

INDEPENDENT AUDITOR'S REPORT

The Hong Kong and China Gas Company Limited
Annual Report 2020



羅兵咸永道

TO THE MEMBERS OF THE HONG KONG AND CHINA GAS COMPANY LIMITED
(incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The consolidated financial statements of The Hong Kong and China Gas Company Limited (the “Company”) and its subsidiaries (the “Group”) set out on pages 92 to 187 which comprise:

- the consolidated income statement for the year ended 31st December 2020;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of financial position as at 31st December 2020;
- the consolidated cash flow statement for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant 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 31st December 2020, 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”) and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing (“HKSA”) 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.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters (Continued)

Key audit matters identified in our audit are summarised as follows:

- Valuation of investment in certain equity interest of an unlisted company
- Impairment assessment of (i) coal mine and oil properties and (ii) property, plant and equipment and goodwill of individual city-gas projects
- Recognition of gas connection income

Key audit matter	How our audit addressed the key audit matter
<p>Valuation of investment in certain equity interest of an unlisted company</p> <p>Refer to notes 3, 4(g) and 24 to the consolidated financial statements</p> <p>The investment in certain equity interest of an unlisted company (the “Investment”) which owned a coking coal mine and related coke production and coke-gas conversion facility in Inner-Mongolia, was accounted for as a financial asset at fair value through profit or loss and it was subject to fair value revaluation at each reporting date. The Investment at 31st December 2020 was valued by an independent professional valuer. With reference to the valuation, management had estimated the fair value of the Investment at HK\$3.1 billion at year end.</p> <p>In consideration of the Investment is operating in an emerging industry and its fair value is highly dependent on its expansion plan, the valuation involved significant management judgements. Accordingly, the valuation of the Investment was considered as one of the key audit matters.</p> <p>The fair value was determined based on the discounted cash flow model. The valuation involved significant judgements and estimates from management, including coking coal reserves, future business growth driven by future expansion plan, future products selling prices and production costs of the investee, discount rate, marketability discount and minority discount etc.</p>	<p>Our procedures in relation to management’s valuation of the Investment include:</p> <ul style="list-style-type: none"> • Obtaining an understanding of the management’s control procedures of valuation of the Investment and assessing the inherent risk of material misstatement by considering the degree of estimation uncertainty and level of other inherent risk factors; • Evaluating the independent professional valuer’s competence, capabilities and objectivity; • Assessing the valuation methodology used by the independent professional valuer to estimate the fair value of the Investment; • Checking, on a sample basis, the accuracy and reasonableness of the input data provided by management to the independent professional valuer, to supporting evidence, such as approved budgets and considering the reasonableness of these budgets by comparing the budgets to the historical results and market data; • Assessing the reasonableness of cash flows projection, challenging and performing audit procedures on management’s assumptions such as coking coal reserves, the future business growth driven by future expansion plan, future products selling prices and production costs, discount rate by comparing the assumptions to historical results and published market and industry data and comparing the current year’s results with the prior year forecast and other relevant information. Internal valuation expert had been engaged to assist the review on valuation methodology, discount rate, marketability discount and minority discount. In addition, we had communicated with the management of the Investment to understand the business and assessed if there was any inconsistency in the assumptions used in the cash flows projection; and • Testing the mathematical accuracy of the cash flows projection. <p>Based on the audit procedures performed, we found the assumptions made by management in relation to the valuation were supported by available evidence.</p>

Key audit matters (Continued)

Key audit matter	How our audit addressed the key audit matter
<p>Impairment assessment of (i) coal mine and oil properties and (ii) property, plant and equipment and goodwill of individual city-gas projects</p> <p>Refer to notes 4(a), 7 and 16 to the consolidated financial statements</p> <p>In relation to the New Energy business segment, the Group owned a coal mine in mainland China and oil properties in Thailand which were engaged in the exploration, drilling and sale of crude oil. The carrying values of the coal mine and oil properties are mainly included under “mining and oil properties” of HK\$2.3 billion of property, plant and equipment as at 31st December 2020. In consideration of the prices of the primary outputs of these projects, namely coal and oil were in relatively low level and volatile in recent years, management considered there were impairment indicators and performed impairment assessments on these assets. A provision for impairment of HK\$385.0 million was recognised in the consolidated income statement for the year ended 31st December 2020 for the oil properties in Thailand.</p>	<p>Our procedures in relation to management’s impairment assessment include:</p> <ul style="list-style-type: none"> • Obtaining an understanding of the management’s control procedures of impairment assessment and assessing the inherent risk of material misstatement by considering the degree of estimation uncertainty and level of other inherent risk factors; • Understanding, evaluating and testing management’s control procedures in relation to impairment assessment, where applicable; • Evaluating the independent professional valuer’s and consultant’s competence, capabilities and objectivity, where applicable; • Assessing the methodology used by management to estimate the recoverable amounts; • Checking, on a sample basis, the accuracy and relevance of the input data to supporting evidence, such as approved budgets and considering the reasonableness of these budgets by comparing the budgets to the historical results and the market data;

Key audit matters (Continued)

Key audit matter	How our audit addressed the key audit matter
<p>In relation to city-gas business in mainland China operated by the Group's subsidiaries, the attributable carrying values of property, plant and equipment and goodwill related to these individual city-gas projects as at 31st December 2020 amounting to approximately HK\$34.6 billion. The Group's share of property, plant and equipment, together with goodwill related to individual city-gas projects accounted for associates and joint ventures of the Group as at 31st December 2020 were carried at approximately HK\$12.0 billion and HK\$17.0 billion respectively. In consideration of regulatory development and market-oriented reforms for the natural gas industry in the mainland China, management considered there were uncertainties to future profitability from these projects and performed impairment assessments on these assets. Based on the results of these impairment assessments on these assets. The Group considered the carrying values of property, plant and equipment and goodwill related to these individual city-gas projects as at 31st December 2020 were recoverable.</p> <p>Under the impairment assessments, management calculated the recoverable amounts under value-in-use or fair value less cost of disposal method. As the calculations require the use of significant management judgement and estimates, including the coal and oil reserves, future business growth, future products selling price and production costs, production volume, expected impact of the regulatory changes, discount rate, terminal value etc., we considered it was one of the key audit matters.</p>	<ul style="list-style-type: none"> • Assessing the appropriateness of cash flows projections in calculation of the recoverable amount of the coal mine and oil properties and city-gas business, challenging the reasonableness of management's assumptions such as the coal and oil reserves, future business growth, future products selling prices and production costs, production volume, expected impact of regulatory changes, discount rate, terminal value, etc. based on our knowledge of the business and industry by comparing the assumptions to historical results and published market and industry data and comparing the current year's actual results with the prior year forecast, where applicable. Internal valuation expert had been engaged to assist the review on the methodology of the recoverable amount calculations and discount rates; and • Performing sensitivity analysis in consideration of potential impact of reasonably possible downside changes in the key assumptions. <p>Based on the audit procedures performed, we found that the assumptions made by management were supported by available evidence.</p>

Key audit matters (Continued)

Key audit matter	How our audit addressed the key audit matter
<p>Recognition of gas connection income</p> <p>Refer to notes 4(e) and 5 to the consolidated financial statements</p> <p>Gas connection income is recognised when or as the control of the underlying performance obligations is transferred to the customer.</p> <p>The Group had recognised gas connection income of HK\$3.2 billion for the year ended 31st December 2020.</p> <p>Management identified performance obligations from the contract and determined corresponding transaction price. For performance obligation being satisfied at a point in time, revenue is recognised when the customer obtains control of the service. For performance obligation being satisfied overtime, the progress towards complete satisfaction of the performance obligation is measured using input method. Management are required to exercise significant judgement in their review and revision of the estimates of the total contract costs and actual costs incurred up to the end of the reporting period for each contract as the contract progresses, based on past experience and specific circumstances.</p> <p>The eventual realisation of these estimates are subject to the finalisation of the costs. Any change in the estimate of the total contract costs, which determined the progress towards complete satisfaction of performance obligation, would affect the gas connection income recognition.</p> <p>Due to its quantitative significance to the consolidated income statement and judgements involved in the determination of the progress, we considered recognition of gas connection income as one of the key audit matters.</p>	<p>Our audit procedures in relation to recognition of gas connection income and margins included the following:</p> <ul style="list-style-type: none"> • Obtaining an understanding of the management’s control procedures of recognition of gas connection income and assessing the inherent risk of material misstatement by considering the degree of estimation uncertainty and level of other inherent risk factors; • Understanding, evaluating and testing the key controls surrounding the gas connection income cycle, including the assessment of project status, estimation of the total contract costs and actual costs incurred; • Evaluating the appropriateness of profit margin adopted by management by comparing to profit margin of similar services and external market data, if available; • Checking, on a sample basis, to contracts, invoices, project status reports and other relevant correspondences to evaluate the project status, reasonableness of management’s assessment of budgeted total contract costs and actual costs incurred, and to validate the amounts of income recognised; and • Selecting contracts, on a sample basis, to perform interview with the project managers and assessed whether or not these estimates showed any evidence of management bias. <p>We found the management’s estimations and judgements in the recognition of gas connection income to be reasonable based on the available evidence.</p>

Other information

The directors of the Company are responsible for the other information. The other information comprises all of the information included in the annual report other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of directors and those charged with governance 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 the Hong Kong Companies Ordinance, 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.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

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 Section 405 of the Hong Kong Companies Ordinance 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 HKSAs 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 HKSAs, 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.

Auditor's responsibilities for the audit of the consolidated financial statements (Continued)

- 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 those charged with governance 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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Chu Ho Kwan Raphael.

PricewaterhouseCoopers

Certified Public Accountants
Hong Kong, 19th March 2021

*PricewaterhouseCoopers, 22/F, Prince's Building, Central, Hong Kong
T: +852 2289 8888, F: +852 2810 9888, www.pwchk.com*