operations. Changes in the collectibility of accounts receivable for which provisions are not made could affect our future results of operations.

Deferred Taxation

Under Hong Kong GAAP, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liability and their carrying amounts in the accounts. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred taxation is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future. In determining whether a liability or asset is expected to be payable or recoverable in the foreseeable future, we assess the effect of our capital expenditures and other plans, such as the existing network capacity, technological changes, future market trends and projected fixed network coverage.

Under U.S. GAAP, deferred tax assets and liabilities are determined based on the temporary differences between the financial reporting basis and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Future tax benefits in respect of tax loss carry forwards are also required to be recognized in full. We must establish a valuation allowance for such assets if we determine it is more likely than not that we will not be able to utilize such benefits in the future.

The recording of certain deferred tax assets requires judgment regarding the results of future operations, including the assumption that there will be sufficient future operations to allow us to utilize the related deferred tax asset. Any changes in the estimate of future operations could change the recognition of such assets, which could significantly affect the results of our operations.

Carrying value of fixed assets, investments and goodwill

We assess the carrying value of our investments in subsidiaries, including acquired goodwill, for impairment on an annual basis based on their recoverable amount. Our assessments generally include methodology of discounted cash flow analysis, and review of comparable entities. This methodology sometimes relies on factors such as forecasts of future performance and long-term growth rates of the investee, and selection of discount rate. If these forecasts and assumptions prove to be incorrect or circumstances change, we may be required to write down our investments.

Based on our most recent assessment of recoverable amount we believe that as at August 31, 2004 our goodwill is recoverable at the amounts at which they are stated in our financial statements.

USC charges

Our management makes their best estimates for charges of the USC payable to PCCW-HKT in order to fund the costs of network development incurred by PCCW-HKT in remote areas in Hong Kong (the “Development”). Such estimated costs are included as part of our costs of rendering services. The estimate is made based on the provisional rates announced by the Telecommunications Authority and is effective up to the date of the release of our financial statements. The Telecommunications Authority periodically reviews the actual costs incurred by PCCW-HKT in the Development and adjusts the amounts owed to PCCW-HKT, or to be refunded by it, to the respective USC contributing parties, including our company (the “Rate Revisions”). Accordingly, the estimate made by our management is subject to changes based on the Rate Revisions identified during a financial year and up to the date prior to the release of our financial statements. We adjust such differences as an addition to, or reduction of, the corresponding costs of services in that particular reporting period.

Any sum received in advance from PCCW-HKT as an estimated refund of USC on a provisional basis, which is subject to the final confirmation and determination of the Telecommunications Authority, is recorded in other payables and accrued charges in our balance sheet.

Revenue Recognition

Revenue for the provision of telecommunications services is recognized when the services are rendered. Revenue received in advance is deferred and amortized based on estimated actual usage by customers or the stated period of time in the subscriber agreement. Network interconnection charges are recorded as revenue based on usage of the fixed telecommunications network of the Company by mobile and other fixed telecommunications network operators. The determination of the rates at which revenue is recognized involved significant estimates by management. Significant changes in management estimates may result in material revenue adjustments.

Legal contingencies

We are currently involved in certain legal proceedings. The assessment of the ultimate outcome of those proceedings is derived from consultation with outside counsel, as well as an assessment of litigation and settlement strategies. A future event or change in the facts and circumstances may require us to make accruals with would be charged to our income statement in the future.

U.S. GAAP Reconciliation

Our financial statements are prepared in accordance with Hong Kong GAAP, which differs in certain material respects from U.S. GAAP. The following tables provide a comparison of our net income and shareholders' equity in accordance with Hong Kong GAAP and U.S. GAAP

	Year Ended August 31,			
	2002	2003	2004	2004
	HK$ (Restated)	HK$ (Restated)	HK$	US$
	(in thousands)			
Net income				
Hong Kong GAAP	90,505	257,743	49,550	6,353
U.S. GAAP adjustments:				
Compensation benefit cost associated with share options	(21,586)	2,731	270	35
Amortization of goodwill (acquired prior to June 30, 2001)	(1,019)	—	—	—
Reversal of amortization of goodwill (acquired after June 30, 2001)	1,065	1,065	1,065	136
Fair value of interest rate swap	—	—	680	87
Net income under U.S. GAAP	68,965	261,539	51,565	6,611
Shareholders' Equity				
Hong Kong GAAP	904,988	1,179,175	1,175,698	150,731
U.S. GAAP adjustments:				
Goodwill	5,092	5,092	5,092	653
Accumulated amortization of goodwill	(3,735)	(3,735)	(3,735)	(479)
Reversal of amortization of goodwill	1,065	2,130	3,195	409
Fair value of interest rate swap	—	—	680	87
Total shareholders' equity under U.S. GAAP	907,410	1,182,662	1,180,930	151,401

Under Hong Kong GAAP, no compensation cost is required to be recognized in respect of the grant of stock options to employees and executive directors. Under U.S. GAAP, compensation expense is required to be measured either in accordance with the intrinsic value method prescribed by APB Opinion No. 25 "Accounting for Stock Issued to Employees" or the fair value method prescribed by Statement of Financial Accounting Standards ("SFAS") No. 123 "Accounting for Stock-based Compensation". We apply the intrinsic value method prescribed by APB Opinion No. 25 and disclose in our consolidated financial statements the pro forma effect that use of the fair value method would have on our net income and earnings per share. The compensation cost for stock options under U.S. GAAP represents the cost of amortizing the compensation expense given to employees over the vesting period of the options. Because the exercise price of certain options granted can decrease during the vesting period, such options are considered variable options under U.S. GAAP and compensation expense is based on our share price at the balance sheet date. The charge for compensation expense for fiscal 2004 primarily relates to such variable options.

Goodwill and accumulated amortization comprises goodwill arising on the acquisition in 1999 of 963673 Ontario Limited group of companies and the goodwill arising on the deemed acquisition of additional interest in one of our wholly owned subsidiaries, HKBN, through subscription of Rights Issue and from acquiring remaining interest from the minority shareholder in 2002.

Under Hong Kong GAAP, the Company charged the goodwill arising from the acquisition of 963673 Ontario Limited group of companies against available reserves. However, in accordance with the change in accounting standards in Hong Kong, goodwill on acquisitions occurring on or after September 1, 2001 is shown separately on the consolidated balance sheet and is amortized using the straight-line method over its estimated useful life. As a result of that, the goodwill arising for HKBN is recorded as an asset on the balance sheet and amortized over its estimated useful life, which in this case is five years. For the goodwill arising for the 963673 Ontario Limited group of companies, the Company has taken advantage of the transitional provisions of the new accounting standard and goodwill previously written off against reserves has not been restated. Where an indication of impairment exists, the carrying amount of goodwill, including goodwill previously written off against reserves, is assessed and written down immediately to its recoverable amount with the charges being recorded in the Company’s profit and loss accounts.

Under U.S. GAAP, goodwill recorded on the acquisition of a business prior to June 30, 2001 was capitalized and amortized to the profit and loss accounts over its expected useful life of five years. In June 2001, FASB issued the SFAS No. 142 “Goodwill and other Intangible Assets” effective for fiscal years beginning after December 15, 2001. In connection with the adoption of this standard in fiscal 2003 under U.S. GAAP, we ceased amortizing goodwill recognized on business combinations initiated prior to June 30, 2001 and performed a transitional goodwill impairment assessment. Goodwill recognized on business combinations initiated after June 30, 2001, is not amortized under SFAS No. 142 and is required to be tested annually for impairment in accordance with the provisions of SFAS No. 142. We have performed the impairment tests on the goodwill recorded prior to and after June 30, 2001 at the fiscal year end and no impairment loss was identified from the process for fiscal 2004.

Under Hong Kong GAAP, there are no specific accounting standards governing the accounting for derivative instruments. As a result, the Company does not recognize the interest rate swap at fair value and does not account for the gains or losses relating to the fair value changes in this derivative. Under U.S. GAAP, the Company recognized the interest rate swap on the balance sheet at fair value in accordance with SFAS No. 133 “Accounting for Certain Derivative Instruments and Certain Hedging Activities”. Since the interest rate swap is not designated as a hedge, the gain or loss on change in fair value of this derivative instrument is recognized currently in earnings.

Recent Accounting Pronouncements

Hong Kong GAAP

In March 2004, the Hong Kong Institute of Certified Public Accountants (“HKICPA”) issued the Hong Kong Accounting Standards (“HKAS”) and HKAS Interpretation (“HKAS Interpretation”) that were converged with equivalent International Accounting Standards and Standing Interpretations Committee Interpretations issued by the International Accounting Standards Board (“IASB”), most of which were revised recently as a result of the IASB’s improvements project.

The HKAS and HKAS Interpretation will become effective for accounting periods beginning on or after January 1, 2005 and are required to be adopted by us for the year ending August 31, 2006. As a consequence, all existing Statement of Standard Accounting Practices (“SSAP”) and the related interpretations issued by the HKICPA, for which there are equivalent International Accounting Standards and Standing Interpretations Committee Interpretations will be renamed as HKAS and HKAS Interpretations, or otherwise, will be superseded at that time.

U.S. GAAP

In December 2003, the FASB issued FIN 46-R “Consolidation of Variable Interest Entities — an Interpretation of ARB No. 51. FIN 46-R requires that certain variable interest entities, or VIE’s, be consolidated by their primary beneficiary if the primary beneficiary is subject to a majority of the risk of losses from the VIE activities, or entitled to receive a majority of the VIE’s residual returns, or both. An entity is subject to FIN 46-R and is considered to be a VIE if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity’s operations, or that do not absorb the expected losses or receive the expected returns of the entity. FIN 46-R is effective immediately for all new VIE’s created or acquired after January 31, 2003. For VIE’s created or acquired prior to February 1, 2003, the provisions of FIN 46-R must be applied by the end of the first reporting period ending after March 15, 2004. The adoption of FIN 46 for VIEs would not have any significant impact on our financial statements.

In December 2003, the Securities and Exchange Commission issued SAB No. 104, “Revenue Recognition”. SAB No. 104 supersedes SAB No. 101, “Revenue Recognition in Financial Statements”. SAB No. 104’s primary purpose is to rescind accounting guidance contained in SAB No. 101 related to multiple element revenue arrangements, superseded as a result of the issuance of Emerging Issues Task Force Issue No. 00-21, “Accounting for Revenue Arrangements with Multiple Deliverables” (“EITF 00-21”). Additionally, SAB No. 104 rescinds the Securities and Exchange Commission’s Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (“the FAQ”) issued with SAB No. 101 that had been codified in Securities and Exchange Commission Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB No. 104. While the wording of SAB No. 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104. As a result, the adoption of this pronouncement did not have any significant impact on our consolidated financial statements.