

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017



INDEPENDENT AUDITOR'S REPORT

TO THE BOARD OF DIRECTORS OF HONG KONG TELECOMMUNICATIONS (HKT) LIMITED
(Incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The consolidated financial statements of Hong Kong Telecommunications (HKT) Limited (the "Company") and its subsidiaries (the "Group") set out on pages 3 to 71, which comprise:

- the consolidated statement of financial position as at December 31, 2017;
- the consolidated income statement for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of principal accounting policies.

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at December 31, 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Responsibilities of Directors for the Consolidated Financial Statements

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.



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INDEPENDENT AUDITOR'S REPORT (CONTINUED)

**TO THE BOARD OF DIRECTORS OF HONG KONG TELECOMMUNICATIONS (HKT) LIMITED
(CONTINUED)**

(Incorporated in Hong Kong with limited liability)

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSA's, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers

PricewaterhouseCoopers
Certified Public Accountants
Hong Kong, March 28, 2018

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED**CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2017**

In HK\$ million	Note	2016	2017
Revenue	5	15,567	15,957
Cost of sales		(4,064)	(4,405)
General and administrative expenses		(6,649)	(5,904)
Other gains, net	6	6	1
Finance costs, net	8	(1,155)	(1,151)
Share of results of a joint venture		(4)	(7)
Profit before income tax	7	3,701	4,491
Income tax	10	(635)	(740)
Profit for the year		3,066	3,751

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2017**

In HK\$ million	2016	2017
Profit for the year	3,066	3,751
Other comprehensive income/(loss)		
Items that have been reclassified or may be reclassified subsequently to consolidated income statement:		
Cash flow hedges:		
- effective portion of changes in fair value	711	(280)
- transfer from equity to consolidated income statement	48	(332)
Other comprehensive income/(loss) for the year	759	(612)
Total comprehensive income for the year	3,825	3,139

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2017**

In HK\$ million	Note	2016			Retained earnings	Total
		Hedging reserve	Capital contribution reserve	Merger reserve		
At January 1, 2016		(268)	28	(695)	4,180	3,245
Comprehensive income						
Profit for the year		-	-	-	3,066	3,066
Other comprehensive income						
Items that have been reclassified or may be reclassified subsequently to consolidated income statement:						
Cash flow hedges:						
- effective portion of changes in fair value		711	-	-	-	711
- transfer from equity to consolidated income statement		48	-	-	-	48
Total other comprehensive income		759	-	-	-	759
Total comprehensive income for the year		759	-	-	3,066	3,825
Transactions with equity holder						
Contributions by and distributions to equity holder:						
Final dividend paid in respect of the previous year	11	-	-	-	(2,141)	(2,141)
Interim dividend declared and paid in respect of the current year	11	-	-	-	(2,051)	(2,051)
Total transactions with equity holder		-	-	-	(4,192)	(4,192)
At December 31, 2016		491	28	(695)	3,054	2,878

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2017

In HK\$ million	Note	2017			Retained earnings	Total
		Hedging reserve	Capital contribution reserve	Merger reserve		
At January 1, 2017		491	28	(695)	3,054	2,878
Comprehensive income/(loss)						
Profit for the year		-	-	-	3,751	3,751
Other comprehensive loss						
Items that have been reclassified or may be reclassified subsequently to consolidated income statement:						
Cash flow hedges:						
- effective portion of changes in fair value		(280)	-	-	-	(280)
- transfer from equity to consolidated income statement		(332)	-	-	-	(332)
Total other comprehensive loss		(612)	-	-	-	(612)
Total comprehensive (loss)/income for the year		(612)	-	-	3,751	3,139
Transactions with equity holder						
Contributions by and distributions to equity holder:						
Final dividend paid in respect of the previous year	11	-	-	-	(2,632)	(2,632)
Interim dividend declared and paid in respect of the current year	11	-	-	-	(329)	(329)
Total transactions with equity holder		-	-	-	(2,961)	(2,961)
At December 31, 2017		(121)	28	(695)	3,844	3,056

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2017**

In HK\$ million	Note(s)	2016	2017
ASSETS AND LIABILITIES			
Non-current assets			
Property, plant and equipment	12	15,701	17,008
Interests in leasehold land	13	253	240
Goodwill	14	32,625	32,625
Intangible assets	15	6,201	6,242
Interest in a joint venture	16	422	394
Derivative financial instruments	21	277	223
Financial assets at fair value through profit or loss	17	4	5
Other non-current assets		77	67
		55,560	56,804
Current assets			
Prepayments, deposits and other current assets		4,326	4,719
Inventories	19(a)	380	430
Trade receivables, net	19(b)	825	534
Amounts due from related companies	4(c)	94	48
Amounts due from fellow subsidiaries	4(c)	8,044	9,250
Financial assets at fair value through profit or loss	17	25	14
Short-term deposits		450	450
Cash and cash equivalents	26(d)	1,759	1,884
		15,903	17,329
Current liabilities			
Trade payables		792	955
Accruals and other payables		3,416	3,234
Carrier licence fee liabilities	25	173	173
Amounts due to fellow subsidiaries and intermediate holding companies	4(c) & 4(d)	11,944	12,974
Advances from customers		799	752
Current income tax liabilities		167	180
		17,291	18,268

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

AS AT DECEMBER 31, 2017

In HK\$ million	Note(s)	2016	2017
Non-current liabilities			
Long-term borrowings	20	38,193	39,146
Derivative financial instruments	21	14	150
Deferred income tax liabilities	24	2,182	2,516
Deferred income		26	31
Carrier licence fee liabilities	25	544	455
Other long-term liabilities		390	566
		41,349	42,864
Net assets		12,823	13,001
CAPITAL AND RESERVES			
Share capital	23	9,945	9,945
Reserves		2,878	3,056
Total equity		12,823	13,001

Approved and authorized for issue by the board of directors (the "Board") on March 28, 2018 and signed on behalf of the Board by



Alexander Anthony Arena
Director



Hui Hon Hing, Susanna
Director

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017**

In HK\$ million	Note	2016	2017
NET CASH GENERATED FROM OPERATING ACTIVITIES	26(a)	9,076	7,133
INVESTING ACTIVITIES			
Proceeds from disposals of property, plant and equipment		26	4
Purchases of property, plant and equipment		(2,305)	(2,275)
Purchases of intangible assets		(2,060)	(2,151)
Repayment/(loan to) from a joint venture		38	(84)
(Loan to)/repayment from a related company		(39)	24
Increase in short-term deposits with maturity more than three months		(450)	-
Net inflow of cash and cash equivalents in respect of business combination	26(c)	24	-
NET CASH USED IN INVESTING ACTIVITIES		(4,766)	(4,482)
FINANCING ACTIVITIES			
New borrowings raised, net		16,828	5,275
Finance costs paid		(840)	(856)
Repayments of borrowings		(17,036)	(4,650)
Movement in amounts due to fellow subsidiaries		82	665
Dividends paid	11	(4,192)	(2,961)
NET CASH USED IN FINANCING ACTIVITIES		(5,158)	(2,527)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(848)	124
Exchange differences		6	1
CASH AND CASH EQUIVALENTS			
Beginning of year		2,601	1,759
End of year	26(d)	1,759	1,884

The notes on pages 10 to 71 form part of these consolidated financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 GENERAL INFORMATION

Hong Kong Telecommunications (HKT) Limited (the “Company”) is a limited liability company incorporated in the Hong Kong Special Administrative Region (“Hong Kong”). The address of its registered office is 39th Floor, PCCW Tower, Taikoo Place, 979 King’s Road, Quarry Bay, Hong Kong.

The Company is a direct wholly-owned subsidiary of HKT (Hong Kong) Limited, which is a company incorporated in the British Virgin Islands, and is an indirect wholly-owned subsidiary of HKT Limited (“HKT”) which is a company incorporated in the Cayman Islands with its share stapled units (the “Share Stapled Units”) jointly issued with the HKT Trust listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”). The directors consider PCCW Limited (“PCCW”), a company incorporated in Hong Kong with its shares listed on the Stock Exchange, to be the ultimate holding company of the Company.

The principal activities of the Company and its subsidiaries (collectively the “Group”) are the provision of wholesale mobile, local and international telecommunications services, Internet access services, sale and rental of telecommunications equipment, and the provision of computer, engineering and other technical services in Hong Kong.

These consolidated financial statements are presented in millions of units of Hong Kong dollars (HK\$ million), unless otherwise stated.

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES

a. Statement of compliance

These consolidated financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standard, which is a collective term for all individual Hong Kong Financial Reporting Standards (“HKFRSs”), Hong Kong Accounting Standards (“HKASs”) and Interpretations (“Ints”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and accounting principles generally accepted in Hong Kong. A summary of the principal accounting policies adopted by the Group is set out below.

b. Basis of preparation of the financial statements

The following amended Hong Kong Financial Reporting Standards are mandatory for the first time for the financial year beginning January 1, 2017, but have no material effect on the Group’s results and financial position for the current and prior accounting periods.

- HKAS 7 (Amendment), Statement of Cash Flows.
- HKAS 12 (Amendment), Income Taxes.
- Annual Improvements to HKFRSs 2014-2016 Cycle published in March 2017 by HKICPA.

The amendments to HKAS 7 require disclosure of changes in liabilities arising from financing activities, see note 26(b).

The Group has not adopted any new and amended Hong Kong Financial Reporting Standards that are not yet effective for the current accounting period, details of which are set out in note 33.

The consolidated financial statements for the year ended December 31, 2017 have been prepared for refinancing purpose. The Company, as a holding company has applied section 379(3) of the Hong Kong Companies Ordinance to prepare company level financial statements as the Company’s statutory financial statements for the year ended December 31, 2017. Consequently, these consolidated financial statements and the comparatives do not constitute the Company’s statutory financial statements for either of the years ended December 31, 2016 or 2017. Information relating to the Company’s statutory financial statements required to be disclosed in accordance with section 436 of the Hong Kong Companies Ordinance is as follows:

As the Company is a private company, it is not required to deliver its financial statements to the Registrar of Companies, and has not done so.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

b. Basis of preparation of the financial statements (continued)

The Company's auditor has reported on the company level financial statements for both years. The auditor's reports were unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis; and did not contain a statement under either sections 406(2), 407(2) or 407(3) of the Hong Kong Companies Ordinance.

The consolidated financial statements for the year ended December 31, 2017 comprise the financial statements of the Group, and the Group's interest in a joint venture.

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 fair value as explained in the accounting policies set out below:

- financial assets at fair value through profit or loss (see note 2(j)); and
- derivative financial instruments (see note 2(l)).

The preparation of financial statements in conformity with Hong Kong Financial Reporting Standards 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 judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized 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 Hong Kong Financial Reporting Standards that have significant effect on the consolidated financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 3.

c. Subsidiaries

Subsidiaries are entities (including structured entities) controlled by the Group. Control exists when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

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

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the aggregate fair value of the assets transferred, equity instruments issued and liabilities incurred or assumed at the date of exchange. The consideration transferred includes the fair value of any asset, liability or equity resulting from a contingent consideration arrangement. A subsequent change to the fair value of the contingent consideration that is deemed to be an asset or a liability is recognized in accordance with HKAS 39 in the consolidated income statement. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

c. Subsidiaries (continued)

Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognizes any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All other components of non-controlling interests are measured at their acquisition date fair value, unless other measurement basis is required by Hong Kong Financial Reporting Standards. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill (see note 2(h)). If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the consolidated income statement. Where businesses are acquired and fair values of the net assets of the acquired business are finalized within 12 months of the acquisition date, all fair value adjustments are recorded with effect from the date of acquisition and consequently may result in the restatement of previously reported financial results.

If the business combination is achieved in stages, the acquisition date carrying value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date; any gains or losses arising from such remeasurement are recognized in profit or loss.

For subsidiaries which have accounting year ends different from the Group, the subsidiaries prepare, for the purpose of consolidation, financial statements up to and as at the same date as the Group.

Adjustments have been made to the financial statements of subsidiaries when necessary to align their accounting policies to ensure consistency with the policies adopted by the Group.

Intra-group balances and transactions and any unrealized profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealized losses resulting from intra-group transactions are eliminated in the same way as unrealized gains.

d. Joint arrangements

The Group has applied HKFRS 11 to all joint arrangements. Under HKFRS 11, joint arrangements are classified as either joint ventures or joint operations depending on the contractual rights and obligations of each investor.

The Group classified joint arrangements as joint ventures whereby the Group has rights to the net assets of the joint arrangement.

Investment in a joint venture is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost. The Group's interest in a joint venture includes goodwill identified on acquisition, net of any accumulated impairment loss and adjusted thereafter for the post-acquisition change in the Group's share of the joint venture's net assets. The consolidated income statement includes the Group's share of post-acquisition, post-tax results of the joint venture and any impairment losses for the year. The consolidated statement of comprehensive income includes the Group's share of the post-acquisition, post-tax items of the joint venture's other comprehensive income.

When the Group's share of losses exceeds its interest in the joint venture, 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 joint venture. For this purpose, the Group's interest in the joint venture 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 joint venture.

Unrealized profits and losses resulting from transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the joint venture, except where unrealized losses provide evidence of an impairment of the asset transferred, in which case they are recognized immediately in the consolidated income statement.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

d. Joint arrangements (continued)

Adjustments have been made to the financial statements of joint venture when necessary to align their accounting policies to ensure consistency with the policies adopted by the Group.

e. Gaining or losing control

When the Group ceases to have control, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognized in investor profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as a joint arrangement or financial asset. In addition, any amounts previously recognized in other comprehensive income in respect of that entity are accounted for as if the Group had disposed of the related assets or liabilities. This may mean that amounts previously recognized in other comprehensive income are reclassified to the consolidated income statement.

f. Property, plant and equipment

The following items of property, plant and equipment are stated in the consolidated statement of financial position at cost less accumulated depreciation and impairment losses (see note 2(k)(ii)):

- buildings held for own use which are situated on leasehold land, where the fair value of the building could be measured separately from the fair value of the leasehold land at the inception of the lease (see note 2(g)); and
- other items of plant and equipment.

The cost of an item of property, plant and equipment comprises (i) its purchase price, (ii) any directly attributable costs of bringing the asset to its working condition and location for its intended use, and (iii) the initial estimate at the time of installation and during the period of use, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located.

Subsequent costs are included in the carrying amount of an item of property, plant and equipment or recognized as a separate item of property, plant and equipment, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other costs, such as repairs and maintenance and overhaul costs, are recognized in the consolidated income statement as an expense in the period in which they are incurred.

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognized in the consolidated income statement on the date of retirement or disposal.

Projects under construction are not depreciated. Depreciation on other property, plant and equipment is calculated to write off the cost of items of property, plant and equipment, less their expected residual value, if any, using the straight-line method over their estimated useful lives as follows:

Buildings	Over the shorter of the unexpired term of land lease and the estimated useful lives
Exchange equipment	5 to 20 years
Transmission plant	5 to 36 years
Other plant and equipment	Over the shorter of 1 to 20 years and the term of lease

The assets' useful lives and residual values, if any, are reviewed, and adjusted if appropriate, at the end of each reporting period.

g. Leased assets

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.

i. Classification of assets leased to the Group

Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

g. Leased assets (continued)

ii. Assets leased out under operating leases

Where the Group leases out assets under operating leases, the assets are included in the consolidated statement of financial position according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies, as set out in note 2(f). Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(k)(ii). Revenue arising from operating leases is recognized in accordance with the Group's revenue recognition policies, as set out in note 2(t)(iii).

iii. Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to the consolidated income statement in equal instalments over the accounting periods covered by the lease term. Lease incentives received are recognized in the consolidated income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the consolidated income statement in the accounting period in which they are incurred.

The cost of acquiring land held under an operating lease is stated in the consolidated statement of financial position as "Interests in leasehold land" and is amortized to the consolidated income statement on a straight-line basis over the period of the lease term.

h. Goodwill

Goodwill represents the excess of the cost of the consideration transferred, the amount of any non-controlling interest in the acquire and the acquisition-date fair value of any previous equity interest in the acquire over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition.

Goodwill is stated in the consolidated statement of financial position at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units ("CGUs") and is tested annually for impairment (see note 2(k)(ii)). In respect of the joint venture, the carrying amount of goodwill is included in the carrying amount of the interest in a joint venture.

On disposal of a CGU or part of a CGU and a joint venture during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

i. Intangible assets (other than goodwill)

i. Customer acquisition costs

Costs incurred to acquire contractual relationships with customers are capitalized if it is probable that future economic benefits will flow from the customers to the Group and such costs can be measured reliably. Capitalized customer acquisition costs are amortized on a straight-line basis over the minimum enforceable contractual periods. At the end of the minimum enforceable contractual period, fully amortized customer acquisition costs will be written off.

In the event that a customer terminates the contract prior to the end of the minimum enforceable contractual period, the unamortized customer acquisition cost will be written off immediately in the consolidated income statement.

ii. Carrier licences

The carrier licences to establish and maintain the telecommunication network and to provide telecommunication services are recorded as intangible assets. Upon the issuance of the licence, the cost thereof, which is the discounted value of the minimum annual fees payable over the period of the licence and directly attributable costs of preparing the asset for its intended use, is recorded together with the related obligations. Where the Group has the right to return a licence and expects to do so, the asset and the related obligation recorded reflect the expected period that the licence will be held. Amortization is provided on a straight-line basis over the estimated useful life of the licence, commencing from the date of launch of the relevant telecommunications services.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

i. Intangible assets (other than goodwill) (continued)

ii. Carrier licences (continued)

The difference between the discounted value and the total of the minimum annual fee payments represents the effective cost of financing. Such finance cost will be charged to the consolidated income statement in the period in which it is incurred using the effective interest method.

Variable annual payments on top of the minimum annual payments, if any, are recognized in the consolidated income statement as incurred.

iii. Software

Costs incurred to acquire, develop or enhance scientific or technical knowledge, design and implementation of new process or systems, licences and market knowledge are capitalized as “intangible assets” if it is identifiable and the Group has power or obtain future economic benefits flowing from the underlying resource.

Development costs that are directly attributable to the design and testing of the identifiable software are capitalized as intangible assets if the following criteria are met:

- it is technically feasible to complete the software so that it will be available for use;
- adequate technical, financial and other resources are available to complete the development and to use the software;
- the costs attributable to acquisition, development and enhancement of the software can be reliably measured; and
- the Group has power to obtain future economic benefits flowing from the underlying source.

Development costs that do not meet the above criteria are expensed in the consolidated income statement as incurred.

Capitalized software costs are amortized on a straight-line basis over the estimated useful life of 8 years.

iv. Other intangible assets

Other intangible assets that are acquired by the Group is stated in the consolidated statement of financial position at cost less accumulated amortization (where the estimated useful life is finite) and impairment losses (see note 2(k)(ii)). Expenditures on internally generated goodwill and brands are recognized as expenses in the period in which they are incurred.

Amortization of intangible assets with finite useful lives is charged to the consolidated income statement on a straight-line basis over their estimated useful lives. The following intangible assets with finite useful lives are amortized from the date they are available for use and their estimated useful lives are as follows:

Trademarks	20 years
Customer base	1 to 10 years

The assets' useful lives and their amortization methods are reviewed annually.

j. Investments in equity securities

The Group classifies its investments in equity securities, other than interests in subsidiaries and interest in a joint venture, as financial assets at fair value through profit or loss.

Investments in equity securities are initially recognized at fair value plus transaction costs, except as indicated otherwise below. The fair value of quoted investments is based on current bid price. The investments are subsequently accounted for based on their classification as financial assets at fair value through profit or loss.

This category comprises financial assets designated as fair value through profit or loss at inception. A financial asset is classified as held for trading if acquired principally for the purpose of selling in the short term or if so designated by management.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

j. Investments in equity securities (continued)

Financial assets at fair value through profit or loss are classified as current assets, if they are either held for trading or are expected to be realized within 12 months from the end of the reporting period. Any attributable transaction costs are recognized in the consolidated income statement as incurred.

At the end of each reporting period, the fair value is re-measured based on their current bid prices in an active market, with any unrealized holding gains or losses arising from the changes in fair value being recognized in the consolidated income statement in the period in which they arise. The net gain or loss recognized in the consolidated income statement does not include any interest earned on the financial assets as these are recognized in accordance with the policies set out in note 2(t)(v).

Investments in equity securities are recognized or derecognized on the date the Group commits to purchase or sell the investments or they expire.

k. Impairment of assets

i. Impairment of investments in equity securities and other receivables

Investments in equity securities (other than interest in a joint venture: see note 2(k)(ii)) and other current and non-current receivables that are stated at cost or amortized cost are reviewed at the end of each reporting period to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

- significant financial difficulty of the debtor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- it becoming probable that the debtor will enter bankruptcy or other financial reorganization; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets.

If any such evidence exists, any impairment loss is determined and recognized as follows:

- For trade and other current receivables and other financial assets carried at amortized 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. This assessment is made collectively where financial assets carried at amortized cost share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective group.

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 recognized, the impairment loss is reversed through the consolidated income statement. 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 recognized in prior years.

Impairment losses are written off against the corresponding assets directly, except for impairment losses recognized in respect of trade receivables, whose recovery are considered doubtful but not remote. In this case, the impairment loss for doubtful debts is recorded using an allowance account. When the Group is satisfied that recovery is remote, the amount considered irrecoverable is written off against receivables directly and any amounts held in the allowance account relating to that debt are reversed. Subsequent recoveries of amounts previously charged to the allowance account are reversed against the allowance account. Other changes in the allowance account and subsequent recoveries of amounts previously written off directly are recognized in the consolidated income statement.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

k. Impairment of assets (continued)

ii. Impairment of other assets

Internal and external sources of information are reviewed at the end of reporting period, or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognized no longer exists or may have decreased:

- property, plant and equipment;
- interests in leasehold land;
- intangible assets;
- interest in a joint venture; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. Impairment tests are performed for CGUs containing goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives annually, whether or not there is any indication of impairment.

- Calculation of recoverable amount

The recoverable amount of an asset is the higher of its fair value less costs to disposal and value-in-use. Fair value less costs to disposal is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. 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 CGU).

- Recognition of impairment losses

An impairment loss is recognized in the consolidated income statement whenever the carrying amount of an asset, or the CGU to which it belongs, exceeds its recoverable amount. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then, to reduce the carrying amount of the other assets in the CGU 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 allowed to be 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 recognized in prior years. Reversals of impairment losses are credited to the consolidated income statement in the period in which the reversals are recognized.

l. Derivative financial instruments

Derivative financial instruments are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value at the end of each reporting period. The gain or loss on remeasurement to fair value is recognized immediately in the consolidated income statement, except where the derivatives are designated and qualify for hedge accounting, in which case recognition of any resultant gain or loss depends on the nature of the item being hedged (see note 2(m)).

The full fair value of a hedging derivative is classified as non-current asset or liability when the remaining maturity of the hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current assets or liabilities.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

m. Hedging

i. Fair value hedge

Where a derivative financial instrument is designated as a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment (or an identified portion of such asset, liability or firm commitment), changes in the fair value of the derivative are recorded in the consolidated income statement within "Finance costs, net", together with any changes in fair value of the hedged asset or liability that are attributable to the hedged risk.

When a hedging instrument expires or is sold, terminated or exercised, or no longer meets the criteria for hedge accounting; or the Group revokes designation of the hedge relationship, the cumulative adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to the consolidated income statement over the residual period to maturity.

ii. Cash flow hedge

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognized asset or liability, or a highly probable forecast transaction or the foreign currency risk of a committed future transaction, the effective portion of changes in the fair value of the derivative is recognized in other comprehensive income and accumulated separately in the hedging reserve under equity. The ineffective portion of any gain or loss is recognized immediately in the consolidated income statement.

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

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

When a hedging instrument expires or is sold, terminated or exercised, or no longer meets the criteria for hedge accounting; or the Group revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the associated cumulative gain or loss at that point remains in equity and is recognized in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to occur, the cumulative unrealized gain or loss recognized in equity is recognized immediately in the consolidated income statement.

n. Inventories

Inventories consist of trading inventories, work-in-progress and consumable inventories.

Trading inventories are carried at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Work-in-progress is stated at the lower of cost, which comprises labor, materials and overheads where appropriate, and the net realizable value.

Consumable inventories, held for use in the maintenance and expansion of the Group's telecommunications systems, are stated at cost less provision for deterioration and obsolescence.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (*CONTINUED*)

o. Trade and other receivables

Trade and other receivables are initially recognized at fair value and thereafter stated at amortized cost using the effective interest method, less allowance for impairment of doubtful debts (see note 2(k)(i)).

p. Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions (other than restricted cash), 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 and form an integral part of the Group's cash management.

q. Trade and other payables

Trade and other payables are initially recognized at fair value and subsequently stated at amortized cost using the effective interest method.

r. Borrowings

Borrowings are recognized initially at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are stated at amortized cost with any difference between the amount initially recognized, being the proceeds net of transaction costs, and the redemption value being recognized in the consolidated income statement over the period of the borrowings, using the effective interest method.

s. Provisions and contingent liabilities

Provisions are recognized when (i) the Group has a present legal or constructive obligation arising as a result of a past event; (ii) it is probable that an outflow of economic benefits will be required to settle the obligation; and (iii) a reliable estimate can be made of the amount of the obligation. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation. The increase in provision due to the passage of time is recognized as interest expenses.

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.

t. Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognized in the consolidated income statement as follows:

i. Telecommunications and other services

Telecommunications services comprise the fixed line and mobile telecommunications network services, and equipment business mainly in Hong Kong.

Telecommunications service revenue based on usage of the Group's network and facilities is recognized when the services are rendered. Telecommunications revenue for services provided for fixed periods is recognized on a straight-line basis over the respective period.

Up-front fees received for installation of equipment and activation of customer service are deferred and recognized over the estimated customer relationship period.

Other service income is recognized when services are rendered to customers.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (*CONTINUED*)

t. Revenue recognition (*continued*)

i. Telecommunications and other services (*continued*)

Under certain telecommunications service arrangements, customers can purchase telecommunications equipment together with a fixed period of telecommunications service. When such multiple-element arrangements exist, the Group uses the residual value method. Under this method, the Group determines the fair value of the delivered element by deducting the fair value of the undelivered element from the total contract consideration. The revenue relating to the service element, which represents the fair value of the servicing arrangement is recognized over the service period.

ii. Sales of goods

Revenue from the sale of goods is recognized when goods are delivered to customers which generally coincides with the time when the customer has accepted the goods and the related risks and rewards of ownership have been transferred to the customer. Revenue is recorded after deduction of any trade discounts.

iii. Rental income from operating leases

Rental income receivable under operating leases is recognized in the consolidated income statement in equal installments over the accounting periods covered by the lease term. Lease incentives granted are recognized in the consolidated income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognized as income in the accounting period in which they are earned.

iv. Contract revenue

Revenue from a fixed price contract is recognized using the percentage of completion method, measured by reference to the percentage of contract costs incurred to date to estimated total contract costs for the contract.

When the outcome of a construction contract cannot be estimated reliably, revenue is recognized only to the extent that it is probable the contract costs incurred will be recoverable.

v. Interest income

Interest income is recognized on a time-apportioned basis using the effective interest method.

vi. Commission income

Commission income is recognized when entitlement to the income is ascertained.

u. Borrowing costs

Borrowing costs are expensed in the consolidated income statement in the period in which they are incurred, except to the extent that they are capitalized 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 capitalization of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is 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. Capitalization 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 completed.

Discounts or premiums relating to borrowings, and ancillary costs incurred in connection with arranging borrowings, to the extent that they are regarded as adjustments to interest costs, are recognized as expenses over the period of the borrowing using the effective interest method.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

v. Income tax

- i. Income tax for the year comprises current income tax and movements in deferred income tax assets and liabilities. Current income tax and movements in deferred income tax assets and liabilities are recognized in the consolidated income statement except to the extent that they relate to items recognized in other comprehensive income or directly in equity, in which case the relevant amounts are recognized in other comprehensive income or directly in equity, respectively.
- ii. Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to income tax payable in respect of previous year.
- iii. Deferred income 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 the tax bases. Deferred income tax assets also arise from unused tax losses and unused tax credits.

All deferred income tax liabilities, and all deferred income tax assets to the extent that future taxable profits will be available against which the asset can be utilized, are recognized. Future taxable profits that may support the recognition of deferred income tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred income tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred income tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilized.

The amount of deferred income tax recognized is measured based on the expected manner of realization or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the end of the reporting period and are expected to apply when the related deferred income tax asset is realized and the deferred income tax liability is settled. Deferred income tax assets and liabilities are not discounted.

The carrying amount of a deferred income tax asset is reviewed at the end of each reporting period 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 utilized. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

- iv. Current income tax balances and deferred income tax balances, and movements therein, are presented separately from each other and are not offset. Current income tax assets are offset against current income tax liabilities, and deferred income tax assets against deferred income tax liabilities, if the Group has the legally enforceable right to set off current income tax assets against current income tax liabilities and the following additional conditions are met:
 - in the case of current income tax assets and liabilities, the Group intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously; or
 - in the case of deferred income tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred income tax liabilities or assets are expected to be settled or recovered, intend to realize the current income tax assets and settle the current income tax liabilities on a net basis or realize and settle simultaneously.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (*CONTINUED*)

w. 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. Retirement benefits

The Group operates defined contribution retirement schemes (including the Mandatory Provident Fund) for its employees, the assets of which are generally held in separate trustee-administered funds. The schemes are generally funded by payments from the relevant companies in the Group.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid.

The Group's contributions to the defined contribution schemes are recognized as an expense in the consolidated income statement in the period to which the contributions relate.

iii. Share-based payments

PCCW, the HKT Trust and HKT operate share option schemes where employees of the Group (and including directors) are granted options to acquire shares of PCCW and Share Stapled Units at specified exercise prices. The fair value of the employee services received in exchange for the grant of the options is recognized as staff costs in the consolidated income statement with a corresponding increase in an employee share-based compensation reserve under equity. The fair value of the options granted is measured at grant date using the trinomial option pricing model, taking into account the terms and conditions upon which the options were granted, and spread over the respective vesting period during which the employees become unconditionally entitled to the options. During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognized in prior years is charged or credited in the consolidated income statement for the year of the review, unless the original staff costs qualify for recognition as an asset, with a corresponding adjustment to the employee share-based compensation reserve. On vesting date, the amount recognized as staff costs is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to employee share-based compensation reserve). The equity amount is recognized in the employee share-based compensation reserve until either the share options are exercised (when it is transferred to the share premium account) or the share options expire (when it is released directly to retained profit).

The boards of directors of HKT Management Limited (the trustee-manager of the HKT Trust) and HKT may also grant Share Stapled Units to employees at nil consideration under the HKT's Share Stapled Units award schemes, under which the awarded shares are either newly issued at issue price (the "HKT Share Stapled Units Subscription Scheme") or are purchased from the open market (the "HKT Share Stapled Units Purchase Scheme"). Awards under the HKT Share Stapled Units Purchase Scheme and the HKT Share Stapled Units Subscription Scheme, are accounted for as cash-settle share-based payments. The fair value of the awarded Share Stapled Units represents the quoted market price of Share Stapled Units purchased from the open market under the HKT Share Stapled Units Purchase Scheme and the issue price of Share Stapled Units under the HKT Share Stapled Units Subscription Scheme are recognized as financial assets at fair value through profit and loss, and subsequently measured at fair value. The fair value of the employee services received in exchange for the grant of Share Stapled Units are recognized as staff costs in the income statement over the respective vesting period with a corresponding obligation being recognized. During the vesting period, the number of awarded Share Stapled Units that are expected to vest is reviewed. Any adjustment to the cumulative fair value recognized in prior years is charged or credited in the income statement for the year of the review, unless the original staff costs qualify for recognition as an asset, with a corresponding adjustment to the obligation. On vesting date, the amount recognized as staff costs is adjusted to reflect the actual number of awarded Share Stapled Units that vest (with a corresponding adjustment to the obligation) and the carrying amount of awarded Share Stapled Units recognized in the financial assets at fair value through profit and loss is offset with the obligation.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (*CONTINUED*)

w. Employee benefits (*continued*)

iii. Share-based payments (*continued*)

The board of directors of PCCW (the “PCCW Board”) may also grant shares of PCCW and Share Stapled Units to employees of the participating subsidiaries of PCCW at nil consideration under its share award schemes, under which the awarded PCCW shares are either newly issued at par value (the “PCCW Subscription Scheme”) or are purchased from the open market (the “PCCW Purchase Scheme”).

Awards under the PCCW Purchase Scheme and the PCCW Subscription Scheme, are accounted for as cash-settle share-based payments. The fair value of the awarded PCCW shares represents the quoted market price of PCCW shares purchased from the open market under the PCCW Purchase Scheme and the issue price of PCCW shares under the PCCW Subscription Scheme are recognized as financial assets at fair value through profit and loss, and subsequently measured at fair value. The fair value of the employee services received in exchange for the grant of PCCW shares are recognized as staff costs in the income statement over the respective vesting period with a corresponding obligation being recognized. During the vesting period, the number of awarded PCCW shares that are expected to vest is reviewed. Any adjustment to the cumulative fair value recognized in prior years is charged or credited in the income statement for the year of the review, unless the original staff costs qualify for recognition as an asset, with a corresponding adjustment to the obligation. On vesting date, the amount recognized as staff costs is adjusted to reflect the actual number of awarded PCCW shares that vest (with a corresponding adjustment to the obligation) and the carrying amount of awarded PCCW shares recognized in the financial assets at fair value through profit and loss is offset with the obligation.

iv. Termination benefits

Termination benefits are recognized only after either an agreement is in place with the appropriate employee representatives specifying the terms of redundancy and the numbers of employees affected, or, after individual employees have been advised of the specific terms.

x. Translation of foreign currencies

Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the entity operates (the “functional currency”). The consolidated financial statements are presented in Hong Kong dollars (HK\$), which is the Group’s functional and presentation currency.

Foreign currency transactions during the year are translated to functional currencies at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the end of the reporting period. Exchange gains and losses are recognized in the consolidated income statement, except when deferred in other comprehensive income as qualifying cash flow hedges.

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. Exchange differences arising on translation of non-monetary assets and liabilities are reported as part of the fair value gain or loss in the consolidated income statement. Exchange differences arising on translation of non-monetary assets and liabilities, such as available-for-sale financial assets, are included in the fair value gain or loss in the available-for-sale financial assets reserve under equity.

The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of transactions. Items of foreign operations in the statement of financial position, including goodwill arising on consolidation of foreign operations, are translated into Hong Kong dollars at the foreign exchange rates ruling at the end of the reporting period. The resulting exchange differences are recognized in other comprehensive income and accumulated separately in the currency translation reserve under equity.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES (*CONTINUED*)

x. Translation of foreign currencies (*continued*)

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, if any, are taken to other comprehensive income and accumulated separately in the currency translation reserve under equity. On disposal of a foreign operation, the cumulative amount of the exchange differences recognized in the currency translation reserve under equity which relate to that foreign operation is included in the calculation of the profit or loss on disposal.

y. Related parties

For the purposes of these consolidated 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 individual;
- v. the party is a close family member of a party referred to in (i) above or is an entity under the control, joint control or significant influence of such party;
- 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; or
- vii. the entity, or any member of the Group of which it is a part, provides key management personnel services to 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.

z. Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (the "CODM"). The CODM, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Group's senior executive management.

Segment revenue, expenses, results and assets include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses and segment performance include transactions between segments. Inter-segment pricing is based on similar terms as those available to other external parties for similar services. Inter-segment transactions are eliminated in full in preparing the Group's consolidated financial statements.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets (including property, plant and equipment, and interests in leasehold land) that are expected to be used for more than one year.

aa. Dividend distribution

Dividend distribution to the Company's sole shareholder is recognized as a liability in the consolidated financial statements in the period in which the dividends are approved by the Board or the Company's sole shareholder, where appropriate.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Notes 14 and 28 contain information about the assumptions and the risk factors relating to goodwill impairment and financial instruments. Management has also made judgements in applying the Group's accounting policies. Other key sources of estimation uncertainty are discussed below:

i. Impairment of assets (other than investments in equity securities and other receivables)

At the end of each reporting period, the Group reviews internal and external sources of information to identify indications that the following classes of assets may be impaired or, except in the case of goodwill, an impairment loss previously recognized no longer exists or may have decreased:

- property, plant and equipment;
- interests in leasehold land;
- intangible assets;
- interest in a joint venture; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. Impairment tests are performed for CGUs containing goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives annually whether or not there is any indication of impairment. Significant judgement is used to identify CGUs appropriately. An impairment loss is recognized in the consolidated income statement whenever the carrying amount of an asset exceeds its recoverable amount.

The sources utilized to identify indications of impairment are often subjective in nature and the Group is required to use judgement in applying such information to its business. The Group's interpretation of this information has a direct impact on whether an impairment assessment is performed as at the end of any given reporting period. Such information is particularly significant as it relates to the Group's telecommunications services and infrastructure businesses in Hong Kong.

If an indication of impairment is identified, such information is further subject to an exercise that requires the Group to estimate the recoverable value, representing the greater of the asset's fair value less costs to disposal or its value-in-use. Depending on the Group's assessment of the overall materiality of the asset under review and complexity of deriving reasonable estimates of the recoverable value, the Group may perform such assessment utilizing internal resources or the Group may engage external advisors to counsel the Group in making this assessment. Regardless of the resources utilized, the Group is required to make many assumptions to make this assessment, including the utilization of such asset, the cash flows to be generated, appropriate market discount rates and the projected market and regulatory conditions. Changes in any of these assumptions could result in a material change to future estimates of the recoverable value of any asset.

ii. Revenue recognition

Telecommunications service revenue based on usage of the Group's network and facilities is recognized when the services are rendered. Telecommunications revenue for services provided for fixed periods is recognized on a straight-line basis over the respective period. In addition, up-front fees received for installation of equipment and activation of customer service are deferred and recognized over the expected customer relationship period. The Group is required to exercise considerable judgement in revenue recognition particularly in the areas of customer discounts and customer disputes. Significant changes in management estimates may result in material revenue adjustments.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (*CONTINUED*)

ii. Revenue recognition (*continued*)

Under certain telecommunications service arrangements, customers can purchase telecommunications equipment together with a fixed period of telecommunications service. When such multiple-element arrangements exist, the Group uses the residual value method. Under this method, the Group determines the fair value of the delivered element by deducting the fair value of the undelivered element from the total contract consideration. The revenue relating to the service element, which represents the fair value of the servicing arrangement is recognized over the service period. The Group is required to exercise considerable judgement in relation to estimating the fair value of the undelivered element.

iii. Deferred income tax

While deferred income tax liabilities are provided in full on all taxable temporary differences, deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. In assessing the amount of deferred income tax assets that need to be recognized, the Group considers future taxable income and ongoing prudent and appropriate tax planning strategies. In the event that the Group's estimate of projected future taxable income and benefits from available tax strategies are changed, or changes in current income tax regulations are enacted that would impact the timing or extent of the Group's ability to utilize the tax benefits of net operating loss carry-forwards in the future, adjustments to the recorded amount of net deferred income tax assets and income tax expense would be made.

iv. Current income tax

The Group makes a provision for current income tax based on estimated taxable income for the year. The estimated income tax liabilities are primarily computed based on the tax computations as prepared by the Group. Nevertheless, from time to time, there are queries raised by the tax authorities of Hong Kong and elsewhere on the tax treatment of items included in the tax computations and certain non-routine transactions. If the Group considers it probable that these queries or judgments will result in different tax positions, the most likely amounts of the outcome will be estimated and adjustments to the income tax expense and income tax liabilities will be made accordingly.

v. Useful lives of property, plant and equipment and intangible assets (other than goodwill)

The Group has significant property, plant and equipment and intangible assets (other than goodwill). The Group is required to estimate the useful lives of property, plant and equipment and intangible assets (other than goodwill) in order to ascertain the amount of depreciation and amortization charges for each reporting period.

The useful lives are estimated at the time of purchase of these assets after considering future technology changes, business developments and the Group's strategies. The Group performs annual reviews to assess the appropriateness of the estimated useful lives. Such review takes into account any unexpected adverse changes in circumstances or events, including declines in projected operating results, negative industry or economic trends and rapid advancement in technology. The Group extends or shortens the useful lives according to the results of the review.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4 RELATED PARTY TRANSACTIONS

During the year, the Group had the following significant transactions with related parties:

In HK\$ million	Note	2016	2017
Telecommunications service fees and interest income received or receivable from a joint venture	a	26	32
Telecommunications service fees and finance charges paid or payable to a joint venture	a	109	122
Rental charges paid or payable to a related company	a	29	26
Telecommunications service fees, IT and logistics charges, management fee, interest income and other recharge costs received or receivable from fellow subsidiaries	a	2,663	2,680
Rental charges received or receivable from a fellow subsidiary	a	20	21
Telecommunications service fees, IT and logistics charges, system development and integration charges, consultancy fee, management fee and other recharged costs paid or payable to fellow subsidiaries	a	2,334	2,223
Rental and facilities management charges paid or payable to fellow subsidiaries	a	69	65
Interest paid or payable to an intermediate holding company	a	43	63
Key management compensation	b	-	-

- a. The above transactions were carried out after negotiations between the Group and the related parties in the ordinary course of business and on the basis of estimated market value as determined by the directors. In respect of transactions for which the price or volume has not yet been agreed with the relevant related parties, the directors have determined the relevant amounts based on their best estimation.

b. Details of key management compensation

Key management compensation for the year ended December 31, 2017 was borne by fellow subsidiaries of the Company (2016: same).

c. Balances with related companies and fellow subsidiaries

The balances with related companies are unsecured, non-interest bearing and have no fixed repayment terms as at December 31, 2016 and 2017.

Among the balances with fellow subsidiaries, there are loans receivable of GBP37.21 million (2016: GBP37.21 million) which bear interests ranging from London Interbank Offered Rate ("GBP LIBOR") plus 1% per annum to GBP LIBOR plus 2.5% per annum (2016: same), loans payable of USD18 million (2016: USD18 million) which bear interests ranging from United States Interbank Offered Rate ("US LIBOR") per annum to US LIBOR plus 2% per annum (2016: same), and loans payable of RMB33.4m (2016: nil) which bear interests of 2.93% per annum. These loans are repayable on demand. The remaining balances are unsecured, non-interest bearing and have no fixed repayment terms.

d. Balances with intermediate holding companies

The balances with intermediate holding companies are unsecured, non-interest bearing and have no fixed repayment terms, except for a loan payable of HK\$7,236 million (2016: HK\$7,244 million) which bears interest at HIBOR plus 0.3% per annum (2016: same) and repayable within one year.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

5 REVENUE AND SEGMENT INFORMATION

a. Revenue

In HK\$ million	2016	2017
Local data and broadband services	6,131	6,133
Local telephony services	3,424	3,278
CPE sales and services	2,049	2,121
International telecommunications services	532	474
Mobile services	2,676	3,115
Other services	755	836
	15,567	15,957

b. Segment information

The directors consider that the Group as a whole is an operating segment since the Group is only engaged in local and international telecommunications and related business. No geographical information has been disclosed as the majority of the Group's operating activities are carried out in Hong Kong. The Group's assets located and operating revenue derived from activities outside Hong Kong are less than 5% of the Group's assets and operating revenue, respectively.

6 OTHER GAINS, NET

In HK\$ million	2016	2017
Net gain on fair value hedging instruments	4	-
Others	2	1
	6	1

7 PROFIT BEFORE INCOME TAX

Profit before income tax is stated after charging and crediting the following:

a. Staff costs

In HK\$ million	2016	2017
Salaries, bonuses and other benefits	843	277
Share-based compensation expenses	28	24
Retirement costs for staff under defined contribution retirement schemes	132	151
Staff costs included in general and administrative expenses	1,003	452

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7 PROFIT BEFORE INCOME TAX (CONTINUED)

b. Other items

In HK\$ million	2016	2017
Crediting		
Gain on disposals of property, plant and equipment, net	26	2
Exchange gain/(loss), net	(40)	(284)
Less: Cash flow hedges-transferred from equity	(48)	332
Charging:		
Impairment loss for doubtful debts	94	79
Provision for inventory obsolescence	4	8
Depreciation of property, plant and equipment	999	1,019
Amortization of land lease premium	12	13
Amortization of intangible assets	1,909	1,838
Cost of inventories sold	1,526	1,527
Cost of sales, excluding inventories sold	2,538	2,878
Auditor's remuneration	6	7
Operating lease rental	773	834

8 FINANCE COSTS, NET

In HK\$ million	2016	2017
Interest expenses	(1,083)	(1,157)
Notional accretion on carrier licence fee liabilities	(83)	(52)
Other borrowing costs	(48)	(69)
Cash flow hedges: changes in fair value	(1)	54
Impact of re-designation of fair value hedges	(16)	(16)
	(1,231)	(1,240)
Interest capitalized in property, plant and equipment (<i>note (a)</i>)	43	53
Total finance costs	(1,188)	(1,187)
Interest income	33	36
Finance costs, net	(1,155)	(1,151)

- a. The capitalization rate used to determine the amount of interest eligible for capitalization ranged from 3.07% to 3.16% for the year ended December 31, 2017 (2016: 3.08% to 3.43%).

9 DIRECTORS' EMOLUMENTS

Directors' emoluments for the year ended December 31, 2017 were borne by fellow subsidiaries of the Company (2016: same).

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

10 INCOME TAX

a. Income tax expense in the consolidated income statement represents:

In HK\$ million	2016	2017
Hong Kong profits tax		
- provision for current year	357	406
Movement of deferred income tax (note 24(a))	278	334
	635	740

Hong Kong profits tax has been provided at the rate of 16.5% (2016: 16.5%) on the estimated assessable profits for the year.

b. Reconciliation between income tax expense and accounting profit at the Hong Kong tax rate:

In HK\$ million	2016	2017
Profit before income tax	3,701	4,491
Notional tax on profit before income tax, calculated at the Hong Kong tax rate of 16.5% (2016: 16.5%)	611	741
Income not subject to tax	(7)	(16)
Expenses not deductible for tax purposes	32	16
Utilization of previously unrecognized tax losses	(2)	(2)
Net losses of a joint venture not deductible for tax purpose	1	1
Income tax expense	635	740

The effective tax rate for the year ended December 31, 2017 remained fairly stable as compared to 2016.

11 DIVIDENDS

In HK\$ million	2016	2017
Interim dividend declared and paid in respect of the current year of 13.23 HK cents (2016: 82.43 HK cents) per ordinary share of the Company	2,051	329
Final dividend declared, approved and paid in respect of the previous financial year of 105.78 HK cents (2016: 86.03 HK cents) per ordinary share of the Company	2,141	2,632
Final dividend declared after the end of the reporting period	2,632	2,783

The final dividend declared after the end of the reporting period have not been recognized as liabilities as at the end of the reporting period.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

12 PROPERTY, PLANT AND EQUIPMENT

2016						
In HK\$ million	Buildings	Exchange equipment	Transmission plant	Other plant and equipment	Projects under construction	Total
Cost						
Beginning of year	1,466	19,756	20,688	11,618	1,132	54,660
Additions	-	190	213	318	1,627	2,348
Additions upon business combination (note 32)	-	-	-	3	-	3
Transfers	(77)	355	411	433	(1,199)	(77)
Disposals	-	(243)	(320)	(59)	-	(622)
End of year	1,389	20,058	20,992	12,313	1,560	56,312
Accumulated depreciation and impairment						
Beginning of year	631	16,537	13,171	9,902	-	40,241
Charge for the year	31	253	396	319	-	999
Transfers	(7)	-	-	-	-	(7)
Disposals	-	(243)	(320)	(59)	-	(622)
End of year	655	16,547	13,247	10,162	-	40,611
Net book value						
End of year	734	3,511	7,745	2,151	1,560	15,701
Beginning of year	835	3,219	7,517	1,716	1,132	14,419

2017						
In HK\$ million	Buildings	Exchange equipment	Transmission plant	Other plant and equipment	Projects under construction	Total
Cost						
Beginning of year	1,389	20,058	20,992	12,313	1,560	56,312
Additions	-	479	250	383	1,216	2,328
Transfers	-	554	478	232	(1,264)	-
Disposals	-	(215)	(115)	(59)	-	(389)
End of year	1,389	20,876	21,605	12,869	1,512	58,251
Accumulated depreciation and impairment						
Beginning of year	655	16,547	13,247	10,162	-	40,611
Charge for the year	29	261	365	364	-	1,019
Disposals	-	(214)	(115)	(58)	-	(387)
End of year	684	16,594	13,497	10,468	-	41,243
Net book value						
End of year	705	4,282	8,108	2,401	1,512	17,008
Beginning of year	734	3,511	7,745	2,151	1,560	15,701

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

12 PROPERTY, PLANT AND EQUIPMENT (*CONTINUED*)

The depreciation charge for the year is included in “General and administrative expenses” in the consolidated income statement.

During the year ended December 31, 2017, the Group performed a review to reassess the useful lives of certain property, plant and equipment of the Group, based on the expectations of the Group’s operational management and technological trend. The reassessment has resulted in changes in the estimated useful lives of these assets. The Group considers this to be a change in accounting estimate and therefore accounted for the change on a prospective basis. As a result of this change in accounting estimate, the Group’s profit attributable to the shareholder of the Company for the year ended December 31, 2017 increased by HK\$103 million (2016: HK\$382 million) and the equity attributable to the shareholder of the Company as at December 31, 2017 increased by HK\$103 million (2016: HK\$382 million).

13 INTERESTS IN LEASEHOLD LAND

In HK\$ million	2016	2017
Cost		
Beginning of year and end of year	536	536
Accumulated amortization		
Beginning of year	271	283
Charge for the year	12	13
End of year	283	296
Net book value		
End of year	253	240
Beginning of year	265	253

14 GOODWILL

In HK\$ million	2016	2017
Cost		
Beginning of year	32,592	32,625
Additions upon business combination (note 32)	33	-
End of year	32,625	32,625

The recoverable amount of the CGU is determined based on value-in-use calculations. The calculation uses cash flow projection based on financial budget approved by management generally covering a five-year period. Cash flows beyond the projection period are extrapolated using the estimated terminal growth rate stated below.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

14 GOODWILL (CONTINUED)

The key assumptions used for value-in-use calculations in 2016 and 2017 are as follows:

	Revenue growth rate	EBITDA growth Rate	2016 Terminal growth rate	Discount rate	Revenue growth rate	EBITDA growth Rate	2017 Terminal growth rate	Discount rate
Local telephony and data services	1%	1%	1%	8%	1%	1%	1%	7%

These assumptions have been used for the analysis of the CGU.

There was no impairment required from the review on goodwill as at October 31, 2017.

Management determined budgeted revenue and EBITDA growth rate based on past performance and its expectations for market development. The average growth rates used are consistent with the forecasts included in industry reports. The terminal growth rate does not exceed the long-term average growth rate for the business in which the CGU operates. The discount rate used is pre-tax and reflect specific risks relating to the CGU.

15 INTANGIBLE ASSETS

In HK\$ million	Trademarks	Carrier licences	Customer acquisition costs	2016 Customer base	Software	Others	Total
Cost							
Beginning of year	459	4,157	1,342	5,040	1,063	14	12,075
Additions	-	2,061	733	-	597	175	3,566
Write-off	-	(1,143)	(561)	-	-	(175)	(1,879)
End of year	459	5,075	1,514	5,040	1,660	14	13,762
Accumulated amortization							
Beginning of year	165	1,827	726	4,576	223	14	7,531
Charge for the year	23	519	711	223	258	175	1,909
Write-off	-	(1,143)	(561)	-	-	(175)	(1,879)
End of year	188	1,203	876	4,799	481	14	7,561
Net book value							
End of year	271	3,872	638	241	1,179	-	6,201
Beginning of year	294	2,330	616	464	840	-	4,544

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

15 INTANGIBLE ASSETS (CONTINUED)

In HK\$ million	2017						Total
	Trademarks	Carrier licences	Customer acquisition costs	Customer base	Software	Others	
Cost							
Beginning of year	459	5,075	1,514	5,040	1,660	14	13,762
Additions	-	103	739	-	859	178	1,879
Write-off	-	-	(785)	-	-	(178)	(963)
End of year	459	5,178	1,468	5,040	2,519	14	14,678
Accumulated amortization							
Beginning of year	188	1,203	876	4,799	481	14	7,561
Charge for the year	23	414	823	223	177	178	1,838
Write-off	-	-	(785)	-	-	(178)	(963)
End of year	211	1,617	914	5,022	658	14	8,436
Net book value							
End of year	248	3,561	554	18	1,861	-	6,242
Beginning of year	271	3,872	638	241	1,179	-	6,201

The amortization charge for the year is included in “General and administrative expenses” in the consolidated income statement.

16 INTEREST IN A JOINT VENTURE

a. In HK\$ million	2016	2017
Share of net liabilities of a joint venture	(24)	(32)
Loan due from a joint venture	446	426
	422	394
Investment at cost, unlisted	-	-

As at December 31, 2017, the loan due from a joint venture of HK\$426 million (2016: HK\$446 million) bears interests at HIBOR plus 3% per annum (2016: same). The loan is unsecured and has no fixed terms of repayment. The amount is considered as part of the interest in the joint venture.

Company name	Principal place of business/Place of incorporation	Principal activities	Value of issued capital	Interest held by the Company		Measurement method
				Directly	Indirectly	
Genius Brand Limited (“GBL”)	Hong Kong	Provision of mobile telecommunications services in Hong Kong	HK\$10,000	-	50%	Equity

GBL is a strategic partnership of the Group, providing access to advance connectivity services in Hong Kong for the development of mobile business.

The above joint venture is a private company and there is no quoted market price available for its shares.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

16 INTEREST IN A JOINT VENTURE (CONTINUED)

b. Commitments and contingent liabilities in respect of the joint venture

As at December 31, 2017, the Group's share of its joint venture's commitments was as follows:

In HK\$ million	2016	2017
Commitment to provide funding	53	42
Capital commitments		
- Authorized & contracted for acquisition of property, plant and equipment	-	37
Operating lease commitments		
- Within 1 year	2	5
- After 1 year but within 5 years	2	8

There were no contingent liabilities relating to the Group's interest in the joint venture. The Group had no share of contingent liabilities relating to the joint venture as at December 31, 2016 and 2017.

c. Summarized unaudited financial information of the Group's joint venture

Set out below is the summarized unaudited financial information of GBL, the joint venture of the Group and being accounted for using the equity method:

In HK\$ million	2016	2017
Non-current assets	986	961
Current assets		
Cash and cash equivalents	30	12
Other current assets (excluding cash and cash equivalents)	25	30
Total current assets	55	42
Current liabilities		
Financial liabilities (excluding trade payables, accruals and other payables)	(275)	(285)
Other current liabilities (including trade payables, accrual and other payables)	(61)	(88)
Total current liabilities	(336)	(373)
Non-current liabilities		
Financial liabilities	(730)	(663)
Other non-current liabilities	(24)	(30)
Total non-current liabilities	(754)	(693)
Net liabilities	(49)	(63)
Equity attributable to equity holders	(49)	(63)
Revenue	219	245
Depreciation and amortization	(84)	(97)
Interest expense	(32)	(34)
Profit before income tax	1	1
Income tax	(10)	(15)
Loss after income tax and total comprehensive loss	(9)	(14)
Dividend received from the joint venture	-	-

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

16 INTEREST IN A JOINT VENTURE (CONTINUED)

c. Summarized unaudited financial information of the Group's joint venture (continued)

The information above reflects the amounts presented in the financial statements of the joint venture (not the Group's share of those amounts) adjusted for differences in accounting policies between the Group and the joint venture.

d. Reconciliation of summarized unaudited financial information of the joint venture

Reconciliation of the summarized unaudited financial information presented to the carrying amount of the Group's interest in the joint venture, GBL.

In HK\$ million	2016	2017
Net liabilities		
Beginning of year	(40)	(49)
Loss and total comprehensive loss for the year	(9)	(14)
End of year	(49)	(63)
Interest in the joint venture	50%	50%
Interest in the joint venture	(24)	(32)
Loan due from the joint venture	446	426
Carrying value	422	394

During the year ended December 31, 2017, the Group did not have any unrecognized share of losses of joint venture (2016: nil). As at December 31, 2017, there was no accumulated share of losses of the joint venture unrecognized by the Group (2016: nil).

17 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

In HK\$ million	2016	2017
Listed securities	29	19
Less: Securities held for employee share award to be vested within one year classified as current assets	(25)	(14)
Non-current portion	4	5

Financial assets at fair value through profit or loss represent shares of PCCW and Share Stapled Units acquired under the PCCW Share Award Schemes and the HKT Share Stapled Units Award Schemes, respectively. Please refer to notes 22(b)(iv) and 22(b)(iii) for details of the share award schemes of PCCW and Share Stapled Units award schemes of HKT, respectively.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

18 INTERESTS IN SUBSIDIARIES

As at December 31, 2017, particulars of the principal subsidiaries of the Company are as follows:

Company	Country/place of incorporation/ establishment and operation	Value of issued and fully paid share capital/ paid-in capital/ registered capital	Interest held by the Company		Principal activities
			Directly	Indirectly	
Chuang Xin Group Limited	British Virgin Islands	US\$1.00	100%	-	Investment holding
eSmartHealth Limited	Hong Kong	HK\$1.00	-	100%	Sale of electronic digital devices
HKT Capital No. 1 Limited	British Virgin Islands	US\$1.00	100%	-	Notes issuer
HKT Capital No. 2 Limited	British Virgin Islands	US\$1.00	100%	-	Notes issuer
HKT Capital No. 3 Limited	British Virgin Islands	US\$1.00	100%	-	Notes issuer
HKT Capital No. 4 Limited	British Virgin Islands	US\$1.00	100%	-	Notes issuer
HKT CSP Limited	Hong Kong	HK\$1.00	100%	-	Provision of customer services and online sales of products and services
PCCW-HKT Capital No.5 Limited	British Virgin Islands	US\$1.00	100%	-	Notes issuer
PCCW-HKT Consumer Services Limited	Hong Kong	HK\$2.00	-	100%	Investment holding
PCCW-HKT Site Leasing (HK) Limited	Hong Kong	HK\$1.00	-	100%	Leasing real estate properties
PCCW-HKT Site Leasing Limited	British Virgin Islands	US\$1.00	-	100%	Inactive
電訊盈科科技(北京)有限公司 (PCCW Technology (Beijing) Limited*)	The People's Republic of China ("PRC")	RMB40,000,000	100%	-	System integration software development and technical services consultancy
Red Fortune Investments Limited	British Virgin Islands	US\$1.00	100%	-	Investment holding

*unofficial name

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

19 CURRENT ASSETS AND LIABILITIES

a. Inventories

In HK\$ million	2016	2017
Work-in-progress	255	328
Finished goods	66	46
Consumable inventories	59	56
	380	430

b. Trade receivables, net

In HK\$ million	2016	2017
Trade receivables	860	584
Less: Impairment loss for doubtful debts (<i>note (i)</i>)	(35)	(50)
Trade receivables, net	825	534

i. Impairment loss for doubtful debts

The movements in the provision for doubtful debts during the year, including both specific and collective loss components, are as follows:

In HK\$ million	2016	2017
Beginning of year	30	35
Impairment loss recognized	94	79
Uncollectable amounts write off	(89)	(64)
End of year	35	50

As at December 31, 2017, trade receivables of HK\$50 million (2016: HK\$35 million) were impaired. The individually impaired receivables mainly relate to customers that were in financial difficulties and management assessed that the receivables are not expected to be recovered. The Group does not hold any collateral over these balances.

ii. Trade receivables that are not impaired

The aging of trade receivables that are neither individually nor collectively considered to be impaired is as follows:

In HK\$ million	2016	2017
Neither past due nor impaired	406	372
1-30 days past due	173	55
31-60 days past due	64	44
61-90 days past due	33	16
Over 90 days past due	149	47
Past due but not considered impaired	419	162
	825	534

Trade receivables that were neither past due nor impaired relate to a wide range of customers for whom there was no recent history of default.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

19 CURRENT ASSETS AND LIABILITIES (CONTINUED)

b. Trade receivables, net (continued)

Trade receivables that were past due but not considered impaired relate to customers that have a good track record with the Group or a sound credit quality. Based on past experience and regular credit risk assessment performed on all significant outstanding trade receivables, management believes that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable.

Included in trade receivables, net of the Group was the amount due from related parties of HK\$3 million (2016: HK\$2 million).

20 LONG-TERM BORROWINGS

In HK\$ million	2016	2017
Repayable within a period		
- over one year, but not exceeding two years	1,194	9,350
- over two years, but not exceeding five years	19,735	12,164
- over five years	17,264	17,632
	38,193	39,146
Representing:		
US\$500 million 3.75% guaranteed notes due 2023 (note (a))	3,736	3,787
US\$300 million zero coupon guaranteed notes due 2030 (note (b))	2,311	2,329
US\$500 million 3.625% guaranteed notes due 2025 (note (c))	3,829	3,863
EUR200 million 1.65% guaranteed notes due 2027 (note (d))	1,613	1,830
US\$750 million 3.00% guaranteed notes due 2026 (note (e))	5,775	5,823
Bank borrowings	20,929	21,514
	38,193	39,146
Secured	-	-
Unsecured	38,193	39,146

a. US\$500 million 3.75% guaranteed notes due 2023

On March 8 2013, PCCW-HKT Capital No. 5 Limited, a direct wholly-owned subsidiary of the Company, issued US\$500 million 3.75% guaranteed notes due 2023, which are listed on the Singapore Exchange Securities Trading Limited. The notes are irrevocably and unconditionally guaranteed by HKT Group Holdings Limited ("HKTGH") and the Company and rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTGH and the Company.

b. US\$300 million zero coupon guaranteed notes due 2030

On January 15, 2015, HKT Capital No. 1 Limited, a direct wholly-owned subsidiary of the Company, issued US\$300 million zero coupon guaranteed notes due 2030, which are listed on the Taipei Exchange in Taiwan, China. The notes are irrevocably and unconditionally guaranteed by HKTGH and the Company and rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTGH and the Company.

c. US\$500 million 3.625% guaranteed notes due 2025

On April 2, 2015, HKT Capital No. 2 Limited, a direct wholly-owned subsidiary of the Company, issued US\$500 million 3.625% guaranteed notes due 2025, which are listed on the Singapore Exchange Securities Trading Limited. The notes are irrevocably and unconditionally guaranteed by HKTGH and the Company and rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTGH and the Company.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

20 LONG-TERM BORROWINGS (CONTINUED)

d. EUR200 million 1.65% guaranteed notes due 2027

On April 10, 2015, HKT Capital No. 3 Limited, a direct wholly-owned subsidiary of the Company, issued EUR200 million 1.65% guaranteed notes due 2027, which are listed on the Singapore Exchange Securities Trading Limited. The notes are irrevocably and unconditionally guaranteed by HKTGH and the Company and rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTGH and the Company.

e. US\$750 million 3.00% guaranteed notes due 2026

On July 14, 2016, HKT Capital No. 4 Limited, a direct wholly-owned subsidiary of the Company, issued US\$750 million 3.00% guaranteed notes due 2026, which are listed on the Singapore Exchange Securities Trading Limited. The notes are irrevocably and unconditionally guaranteed by HKTGH and the Company and rank pari passu with all other outstanding unsecured and unsubordinated obligations of HKTGH and the Company.

f. Please refer to note 31 for details of the Group's bank loan facilities.

21 DERIVATIVE FINANCIAL INSTRUMENTS

In HK\$ million	2016	2017
Non-current assets		
Fixed-to-fixed cross currency swap and foreign exchange forward contracts - cash flow hedges (note (a)&(b))	215	183
Floating-to-fixed interest rate swap contract - cash flow hedges (note (c))	62	40
	277	223
Non-current liabilities		
Fixed-to-fixed cross currency swap and foreign exchange forward contracts - cash flow hedges (note(a)&(b))	14	150

- a. Fixed-to-fixed cross currency swap contracts outstanding as at December 31, 2017 with notional contract amounts of US\$1,250 million (approximately HK\$9,694 million) (2016: US\$1,250 million (approximately HK\$9,694 million)) were designated as cash flow hedge of the foreign currency risk in the Group's foreign currency denominated borrowings. Maturity of these swap contracts matches with the maturity of the underlying borrowings and the Group has fixed the USD/HKD exchange rate at 7.7544-7.7580 (2016: 7.7544-7.7580) for the notional amounts (see note 28(c)(i)). Gains and losses recognized in the hedging reserve under equity on such cross currency swap contracts represents the effective portion on the hedging relationship, and will be continuously released to the consolidated income statement until the repayment of the borrowings.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

21 DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

a. (continued)

As at December 31, 2017, the Group had outstanding foreign exchange forward contract with notional contract amount of US\$376 million (approximately HK\$2,905 million) (2016: US\$376 million (approximately HK\$2,905 million)). The contract was designated as cash flow hedge of the foreign currency risk in the Group's foreign currency denominated borrowings. The Group has fixed the USD/HKD exchange rate at 7.733 (2016: 7.733) for the notional amounts (see note 28(c)(i)). The gain/loss recognized in the hedging reserves under equity represents the effective portion of the hedging relationship, and will be continuously released to the consolidated income statement until the repayment of the underlying borrowings. The gain/loss recognized in the "Finance cost, net" representing the ineffective portion of hedging relationship, amounted to a loss of approximately HK\$15 million for the year ended December 31, 2017 (2016: gain of approximately HK\$15 million).

As at December 31, 2017, the Group had outstanding fixed-to-fixed cross currency swap contract with notional contract amounts of EUR200 million (approximately HK\$1,665 million) (2016: EUR200 million (approximately HK\$1,665 million)). The contract was designated as cash flow hedge of the foreign currency risk in the Group's foreign currency denominated borrowings. Maturity of this swap contract matches with the maturity of the underlying borrowings and the Group has fixed the EUR/HKD exchange rate at 8.3245 (2016: 8.3245) for the notional amounts (see note 28(c)(i)). The gain/loss recognized in the hedging reserves under equity represents the effective portion of the hedging relationship, and will be continuously released to the consolidated income statement until the repayment of the underlying borrowings. The gain/loss recognized in the "Finance cost, net", representing the ineffective portion of hedging relationship, amounted to a gain of approximately HK\$28 million for the year ended December 31, 2017 (2016: nil).

- b. As at December 31, 2017, the Group had fixed-to-floating cross currency swap contracts with an aggregate notional contract amounts of US\$500 million (approximately HK\$3,879 million) (2016: US\$500 million (approximately HK\$3,879 million)). Maturity of these swap contracts matches with the maturity of the underlying fixed rate borrowings and the Group has fixed the USD/HKD exchange rate at 7.7570 (2016: 7.7570) for the notional amounts (see note 28(c)(i)). The Group further entered into floating-to-fixed interest rate swap contracts with an aggregate notional amount of approximately HK\$3,879 million (2016: approximately HK\$3,879 million). Accordingly, the Group had a synthetic fixed-to-fixed cross currency swap contract position and re-designated such swap contracts as cash flow hedges. The gain/loss recognized in the hedging reserve under equity represents the effective portion of the hedging relationship, and will be continuously released to the consolidated income statement until the repayment of the underlying borrowings. The gain/loss recognized in the "Finance cost, net" representing the ineffective portion of hedging relationship, amounted to a gain of approximately HK\$38 million for the year ended December 31, 2017 (2016: loss of approximately HK\$17 million).
- c. As at December 31, 2017, the Group had a floating-to-fixed interest rate swap contract with notional contract amount of HK\$1,500 million. The contract pre-determined the interest rate at a fixed level. The contract was designated as cash flow hedge of the interest rate risk in the Group's floating rate borrowings (see note 28(c)(ii)). The gain/loss recognized in the hedging reserves under equity represents the effective portion of the hedging relationship, and will be continuously released to the consolidated income statement until the repayment of the underlying borrowings. The gain/loss recognized in the "Finance cost, net" representing the ineffective portion of hedging relationship, amounted to a gain of approximately HK\$3 million or the year ended December 31, 2017 (2016: gain of approximately HK\$1 million).

These swap and forward contracts were designated as cash flow hedges of the foreign currency risk in the Group's foreign currency denominated borrowings or the interest rate risk in the Group's borrowings at floating interest rates.

Gains and losses recognized in the hedging reserve under equity on those swap and forward contracts designated as cash flow hedges will be continuously released to the consolidated income statement until the repayment of the borrowings.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS

a. Employee retirement benefits - Defined contribution retirement schemes

The Group participates in defined contribution schemes, including the Mandatory Provident Fund Scheme (the “MPF scheme”) under the Hong Kong Mandatory Provident Fund Schemes Ordinance, for employees employed under the jurisdiction of the Hong Kong Employment Ordinance. The schemes are operated by HKT Services Limited, a fellow subsidiary of the Company, and administered by independent trustees.

Under the defined contribution scheme, the employer is required to make contributions to the scheme at rates specified under the rules of the scheme. Where employees leave the scheme prior to the full vesting of the employer’s contributions, the amount of forfeited contributions is used to reduce the contributions payable by the Group.

Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5% of the employees’ relevant income, subject to a cap of monthly relevant income of HK\$30,000. Contributions to the scheme vest immediately upon the completion of the service in the relevant service period.

b. Equity compensation benefits

i. Share Option Schemes of PCCW

PCCW operates a share option scheme which was adopted by the shareholders of PCCW at the annual general meeting of PCCW held on May 8, 2014 (the “2014 Scheme”). Under the 2014 Scheme, the PCCW Board shall be entitled to offer to grant a share option to any eligible participant whom the PCCW Board may, at its absolute discretion, select. The major terms of the 2014 Scheme are set out below:

- (i) The purpose of the 2014 Scheme is to provide eligible participants with the opportunity to acquire proprietary interests in PCCW and to encourage eligible participants to work towards enhancing the value of PCCW and its shares (“PCCW Shares”) for the benefit of PCCW and its shareholders as a whole.
- (ii) Eligible participants include any director, executive director, non-executive director, independent non-executive director, officer and/or employee of PCCW and its subsidiaries (“PCCW Group”) or any member of it, whether in full time or part time employment of the PCCW Group or any member of it, and any consultant, adviser, supplier, customer, or sub-contractor of the PCCW Group or any member of it and any other person whomsoever is determined by the PCCW Board as having contributed to the development, growth or benefit of the PCCW Group or any member of it or as having spent any material time in or about the promotion of the PCCW Group or its business; and provided always, that an eligible participant can be an individual or any other person permitted under the 2014 Scheme.
- (iii) The maximum number of PCCW Shares in respect of which options may be granted under the 2014 Scheme shall not in aggregate exceed 10% of the PCCW Shares in issue as at the date of adoption of the 2014 Scheme. Subject to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”) requirements, the 10% limit may be renewed with prior shareholders’ approval. The overall limit on the number of PCCW Shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the 2014 Scheme and other share option schemes of PCCW must not exceed 30% of the PCCW Shares in issue from time to time.
- (iv) The total number of PCCW Shares issued and to be issued upon exercise of options granted to any single eligible participant (other than a substantial shareholder or an independent non-executive director of PCCW, or any of their respective associates) under the 2014 Scheme in any 12-month period shall not exceed 1% of the PCCW Shares in issue at the relevant time. For options granted or to be granted to a substantial shareholder or an independent non-executive director of PCCW, or any of their respective associates, the said limit is reduced to 0.1% of the PCCW Shares in issue and HK\$5 million in aggregate value based on the closing price of the PCCW Shares on the date of each grant. Any further grant of share options in excess of such limits is subject to shareholders’ approval at general meeting.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

- (v) The 2014 Scheme does not specify a minimum period for which an option must be held nor a performance target which must be achieved before an option can be exercised. The terms and conditions under and the period within which an option may be exercised under the 2014 Scheme shall be determined by the PCCW Board, provided that such terms and conditions shall not be inconsistent with the 2014 Scheme and no option may be exercised 10 years after the date of grant.
- (vi) The 2014 Scheme does not specify any consideration which is payable on the acceptance of an option. An option shall be deemed to have been granted and accepted by the grantee and to have taken effect upon the date of grant of such option unless the grantee rejects the grant in writing within 14 days after the date of grant.
- (vii) The exercise price in relation to each option shall not be less than the higher of (i) the closing price of the PCCW Shares as stated in the daily quotation sheet of the Stock Exchange on the date of grant; and (ii) the average closing price of the PCCW Shares as stated in the daily quotation sheet of the Stock Exchange for the 5 days last preceding the date of grant on which days it has been possible to trade shares on the Stock Exchange.
- (viii) Subject to the early termination by an ordinary resolution in general meeting of shareholders or resolutions of the PCCW Board, the 2014 Scheme shall be valid and effective for a period of 10 years commencing on the date of adoption, after which period no further options shall be granted but the provisions of the 2014 Scheme shall remain in full force and effect in all other respects.

No share options have been granted under the 2014 Scheme since its adoption and up to and including December 31, 2017.

ii. Share Stapled Units Option Scheme of the HKT Trust and HKT

The HKT Trust and HKT conditionally adopted on November 7, 2011 (the “Adoption Date”) a Share Stapled Units option scheme (the “2011-2021 Option Scheme”) which became effective upon listing of the Share Stapled Units. Under the 2011-2021 Option Scheme, the board of director of the Trustee-Manager (the “Trustee-Manager Board”) and the board of directors of HKT (the “HKT Board”) shall be entitled to offer to grant a Share Stapled Unit option to any eligible participant whom the Trustee-Manager Board and the HKT Board may, at their absolute discretion, select. The major terms of the 2011-2021 Option Scheme are set out below:

- (1) The purpose of the 2011-2021 Option Scheme is to enable the HKT Trust and HKT, acting jointly by mutual agreement between them, to grant options to the eligible participants as incentives or rewards for their contribution to the growth of the HKT Trust and HKT and its subsidiaries (the “HKT Group”) and to provide the HKT Group with a more flexible means to reward, remunerate, compensate and/or provide benefits to the eligible participants.
- (2) Eligible participants include (a) any full time or part time employee of HKT and/or any of its subsidiaries; (b) any director (including executive, non-executive or independent non-executive director) of HKT and/or any of its subsidiaries; and (c) any consultant or adviser (whether professional or otherwise and whether on an employment or contractual or honorary basis or otherwise and whether paid or unpaid), distributor, contractor, supplier, service provider, agent, customer and business partner of HKT and/or any of its subsidiaries. The Trustee-Manager is not an eligible participant under the 2011-2021 Option Scheme.
- (3) (i) Notwithstanding any other provisions of the 2011-2021 Option Scheme, no options may be granted under the 2011-2021 Option Scheme if the exercise of the options may result in PCCW ceasing to hold at least 51% of the Share Stapled Units in issue (on a fully diluted basis assuming full conversion or exercise of all outstanding options and other rights of subscription, conversion and exchange for Share Stapled Units).

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

ii. Share Stapled Units Option Scheme of the HKT Trust and HKT (continued)

(3) (continued)

- (ii) Subject to the further limitation in (i) above, as required by the Listing Rules, the total number of Share Stapled Units which may be issued upon exercise of all options to be granted under the 2011-2021 Option Scheme and any other share option schemes of the HKT Trust and HKT must not, in aggregate, exceed 10% of the issued Share Stapled Units as at November 29, 2011 unless the approval of holders of Share Stapled Units has been obtained.
- (iii) In addition, as prescribed by the Listing Rules, the maximum aggregate number of Share Stapled Units which may be issued upon exercise of all outstanding options granted and yet to be exercised under the 2011-2021 Option Scheme and any other share option schemes of the HKT Trust and HKT must not exceed 30% of the issued Share Stapled Units from time to time. No options may be granted under the 2011-2021 Option Scheme if this will result in such limit being exceeded.
- (4) The total number of Share Stapled Units issued and to be issued upon exercise of options granted and to be granted to any single eligible participant (other than a substantial holder of Share Stapled Units or an independent non-executive director of HKT, or any of their respective associates) under the 2011-2021 Option Scheme (including exercised, cancelled and outstanding options under the 2011-2021 Option Scheme) in any 12-month period shall not exceed 1% of the Share Stapled Units in issue at the relevant time. For options granted or to be granted to a substantial holder of Share Stapled Units or an independent non-executive director of HKT, or any of their respective associates, the said limit is reduced to 0.1% of the Share Stapled Units in issue and HK\$5 million in aggregate value based on the closing price of the Share Stapled Units on the date of each grant. Any further grant of Share Stapled Unit options in excess of such limits is subject to the approval of registered holders of Share Stapled Units at general meeting.
- (5) The 2011-2021 Option Scheme does not specify a minimum period for which an option must be held nor a performance target which must be achieved before an option can be exercised. The terms and conditions under and the period within which an option may be exercised under the 2011-2021 Option Scheme shall be determined by the Trustee-Manager Board and the HKT Board, provided that such terms and conditions shall not be inconsistent with the 2011-2021 Option Scheme and no option may be exercised 10 years after the date of grant.
- (6) Upon acceptance of the offer, the grantee shall pay HK\$1.00 to HKT by way of consideration for the grant and the date on which the option is offered shall be deemed to be the date of grant of the relevant option, except in determining the date of grant for the purpose of calculating the subscription price for grants requiring approval of holders of Share Stapled Units in accordance with the provisions of the 2011-2021 Option Scheme.
- (7) The subscription price for Share Stapled Units in respect of any particular option shall not be less than the highest of (i) the closing price per Share Stapled Unit on the main board as stated in the Stock Exchange's daily quotation sheet on the date of grant, which must be a business day; (ii) the average closing price per Share Stapled Unit on the main board as stated in the Stock Exchange's daily quotation sheet for the 5 business days immediately preceding the date of grant; and (iii) the aggregate of the nominal values of the preference share and ordinary share components of a Share Stapled Unit.
- (8) Subject to the early termination by an ordinary resolution in general meeting of registered holders of Share Stapled Units or resolutions of the HKT Board and the Trustee-Manager Board, the 2011-2021 Option Scheme shall be valid and effective for a period of 10 years commencing from the Adoption Date, after which period no further options shall be granted but the provisions of the 2011-2021 Option Scheme shall remain in full force and effect in all other respects.

No Share Stapled Unit options have been granted under the 2011-2021 Option Scheme since its adoption and up to and including December 31, 2017.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iii. Share Stapled Units Award Schemes of HKT

On October 11, 2011, HKT adopted two award schemes pursuant to which awards of Share Stapled Units may be made, namely the HKT Share Stapled Units Purchase Scheme and the HKT Share Stapled Units Subscription Scheme, in respect of which the most recent changes were approved by the Approving Body (as defined below) on February 6, 2018 (collectively the “Share Stapled Units Award Schemes”). The purposes of the Share Stapled Units Award Schemes are to incentivize and reward participants for their contribution to the growth of the HKT Group and to provide the HKT Group with a more flexible means to reward, remunerate, compensate and/or provide benefits to the participants.

Participants of the HKT Share Stapled Units Award Schemes include any director or employee of HKT or any of its subsidiaries.

The Share Stapled Units Award Schemes are administered by the HKT Board, any committee or sub-committee of the HKT Board and/or any person delegated with the power and authority to administer all or any aspects of the respective Share Stapled Units Award Schemes (the “Approving Body”) and an independent trustee (the “Trustee”) appointed to hold the relevant Share Stapled Units until such time as the Share Stapled Units vest in the selected participants.

Pursuant to the scheme rules, no sum of money shall be set aside and no Share Stapled Units shall be purchased or subscribed (as the case may be), nor any amounts paid to the Trustee for the purpose of making such a purchase or subscription, if, as a result of such purchase or subscription, the number of Share Stapled Units administered under the respective schemes would represent in excess of 1% of the total number of Share Stapled Units in issue from time to time, excluding the Share Stapled Units which have been transferred to selected participants on vesting. In addition, under the HKT Share Stapled Units Subscription Scheme, no sum of money shall be set aside and no Share Stapled Units shall be subscribed nor any amounts paid to the Trustee for the purpose of making such a subscription if:

- (i) as a result of such subscription, PCCW’s aggregate holding of Share Stapled Units would on a fully-diluted basis (which shall take into account the relevant subscription(s) proposed to be made under the HKT Share Stapled Units Subscription Scheme, the amount of all outstanding options in respect of Share Stapled Units as granted pursuant to the 2011-2021 Option Scheme, and all other rights or entitlements granted by HKT concerning the prospective allotment of new Share Stapled Units) represent less than 51% of the total number of Share Stapled Units as would exist were all such commitments to allot new Share Stapled Units to be duly fulfilled; or
- (ii) HKT does not have a relevant general mandate or specific mandate from holders of the Share Stapled Units necessary to effect the allotment and issue of Share Stapled Units pursuant to the scheme.

Subject to the relevant scheme rules, each scheme provides that following the making of an award to a selected participant, the relevant Share Stapled Units are held in trust for that selected participant and then shall vest over a period of time determined by the Approving Body provided that the selected participant remains at all times up to and including the relevant vesting date (or, as the case may be, each relevant vesting date) an employee or director of the HKT Group and satisfies any other conditions specified at the time the award is made, notwithstanding that the Approving Body shall be at liberty to waive such conditions. Other than satisfying the vesting conditions, selected participants are not required to provide any consideration in order to acquire the Share Stapled Units awarded to him/her under the schemes.

The Share Stapled Units Award Schemes, unless terminated earlier, shall be valid and effective for a term of 10 years commencing from October 11, 2011, being the date of adoption. The Approving Body may also by resolution terminate the operation of the schemes at any time subject to the terms of the schemes.

No Share Stapled Units have been awarded under the HKT Share Stapled Units Purchase Scheme since the date of its adoption and up to and including December 31, 2017.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iii. Share Stapled Units Award Schemes of HKT (continued)

A summary of movements in the Share Stapled Units held by the Group under the HKT Share Stapled Units Purchase Scheme in respect of selected participants of the Group during the year is as follows:

	Number of Share Stapled Units	
	2016	2017
Beginning of year	3,929,132	1,690,735
Purchase from the market by the Trustee at weighted average market price of HK\$10.44 per Share Stapled Unit	-	368,583
Changes due to the transfer of employees (to)/from a fellow subsidiary	(55,316)	509,768
Share Stapled Units vested	(2,183,081)*	(2,098,122)
End of year	1,690,735	470,964

* Included 1,302 Share Stapled Units vested during the year ended December 31, 2016 pursuant to the delegated authority of the relevant board committees on compassionate grounds.

Details of Share Stapled Units awarded to selected participants of the Group pursuant to the HKT Share Stapled Units Purchase Scheme during the year and the unvested Share Stapled Units held by the Group are as follows:

(1) Movements in the number of unvested Share Stapled Units and their related weighted average fair value at date of award

	2016		2017	
	Weighted average fair value at date of award HK\$	Number of Share Stapled Units	Weighted average fair value at date of award HK\$	Number of Share Stapled Units
Beginning of year	9.28	3,929,132	9.89	2,635,885
Awarded (note (3))	10.70	981,526	10.04	1,145,801
Forfeited (note (4))	9.99	(49,050)	10.26	(54,720)
Vested (note (5))	9.17	(2,181,779)	9.71	(2,098,122)
Transfer of employees to a fellow subsidiary (note (6))	9.27	(43,944)	9.51	(51,994)
End of year (note (2))	9.89	2,635,885	10.23	1,576,850

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iii. Share Stapled Units Award Schemes of HKT (continued)

(2) Terms of unvested Share Stapled Units held by the Group as at the end of the reporting period

Date of award	Vesting period	Fair value at date of award HK\$	Number of Share Stapled Units	
			2016	2017
July 1, 2014	July 1, 2014 to April 1, 2017	9.13	1,259,567	-
April 1, 2015	April 1, 2015 to April 1, 2017	10.20	1,215	-
May 7, 2015	May 7, 2015 to May 7, 2017	10.30	414,633	-
April 5, 2016	April 5, 2016 to April 5, 2017	10.70	480,642	-
April 5, 2016	April 5, 2016 to April 5, 2018	10.70	479,828	458,598
April, 3, 2017	April 3, 2017 to April 3, 2018	10.04	-	559,506
April, 3, 2017	April 3, 2017 to April 3, 2019	10.04	-	558,746
			2,635,885	1,576,850

The unvested Share Stapled Units held by the Group at December 31, 2017 had a weighted average remaining vesting period of 0.61 year (2016: 0.45 year).

(3) Details of Share Stapled Units awarded to selected participants of the Group during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of Share Stapled Units	
			2016	2017
April 5, 2016	April 5, 2016 to April 5, 2017	10.70	491,181	-
April 5, 2016	April 5, 2016 to April 5, 2018	10.70	490,345	-
April, 3, 2017	April 3, 2017 to April 3, 2018	10.04	-	573,300
April, 3, 2017	April 3, 2017 to April 3, 2019	10.04	-	572,501
			981,526	1,145,801

(4) Details of Share Stapled Units forfeited during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of Share Stapled Units	
			2016	2017
April 11, 2014	April 11, 2014 to April 11, 2016	8.26	5,867	-
July 1, 2014	July 1, 2014 to April 1, 2016	9.13	668	-
July 1, 2014	July 1, 2014 to April 1, 2017	9.13	8,617	3,351
April 1, 2015	April 1, 2015 to April 1, 2017	10.20	-	333
May 7, 2015	May 7, 2015 to May 7, 2016	10.30	4,695	-
May 7, 2015	May 7, 2015 to May 7, 2017	10.30	10,433	3,298
April 5, 2016	April 5, 2016 to April 5, 2017	10.70	9,396	5,161
April 5, 2016	April 5, 2016 to April 5, 2018	10.70	9,374	16,423
April, 3, 2017	April 3, 2017 to April 3, 2018	10.04	-	13,095
April, 3, 2017	April 3, 2017 to April 3, 2019	10.04	-	13,059
			49,050	54,720

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

- b. Equity compensation benefits (continued)**
 iii. Share Stapled Units Award Schemes of HKT (continued)
 (5) Details of Share Stapled Units vested during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of Share Stapled Units	
			2016	2017
April 11, 2014	April 11, 2014 to April 11, 2016	8.26	461,143	-
July 1, 2014	July 1, 2014 to April 1, 2016	9.13	1,297,401	-
July 1, 2014	July 1, 2014 to April 1, 2017	9.13	-	1,218,747
April 1, 2015	April 1, 2015 to April 1, 2016	10.20	1,215	-
May 7, 2015	May 7, 2015 to May 7, 2016	10.30	422,020	-
May 7, 2015	May 7, 2015 to May 7, 2017	10.30	-	407,357
April 5, 2016	April 5, 2016 to April 5, 2017	10.70	-	472,018
			2,181,779	2,098,122

- (6) Details of unvested Share Stapled Units transferred to a fellow subsidiary during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of Share Stapled Units	
			2016	2017
April 11, 2014	April 11, 2014 to April 11, 2016	8.26	1,219	-
July 1, 2014	July 1, 2014 to April 1, 2016	9.13	3,905	-
July 1, 2014	July 1, 2014 to April 1, 2017	9.13	33,343	37,469
April 1, 2015	April 1, 2015 to April 1, 2017	10.20	-	882
May 7, 2015	May 7, 2015 to May 7, 2016	10.30	1,125	-
May 7, 2015	May 7, 2015 to May 7, 2017	10.30	2,066	3,978
April 5, 2016	April 5, 2016 to April 5, 2017	10.70	1,143	3,463
April 5, 2016	April 5, 2016 to April 5, 2018	10.70	1,143	4,807
April, 3, 2017	April 3, 2017 to April 3, 2018	10.04	-	699
April, 3, 2017	April 3, 2017 to April 3, 2019	10.04	-	696
			43,944	51,994

The fair value of the Share Stapled Units awarded during the year at the dates of award are measured by the quoted market price of the Share Stapled Units at the respective award dates.

During the year ended December 31, 2017, share-based compensation expenses of HK\$13 million (2016: HK\$18 million) is recognized for HKT Share Stapled Units Award Schemes in the consolidated income statement and obligation in liabilities in the consolidated statement of financial position, respectively.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iv. Share award schemes of PCCW

PCCW adopted two share incentive award schemes, namely the PCCW Purchase Scheme and the PCCW Subscription Scheme (collectively, the “PCCW Share Award Schemes”) with the purposes and objectives to recognize the contributions by eligible participants and to give incentives thereto in order to retain them for the continual operation and development of the PCCW Group and to attract suitable personnel for further development of the PCCW Group.

Participants of the PCCW Share Award Schemes include any director or employee of PCCW and its participating subsidiaries.

The PCCW Share Award Schemes are administered by the PCCW Board, any committee or sub-committee of the PCCW Board and/or any person delegated with the power and authority to administer all or any aspects of the respective PCCW Share Award Schemes (the “PCCW Approving Body”) and an independent trustee (the “PCCW Trustee”) appointed to hold the relevant Shares/Share Stapled Units until such time as the PCCW Shares/Share Stapled Units vest in the selected participants.

Pursuant to the scheme rules, no sum of money shall be set aside and no PCCW Shares/Share Stapled Units shall be purchased or subscribed (as the case may be), nor any amounts paid to the PCCW Trustee for the purpose of making such a purchase or subscription, if, as a result of such purchase or subscription, the number of PCCW Shares/Share Stapled Units administered under the schemes and any other scheme of a similar nature adopted by PCCW and/or any of its subsidiaries would represent in excess of 1% of the PCCW Shares in issue and/or 1% of the Share Stapled Units in issue (as the case may be) from time to time, (excluding PCCW Shares/Share Stapled Units which have been transferred to selected participants on vesting) and provided further that the PCCW Approving Body may resolve to increase such limit at its sole discretion.

Subject to the relevant scheme rules, each scheme provides that following the making of an award to a selected participant, the relevant PCCW Shares/Share Stapled Units are held in trust for that selected participant and then shall vest over a period of time determined by the PCCW Approving Body provided that the selected participant remains at all times up to and including the relevant vesting date (or, as the case may be, each relevant vesting date) an employee or director of PCCW or the relevant participating company and satisfies any other conditions specified at the time the award is made, notwithstanding that the PCCW Approving Body shall be at liberty to waive such conditions. Other than satisfying the vesting conditions, selected participants are not required to provide any consideration in order to acquire the PCCW Shares/Share Stapled Units awarded to him/her under the schemes.

The PCCW Purchase Scheme and the PCCW Subscription Scheme expired on November 15, 2012 however the PCCW Shares which were previously awarded prior to the expiry date were not affected. New scheme rules in respect of the PCCW Purchase Scheme and the PCCW Subscription Scheme were adopted on November 15, 2012 so as to allow both schemes to continue to operate for a further 10 years and to accommodate the grant of the Share Stapled Units in addition or as an alternative to the PCCW Shares, in the future, in respect of which the most recent changes were approved by the PCCW Approving Body on February 7, 2018. The PCCW Approving Body may by resolution terminate the operation of the schemes at any time subject to the terms of the schemes.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iv. Share award schemes of PCCW (continued)

A summary of movements in PCCW shares held by the Group under the PCCW Share Award Schemes in respect of selected participants of the Group during the year is as follows:

	Number of PCCW shares	
	2016	2017
Beginning of year	2,750,344	2,691,748
Purchase from the market by the Trustee at the weighted average market price of HK\$4.79 per PCCW share	-	255,356
Changes due to the transfer of employees from/to a fellow subsidiary	(49,978)	2,101,985
PCCW shares obtained under the PCCW Subscription Scheme	1,874,660	-
PCCW shares vested	(1,883,278)*	(1,847,699)
End of year	2,691,748	3,201,390

* Included 1,473 PCCW Shares vested during the year ended December 31, 2016 pursuant to the delegated authority of the relevant board committees on compassionate grounds.

Details of PCCW shares awarded to selected participants of the Group pursuant to the PCCW Share Award Schemes during the year and the unvested PCCW shares held by the Group, are as follows:

- (1) Movements in the number of unvested PCCW shares held by the Group and their related weighted average fair value on date of award

	2016		2017	
	Weighted average fair value at date of award HK\$	Number of PCCW shares	Weighted average fair value at date of award HK\$	Number of PCCW shares
The PCCW Purchase Scheme:				
Beginning of year	4.82	334,484 [#]	5.11	337,898
Awarded (note (3))	5.01	235,354	4.60	272,260
Vested (note (5))	4.59	(231,940)	5.17	(220,223)
End of year (note (2))	5.11	337,898	4.72	389,935
The PCCW Subscription Scheme:				
Beginning of year	4.82	2,415,860 [#]	5.10	2,609,206
Awarded (note (3))	5.01	1,944,148	4.60	2,243,028
Forfeited (note (4))	4.94	(87,046)	4.83	(115,064)
Vested (note (5))	4.59	(1,649,865)	5.16	(1,627,476)
Transfer of employees to a fellow subsidiary (note (6))	4.98	(13,891)	5.06	(25,979)
End of year (note (2))	5.10	2,609,206	4.72	3,083,715
Total		2,947,104		3,473,650

[#] During the year ended December 31, 2016, 18,529 PCCW Shares awarded on May 7, 2015 under the PCCW Subscription Scheme were re-designated as awarded under the PCCW Purchase Scheme.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iv. Share award schemes of PCCW (continued)

(2) Terms of unvested PCCW shares held by the Group at the end of the reporting period

Date of award	Vesting period	Fair value at date of award HK\$	Number of PCCW shares	
			2016	2017
The PCCW Purchase Scheme:				
May 7, 2015	May 7, 2015 to May 7, 2017	5.35	102,544	-
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	117,679	-
April 5, 2016	April 5, 2016 to April 5, 2018	5.01	117,675	117,675
April, 3, 2017	April 3, 2017 to April 3, 2018	4.60	-	136,132
April, 3, 2017	April 3, 2017 to April 3, 2019	4.60	-	136,128
			337,898	389,935
The PCCW Subscription Scheme:				
May 7, 2015	May 7, 2015 to May 7, 2017	5.35	711,802	-
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	949,101	-
April 5, 2016	April 5, 2016 to April 5, 2018	5.01	948,303	901,137
April, 3, 2017	April 3, 2017 to April 3, 2018	4.60	-	1,091,667
April, 3, 2017	April 3, 2017 to April 3, 2019	4.60	-	1,090,911
			2,609,206	3,083,715
Total			2,947,104	3,473,650

The PCCW shares unvested held by the Group at December 31, 2017 had a weighted average remaining vesting period of 0.61 year (2016: 0.65 year).

(3) Details of PCCW shares awarded to selected participants of the Group during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of PCCW shares	
			2016	2017
The PCCW Purchase Scheme:				
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	117,679	-
April 5, 2016	April 5, 2016 to April 5, 2018	5.01	117,675	-
April, 3, 2017	April 3, 2017 to April 3, 2018	4.60	-	136,132
April, 3, 2017	April 3, 2017 to April 3, 2019	4.60	-	136,128
			235,354	272,260
The PCCW Subscription Scheme:				
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	972,486	-
April 5, 2016	April 5, 2016 to April 5, 2018	5.01	971,662	-
April, 3, 2017	April 3, 2017 to April 3, 2018	4.60	-	1,121,912
April, 3, 2017	April 3, 2017 to April 3, 2019	4.60	-	1,121,116
			1,944,148	2,243,028
Total			2,179,502	2,515,288

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iv. Share award schemes of PCCW (continued)

(4) Details of PCCW shares forfeited during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of PCCW shares	
			2016	2017
The PCCW Subscription Scheme:				
April 11, 2014	April 11, 2014 to April 11, 2016	3.99	15,674	-
May 7, 2015	May 7, 2015 to May 7, 2016	5.35	9,209	-
May 7, 2015	May 7, 2015 to May 7, 2017	5.35	20,495	7,120
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	20,847	12,762
April 5, 2016	April 5, 2016 to April 5, 2018	5.01	20,821	37,794
April, 3, 2017	April 3, 2017 to April 3, 2018	4.60	-	28,713
April, 3, 2017	April 3, 2017 to April 3, 2019	4.60	-	28,675
Total			87,046	115,064

(5) Details of PCCW shares vested during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of PCCW shares	
			2016	2017
The PCCW Purchases Scheme:				
April 11, 2014	April 11, 2014 to April 11, 2016	3.99	129,393	-
May 7, 2015	May 7, 2015 to May 7, 2016	5.35	102,547	-
May 7, 2015	May 7, 2015 to May 7, 2017	5.35	-	102,544
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	-	117,679
			231,940	220,223
The PCCW Subscription Scheme:				
April 11, 2014	April 11, 2014 to April 11, 2016	3.99	924,245	-
May 7, 2015	May 7, 2015 to May 7, 2016	5.35	725,620	-
May 7, 2015	May 7, 2015 to May 7, 2017	5.35	-	697,501
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	-	929,975
			1,649,865	1,627,476
Total			1,881,805	1,847,699

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

22 EMPLOYEE BENEFITS (CONTINUED)

b. Equity compensation benefits (continued)

iv. Share award schemes of PCCW (continued)

(6) Details of unvested PCCW shares transferred to a fellow subsidiary during the year

Date of award	Vesting period	Fair value at date of award HK\$	Number of PCCW shares	
			2016	2017
The PCCW Subscription Scheme:				
April 11, 2014	April 11, 2014 to April 11, 2016	3.99	2,547	-
May 7, 2015	May 7, 2015 to May 7, 2016	5.35	2,211	-
May 7, 2015	May 7, 2015 to May 7, 2017	5.35	4,057	7,181
April 5, 2016	April 5, 2016 to April 5, 2017	5.01	2,538	6,364
April 5, 2016	April 5, 2016 to April 5, 2018	5.01	2,538	9,372
April, 3, 2017	April 3, 2017 to April 3, 2018	4.60	-	1,532
April, 3, 2017	April 3, 2017 to April 3, 2019	4.60	-	1,530
Total			13,891	25,979

The fair value of the PCCW shares awarded to selected participants of the Group during the year at the dates of award are measured by the quoted market price of the PCCW shares at the respective award dates.

During the year ended December 31, 2017, share-based compensation expenses of HK\$11 million (2016: HK\$10 million) is recognized in the consolidated income statement and an obligation in liabilities in the consolidated statement of financial position, respectively.

23 SHARE CAPITAL

	2016		2017	
	Number of shares	Value HK\$ million	Number of shares	Value HK\$ million
Issued and fully paid:				
Ordinary shares				
Beginning and end of year	2,488,200,001	9,945	2,488,200,001	9,945

24 DEFERRED INCOME TAX

a. Movement in deferred income tax liabilities/(assets) during the year is as follows:

In HK\$ million	2016		
	Accelerated tax depreciation and amortization	Others	Total
Beginning of year	1,904	-	1,904
Charged/(credited) to consolidated income statement (note 10(a))	282	(4)	278
End of year	2,186	(4)	2,182

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

24 DEFERRED INCOME TAX (CONTINUED)

a. Movement in deferred income tax liabilities/(assets) during the year is as follows: *(continued)*

In HK\$ million	2017		Total
	Accelerated tax depreciation and amortization	Others	
Beginning of year	2,186	(4)	2,182
Charged to consolidated income statement (note 10(a))	333	1	334
End of year	2,519	(3)	2,516
In HK\$ million		2016	2017
Deferred income tax assets:			
- to be recovered after more than 12 months		-	-
- to be recovered within 12 months		-	-
Deferred income tax assets recognized in the consolidated statement of financial position		-	-
Deferred income tax liabilities:			
- to be recovered after more than 12 months		2,103	2,453
- to be recovered within 12 months		79	63
Deferred income tax liabilities recognized in the consolidated statement of financial position		2,182	2,516
Deferred income tax liabilities (net)		2,182	2,516

- b. As at December 31, 2017, the Group had unutilized estimated tax losses for which no deferred income tax assets have been recognized of HK\$215 million (2016: HK\$209 million) to carry forward for deduction against future taxable income. Estimated adjusted tax loss of HK\$24 million (2016: HK\$24 million) will expire within 1 to 5 years. The remaining portion of the tax loss, relating to Hong Kong companies, can be carried forward indefinitely.

No deferred income tax assets (2016: nil) had been recognized for tax losses carry-forward to the extent that realization of the related tax benefit through utilization against future taxable profits is probable.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

25 CARRIER LICENCE FEE LIABILITIES

As at December 31, 2017, the Group had carrier licence fee liabilities repayable as follows:

In HK\$ million	Present value of the minimum annual fees	2016 Interest expense relating to future periods	Total minimum annual fees	Present value of the minimum annual fees	2017 Interest expense relating to future periods	Total minimum annual fees
Repayable within a period						
- not exceeding one year	173	7	180	173	7	180
- over one year, but not exceeding two years	123	19	142	123	19	142
- over two years, but not exceeding five years	312	112	424	257	75	332
- over five years	109	41	150	75	25	100
	717	179	896	628	126	754
Less: Amounts repayable within one year included under current liabilities	(173)	(7)	(180)	(173)	(7)	(180)
Non-current portion	544	172	716	455	119	574

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

26 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

a. Reconciliation of profit before income tax to net cash generated from operating activities

In HK\$ million	2016	2017
Profit before income tax	3,701	4,491
Adjustments for:		
Finance costs, net	1,155	1,151
Net gain on fair value hedging instruments	(4)	-
Other gain	(2)	(1)
Gain on disposals of property, plant and equipment	(26)	(2)
Provision for inventory obsolescence	4	8
Impairment loss for doubtful debts	94	79
Depreciation of property, plant and equipment	999	1,019
Amortization of intangible assets	1,909	1,838
Amortization of land lease premium	12	13
Share of result of a joint venture	4	7
Share-based payment	28	24
Increase in financial assets at fair value through profit or loss for equity compensation scheme	-	(5)
Decrease/(increase) in operating assets		
- inventories	56	(58)
- trade receivables, prepayments, deposits and other current assets	1,520	(202)
- amounts due from related companies	8	4
- other non-current assets	(51)	10
Increase/(decrease) in operating liabilities		
- trade payables, accruals and other payables	175	(838)
- other long-term liabilities	(9)	(5)
- advances from customers	(23)	(47)
- deferred income (non-current)	(3)	5
Cash generated from operations	9,547	7,491
Interest received	8	36
Income tax paid, net of tax refund		
- Hong Kong profits tax paid	(479)	(394)
Net cash generated from operating activities	9,076	7,133

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

26 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

b. Movement of financial liabilities arising from financing activities

Movement of financial liabilities arising from financing activities for the year ended December 31, 2017 are as follows:

In HK\$ million	2017			Total
	Interest payable (included in accruals and other payables)	Long-term borrowings	Derivative financial instruments, net	
As at January 1, 2017	178	38,193	(263)	38,108
Cash flows in financing activities				
New borrowings raised, net	-	5,275	-	5,275
Finance costs (paid)/received	(877)	-	21	(856)
Repayments of borrowings	-	(4,650)	-	(4,650)
Classified as investing activities (note 28(b)(i))	-	(130)	-	(130)
Non-cash movement	886	458	169	1,513
As at December 31, 2017	187	39,146	(73)	39,260

c. Additions upon business combination

In HK\$ million	2016	2017
Purchase consideration	6	-
Net liabilities acquired:		
Property, plant and equipment	3	-
Inventories, trade receivables, prepayments and deposits	58	-
Cash and cash equivalents	24	-
Trade payables, accruals, other payables and advances from customers	(112)	-
	(27)	-
Goodwill on acquisition	33	-
Analysis of net inflow of cash and cash equivalents in respect of additions upon business combination:		
Purchase consideration	6	-
Less: Amount due to a fellow subsidiary	(6)	-
	-	-
Cash and cash equivalents acquired	24	-
Net inflow of cash and cash equivalents in respect of business combination	24	-

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

26 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

d. Analysis of cash and cash equivalents

In HK\$ million	2016	2017
Total cash and bank balances	2,209	2,334
Less: Short-term deposits	(450)	(450)
Cash and cash equivalents as at December 31,	1,759	1,884

27 CAPITAL MANAGEMENT

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, to support the Group's stability and growth, and to earn a margin commensurate with the level of business and market risks in the Group's operation.

The Group monitors capital by reviewing the level of capital that is at the disposal of the Group ("adjusted capital"), taking into consideration the future capital requirements of the Group, prevailing and projected profitability, projected operating cash flows, projected capital expenditures and projected strategic investment opportunities. Adjusted capital comprises all components of equity.

The Group is not subject to externally imposed capital requirements.

28 FINANCIAL INSTRUMENTS

The table below analyzes financial instruments by category:

In HK\$ million	Financial assets at amortized cost	2016 Assets at fair value through profit or loss	Derivative used for hedging	Total
Non-current assets				
Financial assets at fair value through profit or loss	-	4	-	4
Derivative financial instruments*	-	-	277	277
Other non-current assets	77	-	-	77
	77	4	277	358
Current assets				
Prepayments, deposits and other current assets (excluding prepayments)	4,040	-	-	4,040
Trade receivables, net	825	-	-	825
Financial assets at fair value through profit or loss	-	25	-	25
Amount due from related companies	94	-	-	94
Amounts due from fellow subsidiaries	8,044	-	-	8,044
Short-term deposits	450	-	-	450
Cash and cash equivalents	1,759	-	-	1,759
	15,212	25	-	15,237
Total	15,289	29	277	15,595

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

The table below analyzes financial instruments by category: *(continued)*

In HK\$ million	Derivative used for hedging	2016 Other financial liabilities at amortized cost	Total
Current liabilities			
Trade payables	-	792	792
Accruals and other payables	-	3,416	3,416
Carrier licence fee liabilities	-	173	173
Amounts due to fellow subsidiaries and intermediate holding companies	-	11,944	11,944
	-	16,325	16,325
Non-current liabilities			
Long-term borrowings	-	38,193	38,193
Derivative financial instruments	14	-	14
Carrier licence fee liabilities	-	544	544
Other long-term liabilities	-	390	390
	14	39,127	39,141
Total	14	55,452	55,466

In HK\$ million	Financial assets at amortized cost	2017 Assets at fair value through profit or loss	Derivative used for hedging	Total
Non-current assets				
Financial assets at fair value through profit or loss	-	5	-	5
Derivative financial instruments*	-	-	223	223
Other non-current assets	67	-	-	67
	67	5	223	295
Current assets				
Prepayments, deposits and other current assets (excluding prepayments)	4,469	-	-	4,469
Trade receivables, net	534	-	-	534
Financial assets at fair value through profit or loss	-	14	-	14
Amount due from related companies	48	-	-	48
Amounts due from fellow subsidiaries	9,250	-	-	9,250
Short-term deposits	450	-	-	450
Cash and cash equivalents	1,884	-	-	1,884
	16,635	14	-	16,649
Total	16,702	19	223	16,944

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

The table below analyzes financial instruments by category: (continued)

In HK\$ million	Derivative used for hedging	2017 Other financial liabilities at amortized cost	Total
Current liabilities			
Trade payables	-	955	955
Accruals and other payables	-	3,234	3,234
Carrier licence fee liabilities	-	173	173
Amounts due to fellow subsidiaries and intermediate holding companies	-	12,974	12,974
	-	17,336	17,336
Non-current liabilities			
Long-term borrowings	-	39,146	39,146
Derivative financial instruments	150	-	150
Carrier licence fee liabilities	-	455	455
Other long-term liabilities	-	566	566
	150	40,167	40,317
Total	150	57,503	57,653

* As at December 31, 2017, derivative financial instruments of HK\$8 million (2016: HK\$37 million) related to the foreign exchange forward contracts with notional contract amounts of US\$376 million (approximately HK\$2,905 million) were designated as cash flow hedge of US\$300 million zero coupon guaranteed notes due 2030. These guaranteed notes may be redeemed at the option of the Group on January 15, 2020 at an early redemption amount of US\$376 million. Please refer to note 20(b) and note 21(a) for details of the guaranteed notes and the foreign exchange contract respectively.

Exposures to credit, liquidity and market risks (including foreign currency risk and interest rate risk) arise in the normal course of the Group's business. The Group is also exposed to equity price risk arising from its equity investments in other entities. Exposures to these risks are controlled by the Group's financial management policies and practices described below.

a. Credit risk

The Group's credit risk is primarily attributable to trade receivables, amounts due from related companies and fellow subsidiaries, interest receivable, foreign exchange and swap contracts and cash transactions entered into for risk and cash management purposes. Management has policies in place and exposure to these credit risks are monitored on an ongoing basis.

Trade receivables have a normal credit period ranging up to 30 days from the date of invoice unless there is a separate mutual agreement on extension of the credit period. The Group maintains a well-defined credit policy and individual credit evaluations are performed on all customers requiring credit over a certain amount. These evaluations focus on the customer's past history of making payments when due and current ability to pay, and take into account information specific to the customer as well as pertaining to the economic environment in which the customer operates. Debtors who have overdue payables are requested to settle all outstanding balances before any further credit is granted. Normally, the Group does not obtain collateral from customers. As at December 31, 2016 and 2017, the Group did not have a significant exposure to any individual debtors or counterparties.

Further quantitative disclosures in respect of the Group's exposure to credit risk arising from trade receivables are set out in note 19(b).

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

a. Credit risk (continued)

Amounts due from related companies and other receivables are continuously monitored by assessing the credit quality of the counterparty, taking into account its financial position, past experience and other factors. Where necessary, provision for impairment loss is made for estimated irrecoverable amounts. As at December 31, 2016 and 2017, the amounts due from related companies and other receivables were fully performing.

Investments, derivative financial instruments, interests receivable and cash transactions are executed with financial institutions or investment counterparties with sound credit ratings and the Group does not expect any significant counterparty risk. Moreover, credit limits are set for individual counterparties and periodic reviews are conducted to ensure that the limits are strictly followed.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the consolidated statement of financial position. Except for the guarantees given by the Group as disclosed in note 30, the Group does not provide any other guarantees which would expose the Group to credit risk.

b. Liquidity risk

The Group's policy is to regularly monitor current and expected liquidity requirements and its compliance with debt covenants, 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. Management believes there is no significant liquidity risk as the Group has sufficient cash and committed facilities to fund its operations and debt servicing requirements.

The Group is subject to certain corporate guarantee obligations to guarantee performance of its subsidiaries and fellow subsidiaries in the normal course of their business. Please refer to note 30 for details.

The following table details the remaining contractual maturities at the end of the reporting periods of the Group's non-derivative financial liabilities and derivative financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the end of the reporting periods) and the earliest date the Group can be required to pay:

In HK\$ million	2016				Total contractual undiscounted cash outflow	Carrying Amount
	Within 1 year or on demand	More than 1 year but within 2 years	More than 2 years but within 5 years	More than 5 years		
Current liabilities						
Trade payables	(792)	-	-	-	(792)	(792)
Accruals and other payables	(3,391)	-	-	-	(3,391)	(3,391)
Carrier licence fee liabilities	(180)	-	-	-	(180)	(173)
Amounts due to fellow subsidiaries and intermediate holding companies	(11,944)	-	-	-	(11,944)	(11,944)
	(16,307)	-	-	-	(16,307)	(16,300)
Non-current liabilities						
Long-term borrowings (note (i))	(796)	(1,971)	(21,726)	(21,240)	(45,733)	(38,193)
Derivative financial instruments	(37)	(36)	(104)	216	39	(14)
Carrier licence fee liabilities	-	(142)	(424)	(150)	(716)	(544)
Other long-term liabilities (note (ii))	(14)	-	(7)	(1,012)	(1,033)	(390)
	(847)	(2,149)	(22,261)	(22,186)	(47,443)	(39,141)
Total	(17,154)	(2,149)	(22,261)	(22,186)	(63,750)	(55,441)

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

b. Liquidity risk (continued)

In HK\$ million	2017					Carrying Amount
	Within 1 year or on demand	More than 1 year but within 2 years	More than 2 years but within 5 years	More than 5 years	Total contractual undiscounted cash outflow	
Current liabilities						
Trade payables	(955)	-	-	-	(955)	(955)
Accruals and other payables	(3,218)	-	-	-	(3,218)	(3,218)
Carrier licence fee liabilities	(180)	-	-	-	(180)	(173)
Amounts due to fellow subsidiaries and intermediate holding companies	(12,974)	-	-	-	(12,974)	(12,974)
	(17,327)	-	-	-	(17,327)	(17,320)
Non-current liabilities						
Long-term borrowings (note (i))	(937)	(10,198)	(14,064)	(21,134)	(46,333)	(39,146)
Derivative financial instruments	1	(1)	(5)	(172)	(177)	(150)
Carrier licence fee liabilities	-	(142)	(332)	(100)	(574)	(455)
Other long-term liabilities (note (ii))	(6)	(1)	(21)	(1,010)	(1,038)	(566)
	(942)	(10,342)	(14,422)	(22,416)	(48,122)	(40,317)
Total	(18,269)	(10,342)	(14,422)	(22,416)	(65,449)	(57,637)

- (i) As at December 31, 2017, bank borrowings of HK\$1,820 million (2016: HK\$1,950 million) included in long-term borrowings were drawn for financing a 15-year 3G spectrum utilization fee paid upfront by the Group.
- (ii) As at December 31, 2017, other long-term liabilities included HK\$164 million (2016: HK\$102 million) of long term interest payable, which related to interest drawn under an arrangement with a bank to receive agreed amounts by installments to settle interest payments of a fixed-to-fixed cross currency swap contract with notional contract amounts of EUR200 million (approximately HK\$1,665 million) (2016: EUR200 million (approximately HK\$1,665 million)). Please refer to note 20(d) and note 21(a) for details of the guaranteed notes and the fixed-to-fixed cross currency swap contract respectively.

c. Market risk

Market risk comprises foreign currency, interest rate and equity price exposures deriving from the Group's operation, investment and funding activities. As a matter of policy, the Group enters into cross currency swap contracts, interest rate swap contracts, foreign exchange forward contracts and other financial instruments to manage its exposure to market risk directly related to its operations and financing. The Group does not undertake any speculative trading activities in connection with these financial instruments or enter into or acquire high market risk instruments for trading purposes.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

c. Market risk (continued)

The Finance and Management Committee, a sub-committee of the Executive Committee of the HKT Board, determines the appropriate risk management activities with the aim of prudently managing the market risk associated with transactions entered into in the normal course of business.

All treasury risk management activities are carried out in accordance with policies and guidelines approved by the Finance and Management Committee and the Executive Committee, which are reviewed on a regular basis. Early termination and amendments to the terms of the transaction would typically occur when there are changes in the underlying assets or liabilities or in the risk management strategy of the Group.

In the normal course of business, the Group uses the above-mentioned financial instruments to limit the exposure to adverse fluctuations in foreign currency exchange rates and interest rates. These instruments are executed with creditworthy financial institutions and all contracts are denominated in major currencies.

i. Foreign currency risk

Foreign exchange risk arises when the Group's recognized assets and liabilities are denominated in a currency that is not the functional currency of the relevant group entity.

The Group's borrowings are denominated in either Hong Kong dollars, United States dollars or Euro. As at December 31, 2017, all of the Group's borrowings denominated in United States dollars/Euro were swapped into Hong Kong dollars by cross currency swap and foreign exchange forward contracts. Given this, management does not expect that there will be any significant foreign currency risk associated with the Group's borrowings. The cross currency swap and foreign exchange forward contracts outstanding as at December 31, 2017 with an aggregate notional contract amount of US\$2,126 million (approximately HK\$16,478 million) (2016: US\$2,126 million (approximately HK\$16,478 million)) and EUR200 million (approximately HK\$1,665 million) (2016: EUR200 million (approximately HK\$1,665 million)) were designated or re-designated as cash flow hedges against foreign currency risk.

In respect of trade receivables and payables held in currencies other than the functional currency of the operations to which they relate, the Group ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot or forward rates where necessary to address short-term imbalances.

The following table details the Group's exposure at the end of the reporting period to currency risk arising from significant monetary assets or liabilities denominated in foreign currencies.

In HK\$ million	2016		2017	
	United States Dollars	Euro	United States Dollars	Euro
Trade receivables	311	-	268	142
Cash and cash equivalents	166	5	288	12
Trade payables	(581)	-	(721)	(33)
Long-term borrowings	(15,651)	(1,613)	(15,802)	(1,830)
Gross exposure arising from monetary liabilities	(15,755)	(1,608)	(15,967)	(1,709)
Borrowings with hedging instruments	15,651	1,613	15,802	1,830
Overall net exposure	(104)	5	(165)	121

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

c. Market risk (continued)

i. Foreign currency risk (continued)

As at December 31, 2017, if the Hong Kong dollar had weakened/strengthened by 1% against the United States dollar, with all other variables held constant, the profit after tax of the Group would have decreased/increased by approximately HK\$1 million (2016: HK\$1 million), mainly as a result of foreign exchange losses/gains (2016: same) on translation of United States dollar denominated monetary assets and liabilities which are not hedged by hedging instruments. Meanwhile, the hedging reserve as at December 31, 2017 would have decreased/increased by approximately HK\$158 million (2016: HK\$157 million) mainly as a result of foreign exchange losses/gains on the long-term borrowings being hedged by cross currency swap contracts and foreign exchange forward contracts.

As at December 31, 2017, if the Hong Kong dollar had weakened/strengthened by 5% against the Euro, with all other variables held constant, the profit after tax of the Group would have increased/decreased by approximately HK\$5 million (2016: HK\$1 million), mainly as a result of foreign exchange gains/losses (2016: same) on translation of Euro denominated monetary assets and liabilities which are not hedged by hedging instruments. Meanwhile, the hedging reserve as at December 31, 2017 would have decreased/increased by approximately HK\$92 million (2016: HK\$81 million) mainly as a result of foreign exchange losses/gains on the long-term borrowings being hedged by cross currency swap contract.

The sensitivity analysis has been determined assuming that the change in foreign exchange rates had occurred as at the end of the reporting periods and had been applied to the Group's exposure to currency risk for monetary assets and liabilities in existence at those dates, and that all other variables, in particular interest rates, remain constant.

The stated changes represent management's assessment of reasonably possible changes in foreign exchange rates over the periods until the end of the next annual reporting period. In this respect, it is assumed that the pegged rate between the Hong Kong dollar and the United States dollar would be materially unaffected by any change in the movement in value of the United States dollar against other currencies. The analysis is performed on the same basis for the years ended December 31, 2016 and 2017.

ii. Interest rate risk

As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

The Group's interest rate risk arises primarily from long-term borrowings and amount due to an intermediate holding company. Borrowings at variable rates and fixed rates expose the Group to cash flow interest rate risk and fair value interest rate risk respectively. In addition, from time to time, the Group draws under long-term revolving credit and term facilities which are denominated in Hong Kong dollars and pays interest at floating rate.

The Group had fixed-to-floating cross currency swap contracts to manage the fair value interest rate risk arising from certain fixed rate long-term borrowings. The Group further entered into floating-to-fixed swap contracts, therefore the Group had a synthetic fixed-to-fixed cross currency swap position and re-designated it as cash flow hedging instrument accordingly.

The Group also had entered into a floating-to-fixed interest rate swap contract which was designated as cash flow hedge, to hedge the interest rate risk arising from the Group's certain floating rate borrowings.

The following table details the interest rate profile of the Group's borrowings as at the end of the reporting periods, after taking into account the effect of cross currency swap contracts and interest rate swap contracts designated as cash flow hedging instruments.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

c. Market risk (continued)

ii. Interest rate risk (continued)

	2016		2017	
	Effective interest rate %	HK\$ million	Effective interest rate %	HK\$ million
Net fixed rate borrowings:				
Long-term bank borrowings with hedging instruments	1.84	1,484	1.84	1,488
Long-term borrowings with hedging instruments	3.51	17,264	3.72	17,632
Balances due to fellow subsidiaries	N/A	-	2.93	41
Variable rate borrowings:				
Long-term borrowings	1.46	19,445	1.63	20,026
Balances due to an intermediate holding company and fellow subsidiaries	0.60	7,383	0.88	7,378
Total borrowings		45,576		46,565

As at December 31, 2017, if interest rates on variable rate borrowings had increased/decreased by 50 basis points (2016: 50 basis points) with all other variables held constant, the Group's profit after tax would have decreased/increased by approximately HK\$97 million (2016: HK\$91 million) mainly as a result of higher/lower interest expense on floating rate borrowings.

The sensitivity analysis above has been determined assuming that the change in interest rate had occurred as at the end of the reporting periods and had been applied to the exposure to interest rate risk for the Group's floating rate borrowings in existence at those dates. The 50 basis points (2016: 50 basis points) increase or decrease represents management's assessment of a reasonably possible change in interest rates over the periods until the end of the next annual reporting period. The analysis was performed on the same methodology for 2016 and 2017.

iii. Equity price risk

The Group is exposed to equity price changes arising from equity investment classified as financial assets at fair value through profit or loss (note 17). The investments are listed on a recognized stock exchange market.

Given the insignificant portfolio of listed equity securities held by the Group, management believes that the Group's equity price risk is minimal.

d. Fair values of financial liabilities measured at amortized cost

All financial instruments are carried at amounts not materially different from their fair values as at December 31, 2016 and 2017 except as follows:

	2016		2017	
In HK\$ million	Carrying amount	Fair value	Carrying amount	Fair value
Long-term borrowings	38,193	37,876	39,146	39,271

The fair values of long-term borrowings are the net present value of the estimated future cash flows discounted at the prevailing market rates. The fair values are within level 2 of the fair value hierarchy (see note 28(e)).

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28 FINANCIAL INSTRUMENTS (CONTINUED)

e. Estimation of fair values

The table below analyzes financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for asset or liability that are not based on observable market data (level 3).

The following table presents the Group's financial assets and liabilities that are measured at fair value:

In HK\$ million	2016			Total
	Level 1	Level 2	Level 3	
Assets				
Derivative financial instruments	-	277	-	277
Financial assets at fair value through profit or loss	29	-	-	29
Liabilities				
Derivative financial instruments	-	(14)	-	(14)

In HK\$ million	2017			Total
	Level 1	Level 2	Level 3	
Assets				
Derivative financial instruments	-	223	-	223
Financial assets at fair value through profit or loss	19	-	-	19
Liabilities				
Derivative financial instruments	-	(150)	-	(150)

The fair value of financial instruments traded in active markets is based on quoted market prices as at the end of the reporting periods. The quoted market price used for financial assets held by the Group included in level 1 is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques and making assumptions that are based on market conditions existing at the end of each reporting period. Instruments included in level 2 comprise cross currency swap contracts, interest rate swap contracts and foreign exchange forward contracts. In measuring the swap transactions, the fair value is the net present value of the estimated future cash flow discounted at the market quoted swap rates. The fair value of the foreign exchange forward contracts is calculated based on the prevailing market foreign currency exchange rates quoted for contracts with same notional amounts adjusted for maturity differences.

There were no transfers of financial assets and liabilities between fair value hierarchy classifications during the years ended December 31, 2016 and 2017.

f. Group's valuation process

The Group performs and monitors valuations of financial assets required for financial reporting purposes. Material movements in valuations are reported to senior management immediately. Valuation results are reviewed by senior management at least on a semi-annual basis.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

29 COMMITMENTS

a. Capital

In HK\$ million	2016	2017
Authorized and contracted for acquisition of property, plant and equipment	349	335

b. Operating leases

As at December 31, 2017, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

Land and buildings

In HK\$ million	2016	2017
Within 1 year	615	526
After 1 year but within 5 years	314	250
After 5 years	1	1
	930	777

Majority of the leases typically run for a period of 1 to 9 years as at December 31, 2017 (2016: 1 to 9 years). None of the leases include material contingent rentals.

Network capacity and equipment

In HK\$ million	2016	2017
Within 1 year	65	78
After 1 year but within 5 years	118	55
	183	133

Majority of the leases typically run for a period of 1 to 15 years as at December 31, 2017 (2016: 1 to 15 years). None of the leases include contingent rentals.

30 CONTINGENT LIABILITIES

In HK\$ million	2016	2017
Performance guarantees	45	39

The Group is subject to certain corporate guarantee obligations to guarantee performance of the fellow subsidiaries in the normal course of their businesses. The amount of liabilities arising from such obligations, if any, cannot be ascertained but the directors are of the opinion that any resulting liability would not materially affect the financial position of the Group.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 BANK LOAN FACILITIES

Aggregate bank loan facilities as at December 31, 2017 were HK\$27,381 million (2016: HK\$27,181 million) of which the unused facilities amounted to HK\$5,698 million (2016: HK\$6,038 million).

All of the Group's banking facilities are subject to the fulfillment of covenants relating to certain of HKTGH's consolidated statement of financial position ratios, as are commonly found in lending arrangement with financial institutions. If the covenants were breached, the drawn down facilities would become payable on demand. The Group regularly monitors the compliance with these covenants. As at December 31, 2017, none of the covenants relating to drawn down facilities was breached. Further details of the Group's management of liquidity risk are set out in note 28(b).

Summaries of long-term borrowings are set out in note 20.

32 BUSINESS COMBINATION

a. Business combination during the year ended December 31, 2017

There was no business combination transaction occurred for the year ended December 31, 2017.

b. Business combination during the year ended December 31, 2016

Acquisition of PCCW Technology (Beijing) Limited

On July 15, 2016, the Company completed the acquisition of the entire issued share capital of PCCW Technology (Beijing) Limited from its fellow subsidiary at a consideration of approximately RMB5 million (approximately HK\$6 million). PCCW Technology (Beijing) Limited is a company engaged in computer system integration and technical services in the PRC. The purpose of the acquisition is to expand the Group's telecommunication business in the PRC.

- (i) Details of net liabilities acquired and goodwill in respect of the acquisition of PCCW Technology (Beijing) Limited at the acquisition date were as follows:

In HK\$ million	Net liabilities acquired and goodwill
Purchase consideration	6
Add: Fair value of net liabilities acquired	27
Goodwill on acquisition	33

The goodwill is attributable to expected future profits generated from the expansion of its telecommunication business in the PRC.

None of the goodwill is expected to be deducted for tax purposes.

The assets and liabilities of PCCW Technology (Beijing) Limited at the acquisition date were as follows:

In HK\$ million	Fair value
Property, plant and equipment	3
Inventories, trade receivables, prepayments and deposits	58
Cash and cash equivalents	24
Trade payables, accruals, other payables and advances from customers	(112)
Net liabilities acquired	(27)

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

32 BUSINESS COMBINATION (CONTINUED)

b. Business combination during the year ended December 31, 2016 (continued) Acquisition of PCCW Technology (Beijing) Limited (continued)

In HK\$ million	Net cash inflow
Purchase consideration settled through balances with a fellow subsidiary	-
Cash and cash equivalents acquired	24
Total net cash inflow for the year ended December 31, 2017	24

(ii) Revenue and profit contribution

The revenue and profit attributable to the Group included in the consolidated income statement since acquisition contributed by PCCW Technology (Beijing) Limited were HK\$55 million and HK\$5 million respectively.

Had PCCW Technology (Beijing) Limited been consolidated from January 1, 2016, the consolidated income statement would show pro-forma revenue and profit for the year of HK\$15,597 million and HK\$3,063 million respectively.

33 POSSIBLE IMPACT OF NEW AND AMENDED STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED DECEMBER 31, 2017

Up to the date of approval of these financial statements, the HKICPA has issued the following new and amended standards and interpretations which are not yet effective for the accounting period ended December 31, 2017 and which have not been early adopted in these financial statements:

		Effective for accounting periods beginning on or after
HKAS 40 (Amendment)	Investment Property	January 1, 2018
HKFRS 2 (Amendment)	Share-based Payment	January 1, 2018
HKFRS 4 (Amendment)	Insurance Contracts	January 1, 2018
HKFRS 9 (2014)	Financial Instruments	January 1, 2018
HKFRS 15	Revenue from Contracts with Customers	January 1, 2018
HKFRS 16	Leases	January 1, 2019
HKFRS 17	Insurance Contracts	January 1, 2021
HK(IFRIC)-Int 22	Foreign Currency Transactions and Advance Consideration	January 1, 2018
HK(IFRIC)-Int 23	Uncertainty over Income Tax Treatments	January 1, 2019
Annual Improvements to HKFRSs 2014-2016 Cycle		January 1, 2018
Annual Improvements to HKFRSs 2015-2017 Cycle		January 1, 2019

Apart from the above, a number of improvements and minor amendments to Hong Kong Financial Reporting Standards have also been issued by the HKICPA but they are not yet effective for the accounting period ended December 31, 2017 and have not been early adopted in these financial statements.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

33 POSSIBLE IMPACT OF NEW AND AMENDED STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED DECEMBER 31, 2017 (CONTINUED)

None of the above is expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below:

HKFRS 15, “Revenue from Contracts with Customers”

HKFRS 15 will replace HKAS 18 which deals with contracts for goods and services, HKAS 11 which deals with construction contracts and related literature. HKFRS 15 is based on the principle that revenue is recognized when control of a good or service transfers to a customer. HKFRS 15 permits adoption using either the full retrospective approach or a modified retrospective approach. The Group intends to use the full retrospective approach when it adopts HKFRS 15 effective January 1, 2018.

While the Group is continuing to assess the effect of applying HKFRS 15 on the Group’s consolidated financial statements, the Group has identified a number of current revenue recognition policies and disclosures that will be impacted by HKFRS 15. The most significant areas are discussed below. The Group has not yet completed the quantitative assessment of the impact of HKFRS 15.

HKFRS 15 will require the identification of deliverables in contracts with customers that qualify as separate “performance obligations”. The performance obligations identified will depend on the nature of individual customer contracts. These are expected to include mobile handsets, telecommunications and other equipment, gifts provided free of charge and telecommunications services provided to customers.

Where customer contracts contain more than one performance obligation, the transaction price receivable from customers must be allocated between the Group’s performance obligations on a relative standalone selling price basis. The primary impact on revenue reporting will be that when the Group sells telecommunications or other equipment or subsidized mobile handsets together with gifts and telecommunications service agreements to customers, revenue allocated to the equipment, handsets and gifts, which are recognized at contract inception when control typically passes to the customer, will be recorded at their relative standalone fair value and not using the current residual value method as set out in Note 2(t)(i). Nevertheless, it is expected that there will be no material impact on the total revenue to be recognized by the Group in the consolidated income statement over the respective contract periods.

Currently, the Group capitalizes subsidized handsets and gifts as customer acquisition costs and amortize these amounts on a straight-line basis over the minimum enforceable contractual periods. Under HKFRS 15, the costs of subsidized handsets and gifts are required to be recognized as costs of goods sold immediately when the corresponding revenue is recognized, rather than the existing treatment of being charged to the consolidated income statement through amortization of customer acquisition costs. The total net profit recognized by the Group over the full contract period is not expected to be materially affected.

The adoption of HKFRS 15 will not have any material impact on the Group’s consolidated statement of cash flows.

HONG KONG TELECOMMUNICATIONS (HKT) LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

33 POSSIBLE IMPACT OF NEW AND AMENDED STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED DECEMBER 31, 2017 (CONTINUED)

HKFRS 9, “Financial instruments”

HKFRS 9, “Financial instruments”, addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the guidance in HKAS 39 that relates to the classification and measurement of financial instruments. HKFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through other comprehensive income and fair value through profit or loss. The basis of classification depends on the entity’s business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in other comprehensive income not recycling. Furthermore, under the new HKFRS 9, there is now a new expected credit losses model that replaces the incurred loss impairment model used in HKAS 39. Measurement of impairment loss on trade receivable based on an expected credit losses model requires the use of historical data as well as forward looking information. HKFRS 9 also relaxes the requirements for hedge effectiveness but contemporaneous documentation is still required. Management is in the process of assessing the impact of HKFRS 9. It is not practicable to provide a reasonable estimate of the effect until the Group completes this detailed review. The adoption of HKFRS 9 is also expected to require more disclosures on the Group’s consolidated financial statements.

HKFRS 16, “Leases”

HKFRS 16 will affect primarily the accounting for the Group’s operating leases. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognized in the consolidated statement of financial position. The Group is in the process of assessing to what extent the operating lease commitments as disclosed in note 29(b) will result in the recognition of an asset and a liability for future payments and how this will affect the Group’s profit and classification of cash flows.

There are no other new and amended standards and interpretations that are not yet effective which would be expected to have a significant impact on the Group’s results of operations and financial position.