ote 1 to the Group's consolidated financial statements includes a summary of the significant accounting policies used in the preparation of the statements. The preparation of financial statements often requires the selection of specific accounting methods and policies from several acceptable alternatives. Furthermore, significant estimates and judgements may be required in selecting and applying those methods and policies in the Group's consolidated financial statements. The Group bases its estimates and judgements on historical experience and various other assumptions that it believes are reasonable under the circumstances. Actual results may differ from these estimates and judgements under different assumptions or conditions.

The selection and disclosure of the critical accounting policies and estimates have been discussed with the Group's Audit Committee. The following is a review of the more significant assumptions and estimates, as well as the accounting policies and methods used in the preparation of the consolidated financial statements.

## **Long-lived Assets**

The Group has made substantial investments in tangible and intangible long-lived assets, primarily in mobile and fixed-line telecommunications networks and licences, container terminals, and properties. Changes in technology or changes in the intended use of these assets may cause the estimated period of use or value of these assets to change.

The Group considers its asset impairment accounting policy to be a policy that requires one of the most extensive applications of judgement and estimates by management.

Assets that have an indefinite useful life are tested for impairment annually. Assets that are subject to depreciation and amortisation are reviewed to determine whether there is any indication that the carrying value of these assets may not be recoverable and have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Such impairment loss is recognised in the consolidated profit and loss account except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that asset, in which case it is treated as a revaluation decrease.

Management judgement is required in the area of asset impairment, particularly in assessing: (1) whether an event has occurred that may affect asset values; (2) whether the carrying value of an asset can be supported by the net present value of future cash flows which are estimated based upon the continued use of the asset in the business; and (3) the appropriate key assumptions to be applied in preparing cash flow projections including whether these cash flow projections are discounted using an appropriate rate. Changing the assumptions selected by management to determine the level, if any, of impairment, including the discount rates or the growth rate assumptions in the cash flow projections, could materially affect the net present value used in the impairment test and as a result affect the Group's financial condition and results of operations.

The Group's 3G businesses commenced commercial operations from 2003 and in accordance with initial business plans are incurring start-up losses as the businesses develop. A review was undertaken at 31 December 2004 to assess whether the carrying value of the Group's 3G telecommunications fixed assets and licences was supported by the net present value of future cash flows derived from these assets using cash flow projections for each business. The results of the review undertaken at 31 December 2004 indicated that no impairment charge was necessary.

Cash flow projections for the 3G businesses reflect investments in telecommunications spectrum licences and network infrastructure to provide voice and increasing demand for non-voice value added services such as content, multi-media messaging and video services which are forecast to be significant drivers of future revenue as well as investments in customer acquisitions. Capital expenditure and customer acquisition costs are heaviest in the early years of projections but are forecast to decline progressively as a percentage of revenues. Forecast revenue growth and profitability are driven by a combination of new customers and improving operating margins driven in part by a change in the mix of voice and non-voice revenues and enhanced customer propositions. Projections in excess of five years are used to take into account contracted telecommunications spectrum licence periods, increasing market share and growth momentum. The discount rates for the review were based on country specific pre-tax weighted average cost of capital percentages and ranged from 8% to 12%. Judgement is required to determine key assumptions adopted in the cash flow projections and changes to key assumptions can significantly affect these cash flow projections.

# **Depreciation and Amortisation**

### (i) Property, Plant and Equipment

Depreciation of operating assets constitutes a substantial operating cost for the Group. The cost of property, plant and equipment is charged as depreciation expense over the estimated useful lives of the respective assets using the straight line method. The Group periodically reviews changes in technology and industry conditions, asset retirement activity and salvage values to determine adjustments to estimated remaining useful lives and depreciation rates.

Actual economic lives may differ from estimated useful lives. Periodic reviews could result in a change in depreciable lives and therefore depreciation expense in future periods.

### (ii) Telecommunications Licences

Telecommunications spectrum licences acquired are stated at cost for the period from acquisition to the dates of first commercial usage of the related spectrum. Thereafter licences are stated net of accumulated amortisation and amortised on a straight line basis over the remaining licence periods. The actual economic lives of the Group's telecommunications spectrum licences may differ from the current contracted licence periods, which could impact the amount of amortisation expense charged to the profit and loss account.

## (iii) Telecommunications 3G Customer Acquisition Costs

Costs to acquire 3G mobile telecommunications customers pursuant to a contract with early termination penalties ("Postpaid 3G CAC") are capitalised and amortised over the period that the penalties apply (the period of contractual control), which is generally a period of twelve months. In the event that a customer churns off the network within the contractual control period, any

unamortised 3G customer acquisition costs are written off in the period in which the customer churns.

Costs to acquire prepaid 3G mobile telecommunications customers ("Prepaid 3G CAC") are expensed in the period incurred.

In previous years, costs to acquire postpaid and prepaid 3G mobile telecommunications customers were capitalised and amortised over the estimated customer relationship period of 36 months. This is a change in accounting policy that has been applied retrospectively and the comparative figures have been restated accordingly.

#### Goodwill

Goodwill represents the excess of the cost of acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary company, associated company or jointly controlled entity at the date of acquisition. Goodwill is recorded as a separate asset or, as applicable, included within investments in associated companies and joint ventures. Goodwill is also subject to the annual impairment review described above to assess whether there are indications that the carrying value may not be recoverable.

Judgement is required to determine key assumptions adopted for the annual impairment review as described above.

## **Investment Properties**

Investment properties are interests in land and buildings in respect of which construction work has been completed that are held for their investment potential. Such properties are carried in the balance sheet at their fair value based on existing use as determined by an annual professional valuation. Upon the adoption in 2004 of HKAS 40 "Investment Property", changes in fair values of investment properties, which were previously taken directly to investment properties revaluation reserves, are recorded in the consolidated profit and loss account. This is a change in accounting policy that has been applied retrospectively and the comparative figures have been restated accordingly.

#### **Taxation**

Deferred tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying values in the consolidated financial statements.

Deferred tax assets are recognised for unused tax losses carried forward to the extent it is probable (i.e. more likely than not) that future taxable profits will be available against which the unused tax losses can be utilised, based on all available evidence. Recognition primarily involves judgement regarding the future financial performance of the particular legal entity or tax group in which the deferred tax asset has been recognised. A variety of other factors are also evaluated in considering whether there is convincing evidence that it is probable that some portion or all of the deferred tax assets will ultimately be realised, such as the existence of taxable temporary differences, group relief, tax planning strategies and the periods in which estimated tax losses can be utilised. The carrying amount of deferred tax assets and related financial models and budgets are reviewed at each balance sheet date and to the extent that there is insufficient convincing evidence that sufficient taxable profits will be available within the utilisation periods to allow utilisation of the carry forward tax losses, the asset balance will be reduced and charged to the profit and loss account.

The 3G businesses commenced commercial operations from 2003 and in accordance with initial business plans are incurring start-up losses as the businesses develop. The ultimate realisation of these deferred tax assets depend principally on these businesses achieving profitability and generating sufficient taxable profits to utilise the underlying unused tax losses. Based on the taxable profit and loss projections of these businesses, it is more likely than not that the Group can fully utilise the deferred tax assets recognised within the utilisation periods. It may be necessary for some or all of these deferred tax assets be reduced and charged to the profit and loss account if there is a significant adverse change in the projected performance and resulting projected taxable profits of these businesses. Judgement is required to determine key assumptions adopted in the taxable profit and loss projections and changes to key assumptions used in the taxable profit and loss projections can significantly affect these taxable profit and loss projections.

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

### **Pension Costs**

The Group operates several defined benefit plans.

Pension costs for defined benefit plans are using the projected unit credit method in accordance with SSAP 34 "Employee Benefits". Under this method, the cost of providing pensions is charged to the profit and loss account so as to spread the regular cost over the

future service lives of employees, in accordance with the advice of the actuaries who carry out a full valuation of the plans each year. The pension obligation is measured as the present value of the estimated future cash outflows using interest rates determined by reference to market yields at the balance sheet date based on high quality corporate bonds with currency and term similar to the estimated term of benefit obligations. Cumulative unrecognised net actuarial gains and losses at the previous financial year end, to the extent of the amount in excess of 10% of greater of the present value of plan obligations and the fair value of plan assets at that date, are recognised over the average remaining service lives of employees. Management appointed actuaries to carry out a full valuation of these pension plans to determine the pension obligations that are required to be disclosed and accounted for in the audited consolidated accounts for the year ended 31 December 2004 in accordance with the Hong Kong accounting requirements.

The actuaries use assumptions and estimates in determining the fair value of its defined benefit plans and evaluate and update these assumptions on an annual basis. The actuaries have assumed that the expected long-term rate of return on the assets of the Group's various defined benefit schemes range from 4.5% to 11%. At 31 December 2004 the fair value of plan assets and the present value of defined benefit obligations amounted to HK\$7,977 million and HK\$10,401 million respectively, resulting in a deficit between the fair value of plan assets and the present value of plan obligations of HK\$2,424 million of which HK\$1,143 million has been recognised.

Judgement is required to determine the principal actuarial assumptions to determine the present value of defined benefit obligations and service costs.

Changes to the principal actuarial assumptions can significantly affect the present value of plan obligations and service costs in future periods.