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

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRSs for the current and prior accounting periods reflected in these financial statements is provided in note 2.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 August 2006 comprise City Telecom (H.K.) Limited (the "Company") and its subsidiaries (collectively referred to as the "Group").

The measurement basis used in the preparation of the financial statements is the historical cost basis except that the financial instruments are stated at their fair value or amortised costs as explained in the accounting policies set out below (see note 1(j), 1(k) & 1(s)).

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

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

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the following year are discussed in note 34.

(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.

(d) Group accounting

(i) Consolidation

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

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

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

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

1. SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(d) Group accounting *(CONTINUED)*

(ii) Translation of foreign currencies

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

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

(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 1(i)). In respect of associates or jointly controlled entities, 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) Investment property

Investment properties are land and/or buildings which are owned and held to earn rental income and/or for capital appreciation.

Investment properties are stated in the balance sheet at cost less accumulated depreciation (see note 1(g)) and impairment losses (see note 1(i)) if any. Any gain or loss arising from the retirement or disposal of an investment property is recognised in the statement of operations. Rental income from investment property is accounted for as described in note 1(u)(vi).

(g) Fixed assets

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

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight-line method over their estimated useful lives as follows:

– Buildings and investment property situated on leasehold land are depreciated over the shorter of the unexpired term of lease and their estimated useful lives of 50 years	
– Furniture, fixtures and fittings	25%
– Telecommunications, computer and office equipment	7% – 25%
– Motor vehicles	25%
– Leasehold improvements are depreciated over the shorter of the unexpired term of the leases and their expected useful lives	

Where the 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.

Major costs incurred in restoring fixed assets to their normal working condition are charged to the statement of operations. Major improvements are capitalised and depreciated over their expected useful lives to the Group.

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

1. SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(h) Assets held under leases

(i) 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.

Land held for own use under an operating lease where its fair value 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 (see note 1(h)(iii)).

(ii) Finance leases

Where the Group acquired 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 with the corresponding liabilities, net of finance charges, recorded as obligations under finance leases. Depreciation and impairment losses are accounted for in accordance with the accounting policy in note 1(g) and note 1(i). 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.

(iii) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Receipts and payments made under operating leases net of any incentives received by/from the lessor are credited/charged to the statement of operations on a straight-line basis over the lease periods.

(i) Impairment of assets

(i) Impairment of investments in debt and equity securities and other receivables

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

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

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

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

(ii) Impairment of other assets

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

– fixed assets;
– investment property;
– investments in subsidiaries; and
– goodwill.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

1. SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(i) Impairment of assets *(CONTINUED)*

(ii) Impairment of other assets *(CONTINUED)*

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

– Calculation of recoverable amount

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

– Recognition of impairment losses

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

– Reversals of impairment losses

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

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

(j) Other financial assets

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

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

Dated debt securities that the Group or the Company has the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are initially recognised in the balance sheet at fair value plus transaction costs. Subsequently, they are stated in the balance sheet at amortised cost less impairment losses (see note 1(i)(i)).

Other investments in securities are classified as available-for-sale securities and are initially recognised at fair value plus transaction costs. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except for impairment losses (see note 1(i)(i)) and, in the case of monetary items such as debt securities, foreign exchange gains and losses which are recognised directly in profit or loss. Where these investments are interest-bearing, interest is calculated using the effective interest method and recognised in profit or loss. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss.

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

(k) 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.

1. SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(l) Deferred expenditure

Deferred expenditure represents customer acquisition costs incurred for successful acquisition or origination of a long-term service agreements. Such costs are deferred and amortised on a straight-line basis over the period of the underlying service subscription agreements executed with the customers. All other related advertising and marketing costs are charged to the statement of operations as incurred.

(m) Accounts receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 1(i)(i)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 1(i)(ii)).

(n) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is determined using the first in, first out method ("FIFO") and comprises all costs of purchase.

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, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

As of 31 August 2006, there was no write-down or provision made against inventories due to change in net realisable value.

(o) Cash and pledged bank deposits

Cash consists of cash on hand, cash in bank accounts and interest-bearing savings accounts. Cash that is restricted for use or pledged as security is disclosed separately on the face of the balance sheet, and is not included in the cash total in the consolidated statements of cash flows. The pledged bank deposits represent cash maintained at a bank as security for bank facility and bank guarantees issued by the bank to third party suppliers and utility vendors (see note 30).

(p) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the time value of money is material, provisions are stated at present value of the expenditure expected to settle the obligation.

(q) Employee benefits

(i) Employee leave entitlements

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

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

(ii) Profit sharing and bonus plans

Provisions for profit sharing and bonus plans are recognised when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

1. SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(q) Employee benefits *(CONTINUED)*

(iii) Retirement benefit costs

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

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

(iv) Share-based payments

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date using the Black-Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the share options, the total estimated fair value of the share options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to the profit or loss in the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to the capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Company's shares. The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is transferred to retained profits).

(r) Deferred taxation

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

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

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

(s) Senior notes

Long-term debt, representing senior notes, are recognised initially at fair value less its incidental costs of issuance. Subsequent to initial recognition, the senior notes are stated at amortised cost with any difference between cost and redemption value being recognised in profit or loss over the period of borrowings using the effective interest method.

In the event that the senior notes are redeemed prior to the maturity date, the unamortised expenses are charged immediately to the statement of operations.

(t) Contingent liabilities and assets

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

A contingent liability is not recognised but is disclosed in the notes to the financial statements unless the probability of outflow of economic benefits is remote. When a change in the probability of an outflow occurs so that outflow is probable, the amount is then recognised as a liability.

1. SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(u) Revenue recognition

(i) Revenue for the provision of international telecommunications and fixed telecommunications network services is recognised, when an arrangement exists, service is rendered, the fee is fixed or determinable, and collectibility is probable.

(ii) Amount received in advance for the provision of international telecommunications services using calling cards is deferred and included under deferred services revenue and subsequently recognised as revenue when the calling cards are used by customers or when the calling cards have expired.

(iii) Amount received in advance for the provision of fixed telecommunications network services is deferred and included under deferred services revenue, and subsequently recognised as revenue on a straight-line basis over the agreed period of time in accordance with the terms of the subscription agreement.

(iv) Revenue from the sales of products is recognised upon the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and title has passed.

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

(vi) Rental income receivable under operating leases is recognised in the statement of operations in equal instalments over the periods covered by the lease term. Lease incentives granted are recognised in the statement of operations as an integral part of the aggregate net lease payments receivable.

(v) Borrowing costs

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

All other borrowing costs are charged to the statement of operations in the year in which they are incurred.

(w) Segment reporting

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

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

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

(x) Accounting for barter transactions

When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a revenue generating transaction.

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

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

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.

2. CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued a number of new and revised HKFRSs 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 HKFRSs 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 has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 35).

(a) Employee share option scheme (HKFRS 2, Share-based payment)

In prior years, no amounts were recognised when employees (which term included directors) were granted share options over shares in the Group. Upon the exercise of the options, the nominal amount of share capital and share premium were credited only to the extent of the option's exercise price receivable.

With effect from 1 September 2005, in order to comply with HKFRS 2, the Group recognises the fair value of such share options as an expense in the statement of operations, or as an asset, if the cost qualifies for recognition as an asset under the Group's accounting policies. A corresponding increase is recognised in capital reserve within equity. The fair value of the share options is measured at the date of grant.

Where the employees are required to meet vesting conditions before they become entitled to the options, the Group recognises the fair value of the options granted over the vesting period. Otherwise, the Group recognises the fair value in the period in which the options are granted.

Upon exercise of the options, the related capital reserve is transferred to share capital and share premium. If the options lapse, the related capital reserve is transferred to share premium.

This new accounting standard has been applied retrospectively with comparatives restated in accordance with HKFRS 2, except that the Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the new recognition and measurement policies have not been applied to the following options:

(i) all options granted to employees on or before 7 November 2002; and

(ii) all options granted to employees after 7 November 2002 but which had vested before 1 September 2005.

As a result of the adoption of the policy, other operating expenses for the year ended 31 August 2006 increased by HK$6,823,000 with the corresponding amount credited to capital reserve and HK$882,000 was transferred from capital reserve to share premium for vested share options that lapsed during the year.

The adoption of this accounting policy retrospectively resulted in (a) a decrease of HK$87,000 in the opening balance of the retained profits at 1 September 2004 and a corresponding increase in capital reserve; (b) an increase in other operating expenses of HK$6,965,000 for the year ended 31 August 2005 and a corresponding increase in capital reserve and; (c) a decrease of HK$7,052,000 of the opening balance of the retained profits at 1 September 2005 and a corresponding increase in capital reserve.

Details of the employee share option scheme can be found in note 12 on these financial statements.

2. CHANGES IN ACCOUNTING POLICIES *(CONTINUED)*

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

In prior periods:

- positive or negative goodwill which arose prior to 1 September 2001 was taken directly to reserves at the time it arose, and was not recognised in the statement of operations until disposal or impairment of the acquired business;

- positive goodwill which arose on or after 1 September 2001 was amortised on a straight-line basis over its estimated useful life and was subject to impairment testing when there were indications of impairment; and

- negative goodwill which arose on or after 1 September 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 consolidated statement of operations as those expected losses were incurred.

With effect from 1 September 2005, in order to comply with HKFRS 3 and HKAS 36, the Group no longer amortises positive goodwill. Such goodwill is tested annually for impairment, as well as when there are indications of impairment. Impairment losses are recognised when the carrying amount of the cash generating unit to which the goodwill has been allocated exceeds its recoverable amount.

Also with effect from 1 September 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), (a) the acquirer shall reassess the identification and fair value measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the business combination and (b) recognise immediately in profit and loss any excess remaining after the reassessment.

The new policy in respect of the amortisation of positive goodwill has been applied prospectively in accordance with the transitional arrangements under HKFRS 3. As a result, comparative amounts have not been restated and, the cumulative amount of amortisation as at 1 September 2005 has been offset against the cost of the goodwill and no amortisation charge for goodwill has been recognised in the consolidated statement of operations for the year ended 31 August 2006. As a result of the adoption of this accounting policy, loss for the year ended 31 August 2006 has decreased by HK$1,065,000.

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 September 2001) will not be recognised in the statement of operations on disposal or impairment of the acquired business, or under any other circumstances. The Group did not have any goodwill taken directly to reserves.

The change in policy relating to negative goodwill had no effect on the financial statements as no negative goodwill existed as at 31 August 2005.

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

With effect from 1 September 2005, in order to comply with HKAS 32 and HKAS 39, the Group has changed its accounting policies relating to financial instruments. Further details of the changes are as follows.

(i) Debt securities

The Group's investments in money market funds (included in other financial assets) have been carried at fair value since inception. At each balance sheet date, the net unrealised gains or losses arising from the change in fair value of debt securities are recognised in statement of operations. Profits or losses on disposal of these investments, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the statement of operations.

With effect from 1 September 2005, and in accordance with HKAS 39, these investments are carried at fair value with changes in fair value recognised in statement of operations. No adjustment arose from the adoption of the new policies for these securities because they have been carried at fair value prior to the adoption.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

2. CHANGES IN ACCOUNTING POLICIES *(CONTINUED)*

(c) Financial instruments (HKAS 32, Financial instruments: Disclosure and presentation and HKAS 39, Financial instruments: Recognition and measurement) *(CONTINUED)*

(ii) Loans and receivable

The Group's long-term bank deposit (included in other financial assets) has been carried at amortised cost since inception.

With effect from 1 September 2005, and in accordance with HKAS 39, loans and receivables that are non-derivative financial assets with fixed or determinable payments, and that are not quoted in an active market are included in current assets, except for maturities greater than 12 months after the balance sheet date. Financial assets classified under loans and receivables are carried at amortised cost. The Group's long-term bank deposit is classified as loans and receivables and is included in other financial assets. No adjustment arose from the adoption of the new policies for the long-term bank deposit because it has been carried at amortised cost prior to the adoption.

(iii) Derivative financial instruments

Prior to 1 September 2005, derivative financial instruments entered into by the Group to hedge the interest rate risk of a recognised asset or liability or the foreign currency risk of a committed future transaction were recognised on an accrual basis with reference to the timing of recognition of the hedged transaction.

With effect from 1 September 2005, and in accordance with HKAS 39, all derivative financial instruments entered into by the Group are stated at fair value. Changes in the fair value of derivatives held as hedging instruments in a cash flow hedge are recognised in equity to the extent that the hedge is effective and until the hedged transaction occurs. Any changes in the fair value of derivative financial instruments which do not qualify as cash flow hedges are recognised in profit or loss.

The retrospective adoption of this accounting policy resulted in recognition of derivative financial instruments as assets of HK$6,609,000 on 1 September 2005 and a corresponding increase in the opening balance of retained profits at 1 September 2005. In addition, the adoption resulted in an increase in loss from change in fair value of derivative financial instruments of HK$725,000 for the year ended 31 August 2006 and a corresponding reduction in derivative financial instruments at 31 August 2006.

(iv) Financial liabilities

Prior to 1 September 2005, the Group's 10-year senior notes payable (included in long-term debt and other liabilities) was initially measured at fair value (which is equivalent to the issuance price) less the amount of incidental issuance costs. After initial recognition, the senior notes were stated at amortised cost.

With effect from 1 September 2005, and in accordance with HKAS 39, financial liabilities, other than those held for trading purposes, are measured initially at fair value with transaction costs included in the initial measurement. Subsequent to initial recognition, financial liabilities are measured at amortised cost except for those liabilities (a) measured at fair value through profit or loss and (b) that arise when a transfer of a financial asset does not qualify for derecognition and therefore is accounted for using the continuing involvement approach. No adjustment arose from the adoption of this new accounting policy for the 10-year senior notes because they have been carried at amortised cost prior to the adoption.

(d) Definition of related parties (HKAS 24, Related party disclosures)

As a result of the adoption of HKAS 24, Related party disclosures, the definition of related parties as disclosed in note 1(y) 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 period, as compared to those that would have been reported had SSAP 20, *Related party disclosures*, still been in effect.

3. TURNOVER, REVENUES AND SEGMENT INFORMATION

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

	2006 HK$'000	2005 HK$'000
Turnover		
International telecommunications services	**418,276**	532,595
Fixed telecommunications network services (note 3(c))	**741,303**	604,761
	1,159,579	1,137,356
Other revenues		
Interest income	**20,378**	13,578
Other income	**4,465**	6,037
	24,843	19,615
Total revenues	**1,184,422**	1,156,971

(a) Primary reporting format – business segments

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

– International telecommunications : provision of international long distance calls services

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

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

2006	International telecommunications services HK$'000	Fixed telecommunications network services HK$'000	Elimination HK$'000	Group HK$'000
Turnover				
– External sales	**418,276**	**741,303**	**–**	**1,159,579**
– Inter-segment sales	**5,670**	**31,275**	**(36,945)**	**–**
	423,946	**772,578**	**(36,945)**	**1,159,579**
Segment results	**43,405**	**(54,253)**		**(10,848)**
Finance costs				**(88,637)**
Loss before taxation				**(99,485)**
Tax benefit				**7,244**
Net loss				**(92,241)**

2005	International telecommunications services HK$'000 (restated)	Fixed telecommunications network services HK$'000 (restated)	Elimination HK$'000	Group HK$'000 (restated)
Turnover				
– External sales	532,595	604,761	–	1,137,356
– Inter-segment sales	4,108	33,188	(37,296)	–
	536,703	637,949	(37,296)	1,137,356
Segment results	103,075	(268,655)		(165,580)
Finance costs				(54,462)
Loss before taxation				(220,042)
Tax benefit				6,725
Net loss				(213,317)

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

3. TURNOVER, REVENUES AND SEGMENT INFORMATION *(CONTINUED)*

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

2006	International telecommunications services HK$'000	Fixed telecommunications network services HK$'000	Group HK$'000
Segment assets	**626,480**	**1,497,388**	**2,123,868**
Unallocated assets			**347**
Total assets			**2,124,215**
Segment liabilities	**114,847**	**921,230**	**1,036,077**
Unallocated liabilities			**196,484**
Total liabilities			**1,232,561**
Significant non-cash expenses:			
Capital expenditure	**13,838**	**309,097**	**322,935**
Depreciation	**23,598**	**252,866**	**276,464**

2005	International telecommunications services HK$'000	Fixed telecommunications network services HK$'000	Group HK$'000
Segment assets	942,304	1,354,768	2,297,072
Unallocated assets			535
Total assets			2,297,607
Segment liabilities	130,011	721,748	851,759
Unallocated liabilities			475,215
Total liabilities			1,326,974
Significant non-cash expenses:			
Capital expenditure	11,582	407,544	419,126
Depreciation	24,928	211,721	236,649
Goodwill amortisation charge	–	1,065	1,065

(b) Secondary reporting format – geographical segments

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

– Hong Kong : international telecommunications and fixed telecommunications network services

– Canada : international telecommunications and fixed telecommunications network services

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

3. TURNOVER, REVENUES AND SEGMENT INFORMATION *(CONTINUED)*

(b) Secondary reporting format – geographical segments *(CONTINUED)*

There were no sales between the geographical segments.

2006	Turnover HK$'000	Segment results HK$'000	Total assets HK$'000	Capital expenditure HK$'000
Hong Kong	**1,139,155**	**(6,177)**	**2,114,018**	**321,708**
Canada	**20,424**	**(4,671)**	**9,850**	**1,227**
	1,159,579		**2,123,868**	**322,935**
Operating loss		**(10,848)**		
Unallocated assets			**347**	
Total assets			**2,124,215**	

2005	Turnover HK$'000	Segment results HK$'000 (restated)	Total assets HK$'000	Capital expenditure HK$'000
Hong Kong	1,114,118	(162,775)	2,287,972	418,981
Canada	23,238	(2,805)	9,100	145
	1,137,356		2,297,072	419,126
Operating loss		(165,580)		
Unallocated assets			535	
Total assets			2,297,607	

(c) Hong Kong Broadband Network Limited ("HKBN"), a wholly-owned subsidiary of the Group, as a Fixed Telecommunications Network Services ("FTNS") licensee, provides interconnection services to enable delivery of telecommunications service to customers of different operators. Since the FTNS license was granted by the Telecommunications Authority ("TA") and interconnection services have been provided, HKBN has been recognising interconnection services billed to mobile operators as revenue ("mobile interconnection charges"). As at 31 August 2005, substantially all of the mobile operators had not made any payments to HKBN since 2002 when HKBN started to bill for the mobile interconnection services.

The charges recognised as income up to 31 August 2004 were determined using the available rates under the existing calculation model (fully distributed cost model) for interconnection service between fixed and mobile operators, which are based on historical cost data of PCCW-HKT Telephone Limited ("PCCW-HKT"). In May 2004, TA confirmed to HKBN that mobile operators should pay interconnection charges to fixed network operators in accordance with the existing charging principles under the relevant TA statements. In August 2004, TA agreed to make a determination (the "Determination") under section 36A of the Telecommunications Ordinance to cover the level of mobile and fixed interconnection charges payable by one of the mobile operators to HKBN; and the effective date of the determined interconnection charges.

According to TA statement on "Revision of Procedures for Making Determinations on the Terms and Conditions of Interconnection Agreements" dated 27 September 2001, the benchmark for determination processing time on "Complex Cases" is approximately six and a half months. This benchmark processing time passed without determination being made as of the date of issuance of the 2005 financial statements. Therefore, the Group performed an assessment as at 31 August 2005 on the timing and the recoverability of these charges and determined that it was not able to provide a reasonable estimate on the timing of the completion of the determination process. Accordingly, the Group concluded that no revenue from the mobile interconnection charges billed to several mobile operators should be recognised for the year ended 31 August 2005.

In addition, management evaluated the collectibility of the receivables of HK$44,617,000 relating to mobile interconnection charges as at 31 August 2005 and determined that a full bad debt provision needed to be made due to the uncertainties about the timing of the collection and the long outstanding aging of the receivable balance.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

3. TURNOVER, REVENUES AND SEGMENT INFORMATION *(CONTINUED)*

(c) *(CONTINUED)*

During the year ended 31 August 2006, the following events have happened:

- In late November 2005, HKBN entered into a contractual agreement with a mobile operator which agreed to pay mobile interconnection charges at an interim rate based on PCCW-HKT's published rate of HK$0.0436 per occupancy minute. The final rate to be paid by this mobile operator will be adjusted based on the Determination issued by TA.

- In December 2005, TA indicated that it would make a determination of the mobile interconnection charges by the end of April 2006.

- In March 2006, TA issued a preliminary analysis on the Determination with respect to the rates of mobile interconnection charges ("preliminary rates") payable by the mobile operator under dispute and the timing of the Determination. However, the final level of mobile interconnection charges is still subject to the Determination to be issued by TA.

Based on the above, management re-assessed its previous conclusions regarding revenue recognition for mobile interconnection charges for the year ended 31 August 2006 and the amount it expected to collect for billings outstanding through that date. As a result of the re-assessment, the Group recorded revenue related to mobile interconnection charges of HK$46,740,000 for the year ended 31 August 2006 which comprises charges for the year ended 31 August 2005 previously not recognised due to the uncertainties existed at that time and charges for the current year, both of which were measured based on the preliminary rates from TA.

During the year, the Group also updated its assessment of the bad debt provision previously set up for mobile interconnection charges receivable as at 31 August 2005 and reduced the provision from HK$44,617,000 to HK$20,809,000.

4. NETWORK COSTS AND COST OF INVENTORIES

Network costs and cost of inventories mainly include interconnection charges paid to local and overseas carriers, leased line rentals, program fees, production costs for the IP-TV service and costs of inventories sold, and do not include depreciation charge which is included in other operating expenses.

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

On 13 November 2006, TA issued a statement on the USC and confirmed the actual contribution level for calendar year 2004. In aggregate, an amount of HK$1,365,088 was recorded as a reduction against the network costs of the Group for the year ended 31 August 2006.

On 11 November 2005, TA issued a statement on the USC and confirmed the actual contribution level for calendar year 2003. In aggregate, an amount of HK$6,447,888 was recorded as a reduction against the network costs of the Group for the year ended 31 August 2005.

The actual contribution level for calendar year 2005 and 2006 has not yet been confirmed by TA.

5. LOSS BEFORE TAXATION

Loss before taxation is arrived at after charging/(crediting):

(a) Other operating expenses

	2006 HK$'000	2005 HK$'000 (restated)
Advertising and marketing expenses (note i)	**204,952**	267,983
Goodwill amortisation charge	**–**	1,065
Amortisation of deferred expenditure (note 18)	**13,973**	12,927
Auditors' remuneration	**2,990**	1,914
Depreciation of owned fixed assets	**275,538**	236,269
Depreciation of fixed assets held under finance lease	**926**	380
Impairment loss – investment property	**1,131**	–
Operating lease charges in respect of land and buildings	**17,556**	13,081
Operating lease charges in respect of equipment	**840**	914
(Write-back of provision)/provision for doubtful debts (note ii)	**(7,668)**	60,563
Loss/(gain) on disposal of fixed assets	**9,621**	(134)
Staff costs (note 5(c))	**256,721**	259,392
Others	**118,097**	128,795
	894,677	983,149

(i) Included in the advertising and marketing expenses is expense in respect of equity settled share-based transaction of HK$143,000 (2005: HK$560,000).

(ii) The amount for the year ended 31 August 2006 included write-back of provision for mobile interconnection charges receivables of HK$23,808,000 (2005: provision of HK$44,617,000) (note 3(c)).

(b) Finance costs

	2006 HK$'000	2005 HK$'000
Interest on long term bank loans and overdrafts	**–**	2,421
Interest element of finance leases	**54**	23
Interest on 10-year senior notes	**85,235**	52,372
Amortisation of incidental issuance costs	**1,429**	1,693
Other borrowing costs	**1,919**	–
Total borrowing cost incurred	**88,637**	56,509
Less: Interest capitalised as fixed assets (note)	**–**	(2,047)
	88,637	54,462

Note: The entire sum of previous year's interest from the long-term bank loan, which was fully repaid during January 2005, was capitalised as fixed assets.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

5. LOSS BEFORE TAXATION *(CONTINUED)*

(c) Staff costs

	2006 HK$'000	2005 HK$'000 (restated)
Wages and salaries	**244,337**	245,472
Unutilised annual leave	**(312)**	924
Equity settled share-based transactions	**6,680**	6,405
Retirement benefit costs – defined contribution plans (note 10)	**27,956**	27,437
Less: Staff costs capitalised as fixed assets	**(21,940)**	(20,846)
	256,721	259,392

Staff costs include directors' emoluments and research and development cost of HK$9,605,000 (2005: HK$11,023,000) but exclude staff costs of HK$19,949,000 (2005: HK$21,860,000) recorded in network costs and HK$121,883,000 (2005 (restated): HK$143,631,000) recorded in advertising and marketing expenses.

(d) Other items

	2006 HK$'000	2005 HK$'000 (restated)
Net exchange gains	**(1,044)**	(3,300)
Unrealised gains on other financial assets	**(668)**	(300)
Realised and unrealised loss on derivative financial instruments	**125**	–
Cost of inventories	**21,249**	23,105

6. TAXATION

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profit for the year. Taxation on overseas profits has been calculated on the estimated assessable profit for the year at the income tax rates prevailing in the overseas countries in which the Group operates.

The amount of tax benefit to the consolidated statement of operations represents:

	2006 HK$'000	2005 HK$'000
Current taxation:		
– Hong Kong profits tax	**24**	147
– Overseas taxation	**2,367**	919
– Underprovision in prior years	**552**	333
Deferred taxation relating to the origination and reversal of temporary differences (note 24)	**(10,187)**	(8,124)
Tax benefit	**(7,244)**	(6,725)

6. TAXATION *(CONTINUED)*

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

	2006 HK$'000	2005 HK$'000 (restated)
Loss before tax	**(99,485)**	(220,042)
Notional tax on loss before tax, calculated at the prevailing tax rates applicable to loss in the countries concerned	**(16,951)**	(38,371)
Effect of income not subject to taxation	**(3,492)**	(3,963)
Effect of expenses not deductible for taxation purposes	**883**	1,788
Recognition of deferred tax assets in respect of tax losses of prior years, net of other temporary differences	**(2,416)**	(4,981)
Effect of share-based payment not recognised	**2,305**	1,219
Effect of tax loss not recognised	**11,878**	37,183
Underprovision of Hong Kong income tax in prior years	**552**	333
Others	**(3)**	67
Tax benefit	**(7,244)**	(6,725)

7. LOSS ATTRIBUTABLE TO SHAREHOLDERS

The loss attributable to shareholders is dealt with in the financial statements of the Company to the extent of HK$30,893,000 (2005 (restated): a loss of HK$35,340,000).

8. DIVIDENDS

The board of directors has resolved not to declare any final dividend for the year ended 31 August 2006 (2005: Nil).

9. LOSS PER SHARE

	2006 HK$'000	2005 HK$'000 (restated)
Loss attributable to shareholders	**(92,241)**	(213,317)

Weighted average number of ordinary shares

	2006 No. of shares in thousand	2005 No. of shares in thousand
Issued ordinary shares at 1 September	**614,125**	610,573
Effect of share options exercised	**9**	4
Effect of warrants exercised	**–**	2,948
Weighted average number of ordinary shares	**614,134**	613,525

	2006 No. of shares in thousand	2005 No. of shares in thousand (restated)
Weighted average number of shares in issue	**614,134**	613,525
Incremental shares from assumed exercise of share options	**–**	–
Diluted weighted average number of shares	**614,134**	613,525
Basic and diluted loss per share	**HK 15.0 cents**	HK 34.8 cents

The number of shares used in the calculation of diluted loss per share is equal to the number of shares used to calculate basic loss per share as the incremental effect of share options would be anti-dilutive in a loss-making year.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

10. RETIREMENT BENEFIT COSTS

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

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

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

The aggregate employer's contributions, net of forfeited contributions, which have been dealt with in the consolidated statement of operations during the year are as follows:

	2006 **HK$'000**	2005 HK$'000
Gross contributions	**28,912**	27,789
Less: Forfeited contributions utilised to offset the Group's contributions during the year	**(956)**	(352)
Net contributions charged to consolidated statement of operations (note 5(c))	**27,956**	27,437

At 31 August 2006, there was no forfeited contribution available to offset future contributions by the Group to the schemes (2005: $Nil).

11. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

(a) Directors' remuneration

The remuneration of each director for the year ended 31 August 2006 is set out below:

Name of Director	**Fee** HK$'000	**Salary** HK$'000	**Discretionary bonuses** HK$'000	**Share-based payment** HK$'000	**Employer's contribution to pension scheme** HK$'000	**Total** HK$'000
Wong Wai Kai, Ricky	–	5,856	488	1,683	586	8,613
Cheung Chi Kin, Paul	–	5,856	488	1,683	586	8,613
Lai Ni Quiaque***	–	1,480	123	154	148	1,905
Sio Veng Kuan, Corinna*	–	407	–	145	36	588
Chan Kin Man	150	–	–	–	–	150
Cheng Mo Chi, Moses	145	–	–	–	–	145
Lee Hon Ying, John	160	–	–	–	–	160
Peh Jefferson Tun Lu	150	–	–	–	–	150
Total	605	13,599	1,099	3,665	1,356	20,324

11. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS *(CONTINUED)*

(a) Directors' remuneration *(CONTINUED)*

The remuneration of each director for the year ended 31 August 2005 is set out below:

Name of Director	Fee HK$'000	Salary HK$'000	Discretionary bonuses HK$'000	Share-based payment HK$'000	Employer's contribution to pension scheme HK$'000	Total HK$'000
Wong Wai Kai, Ricky	–	5,856	418	1,586	585	8,445
Cheung Chi Kin, Paul	–	5,856	418	1,586	585	8,445
Chong Kin Chun, John**	–	2,223	126	447	154	2,950
Fung So Mui, Fion**	–	850	70	147	85	1,152
Sio Veng Kuan, Corinna*	–	1,069	88	224	107	1,488
To Wai Bing**	–	1,337	110	447	134	2,028
Chan Kin Man	116	–	–	–	–	116
Cheng Mo Chi, Moses	139	–	–	–	–	139
Lee Hon Ying, John	116	–	–	–	–	116
Peh Jefferson Tun Lu	116	–	–	–	–	116
Total	487	17,191	1,230	4,437	1,650	24,995

* Resigned on 1 January 2006
** Resigned on 28 July 2005
*** Appointed on 1 January 2006

No director waived any emoluments in respect of the years ended 31 August 2005 and 2006.

The above emoluments include the fair value of share options granted to certain directors under the Company's share option scheme as estimated at the date of grant. The details of the benefits in kind are disclosed in note 12.

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include three (2005: four) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining two (2005: one) individuals during the year are as follows:

	2006 HK$'000	2005 HK$'000 (restated)
Basic salaries, other allowances and benefits in kind	**4,884**	1,457
Discretionary bonuses	**117**	80
Share-based payments	**746**	353
Retirement benefit costs – defined contribution plans	**455**	12
	6,202	1,902

The emoluments fell within the following band:

	Number of individual **2006**	2005
HK$1,500,001 – HK$2,000,000	**–**	1
HK$2,500,001 – HK$3,000,000	**1**	–
HK$3,500,001 – HK$4,000,000	**1**	–

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

12. EQUITY SETTLED SHARE-BASED TRANSACTIONS

The Company operates a share option scheme (the "2002 Share Option Scheme") which was adopted by the shareholders of the Company on 23 December 2002 which the directors may, at their discretion, invite eligible participants to take up options to subscribe for shares subject to the terms and conditions stipulated therein.

The Company also had a previous share option scheme (the "1997 Share Option Scheme") adopted by shareholders on 12 July 1997 which was terminated on 23 December 2002 upon the adoption of the 2002 Share Option Scheme. Upon termination, no further options can be granted under the 1997 Share Option Scheme but the provisions of such scheme in all other respects remain in force and all options granted prior to termination continue to be valid and exercisable.

Effective from 1 September 2005, upon the adoption of HKFRS 2 Share-based payment, the Group recognises the fair value of share options granted under 2002 Share Option Scheme over the vesting period, or as an asset, if the cost qualifies for recognition as an asset. The fair value of share option is measured at the date of grant.

However, the Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the new recognition and measurement policies have not been applied to the following options:

(i) share options granted under the 1997 Share Option Scheme since all options were granted to employees before 7 November 2002; and

(ii) share options granted under the 2002 Share Option Scheme and vested before 1 September 2005.

(a) The terms and conditions of the grants that existed (inclusive of options cancelled or exercised) during the year are as follows, whereby all options are settled by physical delivery of shares:

	Number of option	Vesting conditions	Contractual life of options
1997 Share Option Scheme			
Options granted to employees:			
– 3 September 1998	190,000	3 September 1998 to 2 September 2000	8 years and 10 months
– 10 September 1999	60,000	Immediately effect	7 years and 10 months
– 20 October 2000	298,000	20 October 2000 to 1 June 2001	6 years and 9 months
Total share options	548,000		
2002 Share Option Scheme			
Options granted to directors:			
– 3 June 2004	6,000,000	3 June 2004 to 30 April 2006	10 years
– 21 October 2004	1,000,000	21 October 2004 to 31 December 2006	10 years
– 5 January 2005	16,000,000	5 January 2005 to 31 December 2006	10 years
– 22 May 2006	15,000,000	22 May 2006 to 21 May 2009	10 years
Options granted to employees:			
– 21 October 2004	13,670,000	21 October 2004 to 31 December 2006	10 years
– 3 October 2005	1,000,000	3 October 2005 to 30 September 2006	10 years
– 22 May 2006	17,210,000	22 May 2006 to 21 May 2009	10 years
– 3 July 2006	1,000,000	3 July 2006 to 2 July 2009	10 years
– 3 August 2006	100,000	3 August 2006 to 2 August 2009	10 years
Total share options	70,980,000		
Total share options	71,528,000		

12. EQUITY SETTLED SHARE-BASED TRANSACTIONS *(CONTINUED)*

(b) The number and weighted average exercise prices of share options are as follows:

	2006 Weighted average exercise price	2006 Number of options	2005 Weighted average exercise price	2005 Number of options
1997 Share Option Scheme				
Outstanding at the beginning of the year	**0.64**	**548,000**	0.63	600,000
Lapsed during the year	**1.34**	**(40,000)**	–	–
Exercised during the year	**0.26**	**(50,000)**	0.58	(52,000)
Outstanding at the end of the year	**0.61**	**458,000**	0.64	548,000
Exercisable at the end of the year	**0.61**	**458,000**	0.64	548,000
2002 Share Option Scheme				
Outstanding at the beginning of the year	**1.53**	**36,670,000**	1.47	6,000,000
Granted during the year	**0.67**	**34,310,000**	1.54	30,670,000
Lapsed during the year	**1.54**	**(5,220,000)**	–	–
Outstanding at the end of the year	**1.08**	**65,760,000**	1.53	36,670,000
Exercisable at the end of the year	**1.52**	**25,670,000**	1.52	20,400,000

The options outstanding at 31 August 2006 had a weighted exercise price of HK$1.08 (2005: HK$1.52) and a weighted average remaining contractual life of 9 years (2005: 9 years).

(c) Fair value of share options and assumptions

In assessing the value of the share options granted during the year ended 31 August 2006, the Black-Scholes option pricing model (the "Black-Scholes Model") has been used. The Black-Scholes Model is one of the most generally accepted methodologies used to calculate the value of options and is one of the recommended option pricing models as set out in Chapter 17 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited. The variables of the Black-Scholes Model include expected life of the options, risk-free interest rate, expected volatility, expected dividend and the market value of the ordinary shares of the Company.

In assessing the value of the share options granted during the year, the following variables have been applied to the Black-Scholes Model:

Measurement Date	**3 October 2005**	**22 May 2006**	**3 July 2006**	**3 August 2006**
Variables				
– Expected life	5 years	5 years	5 years	5 years
– Risk-free rate	4.41%	4.63%	4.45%	4.06%
– Expected volatility	58.29%	55.04%	53.56%	52.71%
– Expected dividend yield	0%	0%	0%	0%

The above variables were determined as follows:

(i) The expected life is estimated to be 5 years from the date of grant (the "Measurement Date").

(ii) The risk-free rate represents the yield of the Hong Kong Exchange Fund Notes corresponding to the expected life of the options as at the Measurement Date.

(iii) The expected volatility represents the annualised standard deviation of the continuously compounded rates of return on the shares of the most recent period from the Measurement Date that is generally commensurate with the expected term of option (taking into account the remaining contractual life of the option and the effects of the expected early exercise of the option).

(iv) A dividend yield of 0% has been assumed.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

12. EQUITY SETTLED SHARE-BASED TRANSACTIONS *(CONTINUED)*

(c) Fair value of share options and assumptions *(CONTINUED)*

Using the Black-Scholes Model in assessing the value of share options granted during the year, the fair value is estimated as below:

Date of grant	3 October 2005	22 May 2006	3 July 2006	3 August 2006
Fair value per share option	HK$0.44	HK$0.33	HK$0.35	HK$0.36

The Black-Scholes Model, applied for determination of the estimated fair value of the share options granted under the 2002 Share Option Scheme, was developed for use in estimating the fair value of traded options that are fully transferable and have no vesting restrictions. Such an option pricing model requires input of highly subjective assumptions, including the expected stock volatility. As the Company's share options have characteristics significantly different from those of traded options, changes in subjective inputs may materially affect the estimated fair value of the options granted.

13. GOODWILL – GROUP

	The Group HK$'000
Cost:	
At 31 August 2005	5,326
At 1 September 2005	5,326
Opening balance adjustment to eliminate accumulated amortisation	(4,260)
At 31 August 2006	1,066
Accumulated amortisation:	
At 1 September 2004	3,195
Amortisation for the year	1,065
At 31 August 2005	4,260
At 1 September 2005	4,260
Eliminated against cost at 1 September 2005	(4,260)
At 31 August 2006	–
Carrying amount	
At 31 August 2006	1,066
At 31 August 2005	1,066

In 2005, positive goodwill not already recognised directly in reserves was amortised on a straight-line basis over five years. The amortisation of positive goodwill for the year ended 31 August 2005 was included in "other operating expenses" in the consolidated statement of operations.

As explained further in note 2(b), with effect from 1 September 2005 the Group no longer amortises goodwill. In accordance with the transitional provisions set out in HKFRS 3, the accumulated amortisation of goodwill as at 1 September 2005 has been eliminated against the cost of goodwill as at that date.

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Group's cash-generating units (CGU) identified according to country of operation and business segment as follows:

	2006 HK$'000	2005 HK$'000
Fixed telecommunications network services segment	**1,066**	1,066

13. GOODWILL – GROUP *(CONTINUED)*

Impairment tests for cash-generating units containing goodwill *(CONTINUED)*

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a three-year period. Cash flows for the three-year period are estimated based on growth rates between 10% to 17% and a pre-tax discount rate of 18%. Cash flows beyond the three year period are assumed to remain constant. The estimated growth rates used are comparable to the growth rate for the industry.

The key assumption used in the value-in-use calculation is the annual growth of the turnover of the fixed telecommunications network services segment and it is determined based on the past performance and management's expectation for market development. The discount rate used is pre-tax and reflects specific risks relating to the Fixed telecommunication services segment.

The carrying amount of the unit approximates to its recoverable amount. Any adverse change in the key assumption could reduce the recoverable amount below carrying amount.

14. FIXED ASSETS

Group

	Investment property HK$'000	Leasehold land and buildings HK$'000	Leasehold improvements HK$'000	Furniture, fixtures and fittings HK$'000	Telecom–munications, computer and office equipment HK$'000	Motor vehicles HK$'000	Total HK$'000
Cost:							
At 1 September 2005	–	84,170	68,618	15,492	2,067,146	8,372	2,243,798
Additions	–	625	9,342	2,880	309,744	344	322,935
Disposals	–	–	–	(728)	(26,817)	(1,760)	(29,305)
Transfer to investment property	5,197	(5,197)	–	–	–	–	–
Exchange adjustments	–	–	281	126	2,180	–	2,587
At 31 August 2006	5,197	79,598	78,241	17,770	2,352,253	6,956	2,540,015
Accumulated depreciation:							
At 1 September 2005	–	6,702	30,225	10,509	853,325	6,494	907,255
Charge for the year	–	1,695	9,980	2,190	261,819	780	276,464
Disposals	–	–	–	(326)	(11,922)	(1,760)	(14,008)
Transfer to investment property	866	(866)	–	–	–	–	–
Impairment loss (note (a))	1,131	–	–	–	–	–	1,131
Exchange adjustments	–	–	223	74	1,642	–	1,939
At 31 August 2006	1,997	7,531	40,428	12,447	1,104,864	5,514	1,172,781
Net book value:							
At 31 August 2006	3,200	72,067	37,813	5,323	1,247,389	1,442	1,367,234

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

14. FIXED ASSETS *(CONTINUED)*

Group *(CONTINUED)*

	Leasehold land and buildings HK$'000	Leasehold improvements HK$'000	Furniture, fixtures and fittings HK$'000	Telecom–munications, computer and office equipment HK$'000	Motor vehicles HK$'000	Total HK$'000
Cost:						
At 1 September 2004	83,708	64,699	13,238	1,660,799	7,773	1,830,217
Additions	462	3,701	2,122	411,550	1,291	419,126
Adjustment (note (b))	–	–	–	(4,825)	–	(4,825)
Disposals	–	(26)	(1)	(2,875)	(692)	(3,594)
Exchange adjustments	–	244	133	2,497	–	2,874
At 31 August 2005	84,170	68,618	15,492	2,067,146	8,372	2,243,798
Accumulated depreciation:						
At 1 September 2004	5,024	21,603	9,052	630,027	5,636	671,342
Charge for the year	1,678	8,445	1,390	224,444	1,346	237,303
Adjustment (note (b))	–	–	–	(654)	–	(654)
Disposals	–	(11)	(1)	(2,260)	(488)	(2,760)
Exchange adjustments	–	188	68	1,768	–	2,024
At 31 August 2005	6,702	30,225	10,509	853,325	6,494	907,255
Net book value:						
At 31 August 2005	77,468	38,393	4,983	1,213,821	1,878	1,336,543

Company

	Investment property HK$'000	Leasehold land and buildings HK$'000	Leasehold improvements HK$'000	Furniture, fixtures and fittings HK$'000	Telecom–munications, computer and office equipment HK$'000	Motor vehicles HK$'000	Total HK$'000
Cost:							
At 1 September 2005	–	5,197	7,898	7,145	312,130	5,425	337,795
Additions	–	–	59	6	2,234	–	2,299
Transfer to investment property	5,197	(5,197)	–	–	–	–	–
Disposals	–	–	–	–	(1,929)	(1,760)	(3,689)
At 31 August 2006	5,197	–	7,957	7,151	312,435	3,665	336,405
Accumulated depreciation:							
At 1 September 2005	–	762	4,854	6,675	187,201	4,975	204,467
Charge for the year	–	104	652	153	18,391	176	19,476
Transfer to investment property	866	(866)	–	–	–	–	–
Impairment loss (note (a))	1,131	–	–	–	–	–	1,131
Disposals	–	–	–	–	(1,923)	(1,760)	(3,683)
At 31 August 2006	1,997	–	5,506	6,828	203,669	3,391	221,391
Net book value:							
At 31 August 2006	3,200	–	2,451	323	108,766	274	115,014

14. FIXED ASSETS *(CONTINUED)*

Company *(CONTINUED)*

	Leasehold land and buildings HK$'000	Leasehold improvements HK$'000	Furniture, fixtures and fittings HK$'000	Telecom–munications, computer and office equipment HK$'000	Motor vehicles HK$'000	Total HK$'000
Cost:						
At 1 September 2004	5,197	7,845	7,020	315,104	5,425	340,591
Additions	–	53	127	6,906	–	7,086
Adjustment (note (b))	–	–	–	(4,825)	–	(4,825)
Disposals	–	–	(2)	(5,055)	–	(5,057)
At 31 August 2005	5,197	7,898	7,145	312,130	5,425	337,795
Accumulated depreciation:						
At 1 September 2004	658	4,156	6,531	167,730	4,109	183,184
Charge for the year	104	698	146	20,301	866	22,115
Adjustment (note (b))	–	–	–	(654)	–	(654)
Disposals	–	–	(2)	(176)	–	(178)
At 31 August 2005	762	4,854	6,675	187,201	4,975	204,467
Net book value:						
At 31 August 2005	4,435	3,044	470	124,929	450	133,328

(a) In 2006, a property which had been held for own use was leased to a third party to earn rental income. Under HKAS 40, Investment Property, the Group has adopted the cost model and recorded the property at cost less accumulated depreciation and impairment losses, if any. Upon adoption of HKAS 40, the Group assessed the open market value of the property and based on such assessment, wrote down the carrying amount of the property by HK$1,131,000 (included in "other operating expenses"). The estimate of open market value was made by reference to net rental income allowing for reversionary income potential.

(b) The adjustment of the cost and the depreciation charge for the year ended 31 August 2005 of the Group and the Company amounting to HK$4,825,000 and HK$654,000 represented the adjustment for estimated acquisition cost related to the submarine cable made in prior years, which was finalised and adjusted accordingly during the year ended 31 August 2005.

(c) The Group's and the Company's total future aggregate lease income receivable under non-cancellable operating lease as follows:

	2006 HK$'000	2005 HK$'000
Within 1 year	**228**	–
After 1 year but within 5 years	**228**	–
	456	–

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

14. FIXED ASSETS *(CONTINUED)*

Company *(CONTINUED)*

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

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Leases of between 10 to 50 years	**75,267**	77,468	**3,200**	4,435

Representing:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Leasehold land and building carried at cost	**72,067**	77,468	**–**	4,435
Investment property arrived at cost less impairment loss	**3,200**	–	**3,200**	–
	75,267	77,468	**3,200**	4,435

In addition to the leasehold land and buildings classified as being held under a finance lease, the Group leases telecommunications, computer and office equipment under finance leases expiring from one to five years. At the end of the lease term the Group has the option to purchase the equipment at a price deemed to be a bargain purchase option. None of the leases included contingent rental.

(e) At 31 August 2006, the net book value of telecommunications, computer and office equipment under finance lease held by the Group amounted to HK$2,772,000 (2005: HK$3,251,000).

15. INVESTMENTS IN SUBSIDIARIES

	Company	
	2006 HK$'000	2005 HK$'000 (restated)
Unlisted investments, at cost (note (a))	**51,791**	51,791
Amounts due from subsidiaries (note (b))	**1,492,749**	1,159,455
	1,544,540	1,211,246
Less: Impairment loss	**(7,722)**	(5,326)
	1,536,818	1,205,920

15. INVESTMENTS IN SUBSIDIARIES *(CONTINUED)*

Notes:

(a) The following is a list of the principal subsidiaries which principally affected the results, assets or liabilities of the Group at 31 August 2006:

Name	Place of incorporation	Principal activities and place of operations	Particulars of issued share capital	Percentage of interest held
Attitude Holdings Limited	British Virgin Islands	Inactive	Ordinary US$1	100
Automedia Holdings Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$1	* 100
City Telecom (B.C.) Inc. #	Canada	Provision of international telecommunications and dial-up internet access services in Canada	Common CAD501,000	100
City Telecom (Canada) Inc. #	Canada	Leasing and maintenance of switching equipment and provision of operational services in Canada	Common CAD100	100
City Telecom Inc. #	Canada	Provision of international telecommunications and dial-up internet access services in Canada	Common CAD1,000	100
City Telecom International Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$5,294	* 100
Credibility Holdings Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$1	* 100
CTI Guangzhou Customer Services Co. Ltd. (translated from the registered name in Chinese) #	The People's Republic of China ("the PRC")	Provision of administrative support services in the PRC	Paid in capital of HK$8,000,000	* 100
CTI Marketing Company Limited	Hong Kong	Provision of media marketing services in Hong Kong	Ordinary HK$10,000	100
Golden Trinity Holdings Limited	British Virgin Islands	Investment holding in Hong Kong	Ordinary US$1	* 100
Hong Kong Broadband Network Limited	Hong Kong	Provision of international telecommunications and fixed telecommunications network services in Hong Kong	Ordinary HK$383,049	100
IDD 1600 Company Limited	Hong Kong	Provision of international telecommunications services in Hong Kong	Ordinary HK$2	100

* Shares held directly by the Company.

\# Subsidiaries not audited by KPMG.

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

16. OTHER FINANCIAL ASSETS

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Debt securities, at fair value and unlisted outside Hong Kong-unrestricted	**26,633**	25,901	**23,004**	22,315
Long term bank deposit, at amortised cost (note)	**13,641**	15,540	**13,641**	15,540
	40,274	41,441	**36,645**	37,855

Note: The balance is a ten-year US$2 million (31 August 2005: US$2 million) (equivalent to HK$15,560,000) deposit placed with a bank in which the Group receives a floating rate deposit interest. An interest rate of 10% per annum has been guaranteed for the first year from the inception date on 22 August 2003. The deposit has a 10-year term maturing on 22 August 2013. The deposit will be terminated once the cumulative interest reaches the predetermined accrued interest cap at 13% of the principal amount or an aggregate sum of US$260,000 (equivalent to HK$2,022,800). The effective interest rate of the long-term deposit for the year ended 31 August 2006 is 5.4% (2005: 5.4%) per annum.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

17. DERIVATIVE FINANCIAL INSTRUMENT

	Group	
	2006 HK$'000	2005 HK$'000
Non-current assets		
Interest rate swap, at fair value through profit or loss	**1,845**	–
Current assets		
Forward foreign exchange contracts, at fair value through profit or loss	**–**	–
	1,845	–

(a) Interest rate swap

As at 31 August 2006, the Group had an outstanding interest rate swap contract with notional principle amount of HK$66,666,667 (2005: HK$86,666,667).

Under this arrangement, the Group will pay a fixed rate interest of 2.675% per annum on the notional amount on a monthly basis, and receive a floating interest rate based on HIBOR rate.

The purpose of the arrangement was to hedge the interest payments on the long-term bank loan which bears a floating interest rate. The said loan was fully repaid by 24 January 2005 but the interest rate swap contract remains valid. The maturity date of the contract is 1 December 2009.

(b) Forward foreign exchange contracts

As at 31 August 2005, the Group had outstanding forward foreign exchange contracts of RMB155,632,000 and US$13,421,000 that mature at various dates over the following one year. The purpose of the arrangement is to manage the Group's exposure to foreign currencies fluctuations. All of the forward contracts matured during the year ended 31 August 2006.

18. DEFERRED EXPENDITURE

	Group	
	2006 HK$'000	2005 HK$'000
Balance at the beginning of the year	**21,131**	21,563
Additions during the year	**5,287**	12,495
Less: Amortisation charge for the year (note 5(a))	**(13,973)**	(12,927)
	12,445	21,131
Current portion	**(10,808)**	(12,960)
Balance as at the end of the year	**1,637**	8,171

Deferred expenditure represents costs incurred to acquire subscribers of the services offered by the Group, which is treated as customer acquisition costs and are amortised over the period of the underlying service subscription agreements.

19. ACCOUNTS RECEIVABLE

The majority of the Group's accounts receivables are due within 30 days from the date of billings. Subscribers with receivables that are more than 3 months overdue are requested to settle all outstanding balances before any further credit is granted.

The aging analysis of the accounts receivable was as follows:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Current – 30 days	**58,700**	57,028	**10,188**	13,336
31 – 60 days	**13,277**	14,775	**888**	888
61 – 90 days	**9,442**	5,824	**358**	325
Over 90 days (note (a))	**114,924**	75,996	**2,130**	1,773
	196,343	153,623	**13,564**	16,322
Less: Provision for doubtful debts (note (b))	**(55,745)**	(73,434)	**(1,058)**	(1,069)
	140,598	80,189	**12,506**	15,253

19. ACCOUNTS RECEIVABLE *(CONTINUED)*

Notes:

(a) The amounts over 90 days for the Group included receivables relating to mobile interconnection charges of HK$82,864,000 for the year ended 31 August 2006 (31 August 2005: HK$44,666,000).

(b) Provision for doubtful debts as at 31 August 2006 includes provision for mobile interconnection charges receivables of HK$20,809,000 (31 August, 2005: HK$44,617,000) (see note 3(c)).

20. INVENTORIES

(a) Inventories in the balance sheet comprise:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Finished goods	**856**	1,957	**812**	1,581

(b) The amount of inventories recognised as an expense is analysed as follows:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Cost of inventories	**21,249**	23,105	**18,621**	22,989

21. CASH AT BANK AND IN HAND

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Time deposits with banks and other financial institutions	**100,200**	438,688	**63,143**	416,210
Cash at bank and in hand	**44,717**	100,903	**23,527**	44,791
Cash at bank and in hand in the balance sheet	**144,917**	539,591	**86,670**	461,001

Included in cash at bank and in hand 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	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
RMB	**27,453**	19,506	**–**	–
USD	**5,182**	25,084	**4,811**	24,105
CAD	**459**	355	**47**	45
YEN	**5,195**	4,424	**5,195**	4,424
AUD	**14**	–	**–**	–

22. ACCOUNTS PAYABLE

The aging analysis of the accounts payable was as follows:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Current – 30 days	**15,395**	6,641	**5,392**	6,542
31 – 60 days	**8,284**	19,469	**4,334**	8,979
61 – 90 days	**6,874**	5,041	**5,212**	4,555
Over 90 days	**55,832**	59,611	**44,205**	38,652
	86,385	90,762	**59,143**	58,728

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

23. CAPITAL AND RESERVES

(a) Group

	Share capital HK$'000	Share premium HK$'000	Capital reserve HK$'000	Retained profits HK$'000	Exchange Reserve HK$'000	Total HK$'000
At 1 September 2005						
– as previously reported	61,412	619,408	–	288,973	840	970,633
– prior period adjustment arising from adoption of HKFRS 2 (note 2(a))	–	–	7,052	(7,052)	–	–
– as restated, before opening balance adjustment arising from adoption of HKAS 32 and HKAS 39	61,412	619,408	7,052	281,921	840	970,633
– opening balance adjustment arising from adoption of HKAS 32 and HKAS 39 (note 2(c))	–	–	–	6,609	–	6,609
– as restated, after opening balance adjustment	61,412	619,408	7,052	288,530	840	977,242
Loss attributable to shareholders	–	–	–	(92,241)	–	(92,241)
Shares issued upon exercise of share options	5	8	–	–	–	13
Equity settled share-based transactions (note 2(a))	–	882	5,941	–	–	6,823
Exchange adjustments on translation of the financial statements of subsidiaries	–	–	–	–	(183)	(183)
At 31 August 2006	61,417	620,298	12,993	196,289	657	891,654

	Share capital HK$'000	Share premium HK$'000	Capital reserve HK$'000 (restated)	Warrant reserve HK$'000	Retained profits HK$'000 (restated)	Exchange reserve HK$'000	Total HK$'000 (restated)
At 1 September 2004							
– as previously reported	61,057	617,986	–	365	495,307	983	1,175,698
– prior period adjustment arising from adoption of HKFRS 2 (note 2(a))	–	–	87	–	(87)	–	–
– as restated, after prior period adjustment	61,057	617,986	87	365	495,220	983	1,175,698
Loss attributable to shareholders (restated)	–	–	–	–	(213,317)	–	(213,317)
Realisation of outstanding warrant reserve upon warrant expiration	–	–	–	(18)	18	–	–
Equity settled share-based transactions (note 2(a))	–	–	6,965	–	–	–	6,965
Shares issued upon exercise of warrants	350	1,397	–	(347)	–	–	1,400
Shares issued upon exercise of share options	5	25	–	–	–	–	30
Exchange adjustments on translation of the financial statements of subsidiaries	–	–	–	–	–	(143)	(143)
At 31 August 2005, as restated	61,412	619,408	7,052	–	281,921	840	970,633

23. CAPITAL AND RESERVES *(CONTINUED)*

(b) Company

	Share capital HK$'000	Share premium HK$'000	Capital reserve HK$'000	Retained profits HK$'000	Total HK$'000
At 1 September 2005					
– as previously reported	61,412	619,408	–	262,554	943,374
– prior period adjustment arising from adoption of HKFRS 2	–	–	7,052	(2,371)	4,681
– as restated, before opening balance adjustment arising from adoption of HKAS 32 and HKAS 39	61,412	619,408	7,052	260,183	948,055
– opening balance adjustment arising from adoption of HKAS 32 and HKAS 39	–	–	–	1,337	1,337
– as restated, after opening balance adjustment	61,412	619,408	7,052	261,520	949,392
Loss attributable to shareholders	–	–	–	(30,893)	(30,893)
Shares issued upon exercise of share options	5	8	–	–	13
Equity settled share-based transactions	–	882	5,941	–	6,823
At 31 August 2006	61,417	620,298	12,993	230,627	925,335

	Share capital HK$'000	Share premium HK$'000	Capital reserve HK$'000 (restated)	Warrant reserve HK$'000	Retained profits HK$'000 (restated)	Total HK$'000 (restated)
At 1 September 2004						
– as previously reported	61,057	617,986	–	365	295,592	975,000
– prior period adjustment arising from adoption of HKFRS 2	–	–	87	–	(87)	–
– as restated, after prior period adjustment	61,057	617,986	87	365	295,505	975,000
Realisation of outstanding warrant reserve upon warrant expiration	–	–	–	(18)	18	–
Equity settled share-based transactions	–	–	6,965	–	–	6,965
Loss attributable to shareholders (restated)	–	–	–	–	(35,340)	(35,340)
Shares issued upon exercise of warrants (note 23(c))	350	1,397	–	(347)	–	1,400
Shares issued upon exercise of share options	5	25	–	–	–	30
At 31 August 2005, as restated	61,412	619,408	7,052	–	260,183	948,055

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

23. CAPITAL AND RESERVES *(CONTINUED)*

(b) Company *(CONTINUED)*

Nature and purpose of reserves

(i) Share premium

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

(ii) Capital reserve

The capital reserve comprises the fair value of the actual or estimated number of unexercised share options granted to employees of the Company recognised in accordance with the accounting policy adopted for share-based payment in note 1(q)(iv).

(iii) PRC statutory reserve

In accordance with Accounting Regulations for Business Enterprises, foreign investment enterprises in the PRC are required to transfer at least 10% of their profit after taxation, as determined under accounting principles generally accepted in the PRC ("PRC GAAP") to the general reserve until the balance of the general reserve is equal to 50% of their registered capital. During the year, appropriations were made by CTI Guangzhou Customer Services Co. Ltd ("CTIGZ"), a wholly-owned subsidiary of the Group, to the statutory reserve at 10% of its profit after taxation determined under PRC GAAP. The statutory reserve can be used to reduce previous years' losses and to increase the capital of the subsidiary.

For the year ended 31 August, 2006, CTIGZ made appropriation to the statutory reserve of RMB202,000 (2005: Nil). The accumulated balance of the statutory reserve maintained at the CTIGZ as at 31 August, 2006 was RMB202,000 (2005: Nil).

(iv) Exchange reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policies set out in note 1(d)(ii).

(c) Share capital

	2006		2005	
	No. of shares	**Amount HK$'000**	No. of shares	Amount HK$'000
Authorised:				
Ordinary shares of HK$0.10 each	**2,000,000,000**	**200,000**	2,000,000,000	200,000
Issued and fully paid:				
Ordinary shares of HK$0.10 each				
At the beginning of the year	**614,125,404**	**61,412**	610,573,361	61,057
Exercise of share options (note (i))	**50,000**	**5**	52,000	5
Exercise of warrants (note (ii))	**–**	**–**	3,500,043	350
At the end of the year	**614,175,404**	**61,417**	614,125,404	61,412

The holders of ordinary shares 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.

23. CAPITAL AND RESERVES *(CONTINUED)*

(c) Share capital *(CONTINUED)*

Notes:

(i) During the year ended 31 August 2006, 50,000 ordinary shares (2005: 52,000 ordinary shares) were issued at a price of HK$0.26 per share (2005: HK$0.58 per share), to share option holders who had exercised their subscription rights. These shares so issued rank pari passu with the then existing ordinary shares in issue.

(ii) The Company effected a warrant issue at a price of HK$0.11 per warrant to certain qualifying shareholders (shareholders domiciled in Hong Kong) for cash during the year ended 31 August 2002. One warrant was offered for every five existing ordinary shares held on the date of record. The warrants entitle the holders to subscribe for ordinary shares of the Company (on a one to one basis) at a price of HK$0.40 per share (subject to adjustment), totalling HK$39,325,920 in cash at any time on or before 1 November 2004. If the warrants were fully exercised, the Company would be required to issue 98,314,800 additional ordinary shares. During the year ended 31 August 2005, 3,500,043 warrants were exercised for an equivalent number of ordinary shares at a price of HK$0.40 per share. The shares so issued rank pari passu with the then existing ordinary shares in issue. The remaining outstanding warrants of 135,396 expired on 1 November 2004.

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

Date of grant	Exercise price per share	Number of share options outstanding at 1 September 2005	Granted	Exercised	Lapsed	Number of share options outstanding at 31 August 2006
1997 Share Option Scheme						
3 September 1998	HK$0.26	190,000	–	(50,000)	–	140,000
10 September 1999	HK$2.10	60,000	–	–	(20,000)	40,000
20 October 2000	HK$0.58	298,000	–	–	(20,000)	278,000
		548,000	–	(50,000)	(40,000)	458,000
2002 Share Option Scheme						
3 June 2004	HK$1.47	6,000,000	–	–	–	6,000,000
21 October 2004	HK$1.54	14,670,000	–	–	(5,220,000)	9,450,000
5 January 2005	HK$1.54	16,000,000	–	–	–	16,000,000
3 October 2005	HK$0.81	–	1,000,000	–	–	1,000,000
22 May 2006	HK$0.66	–	32,210,000	–	–	32,210,000
3 July 2006	HK$0.68	–	1,000,000	–	–	1,000,000
3 August 2006	HK$0.71	–	100,000	–	–	100,000
		36,670,000	34,310,000	–	(5,220,000)	65,760,000
		37,218,000	34,310,000	(50,000)	(5,260,000)	66,218,000

Share options granted under the share option scheme approved by the shareholders of the Company on 12 July 1997 (the "1997 Share Option Scheme") are immediately exercisable.

At an Extraordinary General Meeting held on 23 December 2002, a new share option scheme (the "2002 Share Option Scheme") was approved by the shareholders of the Company and the 1997 Share Option Scheme was terminated on the same date. No further share option could be granted under the 1997 Share Option Scheme after the date of its termination, but all share options outstanding in respect of the 1997 Share Option Scheme as of 31 August 2006 shall continue to be exercisable in accordance with the terms of the 1997 Share Option Scheme.

During the year ended 31 August 2006, options were granted under the 2002 Share Option Scheme to eligible participants for the subscription of 34,310,000 shares of the Company at a weighted average exercise price of HK$0.67 each.

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

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

24. DEFERRED TAXATION

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

The movement of the deferred tax liabilities is as follows:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
At the beginning of the year	**10,539**	18,662	**9,992**	18,842
Exchange differences	**1**	1	**–**	–
Deferred taxation credited to statement of operations				
– relating to the origination and reversal of temporary differences (note 6)	**(10,187)**	(8,124)	**(9,992)**	(8,850)
At the end of the year	**353**	10,539	**–**	9,992

Deferred tax assets are recognised to the extent that realisation of the related tax benefit through the utilisation of tax losses against the future taxable profits is probable.

The Group has unrecognised tax losses carried forward from prior years of HK$279,199,000 at 31 August 2006 (2005: HK$215,683,000) and unrecognised equity settled share-based payment expenses of HK$13,171,000 at 31 August 2006 (2005: $Nil) which can offset against future taxable income. They will expire in the following periods:

	Group	
	2006 HK$'000	2005 HK$'000
After 5 years	**4,130**	934
From 2 to 5 years	**1,909**	2,863
No expiry date	**286,331**	211,886
	292,370	215,683

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

	Group					
	Accelerated depreciation allowances		Others		Total	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Deferred tax liabilities						
At the beginning of the year	**158,477**	140,202	**85**	49	**158,562**	140,251
(Credited)/charged to consolidated statement of operations	**(3,805)**	18,267	**(86)**	35	**(3,891)**	18,302
Exchange differences	**6**	8	**1**	1	**7**	9
At the end of the year	**154,678**	158,477	**–**	85	**154,678**	158,562

	Group					
	Share-based payment		tax losses		Total	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Deferred tax assets						
At the beginning of the year	**–**	–	**(148,023)**	(121,589)	**(148,023)**	(121,589)
Credited to consolidated statement of operations	**(123)**	–	**(6,173)**	(26,426)	**(6,296)**	(26,426)
Exchange differences	**–**	–	**(6)**	(8)	**(6)**	(8)
At the end of the year	**(123)**	–	**(154,202)**	(148,023)	**(154,325)**	(148,023)

24. DEFERRED TAXATION *(CONTINUED)*

	Company Accelerated depreciation allowances 2006 HK$'000	2005 HK$'000
Deferred tax liabilities		
At 1 September	**16,255**	18,842
Credited to statement of operations	**(2,962)**	(2,587)
At 31 August	**13,293**	16,255

	Company Tax losses 2006 HK$'000	2005 HK$'000
Deferred tax assets		
At 1 September	**(6,263)**	–
Credited to statement of operations	**(7,030)**	(6,263)
At 31 August	**(13,293)**	(6,263)

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

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Deferred tax asset	**–**	–	**–**	–
Deferred tax liabilities	**353**	10,539	**–**	9,992
	353	10,539	**–**	9,992

25. LONG-TERM DEBT AND OTHER LIABILITIES

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
8.75% senior notes due 2015 (note a)	**948,027**	945,348	**948,027**	945,348
Obligations under finance leases (note b)	**2,373**	3,135	**390**	–
	950,400	948,483	**948,417**	945,348
Current portion of				
– obligations under finance leases	**(1,297)**	(1,194)	**(71)**	–
	949,103	947,289	**948,346**	945,348

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

25. LONG-TERM DEBT AND OTHER LIABILITIES *(CONTINUED)*

At 31 August 2006, the Group's and the Company's long-term debt and other liabilities were repayable as follows:

	Group		Company	
	2006 HK$'000	2005 HK$'000	**2006 HK$'000**	2005 HK$'000
Long-term debt and other liabilities, repayable:				
8.75% senior notes due 2015				
– after the fifth year	**948,027**	945,348	**948,027**	945,348
Obligations under finance leases				
– within one year	**1,297**	1,194	**71**	–
– between one to two years	**806**	1,218	**75**	–
– between two to five years	**270**	723	**244**	–
	2,373	3,135	**390**	–
Less: Current portion of obligations under finance leases	**(1,297)**	(1,194)	**(71)**	–
	1,076	1,941	**319**	–
	949,103	947,289	**948,346**	945,348

(a) On 20 January 2005, the Company issued unsecured 10-year senior fixed rates notes (the "10-year senior notes") with a principle amount of US$125 million at an issue price equal to 100 per cent of the principal amount. The 10-year senior notes mature on 1 February 2015 and bear interest at the fixed rate of 8.75% per annum and such interest is payable semi-annually on 1 February and 1 August of each year, commencing 1 August 2005.

The 10-year senior notes are unconditionally and irrevocably guaranteed on a joint and several basis by the Company's subsidiaries (other than CTI Guangzhou Customer Services Co. Limited) as subsidiary guarantors.

The 10-year senior notes were issued as an underwritten transaction and the net proceeds were approximately US$121 million after deduction of expenses and commissions. The Group used the net proceeds, in part, to repay in full an existing bank loan in the outstanding amount of HK$196.7 million, and is using the remaining net proceeds for capital expenditures, including expanding and upgrading the Group's Metro Ethernet network in Hong Kong, and for additional working capital and general corporate purposes.

As at 31 August 2006, the 10-year senior notes are stated at amortised cost of US$121,854,000, equivalent to HK$948,027,000 (31 August 2005: US$121,660,000, equivalent to HK$945,348,000).

The effective interest rate of the 10-year senior notes for the year ended 31 August 2006 is 9.2% (2005: 9.2%) per annum.

(b) At 31 August 2006, the Group had obligations under finance leases repayable as follows:

	Group					
	2006			2005		
	Present value of the minimum lease payments HK$'000	**Interest expense relating to future periods HK$'000**	**Total minimum lease payments HK$'000**	Present value of the minimum lease payments HK$'000	Interest expense relating to future periods HK$'000	Total minimum lease payments HK$'000
Within one year	**1,297**	**54**	**1,351**	1,194	52	1,246
After one year but within two years	**806**	**26**	**832**	1,218	28	1,246
After two years but within five years	**270**	**27**	**297**	723	4	727
	1,076	**53**	**1,129**	1,941	32	1,973
	2,373	**107**	**2,480**	3,135	84	3,219

25. LONG-TERM DEBT AND OTHER LIABILITIES *(CONTINUED)*

(b) *(CONTINUED)*

At 31 August 2006, the Company had obligations under finance leases repayable as follows:

	Company					
	2006			2005		
	Present value of the minimum lease payments HK$'000	**Interest expense relating to future periods HK$'000**	**Total minimum lease payments HK$'000**	Present value of the minimum lease payments HK$'000	Interest expense relating to future periods HK$'000	Total minimum lease payments HK$'000
Within one year	**71**	**24**	**95**	–	–	–
After one year but within two years	**75**	**20**	**95**	–	–	–
After two years but within five years	**244**	**25**	**269**	–	–	–
	319	**45**	**364**	–	–	–
	390	**69**	**459**	–	–	–

26. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

	2006 HK$'000	2005 HK$'000 (restated)
Loss before taxation	**(99,485)**	(220,042)
Goodwill amortisation charge	**–**	1,065
Depreciation of owned fixed assets	**275,538**	236,269
Depreciation of fixed assets held under finance leases	**926**	380
Impairment loss on investment property	**1,131**	–
Amortisation of deferred expenditure	**13,973**	12,927
Interest income	**(20,378)**	(13,578)
Interest expenses	**–**	374
Interest element of finance lease	**54**	23
Loss/(gain) on disposal of fixed assets	**9,621**	(134)
Unrealised gain on other financial assets	**(668)**	(300)
Amortisation of incidental issuance costs	**1,429**	1,693
Other borrowing costs	**1,919**	–
Equity settled share-based transactions	**6,823**	6,965
Realised and unrealised loss on derivative financial instruments	**125**	–
Interest on 10-year senior notes	**85,235**	52,372
Net cash inflow before working capital changes	**276,243**	78,014
Decrease/(increase) in long-term receivable and prepayment	**567**	(6,893)
(Increase)/decrease in accounts receivable, other receivables, deposits and prepayments	**(59,234)**	19,931
Decrease/(increase) in inventories	**1,101**	(1,957)
Increase in deferred expenditure	**(5,287)**	(12,495)
(Decrease)/increase in accounts payable, other payables, accrued charges and deposits received	**(23,652)**	5,258
Decrease in deferred services income	**(3,001)**	(2,685)
Net cash inflow generated from operations	**186,737**	79,173

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

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

(b) Analysis of changes in financing during the year

	Share capital (including share premium and warrant reserve) HK$'000	Obligations under finance leases HK$'000	Bank loan HK$'000	Senior notes HK$'000
Balance at 1 September 2004	679,408	–	100,000	–
Issue of new shares	1,430	–	–	–
Net proceeds of senior notes issue	–	–	–	943,655
Bank loan drawn down	–	–	100,000	–
Repayment of bank loan	–	–	(200,000)	–
Acquisition of fixed assets	–	3,632	–	–
Repayment of capital element of finance leases	–	(497)	–	–
Realisation of outstanding warrant reserve upon warrant expiration	(18)	–	–	–
Amortisation of incidental issuance costs	–	–	–	1,693
Balance at 31 August 2005	680,820	3,135	–	945,348
Balance at 1 September 2005	680,820	3,135	–	945,348
Issue of new shares	13	–	–	–
Acquisition of fixed assets	–	448	–	–
Repayment of capital element of finance leases	–	(1,210)	–	–
Amortisation of incidential issuance costs	–	–	–	1,429
Equity settled share-based transactions	882	–	–	–
Effect of foreign exchange rate changes	–	–	–	1,250
Balance at 31 August 2006	681,715	2,373	–	948,027

(c) The amount relates to proceeds received upon maturity of the foreign exchange forward contracts during the year ended 31 August 2006.

(d) Cash flows generated from operations and from investing activities for the year ended 31 August 2005 have been revised to conform to the current year's presentation. The impact of the affected line items in the consolidated statement of cash flows with respect to the year ended 31 August, 2005 is as follows:

	HK$'000
Net cash outflow generated from operations, as previously reported	(13,677)
Increase in term deposits	92,850
Net cash inflow generated from operations, as adjusted	79,173
Net cash outflow from investing activities, as previously reported	(464,590)
Increase in term deposits	(92,850)
Net cash outflow from investing activities, as adjusted	(557,440)

27. FINANCIAL INSTRUMENTS

Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

(a) Credit risk

The Group's credit risk is primarily attributable to trade and other receivables, listed debt investments and over-the-counter derivative financial instruments entered into for hedging purposes. Management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis.

In respect of trade and other receivables, credit evaluations are performed on all customers requiring credit over a certain amount. These receivables are generally due within 30 days from the date of billing. Subscribers with receivables that are more than 3 months overdue are requested to settle all outstanding balances before any further credit is granted. The Group generally does not obtain collateral from customers.

27. FINANCIAL INSTRUMENTS *(CONTINUED)*

(a) Credit risk *(CONTINUED)*

Derivative counterparties and cash transactions are limited to high credit-quality financial institution. The Group has policies that limit the amount of credit exposure to any financial institution. Given their high credit ratings, management does not expect any investment counterparty to fail to meet its obligations.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. Except for the financial guarantee given by the Group as disclosed in note 28, the Group does not provide any other guarantees which expose the Group to credit risk.

(b) Liquidity risk

The Company is responsible for the cash management, including the short term investment of cash surpluses and the raising of loans to cover expected cash demands, of its subsidiaries. The Company's policy is to regularly monitor current and expected liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient cash and readily realisable marketable securities and adequate amount of committed credit facilities from major financial institutions to meet its liquidity requirements in the short and longer term. Due to the dynamic nature of the underlying business, the Company aims to maintain flexibility in funding by keeping committed credit lines available.

(c) Interest rate risk

The Group's interest-rate risk arises mainly from its 10-year senior notes which bear interest at the fixed rate of 8.75% per annum. Borrowings issued at fixed rates expose the Group to fair value interest-rate risk.

The Group adopts a policy to maintain at least 50% of its borrowings in fixed rate instruments. At 31 August 2006, the Group had interest rate swap with a notional contract amount of HK$66,666,667 (2005: HK$86,666,667) which will mature over the next 4 years (note 17(a)).

(d) Foreign currency risk

All the Group's monetary assets and liabilities are primarily denominated in either Hong Kong dollars or United States dollars. Given the exchange rate of the Hong Kong dollar to the U.S. dollar has remained close to the current pegged rate of HK$7.80 = US$1.00 since 1983, management does not expect significant foreign exchange gains or losses associated with that currency.

The Group is also exposed to a certain amount of foreign exchange risk in relation to fluctuations between the Hong Kong dollars and the Renminbi arising from its operations in the PRC. In order to limit this foreign currency risk exposure, the Group entered into certain forward foreign exchange contracts during fiscal 2005 and in 2006 the Group maintained Renminbi cash balance that approximates six months' operating cash flows.

(e) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 August 2006 and 2005:

	2006		2005	
	Carrying amount HK$'000	**Fair value HK$'000**	Carrying amount HK$'000	Fair value HK$'000
The Group and the Company				
Long-term bank deposit	**13,641**	**13,459**	15,540	15,193
8.75% senior notes	**948,027**	**722,081**	945,348	888,694

(f) Estimation of fair values

Fair value of financial instruments is estimated as follows:

(i) The fair value of financial instruments traded in active markets (such as trading and available-for-sale financial assets, and listed long-term borrowings and convertible notes and bonds) is based on quoted market prices at the balance sheet date.

(ii) The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for interest rate swap. The fair value of the 8.75% senior notes is determined based on quoted market price. The fair value of the long term bank deposits are determined based on the issuer's quoted price.

(iii) Trade receivables less impairment provision and account payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

28. CONTINGENT LIABILITIES

	Group 2006 HK$'000	Group 2005 HK$'000	Company 2006 HK$'000	Company 2005 HK$'000
Bank guarantees provided to suppliers (note 30(i) and (ii))	**6,303**	6,200	**6,200**	6,200
Bank guarantee in lieu of payment of utility deposits (note 30(iii))	**5,272**	3,772	**–**	–
Corporate guarantee provided to a subsidiary for shared banking facility (note)	**–**	–	**70,020**	69,930
	11,575	9,972	**76,220**	76,130

Note: Corporate guarantee provided to a subsidiary represented the maximum amount of contingent liabilities of the Company had the shared banking facility of HK$70,020,000 as at 31 August 2006 (2005: HK$69,930,000) been fully drawn. As at 31 August 2006, HK$2,003,000 (2005: HK$13,250,000) of the HK$70,020,000 (2005: HK$69,930,000) shared banking facility (note 30(i)) was utilised by the Company and the subsidiary.

29. COMMITMENTS

(a) Capital commitments

	Group 2006 HK$'000	Group 2005 HK$'000	Company 2006 HK$'000	Company 2005 HK$'000
Purchase of telecommunications, computer and office equipment – contracted but not provided for	**80,240**	178,793	**874**	29

(b) Commitments under operating leases

(i) At 31 August 2006, the Group had future aggregate lease income receivable under non-cancellable operating leases as follows:

	2006 HK$'000	2005 HK$'000
Leases in respect of telecommunications facilities and computer equipment which are receivable:		
– Within one year	**1,980**	934
– After one year but within five years	**798**	583
	2,778	1,517

(ii) At 31 August 2006, the Group and the Company had future aggregate minimum lease payments under non-cancellable operating leases as follows:

	Group 2006 HK$'000	Group 2005 HK$'000	Company 2006 HK$'000	Company 2005 HK$'000
Leases in respect of land and buildings which are payable:				
– Within one year	**15,212**	17,759	**1,320**	1,380
– After one year but within five years	**9,370**	22,623	**660**	1,320
	24,582	40,382	**1,980**	2,700

	Group 2006 HK$'000	Group 2005 HK$'000	Company 2006 HK$'000	Company 2005 HK$'000
Leases in respect of telecommunications facilities and computer equipment which are payable:				
– Within one year	**24,881**	25,895	**2,460**	2,794
– After one year but within five years	**5,575**	7,127	**158**	–
– After five years	**6,400**	7,111	**–**	–
	36,856	40,133	**2,618**	2,794
	61,438	80,515	**4,598**	5,494

29. COMMITMENTS *(CONTINUED)*

(c) Program fee commitments

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

	2006 HK$'000	2005 HK$'000
Program fee in respect of program rights which are payable:		
– Within one year	**7,638**	13,055
– After one year but within five years	**4,888**	6,259
	12,526	19,314

30. PLEDGE OF ASSETS

As at 31 August 2006, the Group had pledged bank deposits of US$9,900,000 (equivalent to HK$77,022,000) and HK$10,000,000 as security for the following significant banking facilities:

(i) bank facility of US$9,000,000 (equivalent to HK$70,020,000) granted by a bank for issuance of bank guarantees to third party suppliers, letters of credit, short-term loan, overdraft, foreign exchange and interest rate hedging arrangements. As of 31 August 2006, bank guarantees of HK$2,003,000 were issued against this bank facility (31 August 2005; bank guarantees of HK$1,900,000 and letters of credit of HK$11,350,000 were issued against this bank facility);

(ii) bank guarantees of HK$4,300,000 (31 August 2005: HK$4,300,000) issued by the bank to third party suppliers of the company and one of its subsidiaries for payment of certain products and services procured by the Group from these third party suppliers;

(iii) bank guarantees of HK$5,272,000 (31 August 2005: HK$3,772,000) issued by the bank to certain utility vendors of the Group in lieu of payment of utility deposits; and

(iv) Forward foreign exchange contract of Nil (2005: RMB155,632,000).

As at 31 August 2005, the Group had pledged bank deposits of US$9,900,000 (equivalent of HK$76,923,000), RMB4,705,000 (equivalent to HK$4,524,000) and HK$9,000,000 as security for the above significant banking facilities and forward foreign exchange contract.

31. BARTER TRANSACTIONS

(a) During the year ended 31 August 2004, Hong Kong Broadband Network Limited ("HKBN"), a wholly-owned subsidiary of the Group entered into two sets of agreements with a third party (the "Contract Party 1"). Pursuant to one agreement ("First Agreement"), the Contract Party 1 agreed to sell to HKBN a set of un-activated telecommunications facility (the "Facility") at a cash consideration of approximately HK$42.4 million (the "Facility Consideration"). The full amount of the Facility Consideration was paid by HKBN during the year ended 31 August 2004. In conjunction with the First Agreement, HKBN also entered into an operations and maintenance agreement with the Contract Party 1 for the provision of ongoing operations and maintenance services for the Facility at a fee of approximately HK$1 million per annum, commencing 1 September 2007 onwards.

Another agreement ("Second Agreement") was entered into on the same date by both contract parties that HKBN agree to provide certain telecommunication services to the Contract Party 1 (the "Services") with fees computed based on unit service charges specified in the Second Agreement. The Contract Party 1 is required to pay to HKBN a guarantee minimum service fee of approximately HK$42.4 million over a period of three years, commencing 1 September 2004. A prepayment of the service charges of HK$36.5 million (the "Prepaid Charges") was paid by the Contract Party 1 to HKBN during the year ended 31 August 2004.

The directors of the Company made an assessment of the fair values of the items under exchange and have drawn a conclusion that no fair values could be assigned to them. Accordingly, the Facility was not recognised as an asset and no revenue or deferred revenue was recognised in the financial statements of the Group as at and for the year ended 31 August 2005 and 2006. The difference between the amounts paid for the Facility Considerations and the Prepaid Charges received, amounting to approximately $5.9 million, was recorded as a long-term receivable balance in the balance sheet as at 31 August 2005 and 2006. The balance will be paid by the Contract Party 1 prior to the end of service period on 1 September 2007.

NOTES TO THE FINANCIAL STATEMENTS *(CONTINUED)*

31. BARTER TRANSACTIONS *(CONTINUED)*

(b) During the year ended 31 August 2005, HKBN entered into two agreements with a third party (the "Contract Party 2"). Pursuant to the agreements.

(i) HKBN and the Contract Party 2 agreed to make available certain telecommunications services (the "Services Component") to each other on a barter basis at no consideration for a period of ten years, commencing 1 January 2005.

(ii) HKBN agreed to provide network capacity to the Contract Party 2 for a service term of fifteen years from the respective activation of the relevant network capacity, and, in exchange, the Contract Party 2 agreed to provide HKBN the right to use telecommunications facilities (the "Capacity Component") for a term of fifteen years from the respective activation of the relevant facilities. The transaction was entered into on a barter basis at no consideration being exchanged.

The Directors of the Company made an assessment and determined that since the Service Component for (i) above and Capacity Component for (ii) above involve exchange of services of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. Accordingly, both components were not recognised as an asset or expense and no revenue or deferred revenue was recognised in the financial statements of the Group as at and for the year ended 31 August 2005 and 2006.

32. MATERIAL RELATED PARTY TRANSACTIONS

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Group entered into the following material related party transactions.

Key management personnel remuneration

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

	2006 HK$'000	2005 HK$'000
Short-term employee benefits	**21,443**	21,505
Post-employment benefits	**1,916**	1,754
Equity compensation benefits	**4,571**	4,937
	27,930	28,196

33. 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. In addition, certain comparative figures have been reclassified to conform with the current year's presentation.

34. ACCOUNTING ESTIMATES AND JUDGEMENTS

Key sources of estimation uncertainty

Notes 12 and 27 contain information about the assumptions and their risk factors relating to fair value of share options granted and financial instruments. Other key sources of estimation uncertainty are as follows:

Impairment loss for doubtful accounts

The Group maintains impairment loss for doubtful accounts based upon evaluation of the recoverability of the accounts receivable and other receivables balances and the historical write-off experience, net of recoveries. If the financial condition of the customers were to deteriorate, additional impairment may be required.

34. ACCOUNTING ESTIMATES AND JUDGEMENTS *(CONTINUED)*

Depreciation

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight-line method over their estimated useful lives. The Group reviews the estimated useful lives and residual values of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives and residual values are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Deferred tax

At 31 August 2006, the Group has recognised a deferred tax asset in relation to the deductible temporary differences as set out in note 24. The realisability of the deferred tax asset mainly depends on whether it is probable that future taxable profits or taxable temporary differences will be available against which the asset can be utilised. In cases where the actual future taxable profits or taxable temporary differences generated are less than expected, a reversal of deferred tax asset may arise, which will be recognised in profit or loss for the period in which such a reversal takes place.

35. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 AUGUST 2006

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 August 2006 and which have not been adopted in these financial statements:

		Effective for accounting periods beginning on or after
HK(IFRIC) 4	Determining whether an arrangement contains a lease	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
Amendments 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 September 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 these is unlikely to have a significant impact on the Group's results of operations and financial position.