4,536

The secured banking facility and the book value of the mortgaged properties amounted to **HK$384 million** (2004: HK$377 million) and **HK$1,315 million** (2004 *restated*: HK$1,257 million) respectively.

26. INTEREST-BEARING BORROWINGS (HK$m) *continued*

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	2004 million
US dollars	**USD 104**	USD 132
Japanese yen	**JPY 2,666**	JPY 3,200

All the above US dollar borrowings were obtained by a Hong Kong subsidiary. In the light of the Hong Kong dollar peg, the directors consider that the foreign exchange risk associated with these US dollar borrowings is not expected to be material to the group. As at 31 December 2005 and 2004, a Thai subsidiary had an amortising bank loan in Japanese yen, which was hedged and swapped to its functional currency by means of a cross currency swap. The group classifies this currency swap as a cash flow hedge as disclosed in note 20A.

All of the group's banking facilities are subject to the fulfilment of covenants relating to certain of the group's balance sheet ratios, as are commonly found in lending arrangements with financial institutions. If the group were to breach the covenants the drawn down facilities would become payable on demand. The group regularly monitors its compliance with these covenants. Further details of the group's management of liquidity risk are set out in note 33. As at 31 December 2005 and 2004, none of the covenants relating to drawn down facilities had been breached.

27. SHARE CAPITAL

	2005	2004
Number of shares of HK$0.50 each (million)		
Authorised	**1,800**	1,800
Issued		
At 1 January	**1,402**	1,402
New shares issued	**15**	–
At 31 December	**1,417**	1,402
Nominal value of shares (HK$m)		
Authorised	**900**	900
Issued		
At 1 January	**701**	701
New shares issued	**8**	–
At 31 December	**709**	701

During the year, the company issued and allotted approximately 5.5 million new shares (at HK$5.855 per share) as part consideration to acquire the 31.68% additional interest in Manila Peninsula Hotel, Inc. In addition, the company issued and allotted 7.5 million (at HK$7.62 per share) and 2.3 million (at HK$9.21 per share) new shares in respect of the 2004 final scrip dividend and 2005 interim scrip dividend respectively. The new shares issued have resulted in an increase in fully paid share capital of HK$8 million and share premium of HK$103 million as disclosed in note 28. All ordinary shares issued during the year rank pari passu in all respects with the existing shares in issue. All shareholders are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the company. All ordinary shares rank equally with regard to the company's residual assets.

28. RESERVES (HK$m)

A. Group

	Attributable to equity shareholders of the company											
				Revaluation reserves								
	Share premium	Capital redemption reserve	Capital reserve	Hotel and other properties	Investment properties	Hedging reserve	Exchange reserve	General reserve	Retained profits	sub-total	Minority interests	Total
At 1 January 2004:												
– as previously reported	2,582	9	4	655	8,585	–	(634)	1,098	441	12,740	579	13,319
– prior period adjustments in respect of:												
– HK(SIC)-INT 21	–	–	–	–	–	–	–	–	(1,571)	(1,571)	–	(1,571)
– HKAS 16	–	–	–	(655)	–	–	–	–	(1,422)	(2,077)	4	(2,073)
– HKAS 17	–	–	–	–	–	–	–	–	(125)	(125)	–	(125)
– HKAS 40	–	–	–	–	(8,585)	–	–	–	8,623	38	9	47
– HKFRS 3	–	–	(4)	–	–	–	–	–	4	–		–
– as restated	2,582	9	–	–	–	–	(634)	1,098	5,950	9,005	592	9,597
Dividends approved in respect of the previous year	–	–	–	–	–	–	–	–	(112)	(112)	–	(112)
Exchange difference on translation of financial statements of overseas subsidiaries	–	–	–	–	–	–	4	–	–	4	–	4
Profit for the year *(restated)*	–	–	–	–	–	–	–	–	2,786	2,786	27	2,813
Dividends declared in respect of the current year	–	–	–	–	–	–	–	–	(42)	(42)	(5)	(47)
At 31 December 2004 *(as restated)*	2,582	9	–	–	–	–	(630)	1,098	8,582	11,641	614	12,255
At 1 January 2005:												
– as previously reported	2,582	9	4	1,396	11,367	–	(634)	1,098	861	16,683	602	17,285
– prior period adjustments in respect of:												
– HK(SIC)-INT 21	–	–	–	–	–	–	–	–	(2,008)	(2,008)	–	(2,008)
– HKAS 16	–	–	–	(1,396)	–	–	1	–	(1,550)	(2,945)	2	(2,943)
– HKAS 17	–	–	–	–	–	–	–	–	(133)	(133)	–	(133)
– HKAS 40	–	–	–	–	(11,367)	–	3	–	11,408	44	10	54
– HKFRS 3	–	–	(4)	–	–	–	–	–	4	–	–	–
– as restated, before opening balance adjustments	2,582	9	–	–	–	–	(630)	1,098	8,582	11,641	614	12,255
– HKAS 39	–	–	–	–	–	(277)	(1)	–	(26)	(304)	–	(304)
– as restated, after opening balance adjustments	2,582	9	–	–	–	(277)	(631)	1,098	8,556	11,337	614	11,951
Dividends approved in respect of the previous year	54	–	–	–	–	–	–	–	(126)	(72)	–	(72)
Exchange difference on translation of financial statements of overseas subsidiaries	–	–	–	–	–	–	4	–	–	4	2	6
Cash flow hedges: effective portion of changes in fair value, net of tax	–	–	–	–	–	48	–	–	–	48	2	50
Cash flow hedges: transfer from equity to profit or loss, net of tax	–	–	–	–	–	214	–	–	–	214	–	214
Profit for the year	–	–	–	–	–	–	–	–	2,664	2,664	57	2,721
New shares issued	29	–	–	–	–	–	–	–	–	29	–	29
Dividends declared in respect of the current year	20	–	–	–	–	–	–	–	(57)	(37)	(5)	(42)
Acquisition of subsidiary	–	–	–	–	–	–	–	–	–	–	40	40
At 31 December 2005	**2,685**	**9**	**–**	**–**	**–**	**(15)**	**(627)**	**1,098**	**11,037**	**14,187**	**710**	**14,897**

28. RESERVES (HK$m) *continued*

B. Company

	Share premium	Capital redemption reserve	Capital reserve	Hedging reserve	General reserve	Retained profits	Total
At 1 January 2004:	2,582	9	4,975	–	980	293	8,839
Dividends approved in respect of the previous year	–	–	–	–	–	(112)	(112)
Profit for the year	–	–	–	–	–	225	225
Dividends declared in respect of the current year	–	–	–	–	–	(42)	(42)
At 31 December 2004	2,582	9	4,975	–	980	364	8,910
At 1 January 2005:	2,582	9	4,975	–	980	364	8,910
Dividends approved in respect of the previous year	54	–	–	–	–	(126)	(72)
Cash flow hedge: effective portion of changes in fair value, net of tax	–	–	–	(51)	–	–	(51)
Cash flow hedge: transfer from equity to profit or loss, net of tax	–	–	–	5	–	–	5
New shares issued	29	–	–	–	–	–	29
Profit for the year	–	–	–	–	–	670	670
Dividends declared in respect of the current year	20	–	–	–	–	(57)	(37)
At 31 December 2005	**2,685**	**9**	**4,975**	**(46)**	**980**	**851**	**9,454**

C. Nature and purpose of reserves

Share premium and capital redemption reserve

The application of the share premium account and the capital redemption reserve is governed by Sections 48B and 49H respectively of the Hong Kong Companies Ordinance.

Capital reserve

The company's capital reserve represents the profit recognised on the intra-group transfer of properties as a result of the corporate restructuring in 1991.

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 flows in accordance with the accounting policy adopted for cash flow hedges in note 1H.

Exchange reserve

The exchange reserve comprised 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 1H and 1W.

General reserve

General reserve represents retained profits set aside for general purposes.

D. Distributability of reserves

At 31 December 2005, the aggregate amount of reserves available for distribution to equity shareholders of the company was **HK$1,831 million** (2004: HK$1,344 million). After the balance sheet date the directors proposed a final dividend of **10 cents** per share (2004: 9 cents per share), amounting to **HK$142 million** (2004: HK$126 million). This dividend has not been recognised as a liability at the balance sheet date.

29. BUSINESS COMBINATION

On 3 March 2005, the group increased its shareholding in Manila Peninsula Hotel, Inc. (MPHI) from 40% to 71.68%. The consideration of approximately HK$44 million was satisfied by a cash payment of HK$12 million and the issue and allotment of approximately 5.5 million new shares of the company at a value of HK$5.855 per share.

On 3 November 2005, the group further increased its interest in MPHI to 76.09% through the conversion of a shareholder loan amounting to HK$25.9 million for additional shares of MPHI.

The consolidation of MPHI has resulted in an increase of approximately HK$147 million in turnover during 2005. This has not resulted in any material change to the group's capital commitments and contingent liabilities as disclosed in the 2004 annual financial statements. Details of the assets and liabilities arising from the acquisition of MPHI are disclosed in note 30.

There were no acquisitions in the year ended 31 December 2004.

30. NET CASH (OUTFLOW)/INFLOW OF CASH AND CASH EQUIVALENTS ARISING FROM THE ACQUISITION/DISPOSAL OF SUBSIDIARIES DURING THE YEAR (HK$m)

	Acquisition	Disposal
Cash consideration paid	(12)	–
Balance of sales consideration received, net of expenses	–	1,687
Cash and cash equivalents acquired/(disposed of)	10	(3)
	(2)	1,684
Details of net assets acquired/(disposed of) and the consideration (paid)/received are analysed below:		
Properties, plant and equipment	176	(264)
Investment properties	8	(452)
Current assets	20	(18)
Cash and cash equivalents	10	(3)
Current taxation	(1)	7
Deferred taxation	6	7
Current liabilities	(42)	18
Interest-bearing borrowings	(10)	–
Minority interests	(40)	–
Net assets acquired/(disposed of)	127	(705)
Interest in an associate	(83)	–
Gain on disposal of a subsidiary (note 6)	–	(1,171)
	44	(1,876)
Consideration:		
Cash consideration paid	(12)	–
New shares issued	(32)	–
Sales consideration received, net of expenses	–	1,876
	(44)	1,876

31. LOANS TO OFFICERS

Loans to officers of the company and its subsidiaries disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

A. Loans made by a third party under guarantees given by the company

Name of borrower:	Mr Martyn P A Sawyer
Position:	Group General Manager, Properties and Clubs
Extent of guarantee given to a bank	GBP120,000
Maximum liability under the guarantee:	
at 1 January 2004	HK$1,285,000
at 31 December 2004 and 1 January 2005	HK$1,245,000
at 31 December 2005	HK$1,205,000
Amount paid or liability incurred under the guarantee	HK$nil (2004: HK$nil)

The directors do not consider it probable that the company will be called upon under the guarantee. The guarantee will be outstanding until a loan granted to the officer by the bank is repaid, and the loan has a remaining term until 2014.

B. Loans made by the company and its subsidiaries

Name of borrower:	Mr Peter C Borer	Mr J Niklaus Leuenberger
Position:	Director	Senior Vice President, The Peninsula Hotels, the Americas
Terms of the loan:		
duration and repayment terms	5 years to May 2007	Approximately 2 years to December 2005
interest rate	The company's borrowing rate	Interest-free
security	Borrower's retirement fund	None
Balance of the loan:		
at 1 January 2004	HK$1,349,932	US$45,000
at 31 December 2004 and 1 January 2005	HK$954,830	US$20,000
at 31 December 2005	HK$559,727	US$nil
Maximum balance outstanding:		
during 2004	HK$1,349,932	US$45,000
during 2005	HK$954,830	US$20,000

There was no amount due but unpaid, nor any provision made against the principal amount of or interest on these loans at 31 December 2004 and 2005.

32. EMPLOYEE RETIREMENT BENEFITS

A. Defined benefit retirement plans

The group's newly acquired subsidiary Manila Peninsula Hotel, Inc. (MPHI) operates a non-contributory defined benefit retirement plan which covers all its employees. The plan is administered by an independent trustee with the assets held separately from those of MPHI.

The above plan is funded by contributions from MPHI in accordance with an independent actuary's recommendation based on annual actuarial valuation. The latest independent actuarial valuation of the plan was at 31 December 2005 and was prepared by qualified staff of Actuarial Advisers, Inc., who are members of the Actuarial Society of the Philippines, using the projected unit credit method. The actuarial valuation indicated that MPHI's obligations under the defined benefit retirement plan were 46% covered by the plan assets held by the trustee. The uncovered obligations were fully provided for as at 31 December 2005.

In addition, Quail Lodge, Inc. (QLI), a U.S. subsidiary of the company, has retirement compensation agreements with certain employees which provide, among other things, that during the employees' lifetime after retirement, QLI will pay such employees retirement compensation equal to 30% of their average salaries in their final three years of employment. The pension liabilities were valued at **HK$5 million** (2004: HK$5 million) using a discount rate of **6.5%** (2004: 6.5%).

QLI also has a deferred compensation agreement with a key employee which provides, among other things, that during each of the 10 years after termination of his employment because of retirement, death or disability, such employee or his estate will be paid deferred compensation, adjusted for cost-of-living increases. The net present value of this commitment, computed by using a discount rate of **6.5%** (2004: 6.5%), was approximately **HK$4 million** (2004: HK$5 million) as of 31 December 2005, and was included in the net defined benefit retirement obligation in the consolidated balance sheet. In 2005 the employee died and his estate is being paid in accordance with the agreement.

QLI has not funded the above retirement and deferred compensation arrangements, and the liability in respect of its obligations was fully recognised in its financial statements at each year end date based on independent actuarial valuation.

The amounts recognised in the balance sheets are as follows (HK$m):

	Group	
	2005	2004
Present value of wholly or partly funded obligations	**28**	10
Fair value of plan assets	**(8)**	–
	20	10
Unrecognised actuarial gains	**3**	–
	23	10

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.

32. EMPLOYEE RETIREMENT BENEFITS *continued*

A. **Defined benefit retirement plans** *continued*

Movements in the net liability recognised in the balance sheet are as follows (HK$m)*:*

	Group	
	2005	2004
At 1 January	**10**	10
Liability arising from the acquisition of MPHI	**14**	–
Expense recognised in profit or loss	**4**	–
Contributions paid to plan	**(5)**	–
At 31 December	**23**	10
Less: Current portion (included in creditors and accruals)	**(2)**	–
Non-current portion	**21**	10

The expense recognised as staff costs in the consolidated income statement is as follows (HK$m)*:*

	Group	
	2005	2004
Current service cost	**1**	–
Interest cost	**5**	–
Actuarial expected return on plan assets	**(2)**	–
	4	–

The actual return on plan assets (taking into account all changes in the fair value of the plan assets excluding contributions paid and received) was net income of **HK$3 million** (2004: HK$nil million).

The principal actuarial assumptions used as at 31 December 2005 are as follows:

	Group	
	2005	2004
Discount rate	**14.0% and 6.5%**	6.5%
Expected rate of return on plan assets	**10%**	N/A
Future salary increases	**6.2%**	N/A

32. EMPLOYEE RETIREMENT BENEFITS *continued*

B. Defined contribution retirement plan

The group has a defined contribution retirement plan covering **1,177 employees** (2004: 1,531 employees) mostly in Hong Kong. The defined contribution retirement plan is formally established under an independent trust with the assets of the funds held separately from those of the group by an independent trustee. The plan is registered under the Occupational Retirement Schemes Ordinance and is exempted under the Mandatory Provident Fund Schemes (Exemption) Regulation. Employees covered by this plan are not required to make contributions and funds contributed by employers are fully vested immediately. The average contribution rate against employees' relevant income for the year was **13%** (2004: 12%).

In addition, the group also participates in the Mandatory Provident Fund Scheme operated by an independent service provider to cover **182 employees** (2004: 249 employees) in Hong Kong not covered by the above defined contribution retirement plan. Contributions at a fixed rate of 5% of the employees' relevant income, subject to a cap of monthly relevant income of HK$20,000 per employee, are made to the scheme and are vested immediately.

The group also operates several defined contribution retirement plans including union pension schemes for its overseas subsidiaries covering **2,366 employees** (2004: 2,299 employees) in other Asian countries and the United States of America in accordance with respective applicable labour regulations.

Total contributions to all of the above defined contribution retirement plans made by the group amounting to **HK$53 million** (2004: HK$57 million) were charged to the income statement during the year.

33. FINANCIAL INSTRUMENTS (HK$m)

The group is exposed to foreign exchange, interest rate, liquidity and credit risks in its normal course of business. Various techniques and derivative financial instruments are used to control or reduce these risks, as described below.

A. Foreign exchange risk

The group manages its foreign exchange exposure with a view to protecting its net assets and profitability against adverse fluctuations in exchange rates. The company reports its results in Hong Kong dollars. In the light of the Hong Kong dollar peg, the group does not hedge US dollar exposures, and it aims to preserve its value in Hong Kong dollar and/or United States dollar terms.

Forecast transactions

Foreign exchange risk may arise in sale and purchase transactions that are denominated in a currency other than the functional currency of the operations to which they relate.

In respect of committed future transactions and highly probable forecast transactions, the group hedges most of the estimated foreign currency transaction exposures if the foreign exchange risk of these exposures is considered to be significant. The group mainly uses forward exchange contracts to hedge this type of the foreign exchange risk and classifies these contracts as cash flow hedges.

At 31 December 2005, the group had forward foreign exchange contracts hedging forecast transactions in respect of a project in Tokyo with a net fair value of **HK$3 million** (1 January 2005: negative HK$29 million), recognised as derivative financial instruments. These forward exchange contracts have maturities of less than **2 years** (2004: less than 3 years) after the balance sheet date.

33. FINANCIAL INSTRUMENTS (HK$m) *continued*

A. Foreign exchange risk *continued*

Recognised assets and liabilities

The group has foreign currency monetary assets and liabilities that are denominated in a currency other than the functional currency of the operations to which they relate. Exchange differences arising on settling or translating these foreign currency monetary items at rates different from those at dates of transactions giving rise to these monetary items are recognised in the income statement.

The group hedges most of the foreign exchange exposures arising from significant foreign currency monetary assets and liabilities, including foreign currency borrowings. The group mainly uses currency swaps or forward exchange contracts to hedge this type of foreign exchange risk and classifies these derivative financial instruments as cash flow hedges or held for trading depending on whether the future foreign currency cash flows are fixed or not. Changes in the fair value of these cash flow hedges or derivative financial instruments held for trading are recognised in the hedging reserve or the income statement respectively.

At 31 December 2005, the net fair value of currency swaps used by the group to hedge foreign currency borrowings was as follows (HK$m):

	Group	
	31 December 2005	1 January 2005
Cash flow hedges	**2**	17
Held for trading	**3**	(7)
	5	10

In respect of other debtors and creditors that are denominated in a currency other than the functional currency of the operations to which they relate, the group monitors the net exposure, which is not material. The group usually sells and buys foreign currencies at spot rates to settle these debtors and creditors.

Except for foreign currency borrowings hedged by currency swaps or forward foreign exchange contracts, all the group's borrowings are denominated in the functional currency of the operations to which they relate or, in case of group entities whose functional currency is Hong Kong dollars, in either Hong Kong dollars or United States dollars. Given this, it is not expected that there will be any significant currency risk associated with the group's borrowings.

Net investment in foreign subsidiary

At 31 December 2005, the group did not hedge any net investment in foreign subsidiaries.

33. FINANCIAL INSTRUMENTS (HK$m) *continued*

B. Interest rate risk

All the group's borrowings bear floating interest rates that are reset on a regular basis as market interest rates change. As the borrowing costs are subject to market fluctuations in interest rates, the group adopts a long-term policy to hedge this exposure by fixing interest rates of approximately 50% of its borrowings mainly by way of interest rate swaps or other derivative financial instruments.

During the year, sale proceeds in respect of The Kowloon Hotel were applied towards reducing bank borrowings and re-adjusting the loan interest hedging ratio, rendering some outstanding interest rate swaps ineffective at the group level (see note 6). The company entered into new interest rate swaps to offset the financial effect of the ineffective interest rate swaps, and classified these new swaps as cash flow hedges against intra-group borrowings. However, the group classified these pairs of offsetting interest rate swaps as held for trading, and changes in their fair value are recognised in the consolidated income statement because the intra-group borrowings are eliminated upon consolidation. At 31 December 2005, these pairs of swaps had a total notional principal of **HK$3,658 million** (2004: HK$nil) maturing over the next 8 years.

Also, at 31 December 2005, the group and the company had interest rate swaps that are classified as cash flow hedges with a total notional contract amount of **HK$1,448 million** (2004: HK$3,441 million) and **HK$1,829 million** (2004: HK$nil) maturing over the next **12 years** (2004: 13 years) and **8 years** (2004: 9 years) respectively. Changes in fair value of these interest rate swaps for cash flow hedges are recognised in the hedging reserve. The group locked in the following ranges of fixed rates by the interest rate swaps at 31 December 2005:

	31 December 2005	31 December 2004
HK dollars	**4.8% to 4.9%**	4.8% to 7.5%
US dollars	**4.6% to 5.8%**	4.6% to 6.0%
Japanese yen	**1.5% to 2.1%**	1.5% to 2.1%

The net fair value of all the interest rate swaps, recognised as derivative financial instruments, entered into by the group and the company at 31 December 2005 was as follows:

	Group		Company	
	31 December 2005	1 January 2005	**31 December 2005**	1 January 2005
Cash flow hedges	**(26)**	(307)	**(56)**	–
Held for trading	**(166)**	–	**–**	–
	(192)	(307)	**(56)**	–

In respect of interest-earning financial assets and interest-bearing financial liabilities (including borrowings), 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.

33. FINANCIAL INSTRUMENTS (HK$m) *continued*

B. Interest rate risk *continued*

Group

	2005						2004					
	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years
Repricing dates for assets/(liabilities) which reprice before maturity												
Cash and cash equivalents	2.0%	258	258	–	–	–	1.2%	221	221	–	–	–
Debtors	5.2%	1	1	–	–	–	5.1%	2	2	–	–	–
Loans to associates	N/A	–	–	–	–	–	3.6%	38	38	–	–	–
Bank loans	4.3%	(2,598)	(2,598)	–	–	–	2.0%	(4,517)	(4,517)	–	–	–
Effect of derivative financial instruments on bank loans	0.4%	–	1,330	(35)	(105)	(1,190)	2.8%	–	2,855	(139)	(1,151)	(1,565)
		(2,339)	(1,009)	(35)	(105)	(1,190)		(4,256)	(1,401)	(139)	(1,151)	(1,565)

Company

	2005						2004					
	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years
Repricing dates for assets/(liabilities) which reprice before maturity												
Cash and cash equivalents	5.5%	6	6	–	–	–	2.8%	22	22	–	–	–
Loans to associates	N/A	–	–	–	–	–	4.2%	26	26	–	–	–
Loans to subsidiaries	4.9%	3,257	3,257	–	–	–	2.6%	2,327	2,327	–	–	–
Effect of derivative financial instruments on loans to subsidiaries	(0.8%)	–	(1,532)	498	500	534	N/A	–	–	–	–	–
		3,263	1,731	498	500	534		2,375	2,375	–	–	–

C. Liquidity risk

Borrowings and cash management, including short term investment of surplus cash, are arranged centrally to cover expected cash demands. The group's policy is to regularly monitor current and expected liquidity requirements and its compliance with loan covenants, and to ensure that it maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to meet its obligations and commitments.

At 31 December 2005, total available borrowing facilities amounted to **HK$5,473 million** (2004: HK$6,972 million) of which **HK$2,614 million** (2004: HK$4,536 million) was drawn down. Undrawn committed facilities, in the form of revolving credit and term loan facilities, totalled **HK$1,793 million** (2004: HK$1,519 million).

D. Credit risk

The group's credit risk is primarily attributable to bank deposits, trade debtors and derivative financial instruments, and is monitored on an ongoing basis.

Cash is deposited in financial institutions with good credit ratings that are located where the group entities are operated. At 31 December 2005, bank deposits amounted to HK$318 million, over 90% of which were made to financial institutions with credit ratings of no less than BBB- (Standard & Poor's) or Baa2 (Moody's). The directors consider that it is highly unlikely that any of these financial institutions will fail to meet their obligations.

The group has no concentrations of credit risk in view of its large number of customers. The group maintains a defined credit policy to ensure that credit is given only to customers with an appropriate credit history. In respect of the group's rental income from operating leases, rentals are normally received in advance and sufficient rental deposits are held to cover potential exposure to credit risk. As such, the group normally does not obtain collateral from its customers. The ageing of trade debtors at 31 December 2005 is summarised in note 23.

Transactions involving derivative financial instruments are with financial institutions with sound credit ratings. Given their high credit ratings, the directors consider that it is highly unlikely that any of these financial institutions will fail to meet their obligations. At 31 December 2005, the credit ratings of these financial institutions were no less than A (Standard & Poor's) or A2 (Moody's).

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including the derivative financial instrument, in the balance sheet. Except for the financial guarantee given by the company in respect of a loan to an officer of the company as disclosed in note 31, the group does not provide any other guarantee which would expose the group to credit risk.

E. Sensitivity analysis

In managing foreign exchange and interest rate risks, the group aims to reduce the impact of short term fluctuations on the group's earnings. Over the longer term, however, permanent changes in foreign exchange and interest rates would have an impact on consolidated earnings.

At 31 December 2005, it is estimated that a general increase of one percentage point in interest rates would decrease the group's profit before tax by approximately **HK$11 million** (2004: HK$16 million), so far as the effect on interest bearing financial instruments is concerned. Interest rate swaps have been included in this calculation.

33. FINANCIAL INSTRUMENTS *continued*

F. Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2005 except that interests in unlisted equity instruments are stated at cost less impairment losses (see note 1F). The fair values of the equity instruments cannot be reasonably measured because they can only be sold either with the consent of third parties or in an illiquid market.

G. Estimation of fair values

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

Derivative financial instruments

Forward foreign exchange contracts are either marked to market using listed market prices or by discounting the contractual forward price and deducting the current spot rate. The fair value of interest rate swaps is the estimated amount that the group or company would receive or pay to terminate the swaps at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

When discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument at the balance sheet date. Where other pricing models are used, inputs are based on market related data at the balance sheet date.

The group uses the following discount rates for determining fair value of derivative financial instruments.

	31 December 2005	1 January 2005
Hong Kong dollars	**4.0%-6.8%**	0.2%-5.5%
United States dollars	**4.2%-5.3%**	2.1%-5.5%
Thai baht	**4.3%-5.8%**	2.2%-4.7%
Japanese yen	**0.1%-2.8%**	0.1%-3.1%
Philippines pesos	**7.4%**	N/A

Interest-bearing borrowings

The fair value is estimated as the present value of future cash flows, discounted at current market interest rates for similar borrowings.

34. COMMITMENTS (HK$m)

A. Capital commitments outstanding at 31 December 2005 not provided for in the financial statements were as follows:

	Group	
	2005	2004
Contracted for	**525**	202
Authorised but not contracted for	**2,054**	2,530
	2,579	2,732

Capital commitments include amounts in respect of the group's capital expenditure at existing properties and its commitment to the projects in Tokyo and Shanghai.

B. At 31 December 2005, the total future minimum lease payments under non-cancellable operating leases of the group in respect of land and buildings are (receivable)/ payable as follows:

	Receivable		Payable	
	2005	2004	**2005**	2004
Within 1 year	**(542)**	(401)	**60**	60
After 1 year but within 5 years	**(710)**	(339)	**470**	483
After 5 years	**(203)**	(43)	**7,647**	8,267
	(1,455)	(783)	**8,177**	8,810

Following the completion of the restructuring of The Palace Hotel Co., Ltd. (TPH) on 13 December 2002, the group is committed to making an annual payment of a minimum RMB 8 million to China Everbright Group Limited (CEG) up to and including 11 November 2033 (the "Annual Payment"). The Annual Payment is a deemed lease payment and is included as a payment under non-cancellable operating leases of the group (note 36F).

Manila Peninsula Hotel, Inc. (MPHI) became a non-wholly owned subsidiary of the group on 3 March 2005 (see note 29). The Peninsula Manila, the hotel owned by MPHI, is situated on a piece of land which belongs to Ayala Hotel, Inc. ("Ayala"). The hotel land lease was negotiated in 1975 by the management of MPHI at the time with Ayala in the ordinary and usual course of business based on normal commercial terms and on an arm's length basis (the "Land Lease"). The initial term of the Land Lease was from 31 December 1975 to 31 December 2001, with an option to renew until 31 December 2027 on the same terms and conditions, which was exercised by MPHI. Pursuant to the terms and conditions, MPHI is committed to paying Ayala annual rental at 5% of its gross income on a quarterly basis.

The group also leases certain pieces of land in respect of its hotels located in the United States of America from third parties under long term leases. In addition, the group leases a number of office premises under operating leases that typically run for an initial period of two to four years with an option to renew the leases when all terms are renegotiated. None of the leases includes contingent rentals.

The group entered into a long term lease with respect to The Peninsula Tokyo commencing on the date of completion which is expected to be in 2007.

35. CONTINGENT LIABILITIES (HK$m)

Contingent liabilities at 31 December are analysed as follows:

	Group		Company	
	2005	2004	**2005**	2004
Guarantees given in respect of borrowings and other banking facilities for subsidiaries	**–**	–	**2,547**	4,405
Other guarantees	**5**	5	**5**	5
Legal and other disputes	**13**	8	**–**	–
	18	13	**2,552**	4,410

The directors consider that the above contingent liabilities are unlikely to materialise. No provision was therefore made in this respect at 31 December 2005 and 2004.

36. MATERIAL RELATED PARTY TRANSACTIONS

A. Under a tenancy agreement commenced on 1 April 2003 and due to expire on 31 March 2007, a wholly owned subsidiary, HSH Management Services Limited, has leased the 7th and 8th floors of St. George's Building, 2 Ice House Street, Central, Hong Kong at a market rate of approximately HK$469,650 plus service charges of HK$146,531 per month from Kadoorie Estates Limited which is an agent for the owner which is indirectly owned by our controlling shareholder. This tenancy falls under Listing Rules as a connected transaction. Details of the connected transaction are disclosed in the Directors' Report.

B. Under a master agreement entered into between Tai Ping Carpets International Limited (TPC) and the company dated 22 March 2005, TPC agreed to supply carpets and all forms of floor coverings on normal commercial terms to the company and its subsidiaries (the "group") for a period of three years commencing on the date of the agreement at an annual cap of HK$8.5 million. During the year the group has committed to purchasing carpets for a gross consideration of **HK$7.3 million** (2004: HK$3.9 million). **HK$6.5 million** (2004: HK$0.8 million) was paid in 2005 and the remainder will be paid in 2006. Bermuda Trust Company Limited, the controlling shareholder of the company, holds more than 30% of TPC's equity.

C. The Peninsula Manila is owned by Manila Peninsula Hotel, Inc. (MPHI – a 40% associate of the group prior to 3 March 2005). MPHI became a subsidiary on 3 March 2005 following the completion of an offer made to shareholders as announced on 29 October 2004. The Peninsula Manila is situated on a piece of land owned by Ayala Hotels, Inc. ("Ayala"), an associate of an MPHI director. Ayala is entitled to receive contingent rental from MPHI based on 5% of the gross income of MPHI pursuant to a land lease contract dated 2 January 1975 with an initial term from 31 December 1975 to 31 December 2001 and as extended to 31 December 2027. The amount of rent paid to Ayala under the lease from March to December 2005 was HK$7.4 million. This lease falls under Listing Rules as a continuing connected transaction. Details of this continuing connected transaction are disclosed in the Directors' Report.

36. MATERIAL RELATED PARTY TRANSACTIONS *continued*

D. MPHI was granted unsecured banking facilities of up to Pesos 70 million (approximately HK$9.9 million) by Bank of Philippine Islands (BPI) based on normal commercial terms. Approximately 35% of BPI's equity is held by Ayala, and BPI is also an associate of an MPHI director. The balance of the loan owed by MPHI to BPI as at 3 March 2005 and 31 December 2005 amounted to Pesos 50 million (approximately HK$7.1 million) and Pesos 15 million (approximately HK$2.1 million) respectively. The loan was fully repaid on 13 February 2006.

E. Security and interest-free shareholder's loans amounting to US$57 million (HK$445 million) were granted by Peninsula International Investment Holdings Limited, a wholly-owned subsidiary of the company, to The Peninsula Shanghai (BVI) Limited (TPS), a 50% jointly controlled entity of the group. TPS holds a 100% direct interest in The Peninsula Shanghai Waitan Hotel Company Limited (PSW), a foreign owned enterprise incorporated in the People's Republic of China, engaged in the development of The Peninsula Shanghai project.

As at the year end, the entire sum of the US$57 million shareholder's loan was on-lent by TPS to PSW for the purpose of funding the project.

F. The company announced on 6 December 2000 that Kam Lung Investments Limited, a wholly owned subsidiary of the company, entered into various agreements with the then independent third parties, including China Everbright Group Limited (CEG) to carry out the restructuring of The Palace Hotel Co., Ltd. (TPH), the owner of The Peninsula Palace Beijing. Upon completion of the restructuring under the terms of the agreement as announced, CEG was entitled to appoint two representatives as directors of TPH's board consisting of nine members and to receive a priority payment of minimum RMB 8 million up to and including 11 November 2033 ("Annual Payment"). Completion of the restructuring took place on 13 December 2002 and the Annual Payment became payable. The Annual Payment in an amount of **RMB 8 million** was recorded in 2005 (2004: RMB 8 million).

G. During the year, Quail Lodge, Inc.(QLI), a wholly owned subsidiary of the company, paid a total of **HK$16.1 million** (2004: HK$17.3 million) marketing and management fees to Valley Resort Management, LLC (VRM), an associated company of which the company holds a 50% equity interest indirectly. The fees were mutually agreed by both parties after taking into account VRM's operating and financial requirements. The balance of the fees due by QLI to VRM at the year end amounted to **HK$0.3 million** (2004: HK$0.8 million).

With effect from 1 April 2006, this related party transaction will be terminated and the group will resume full control of QLI (note 37B).

37. NON-ADJUSTING POST BALANCE SHEET EVENTS

A. After the balance sheet date the directors proposed a final dividend, the details of which are disclosed in note 13.

B. As disclosed in note 36G, with effect from 1 April 2006, the resort and golf club owned by Quail Lodge, Inc. (QLI), a wholly owned subsidiary, will cease to be managed by Valley Resort Management, LLC. The directors consider that the termination of the marketing and management agreements will not have material impacts on the operational and financial performance of QLI.

38. 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 2.

39. KEY SOURCES OF ESTIMATION UNCERTAINTY

Notes 32A and 33 contain information about the assumptions and their risk factors relating to defined benefit retirement obligations and financial instruments. Other key sources of estimation uncertainty are as follows:

Estimated useful lives of properties, plant and equipment
The group estimates the useful lives of its properties, plant and equipment based on the periods over which the assets are expected to be available for use. The group reviews annually their estimated useful lives, based on factors that include asset utilisation, internal technical evaluation, technological and environmental changes, and anticipated use of the assets tempered by related industry benchmark information. It is possible that future results of operation could be materially affected by changes in these estimates brought about by changes in factors mentioned. A reduction in the estimated useful lives of properties, plant and equipment would increase depreciation charges and decrease non-current assets.

Asset impairment
The group assesses the impairment of assets in accordance with the accounting policy set out in note 1M. The factors that the group considers important in assessing the impairment include the following:
– significant underperformance relative to expected historical or projected future operating results;
– significant negative industry or economic trends.

Deferred tax assets
The group reviews the carrying amounts of deferred taxes at each balance sheet date and reduces deferred tax assets to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilised. However, there is no assurance that the group will generate sufficient taxable income to allow all or part of its deferred tax assets to be utilised.

40. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 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 ended 31 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	1 January 2006
HK(IFRIC) 4, Determining whether an arrangement contains a lease	1 January 2006
HK(IFRIC) 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds	1 January 2006
HK(IFRIC) 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005
Amendments to HKAS 19, Employee benefits – Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
Amendments to HKAS 39, Financial instruments: Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:	
– HKAS 1, Presentation of financial statements	1 January 2006
– HKAS 27, Consolidated and separate financial statements	1 January 2006
– HKFRS 3, Business combinations	1 January 2006
HKFRS 7, Financial instruments: Disclosures	1 January 2007
Amendment to HKAS 1, Presentation of financial statements: Capital disclosures	1 January 2007

In addition, the Hong Kong Companies (Amendment) Ordinance 2005 came into effect on 1 December 2005 and would be first applicable to the group's financial statements for the period beginning 1 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 the adoption of HKFRS 6, HK(IFRIC) 5 and HK(IFRIC) 6 are not applicable to any of the group's operations and that the adoption of the rest of them is unlikely to have a significant impact on the group's results of operations and financial position.