(Amounts expressed in Rmb unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

p. Taxation *(Cont'd)*

(ii) Income Tax *(Cont'd)*

The income tax charge is based on profit for the year and considers deferred taxation. Deferred taxes are calculated using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured using the tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying account of its assets and liabilities.

Deferred tax assets and liabilities are recognized regardless of when the timing difference is likely to reverse. Deferred tax assets are recognized when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilized. At each balance sheet date, the Company re-assesses unrecognized deferred tax assets and the carrying amount of deferred tax assets. The Company recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. The Company conversely reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized.

q. Related Parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

(Amounts expressed in Rmb unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

r. Financial Instruments

Financial assets and financial liabilities carried on the balance sheet include cash and cash equivalents, investments, accounts receivable and payable, other receivables and payables, loans and borrowings. The significant accounting policies on recognition and measurement of the major items are disclosed in the respective accounting policies above.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument classified as a liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Company has a legally enforceable right to offset and intends to settle either on a net basis or to realize the asset and settle the liability simultaneously.

s. Hedging Interest Rate Exposure

Interest rate swap agreements are undertaken by the Company to hedge its debt obligations against the risk of interest rate movements. The interest differentials to be paid or received under such swaps are recognized over the life of the agreements as adjustments to interest expenses.

t. Impairment of Assets

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in income for items of property, plant and equipment and intangibles carried at cost. The recoverable amount is the higher of an asset's net selling price and value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit.

Reversal of impairment losses recognized in prior years is recorded when there is an indication that the impairment losses recognized for the asset no longer exist or has decreased. The reversal is recorded in income.

Based on its most recent analysis, the Company believed that there was no impairment of its assets as at 31st December, 2000.

(Amounts expressed in Rmb unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

u. Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognized in the financial statements but disclosed when an inflow of economic benefits is probable.

v. Subsequent Events

Post-year-end events that provide additional information about a company's position at the balance sheet date (adjusting events), are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

3. SALES OF ELECTRIC POWER

The Company has contractual arrangements for the sale of electric power with the local power companies. All power output is sold at rates designed to cover all operating and debt service costs, taxes and any exchange losses incurred, plus a reasonable return on the Company's rate base.

For the years ended 31st December, 2000 and 1999, all operating revenues were billed at the on-grid wholesale rates to the local power companies, except for the Shantou Oil-Fired Power Plant whereby operating revenues were billed at the retail rate being charged to the ultimate consumers.

Under the retail rate arrangement, the local power company collected revenue from the ultimate consumers and remitted it to the Shantou Oil-Fired Power Plant after deducting the cost of transmission and an agreed amount of handling fees. The Shantou Oil-Fired Power Plant recognized the gross amount received as revenue with the reimbursement of transmission costs and payment of handling fees to the local power company being separately recorded as transmission fees under operating expense. For power plants subject to on-grid wholesale rates, since such rates excluded the transmission costs incurred by the local power companies, no transmission fees were recorded.

Sales incentives are paid to the power companies usually as an incentive to dispatch electricity of the Company in excess of the amount the Company has agreed to generate for them during the year. No sales incentives were paid for the year ended 31st December, 2000 (1999: Rmb63 million).

(Amounts expressed in Rmb unless otherwise stated)

4. PROFIT BEFORE TAXATION

Profit before taxation was determined after charging and (crediting) the following:

	2000	1999
	'000	'000
Interest expenses on convertible notes	**146,762**	139,776
Interest expenses on:		
- bank loans wholly repayable within 5 years	**135,835**	111,776
- bank loans repayable beyond 5 years	**572,040**	894,766
Interest expenses on:		
- shareholders loans wholly repayable within 5 years	**153,044**	120,190
- shareholders loans repayable beyond 5 years	**—**	113,644
Interest expenses on loan from Nanjing Investment wholly repayable within 5 years	**16,972**	22,703
	1,024,653	1,402,855
Less: amount capitalized in property, plant and equipment	**—**	(503,075)
Total interest expenses	**1,024,653**	899,780
Interest income	**(79,723)**	(108,601)
Interest expense, net	**944,930**	791,179
Auditors' remuneration	**7,119**	4,796
Loss on disposals of fixed assets	**50,879**	6,444
Operating lease rentals	**32,334**	7,834
Exchange loss (gain), net	**34,936**	(63,923)
Depreciation and amortization	**2,666,949**	2,391,998
Cost of materials and supplies	**4,001,614**	3,499,699
Pension cost	**80,608**	62,620
Provision for bad debts	**4,588**	—
Provision for obsolescence	**10,608**	—

(Amounts expressed in Rmb unless otherwise stated)

5. RELATED PARTY TRANSACTIONS

a. Pursuant to the relevant service agreements, HIPDC provides transmission and transformer facilities to some of the power plants of the Company and receives service fees. Such service fees represent recoverable costs for rate setting purposes. For the Shangan Power Plant, the Fuzhou Power Plant and the Shantou Oil-Fired Power Plant, such service fees include various costs of transmission incurred by HIPDC plus a profit margin of 10% of the average net book value of HIPDC's transmission facilities. For the Shantou Power Plant, the Shangan Power Plant Phase II and the Shanghai Power Plant, the annual service fees were fixed and equal to 12% of the original book value of HIPDC's transmission and transformer facilities. The total service fees paid to HIPDC for the year ended 31st December, 2000 was approximately Rmb311 million (1999: Rmb306 million).

b. At the time of the formation of the Company, HIPDC transferred the land use rights pertaining to existing sites occupied by the five original operating plants for a period of 50 years in return for an amount of approximately Rmb148 million. Payments to HIPDC for the land use rights are being made in 10 equal, non-interest bearing, annual installments starting in 1994. The land use rights have been included in the fixed assets of the Company and are being amortized over the land use period of 50 years. Amortization expenses are recovered under the rate setting scheme.

c. In accordance with the leasing agreement entered into between the Company and HIPDC, the land use rights of the Shanghai Power Plant is leased to the Company for a period of 50 years at an annual rental payment of Rmb6 million.

d. Pursuant to an acquisition agreement entered into amongst the Company, HIPDC and Nanjing Investment in 1999 (the "Nanjing Acquisition Agreement"), the Company acquired from HIPDC and Nanjing Investment the existing power generation facilities and related assets and liabilities of the Nanjing Power Plant. The total purchase price was approximately Rmb2,702 million which was based on the appraised value of the assets acquired as determined by an independent appraiser. According to the Nanjing Acquisition Agreement, the total purchase price was to be settled as follows:

   (i) assumption by the Company of the current and long-term liability of Nanjing Power Plant in an aggregate principal amount of approximately Rmb1,349 million (including Rmb98 million payable to HIPDC);

   (ii) issuance and allotment to HIPDC of 160,000,000 domestic share and to Nanjing Investment of 40,000,000 domestic shares on the date on which a public offering of domestic shares of the Company is completed on or before 31st December, 1999 where each of the domestic shares are to be valued at the same issue price of the public offering;

(Amounts expressed in Rmb unless otherwise stated)

5. RELATED PARTY TRANSACTIONS *(Cont'd)*

(iii) remaining balance to be settled in cash within ten days upon completion of the public offering of the domestic shares of the Company;

(iv) if the public offering of the domestic shares is not completed by 31st December, 1999, the net consideration payable would be fulfilled partly by cash payment of approximately Rmb776 million (composed of Rmb534 million and Rmb242 million payable to HIPDC and Nanjing Investment respectively). There were no specific repayment terms regarding the remaining balance of approximately Rmb577 million payable to HIPDC.

As the public offering of Domestic Shares was not completed by 31st December, 1999, the Company and HIPDC entered into a supplementary agreement ("Nanjing Acquisition Supplementary Agreement") on the same date. According to the Nanjing Acquisition Supplementary Agreement, the Company settled the current liability of Nanjing Power Plant of approximately Rmb98 million (included in (i)) and the cash payment of Rmb534 million and Rmb577 million to HIPDC (included in(iv)) on 31st December, 1999. In 2000, the Company paid Rmb100 million to Nanjing Investment to settle part of the remaining consideration for Nanjing Acquisition.

e. With reference to the Nanjing Acquisition Agreement, the Company, HIPDC and Nanjing Investment entered into a leasing agreement whereby HIPDC and Nanjing Investment leased to the Company the land where the Nanjing Power Plant operates for 50 years with an annual rental payment of approximately Rmb1.3 million, starting from the year ended 31st December, 1999.

f. Effective from 1st July, 1997, pursuant to a coal purchase agreement and a supplemental letter relating thereto entered into between the Company and HIPDC, HIPDC agreed to purchase coal on behalf of the Company and charge a handling fee at Rmb1.5 to 2.0 per ton. The total handling fees paid to HIPDC for the year ended 31st December, 2000 was approximately Rmb2.27 million (1999 Rmb5.3 million).

g. As at 31st December, 2000, current deposits of approximately Rmb166 million (1999: Rmb420 million) and fixed deposits of approximately Rmb100 million (1999: Rmb650 million) were placed with a non-bank PRC financial institution, which is a subsidiary of China Huaneng Group (see Note 9).

h. The Company entered into a service agreement with HIPDC under which, effective from 1st July, 1997, HIPDC agreed to lease certain office space to the Company at an annual rental of Rmb500,000 and permit the Company to use its satellite telecommunication facilities at an annual fee of Rmb300,000. Such agreement expired on 31st December, 1999.

i. Pursuant to the leasing agreement between the Company and HIPDC signed on 26th December, 2000, HIPDC agreed to rent its building to the Company as new office for 5 years at an annual rental of Rmb25 million effective from 1st January, 2000.

(Amounts expressed in Rmb unless otherwise stated)

5. RELATED PARTY TRANSACTIONS *(Cont'd)*

j. As at 31st December, 2000, long-term bank loans of approximately Rmb418 million (1999 : Rmb692 million) were guaranteed by HIPDC.

k. As described in Note 18(b), certain bank loans were on-lent from HIPDC to the Company.

l. The balances with HIPDC are unsecured, non-interest bearing and repayable within one year.

6. RETIREMENT PLAN AND POST-RETIREMENT BENEFITS

All PRC employees of the Company are entitled to a monthly pension at their retirement dates. The PRC government is responsible for the pension liability to these retired employees. The Company is required to make contributions to the state-sponsored retirement plan at a specified rate, currently set at 17% to 20%, of the basic salary of the PRC employees. The retirement plan contributions paid for the year ended 31st December, 2000 was approximately Rmb42 million (1999: Rmb29 million).

In addition, the Company has implemented a supplementary defined contribution retirement scheme. Under this scheme, the employees are required to make a specified contribution based on the number of years of service with the Company, and the Company is required to make a contribution equal to twice the employees' contributions. Moreover, the Company may, at its discretion, provide additional contributions to the retirement fund depending on the operating results of the year. The employees will receive the total contributions upon their retirement. The contributions paid by the Company for the year ended 31st December, 2000 was approximately Rmb39 million (1999: Rmb34 million).

The Company has no further obligation for post-retirement benefits beyond the above annual contributions made.