ACCOUNTING MINI-SERIES

Foreign Currency Transaction and Translation

The global currency market was very volatile in 2015. The reporting currencies of our major subsidiaries such as Australian dollar and Indian rupee fell by 10.8% and 4.6% respectively against Hong Kong dollar by the end of the year. Their average rates even fell by 16.9% and 5.1% respectively during the year. The fluctuations in exchange rates have affected CLP's earnings, assets and liabilities which are denominated in these currencies. When you read our financial statements and assess our financial performance and position, you should be cautious about the impact of these foreign currency movements on the financial statements. To help you read our financial statements, this year's accounting mini-series will tell you how foreign exchange fluctuation affects both the balance sheet and income statement, and how foreign exchange risk may be mitigated.

Functional currency and presentation currency

Functional currency

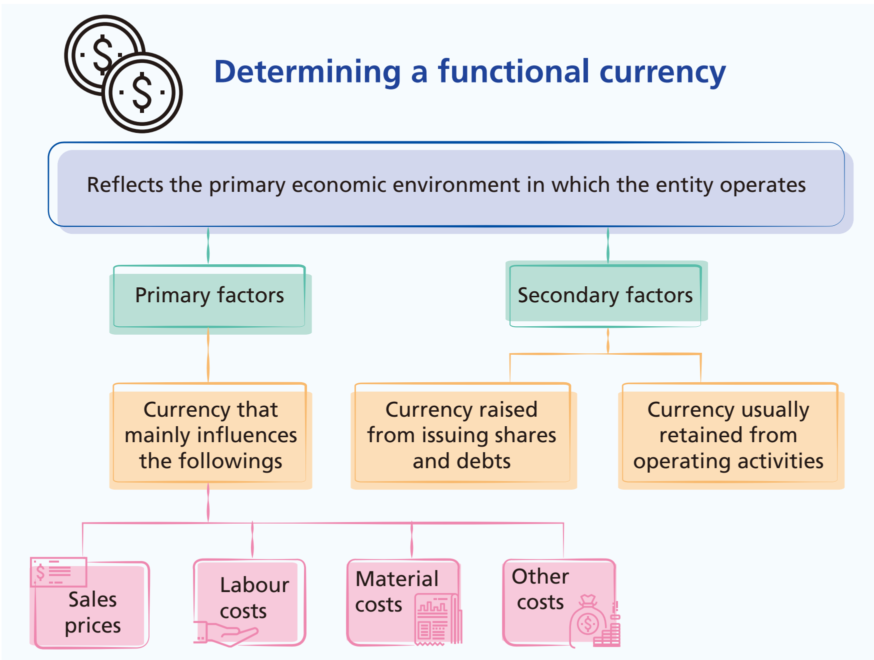
An entity doing business with overseas suppliers or customers, or having foreign operations will have to deal with foreign currency transactions. Foreign currency is defined in the accounting standard as the currency other than the functional currency of that entity.

" The determination of a functional currency is not a free choice to an entity."

This is based on the concept of primary economic environment in which an entity operates. This is governed by the accounting standard, HKAS 21 "The Effects of Changes in Foreign Exchange Rates".

Presentation currency

The presentation currency is the currency in which the financial statements are presented. Unlike functional currency, management is free to choose a presentation currency which may differ from its functional currency. For a group with foreign investments such as subsidiaries, joint ventures and associates, which are reported in different currencies, their financial statements have to be translated in one single currency, i.e. the presentation currency. This is usually the functional currency of the parent company.



Entity level

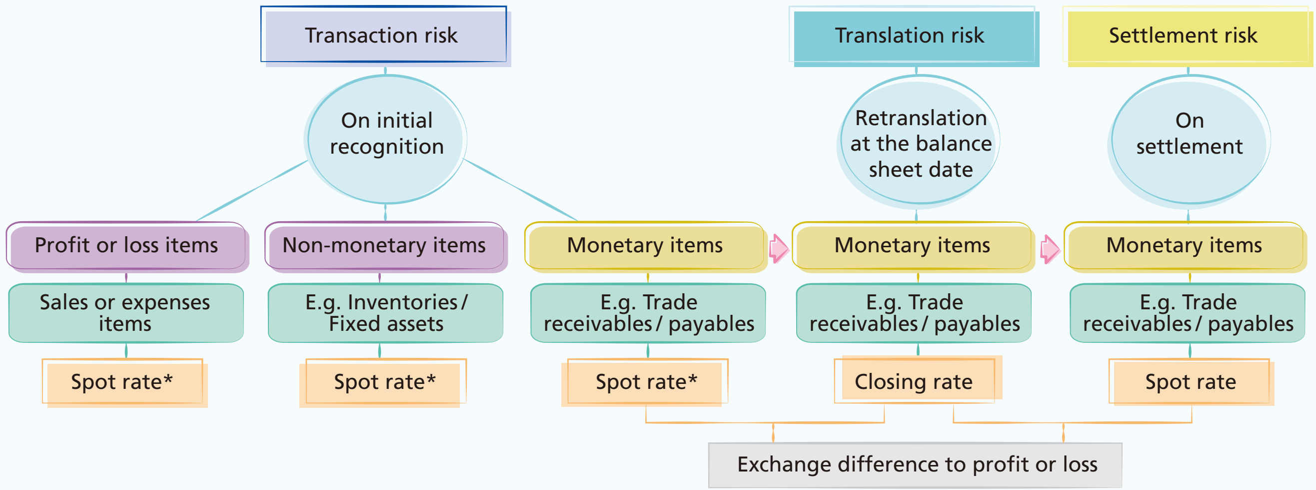
Transactions in foreign currencies are expressed in an entity's functional currency for financial reporting purposes. These transactions expose the entity to the various kinds of foreign exchange risk.

Currency transaction risk

Currency transaction risk occurs when an entity enters into a foreign currency transaction because the value of this transaction may be affected by the unanticipated movement in exchange rate. Foreign currency transaction needs to be converted into a functional currency on initial recognition using the spot rate at the date of the transaction. HKAS 21 permits the use of an average exchange rate if it is a reasonable approximation of the actual rate.

Currency translation and settlement risks

If the day that an entity enters into a transaction differs from the day that it is settled or translated at the reporting date, monetary items like cash, trade receivables, trade payables and loans are converted at the settlement rates or at the closing rates. Gains or losses arising from these foreign currency conversions are recognised in profit or loss.



* HKAS 21 permits the use of an average exchange rate if it is a reasonable approximation of the actual rate.

How to mitigate foreign currency risk?

To mitigate the exposure to variability in cash flows associated with foreign currency transactions, an entity can formulate its hedging strategies such as arranging foreign exchange forward contracts, currency swaps or currency options to hedge the anticipated foreign currency transactions. In the accounting terminology, this is referred to as cash flow hedges. For the financial instrument that is qualified as cash flow hedges, the effective portion of the change in fair value of the financial instrument is recorded in other comprehensive income and accumulated in equity. It is realised to profit or loss when the hedged cash flows / items affect profit or loss to offset the effect; or included in the cost of the non-financial assets when they are initially recognised.

Group level

When preparing consolidated financial statements, results and financial position of foreign operations such as overseas subsidiaries, joint ventures and associates are translated into the presentation currency which the consolidated financial statements are reported.

Currency translation risk

In consolidation, assets and liabilities of foreign operations are translated at the exchange rates at the reporting date. Incomes, expenses and cash flows are translated at the exchange rates at the dates of the relevant transactions, albeit average rates may be used where appropriate. Although this kind of currency translation does not affect the underlying cash flows of foreign operations, exchange differences arose will have two main impacts on the group's financial statements:

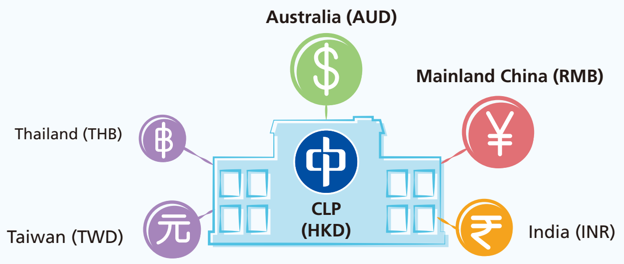
(1) Reported earnings of foreign operations are affected by the translation of their incomes and expenses into the presentation currency of the group.

(2) Exchange differences arising from (a) and (b) below are recognised in the group's translation reserve within equity. There are differences due to (a) incomes and expenses of foreign operations being translated at average rates while the corresponding assets or liabilities generated are translated at closing rates; and (b) change in closing rates of the net assets of foreign operations from its previous closing rates. These exchange differences are reclassified to profit or loss on disposal or partial disposal of foreign operations.

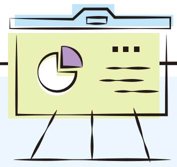
How to mitigate currency translation risk?

Translation of the financial statements of foreign operations into the group's presentation currency is an accounting exercise which does not create an exposure to foreign currency risk. Therefore, hedge accounting is not necessary or permitted. Only when the functional currency of a foreign operation is different from the functional currency of its parent company, a foreign exchange risk is created at the group level. In such situation, a hedge of a net investment in a foreign operation, i.e. a hedge of the parent company's interest in the net assets of that foreign operation, is allowed in the accounting perspective.

Functional currencies of CLP foreign operations



Net investment hedge is performed at the consolidation level. It is in effect the hedge of the foreign currency translation risk of a foreign operation. The hedged item can be the full or partial amount of the net assets of the foreign operation in the consolidated financial statements. The hedging instrument is accounted for in the same way as a cash flow hedge, i.e. translated at the closing rate with the gain or loss on the effective hedge being recognised in equity. This is perfectly matched by the gain or loss on translation of the net investment which is recognised in the translation reserve, resulting in a perfect hedge effect. Gains or losses in the reserves will only be realised when the foreign operation is disposed of.



Unveil the mist of foreign currency translation impact on CLP's 2015 financial statements

CLP has investments in the energy sector of Mainland China, India, Southeast Asia and Taiwan, and Australia. Unavoidably, their 2015 financial performances are blurred by the currency translation as a result of volatile currency movements in 2015. What would our results look like if the impact of currency translation is unveiled? Let us review our Australia and India performances from a different angle.

Segment Information (Australia)	2015		2014		Increase / (Decrease)		Translation impact
	A$M	HK$M	A$M	HK$M	%(A$)	%(HK$)	%(HK$) – %(A$)
Fixed assets	**1,612**	**9,139**	2,201	13,982	(27%)	(35%)	- 8%
Goodwill and other intangible assets	**3,083**	**17,476**	3,161	20,084	(2%)	(13%)	- 11%
Total assets	**6,447**	**36,551**	7,917	50,302	(19%)	(27%)	- 8%
Total liabilities	**1,415**	**8,021**	3,864	24,555	(63%)	(67%)	- 4%
Revenue	**6,165**	**35,707**	7,298	50,895	(16%)	(30%)	- 14%
Operating earnings	**143**	**836**	108	756	32%	11%	- 21%

Segment Information (India)	2015		2014		Increase / (Decrease)		Translation impact
	Rs.M	HK$M	Rs.M	HK$M	%(Rs.)	%(HK$)	%(HK$) – %(Rs.)
Fixed assets	**98,565**	**11,542**	91,760	11,259	7%	3%	- 4%
Bank loans and other borrowings	**75,448**	**8,835**	70,546	8,656	7%	2%	- 5%
Total assets	**143,271**	**16,777**	135,575	16,635	6%	1%	- 5%
Total liabilities	**81,896**	**9,590**	79,731	9,783	3%	(2%)	- 5%
Revenue	**42,311**	**5,104**	37,910	4,821	12%	6%	- 6%
Operating earnings	**5,073**	**612**	2,123	270	139%	127%	- 12%

Decreases in exchange rates of Australian dollar and Indian rupee at year end reduced the assets as well as the liabilities of EnergyAustralia and CLP India in the Group's consolidated financial position. The growths in their operating earnings were also undermined by the decline in the average exchange rates during the year. However, as CLP takes a long-term view on its investments in these regions, short-term fluctuations in exchange rates will not change the Company's development strategy.