

INDEPENDENT AUDITOR'S REPORT



TO THE MEMBERS OF CHINA UNICOM (HONG KONG) LIMITED

(incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated financial statements of China Unicom (Hong Kong) Limited (the "Company") and its subsidiaries ("the Group") set out on pages 86 to 161, which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statement of income, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") and 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 ("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 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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.

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Revenue recognition

Refer to note 6 to the consolidated financial statements on page 121 and the accounting policies on page 106.

The Key Audit Matter

The Group's revenue is primarily generated from the provision of cellular and fixed-line voice and related value-added services, broadband and other Internet-related services, information communications technology services and sales of telecommunication products.

The accuracy of revenue recorded in the consolidated financial statements is an inherent industry risk because the billing systems of telecommunications companies are complex and process large volumes of data with a combination of different products sold during the year, through a number of different systems.

Significant management judgement can be required in determining the appropriate measurement and timing of recognition of different elements of revenue within bundled sales packages, which may include services and telecommunication products such as handsets, and complex settings are required in the Group's information technology ("IT") systems to achieve the appropriate allocation of transaction prices.

We identified revenue recognition as a key audit matter because revenue is one of the key performance indicators of the Group and because it involves complex IT systems and management judgement both of which give rise to an inherent risk that revenue could be recorded in the incorrect period or could be subject to manipulation to meet targets or expectations.

How the matter was addressed in our audit

Our audit procedures to assess the recognition of revenue included the following:

- assessing, with the assistance of our internal IT specialists, the design, implementation and operating effectiveness of management's key internal controls over the general IT environment in which the business systems operate, including access to program controls, program change controls, program development controls and computer operation controls;
- assessing, with the assistance of our internal IT specialists, the design, implementation and operating effectiveness of management's key internal IT controls over the completeness and accuracy of rating and bill generation and the end-to-end reconciliation controls from the rating and billing systems to the accounting system;
- selecting bills issued to customers, on a sample basis, and comparing the details with the corresponding trade receivable details and cash receipts;
- recalculating the balances of trade receivables and advances from customers with the use of electronic audit tools using data extracted from the business support systems and reconciling the results to the Group's financial records;
- assessing, on a sample basis, the standalone selling prices determined by the Group for each distinct service and product offered in bundled sales packages, by comparison with the observable prices of the service or product when the Group sells that service or product separately in similar circumstances and to similar customers;
- assessing, on a sample basis, the settings in the IT system for revenue allocation between the distinct services and products offered in bundled sales packages by comparing the settings with the Group's allocation basis and recalculating and comparing the allocation results with the system generated results;
- evaluating journals entries posted to revenue accounts, on a specific risk-based sample basis, and comparing details of these journals entries with relevant underlying documentation, which included service contracts and progress reports.

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Carrying value of property, plant and equipment ("PP&E")

Refer to note 15 to the consolidated financial statements on page 132 to 133 and the accounting policies on page 99 to 100.

The Key Audit Matter

The Group continues to incur a significant level of capital expenditure in connection with the expansion of its network coverage and improvements to network quality. The carrying value of PP&E as at 31 December 2016 was approximately RMB451,115 million.

There are a number of areas where management judgement impacts the carrying value of PP&E, and the related depreciation profiles. These include:

- determining which costs meet the criteria for capitalisation;
- determining the date on which construction-in-progress is transferred to property, plant and equipment and depreciation commences;
- the estimation of economic useful lives and residual values assigned to property, plant and equipment.

We identified the carrying value of property, plant and equipment as a key audit matter because of the high level of management judgement involved and because of its significance to the consolidated financial statements.

How the matter was addressed in our audit

Our audit procedures to assess the carrying value of PP&E included the following:

- assessing the design, implementation and operating effectiveness of key internal controls over the completeness, existence and accuracy of property, plant and equipment, including the key internal controls over the estimation of useful economic lives and residual values;
- assessing, on a sample basis, costs capitalised during the year by comparing the costs capitalised with the relevant underlying documentation, which included purchase agreements and invoices, and assessing whether the costs capitalised met the relevant criteria for capitalisation; which included comparing interest rates to loan agreements, recalculating the interest capitalisation rate and assessing, on a sample basis, the calculation of interest capitalised in construction-in-progress;
- challenging the date of transferring construction-in-progress to PP&E by examining the inspection reports and/or project progress reports, on a sample basis;
- evaluating management's estimation of useful economic lives and residual values by considering our knowledge of the business and practices adopted in the wider telecommunications industry.

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REPORT**Accounting for the leasing of the Tower Assets**

Refer to note 1, note 7 and note 39.2 to the consolidated financial statements on page 93 to 94, 122 and 157 to 158 and the accounting policies on page 107.

The Key Audit Matter

The Group sold certain of its telecommunications towers and related assets (the "Tower Assets") to China Tower Corporation Limited ("Tower Company") in October 2015 in exchange for shares issued by Tower Company and cash consideration.

The Group signed lease agreements with Tower Company in 2016 to use the telecommunications towers and related assets and recognised operating lease and other service charges for the year ended 31 December 2016 totalling RMB14,887 million.

These arrangements have required significant management judgement in determining whether the arrangements should be classified as operating leases or finance leases in accordance with the requirements of the prevailing accounting standards. The classification of these arrangements has a significant impact on the consolidated financial statements.

There are significant number of leased Tower Assets. Given the volume of the leased assets and the fact that the lease agreements were entered into in the current year there is an increased risk of error in determining the classification of the leases and in reconciling the amount payable to the lessor.

We identified accounting for the leasing of the Tower Assets as a key audit matter because of the significant management judgement required in respect of the classification of the leases and because the massive volume of lease reconciliation work increases the risk of possible error.

How the matter was addressed in our audit

Our audit procedures to assess the accounting for the leasing of the Tower Assets included the following:

- assessing the design, implementation and operating effectiveness of key internal controls over the accounting for the lease transactions, including key internal controls over the management's review on the classification of the lease arrangements, the accruals for lease expenses and reconciliations with Tower Company in respect of rentals payable;
- evaluating management's judgement relating to the classification of the leases by inspecting the lease agreements entered into with Tower Company, to assess whether they met the criteria, as prescribed in the prevailing accounting standards, for classification as operating leases or finance leases;
- obtaining direct confirmation from Tower Company of the annual rentals and payable by the Group under the lease arrangements for the current year and reconciling the details to the Group's accounting records.

Information other than the consolidated financial statements and auditor's report thereon

The directors are responsible for the other information. The other information comprises all 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.

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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 the directors for the consolidated financial statements

The directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs issued by the IASB and 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.

The directors are assisted by the Audit Committee in discharging their responsibilities 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. This report is made 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 HKSAAs 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 HKSAAs, 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.

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- 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 Audit Committee 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 the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and 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 the Audit Committee, 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 Chan Kim Tak.

KPMG

Certified Public Accountants

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15 March 2017