Changes in the provision for doubtful debts consist of:

	Year ended August 31,		
	2003	2004	2005
	(Thousands of HK$)		
Balance at beginning of the year	17,139	22,916	22,959
Additions charged to expense[1]	17,685	11,502	35,445
Write-off	(11,908)	(11,459)	(10,088)
Balance at the end of the year	22,916	22,959	48,316

[1] Provision for doubtful debts as at August 31, 2005 includes provision for mobile interconnection charges receivables of HK$19.5 million (Further details has been included in note 31 of the consolidated financial statements included in this annual report).

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 financial statements. 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 estimate the availability of future taxable profit and 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.

A change in judgement regarding the likelihood of the generation of future taxable income necessary to realize deferred tax assets could result in a change in the valuation allowance on deferred tax assets which would impact our results under both Hong Kong GAAP and U.S. GAAP.

Carrying value of 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, 2005 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.

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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 an arrangement exists, service is rendered, fee is fixed or determinable and collectibility is probable. Revenue received in advance is deferred and amortized based on 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.

Hong Kong Broadband Network Limited (“HKBN”), a wholly-owned subsidiary of the Company, as a Fixed Telecommunications Network Services (“FTNS”) licensee, provides interconnection services to enable delivery of telecommunications service to customers of different operators. Since the FTNS license was granted by the TA and interconnection services have been provided, the Company has been recognising interconnection services billed to mobile operators as revenue (“mobile interconnection charges”). For the years ended August 31, 2003, 2004 and 2005, the Company recorded mobile interconnection charges of HK$6,090,000, HK$38,676,000 and HK$24,703,000, respectively. As of August 31, 2005, substantially all of the mobile operators had not made any payments to the Company since 2002 when the Company started to bill for the mobile interconnection services.

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

We report revenue related to mobile interconnection charges at amounts we believe to be realizable after consideration of the uncertainty regarding the timing and amount of the ultimate collection of amounts due. Amounts reported for the year ended August 31, 2005 reflect a discount from the amount billed which is determined based on our assessment of the range of likely outcomes from the determination process. Actual amounts realized could be different from our estimate.

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,			
	2003	2004	2005	2005
	HK$	HK$ (in thousands)	HK$	US$
Net income/(loss)				
Hong Kong GAAP	257,743	49,550	(156,531)	(20,141)
U.S. GAAP adjustments:				
Compensation benefit cost associated with share options	2,731	270	389	50
Amortization of goodwill (acquired prior to June 30, 2001)	—	—	—	—
Reversal of amortization of goodwill under Hong Kong GAAP (acquired after June 30, 2001)	1,065	1,065	1,065	137
Fair value of interest rate swap	—	680	1,890	243
Fair value of forward foreign exchange contracts	—	—	4,039	520
Tax effects of U.S. GAAP adjustments	—	—	—	—
Net income/(loss) under U.S. GAAP	261,539	51,565	(149,148)	(19,191)
Shareholders’ Equity				
Hong Kong GAAP	1,179,175	1,175,698	1,020,454	131,302
U.S. GAAP adjustments:				
Goodwill	5,092	5,092	5,092	655
Accumulated amortization of goodwill under U.S. GAAP	(3,735)	(3,735)	(3,735)	(481)
Reversal of amortization of goodwill under Hong Kong GAAP	2,130	3,195	4,260	548
Fair value of interest rate swap	—	680	2,570	331
Fair value of forward foreign exchange contracts	—	—	4,039	520
Tax effects of U.S. GAAP adjustments	—	—	—	—
Total shareholders’ equity under U.S. GAAP	1,182,662	1,180,930	1,032,680	132,875

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 APB Opinion No. 25 and compensation expense is based on our share price at the balance sheet date. The charge for compensation expense for fiscal 2005 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 statement of operations.

Under U.S. GAAP, goodwill recorded on the acquisition of a business prior to June 30, 2001 was capitalized and amortized to the statement of operations 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 2005.

Under Hong Kong GAAP, where a non-speculative forward contract is used as a hedge of a net monetary asset or liability the gain or loss on the contract is credited or charged to the statement of operations and the discount or premium is either amortized over the period of the contract or credited or charged to the statement of operations. Where a non-speculative forward contract is used as a hedge of a firm commitment no gain or loss is recognized during the commitment period. At the end of that period any gain or loss will be added to, or deducted from, the amount of the relevant transaction. The discount or premium is either amortized over the period of the contract or deferred with the gain or loss. Where a forward contract is speculative the gain or loss is credited or charged to the statement of operations. As a result, the Company does not recognize the interest rate swap or forward foreign exchange contracts at fair value and does not account for the gains or losses relating to the fair value changes in these derivatives. Interest income or expenses arising from the interest rate swap contracts are netted of against the related interest income or expenses applicable to the on-balance sheet items.

Under U.S. GAAP, the Company accounted for its derivatives under SFAS No. 133 “Accounting for Derivative Instruments and Hedge Activities”, as amended by SFAS No. 138 “Accounting for Certain Derivative Instruments and Certain Hedging Activities”, which requires all derivative instruments be recognized on the balance sheet at fair value.

Since the Company did not have any derivatives that qualify as hedges, the gain or loss on change in fair value of these derivative instruments are 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.

The Company did not early adopt these new Hong Kong Financial Reporting Standards (“HKFRSs”) in the financial statements for fiscal 2005. The Company has made a preliminary assessment of the impact of these new HKFRSs and has concluded that the adoption of HKFRS 2 “Share-based Payment”, HKFRS 3 “Business Combinations” and HKAS 39 “Financial Instruments: Recognition and Measurement” will have an impact on the Company’s financial statements as described below:

(i) HKFRS 2 “Share-based Payment”

With effect from September 1, 2005, HKFRS 2 requires that the Company recognize the fair value of share options granted to employees as an expense in the consolidated statements of operations, or as an asset, if the cost qualifies for recognition as an asset under the Company’s accounting policies. A corresponding increase is recognized in a capital reserve within equity. HKFRS 2 requires that the fair value of the share options is measured at the date of grant. Where the employees are required to meet vesting conditions before they become entitled to the options, the fair value of the options granted should be recognized over the vesting period.

Under the transitional provisions of HKFRS 2, the Company can choose not to apply this treatment to share-based payments which were granted on or before November 7, 2002 or which were granted after November 7, 2002 but already vested before September 1, 2005.

If this revised accounting standard been adopted for fiscal 2005, the other operating expenses and the capital reserve of the Company would increase due to the recognition of share-based compensation expense. Management has assessed and considered the impact of the adoption of this new policy on the Company’s profit/(loss) attributable to shareholders and net assets as not significant.

(ii) HKFRS 3 “Business Combination”

With effect from September 1, 2005, HKFRS 3 requires goodwill to be recorded at cost less any accumulated impairment losses. Positive goodwill under HKFRS 3 is no longer amortized but requires an annual test for impairment, including in the year of its initial recognition, as well as when there are indications of impairment. Impairment losses are recognized when the carrying amount of the cash generating unit to which the goodwill has been allocated exceeds its recoverable amounts.

In accordance with HKFRS 3, if the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill), the excess is recognized immediately in the consolidated statements of operations as it arises.

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

This new policy is to be applied prospectively from September 1, 2005 in accordance with the transitional arrangements under HKFRS 3. This will result in a change to the Company's current accounting policies from September 1, 2005 onwards on the amortization of goodwill. The new policy in respect of negative goodwill would have no impact on the consolidated financial statements of the Company.

If this revised accounting standard been adopted for fiscal 2005, the other operating expenses would decrease and the goodwill balance would increase because of the cessation of the amortization of the goodwill balance.

Management has assessed and considered the impact on of the adoption of this new policy on the Company's consolidated profit/(loss) attributable to shareholders and consolidated net assets as not significant.

(iii)HKAS 39 "Financial Instruments: Recognition and Measurement"

With effect from September 1, 2005, HKAS 39 requires the following:

All non-trading investments are classified as available-for-sale securities and carried at fair value. Changes in fair value are recognized in equity, unless there is objective evidence that an individual investment has been impaired. If there is objective evidence that an individual investment has been impaired, any amount held in fair value reserve in respect of the investment is transferred to the statements of operations for the period in which the impairment is identified. Any subsequent increase in the fair value of available-for-sale securities is recognized directly in equity.

Based on management's evaluation, the adoption of this new policy would not be significant on the financial statements of the Company.

All derivative financial instruments entered into by the Company are stated at fair value. The accounting for changes in fair value depends on whether the derivative instrument qualifies as a hedge. Gains and losses on a derivative instrument designated and qualifying as a fair value hedge as well as the offsetting loss or gain on the hedged item attributable to the hedged risk shall be recognized currently in the statements of operations. The effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedge shall be reported in equity and reclassified into earnings in the same period or periods during which the hedged forecasted transaction impact earnings. Any ineffective portion of the changes in fair value of the derivatives is recognized in the statements of operations.

Management expects that the adoption of this new policy would result in an increase or decrease in the net asset or the other revenues of the Company depending on the change in fair value of the financial instruments. If this new policy been adopted in fiscal 2005, the other revenues and the net asset of the Company would increase due to the recognition of the gain in increase in fair value of the interest rate swap and foreign forward exchange contracts.

Convertible notes issued are split into their liability and equity components at initial recognition by recognizing the liability component at its fair value and attributing to the equity component the difference between the proceeds from the issue and the fair value of the liability component. The liability component is subsequently carried at amortized cost. The equity component is recognized in the capital reserve until the note is either converted (in which case it is transferred to share premium) or the note is redeemed (in which case it is released directly to retained profits). This new policy in respect of convertible notes would have no impact on the financial statements because the Company did not issue any convertible notes as defined under HKAS 32 “Financial instruments: Disclosure and Presentation”.

The Company is continuing its assessment of the impact of other new HKFRSs and other significant changes may be identified as a result.

The Company considers that there is no significant impact on the adoption of HKFRS 4 and HKFRS 5 on our financial statements presented in accordance with Hong Kong GAAP.

U.S. GAAP

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (“SFAS No. 123(R)”) “Share-Based Payment”. SFAS No. 123(R) replaces SFAS No. 123 “Accounting for Stock-Based Compensation” and supersedes APB Opinion No. 25 “Accounting for Stock Issued to Employees” and its related implementation guidance. SFAS No. 123(R) requires the company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and recognize in the financial statements. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. For public entities that do not file as small business issuers, SFAS No. 123(R) is effective for all awards granted after June 15, 2005, and to awards modified, repurchased, or cancelled after that date. For the Company, SFAS No. 123(R) is effective for the accounting period from September 1, 2005. The Company is currently assessing the impact of this statement on its consolidated financial statements and has not yet completed that assessment.