

INDEPENDENT AUDITOR'S REPORT



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 91 to 187, which comprise:

- the consolidated income statement for the year ended 31st December 2017;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of financial position as at 31st December 2017;
- 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 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”) 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 (“HSAs”) 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 interests of an unlisted company
- Impairment assessment of coal mine and oil properties
- Recognition of gas connection income

Key audit matter	How our audit addressed the key audit matter
<p>Valuation of investment in certain equity interests of an unlisted company</p> <p>Refer to notes 3, 4 and 23 to the consolidated financial statements</p> <p>The investment in certain equity interests 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 an available-for-sale financial asset and it was subject to fair value revaluation at each reporting date. The Investment at 31st December 2017 was valued by an independent professional valuer. With reference to the valuation, management had estimated the fair value of the Investment at HK\$3.0 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"> • 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 has been engaged to assist the review on valuation methodology, discount rate, marketability discount and minority discount. In addition, we had met 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; • Testing the mathematical accuracy of the cash flows projection; and • Performing sensitivity analysis in consideration of the potential impact of reasonably possible upside or downside changes in the key assumptions. <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 coal mine and oil properties</p> <p>Refer to notes 4 and 16 to the consolidated financial statements</p> <p>In relation to the new energy business segment, the Group owned oil properties in Thailand which engaged in the exploration, drilling and sale of crude oil and a coal mine in mainland China. The carrying values of the coal mine and oil properties are mainly included under “mining and oil properties” of HK\$3.4 billion (after impairment as detailed below) of property, plant and equipment as at 31st December 2017. In the 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 an impairment loss of HK\$313.6 million was recognised in the consolidated income statement for the year ended 31st December 2017.</p> <p>Under the impairment assessments, with the assistance of independent professional valuer and consultant, management calculated the recoverable amounts using the value-in-use method. As the value-in-use calculations required the use of significant management judgements and estimates, including the coal and oil reserves, future production volume, selling prices and production costs, discount rate etc., we considered it as one of the key audit matters.</p>	<p>Our procedures in relation to management’s impairment assessment of coal mine and oil properties include:</p> <ul style="list-style-type: none"> • Evaluating the independent professional valuer’s and consultant’s competence, capabilities and objectivity; • Assessing the methodology used by management to estimate value-in-use; • 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; • Assessing the appropriateness of cash flows projection in calculation of the value-in-use of the coal mine and oil properties, challenging the reasonableness of management assumptions such as the future production volume, selling prices and production costs, discount rate, coal and oil reserves, 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 and other relevant information. Internal valuation expert had been engaged to assist the review on methodology of the value-in-use calculations and discount rate; and • Performing sensitivity analysis in consideration of the 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 and 5 to the consolidated financial statements</p> <p>The Group recognises its gas connection income with reference to the stage of completion of individual contracting work of gas connection facilities. The Group had recognised gas connection income of HK\$2.9 billion for the year ended 31st December 2017.</p> <p>Stage of completion is measured by reference to work performed up to the end of the reporting period. 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 inherently uncertain, subject to the outcome of finalisation with the sub-contractors. Any change in estimate of the total contract costs, which determined the stage of completion, would affect the gas connection income recognition.</p> <p>Due to its quantitative significance to the consolidated income statement and significant judgements involved in the determination of the stage of completion, 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 include:</p> <ul style="list-style-type: none"> • Understanding, evaluating and testing the key controls operated by the Group around the estimation of the total contract costs and actual costs incurred; • Checked, on a sample basis, to contracts, invoices, project status reports and other relevant correspondences to evaluate the reasonableness of management's assessment of budgeted total contract costs and actual costs incurred; 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, related safeguards.

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, 20th March 2018

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