1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year. The results of subsidiaries established, acquired or disposed of during the year are consolidated from or to their effective dates of establishment, acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors.

Interests in subsidiaries are stated at cost unless, in the opinion of the directors, there have been permanent diminutions in value, when they are written down to values determined by the directors.

Jointly controlled entities

A jointly controlled entity is an entity formed by the Group and other parties under a contractual arrangement to undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity.

The Group's interests in jointly controlled entities are initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the net assets of the jointly controlled entities. The Group's share of post-acquisition results and reserves of jointly controlled entities are included in the consolidated profit and loss account and consolidated reserves respectively.

Fixed assets and depreciation

Fixed assets, other than investment properties, are stated at cost or valuation less accumulated depreciation.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fixed assets and depreciation (Continued)

The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of the fixed asset. The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the sales proceeds and the carrying amount of the relevant asset.

Changes in the values of fixed assets are dealt with as movements in the fixed asset revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the profit and loss account. A subsequent revaluation increase is recognised as income to the extent that it reverses a revaluation deficit of the same asset previously charged to the profit and loss account.

Upon the disposal of revalued fixed assets, the relevant portion of the fixed asset revaluation reserve realised in respect of previous valuations is credited directly from the fixed asset revaluation reserve to retained profits.

Depreciation is calculated on the straight-line basis to write off the cost or valuation of each asset over its estimated useful life, after taking into account its estimated residual value. The principal annual rates used for this purpose are as follows:

Land and buildings	Over the terms of the leases
Leasehold improvements	20% or over the terms of the leases, if shorter
Furniture, fixtures and equipment	10% – 33⅓%
Motor vehicles	20% – 30%

Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are intended to be held on a long term basis for their investment potential. Such properties are not depreciated and are stated at their open market values on the basis of annual professional valuations. Changes in the values of investment properties are dealt with as movements in the investment property revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on a portfolio basis, the excess of the deficit is charged to the profit and loss account.

Upon the disposal of an investment property, the relevant portion of the investment property revaluation reserve realised in respect of previous valuations is released to the profit and loss account.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Leased assets

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

Deferred development costs

Research and development costs are charged to the profit and loss account as incurred, except for product development costs which relate to a clearly defined project, the future economic benefits of which are reasonably assured. Such development costs are deferred and amortised on a straight-line basis over three years commencing from the start of sales of the new products.

The unamortised balance of deferred development costs is reviewed at the end of each period and is written off to the extent that the unamortised balance, taken together with further development and directly related costs, is no longer likely to be recovered.

Cash equivalents

Cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the date of the advance.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the first-in, first-out basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less any further costs expected to be incurred to completion and disposal.

Deferred taxation

Deferred taxation is provided, using the liability method, on all significant timing differences to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised until its realisation is assured beyond reasonable doubt.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign currencies

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of overseas subsidiaries and jointly controlled entities, are translated to Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

Pension costs

The Group operates defined contribution pension schemes for certain of its qualified employees, the assets of which are held separately from those of the Group. Contributions made are based on a percentage of the eligible employees' salaries, which are charged to the profit and loss account as they become payable, in accordance with the rules of the scheme. Forfeited contributions in respect of unvested benefits of those employees who leave the scheme are used to reduce the Group's ongoing contributions.

For those employees that have not joined the pension schemes, the Group has accrued for pension costs for them based on a percentage of their salaries. However, the related assets have not been separated from those of the Group.

Related company

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party, or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

Revenue

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(a) on the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue (Continued)

(b) on the rendering of services, when the transactions have been completed in accordance with the terms of contracts or based on the stage of completion of transactions. The stage of completion of a transaction associated with the rendering of services is established by reference to contract terms;

(c) on disposal of fixed assets, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group has no further substantial acts and/or continuing involvement to complete under the contracts;

(d) interest, on a time proportion basis, taking into account the principal outstanding and the effective interest rate applicable;

(e) rental, on an accruals basis; and

(f) dividends, when the rights to receive the payment are established.

2. TURNOVER AND REVENUE

Turnover represents the invoiced value of goods sold and services rendered, net of business tax, discounts and returns.

The Group's revenue as included in turnover for the year arose from the following activities:

	1998 HK$'000	1997 HK$'000
Software development and systems integration	1,096,929	1,083,819
Sales of computers and related products	1,062,745	889,590
	2,159,674	1,973,409

Revenue arising from rental income and interest income are disclosed in note 3 to the financial statements. Proceeds from the disposal of fixed assets are disclosed on the face of the cash flow statement.

3. OPERATING PROFIT/(LOSS)

The Group's operating profit/(loss) is arrived at after charging/(crediting) the following:

	1998 HK$'000	1997 HK$'000
Depreciation:		
Owned fixed assets	27,413	23,902
Leased fixed assets	—	84
Less: amount capitalised as deferred development costs	—	(1,035)
	27,413	22,951
Operating lease rentals on land and buildings	34,089	24,167
Less: amount capitalised as deferred development costs	—	(3,074)
	34,089	21,093
Cost of inventories sold	1,896,211	1,599,979
Research and development expenses	22,391	15,197
Amortisation and write off of deferred development costs	10,689	2,950
Interest on:		
Bank loans and overdrafts	12,893	7,946
Obligations under finance leases	—	75
Auditors' remuneration	2,000	2,080
Pension contributions (note)	387	587
Revaluation deficit — land and buildings	2,916	1,031
Revaluation deficit — investment properties	4,210	—
Loss on disposal of fixed assets	2,858	1,363
Provision for doubtful debts	33,071	4,860
Exchange loss/(gains) — net	1,550	(206)
Interest income	(3,611)	(4,209)
Rental income — gross and net	(1,781)	(1,516)
Gain on disposal of branch operations	(1,501)	—

Note: The Group's total contribution to the Hong Kong pension scheme charged to the profit and loss account during the year ended 31 December 1998 has been reduced by forfeited contributions of HK$126,000 (1997: HK$33,000). The amount of unutilised forfeited contributions at the balance sheet date was not material.

4. DIRECTORS' REMUNERATION

Directors' remuneration disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance is as follows:

	1998 HK$'000	1997 HK$'000
Fees:		
Executive directors	790	720
Non-executive directors	253	240
Independent non-executive directors	254	240
	1,297	1,200
Other executive directors' emoluments:		
Salaries	1,977	2,212
Discretionary bonus	—	7,000
Pension contributions	40	38
	3,314	10,450

The remuneration of the above directors for the year fell within the following bands:

	1998 Number of directors	1997 Number of directors
HK$Nil – HK$1,000,000	11	4
HK$1,500,001 – HK$2,000,000	—	5
HK$2,000,001 – HK$2,500,000	—	1

There were no arrangements under which a director waived or agreed to waive any remuneration during the year.

5. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included 1 director (1997: all), details of whose remuneration are set out in note 4 above.

The details of the remuneration of the remaining 4 (1997: Nil) non-directors, highest paid employees are set out below:

	1998 HK$'000	1997 HK$'000
Salaries and other emoluments	2,984	—
Pension scheme contributions	50	—
	3,034	—

The remuneration of the above non-director, highest paid employees for the year fell within the following bands:

	1998 Number of employees	1997 Number of employees
HK$Nil – HK$1,000,000	3	—
HK$1,000,001 – HK$1,500,000	1	—

6. TAXATION

	1998 HK$'000	1997 HK$'000
Hong Kong:		
Overprovision in prior year	—	768
Elsewhere:		
Provision for the year	(46)	(11)
Taxation credit/(charge) for the year	(46)	757

6. TAXATION (Continued)

No provision for Hong Kong profits tax has been made as there were no assessable profits for the year.

The Company's subsidiary in the PRC, other than those in Hong Kong, has been subject to PRC profits tax at 50% of its standard tax rate for the three fiscal years which commenced in 1998 and ending on 31 December 2000. At present, the standard tax rate applicable to the PRC subsidiary is 15%. No provision for PRC profits tax has been made as there were no assessable profits for the year.

Taxes on profits assessable elsewhere have been calculated at the applicable rates of taxation on the estimated assessable profits for the year based on existing taxation legislation, interpretations and practices in respect thereof.

The revaluation of the Company's and the Group's fixed assets and investment properties does not constitute a timing difference and, consequently, the amount of potential deferred tax thereon has not been quantified.

The Group did not have any significant unprovided deferred taxation during the year or at the balance sheet date.

7. NET PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The net profit attributable to shareholders dealt with in the financial statements of the Company is HK$5,374,000 (1997: HK$55,237,000).

8. DIVIDENDS

	1998 **HK$'000**	1997 HK$'000
Proposed final — Nil (1997: 8 cents per ordinary share)	—	52,911

9. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the net loss attributable to shareholders for the year of HK$165,696,000 (1997: profit of HK$143,291,000) and the weighted average number of 797,152,000 (1997: 792,857,000) ordinary shares in issue, adjusted to reflect the bonus issues during the year. The basic earnings per share for 1997 have been adjusted accordingly.

9. EARNINGS/(LOSS) PER SHARE (Continued)

The diluted loss per share for the year is not shown as the impact of the outstanding share options was anti-dilutive during the year.

The calculation of diluted earnings per share for 1997 is based on the net profit attributable to shareholders for the year of HK$143,291,000 and the weighted average number of 792,857,000 ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average of 38,944,000 ordinary shares assumed to have been issued at no consideration on the deemed exercise of all options outstanding during the year.

The adoption of the revised Statement of Standard Accounting Practice No. 5 "Earnings per share" issued by the Hong Kong Society of Accountants ("SSAP 5") has resulted in some modification to the basis of calculation of earnings per share amounts and the disclosures presented for earnings per share. Amounts presented for the prior year have been restated to reflect the requirements of the revised SSAP 5.

10. RELATED PARTY TRANSACTIONS

During the year, the Group carried out the following material transactions with related parties:

(i) Pursuant to a rental agreement dated 7 December 1995, the Group paid rental expenses of RMB15 million (HK$14 million) (1997: RMB13 million (HK$12 million)) to Peking University Founder Group Corporation ("Peking Founder") for the year ended 31 December 1998.

(ii) Pursuant to a technology co-operation agreement dated 7 December 1995, the Group paid a research and development fee of RMB4,300,000 (HK$4,026,000) (1997: RMB4,300,000 (HK$4,019,000) to Peking University Research Institute of Computer Science and Technology for the year ended 31 December 1998.

(iii) Trading stocks at cost of HK$10,637,000 (1997: Nil) were sold to a jointly controlled entity.