(Expressed in Hong Kong Dollars)

1. General Information

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

2. Significant Accounting Policies

(a) Statement of Compliance

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

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Company. Information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements is provided in note 3.

(b) Basis of Preparation of the Financial Statements

The consolidated financial statements for the year ended 31st December 2006 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in associates.

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

- financial instruments classified as available-for-sale securities whose fair value can be reliably measured (see note 2(g)); and
- derivative financial instruments (see note 2(h)).

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

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(b) Basis of Preparation of the Financial Statements (continued)

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

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

(c) Basis of Consolidation

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

(d) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

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

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

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

(e) Associates

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

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

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

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

(f) Goodwill

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

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

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

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

(g) Other Investments in Debt and Equity Securities

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

Investments in debt and equity securities are initially stated at cost, which is their transaction price unless fair value can be more reliably estimated using valuation techniques whose variables include only data from observable markets. Cost includes attributable transaction costs, except where indicated otherwise below. These investments are subsequently accounted for as follows, depending on their classification:

Investments in securities held for trading are classified as current assets. Any attributable transaction costs are recognised in profit or loss as incurred. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised in profit or loss.

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(g) Other Investments in Debt and Equity Securities (continued)

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

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

Investments in securities which do not fall into any of the above categories are classified as available-for-sale securities. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except foreign exchange gains and losses in respect of monetary items such as debt securities which are recognised directly in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss. When these investments are derecognised or impaired (see note 2(l)), 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 commits to purchase/sell the investments or they expire.

(h) Derivative Financial Instruments

Derivative financial instruments are recognised initially at fair value. At each balance sheet date the fair value is remeasured. The method of recognising the resultant fair value gain or loss depends on whether the derivative qualifies for hedge accounting and if so, the nature of the item being hedged (see note 2(i)).

(i) Hedging

(i) Fair Value Hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in profit or loss, along with any changes in the fair value of the hedged assets or liabilities that are attributable to the hedged risk.

(ii) Cash Flow Hedges

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

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

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

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

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

(iii) Hedge of Net Investments in Foreign Operations

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

(j) Fixed Assets, Depreciation and Amortisation

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

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

(iii) Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the enterprise. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(j) Fixed Assets, Depreciation and Amortisation (continued)

(iv) Gains or losses arising from the retirement or disposal of an item of fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

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

(vi) Depreciation is calculated to write off the cost of fixed assets less their estimated residual value, if any, using the straight line method over their estimated useful lives as follows:

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

(k) Leased Assets and Operating Lease Charges

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term.

(l) Impairment of Assets

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

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

– For unquoted equity securities 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 equity securities are not reversed.

– For trade and other current receivables and other 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), where the effect of discounting is material.

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

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

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

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

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(l) Impairment of Assets (continued)

(ii) Impairment of Other Assets

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

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

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

- *Calculation of Recoverable Amount*

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

- *Recognition of Impairment Losses*

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

– *Reversals of Impairment Losses*

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

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

(iii) Interim Financial Reporting and Impairment

Under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS 34, Interim Financial Reporting, in respect of the first six months of the financial year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the financial year (see notes 2(l)(i) and (ii)).

Impairment losses recognised in an interim period in respect of goodwill, available-for-sale equity securities and unquoted equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the financial year to which the interim period relates.

(m) Inventories

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

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

(n) Trade and Other Receivables

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

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(o) Interest-bearing Borrowings

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

(p) Trade and Other Payables

Trade and other payables are initially recognised at fair value. Except for financial guarantee liabilities measured in accordance with note 2(t)(i), trade and other payables are subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(q) Cash and Cash Equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the Consolidated Cash Flow Statement.

(r) Employee Benefits

(i) Short Term Employee Benefits

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

(ii) Defined Benefit Retirement Schemes Obligations

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

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

(iii) Contributions to Defined Contribution Retirement Schemes

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

(s) Income Tax

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

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

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

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

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

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

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

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(t) Financial Guarantees Issued, Provisions and Contingent Liabilities

(i) Financial Guarantees Issued

Financial guarantees are contracts that require the issuer (i.e. the guarantor) to make specified payments to reimburse the beneficiary of the guarantee (the "holder") for a loss the holder incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Where the Group issues a financial guarantee, the fair value of the guarantee (being the transaction price, unless the fair value can otherwise be reliably estimated) is initially recognised as deferred income within trade and other payables. Where consideration is received or receivable for the issuance of the guarantee, the consideration is recognised in accordance with the Group's policies applicable to that category of asset. Where no such consideration is received or receivable, an immediate expense is recognised in profit or loss on initial recognition of any deferred income.

The amount of the guarantee initially recognised as deferred income is amortised in profit or loss over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised in accordance with note 2(t)(ii) if and when (i) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (ii) the amount of that claim on the Group is expected to exceed the amount currently carried in trade and other payables in respect of that guarantee i.e. the amount initially recognised, less accumulated amortisation.

(ii) Other Provisions and Contingent Liabilities

Provisions are recognised for other liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

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

(u) Revenue Recognition

(i) Regulation of Earnings under the Scheme of Control

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

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

(ii) Fuel Clause Account

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

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

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

(iii) Income Recognition

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

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

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

Interest income is recognised on a time apportionment basis using the effective interest method.

(Expressed in Hong Kong Dollars)

2. Significant Accounting Policies (continued)

(v) Translation of Foreign Currencies

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

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

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

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

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

(w) Borrowing Costs

Borrowing costs are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

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

(x) Related Parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

(i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;

(ii) the Group and the party are subject to common control;

(iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;

(iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;

(v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or

(vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(y) Segment Reporting

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

In accordance with the Group's internal financial reporting, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

3. Changes in Accounting Policies

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group.

The accounting policies of the Group after the adoption of these developments to the extent that they are relevant to the Group are summarised in note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

(Expressed in Hong Kong Dollars)

3. Changes in Accounting Policies (continued)

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 39) except for HK(IFRIC) 10, Interim Financial Reporting and Impairment, which is effective for accounting periods beginning on or after 1st November 2006.

(a) Estimated Effect of Changes in Accounting Policies for the Years Presented

The adoption of the new and revised HKFRSs in notes 3(b) and 3(c) did not have any financial impact on the consolidated and company financial statements for the years presented.

(b) Financial Guarantees Issued (Amendments to HKAS 39, Financial Instruments: Recognition and Measurement: Financial Guarantee Contracts)

In prior years, financial guarantees issued by the Group were disclosed as contingent liabilities in accordance with HKAS 37, Provisions, Contingent Liabilities and Contingent Assets. No provisions were made in respect of these guarantees unless it was more likely than not that the guarantees would be called upon.

With effect from 1st January 2006, in order to comply with the amendments to HKAS 39 in respect of financial guarantee contracts, the Group has changed its accounting policy for financial guarantees issued. Under the new policy, financial guarantees issued are accounted for as financial liabilities under HKAS 39 and measured initially at fair value, where the fair value can be reliably measured. Subsequently, they are measured at the higher of the amount initially recognised, less accumulated amortisation, and the amount of the provision, if any, that should be recognised in accordance with HKAS 37. Further details of the new policy are set out in note 2(t)(i).

This change in accounting policy has no financial effect on the consolidated and company financial statements. Details of the financial guarantees currently issued by the Group and the Company are set out in note 35.

(c) Reversal of Impairment Losses on Available-for-sale Equity Securities (HK(IFRIC) 10, Interim Financial Reporting and Impairment)

In prior years, impairment losses on available-for-sale equity securities recognised in the interim period were reversed through profit or loss in a subsequent interim period of the same year if no loss, or a smaller loss, would have been recognised had the impairment been assessed on a year-to-date basis.

In 2006, the Group has early adopted HK(IFRIC) 10. With effect from 1st January 2006, in accordance with HK(IFRIC) 10, the Group has changed its accounting policy relating to the reversal of impairment losses on available-for-sale equity financial instruments recognised in an interim period. Under the new policy, impairments reported in the interim period profit or loss will also be reported in the profit or loss for the full financial year which includes that interim period, irrespective of whether conditions have improved at the year end balance sheet date. Further details of the new policy are set out in note 2(l)(iii).

The new accounting policy has been applied prospectively from the date the Group first applied HKAS 39 (i.e. 1st January 2005). This change in accounting policy has no financial effect on the consolidated and company financial statements.

4. Turnover

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

Group turnover represents the sales of electricity, other electricity-related income and engineering and consulting services fees. The amount of each significant category of revenue recognised during the year is analysed as follows:

	2006 $ million	2005 $ million
Sales of electricity	**12,326**	12,309
Special subsidy	**(205)**	(763)
Concessionary discount on sales of electricity	**(5)**	(4)
Electricity-related income	**23**	33
Technical service fees	**42**	47
	12,181	11,622

5. Other Revenue and Net Income

	2006 $ million	2005 $ million
Other Revenue		
Interest income	**724**	902
Dividend income from unlisted available-for-sale equity securities	**177**	66
Profit on disposal of unlisted available-for-sale equity securities	**–**	21
Sundry income	**25**	45
	926	1,034
Other Net Income		
Net profit on disposal of fixed assets	**8**	25
Net foreign exchange gains	**110**	–
	118	25
Total	**1,044**	1,059

6. Segment Information

(a) Business Segments

The Group's principal business segments are sales of electricity and infrastructure investments. Financial information about the Group's business segments is set out in Appendix 1(a) on page 102.

(b) Geographical Segments

The Group operates, through its subsidiaries and associates, in two major geographical regions – Hong Kong and Australia. Financial information about the Group's operations by geographical region is set out in Appendix 1(b) on page 103.

(Expressed in Hong Kong Dollars)

7. Finance Costs

	2006 $ million	2005 $ million
Interest on overdrafts, bank loans and other borrowings repayable within 5 years	**574**	730
Interest on other borrowings repayable over 5 years	**79**	34
Less: Interest capitalised to fixed assets	**(221)**	(167)
Interest transferred to fuel cost	**(12)**	(9)
	420	588

Interest expenses have been capitalised at the average rate of approximately 4.5% p.a. (2005 : 3.9% p.a.) for assets under construction.

8. Profit on Disposal of Interest in Associates

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

9. Profit before Taxation

	2006 $ million	2005 $ million
Profit before taxation is shown after charging:		
Depreciation	**1,832**	1,773
Amortisation of leasehold land	**55**	54
Costs of inventories	**1,774**	1,887
Write down of inventories	**4**	4
Staff costs	**486**	525
Operating lease charges – equipment	**62**	62
Fixed assets written off	**21**	21
Auditors' remuneration:		
Audit and audit related work		
– KPMG	**4**	4
Non audit work		
– Other auditors	**2**	1

The consolidated profit attributable to equity shareholders of the Company includes a profit of $5,870 million (2005 : $8,315 million) which has been dealt with in the financial statements of the Company.

10. Income Tax

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

	2006 $ million	2005 $ million
Current Tax – Hong Kong Profits Tax		
Provision for the year	**1,313**	1,006
Current Tax – Overseas		
Provision for the year	**1**	1
	1,314	1,007
Deferred Tax		
Origination and reversal of temporary differences (see note 27(a))	**(13)**	208
	1,301	1,215

Hong Kong Profits Tax has been provided for at the rate of 17.5% (2005 : 17.5%) based on the estimated assessable profits for the year. Overseas taxation has been provided for at the applicable rate on the estimated assessable profits for the year.

(b) Reconciliation between Tax Expense and Accounting Profit at Applicable Tax Rates:

	2006 $ million	2005 $ million
Profit before taxation	**8,143**	9,777
Notional tax on profit before taxation, calculated at the rates applicable to profits in the countries concerned	**1,386**	1,642
Tax effect of non-deductible expenses	**57**	74
Tax effect of non-taxable revenue	**(142)**	(496)
Tax effect of recognition of previously unrecognised temporary differences	**–**	(3)
Tax effect of recognition of previously unrecognised tax losses	**–**	(2)
Actual tax expenses	**1,301**	1,215

(Expressed in Hong Kong Dollars)

11. Directors' Emoluments and Senior Management Compensation

(a) Directors' Emoluments

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

Name of Directors	Fees $ million	Basic Salaries, Allowances & Other Benefits $ million	Retirement Scheme Contributions $ million	Bonuses $ million	2006 Total Emoluments $ million	2005 Total Emoluments $ million
Executive Directors						
Canning Fok Kin-ning[(4)] *Chairman*	0.12	0.25	–	–	**0.37**	0.34
Tso Kai-sum *Group Managing Director*	0.07	6.05	–	8.50	**14.62**	14.12
Susan Chow Woo Mo-fong	0.07	0.03	–	–	**0.10**	0.10
Andrew John Hunter[(5)]	0.07	2.56	0.02	0.28	**2.93**	8.03
Kam Hing-lam	0.07	0.05	–	–	**0.12**	0.12
Francis Lee Lan-yee *Director & General Manager (Engineering)*	0.07	4.49	–	3.84	**8.40**	8.00
Victor Li Tzar-kuoi	0.07	0.22	–	–	**0.29**	0.25
Neil Douglas McGee[(1) (6)] *Group Finance Director*	0.07	3.82	0.32	2.02	**6.23**	0.59
Frank John Sixt	0.07	0.04	–	–	**0.11**	0.11
Wan Chi-tin *Director & General Manager (Corporate Development)*	0.07	3.62	0.38	2.70	**6.77**	5.19
Non-executive Directors						
Ronald Joseph Arculli[(3)]	0.14	0.06	–	–	**0.20**	0.19
George Colin Magnus	0.07	0.02	–	–	**0.09**	0.14
Holger Kluge[(2) (3)]	0.14	–	–	–	**0.14**	0.14
Ralph Raymond Shea[(2) (3) (4)]	0.16	0.03	–	–	**0.19**	0.19
Wong Chung-hin[(2) (3) (4)]	0.16	0.09	–	–	**0.25**	0.24
Ewan Yee Lup-yuen	0.07	0.03	–	–	**0.10**	0.10
Total for the year 2006	**1.49**	**21.36**	**0.72**	**17.34**	**40.91**	37.85
Total for the year 2005	1.35	19.28	0.61	16.61		37.85

Notes:

(1) During the year, Mr. Neil Douglas McGee received director's fees of THB170,000 from Ratchaburi Power Company, Limited, an associate of the Group. The director's fees were then paid back to the Company.

(2) Independent non-executive directors.

(3) Members of the Audit Committee.

(4) Members of the Remuneration Committee.

(5) Ceased to be Group Finance Director with effect from 1st February 2006.

(6) Assumed position of Group Finance Director with effect from 1st February 2006.

(b) Senior Management Compensation

The five highest paid individuals in the Group included four directors (2005 : four) whose total emoluments are shown above. The emoluments of the other one individual (2005 : one individual) who comprises the five are set out below:

	2006 **$ million**	2005 $ million
Salaries and other benefits	**3.79**	3.73
Retirement scheme contributions	**0.37**	0.37
	4.16	4.10

The total emoluments of the individual (2005 : one individual) are within the following bands:

	2006 **Number**	2005 Number
$4,000,001 to $4,500,000	**1**	1

12. Scheme of Control Transfers

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

(Expressed in Hong Kong Dollars)

13. Dividends

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

	2006 $ million	2005 $ million
Interim dividend declared and paid of 58 cents per ordinary share (2005 : 58 cents per ordinary share)	**1,238**	1,238
Final dividends proposed after the balance sheet date of:		
Ordinary – $1.27 per ordinary share (2005 : $1.01 per ordinary share)	**2,710**	2,156
Special – $nil per ordinary share (2005 : $0.73 per ordinary share)	**–**	1,558
	3,948	4,952

The final dividends proposed after the balance sheet date are based on 2,134,261,654 ordinary shares (2005 : 2,134,261,654 ordinary shares), being the total number of issued shares at the year end. The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

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

	2006 $ million	2005 $ million
Final dividend and special dividend in respect of the previous financial year, approved and paid during the year:		
Ordinary – $1.01 per ordinary share (2005 : $1.19 per ordinary share)	**2,156**	2,540
Special – $0.73 per ordinary share (2005 : $nil per ordinary share)	**1,558**	–
	3,714	2,540

14. Earnings per Share

The calculation of earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of $6,842 million (2005 : $8,562 million) and 2,134,261,654 ordinary shares (2005 : 2,134,261,654 ordinary shares) in issue throughout the year.

There were no dilutive potential ordinary shares in existence during the years ended 31st December 2006 and 2005.

15. Fixed Assets

$ million	Site Formation and Buildings	Plant, Machinery and Equipment	Assets under Construction	Sub-total	Interests in Leasehold Land Held for Own Use under Operating Leases	Total Fixed Assets
Group						
Cost:						
At 1st January 2005	11,922	46,429	3,810	62,161	2,808	64,969
Additions	2	211	2,776	2,989	16	3,005
Transfers between categories	126	936	(1,062)	–	–	–
Disposals	(5)	(123)	–	(128)	(6)	(134)
At 31st December 2005	12,045	47,453	5,524	65,022	2,818	67,840
At 1st January 2006	**12,045**	**47,453**	**5,524**	**65,022**	**2,818**	**67,840**
Additions	**–**	**228**	**2,081**	**2,309**	**(4)**	**2,305**
Transfers between categories	**1,330**	**3,920**	**(5,250)**	**–**	**–**	**–**
Disposals	**(2)**	**(170)**	**–**	**(172)**	**(3)**	**(175)**
At 31st December 2006	**13,373**	**51,431**	**2,355**	**67,159**	**2,811**	**69,970**
Accumulated Depreciation and Amortisation:						
At 1st January 2005	3,176	16,193	–	19,369	324	19,693
Written back on disposals	(3)	(72)	–	(75)	–	(75)
Charge for the year	323	1,587	–	1,910	54	1,964
At 31st December 2005	3,496	17,708	–	21,204	378	21,582
At 1st January 2006	**3,496**	**17,708**	**–**	**21,204**	**378**	**21,582**
Written back on disposals	**(1)**	**(126)**	**–**	**(127)**	**–**	**(127)**
Charge for the year	**335**	**1,629**	**–**	**1,964**	**55**	**2,019**
At 31st December 2006	**3,830**	**19,211**	**–**	**23,041**	**433**	**23,474**
Net Book Value:						
At 31st December 2006	**9,543**	**32,220**	**2,355**	**44,118**	**2,378**	**46,496**
At 31st December 2005	8,549	29,745	5,524	43,818	2,440	46,258

The above are mainly electricity-related fixed assets in respect of which financing costs capitalised during the year amounted to $221 million (2005 : $167 million).

The Group's leasehold land at 31st December 2006 is held in Hong Kong and comprises $50 million (2005 : $54 million) and $2,328 million (2005 : $2,386 million) of long-term and medium-term leasehold land respectively.

Depreciation charges for the year included $132 million (2005 : $137 million), relating to assets utilised in development activities which have been capitalised.

(Expressed in Hong Kong Dollars)

16. Interest in Subsidiaries

	Company	
	2006	2005
	$ million	$ million
Unlisted shares, at cost	**2,417**	2,417
Loan capital (see note below)	**19,646**	23,151
Amounts due from subsidiaries	**4,929**	6,434
	26,992	32,002

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

Particulars of the principal subsidiaries are set out in Appendix 2 on page 104.

17. Interest in Associates

	Group	
	2006	2005
	$ million	$ million
Share of net assets	**1,750**	1,333
Loans to unlisted associates (see note below)	**4,269**	4,087
Amounts due from unlisted associates	**320**	360
	6,339	5,780

The loans to unlisted associates are unsecured, bearing interest ranging from 6.28% p.a. to 13.79% p.a. (2005 : 3.5% p.a. to 13.79% p.a.) and not due within five years.

Included in the loans to unlisted associates are subordinated loans totalling $4,206 million (2005 : $3,913 million). The rights in respect of these loans are subordinated to the rights of any other lenders to the associates and they are treated as part of the investment in the associates.

The amounts due from unlisted associates are unsecured, interest free, have no fixed repayment terms and not due within one year.

The shares of an associate owned by the Group were pledged as part of the security arrangement for project financing facilities to that associate. The carrying value of the associate as at 31st December 2006 was $75 million (2005 : $222 million).

Particulars of the principal associates are set out in Appendix 3 on page 105.

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

	2006 $ million	2005 $ million
Assets	**60,473**	55,725
Liabilities	**(52,893)**	(49,677)
Equity	**7,580**	6,048
Revenues	**10,475**	9,815
Profit	**806**	2,882

18. Other Non-current Financial Assets

	Group	
	2006 **$ million**	2005 $ million
Unlisted available-for-sale equity securities, at cost	**1,687**	1,682

19. Inventories

	Group	
	2006 **$ million**	2005 $ million
Work in progress	**2**	–
Coal, fuel oil and liquefied natural gas	**204**	164
Stores and materials (see note below)	**278**	281
	484	445

Included in stores and materials is capital stock of $176 million (2005 : $191 million) which was purchased for the future maintenance of capital assets.

20. Trade and Other Receivables

	Group		Company	
	2006 **$ million**	2005 $ million	**2006** **$ million**	2005 $ million
Derivative financial instruments	**19**	32	**–**	–
Debtors (see note below)	**1,100**	1,058	**51**	12
	1,119	1,090	**51**	12

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

(Expressed in Hong Kong Dollars)

20. Trade and Other Receivables (continued)

Debtors' ageing is analysed as follows:

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Current or less than 1 month overdue	**596**	555	**–**	–
1 to 3 months overdue	**29**	28	**–**	–
More than 3 months overdue but less than 12 months overdue	**10**	10	**–**	–
Total trade debtors (see note below)	**635**	593	**–**	–
Deposits, prepayments and other receivables	**465**	465	**51**	12
	1,100	1,058	**51**	12

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

21. Fuel Clause Account

The surcharge per unit of electricity sales was 4.9 cents from 1st January 2006 (2005 : 2.2 cents). Movements on the Fuel Clause Account were as follows:

	Group	
	2006	2005
	$ million	$ million
At 1st January	**1,079**	1,197
Transfer to profit or loss	**15**	119
Surcharge during the year	**(528)**	(237)
At 31st December	**566**	1,079

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

22. Cash and Cash Equivalents

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Deposits with banks and other financial institutions	**10,435**	4,548	**10,417**	4,512
Cash at bank and in hand	**27**	13	**–**	8
	10,462	4,561	**10,417**	4,520

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

	Group		Company	
	2006	2005	**2006**	2005
	million	million	**million**	million
United States Dollars	**–**	USD 4	**–**	USD 4
Australian Dollars	**–**	AUD 274	**–**	AUD 271
Thai Baht	**THB 12**	–	**–**	–

23. Trade and Other Payables

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Creditors (see note below)	**1,090**	1,042	**37**	39
Current portion of deferred creditors (see note 25)	**–**	22	**–**	–
Derivative financial instruments	**5**	4	**–**	–
	1,095	1,068	**37**	39

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

Creditors' ageing is analysed as follows:

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Due within 1 month or on demand	**349**	358	**3**	13
Due after 1 month but within 3 months	**267**	170	**–**	–
Due after 3 months but within 12 months	**441**	485	**5**	1
	1,057	1,013	**8**	14
Other payables	**33**	29	**29**	25
	1,090	1,042	**37**	39

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

	Group		Company	
	2006	2005	**2006**	2005
	million	million	**million**	million
United States Dollars	**USD 31**	USD 31	**–**	–
Japanese Yen	**JPY 289**	JPY 273	**–**	–
Euros	**EUR 1**	EUR 4	**–**	–
Pounds Sterling	**GBP 1**	GBP 1	**–**	–

(Expressed in Hong Kong Dollars)

24. Non-current Interest-bearing Borrowings

	Group 2006 $ million	2005 $ million
Bank loans	**11,278**	8,043
Current portion	**(577)**	(354)
	10,701	7,689
Hong Kong dollar notes (see note below)	**3,407**	2,520
Current portion	**(512)**	–
	2,895	2,520
Total	**13,596**	10,209

Hong Kong dollar fixed rate notes bear interest at rates between 4.13% p.a. to 7.35% p.a. (2005 : 4.13% p.a. to 7.35% p.a.), while interest on floating rate notes is determined with reference to the Hong Kong Interbank Offered Rate. Details of issuers of Hong Kong dollar notes are set out in Appendix 2 on page 104. None of the non-current interest-bearing borrowings is expected to be settled within one year.

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

	Bank Loans		Hong Kong Dollar Notes		Total	
$ million	**2006**	2005	**2006**	2005	**2006**	2005
Within 1 year	**577**	354	**512**	–	**1,089**	354
After 1 year but within 2 years	**2,700**	115	**–**	520	**2,700**	635
After 2 years but within 5 years	**5,751**	7,574	**1,000**	1,000	**6,751**	8,574
After 5 years	**2,250**	–	**1,895**	1,000	**4,145**	1,000
	11,278	8,043	**3,407**	2,520	**14,685**	10,563

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

	Group 2006 million	2005 million
United States Dollars	**–**	USD 154
Euros	**EUR 1**	EUR 4

25. Deferred Creditors and Other Payables

	Group 2006 $ million	2005 $ million
Deferred creditors	–	74
Current portion of deferred creditors (see note 23)	–	(22)
	–	52

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

	Group 2006 $ million	2005 $ million
Within 1 year	–	22
After 1 year but within 2 years	–	22
After 2 years but within 5 years	–	26
After 5 years but within 10 years	–	4
	–	74

Deferred creditors were unsecured and bore interest at a margin over Hong Kong Interbank Offered Rate with final maturities up to 2011. All deferred creditors were repaid during the current year.

26. Derivative Financial Instruments

	Group 2006 $ million	2005 $ million
Cross currency swaps	(4)	198
Interest rate swaps and caps	(56)	41
Foreign exchange forward contracts	–	(9)
Total	(60)	230
Current portion of derivative financial instruments (see notes 20 and 23)	14	28
	(46)	258
Represented by:		
Derivative financial instruments assets	(47)	(29)
Derivative financial instruments liabilities	1	287
	(46)	258

(Expressed in Hong Kong Dollars)

27. Deferred Taxation

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
At 1st January	**5,368**	5,237	**(13)**	–
(Credited)/charged to profit or loss (see note 10(a))	**(13)**	208	**3**	(4)
Charged/(credited) to reserves	**76**	(77)	**9**	(9)
At 31st December	**5,431**	5,368	**(1)**	(13)

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Net deferred tax assets recognised on the Balance Sheet	**(1)**	(14)	**(1)**	(13)
Net deferred tax liabilities recognised on the Balance Sheet	**5,432**	5,382	**–**	–
At 31st December	**5,431**	5,368	**(1)**	(13)

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Tax effects of:				
Depreciation allowances in excess of the related depreciation	**5,338**	5,223	**–**	–
Fuel clause rebates	**99**	189	**–**	–
Contributions to employee retirement schemes	**–**	(41)	**–**	(11)
Tax losses	**–**	(2)	**–**	(2)
Cash flow hedges	**–**	(1)	**–**	–
Others	**(6)**	–	**(1)**	–
	5,431	5,368	**(1)**	(13)

28. Employee Retirement Benefits

(a) Defined Benefit Retirement Scheme

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

The funding policy in respect of the Schemes is based on valuations prepared periodically by independent professionally qualified actuaries at Watson Wyatt Hong Kong Limited. The policy on employer's contributions is to fund the Schemes in accordance with the actuary's recommendations on an on-going basis, whereas employees' contributions, if applicable, are fixed at 5% of basic pay. The most recent actuarial valuations of both Schemes have been carried out by the appointed actuary, represented by Mr. A. Wong, FSA, FCIA as at 1st January 2006. The principal actuarial assumptions used include a long term yield gap, which is the long term expected rate of investment return net of salary increase, of 1.5% to 2.0% p.a., pension increase of 2.5% p.a., together with appropriate provisions for mortality rates, turnover and adjustments to reflect the short-term market expectation of salary increases. The valuations revealed that the Scheme assets in each case were sufficient to cover the respective discontinuance liabilities as at the valuation date.

Retirement scheme costs charged to the Profit and Loss Account for the year ended 31st December 2006 were determined in accordance with HKAS 19 "Employee Benefits", under which the Schemes are required to be valued using the "Projected Unit Credit Method".

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Present value of funded obligations	**4,410**	4,151	**438**	393
Fair value of scheme assets	**(4,599)**	(3,986)	**(391)**	(337)
	(189)	165	**47**	56
Represented by:				
Employee retirement benefit assets	**(578)**	(170)	**(34)**	(10)
Employee retirement benefit liabilities	**389**	335	**81**	66
	(189)	165	**47**	56

The plan assets include ordinary shares issued by the Company with a fair value of $nil (2005 : $7 million).

(Expressed in Hong Kong Dollars)

28. Employee Retirement Benefits (continued)

(a) Defined Benefit Retirement Scheme (continued)

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

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
At 1st January	**4,151**	3,701	**393**	354
Current service cost	**161**	140	**10**	9
Interest cost	**183**	182	**18**	17
Employee contributions paid to schemes	**27**	28	**2**	2
Actuarial loss	**125**	251	**42**	32
Benefits paid	**(237)**	(151)	**(27)**	(21)
At 31st December	**4,410**	4,151	**438**	393

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
At 1st January	**3,986**	3,639	**337**	312
Expected return	**299**	274	**25**	23
Actuarial gain	**447**	67	**49**	13
Employer contributions paid to schemes	**77**	129	**5**	8
Employee contributions paid to schemes	**27**	28	**2**	2
Benefits paid	**(237)**	(151)	**(27)**	(21)
At 31st December	**4,599**	3,986	**391**	337

The Group expects to contribute $63 million to its defined benefit schemes in 2007.

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

	2006 $ million	2005 $ million
Current service cost	**161**	140
Interest cost	**183**	182
Expected return on scheme assets	**(299)**	(274)
	45	48

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

	2006 $ million	2005 $ million
Direct costs	**25**	25
Other operating costs	**20**	23
	45	48

The actual return on scheme assets of the Group (taking into account all changes in the fair value of the scheme assets excluding contributions paid and received) was net income of $746 million (2005 : $341 million).

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

	2006 $ million	2005 $ million
At 1st January	**439**	–
Actuarial (gains)/losses recognised in the Statement of Recognised Income and Expense during the year	**(322)**	439
At 31st December	**117**	439

(Expressed in Hong Kong Dollars)

28. Employee Retirement Benefits (continued)

(a) Defined Benefit Retirement Scheme (continued)

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

	2006	2005
Hong Kong equities	**18.7%**	17.2%
Europe equities	**13.8%**	14.8%
North America equities	**15.4%**	14.7%
Other Asia Pacific equities	**13.0%**	17.7%
Global bonds	**34.0%**	31.3%
Deposits, cash and others	**5.1%**	4.3%

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

	Group and Company	
	2006	2005
Discount rate	**4.0%**	4.5%
Expected rate of return on scheme assets	**6.5% – 7.0%**	7.5%
Future salary increase rate	**5.0%**	5.0%
Future pension increase rate	**2.5%**	2.5%

The expected long-term rate of return on scheme assets is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based on historical returns, without adjustments.

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

	Group			**Company**		
$ million	**2006**	2005	2004	**2006**	2005	2004
Present value of funded obligations	**(4,410)**	(4,151)	(3,701)	**(438)**	(393)	(354)
Fair value of scheme assets	**4,599**	3,986	3,639	**391**	337	312
Surplus/(deficit)	**189**	(165)	(62)	**(47)**	(56)	(42)
Experience adjustments on:						
Scheme liabilities	**(45)**	(8)	(26)	**(26)**	(10)	(18)
Scheme assets	**447**	67	148	**49**	13	14

(b) Defined Contribution Retirement Scheme

Since the introduction of the Hong Kong Mandatory Provident Fund Scheme (the "MPF Scheme") in December 2000, the Group has also participated in a master trust MPF Scheme operated by an independent service provider. All new recruits not previously covered by the defined benefit retirement schemes are enrolled in this Scheme.

The MPF scheme is a defined contribution retirement scheme with the employer and its employees each contributing to the plan in accordance with the relevant scheme rules. The scheme rules provide for voluntary contributions to be made by the employer calculated as a percentage of the employees' basic salaries. No forfeited contributions have been utilised to reduce current year's level of contribution.

	2006 **$ million**	2005 $ million
Expenses recognised in the Consolidated Profit and Loss Account	**3**	2

29. Share Capital

	Number of Shares	**Company** **2006** **$ million**	2005 $ million
Authorised:			
Ordinary shares of $1 each	3,300,000,000	**3,300**	3,300
Issued and fully paid:			
Ordinary shares of $1 each	2,134,261,654	**2,134**	2,134

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.

(Expressed in Hong Kong Dollars)

30. Total Equity

(a) Group

$ million	Share Capital (note 29)	Share Premium (note 30(c))	Exchange Reserve (note 30(d))	Hedging Reserve (note 30(e))	Revenue Reserve (note 30(f))	Proposed/ Declared Dividend	Total Equity
	Attributable to Equity Shareholders of the Company						
Total equity at 1st January 2005	2,134	4,476	349	(119)	27,805	2,540	37,185
Exchange differences on translation of:							
– financial statements of overseas subsidiaries	–	–	(93)	–	–	–	(93)
– overseas associates	–	–	(124)	–	–	–	(124)
Cash flow hedge:							
– effective portion of changes in fair value, net of deferred tax	–	–	–	117	174	–	291
– transferred to profit or loss	–	–	–	(2)	–	–	(2)
– transferred to initial carrying amount of non-financial hedged items	–	–	–	6	–	–	6
Actuarial gains and losses of defined benefit retirement schemes, net of deferred tax	–	–	–	–	(362)	–	(362)
Net income and expense recognised directly in equity	–	–	(217)	121	(188)	–	(284)
Profit for the year	–	–	–	–	8,562	–	8,562
Total recognised income and expense for the year	–	–	(217)	121	8,374	–	8,278
Final dividend in respect of the previous year approved and paid (see note 13(b))	–	–	–	–	–	(2,540)	(2,540)
Interim dividend paid (see note 13(a))	–	–	–	–	(1,238)	–	(1,238)
Proposed final dividend (see note 13(a))	–	–	–	–	(3,714)	3,714	–
Total equity at 31st December 2005	2,134	4,476	132	2	31,227	3,714	41,685

$ million	Share Capital (note 29)	Share Premium (note 30(c))	Exchange Reserve (note 30(d))	Hedging Reserve (note 30(e))	Revenue Reserve (note 30(f))	Proposed/ Declared Dividend	Total Equity
	Attributable to Equity Shareholders of the Company						
Total equity at 1st January 2006	2,134	4,476	132	2	31,227	3,714	41,685
Exchange differences on translation of:							
– financial statements of overseas subsidiaries	–	–	(33)	–	–	–	(33)
– overseas associates	–	–	103	–	–	–	103
Cash flow hedge:							
– effective portion of changes in fair value, net of deferred tax	–	–	–	111	19	–	130
– transferred to profit or loss	–	–	–	–	–	–	–
– transferred to initial carrying amount of non-financial hedged items	–	–	–	(6)	–	–	(6)
Actuarial gains and losses of defined benefit retirement schemes, net of deferred tax	–	–	–	–	316	–	316
Net income and expense recognised directly in equity	–	–	70	105	335	–	510
Profit for the year	–	–	–	–	6,842	–	6,842
Total recognised income and expense for the year	–	–	70	105	7,177	–	7,352
Final dividend in respect of the previous year approved and paid (see note 13(b))	–	–	–	–	–	(3,714)	(3,714)
Interim dividend paid (see note 13(a))	–	–	–	–	(1,238)	–	(1,238)
Proposed final dividend (see note 13(a))	–	–	–	–	(2,710)	2,710	–
Total equity at 31st December 2006	**2,134**	**4,476**	**202**	**107**	**34,456**	**2,710**	**44,085**

Group revenue reserves as at 31st December 2006 include the Group's share of the retained profits of its associates amounting to $1,534 million (2005 : $1,205 million).

(Expressed in Hong Kong Dollars)

30. Total Equity (continued)

(b) Company

$ million	Share Capital (note 29)	Share Premium (note 30(c))	Revenue Reserve (note 30(f))	Proposed/ Declared Dividend	Total Equity
Total equity at 1st January 2005	2,134	4,476	22,807	2,540	31,957
Actuarial gains and losses of defined benefit retirement schemes, net of deferred tax	–	–	(42)	–	(42)
Net expense recognised directly in equity	–	–	(42)	–	(42)
Profit for the year	–	–	8,315	–	8,315
Total recognised income and expense for the year	–	–	8,273	–	8,273
Final dividend in respect of the previous year approved and paid (see note 13(b))	–	–	–	(2,540)	(2,540)
Interim dividend paid (see note 13(a))	–	–	(1,238)	–	(1,238)
Proposed final dividend (see note 13(a))	–	–	(3,714)	3,714	–
Total equity at 31st December 2005	2,134	4,476	26,128	3,714	36,452
Total equity at 1st January 2006	**2,134**	**4,476**	**26,128**	**3,714**	**36,452**
Actuarial gains and losses of defined benefit retirement schemes, net of deferred tax	**–**	**–**	**(2)**	**–**	**(2)**
Net expense recognised directly in equity	**–**	**–**	**(2)**	**–**	**(2)**
Profit for the year	**–**	**–**	**5,870**	**–**	**5,870**
Total recognised income and expense for the year	**–**	**–**	**5,868**	**–**	**5,868**
Final dividend in respect of the previous year approved and paid (see note 13(b))	**–**	**–**	**–**	**(3,714)**	**(3,714)**
Interim dividend paid (see note 13(a))	**–**	**–**	**(1,238)**	**–**	**(1,238)**
Proposed final dividend (see note 13(a))	**–**	**–**	**(2,710)**	**2,710**	**–**
Total equity at 31st December 2006	**2,134**	**4,476**	**28,048**	**2,710**	**37,368**

All of the Company's revenue reserve is available for distribution to equity shareholders. After the balance sheet date, the directors proposed a final dividend of $1.27 (2005 : a final dividend of $1.01 and a special dividend of $0.73) per ordinary share, amounting to $2,710 million (2005 : $3,714 million). This dividend has not been recognised as a liability at the balance sheet date.

(c) Share Premium

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

(d) Exchange Reserve

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

(e) Hedging Reserve

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

(f) Revenue Reserve

The revenue reserve comprises the accumulative profits retained by the Company and its subsidiaries and includes the Group's share of the retained profits of its associates.

31. Notes to the Consolidated Cash Flow Statement

Reconciliation of profit before taxation to cash generated from operations

	2006 $ million	2005 $ million
Profit before taxation	**8,143**	9,777
Adjustments for:		
Profit on disposal of interest in associates	**–**	(1,560)
Share of profits less losses of associates	**(229)**	(1,050)
Interest income	**(724)**	(902)
Dividend income from unlisted available-for-sale equity securities	**(177)**	(66)
Profit on disposal of unlisted available-for-sale equity securities	**–**	(21)
Finance costs	**432**	597
Depreciation	**1,832**	1,773
Amortisation of leasehold land	**55**	54
Fixed assets written off	**21**	21
Net profit on disposal of fixed assets	**(8)**	(25)
Exchange gains	**(85)**	(14)
Operating profit before changes in working capital	**9,260**	8,584
(Increase)/decrease in inventories	**(53)**	36
Decrease/(increase) in trade and other receivables	**4**	(25)
Decrease in Fuel Clause Account	**513**	118
Increase/(decrease) in trade and other payables, excluding current portion of deferred creditors	**47**	(137)
Increase in net employee retirement benefits	**(32)**	(81)
Cash generated from operations	**9,739**	8,495

(Expressed in Hong Kong Dollars)

32. Financial Instruments

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

(a) Credit Risk

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

In respect of trade and other receivables of electricity charges, The Hongkong Electric Company, Limited, a wholly-owned subsidiary company, obtains sufficient collateral of security from customers in accordance with the Supply Rules. The outstanding amount of deposits received from customers at 31st December 2006 was $1,537 million (2005 : $1,508 million). The credit policy is set out in note 20.

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

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

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

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. Except for the financial guarantees given by the Group as set out in note 35, the Group does not provide any other guarantee which would expose the Group or the Company to credit risk. The maximum exposure to credit risk in respect of these financial guarantees at the balance sheet date is disclosed in note 35.

(b) Liquidity Risk

The Group's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term. The Group has undrawn committed bank facilities of $5,686 million at 31st December 2006 (2005 : $3,465 million).

(c) Interest Rate Risk

The Group is exposed to cash flow interest rate risk on its interest-bearing assets and liabilities. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

(i) Hedging

The Group's policy is to maintain a balanced combination of fixed and variable rate debt to reduce its interest rate exposure. The Group also uses interest rate derivatives to manage the exposure in accordance with the treasury policy. At 31st December 2006, the Group had interest rate swaps with a total notional amount of $5,005 million (2005 : $5,893 million).

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

The fair values of swaps entered into by the Group at 31st December 2006 were recognised as derivative financial instruments assets and liabilities amount of $59 million (2005 : $23 million) and $3 million (2005 : $64 million) respectively.

(Expressed in Hong Kong Dollars)

32. Financial Instruments (continued)

(c) Interest Rate Risk (continued)

(ii) Effective Interest Rate and Repricing Analysis

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

Group

	2006					
$ million	Weighted Average Interest Rate %	One Year or Less	1-2 Years	2-5 Years	More than 5 Years	Total
Repricing dates for assets/(liabilities) which reprice before maturity						
Cash at bank and in hand	–	27	–	–	–	27
Bank overdrafts	7.8	(4)	–	–	–	(4)
Bank loans and other borrowings	5.2	(12,426)	–	–	–	(12,426)
Customers' deposits	2.3	(1,537)	–	–	–	(1,537)
Effect of interest rate swaps	(0.4)	4,005	(250)	(3,755)	–	–
		(9,935)	(250)	(3,755)	–	(13,940)
Maturity dates for assets/(liabilities) which do not reprice before maturity						
Loans to associates	11.3	–	–	–	4,269	4,269
Deposits with banks and other financial institutions	4.0	10,435	–	–	–	10,435
Bank loans and other borrowings	4.3	(364)	–	–	(1,895)	(2,259)
		10,071	–	–	2,374	12,445

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

(Expressed in Hong Kong Dollars)

32. Financial Instruments (continued)

(c) Interest Rate Risk (continued)

(ii) Effective Interest Rate and Repricing Analysis (continued)

Company

2006

$ million	Weighted Average Interest Rate %	One Year or Less	1-2 Years	2-5 Years	More than 5 Years	Total
Repricing dates for assets which reprice before maturity						
Cash at bank and in hand	–	–	–	–	–	–
Maturity dates for assets which do not reprice before maturity						
Deposits with banks and other financial institutions	4.0	10,417	–	–	–	10,417

2005

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

(d) Foreign Currency Risk

(i) Committed and Forecast Transactions

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

The Group uses forward exchange contracts to hedge its foreign currency risk and classifies these as cash flow hedges. At 31st December 2006, the Group had forward exchange contracts hedging committed and forecast transactions with a net fair value of $1 million liabilities (2005 : $8 million assets) recognised as derivative financial instruments.

(ii) *Recognised Assets and Liabilities*

The net fair value of forward exchange contracts and currency swaps contracts used by the Group as economic hedges of monetary assets and liabilities in foreign currencies at 31st December 2006 was $1 million assets (2005 : $1 million assets) and $4 million assets (2005 : $198 million liabilities) recognised as derivative financial instruments.

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

(iii) *Overseas Investments*

Currency exposure arising from overseas investments is hedged by arranging a comparable level of external borrowings in the same currency as the underlying investments. The fair value of the loans at 31st December 2006 was $3,757 million (2005 : $3,274 million).

(e) Fair Values

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

(f) Estimation of Fair Values

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

(i) *Securities*

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

(ii) *Derivatives*

The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date. The fair value of interest rate swaps and cross currency swaps is determined by discounting the future cash flows of the contracts at the current market interest and foreign exchange rates.

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

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

(iv) *Financial Guarantees*

The fair value of financial guarantees issued is determined by reference to fees charged in an arm's length transaction for similar services, when such information is obtainable, or is otherwise estimated by reference to interest rate differentials, by comparing the actual rates charged by lenders when the guarantee is made available with the estimated rates that lenders would have charged, had the guarantees not been available, where reliable estimates of such information can be made.

(Expressed in Hong Kong Dollars)

33. Operating Lease

At 31st December 2006, the total future minimum lease payments by the Group under a non-cancellable equipment operating lease are payable as follows:

	Group	
	2006	2005
	$ million	$ million
Within 1 year	**62**	62
After 1 year but within 5 years	**108**	170
	170	232

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

34. Commitments

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Contracted for:				
Capital expenditure	**1,218**	1,807	**–**	–
Investment in associates	**309**	234	**–**	–
	1,527	2,041	**–**	–
Authorised but not contracted for:				
Capital expenditure	**8,674**	7,400	**–**	–

35. Contingent Liabilities

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Financial guarantees have been issued in respect of banking facilities available to the subsidiaries	**–**	–	**3,757**	3,274
Other guarantees given in respect of:				
Subsidiaries	**10**	10	**1,806**	1,728
Associate	**–**	33	**–**	33
Others	**210**	210	**–**	–
	220	253	**5,563**	5,035

36. Material Related Party Transactions

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

(a) Associates

Interest income received/receivable from associates in respect of the loans to associates amounted to $461 million (2005 : $840 million) for the year. At 31st December 2006, the total outstanding interest bearing loan balances due from associates were $4,269 million (2005 : $4,075 million). The outstanding balances with associates are disclosed in note 17.

(b) Key Management Personnel Compensation

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

	Group		Company	
	2006	2005	**2006**	2005
	$ million	$ million	**$ million**	$ million
Short-term employee benefits	**63**	61	**38**	35
Post-employment benefits	**3**	3	**1**	1
	66	64	**39**	36

Total remuneration is included in "staff costs" (see note 9). At 31st December 2006, the total outstanding amount due from the key management personnel was $1 million (2005 : $nil).

(c) Subsidiaries

Management fees and services fees recharged by the Company to subsidiaries amounted to $138 million (2005 : $134 million) for the year. At 31st December 2006, the outstanding balances with subsidiaries are disclosed in note 16. The transactions and balances with subsidiaries are eliminated on consolidation.

(Expressed in Hong Kong Dollars)

36. Material Related Party Transactions (continued)

(d) Other Related Parties

On 1st June 2006, Status High Investments Limited ("Status High"), a wholly-owned subsidiary of Cheung Kong (Holdings) Limited ("CKH"), entered into a subscription agreement with Hong Kong Telecommunications Holdings (Malaysian) Limited ("HKTHM") (formerly known as CKI/HEI Electricity Holdings (Malaysian) Limited) to subscribe for 50 new shares of par value of US$1.00 each in the share capital of HKTHM. The subscribed new shares represent one-third of the issued share capital of HKTHM as enlarged by the issue of the subscription shares, for an aggregate consideration of US$50 (equivalent to HK$390). The Group and Cheung Kong Infrastructure Holdings Limited ("CKI") each ultimately owned 50% of the issued share capital of HKTHM before the subscription. Following completion of the subscription, HKTHM is ultimately owned by the Group, CKI and CKH in equal proportions (i.e. one-third each). In line with the current funding arrangements under which the Group and CKI have each indirectly granted HKTHM a facility of up to A$12.5 million (equivalent to HK$73.25 million), Status High entered into a loan agreement with HKTHM to grant the facility to HKTHM on identical terms, immediately after completion of the subscription.

CKH is a substantial shareholder of Hutchison Whampoa Limited ("HWL"). HWL is a substantial shareholder of CKI. CKI is a substantial shareholder of the Group. HKTHM is an associate of the Group.

37. Substantial Shareholder of the Company

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

38. Critical Accounting Estimates and Judgements

The methods, estimates and judgements the directors used in applying the Group's accounting policies have a significant impact on the Group's financial position and operating results. Some of the accounting policies require the Group to apply estimates and judgements, on matters that are inherently uncertain. In addition to notes 28 and 32 which contain information about the assumptions and their risk factors relating to valuation of defined benefit retirement obligations and financial instruments, certain critical accounting judgements in applying the Group's accounting policies are described below.

(a) Depreciation and Amortisation

Fixed assets are depreciated on a straight-line basis over the estimated useful lives, after taking into account the estimated residual value. The Group reviews annually the useful life of an asset and its residual value, if any. Interests in leasehold land held for own use under operating leases are amortised on a straight-line basis over the shorter of the estimated useful lives of the lease assets and the lease term. Both the period and methods of amortisation are reviewed annually. The depreciation and amortisation expenses for future periods are adjusted if there are significant changes from previous estimates.

(b) Impairment

In considering the impairment losses that may be required for the Group's assets which include available-for-sale securities and fixed assets, the recoverable amount of the asset needs to be determined. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for these assets may not be readily available. In determining the value in use, expected cash flows generated by the assets are discounted to their present value, which require significant judgement. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount.

Any increase or decrease in the above impairment loss would affect the net profit in future years.

39. Possible Impact of Amendments, New Standards and Interpretations Issued But Not Yet Effective for the Year Ended 31st December 2006

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31st December 2006 and which have not been adopted in these financial statements.

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 them is unlikely to have a significant impact on the Group's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the financial statements:

		Effective for accounting periods beginning on or after
HK(IFRIC 9)	Reassessment of embedded derivatives	1st June 2006
HKFRS 7	Financial Instruments: Disclosures	1st January 2007
Amendments to HKAS 1	Presentation of Financial Statements: Capital Disclosures	1st January 2007

(Expressed in Hong Kong Dollars)

Appendix 1

Segment Information

(a) Business Segments

For the year ended 31st December

$ million	Sales of Electricity 2006	Sales of Electricity 2005	Infrastructure Investments 2006	Infrastructure Investments 2005	Unallocated & Other Items 2006	Unallocated & Other Items 2005	Consolidated 2006	Consolidated 2005
Revenue								
Group turnover	**12,139**	11,575	**–**	–	**42**	47	**12,181**	11,622
Other revenue	**26**	47	**78**	–	**216**	110	**320**	157
Segment revenue	**12,165**	11,622	**78**	–	**258**	157	**12,501**	11,779
Result								
Segment result	**7,347**	6,783	**78**	–	**185**	70	**7,610**	6,853
Interest income	**–**	–	**461**	840	**263**	62	**724**	902
Finance costs	**(186)**	(128)	**(234)**	(460)	**–**	–	**(420)**	(588)
Operating profit	**7,161**	6,655	**305**	380	**448**	132	**7,914**	7,167
Profit on disposal of interest in associates	**–**	–	**–**	1,560	**–**	–	**–**	1,560
Share of profits less losses of associates	**–**	–	**228**	1,049	**1**	1	**229**	1,050
Profit before taxation	**7,161**	6,655	**533**	2,989	**449**	133	**8,143**	9,777
Income tax	**(1,286)**	(1,218)	**(2)**	(1)	**(13)**	4	**(1,301)**	(1,215)
Profit after taxation	**5,875**	5,437	**531**	2,988	**436**	137	**6,842**	8,562
Scheme of Control transfers	**–**	–	**–**	–	**–**	–	**–**	–
Profit attributable to equity shareholders	**5,875**	5,437	**531**	2,988	**436**	137	**6,842**	8,562
At 31st December								
Assets								
Segment assets	**49,209**	49,056	**1,733**	1,738	**36**	(27)	**50,978**	50,767
Interest in associates	**–**	–	**6,329**	5,770	**10**	10	**6,339**	5,780
Cash and cash equivalents	**–**	–	**–**	–	**10,462**	4,561	**10,462**	4,561
Consolidated total assets	**49,209**	49,056	**8,062**	7,508	**10,508**	4,544	**67,779**	61,108
Liabilities								
Segment liabilities	**2,743**	2,601	**150**	458	**129**	117	**3,022**	3,176
Current and deferred taxation	**5,972**	5,602	**1**	–	**10**	–	**5,983**	5,602
Interest-bearing borrowings	**10,937**	7,372	**3,751**	3,273	**1**	–	**14,689**	10,645
Rate Reduction Reserve	**–**	–	**–**	–	**–**	–	**–**	–
Development Fund	**–**	–	**–**	–	**–**	–	**–**	–
Consolidated total liabilities	**19,652**	15,575	**3,902**	3,731	**140**	117	**23,694**	19,423
Other information								
Capital expenditure	**2,304**	3,005	**–**	–	**1**	–	**2,305**	3,005
Depreciation and amortisation	**2,019**	1,964	**–**	–	**–**	–	**2,019**	1,964

(b) Geographical Segments

For the year ended 31st December

$ million	Hong Kong 2006	Hong Kong 2005	Australia 2006	Australia 2005	Unallocated & Other Items 2006	Unallocated & Other Items 2005	Consolidated 2006	Consolidated 2005
Revenue								
Group turnover	**12,166**	11,607	**–**	–	**15**	15	**12,181**	11,622
Other revenue	**65**	53	**78**	–	**177**	104	**320**	157
Segment revenue	**12,231**	11,660	**78**	–	**192**	119	**12,501**	11,779
Result								
Segment result	**7,394**	6,787	**82**	13	**134**	53	**7,610**	6,853
Interest income	**263**	62	**460**	837	**1**	3	**724**	902
Finance costs	**(186)**	(128)	**(234)**	(460)	**–**	–	**(420)**	(588)
Operating profit	**7,471**	6,721	**308**	390	**135**	56	**7,914**	7,167
Profit on disposal of interest in associates	**–**	–	**–**	1,560	**–**	–	**–**	1,560
Share of profits less losses of associates	**1**	1	**254**	1,064	**(26)**	(15)	**229**	1,050
Profit before taxation	**7,472**	6,722	**562**	3,014	**109**	41	**8,143**	9,777
Income tax	**(1,299)**	(1,214)	**(2)**	–	**–**	(1)	**(1,301)**	(1,215)
Profit after taxation	**6,173**	5,508	**560**	3,014	**109**	40	**6,842**	8,562
Scheme of Control transfers	**–**	–	**–**	–	**–**	–	**–**	–
Profit attributable to equity shareholders	**6,173**	5,508	**560**	3,014	**109**	40	**6,842**	8,562
At 31st December								
Assets								
Segment assets	**49,234**	49,023	**46**	56	**1,698**	1,688	**50,978**	50,767
Interest in associates	**10**	10	**6,254**	5,548	**75**	222	**6,339**	5,780
Cash and cash equivalents	**–**	–	**–**	–	**10,462**	4,561	**10,462**	4,561
Consolidated total assets	**49,244**	49,033	**6,300**	5,604	**12,235**	6,471	**67,779**	61,108
Other information								
Capital expenditure	**2,304**	3,005	**–**	–	**1**	–	**2,305**	3,005
Depreciation and amortisaton	**2,019**	1,964	**–**	–	**–**	–	**2,019**	1,964

Appendix 2

Principal Subsidiaries

The following list contains only the particulars of subsidiaries as at 31st December 2006 which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary unless otherwise stated.

Name of Company	Issued Share Capital and Debt Securities	Percentage of Equity Held by the Company	Place of Incorporation/ Operation	Principal Activity
The Hongkong Electric Company, Limited	HK$2,411,600,000	100	Hong Kong	Electricity generation and supply
Associated Technical Services Limited	HK$1,000,000	100	Hong Kong	Consulting
Cavendish Construction Limited	HK$4,200,000	100	Hong Kong	Contracting
Fortress Advertising Company Limited	HK$2	100	Hong Kong	Advertising
Hongkong Electric Fund Management Limited	HK$20	100	Hong Kong	Trustee
Gusbury Enterprises Incorporation	US$2	100	Panama/ Hong Kong	Investment holding
HKE International Limited	US$1	100	British Virgin Islands/ Hong Kong	Investment holding
Hongkong Electric (Natural Gas) Limited	US$1	100	British Virgin Islands/ Hong Kong	Investment holding
Hongkong Electric (Cayman) Limited	US$1 and HK$1,000 million Hong Kong dollar notes (see note 24)	100	Cayman Islands/ Hong Kong	Financing
Hongkong Electric Finance (Cayman) Limited	US$1 and HK$500 million Hong Kong dollar notes (see note 24)	100	Cayman Islands/ Hong Kong	Financing
Fenning Limited	HK$20	100	Hong Kong	Contracting
Dunway Investment Limited	US$1	100	British Virgin Islands	Investment
Coty Limited	US$1	100	British Virgin Islands	Investment holding
Hongkong Electric International Limited	US$1	100	British Virgin Islands	Investment holding
Hongkong Electric Finance Limited	US$1 HK$1,900 million Hong Kong dollar notes (see note 24)	100*	British Virgin Islands/ Hong Kong	Financing
HEI Investment Holdings Limited	HK$2	100*	Hong Kong	Investment holding
Sigerson Business Corp.	US$1	100*	British Virgin Islands	Investment holding
HEI Utilities (Malaysian) Ltd	A$637,510	100*	British Virgin Islands	Investment holding
HEI Power (Malaysian) Ltd	A$52,510	100*	British Virgin Islands	Investment holding
Hong Kong Electric International Finance (Australia) Pty Limited	A$1	100*	Australia	Financing
HEI Transmission Finance (Australia) Pty Limited	A$12	100*	Australia	Financing
HEI Distribution Finance (Australia) Pty Limited	A$100	100*	Australia	Financing
Riverland Investment Limited	US$1	100*	British Virgin Islands	Investment holding
Hongkong Electric International Power (Mauritius) Limited	US$2	100*	Mauritius	Investment holding
HEI Electricity Distribution (Malaysian) Limited	US$100	100*	Malaysia	Investment holding
Kentson Limited	US$1	100*	British Virgin Islands	Investment holding
Alpha Central Profits Limited	US$1	100*	British Virgin Islands	Investment holding

* *Indirectly held*

Appendix 3
Principal Associates

The following list contains only the particulars of associates as at 31st December 2006 which principally affected the results or assets of the Group:

Name of Associate	Issued Share Capital	Percentage of Group's Effective Interest	Place of Incorporation/ Operation	Principal Activity
Secan Limited	HK$10	20%	Hong Kong	Property development
CKI Spark Holdings No. One Limited (see note (a) below)	AUD343,206,585	54.76%	Bahamas/ Australia	Electricity distribution
CKI Spark Holdings No. Two Limited (see note (b) below)	AUD498,038,537	54.76%	Bahamas/ Australia	Electricity distribution
Hong Kong Telecommunication Holdings (Malaysian) Limited (see note (c) below)	AUD150	33.33%	Malaysia	Investment holding
Ratchaburi Power Company, Limited (see note (d) below)	THB2,250,000,000	25%	Thailand	Electricity generation and supply

Notes:

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

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

(c) Hong Kong Telecommunication Holdings (Malaysian) Limited ("HKTHM") (formerly known as CKI/HEI Electricity Holdings (Malaysian) Limited) through its wholly-owned subsidiary holds certain telecommunication assets in Australia. On 1st June 2006, the shareholding of HKTHM was reduced from 50% to 33.33% after the subscription of 50 new shares of HKTHM by a related person (see note 36(d)).

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