Notes to the Financial Statements

1 The group and its principal activities

Background of the group

China Netcom Group Corporation (Hong Kong) Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("Hong Kong") of the People's Republic of China ("PRC") on October 22, 1999 as a limited liability company under the Hong Kong Companies Ordinance. The shares of the Company were listed on The Stock Exchange of Hong Kong Limited on November 17, 2004 and the ADSs of the Company were listed on The New York Stock Exchange Inc. on November 16, 2004. Prior to a reorganization conducted for the listing of the shares of the Company (the "Listing Reorganization"), the Company's ultimate holding company was China Netcom Holdings Company Limited ("China Netcom Holdings").

The Company, China Netcom Holdings and China Network Communications Group Corporation (the "China Netcom Group") underwent the Listing Reorganization on June 30, 2004. China Netcom Group, established by the State Council of the PRC ("State Council") in May 2002, was formed under a restructuring plan approved by the State Council relating to the fixed line telecommunication section. Its fixed line telecommunications businesses were split from the Northern operations originally operated by China Telecommunication Corporation. Immediately after the Listing Reorganization, China Netcom Group became the ultimate holding company of the Group and the Company and its subsidiaries (the "Group") owned the assets and liabilities of fixed line telecommunications businesses originally owned by China Netcom Group in the six northern provinces and municipalities (namely Beijing Municipality, Tianjin Municipality, Hebei Province, Liaoning Province, Shandong Province and Henan Province) and two southern province and municipality (namely Shanghai Municipality and Guangdong Province) in the PRC and the assets and liabilities of fixed line telecommunications business in Asia Pacific Region originally owned by the Group. Also, the Group leased from China Netcom Group, the inter-provincial optic fiber of the twelve service regions in the PRC and the submarine cable assets in the Asia Pacific Region which had been retained by China Netcom Group.

Pursuant to a resolution passed in the extraordinary general meeting of the shareholders on October 25, 2005, the Company acquired the principal telecommunications operations and assets in the four northern provinces/autonomous region, namely Shanxi Province, Neimenggu Autonomous Region, Jilin Province and Heilongjiang Province from China Netcom Group (the "Acquisition"). In anticipation for the Acquisition, China Netcom Group established China Netcom Group New Horizon Communications Corporation (BVI) Limited ("New Horizon (BVI)") and China Netcom Group New Horizon Communications Corpoaration Limited ("New Horizon"). China Netcom Group's fixed line telecommunications businesses in the four northern provinces/autonomous region were transferred to New Horizon (BVI) through a group restructuring. Upon the completion of the acquisition of the entire interest of New Horizon (BVI) and New Horizon from China Netcom Group, the Company controlled the fixed line telecommunications businesses in the four northern provinces/autonomous region.

After taking into consideration the financial position and prospects of the acquired businesses and the conditions of the capital market, the consideration for Acquisition was determined at RMB12,800 million. The consideration consists of an initial cash payment of RMB3,000 million and deferred payments of RMB9,800 million. The deferred payments will be settled in half-yearly installments over five years. The interest charged on the deferred payments is to be calculated at 5.265% per annum.

The Group's PRC operations are subject to the supervision of and regulation by the PRC Government. The Ministry of Information Industry ("MII"), pursuant to the authority delegated by the State Council, is responsible for formulating the telecommunications industry policies and regulations (the "Telecommunications Regulations").

1 The group and its principal activities *(continued)*

Background of the group *(continued)*

Under the Telecommunications Regulations, all telecommunications operators in the PRC must obtain a telecommunications service operating license from the MII or from the provincial telecommunications administrations. Providers of value-added services within a single province are required to obtain licenses from provincial telecommunications administrations. Providers of basic telecommunications services and providers of value-added services in two or more provinces, autonomous regions and municipalities are required to obtain licenses from the MII. China Netcom (Group) Company Limited ("CNC China") and New Horizon, the Group's principal operating subsidiaries in China, as indirect subsidiaries of China Netcom Group, have the right to operate the Group's telecommunications business in twelve service regions under the authorization of China Netcom Group, which holds the license required for operating the Group's telecommunications businesses in the PRC.

Following the Listing Reorganization and the Acquisition, China Netcom Group continues to be the holder of the licenses for operating a telecommunications network in China, but has, with the consent of the MII, granted the Group the right to operate under its licenses, the assets described above and the related business. The Company is the holder of licenses that are necessary to own and operate the assets that are outside the PRC described above in such key countries and regions such as Hong Kong, Japan, Singapore and Korea.

Following the Acquisition, the Group is the dominant provider of fixed line telephone services, broadband, other internet-related services, and business and data communications services in ten northern provinces, municipalities and autonomous region, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Liaoning Province, Shandong Province, Henan Province, Shanxi Province, Neimenggu Autonomous Region, Jilin Province, and Heilongjiang Province. The Group also provides telecommunications services to selected business and residential customers in two southern municipality and province, namely Shanghai Municipality and Guangdong Province in the PRC. In addition, the Group operates a network and offers international data services throughout the Asia Pacific countries and regions.

Following the Listing Reorganization and the Acquisition, the Group's principal services consist of:

- Fixed line telephone services (including the personal handy phone system (PHS) services), comprising:
  - (a) Local, domestic long distance and international long distance services;
  - (b) Value-added services, including caller identity, telephone information services; and
  - (c) Interconnection services provided to other domestic telecommunications service providers including the fellow subsidiary owned by China Netcom Group operating outside the twelve service regions;
- Broadband services and other Internet-related services;
- Business and data communications services, including integrated regional data and voice communications services; and
- International services consisting of international voice services including international inbound calls destined for the PRC or transit through the PRC or other Asia-Pacific countries and regions, and leased line, Internet access, managed data and other telecommunications services provided to business and carrier customers located outside the PRC.

2 Basis of presentation

The financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), Hong Kong Accounting Standards ("HKAS") and interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). They have also been prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance and Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited. They have been prepared under the historical cost convention modified by the revaluation of certain fixed assets and the marking to fair values of certain investments as explained in the accounting policies in Note 4 below, and on a going concern basis.

Prior to the Acquisition, China Netcom Group held the entire telecommunications operations and assets of four northern provinces/autonomous region. Since China Netcom Group is the Group's ultimate holding company, the Acquisition constitutes a business combination under common control. Accordingly, the Company has used merger accounting to record the Acquisition in accordance with the Accounting Guideline 5 "Merger Accounting For Common Control Acquisition" ("AG5") issued by HKICPA, and the acquired assets are stated at carrying amounts as if the fixed line telecommunications operations and assets of the four provinces/autonomous region have been held by the Company from the beginning of the earliest period presented. The 2004 comparatives of the financial statements have been restated accordingly.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 5.

The financial statements include the financial information of the Company and its subsidiaries (collectively referred to as the "Group").

A significant percentage of the Group's funding requirements is achieved through short term borrowings. Consequently, the balance sheet indicates a significant working capital deficit. In the past, a substantial portion of the Group's short term borrowings have been rolled over upon maturity. Based on the Group's history of obtaining finance, its relationships with its bankers and its operating performance, the directors consider that the Group will continue to be able to roll over such short term financing, or will be able to obtain sufficient alternative sources of financing to enable it to operate and meet its liabilities as and when they fall due.

3 Changes in accounting policies

In 2005, the Group adopted certain new or revised HKFRSs which are relevant to its operations as listed below. The comparative figures in respect of the year ended December 31, 2004 have been restated where necessary, in accordance with the relevant requirements.

- HKAS 1 Presentation of Financial Statements
- HKAS 2 Inventories
- HKAS 7 Cash Flow Statements
- HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- HKAS 10 Events after the Balance Sheet Date
- HKAS 12 Income Taxes
- HKAS 14 Segment Reporting
- HKAS 16 Property, Plant and Equipment
- HKAS 17 Leases
- HKAS 18 Revenue
- HKAS 19 Employee Benefits
- HKAS 21 The Effects of Changes in Foreign Exchange Rates
- HKAS 23 Borrowing Costs
- HKAS 24 Related Party Disclosures
- HKAS 27 Consolidated and Separate Financial Statements
- HKAS 28 Investments in Associates
- HKAS 32 Financial Instruments: Disclosure and Presentation
- HKAS 33 Earnings per Share
- HKAS 36 Impairment of Assets
- HKAS 37 Provisions, Contingent Liabilities and Contingent Assets
- HKAS 38 Intangible Assets
- HKAS 39 Financial Instruments: Recognition and Measurement
- HKFRS 2 Share-based Payment
- HKFRS 3 Business Combinations

The adoption of these new or revised HKFRSs did not have any significant impact on the results of operations and financial position of the Group, except for the adoption of HKFRS 2, HKFRS 3, HKAS 36, HKAS 17, HKAS 32 and HKAS 39 as detailed below.

3 Changes in accounting policies *(continued)*

The impact of the adoption of HKFRS 2, HKFRS 3, HKAS 36, HKAS 17, HKAS 32 and HKAS 39 to the financial position and results of the Group was as follows:

(a) HKFRS 2

In prior years, no employee benefits cost or obligation was recognized when employees (including directors) were granted share options by the Group over shares in the Company. When the share options were exercised, equity was increased by the amount of the proceeds received.

With effect from January 1, 2005, in order to comply with HKFRS 2, the Group recognized the fair value of such share options as an expense in the consolidated income statement, or as an asset if the cost qualifies for recognition as an asset under the group's accounting policies. A corresponding increase is recognized in a capital reserve within equity.

This change in accounting policy has been accounted for retrospectively as follows:

	After adjustment for the Acquisition	**Effect of adoption of new HKFRS**	**As restated**
	RMB million	RMB million	RMB million
As at December 31, 2004			
Reserves:			
Retained earnings	8,075	(18)	8,057
Capital reserve	265	18	283

The adoption of HKFRS 2 resulted in:

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated
Increase in staff costs	**104**	18

Details of the share option scheme are presented in Note 35 of the financial statements.

3 Changes in accounting policies *(continued)*

(b) HKFRS 3 and HKAS 36

In prior years:

— Positive goodwill arising from acquisition on or after January 1, 2001 was amortized to the consolidated income statement on a straight-line basis over 20 years. Positive goodwill was stated in the consolidated balance sheet at cost less accumulated amortization and any impairment losses; and

— Negative goodwill which arose from acquisition on or after January 1, 2001 was amortized over the weighted average useful life of the depreciable/amortizable non-monetary assets acquired, except to the extent in relation to identified expected future losses as at the date of acquisition. In such cases it was recognized in the consolidated income statement as those expected losses were incurred.

With effect from January 1, 2005, the Group adopted a new accounting policy in order to comply with HKFRS 3 and HKAS 36. The Group no longer amortized positive goodwill. Such goodwill is tested annually for impairment, including in the year of its initial recognition, as well as when there are indications of impairment. Impairment losses are recognized when the carrying amount of the cash generating unit to which the goodwill has been allocated exceeds its recoverable amount.

With effect from January 1, 2005 and in accordance with HKFRS 3, if the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognized immediately in the consolidated income statement as it arises.

The change in the net book value of negative goodwill, as disclosed in Note 24, arising from the above change in accounting policy has been prospectively accounted for from January 1, 2005 as follows:

	Before adoption of new HKFRS	**Effect of adoption of new HKFRS**	**As restated**
	RMB million	RMB million	RMB million
As at January 1, 2005			
Negative goodwill (included in intangible assets)	(166)	166	—
Retained earnings	8,057	166	8,223

The adoption of HKFRS 3 and HKAS 36 resulted in:

	Year ended December 31, 2005
	RMB million
Increase in amortization expense	**15**

3 Changes in accounting policies *(continued)*

(c) HKAS 17

In prior years, land use rights and buildings held for own use were stated at cost less accumulated depreciation and impairment losses. Depreciation was calculated to write-off the cost of such assets on a straight-line basis over their estimated useful lives, to residual value.

With effect from January 1, 2005, in order to comply with HKAS 17, land use rights held for own use are accounted for as operating leases where the fair value of the interest in any buildings situated on the leasehold land can be separately identified from the fair value of the land use rights at either the time the lease was first entered into by the Group or taken over from the previous lessee, or at the date of construction of those buildings, if later.

Any pre-paid land premiums for acquiring the land use rights, or other lease payments, are stated at cost and are written off on a straight-line basis over the respective periods of the rights.

Any buildings held for own use which are situated on such land leases continue to be presented as part of property, plant and equipment.

The new accounting policy has been adopted retrospectively and land use rights have been reclassified from "Property, plant and equipment" or "Construction in progress" to "Lease prepayments for land" on the face of the consolidated balance sheet. The reclassification has no impact on the Group's net assets as at year end nor on the Group's profit attributable to equity shareholders for the years presented.

	After adjustment for the Acquisition	Effect of adoption of HKFRS	As restated
	RMB million	RMB million	RMB million
As at December 31, 2004			
Land and buildings	21,860	(1,275)	20,585
Construction in progress	11,068	(471)	10,597
Lease prepayments for land (Note 23)	—	1,746	1,746

3 Changes in accounting policies *(continued)*

(d) HKAS 32 and HKAS 39

HKAS 32 and HKAS 39 establish principles for disclosure, presentation, recognition and measurement of financial instruments, including non-derivative financial assets, non-derivative financial liabilities and derivative instruments for hedging activities.

Under HKAS 39, financial instruments will be carried at either amortized cost or fair value, depending on their classification. Movements in fair value will be either charged to income statement or taken to equity in accordance with the standards. In addition, all derivatives, including those embedded in non-derivative host contracts are recognized in the balance sheet at fair value.

This change in accounting policy has been prospectively accounted for from January 1, 2005 as follows:

	Before adoption of new HKFRS	Effect of adoption of new HKFRS	As restated
	RMB million	RMB million	RMB million
As at January 1, 2005			
Contracts receivable (Included in other non-current assets)	408	(408)	—
Contracts payable (Included in other non-current liabilities)	(533)	533	—
Discount on foreign currency exchange forward contracts (Included in other non-current assets)	59	(59)	—
Derivative assets (Included in other non-current assets)	—	9	9
Derivative liabilities (Included in other non-current liabilities)	—	(74)	(74)
Retained earnings	8,057	1	8,058

The adoption of HKAS 39 resulted in:

	Year ended December 31, 2005
	RMB million
Decrease in profit before taxation	15

3 Changes in accounting policies *(continued)*

(e) Summary of impact of changes in accounting policies

The impact of the changes to accounting policies as set out in Notes (a) to (d) above on the Group's profit and equity was as follows:

	2005
	RMB million
For the year ended December 31	
(a) HKFRS 2	104
(b) HKFRS 3 and HKAS 36	15
(d) HKAS 32 and HKAS 39	15
Decrease in profit before taxation	134
As at January 1,	
(b) HKFRS 3 and HKAS 36	166
(d) HKAS 32 and HKAS 39	1
Increase in total equity	167

4 Principal accounting policies

(a) Basis of consolidation

Acquisitions of businesses under common control are accounted for using merger accounting in accordance with AG5 issued by HKICPA. The results of operations and financial position of such businesses are included in the consolidated financial statements as if the businesses had been acquired from the beginning of the earliest period presented or the date that such businesses were acquired by the party common control.

Acquisitions of subsidiaries from third parties are accounted for using acquisition accounting. The results and financial positions of such subsidiaries acquired or disposed of during the year are included in the consolidated income statements from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

4 Principal accounting policies *(continued)*

(b) Subsidiaries

Subsidiaries are those entities in which the Company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivables.

(c) Revenue recognition

(i) The Group's revenues are recognized as follows:

- Revenues derived from local, domestic long distance ("DLD") and international long distance ("ILD") telephone usage, which vary depending on the day, the time of day, the distance and duration of the call and the tariffs, are recognized when the services are provided to customers.

- Monthly telephone service fees are recognized in the period during which the telephone services are provided to customers.

- Upfront connection and installation fees received are deferred and recognized over the expected customer relationship period of 10 years. With effect from July 1, 2001, no further upfront fees for connection were charged to customers.

- Revenues from the sale of prepaid calling cards are deferred and recognized as the cards are consumed by customers.

- Revenues from PHS bundled service contracts are recognized as local, DLD, or ILD service fees according to the type of usage and on a systematic basis to match the pattern of usage of the PHS services by customers. PHS bundled service contracts comprise the provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period in order to receive a free handset (see Note 4(s)(ii) for the policy on cost of the handset).

- Revenues from value-added communication services such as call waiting, call diverting and caller number display are recognized when the services are provided to customers.

- Revenues from the provision of broadband and other Internet-related services and managed data services are recognized when the services are provided to customers.

- Interconnection fees from domestic and foreign telecommunications operators are recognized when the services are rendered as measured by the minutes of traffic processed.

- Lease income from the leasing of lines and customer-end equipment is recognized over the term of the lease. Lease income from other domestic telecommunications operators and business customers for the usage of the Group's fixed line telecommunications networks is measured by the number of lines leased and the agreed upon rate per line leased. The lease arrangements are primarily determined on a year to year basis.

4 Principal accounting policies *(continued)*

(c) Revenue recognition *(continued)*

(ii) Interest income

Interest income is recognized on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(iii) Dividend income

Dividend income is recognized when the right to receive payment is established.

(d) Interest expenses

Interest expenses that are attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of that asset.

All other interest expenses are charged to the consolidated income statement in the year in which they are incurred.

(e) Interconnection charges

Interconnection charges represent amounts incurred for the use of other telecommunications operators' networks for facilitating the completion of calls that originate from the Group's fixed line telecommunications networks. Interconnection charges are recognized on an accrual basis. Interconnection charges with domestic operators and the fellow subsidiaries of the Group are accrued based on actual amounts, while those with overseas operators are accrued based on the actual amounts, if known, or the Group's estimates.

(f) Translation of foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency") which is Renminbi.

(ii) Transactions and balances

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet dates are translated at rates of exchange ruling at the balance sheet dates. Exchange differences arising in these cases are dealt with in the consolidated income statements.

4 Principal accounting policies *(continued)*

(f) Translation of foreign currencies *(continued)*

(iii) The Group

The results and financial position of all the group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

- Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

- All resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognized in the income statement as part of the gain or loss on sale.

(g) Cash and cash equivalents

Cash and cash equivalents, comprising cash on hand, deposits held at call with banks and cash investments with original maturities of three months or less are carried at cost.

(h) Accounts receivable and other receivables

Accounts and other receivables are recognized initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of accounts and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the income statement.

(i) Inventories and consumables

Inventories comprise mainly telephone handsets and are stated at the lower of cost and net realizable value on a first-in, first-out basis, after provisions for obsolescence. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Consumables consist of materials and supplies used in maintaining the Group's telecommunication networks and are charged to the income statement when brought into use. Consumables are valued at cost less any provision for obsolescence.

4 Principal accounting policies *(continued)*

(j) Lease prepayments for land

Lease prepayments for land represent payments for land use rights. Lease prepayments for land are stated at cost initially and expensed on a straight line basis over the respective periods of the rights.

(k) Fixed assets

(i) Construction-in-progress

Construction-in-progress represents buildings, telecommunications networks plant, transmission and switching equipment under construction and pending installation, and is stated at cost less impairment losses. Cost comprises direct costs of construction including borrowing costs attributable to the construction during the period of construction. When the asset being constructed becomes available for use, the construction-in-progress is transferred to the appropriate category of fixed assets.

(ii) Other fixed assets

Fixed assets are initially stated at cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. The subsequent costs of an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its revenues and costs. Any other costs incurred in restoring fixed assets are charged to the income statement as incurred.

Buildings subsequent to initial recognition are stated at cost less accumulated impairment losses and depreciated over their expected useful lives.

(iii) Revaluations

Fixed assets other than buildings are carried at their revalued amounts. Revalued assets are stated at fair value as of the revaluation date less depreciation. When an item of fixed asset is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately together with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount.

Increases in valuation are credited to the revaluation reserve. Decreases in valuation are first set off against revaluation surplus on earlier valuations in respect of the same item and thereafter are debited to operating profit. Any subsequent increases are credited to operating profit up to the amount previously debited. Each year the difference between depreciation based on the revalued carrying amount of the asset expensed in the income statement and depreciation based on the asset's original cost is transferred from revaluation reserve to retained earnings.

Revaluations on fixed assets will be performed with sufficient regularity by independent valuers, in each of the intervening years valuations will be undertaken by executives of the Group.

4 Principal accounting policies *(continued)*

(k) Fixed assets *(continued)*

(iv) Depreciation

Fixed assets are depreciated at rates sufficient to write off their costs or revalued amounts less accumulated impairment losses and estimated residual values over their estimated useful lives on a straight-line basis. The principal useful lives are as follows:

Buildings	8-30 years
Telecommunications networks and equipment	5-10 years
Furniture, fixture, motor vehicles and other equipment	5-10 years

The useful lives and estimated residual values are reviewed and modified periodically at every balance sheet date.

(v) Gain or loss on sale of fixed assets

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognized in the income statement, except where the fixed asset is carried at valuation, the relevant portion of the revaluation reserve realized in respect of previous valuations is transferred to retained earnings and is shown as a movement in reserves.

(l) Impairment of assets

Assets that have an indefinite useful life are not subject to amortization, but instead are tested at least annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposed of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

4 Principal accounting policies *(continued)*

(m) Assets under leases

(i) Finance leases

Leases of assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized upon commencement of the lease at the lower of the fair value of the leased assets and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in current and non-current borrowings. The interest element of the finance cost is recognized in the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

(ii) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the leasing company are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are expensed in the income statement on straight-line basis over the period of the lease.

(n) Intangible assets

(i) Purchased software

Expenditure on purchased software is capitalized and amortized using the straight-line method over the expected useful lives of the software, which vary from three to five years.

(ii) Sponsorship fee

The sponsorship fee for 2008 Beijing Olympic Games has been capitalized and being amortized on a straight-line basis over 4 years, being the beneficial period under the sponsorship program. The cost of the intangible asset is calculated based on the expected cash payment and the fair value of the services to be provided.

(o) Short-term investments

Short-term investments comprise listed securities held for trading purposes and are carried at fair value. At each balance sheet date, the net unrealized gains or losses arising from the changes in fair value of short-term investments are recognized in the income statement. Profits or losses on disposal of short-term investments, representing the difference between the net sales proceeds and the carrying amounts, are recognized in the income statement as they arise.

4 Principal accounting policies *(continued)*

(p) Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are not recognized for operating loss arising from future periods.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

(q) Employee benefits

(i) Pension obligations

(a) Employees in the PRC are entitled to retirement benefits equal to a fixed proportion of their salary at their normal retirement age which are paid by the PRC government. As stipulated by the regulations of the PRC, the subsidiaries in the PRC makes contribution in the basic defined contribution pension plans organized by their respective municipal governments under which they are governed. The Group is required to make such contributions to these plans at a rate of 20% of the salaries, bonuses and certain allowances of the employees. The Group has no other material obligation for post-retirement benefits beyond these payments as they fall due. Payments made under these plans are expensed as incurred.

(b) The Group also operates a mandatory provident fund scheme ("the MPF scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees employed under the jurisdiction of the Hong Kong Employment Ordinance. The MPF scheme is a defined contribution retirement scheme administered by independent trustees. Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5 per cent. of the employees' relevant income, subject to a cap of monthly relevant income of HK$20,000.

(ii) Early retirement benefits

Early retirement benefits are recognized as expenses when the Group reaches agreement with the relevant employees for early retirement.

(iii) Employee housing benefits

One-off cash housing subsidies paid to PRC employees are charged to the consolidated income statements in the year in which it is determined that the payment of such subsidies is probable and the amounts can be reasonably estimated (see Note 32).

PRC full-time employees of the Group participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these housing funds are expensed as incurred.

4 Principal accounting policies *(continued)*

(q) Employee benefits *(continued)*

(iv) Share option scheme

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

(r) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantially enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

(s) Other non-current assets

(i) Deferred installation costs

The direct incremental costs associated with the installation of fixed line services are deferred and expensed to the income statement over the expected customer relationship period of 10 years except when the direct incremental costs exceed the corresponding upfront installation fees. In such cases, the excess of the direct incremental costs over the installation fees are recorded immediately as expenses in the income statement.

(ii) Customer acquisition costs

The cost of handsets given to customers under bundled service contracts and related commissions paid to distributors are deferred as customer acquisition costs and expensed to the income statement on a systematic basis to match with the pattern of the customer service income over the contract period.

(iii) Prepaid network capacities

Prepayments for the network capacities purchased on an indefeasible rights to use ("IRU") basis are capitalized and expensed over the corresponding lease period.

(t) Derivative financial instruments

Derivative financial instruments are stated at fair value on the balance sheet. Realised and unrealised gains and loses arising from change in the fair value are included in the income statement in the period in which they arise.

4 Principal accounting policies *(continued)*

(u) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements when an outflow of economic benefits is less than probable but not remote. When a change in the probability of an outflow occurs so that the outflow is probable, the contingent liability will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group. A contingent asset is disclosed when an inflow of economic benefits is probable but only recognized in income statement when realized.

(v) Segmental reporting

Business segments provide services that are subject to risks and returns that are different from other business segments. Geographical segments provide services within a particular economic environment that is subject to risks and returns that differ from those of components operating in other economic environments. Currently the Group has one business segment, the provision of fixed line telecommunications services. Less than 10% of the Group's assets and operations are located outside the PRC. Accordingly, no business and geographical segment information is presented.

(w) Earnings per share ("EPS") and per American Depository Shares ("ADS")

Basic EPS is computed by dividing net profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

Diluted EPS is computed by dividing net profit attributable to shareholders by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the year. Ordinary equivalent shares consist of ordinary shares issuable upon the exercise of outstanding stock options using the treasury stock method.

Earnings per ADS is computed by multiplying the EPS by 20, which is the number of shares represented by each ADS.

4 Principal accounting policies *(continued)*

(x) New accounting standard pronouncements

The HKICPA has issued a number of new and revised HKFRSs and HKFRS Interpretations ("HKFRS – Ints"), and HKAS and HKAS Interpretations ("HKAS – Ints") as set out below which are effective for accounting periods beginning on or after January 1, 2006. The Group has not early adopted these new and revised standards and interpretations in the financial statements for the year ended December 31, 2005. The Group has commenced an assessment of the impact of these new and revised standards and interpretations, but is not yet in a position to state whether these new and revised standards and interpretations would have a significant impact on its results of operations and financial position.

- HKFRS 7 — Financial Instruments: Disclosures
- HKAS 1 (amended) — Capital Disclosure
- HKAS 21 (amended) — The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation
- HKAS 39 (amended) — Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- HKAS 39 (amended) — The Fair Value Option
- HKAS 39 (amended) and HKFRS 4 (amended) — Financial Guarantee Contracts

5 Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under circumstances.

(a) Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

(i) Depreciation of property, plant and equipment

The property, plant and equipment of the Group are depreciated at rates sufficient to write off their costs or revalued amounts less accumulated impairment losses and estimated residual values over their estimated useful lives on a straight-line basis. The Group reviewed the useful lives periodically to ensure that the method and rates of depreciation are consistent with the expected pattern of economic benefits from property, plant and equipment. The Group estimates the useful lives of the property, plant and equipment as set out in Note 4(k)(iv) based on the historical experience with similar assets, taking into account anticipated technological changes. The depreciation expenses in the future periods will change if there are significant changes from previous estimates.

(ii) Revaluation of property, plant and equipment

For the Listing Reorganization, property, plant and equipment of the Group were revalued as of December 31, 2003 on a depreciated replacement cost basis. The property, plant and equipment acquired as part of the Acquisition were revalued as of December 31, 2004 on a depreciated replacement cost basis in preparation for the Acquisition. Apart from lease prepayments for land and buildings, which are carried at cost, other property, plant and equipment are carried at revalued amounts, being the fair value at the date of revaluation, less subsequent accumulated depreciation and impairment losses. Revaluations on property, plant and equipment will be performed with sufficient regular intervals by independent valuers, in each of the intervening years valuations will be undertaken by executives of the Group. If the subsequent revalued amounts differ significantly from the carrying amounts of the property, plant and equipment in the future, the carrying amounts will be adjusted to the revalued amounts. The key assumptions made to determine the revalued amounts include the newly estimated replacement costs and the estimated useful lives of the property, plant and equipment. This will have an impact on the Group's future results, since any subsequent decreases in valuation are set off first against increases on earlier valuations in respect of the same item and thereafter are charged as an expense to the income statement and any subsequent increases are credited as income to the income statement up to the amount previously charged. In addition, the depreciation expense in future periods will change as the carrying amounts of such property, plant and equipment change as a result of the revaluation.

5 Critical accounting estimates and judgements *(continued)*

(a) Critical accounting estimates and assumptions *(continued)*

(iii) Impairment of non-current assets

At each balance sheet date, the Group considers both internal and external sources of information to assess whether there is any indication that non-current assets, including property, plant and equipment, are impaired. If any such indication exists, the recoverable amount of the assets is estimated and an impairment loss is recognized to reduce the carrying amount of the assets to its recoverable amount. The recoverable amount is the higher of value in use or net selling price. Estimated value in used are determined based on estimated discounted future cash flows of the cash generating unit at the lowest level to which the asset belongs. Key assumptions made to determine the estimated discounted future cash flows include the estimated future cash flow, estimated growth rate and the estimated weighed cost of capital of the Group. Such impairments losses are recognized in the income statement, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset or group of assets, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation reserve. Accordingly, there will be an impact to the future results if there is a significant change in the recoverable amounts of the non-current assets.

(iv) Revenue recognized for upfront connection and installation fees

The Group defers the recognition of upfront customer connection and installation and amortizes them over the expected customer relationship period of 10 years. The related direct incremental installation costs are deferred and amortized over the same expected customer relationship periods of 10 years, except that when the direct incremental costs exceed the corresponding installation fees, if any, the excess amounts are immediately written off as expense to the income statement. The Group estimates the expected customer relationship period based on the historical customer retention experience and after factoring in the expected level of future competition, the risk of technological or functional obsolescence to the Group's services, technological innovation, and the expected changes in the regulatory and social environment. If the Group's estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of the deferred revenues may change for future periods.

(v) Provision for doubtful debts

The Group maintains an allowance for doubtful debts for estimated losses resulting from the inability of its customers to make the required payments. The Group makes its estimates based on the aging of its accounts receivable balances, customers creditworthiness, and historical write-off experience. If the financial condition of its customers were to deteriorate, actual write-offs might be higher than expected, and the Group would be required to revise the basis of making the allowance and its future results would be affected.

(vi) Fair value

The Group estimates the fair value of its financial assets and financial liabilities including the accounts receivable, prepayments, other receivables and other current assets, accounts payable, and bank and other loans for disclosure purposes by discounting its future contractual cash flows at the estimated current market interest rate that is available to the Group for similar financial instruments. The future disclosed values will change if there are changes in the estimated market interest rate.

5 Critical accounting estimates and judgements *(continued)*

(b) Critical judgements in applying the entity's accounting policy

(i) Accounting for business combinations under common control

The Group completed the Acquisition on October 31, 2005. The Acquisition is a business combination under common control. The Group adopted merger accounting to account for the business combinations under common control as the Group believes that the financial statements prepared under merger accounting is more relevant to those transactions.

(ii) Recognition of revenues and costs under PHS bundled service contracts

The Group provides PHS services, which is an extension of the local wireline telecommunications services, to customers. Promotional packages comprise the bundled provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period of time in order to receive a free handset. The total revenues received or receivable are recognized as deferred revenue. The cost of handsets provided to customers is treated as deferred customer acquisition costs, to the extent that they are recoverable through profits made from future service fees. Such deferred revenue and deferred costs are amortized to the income statement on a systematic basis to match the shorter of the pattern of usage of the related service and the minimum non-cancelable contract period. If the pattern of the usage of the PHS services by the customers changes in the future, the amortization period of the revenue and costs will change accordingly, which will have an impact on future results.

6 Financial risk management

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks: market risks including currency risk, credit risk, liquidity risk, cash flow interest risk and fair value interest-rate risk.

(i) Foreign exchange risk

As at December 31, 2005 and 2004, the Group had foreign currency denominated bank balances amounting to RMB1,098 million and RMB8,186 million respectively. As at December 31, 2005 and 2004, the Group had foreign currency denominated bank loans amounting to RMB1,998 million and RMB5,365 million respectively.

(ii) Credit risk

The carrying amount of accounts receivable included in the balance sheet represents the Group's exposure to credit risk in relation to its financial assets. The Group's receivables are unsecured to the extent they are not covered by security deposits. The Group believes that adequate provision for uncollectible account receivable has been made.

(iii) Liquidity risk

A significant percentage of the Group's funding requirements is achieved through short term borrowings, and the balance sheet indicates a significant working capital deficit. Please refer to Note 2 for the details.

(iv) Cash flow and fair value interest rate risk

The Group is exposed to changes in interest due to its long-term debt obligations. The Group enters into debt obligations to support general corporate purpose including capital expenditures, acquisitions, and working capital needs. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The bank loans issued at variable rates and fixed rates are disclosed in Note 29 of these financial statements.

(b) Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

7 Revenues

Revenues represent the turnover of the Group and are derived from the provision of fixed line telecommunications and related services, net of the PRC business taxes and government levies. The Group's revenues by business nature can be summarized as follows:

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Revenues		
Local usage fees	**24,582**	24,858
Monthly telephone services	**18,261**	17,964
Upfront installation fees	**1,442**	1,568
DLD usage fees	**10,260**	11,266
ILD usage fees	**1,464**	1,415
Value-added services	**4,000**	2,993
Interconnection fees	**7,783**	6,453
Upfront connection fees	**3,405**	4,346
Broadband services	**7,916**	5,307
Other Internet-related services	**812**	1,259
Managed data services	**1,802**	1,829
Leased line income	**2,921**	2,591
Other services	**2,584**	1,645
Total	**87,232**	83,494

7 Revenues *(continued)*

The Group's revenues by geographical location of the customers can be summarized as follows:

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Domestic telecommunications services (Being revenues generated from customers located in the PRC)		
Local usage fees	**24,582**	24,858
Monthly telephone services	**18,261**	17,964
Upfront installation fees	**1,442**	1,568
DLD usage fees	**10,260**	11,266
ILD usage fees	**1,180**	1,234
Value-added services	**4,000**	2,993
Interconnection fees	**6,517**	5,441
Upfront connection fees	**3,405**	4,346
Broadband services	**7,812**	5,202
Other Internet-related services	**540**	1,004
Managed data services	**1,395**	1,520
Leased line income	**2,238**	2,095
Other services	**2,345**	1,360
Subtotal	**83,977**	80,851
International telecommunications services (Being revenues generated from customers located outside the PRC, including Hong Kong and Macau Special Administrative Regions and Taiwan)		
ILD usage fees	**284**	181
Interconnection fees	**1,266**	1,012
Broadband services	**104**	105
Other Internet-related services	**272**	255
Managed data services	**407**	309
Leased line income	**683**	496
Other services	**239**	285
Subtotal	**3,255**	2,643
Total	**87,232**	83,494

8 Operating expenses

Operating expenses include:

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Depreciation (included in depreciation and amortization):		
— Owned property, plant and equipment (Note 21)	**24,287**	24,581
— Leased property, plant and equipment (Note 21)	**367**	389
Loss on disposal of property, plant and equipment (included in networks, operations and support expenses)	**363**	212
Amortization of intangible assets (included in depreciation and amortization) (Note 24)	**358**	159
Contributions to pension plans (included in staff costs) (Note 14)	**1,285**	1,181
Early retirement benefits (included in staff costs) (Note 14)	**2**	693
Operating leases:		
— Land and buildings (included in networks, operations and support)	**796**	394
— Land and buildings (included in selling, general and administrative)	**159**	204
— Network and machinery (included in networks, operations and support)	**1,708**	1,606
— Network and machinery (included in selling, general and administrative)	**92**	19
Interconnection charges (included in networks, operations and support)	**3,487**	2,602
Bad and doubtful debt expenses (included in selling, general and administrative)	**1,148**	1,185
Auditor's remuneration (included in selling, general and administrative)	**34**	18
PHS subscriber acquisition costs (included in selling, general and administrative)	**2,323**	3,114
Cost of PHS handsets (included in other operating expenses)	**861**	425

9 Finance costs

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Interest expenses on:		
— Bank and other loans wholly repayable within five years	**3,676**	4,185
— Bank and other loans wholly repayable after more than five years	**207**	114
	3,883	4,299
Less: Interest expenses capitalized in construction in progress	**(297)**	(548)
Amortization of discount on foreign currency exchange forward contracts	**—**	18
Exchange (gain)/loss, net	**(232)**	105
Bank charges	**20**	56
	3,374	3,930
Interest expenses were capitalized in construction in progress using the following annual interest rates	**4.17%-4.97%**	3.69%-5.45%

10 Taxation

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
PRC enterprise income tax ("EIT")	**3,581**	2,932
Overseas profit tax	**10**	—
Deferred taxation (Note 33)	**(162)**	(3,255)
Taxation charges/(credit)	**3,429**	(323)

The provision for PRC EIT is calculated based on the statutory income tax rate of 33% on the assessable profit of each of the entities now comprising the Group in the PRC as determined in accordance with the relevant income tax rules and regulations in the PRC.

10 Taxation *(continued)*

Taxation on profits derived from certain subsidiaries outside the PRC, including Hong Kong, has been calculated on the estimated assessable profit at the rates of taxation ranging from 17.50% to 30.00%, prevailing in the countries in which those entities operate.

The reconciliation between the Group's actual tax charge/(credit) and the amount which is calculated based on the weighted average statutory tax rate is as follows:

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Profit before taxation	**17,317**	2,376
Weighted average statutory tax rate	**33%**	33%
Tax calculated at the weighted average statutory tax rate	**5,715**	784
Non-taxable income (Note (a) below)	**(1,499)**	(1,583)
Utilization of tax losses not recognized in previous years (Note (b) below)	**(837)**	—
Expenses not deductible for tax purposes	**69**	275
Tax losses not recognized	**129**	354
Others	**(148)**	(153)
Tax charge/(credit)	**3,429**	(323)

Note (a): Non-taxable income comprises primarily upfront connection fees charged to customers and amortized over the customer relationship period.

Note (b): In previous years, deferred tax arising from certain tax losses was not recognized as it was uncertain at that time following the change of a subsidiary's tax registration district that the taxable loss could be utilized at the previous period end date.

11 Profit attributable to shareholders

(a) For the year ended December 31, 2005, profit attributable to shareholders included current year profit of RMB126 million (2004: a loss of RMB59 million), which has been dealt with in the financial statements of the Company.

(b) Two of the Company's subsidiaries, CNC China and New Horizon were registered as foreign investment enterprises in the PRC. In accordance with the Articles and Association of both CNC China and New Horizon, they are required to provide for certain statutory reserves, namely, general reserve and staff bonus and welfare fund, which are appropriated from profits after tax but before dividend distributions.

CNC China and New Horizon are required to allocate at least 10% of their profits after tax determined under PRC GAAP to the general reserve fund until the cumulative amounts reach 50% of the registered capital. The statutory reserve can only be used, upon obtaining approval from the relevant authority, to offset accumulated losses or increase capital.

Accordingly, CNC China and New Horizon appropriated approximately RMB894 million and RMB150 million respectively to the general reserve fund for the year ended December 31, 2005 (2004: RMB723 million and Nil respectively).

(c) According to a notification on income tax issued by Ministry of Finance and State Administration of Taxation to the Group's primary operating subsidiaries, the Group's upfront connection fees are not subject to EIT and an amount equal to the upfront connection fees recognized in the income statement should be transferred from retained earnings to a statutory reserve. For the year ended December 31, 2005, the aggregated upfront connection fees recognized in the income statement amounted to RMB6,783 million (2004: Nil), which was transferred to the statutory reserve in accordance with the aforementioned approval document.

12 Profit distributions

	Year ended December 31,			
	2005		2004	
	HK$ million	**RMB million**	HK$ million	RMB million
Final dividend proposed after balance sheet date of HK$0.466 per share (2004 : HK$0.037 per share)	**3,073**	**3,196**	245	259
Dividend distributed during the year	**245**	**259**	—	—

Notes:

(i) In a meeting of board of directors held on March 21, 2006, the directors proposed a final dividend of HK$0.466 per ordinary share for the year ended December 31, 2005. Dividend proposed after the balance sheet date have not been reflected as dividend payable and will be reflected as an appropriation in the 2006 financial statements.

Notes to the Financial Statements

13 Earnings per share

Basic earnings per share is computed using the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share is computed using the weighted average number of ordinary shares and potential ordinary shares outstanding during the year.

The following table sets forth the computation of basic and diluted earnings per share:

	Year ended December 31,	
	2005	2004
	(in RMB millions, except share and per share data)	
		Restated Notes 2&3
Numerator:		
Profit for the year	**13,888**	2,699
Denominator:		
Weighted average number of ordinary shares outstanding and shares used in computing basic earnings per share:	**6,593,529,000**	5,622,685,175
Weighted average number of potential ordinary shares:		
Diluted equivalent shares arising from convertible preference shares prior to their conversion into ordinary shares during 2004	**—**	5,140,036
Diluted equivalent shares arising from share options	**34,112,723**	2,209,241
Shares used in computing diluted earnings per share	**6,627,641,723**	5,630,034,452
Basic earnings per share (RMB)	**2.11**	0.48
Diluted earnings per share (RMB)	**2.10**	0.48

14 Staff cost including directors' remunerations

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Wages, salaries and welfare	**11,046**	10,076
Contributions to pensions	**1,285**	1,181
Early retirement benefits	**2**	693
Total	**12,333**	11,950

15 Directors' and senior management's emoluments

(a) Directors' emoluments

The following table sets out the emoluments paid to the Company's directors during the year:

	Year ended December 31, 2005			
	RMB			
	Fees	**Basic salaries, housing allowances, other allowances and benefits in kind (i)**	**Contributions to retirement schemes**	**Total**
Zhang Chunjiang	**260,715**	**1,641,285**	**16,363**	**1,918,363**
Tian Suning	**260,715**	**1,807,475**	**—**	**2,068,190**
Zhang Xiaotie	**260,715**	**886,071**	**16,363**	**1,163,149**
Miao Jianhua	**260,715**	**1,050,590**	**16,363**	**1,327,668**
Jiang Weiping	**309,370**	**1,039,566**	**16,363**	**1,365,299**
Li Liming	**312,858**	**993,927**	**16,363**	**1,323,148**
Keith Rupert Murdoch (ii)	**218,858**	**361,621**	**—**	**580,479**
Yan Yixun	**260,715**	**361,621**	**—**	**622,336**
John Lawson Thornton	**365,002**	**—**	**—**	**365,002**
Victor Cha Mou Zing	**360,656**	**—**	**—**	**360,656**
Qian Yingyi	**417,145**	**—**	**—**	**417,145**
Hou Ziqiang	**412,799**	**—**	**—**	**412,799**
Timpson Chung Shui Ming	**332,668**	**—**	**—**	**332,668**
José María Álvarez-Pallete (iii)	**94,500**	**—**	**—**	**94,500**
Total	**4,127,431**	**8,142,156**	**81,815**	**12,351,402**

15 Directors' and senior management's emoluments *(continued)*

(a) Directors' emoluments *(continued)*

The fees disclosed above include RMB1,888,270 paid to independent non-executive directors.

The following table sets out the emoluments paid to the Company's directors during the year ended 31 December 2004:

	Year ended December 31, 2004			
	RMB			
	Fees	Basic salaries, housing allowances, other allowances and benefits in kind (i)	Contributions to retirement schemes	Total
		Restated Notes 2 & 3		
Zhang Chunjiang	141,786	646,065	13,927	801,778
Leng Rongquan	—	439,365	13,927	453,292
Tian Suning	260,715	4,174,884	—	4,435,599
Zhang Xiaotie	63,453	571,343	13,927	648,723
Miao Jianhua	63,453	623,247	13,927	700,627
Jiang Weiping	73,572	504,672	9,324	587,568
Li Liming	73,572	482,897	13,927	570,396
Keith Rupert Murdoch (ii)	73,572	70,315	—	143,887
Yan Yixun	63,453	70,315	—	133,768
John Lawson Thornton	83,691	—	—	83,691
Victor Cha Mou Zing	73,572	—	—	73,572
Qian Yingyi	93,810	—	—	93,810
Hou Ziqiang	83,691	—	—	83,691
Timpson Chung Shui Ming	60,715	—	—	60,715
Total	1,209,055	7,583,103	78,959	8,871,117

The fees disclosed above include RMB395,479 paid to independent non-executive directors.

Note:

(i) Benefits in kind include share option benefit.

(ii) Resigned on 12th September 2005.

(iii) Appointed on 12th September 2005.

15 Directors' and senior management's emoluments *(continued)*

(b) Five highest paid individuals

The five individuals whose emoluments were the highest for the years ended December 31, 2005 include two directors (2004: three) whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining individuals are as follows:

	Year ended December 31,	
	2005	2004
	RMB	RMB Restated Notes 2&3
Basic salaries, housing allowances, other allowances and benefits in kind	**5,928,713**	3,399,848
Contributions to retirement schemes	**32,726**	13,927
Total	**5,961,439**	3,413,775

The number of the remaining individuals whose emoluments fell within the following bands are set out as follows:

	Year ended December 31,	
	2005	2004
Nil - RMB1,040,300 (equivalent of Nil - HK$ 1,000,000)	**—**	1
RMB1,040,300 - RMB3,120,900 (equivalent of HK$ 1,000,000 - HK$ 3,000,000)	**3**	1

16 Cash and bank deposits

	Group		Company	
	As at December 31		As at December 31	
	2005	2004	**2005**	2004
	RMB million	RMB million Restated Note 2	**RMB million**	RMB million
Cash and cash equivalents	**4,874**	10,581	**540**	7,789
Time deposits with original maturities over three months	**21**	52	**—**	—
Total cash and bank deposits	**4,895**	10,633	**540**	7,789
Effective interest rate of time deposits with original maturities over three months (%)	**0.72**	0.72		

Included in cash and bank deposits as at December 31, 2005 and 2004 are Renminbi denominated balance amounts held in the PRC amounting to RMB3,797 million and RMB2,448 million respectively. The conversion of Renminbi denominated balances into foreign currencies and the remittance of bank balances and cash out of the PRC are subject to the rules and regulation of foreign exchange control promulgated by the PRC government.

17 Short-term investments

The Group and the Company's short-term investments comprise primarily investments in listed debt securities and investment funds. Most of the short-term investments were disposed of during the year.

18 Accounts receivable

Amounts due from the provision of fixed line telecommunications services to residential and business customers are due within 30 days from the date of billing. Residential customers who have accounts overdue by more than 90 days will in normal circumstances have their services disconnected. Accounts receivable from other telecommunications operators and customers are due between 30 to 90 days from the billing date.

The ageing analysis of accounts receivable based on the billing date is as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
0-30 days	**5,446**	5,503
31-90 days	**1,556**	1,122
Over 90 days	**2,053**	1,961
Total	**9,055**	8,586
Less: Allowance for doubtful debts	**(1,654)**	(1,412)
Net carrying amounts	**7,401**	7,174

The movement of allowance for doubtful debts is as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Balance at beginning of year	**1,412**	1,175
Additional provisions	**1,169**	1,244
Less: Amounts utilized	**(927)**	(958)
Distributed to owner in accordance with Listing Reorganization	**—**	(49)
Balance at end of year	**1,654**	1,412

The carrying value of accounts receivable approximate their fair values based on cash flows discounted using a rate based on the average short-term borrowing rate of 5.58% (2004: 5.22%).

Included in accounts receivable are amounts due from other state-owned telecommunication operators amounting to RMB1,003 million (2004: RMB1,278 million).

19 Inventories and consumables

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Telephone handsets and other customer end-products held for resale, at cost	**144**	427
Consumables, at cost	**328**	816
Total	**472**	1,243

20 Prepayments, other receivables and other current assets

	Group		Company	
	As at December 31,		As at December 31,	
	2005 **RMB** **million**	2004 RMB million Restated Note 2	**2005** **RMB** **million**	2004 RMB million
Prepaid expenses, deposits and other current assets	**997**	637	**14**	8
Other receivables	**485**	805	**12**	8
Total	**1,482**	1,442	**26**	16

Included in other current assets are deferred customer acquisition cost of RMB324 million (2004: Nil).

The carrying value of prepayments and other receivables approximates their fair values based on cash flows discounted using a rate based on the average short-term borrowing rate of 5.58% (2004: 5.22%).

21 Fixed assets

	Buildings	Telecommunications networks and equipment	Furniture, fixture, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB million
Cost / valuation:				
Balance at January 1, 2004, as restated due to the Acquisition (Note 2)	38,369	247,128	11,438	296,935
Effects of adoption of HKAS 17:				
Reclassification of land use rights to lease prepayments for land (Note 3(c))	(2,107)	—	—	(2,107)
Balance at January 1, 2004, as restated	36,262	247,128	11,438	294,828
Additions	114	713	526	1,353
Transferred from construction in progress	1,686	30,817	1,888	34,391
Disposals/write off	(67)	(949)	(177)	(1,193)
Increase as a result of revaluation	—	17,140	1,503	18,643
Decrease as a result of revaluation	—	(21,201)	(1,065)	(22,266)
Distributed to owner on Listing Reorganization	(12,028)	(9,265)	(325)	(21,618)
Balance at December 31, 2004, as restated	25,967	264,383	13,788	304,138
Accumulated depreciation:				
Balance at January 1, 2004, as restated due to the Acquisition (Note 2)	(7,361)	(102,487)	(4,999)	(114,847)
Effects of adoption of HKAS 17:				
Reclassification of land use rights to lease prepayments for land (Note 3(c))	375	—	—	375
Balance at January 1, 2004, as restated	(6,986)	(102,487)	(4,999)	(114,472)
Depreciation charge for the year	(1,042)	(22,377)	(1,551)	(24,970)
Disposals/write off	7	683	125	815
Increase as a result of revaluation	—	(13,458)	(1,322)	(14,780)
Decrease as a result of revaluation	—	10,461	487	10,948
Distributed to owner on Listing Reorganization	2,639	2,505	74	5,218
Balance at December 31, 2004, as restated	(5,382)	(124,673)	(7,186)	(137,241)
Net book value at December 31, 2004 as restated	20,585	139,710	6,602	166,897
Net book value at January 1, 2004, as restated	29,276	144,641	6,439	180,356

21 Fixed assets *(continued)*

	Buildings	Telecommunications networks and equipment	Furniture, fixture, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB million
Cost / valuation:				
Balance at January 1, 2005, as restated due to the Acquisition (Note 2)	27,649	264,383	13,788	305,820
Effects of adoption of HKAS 17:				
Reclassification of land use rights to lease prepayments for land (Note 3 (c))	(1,682)	—	—	(1,682)
Balance at January 1, 2005, as restated	25,967	264,383	13,788	304,138
Reclassifications	818	(4,981)	4,163	—
Additions	413	975	490	1,878
Transferred from construction in progress	1,659	23,106	2,053	26,818
Disposals/write off	(48)	(1,940)	(541)	(2,529)
Distributed to owner upon reorganization for the Acquisition	(1,759)	(1,242)	(183)	(3,184)
Balance at December 31, 2005	27,050	280,301	19,770	327,121
Accumulated depreciation:				
Balance at January 1, 2005, as restated due to the Acquisition (Note 2)	(5,789)	(124,673)	(7,186)	(137,648)
Effects of adoption of HKAS 17:				
Reclassification of land use rights to lease prepayments for land (Note 3(c))	407	—	—	407
Balance at January 1, 2005, as restated	(5,382)	(124,673)	(7,186)	(137,241)
Reclassifications	(354)	1,170	(816)	—
Charge for the year	(956)	(21,541)	(2,157)	(24,654)
Disposals/write off	4	1,662	451	2,117
Distributed to owner upon reorganization for the Acquisition	487	743	90	1,320
Balance at December 31, 2005	(6,201)	(142,639)	(9,618)	(158,458)
Net book value at December 31, 2005	20,849	137,662	10,152	168,663
Net book value at January 1, 2005, as restated	20,585	139,710	6,602	166,897

21 Fixed assets *(continued)*

(a) The net book value of assets held under finance lease is as follows:

	Buildings	Telecommunications networks and equipment	Furniture, fixture, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB million
As at December 31, 2005	**1**	**2,551**	**109**	**2,661**
As at December 31, 2004	8	3,574	97	3,679

(b) The analysis of the cost or revaluation of the fixed assets of the Group is as follows:

	Buildings	Telecommunications networks and equipment	Furniture, fixture, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB million
December 31, 2005				
Cost	**27,050**	**—**	**—**	**27,050**
Valuation	**—**	**280,301**	**19,770**	**300,071**
	27,050	**280,301**	**19,770**	**327,121**
December 31, 2004				
Cost	25,967	—	—	25,967
Valuation	—	264,383	13,788	278,171
	25,967	264,383	13,788	304,138

The Group's buildings are primarily located in the PRC and held on leases of primarily between 10 to 50 years.

21 Fixed assets *(continued)*

(c) As required by the PRC rules and regulations relevant to the Listing Reorganization, each class of fixed assets as at December 31, 2003 was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such assets in the PRC injected into the Group was determined at RMB122,456 million. Such revalued amount serves as the tax base of the assets with immediate effect. Certain fixed assets, other than lease prepayments for land and buildings, of which the surplus on revaluation of RMB2,982 million was credited to the revaluation reserve while the deficit arising from the revaluation of such fixed assets of RMB25,778 million was recognized as an expense for the year ended December 31, 2003.

For the Listing Reorganization, valuations of the lease prepayments for land and buildings were also performed. The surplus value of such assets was determined at RMB6,967 million. Such amount serves as the tax base for such assets with immediate effect. Details have been set out in Note 33(ii).

As required by the PRC rules and regulations relevant to the Acquisition, each class of fixed assets in the PRC, acquired as at December 31, 2004, was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such assets in the PRC acquired was determined at RMB42,879 million. Such amount serves as the tax base for such assets with immediate effect. Certain fixed assets, other than lease prepayments for land and buildings, of which the surplus on revaluation of RMB3,863 million was credited to the revaluation reserve while the deficit arising from the revaluation of such fixed assets of RMB11,318 million was recognized as an expense for the year ended December 31, 2004.

For the Acquisition, valuations of the lease prepayments for land and buildings were also performed. The surplus value of such assets was determined at RMB2,553 million. Such amount serves as the tax base for such assets with immediate effect. Details have been set out in Note 33(ii).

The respective carrying amount of the telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment would have been RMB158,193 million and RMB11,233 million as at December 31, 2005 and RMB141,314 million and RMB6,645 million as at December 31, 2004 had they been stated at cost less accumulated depreciation.

21 Fixed assets *(continued)*

Regarding the valuation of fixed assets carried out at December 31, 2004 in relation to the Acquisition, the carrying amounts of these fixed assets and, where applicable, the corresponding revalued amounts of these assets are as follows:

	Historical carrying amount	**Revaluation surplus**	**Revaluation deficit**	**Revalued amount**
	RMB million	RMB million	RMB million	RMB million
At December 31, 2004				
Buildings	7,142	—	—	7,142
Telecommunications networks and equipment	39,881	3,682	(10,740)	32,823
Furniture, fixture, motor vehicles and other equipment	2,542	181	(578)	2,145
	49,565	3,863	(11,318)	42,110

The directors have carried out a review of the Group's fixed assets and concluded that there was no impairment of fixed assets as at December 31, 2005, nor was there any significant change in value of fixed assets at that date.

At December 31, 2005, no fixed assets were pledged as security for the Group's long term bank and other loans (2004: RMB22 million).

22 Construction in progress

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Balance at beginning of year	**11,068**	18,049
Effects of adoption of HKAS 17:		
Reclassification from land use rights to lease prepayments for land (Note 3 (c))	**(471)**	(643)
Balance as at January 1, as restated	**10,597**	17,406
Additions	**23,258**	28,983
Transferred to fixed assets	**(26,818)**	(34,391)
Distributed to owner in accordance with the Reorganizations	**(215)**	(1,401)
Balance at end of year	**6,822**	10,597

23 Lease prepayments for land

This represents land use rights in PRC and their net book value is analyzed as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Held for:		
Lease of between 10 to 50 years	**1,933**	1,733
Lease of less than 10 years	**16**	13
Balance at end of year	**1,949**	1,746

23 Lease prepayments for land *(continued)*

The movement of the lease prepayments for land is as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Balance at beginning of year from reclassification from land use right	**1,746**	2,375
Additions	**280**	202
Charge for the year	**(37)**	(51)
Distributed to owner in accordance with the reorganizations	**(40)**	(780)
Balance at end of year	**1,949**	1,746

24 Intangible assets

	Negative goodwill	Purchased software	Sponsorship fees	Total
	RMB million	RMB million	RMB million (Note 40(xv))	RMB million
Cost:				
Balance at January 1, 2004	(178)	984	—	806
Additions	—	266	—	266
Balance at December 31, 2004	(178)	1,250	—	1,072
Accumulated amortization:				
Balance at January 1, 2004	(2)	(529)	—	(531)
Amortization for the year	14	(173)	—	(159)
Balance at December 31, 2004	12	(702)	—	(690)
Net book value at January 1, 2004	(180)	455	—	275
Net book value at December 31, 2004	(166)	548	—	382
Cost:				
Balance at January 1, 2005	(178)	1,250	—	1,072
Impacts of adoption of HKFRS 3:				
Transferred from negative goodwill to retained earnings (Note 3(b))	181	—	—	181
Balance at January 1, 2005, as restated	3	1,250	—	1,253
Additions	—	663	540	1,203
Balance at December 31, 2005	3	1,913	540	2,456
Accumulated amortization:				
Balance at January 1, 2005	12	(702)	—	(690)
Impacts of adoption of HKFRS 3:				
Transferred from negative goodwill to retained earnings (Note 3(b))	(15)	—	—	(15)
Balance at January 1, 2005, as restated	(3)	(702)	—	(705)
Amortization for the year	—	(223)	(135)	(358)
Balance at December 31, 2005	(3)	(925)	(135)	(1,063)
Net book value at December 31, 2005	—	988	405	1,393

25 Other non-current assets

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Installation cost	**4,197**	4,866
Customer acquisition costs	**—**	1,304
Prepaid network capacities	**1,454**	1,322
Discount on foreign exchange forward contracts (note 3(d))	**—**	59
Others	**383**	985
	6,034	8,536

During 2005, due to a change in the nature of promotions offered by the Group, the amortisation period of customer acquisition costs fell below one year. In response to this, the Group has recorded customer acquisition costs arising from 2005 as prepayments and other receivables. The total amount of customer acquisition costs in prepaid expenses as at December 31, 2005 was RMB324 million (2004: Nil).

26 Investments in subsidiaries

	Company	
	As at December 31,	
	2005	2004
	RMB million	RMB million
Investments cost in subsidiaries	**58,577**	37,509
Due from subsidiaries (Note (b))	**573**	—
Due to subsidiaries (Note (c))	**(12,820)**	—
	46,330	37,509

26 Investments in subsidiaries *(continued)*

Notes:

(a) As at the December 31, 2005, the Group has direct and indirect interests in the following principal subsidiaries, all of which are private companies:

Company name	Place and date of incorporation/ establishment	Issued and fully paid up/ registered capital	Percentage of equity interest attributable to the Group	Principal activities and place of operation
Directly held:				
China Netcom (Group) Company Limited (Note (i))	PRC, August 6, 1999	Registered capital of RMB 51,481,675,600	100%	Provision of network communication services in the PRC
Indirectly held:				
China Netcom Group New Horizon Telecommunications Co.Limited (Note (ii))	PRC, August 9, 2005	Registered capital of RMB9,466,366,618	100%	Provision of network communication services in the PRC
Asia Netcom Corporation Limited (Note (iii))	Bermuda October 15, 2002	120,000,000 ordinary shares of US$ 0.01 each	100%	Investment holding in Bermuda

(i) The company is a wholly owned foreign enterprise established in the PRC. The accounts of the company for the years ended December 31, 2004 and 2005 were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company.

(ii) The company is a wholly owned foreign enterprise established in the PRC. The accounts of this company for the year ended December 31, 2005 were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company.

(iii) The financial statements for the years ended December 31, 2004 and 2005 had been audited by PricewaterhouseCoopers.

(b) The balances are unsecured, non-interest bearing and have no fixed repayment terms.

(c) Deferred payments arising from the Acquisition (see note 1) has been transferred to CNC China at the carrying amount. The balance is non-secured, non interest bearing and has no fixed repayment terms

27 Accounts payable

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
0-30 days	**6,281**	8,371
31-60 days	**1,796**	2,351
61-90 days	**1,297**	1,223
91-180 days	**1,940**	2,922
Over 180 days	**5,405**	6,258
Total	**16,719**	21,125

Included in accounts payable are amounts due to other state-owned telecommunications operators amounting to RMB48 million (2004: RMB69 million).

28 Accruals and other payables

	Group		Company	
	As at December 31,		As at December 31,	
	2005	2004	**2005**	2004
	RMB million	RMB million Restated Note 2	**RMB million**	RMB million
Accrued expenses	**872**	1,580	**93**	140
Other payables	**3,033**	3,286	**—**	—
Total	**3,905**	4,866	**93**	140

29 Bank and other loans

(a) The short term bank loans were unsecured and comprise:

Currency	Interest rate and final maturity	As at December 31, 2005 RMB million	As at December 31, 2004 RMB million Restated Note 2
Renminbi denominated	Interest rates ranging from 4.70% to 5.02% per annum with maturity through December 18, 2006	**47,341**	44,692
US Dollar denominated	Interest rates ranging from 2.59% to 3.98% per annum	**—**	190
		47,341	44,882

The carrying values of short term bank loans approximate their fair values which are based on cash flows discounted using a rate based on the borrowing rate of 4.70%-5.02% (2004: 2.59%-5.94%).

Included in short-term bank loans were loans from state-owned banks amounting to RMB46,541 million as at December 31, 2005 (2004: RMB43,472 million).

29 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise:

	Note	As at December 31,	
		2005	2004
		RMB million	RMB million Restated Note 2
Long term bank loans	(i)	**22,734**	34,678
Finance lease obligations	(ii)	**2,255**	3,101
		24,989	37,779
Less: Current portion		**(6,846)**	(11,727)
		18,143	26,052

The carrying values of the current portion of long term bank loans approximate their fair values which are based on cash flows discounted using a rate based on the borrowing rate of 5.58% (2004: 5.22%).

Included in long term bank loans were loans from state-owned banks amounting to RMB22,685 million as at December 31, 2005 (2004: RMB33,218 million).

(i) Long term bank loans

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Loans		
Unsecured	**22,414**	32,075
Secured	**320**	2,603
Total	**22,734**	34,678
Less: Current portion	**(5,579)**	(10,796)
Long term loans	**17,155**	23,882

29 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(i) Long term bank loans (continued)

The Group's long term bank loans were repayable as follows:

	As at December 31, 2005 RMB million	As at December 31, 2004 RMB million Restated Note 2
Within one year	**5,579**	10,796
In the second year	**7,774**	8,276
In the third to fifth year, inclusive	**5,886**	12,140
After the fifth year	**3,495**	3,466
	22,734	34,678

Currency	Interest rate and final maturity	As at December 31, 2005 RMB million	As at December 31, 2004 RMB million Restated Note 2
Bank loan			
Renminbi denominated	Interest rates ranging from 2.40% to 10.08% per annum with maturity through December 20, 2019	**20,736**	29,503
US Dollar denominated	Interest rates ranging from 1.25% to 8.00% per annum with maturity through October 31, 2039	**1,241**	3,223
Japanese Yen denominated	Interest rate is 2.12% per annum with maturity through January 7, 2014	**327**	1,342
Euro denominated	Interest rates ranging from 0.50% to 7.35% per annum with maturity through March 15, 2034	**430**	610
		22,734	34,678

29 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(i) Long term bank loans (continued)

As at December 31, 2005, secured bank loans of RMB320 million (2004: RMB2,603 million) which were secured by the following:

- Corporate guarantees granted by China Netcom Group to the extent of RMB75 million (2004: RMB2,148 million); and
- Corporate guarantee granted by third parties to the extent of RMB245 million (2004: RMB452 million).

(ii) Finance lease obligations

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Obligation under finance leases	**2,255**	3,101
Less: current portion	**(1,267)**	(931)
	988	2,170

In 2005, the Group has entered into a finance lease arrangement with a related party, receiving funding of RMB322 million. The net book value of the assets under finance lease was RMB317 million as at December 31, 2005 (2004: RMB2,592 million). The accumulated finance lease obligation as at December 31, 2005 amounted to RMB2,255 million. (2004: RMB2,408 million).

The interest rates charged on finance lease are ranging from 2.50% to 5.70% with maturity through December 8, 2008 (2004: 2.50% to 5.18% with maturity through December 31, 2007).

29 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(ii) Finance lease obligations (continued)

The Group's liabilities under finance leases are analyzed as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Within one year	**1,319**	1,005
In the second year	**903**	1,396
In the third to fifth year, inclusive	**106**	831
	2,328	3,232
Less: future finance charges on finance leases	**(73)**	(131)
Present value of finance lease liabilities	**2,255**	3,101

The present value of finance lease liabilities is as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Within one year	**1,267**	931
In the second year	**885**	1,350
In the third to fifth year, inclusive	**103**	820
	2,255	3,101

(c) The fair value of the Group's non-current portion of long term bank and other loans at December 31, 2005 and 2004 were as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Notes 2&3
Long term bank loans	**15,571**	21,899
Finance lease obligations	**958**	1,908
	16,529	23,807

The fair value are based on cash flows discounted using rates based on the borrowing rates of ranging from 2.54% to 6.12% (2004: 0.19% to 9.20%).

30 Amount due from/(to) holding companies and fellow subsidiaries

	Note	As at December 31,	
		2005	2004
		RMB Million	RMB million Restated Note 2
Current:			
Due from ultimate holding company	(a)	**89**	785
Due from other holding companies	(a)	**1**	1
Due from fellow subsidiaries	(a)	**157**	301
Total		**247**	1,087
Due to ultimate holding company			
— Deferred consideration	(b)	**1,960**	—
— Others	(a)	**3,877**	3,704
Due to fellow subsidiaries	(a)	**3,153**	6,376
Total		**8,990**	10,080
Non-current:			
Due to ultimate holding company			
— Deferred consideration	(b)	**7,840**	—
Total		**7,840**	—

30 Amount due from/(to) holding companies and fellow subsidiaries *(continued)*

Note:

(a) These are interest free, unsecured and have no fixed terms of repayment.

(b) Balance represents the deferred payments arising from the Acquisition outstanding at year end. The balance is charged at interest rate of 5.265% per annum with final maturity through June 30, 2010. The deferred payment is analyzed as follows:

	As at December 31,	
	2005	2004
	RMB million	RMB million
Within one year	**1,960**	—
In the second year	**1,960**	—
In the third to fifth year, inclusive	**5,880**	—
Total	**9,800**	—

31 Deferred revenues

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Balance at beginning of year:		
— upfront connection fees	**8,910**	13,256
— upfront installation fees	**7,638**	8,001
— advances from network capacity sales	**2,173**	2,050
— prepaid telephony services	**4,143**	3,677
	22,864	26,984
Additions for the year:		
— upfront connection fees	**—**	—
— upfront installation fees	**573**	1,205
— advances from network capacity sales	**461**	242
— prepaid telephony services	**24,435**	18,636
	25,469	20,083

31 Deferred revenues *(continued)*

	As at December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2
Reductions for the year:		
— upfront connection fees	**(3,405)**	(4,346)
— upfront installation fees	**(1,442)**	(1,568)
— advances from network capacity sales	**(280)**	(114)
— prepaid telephony services	**(24,306)**	(18,126)
	(29,433)	(24,154)
Distributed to owner in accordance with Listing Reorganization:		
— advances from network capacity sales	**—**	(5)
— prepaid telephony services	**—**	(44)
	—	(49)
Balance at end of year:		
— upfront connection fees	**5,505**	8,910
— upfront installation fees	**6,769**	7,638
— advances from network capacity sales	**2,354**	2,173
— prepaid telephony services	**4,272**	4,143
	18,900	22,864
Representing:		
— Current portion	**7,975**	8,876
— Non-current portion	**10,925**	13,988
	18,900	22,864

32 Provisions

	Early retirement benefits	One-off cash housing subsidies	Total
	RMB million	RMB million	RMB million
	Note(b), 4p(ii)	Note(a),(b)	
At January 1, 2004, as restated (Note 2)	4,139	3,988	8,127
Additional provisions	693	—	693
Payments during the year	(640)	(479)	(1,119)
At December 31, 2004	4,192	3,509	7,701
Analysis of total provisions:			
— Current portion	618	3,509	4,127
— Non-current portion	3,574	—	3,574
	4,192	3,509	7,701
At January 1, 2005	4,192	3,509	7,701
Additional provisions	2	—	2
Payments during the year	(431)	(69)	(500)
At December 31, 2005	3,763	3,440	7,203
Analysis of total provisions:			
— Current portion	589	3,440	4,029
— Non-current portion	3,174	—	3,174
	3,763	3,440	7,203

(a) Certain staff quarters, prior to 1998, have been sold to its employees, subject to a number of eligibility requirements, at preferential prices. In 1998, the State Council issued a circular which stipulated that the sale of quarters to employees at preferential prices should be terminated. In 2000, the State Council issued a further circular stating that cash subsidies should be made to certain eligible employees following the withdrawal of allocation of staff quarters. However, the specific timetable and procedures of implementation of these policies were to be determined by individual provincial or municipal government based on the particular situation of the provinces or municipality.

32 Provisions *(continued)*

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who had not been allocated with quarters or who had not been allocated with quarters up to the prescribed standards before the discounted sales of quarters were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. Based on the available information, the Group estimated the required provision for these cash housing subsidies amounting to RMB4,142 million, which was charged to the consolidated income statement in the year ended December 31, 2000 when the State Council circular in respect of cash subsidies was issued.

(b) Pursuant to the Listing Reorganization and the Acquisition, if the actual payments required for these subsidies and early retirement benefits differ from the amount provided as at June 30, 2004 and June 30, 2005, China Netcom Group will bear any additional payments required or will be paid the difference if the actual payments are lower than the amount provided. There was no material settlement during the year ended December 31, 2005. (2004: Nil)

Notes to the Financial Statements

33 Deferred taxation

Movements of the deferred tax assets and liabilities are as follows:

	Balance at December 31, 2004	Recognised in income statement	Recognized in equity	Recognized in equity	Balance at December 31, 2005
	RMB million Restated Notes 2&3	RMB million	RMB million Note (i)	RMB million Note (ii)	RMB million
Deferred tax assets:					
Deferred revenue, primarily advances from customers	208	(29)	(9)	—	170
Temporary differences from allowance for doubtful debts	398	245	(293)	—	350
Unrecognized revaluation surplus and deficit (Note (ii))	2,114	(96)	—	843	2,861
Provision for early retirement benefits	597	(99)	(498)	—	—
Depreciation of fixed assets	325	95	(420)	—	—
Others	162	(10)	(53)	—	99
Balance at end of year	3,804	106	(1,273)	843	3,480
Deferred tax liabilities:					
Interest capitalized	(1,489)	32	196	—	(1,261)
Others	(87)	24	—	—	(63)
Balance at end of year	(1,576)	56	196	—	(1,324)
The amounts in the consolidated balance sheet are as follows:					
Deferred tax assets to be recovered after more than 12 months	2,997				2,906
Deferred tax liabilities to be settled after more than 12 months	(1,318)				(1,190)

33 Deferred taxation *(continued)*

	Balance at December 31, 2003	Recognized in income statement	Recognized in equity	Recognized in equity	Recognized in equity	Recognized in equity	Balance at December 31, 2004
	RMB million Restated Notes 2&3	RMB million	RMB million Note (iii)	RMB million Note (i)	RMB million Note (i)	RMB million Note (ii)	RMB million
Deferred tax assets:							
Deferred revenue, primarily advances from customers	944	(223)	—	—	(513)	—	208
Temporary differences from allowance for doubtful debts	458	166	—	—	(226)	—	398
Unrecognized revaluation surplus and deficit (Note (ii))	—	(241)	—	—	—	2,355	2,114
Provision for early retirement benefits	1,431	111	—	—	(945)	—	597
Disposal of fixed assets	1,577	(944)	—	—	(633)	—	—
Losses of taxation purpose	—	704	(704)	—	—	—	—
Depreciation of fixed assets	—	325	—	—	—	—	325
Others	450	(25)	—	—	(263)	—	162
Balance at end of year	4,860	(127)	(704)	—	(2,580)	2,355	3,804
Deferred tax liabilities:							
Revenue recognition	(712)	133	—	—	579	—	—
Depreciation of fixed assets	(4,843)	3,321	—	(1,275)	2,797	—	—
Deferred costs	(245)	114	—	—	131	—	—
Interest capitalized	(1,059)	(160)	—	—	(270)	—	(1,489)
Others	(113)	(26)	—	—	52	—	(87)
Balance at end of year	(6,972)	3,382	—	(1,275)	3,289	—	(1,576)
The amounts in the consolidated balance sheet as follows:							
Deferred tax assets to be recovered after more than 12 months	2,408						2,997
Deferred tax liabilities to be settled after more than 12 months	(5,997)						(1,318)

33 Deferred taxation *(continued)*

Notes:

(i) As described in Note 21, in connection with the Listing Reorganization and the Acquisition, certain of the Group's telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment were revalued as at December 31, 2003 and 2004. Such revalued amounts determine the tax bases for these assets for future years. In addition, except for the item described in Note (ii) below, the tax bases of certain assets and liabilities have been adjusted to the revalued amounts incorporated as the carrying values in the balance sheet.

In connection with the Listing Reorganization, the Group's net deferred tax liabilities were reduced by RMB709 million (comprising the recognition of deferred tax assets of RMB2,580 million and deferred tax liabilities of RMB3,289 million), and this decrease was recorded as a credit to owner's equity upon the date of the Reorganization on June 30, 2004. The RMB709 million net reduction of deferred tax liabilities, comprised RMB846 million, being the deferred tax liabilities from the revaluation surplus of fixed assets credited to revaluation reserves and RMB137 million of deferred tax assets debited to retained earnings.

In connection with the Acquisition, the Group's net deferred tax assets were subsequently reduced by RMB1,077 million (comprising deferred tax assets of RMB1,273 million and deferred tax liabilities of RMB196 million), and this decrease was recorded as a debit to owner's equity upon the date of the Reorganization on June 30, 2005. The RMB1,077 million deduction comprises RMB1,097 million, being deferred tax liabilities originating from the revaluation surplus of fixed assets recorded, was credited to revaluation reserves offset by RMB2,174 million deferred tax assets debited to retained earnings.

(ii) In addition, in order to determine the future tax bases used for future years after the Listing Reorganization and the Acquisition, the Group's up-front prepayments made for the leasehold land and buildings were revalued for PRC tax purposes as at December 31, 2003 and 2004. However, the resulting revaluations of the up-front prepayments made for the leasehold land and buildings were not incorporated into the consolidated financial statements. As a result, deferred tax assets were subsequently recorded with a corresponding increase in owner's equity upon the Listing Reorganization on June 30, 2004 and the Acquisition on June 30, 2005. In the opinion of the directors, it is more likely than not that the Group will realize the benefits of the deferred tax asset after making reference to the historical taxable income of the Group. The amount is transferred to retained earnings upon the corresponding realization of the underlying deferred tax assets.

During the Listing Reorganization, the leasehold land and buildings had a net surplus on revaluation of RMB6,967 million as at December 31, 2003. As explained in the preceding paragraph, a deferred tax asset of RMB2,355 million was subsequently recorded with a corresponding increase in owner's equity upon the Listing Reorganization on June 30, 2004. The amount transferred to retained earnings for the year ended December 31, 2005 was RMB57 million (2004: 241 million).

During the Acquisition, the leasehold land and buildings has a net surplus on revaluation of RMB2,553 million as at December 31, 2004. As explained above, a deferred tax asset of RMB843 million was subsequently recorded with a corresponding increase in owner's equity upon the Acquisition on June 30, 2005. The amount transferred to retained earnings for the year ended December 31, 2005 was RMB39 million.

(iii) This represents the net tax loss carried forward of the four newly acquired provinces/(autonomous) from year 2004. As the tax loss was utilised by China Netcom Group in the same year, the utilization of the deferred tax assets was reflected as a distribution to the owner in the combined statement of changes in owner's equity.

34 Share capital

	Authorised							
	Ordinary shares of US$0.04 each			Convertible preference shares of US$0.04 each (note (c))			Total	
	No. of shares	US$	RMB million	No. of shares	US$	RMB million	US$	RMB million
At January 1, 2004, December 31, 2004 and 2005	25,000,000,000	1,000,000,000	8,277	7,741,782	309,671	3	1,000,309,671	8,280

	Issued							
	Ordinary shares of US$0.04 each			Convertible preference shares of US$0.04 each (note (c))			Total	
	No. of shares	US$	RMB million	No. of shares	US$	RMB million	US$	RMB million
At January 1, 2004 (Note (b))	5,492,258,218	219,690,329	1,816	7,741,782	309,671	3	220,000,000	1,819
Conversion of convertible preference shares (Note (c))	7,741,782	309,671	3	(7,741,782)	(309,671)	(3)	—	—
Issue of shares through Global Offering (Note (d))	1,093,529,000	43,741,160	362	—	—	—	43,741,160	362
At December 31, 2004 and 2005	6,593,529,000	263,741,160	2,181	—	—	—	263,741,160	2,181

Notes:

(a) Pursuant to an ordinary resolution dated September 1, 2004, the authorized share capital of the Company was increased to US$1,000,000,000 by creating an additional 99,600,000,000 shares of US$0.01 each. Pursuant to an ordinary resolution passed on September 7, 2004, every four issued and unissued shares of US$0.01 each were consolidated into one new share of US$0.04 each. Following the creation of 99,600,000,000 additional shares and the share consolidation, the authorized share capital of the Company is RMB8,277 million divided into 25,000,000,000 shares of US$0.04 each, of which 5,492,258,218 shares were in issue and fully paid. The shares after the share consolidation rank pair in all respects with each other. All references to the share capital of the Company in this report have been adjusted retrospectively to take into account the increase in authorized share capital and share consolidation. The increase in authorized capital is applied respectively in presentation of share capital of the consolidated balance sheets as detailed in notes below.

(b) The share capital presented in the consolidated balance sheet at January 1, 2004 represents (i) the share capital of the Company, including the shares as at January 1, 2004 totaling 50,000,000 ordinary shares, (ii) shares issued for the asset injection arising from the Listing Reorganization totaling 5,442,258,218 ordinary shares.

The shares described in (ii) are deemed to have been issued since January 1, 2004 as the shares were issued for business combination under common control. The difference between the nominal value of the shares described in (ii) and the value of the net assets injected into the Company under the asset injection, totaling approximately RMB31 billion, is reflected as share premium

(c) All preference shares were converted into ordinary shares of the Company on August 30, 2004.

34 Share capital *(continued)*

(d) On December 8, 2004, the Company completed its Global Offering. The listing proceeds of the aforementioned Global Offering of shares, net of share issue expenses of HK$650 million (equivalent to RMB689 million) amounted to approximately HK$8,438 million (equivalent to RMB8,944 million). The resulting share premium amounted to approximately HK$8,096 million (equivalent to RMB8,582 million).

35 Share option scheme

A share option scheme was approved pursuant to a directors' resolution on September 30, 2004 ("Share Option Scheme"). Share options are granted to directors of the Company and to certain employees of the Group at the directors' discretion. Share options can be exercised at least 18 months from the later of the date of grant or the date of the listing of the shares of the Company on the Hong Kong Stock Exchange and subject to certain vesting schedules.

On October 22, 2004, 158,640,000 share options with an exercise price of HK$ 8.40 each were granted to the directors of the Company and certain employees of the Group (the "First Grant").

The total number of ordinary shares that are available for issuance upon the exercise of options granted pursuant to this scheme may not exceed 10% of the total number of issued ordinary shares. The Company may, however, seek separate approvals from its shareholders for granting options beyond the 10% limit.

Pursuant to the Company's share option plan, the Company granted 158,640,000 options to certain of its directors and employees, immediately prior to the closing of its global offering, to subscribe for its ordinary shares at the initial public offering price under the Hong Kong public offering, excluding brokerage and trading fees, and transaction and investor compensation levies. The First Grant has an exercise period of six years from the date of grant.

On December 6, 2005, the board of directors approved the granting of 79,320,000 shares of share options to certain management personnel of the newly acquired four northern provinces/autonomous region and other professional personnel designated by the Compensation and Nomination Committee.

A director resigned in 2004 and the options granted to him amounting to 920,000 were cancelled on the date of his resignation in accordance with the terms of the share option scheme.

Three staff resigned in 2005 and the options granted to them amounting to 1,017,000 cancelled on the date of his resignation in accordance with the terms of the share option scheme.

The movement of the share options granted during the year is summarized as follows:

	Outstanding as at 01/Jan/05	Granted during the year	Exercised during the year	Lapsed during the year	Cancelled during the year	Outstanding as at 31/Dec/05	Subscription price per share of the Company
							HK$
No. of share options	157,720,000	79,320,000	—	—	(1,017,000)	236,023,000	8.4/12.45
No. of directors and employees	455	260	—	—	(3)	712	

35 Share option scheme *(continued)*

The grant date fair value of the share options granted in the First Grant is determined by the Black-scholes model based on the following assumptions: expected dividend pay-off ratio of 35%, expected vesting period of 5 years, expected fluctuation rate of 23.6% and risk-free interest rate of 4.3%. The weighted average fair value of the share option on grant date was determined as HK$ 1.22 per share (RMB1.28 per share). Since there is subjectivity exercised in the valuation model adopted and the assumption based on which the fair value of the share options are determined, and any change in these subjective assumption may have significant impact to the fair value of the share options, the Black-Scholes Model adopted may not be able to reliably determine the fair value of the share options.

36 Reserves – Company

	Share premium	Capital Reserve	Retained earnings	Total
	RMB million	RMB million	RMB million	RMB million
At January 1, 2004	2,771	—	191	2,962
Issue of shares under listing Reorganisation	31,397	2,982	—	34,379
Distribution to owner in accordance with Listing Reorganization	—	—	(359)	(359)
Loss for the year	—	—	(59)	(59)
Distribution to an owner upon assignment of loan prior to the Global Offering	—	—	(1,021)	(1,021)
Issue of shares through Global Offering (net of issue expenses)	8,582	—	—	8,582
Share based payments (Note 3(a))	—	18	—	18
At December 31,2004, as restated	42,750	3,000	(1,248)	44,502
Profit for the year	—	—	126	126
Dividends distributed during the year (Note 12)	—	—	(259)	(259)
Share based payments	—	104	—	104
At December 31,2005	42,750	3,104	(1,381)	44,473

37 Consolidated cash flow statements

(a) Reconciliation of profit before taxation to net cash flows generated from operations

	Year ended December 31,	
	2005	2004
	RMB million	RMB million Restated Note 2&3
Profit before taxation	**17,317**	2,376
Depreciation of fixed assets and amortization of intangible assets	**25,012**	25,129
Lease prepayments for land	**37**	51
Amortization of deferred revenues	**(29,433)**	(24,154)
Deferred costs charged to the income statements	**2,553**	3,646
Deficit on revaluation of fixed assets	**—**	11,318
Bad and doubtful debts	**1,148**	1,185
Loss on disposal of fixed assets	**363**	212
Share based compensation	**104**	18
Dividend income	**(29)**	(17)
Share of loss of associated companies	**—**	1
Interest income	**(157)**	(87)
Interest expense	**3,586**	3,751
Discount on foreign currency exchange forward contracts	**—**	18
Unrealized loss on short-term investments	**—**	4
Foreign exchange (gain)/loss	**(232)**	105
Operating cashflow before working capital changes	**20,269**	23,556
Increase in accounts receivable	**(1,399)**	(1,010)
Decrease in inventories and consumables	**768**	108
Decrease/(increase) in prepayments, other receivables and other current assets	**788**	(505)
Increase in other non-current assets	**(519)**	(3,302)
(Decrease)/increase in accounts payable	**(3,281)**	1,512
Decrease in accruals and other payables	**(1,363)**	(3,008)
Increase in deferred revenues	**25,469**	20,083
Net cash inflow generated from operations	**40,732**	37,434

37 Consolidated cash flow statements *(continued)*

(b) Major non-cash transactions

During 2005, the Group paid RMB3,000 million as part of the total consideration for the Acquisition (Note 1). The remaining balance of RMB9,800 million is recognized as deferred payments and included in amount due to the ultimate holding company.

During 2005, the Group entered into finance lease arrangements in respect of newly acquired fixed assets with a total capital value at the inception of the lease of RMB338 million (2004: RMB1,950 million).

During 2004, the immediate holding company assigned a loan to the Company which resulted in a direct debit to the Company's equity.

38 Banking facilities

As at December 31, 2005 and 2004, the Group's banking facilities (most of them can be utilised for more than one year) are as follows:

	Group		**Company**	
	As at December 31,		**As at December 31,**	
	2005	2004	**2005**	2004
	RMB million	RMB million Restated Note 2	**RMB million**	RMB million
Amount utilized	**70,075**	79,560	**—**	—
Amount unutilized	**104,731**	24,349	**—**	—
Aggregate banking facilities	**174,806**	103,909	**—**	—

39 Commitments

(a) Capital commitments

	Group		Company	
	As at December 31, 2005 RMB million	As at December 31, 2004 RMB million Restated Note 2	**As at December 31, 2005 RMB million**	As at December 31, 2004 RMB million
Contracted but not provided for				
—Leasehold land and buildings	**227**	137	**—**	—
—Telecommunications networks and equipment	**1,376**	1,072	**—**	—
—Others	**112**	6	**—**	—
	1,715	1,215	**—**	—
Authorized but not contracted for				
—Leasehold land and buildings	**27**	2	**—**	—
—Telecommunications networks and equipment	**112**	1,778	**—**	—
—Others	**—**	—	**—**	—
	139	1,780	**—**	—

39 Commitments *(continued)*

(b) Operating lease commitments

The Group has future minimum lease payments under non-cancelable operating leases in respect of premises and equipment as follows:

	Group		Company	
	As at December 31,	As at December 31,	**As at December 31,**	As at December 31,
	2005	2004	**2005**	2004
	RMB million	RMB million Restated Note 2	**RMB million**	RMB million
Not later than one year	994	804	—	—
Later than one year and not later than five years	1,373	1,148	—	—
Later than five years	1,699	1,518	—	—
	4,066	3,470	—	—

40 Related party transactions

All state-controlled enterprises, their subsidiaries, their key management and their close family, and their employees represent related parties of the Group as defined by HKAS 24. China Netcom Group, the Group's parent company, is a state-controlled enterprise directly controlled by the PRC government, which controls different state-owned enterprises and drives the economy of the PRC. The Group is the dominant fixed line telecommunications service provider in northen China by virtue of its historical monopoly over these services. As a result, the Group has extensive transactions including sales to, purchases of services, goods and fixed assets from, leasing of assets from and banking transactions with other state-owned parties in its ordinary course of business. These transactions are carried out at terms similar to those obtained by other state-owned parties and have been reflected in the financial statements.

The Group's operations are subject to the supervision of and regulation by the PRC Government. The Ministry of Information Industry (MII), pursuant to the authority delegated by the PRC's State Council, is responsible for formulating the policies and regulations for the telecommunications industry in China, including granting license, allocating frequency spectrum, formulating interconnection and settlement arrangement between telecommunications operator, enforcing industry regulation and reviewing tariffs for domestic services. Other PRC governmental authorities also regulate tariff polices, capital investment and foreign investment in the telecommunications industry.

As a state-owned telecommunication operator, the Group has extensive transactions with other state-owned telecommunication operators in its ordinary course of business. These transactions are carried out in accordance with the rules and regulations stipulated by the MII of the PRC Government and disclosed below.

40 Related party transactions *(continued)*

The Group has extensive transactions with other members of the China Netcom Group. It is possible that the terms of the transactions between the Group and other members of the China Netcom Group are not the same as those that would result from transactions with other related parties or wholly unrelated parties.

Management believes that meaningful information relative to related party disclosures has been adequately disclosed.

	Notes	As at December 31, 2005 RMB million	2004 RMB million Restated Note 2
Emolument of key management	(i)		
- salaries and welfare		**22**	14
- contributions to retirement scheme		**1**	1
Subtotal		**23**	15
Interconnection fees			
— from fellow subsidiaries	(iv)(b)	**251**	148
— from other state-owned telecommunications operators	(iv)(b)	**6,442**	5,481
Subtotal		**6,693**	5,629
Interconnection charges			
— to fellow subsidiaries	(iv)(b)	**611**	198
— to other state-owned telecommunications operators	(iv)(b)	**1,475**	1,200
Subtotal		**2,086**	1,398
Rental income from properties leased to fellow subsidiaries	(iv)(a),(iv)(c)	**—**	3
Purchase of materials			
— from fellow subsidiaries	(iv)(a),(iv)(c)	**1,298**	2,122
— from other related companies	(iv)(a),(iv)(c)	**231**	822
Subtotal		**1,529**	2,944

40 Related party transactions *(continued)*

	Notes	As at December 31, 2005 RMB million	2004 RMB million Restated Note 2
Receipt of engineering, project planning, design, construction and information technology services			
— from fellow subsidiaries	(iv)(a),(iv)(b)	**2,236**	3,185
— from other related companies	(iv)(a),(iv)(b)	**413**	392
Subtotal		**2,649**	3,577
Ancillary telecommunications support services			
— from fellow subsidiaries	(v)	**435**	554
— from other related companies	(v)	**51**	235
Subtotal		**486**	789
Payment of operating lease rentals of premises			
— to fellow subsidiaries	(iv)(a),(iv)(c)	**655**	311
— to other related companies	(iv)(a),(iv)(c)	**—**	5
Subtotal		**655**	316
Property sub-lease rentals to fellow subsidiaries	(iv)(a),(iv)(c)	**15**	33
Common corporate services income from ultimate holding company	(vi)	**89**	19
Common corporate services expenditure paid to ultimate holding company	(vi)	**279**	213
Support services received			
— from ultimate holding company	(vii)	**2**	—
— from fellow subsidiaries	(vii)	**888**	937
— from other related companies	(vii)	**264**	1,487
Subtotal		**1,154**	2,424

40 Related party transactions *(continued)*

	Notes	As at December 31, 2005 RMB million	2004 RMB million Restated Note 2
Telecommunications rental income from other state-owned telecommunications operators	(iv)(b)	**1,271**	1,182
Payment for lease of Telecommunications facility			
— to ultimate holding company	(viii)	**85**	—
— to fellow subsidiaries	(viii)	**215**	138
Subtotal		**300**	138
Payment for purchase of long-term telecommunications capacity to fellow subsidiaries	(ix)	**117**	173
Payment for lease of long-term telecommunications capacity to fellow subsidiaries	(x)	**84**	28
Management fee received from fellow subsidiaries	(xi)	**39**	28

Notes:

(i) Represents the emoluments paid to all of the directors and the top management of the Group, who are considered as the related parties of the Group.

(ii) The Group entered into finance lease arrangements with a related party, details have been set out in Note 29 b(ii).

(iii) Related party represents the non-listed investees of the fellow subsidiaries.

(iv) Priced based on one of the following three criteria:

(a) market price;

(b) prices based on government guidance; or

(c) cost plus basis.

40 Related party transactions *(continued)*

Notes: *(continued)*

(v) Represents the provision of ancillary telecommunications support services to the Group by the fellow subsidiaries and the related companies. These services include certain telecommunications pre-sale, on-sale and after-sale services, certain sales agency services, the printing and delivery of invoice services, the maintenance of certain air-conditioning, fire alarm equipment and telephone booths and other customer services.

(vi) The Group entered into a Master Service Sharing agreement with China Netcom Group pursuant to which expenses associated with common corporate services are allocated between the Group and China Netcom Group based on total asset as appropriate.

(vii) Represents the support services provided to the Group by fellow subsidiaries and the related companies. These support services include equipment leasing services, motor vehicles services, safety and security services, conference services, basic construction agency services, equipment maintenance services, employee training services, advertising services, printing services and other support services.

(viii) The Group entered into a Telecommunications Facilities Leasing Agreement with China Netcom Group pursuant to which the Group leases the international telecommunications facilities and inter-provincial transmission optic fibers from China Netcom Group. The lease payment is based on the depreciation charge of the assets.

(ix) The Group entered into a Capacity Purchase Agreement with East Asia Netcom Limited ("EANL"), a wholly owned subsidiary of China Netcom Group, pursuant to which the Group receives certain amounts of long-term telecommunications capacity from China Netcom Group at market prices as set out in the Capacity Purchase Agreement.

(x) The Group entered into a Capacity Lease Agreement with EANL, pursuant to which the Group leases certain amount of capacity of China Netcom Group's telecommunications network at market rates as set out in the Capacity Lease Agreement.

(xi) The Group entered into a Management Services Agreement with EANL, pursuant to which the Group provides certain management services to China Netcom Group either on a cost reimbursement basis or on the basis of cost plus reasonable profits not exceeding the market price as set out in the Management Service Agreement.

(xii) In addition, pursuant to the Listing Reorganization and the Acquisition, China Netcom Group have agreed to hold and maintain, for the Group's benefit, all licenses received from the MII in connection with the Restructured Businesses transferred to the Group. The licenses maintained by China Netcom Group were granted by the MII at nil or nominal costs. To the extent that China Netcom Group incurs a cost to maintain or obtain licenses in the future, the Company has agreed reimburse China Netcom Group for any such expense.

(xiii) China Netcom Group has also agreed to indemnify the Group in connection with any tax and deferred tax liabilities not recognized in the financial statements of the Group arising from transactions prior to the date of Listing Reorganization and the Acquisition in relation to the business of the Group prior to the Acquisition and the business of the newly acquired four provinces/ autonomous region respectively.

(xiv) As at December 31, 2005, China Netcom Group granted corporate guarantees to the Group as set out in Note 29 (b).

(xv) China Netcom Group, the Group's ultimate holding company, entered into an agreement (the "Sponsorship Agreement") with Beijing Organization Committee ("BOCOG") which designated China Netcom Group as the exclusive fixed-line telecommunications services partner in the People's Republic of China ("PRC") to sponsor the 2008 Beijing Olympic Games. China Netcom Group allocated the sponsorship fee to its members based on the estimated future benefits derived from the Sponsorship Agreement to respective members and the Group has contributed a portion of the required support under the Sponsorship Agreement through providing cash to BOCOG amounting to RMB540 million. Accordingly, an intangible asset and a payable to the ultimate holding company of the said amount have been recognized on the Group's balance sheet.

40 Related party transactions *(continued)*

Notes: *(continued)*

(xvi) At December 31, 2005, the Group has balances with other state-owned telecommunication service providers and loans granted from state-owned banks as set out in Notes 18, 27 and 29 respectively.

(xvii) The Acquisition was completed at October 31, 2005. Details have been set out in Note 1.

41 Significant subsequent events

After the balance sheet date the directors proposed a final dividend. Further details are disclosed in Note 12.

42 Ultimate holding party

The ultimate holding company is China Netcom Group which is owned and controlled by PRC Government.

43 Approval of financial statements

The financial statements were approved by the Board of Directors on March 21, 2006.