SIGNIFICANT DIFFERENCE BETWEEN HK GAAP AND US GAAP

The accounting policies adopted by the Group conform to HK GAAP which differ in certain respects from the generally accepted accounting principles in the United States of America ("US GAAP"). The principal differences having a significant effect on the financial statements are set out below.

(a) Revenue and costs recognition

Under HK GAAP, upfront non-refundable revenue, such as connection fees, is recognised when received upon completion of activation services. Under US GAAP, in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements", upfront non-refundable revenue and the related direct incremental costs incurred are deferred and recognised over the estimated customer service periods. The expected customer service period for each of the provincial branches of the Cellular Business is estimated based on the expected stabilised churn rates applicable to that branch. On this basis, the weighted average customer service period is approximately 10 years.

(b) Employee housing schemes

Prior to the establishment of Guoxin and China Unicom, China Telecom and Unicom Group, respectively, provided housing benefits to qualified employees of the Group to enable them to purchase living quarters. Under HK GAAP, housing benefits incurred and borne by China Telecom and Unicom Group for these employees were not recognised by the Group. Under US GAAP, the amount of such housing benefits was recorded as the Group's operating expenses over the estimated average service life of the participating employees. The corresponding amount was recorded as a capital contribution.

(c) Deferred taxation

Under HK GAAP, the Group provides for deferred tax liabilities only to the extent that there is a reasonable probability that such deferred taxes will become payable in the foreseeable future. Deferred tax assets are not recognised unless they are expected to crystallise in the foreseeable future. Under US GAAP, a provision is made for all deferred taxes. If it is more likely than not that deferred tax assets will not be realised, a valuation allowance is recorded.

(d) Revaluation of fixed assets

Under HK GAAP, revaluation surplus in relation to land and buildings is recorded by the Group. Thereafter, depreciation is provided based on the revalued amounts. Under US GAAP, all fixed assets are stated at historical cost.

(e) Impairment of long-lived assets

The carrying amount of fixed assets and goodwill under HK GAAP is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline occurs, the carrying amount is reduced to the recoverable amount based on the expected future cash flows generated by the assets discounted to their present value. A subsequent increase in the recoverable amount is written back to the income statement when circumstances and events that led to the write-down or write-off cease to exist.

Under US GAAP, long-lived assets including goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is evaluated by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognised is measured by the amount by which the carrying amounts of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Impairment of goodwill is evaluated in connection with a business acquired. For the measurement of impairment of goodwill, the fair value is determined based on the estimated discounted future cash flows of the business acquired.

For the years ended 31 December, 1999 and 2000, there were no differences arose in respect of the timing and amount of impairment recognition of long-lived assets.

(f) Losses on debt extinguishment and share warrants

Under HK GAAP, the loss on CCF termination is accounted for as an operating loss which reduces the income from continuous operations of the Group. Under US GAAP, the amounts were classified as an extraordinary item in accordance with the requirement of SFAS Statement No. 4.

Under HK GAAP, the Company share warrants granted to the CJVs or their designees as part of the compensation for terminations of CCF Arrangements do not result in an expense. The proceeds received from share warrants are recognised as an increase to capital upon the exercise of the share warrants. Under US GAAP, in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation", ("SFAS 123"), an additional charge to income statement is recorded to account for the fair value of the share warrants granted at the completion of the Global Offering. The fair value of these share warrants as of the grant date, using the Black-Scholes option pricing method, was approximately RMB1,132 million. The major assumptions used include: no dividend yield, expected volatility of 50%, risk free interest rate of 6.54% and an expected life of one year.

(g) Write-off of redundant fixed assets

Under HK GAAP, non-recurring write-off of redundant fixed assets upon the combination of local paging business is classified as "other expenses". Under US GAAP, in accordance with SFAS 121, such assets write-off is classified as a component of "operating expenses" in determining "operating income".

(h) Share option scheme

Under HK GAAP, the proceeds received from the exercise of the share options granted under the fixed award Pre-Global Offering Share Option Scheme are recognised as an increase to capital upon the exercise of the share options.

Under US GAAP, the Company applies Accounting Principles Board Opinion No. 25 ("APB 25") to account for its fixed award stock options issued to employees. Under APB 25, compensation expense is recorded in the amount of the excess, if any, of the quoted market price of the shares on the date of grant over the exercise price of the options, which is amortised over the vesting period of the option. Since the exercise price of the option granted is the share issue price of the Global Offering, no compensation cost for options has been recognized in the reconciliation of net income to US GAAP. Required disclosures under SFAS 123 are provided below.

(i) Investment in equity securities

Under HK GAAP, negotiable equity securities including ownership interest in an enterprise, which are intended to be held on a continuing basis, are classified as investment securities and are stated at cost. The carrying amounts of investment securities are written down to reflect any diminution in value expected to be other than temporary. Provisions against the carrying value are reversed when the circumstances and events that led to the writedowns or write-offs cease to exist and if there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Under US GAAP, equity securities which are not marketable and do not have readily determinable fair values are classified as other investments, which are stated at cost less impairment in value other than temporary. If an impairment in value is judged to be other than temporary, the cost of the investment is written down to its recoverable amount as a new cost basis and the amount of the write-down is included in the statement of income. The new cost basis is not changed for subsequent recoveries in value.

During the years ended 31 December, 1999 and 2000, there was no recovery in the value of investments in equity securities.

(j) Newly issued accounting standards

In June 1998, FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133 stipulates accounting and reporting standards for derivative instruments and for hedging activities. SFAS 133 requires an entity to recognise all derivatives as either assets or liabilities in the balance sheet and measure those instruments at their fair values. Changes in fair values for derivatives are recorded in either current income or other comprehensive income, depending on whether a derivative is designed as part of a hedge transaction and the type of the hedge transaction. SFAS 133, as recently revised by SFAS 137, is effective for fiscal years beginning after 15 June, 2000. The impact of the adoption of this new standard on the Group's operating results and financial position is not expected to be significant.

Differences between HK GAAP and US GAAP which affect net income of the Group are summarised below:

	Year ended 31 December,	
	2000	1999
	RMB'000	RMB'000
Net income under HK GAAP	**3,234,051**	839,147
Impact of US GAAP adjustments:		
— Deferral and amortisation of upfront non-refundable revenue	**(327,788)**	(498,291)
— Deferral and amortisation of direct incremental cost	**294,581**	324,257
— Additional charge relating to the grant of share warrants for the terminations of CCF arrangements	**(1,131,806)**	—
— Employee housing benefits	**(18,532)**	(15,590)
— Reversal of depreciation for revalued fixed assets	**12,610**	—
— Reversal of revaluation deficit of fixed assets	**28,000**	—
— Recognition of deferred tax assets in relation to loss carryforward from a subsidiary	**23,582**	21,272
— Valuation allowance	**(23,582)**	(21,272)
— Recognition of other deferred tax assets	**90,213**	88,128
Net income as restated (US GAAP)	**2,181,329**	737,651
Add back: Extraordinary item (loss arising from terminations of CCF arrangements)		
— cash compensation	**1,193,838**	224,270
— share warrants compensation	**1,131,806**	—
— less: related tax impact	**(393,967)**	(74,009)
	1,931,677	150,261
Income from continuing operations before extraordinary item (US GAAP)	**4,113,006**	887,912
Basic and diluted net income per share after extraordinary item (RMB)	**0.19**	0.08
Basic and diluted net income per ADS after extraordinary item (RMB)	**1.94**	0.76
Basic and diluted net income per share before extraordinary item (RMB)	**0.37**	0.09
Basic and diluted net income per ADS before extraordinary item (RMB)	**3.67**	0.91

Differences between HK GAAP and US GAAP which affect Shareholders' equity of the Group are summarised below:

	Note	**Consolidated As of 31 December, 2000 RMB'000**	Consolidated As of 31 December, 1999 RMB'000
Shareholders' equity under HK GAAP		**57,224,402**	8,538,346
Impact of US GAAP adjustments:			
— Deferral and amortisation of upfront non-refundable revenue		**(1,645,700)**	(1,317,912)
— Deferral and amortisation of direct incremental cost		**840,256**	545,675
— Reversal of revaluation surplus of fixed assets		**(176,853)**	—
— Reversal of depreciation for revalued fixed assets		**12,610**	—
— Reversal of revaluation deficit of fixed assets		**28,000**	—
— Recognition of deferred tax assets in relation to loss carryforward from a subsidiary		**107,299**	83,717
— Valuation allowance	(i)	**(107,299)**	(83,717)
— Recognition of other deferred tax assets		**228,061**	137,848
Shareholder's equity restated (US GAAP)		**56,510,776**	7,903,957

Note:

(i) A valuation allowance was recorded against the deferred tax assets in relation to the loss carryforward from a subsidiary because it is highly uncertain as to whether sufficient future profit can be generated by the subsidiary to utilise the tax loss within the five-year carryforward period allowed under the current tax laws of the PRC.

Reclassifications

The reconciliation of net income and shareholders' equity from HK GAAP to US GAAP as presented above includes those items which have a net effect on net income or shareholders' equity. Other than the principal differences between HK GAAP and US GAAP explained above, there are no other major GAAP differences which would affect the classification of assets and liabilities or income and expenses.

Statement of cash flows

The Group applies Hong Kong Statement of Standard Accounting Practice No. 15 "Cash Flow Statements" ("SSAP 15"). Its objectives and principles are similar to those set out in the United States Financial Accounting Standard Board Statement No. 95 "Statement of Cash Flows" ("FASB 95"). The principal differences between the standards relate to classification. Under SSAP 15, the Group presents its cash flows for (a) operating activities; (b) return on investments and servicing of finance; (c) taxation; (d) investing activities; and (e) financing activities. Cash flows from taxation and returns on investments and servicing of finance would be included as operating activities under FASB 95, with the exception of distributions, which under FASB 95 would be classified as financing activities. Summarised cash flow data by operating, investing and financing activities in accordance with FASB 95 are as follows:

	Year ended 31 December,	
	2000	1999
	RMB'000	RMB'000
Net cash inflows from:		
Operating activities	**9,343,867**	5,474,186
Investing activities	**(30,550,946)**	(13,929,605)
Financing activities	**59,921,403**	10,121,030
Changes in cash and cash equivalents	**38,714,324**	1,665,611
Cash and cash equivalents, beginning of year	**6,002,361**	4,336,750
Cash and cash equivalents, end of year	**44,716,685**	6,002,361

Share option scheme

Information relating to the stock options outstanding under the Pre-Global Offering Share Option Scheme as of 31 December, 2000 is as follows:

	Options outstanding	**Exercise price HK$**
Outstanding, beginning of year	—	—
Granted during the year	**27,116,600**	**15.42**
Outstanding, end of year	**27,116,600**	**15.42**

As of 31 December, 2000, the remaining contractual life of the options outstanding is approximately 9.5 years.

The SFAS 123 method of accounting is based on several assumptions and should not be viewed as indicative of the operation of the Company in future periods. The fair value of each option granted to the employees is estimated on the date of grant to be HK$8.14 using the Black-Scholes option pricing method with the weighted average assumptions as follows:

	2000
Risk free interest rate	**6%**
Expected life (in years)	**5**
Expected dividend yield	**0%**
Volatility	**54%**

Had the compensation costs for the plan been determined based on the estimated fair value at the grant dates for awards under the plan consistent with the method of SFAS 123, the Company's net income and net income per share on a pro forma basis for the year ended 31 December, 2000 would have been as follows:

	2000
Net income:	
As reported (RMB'000)	**2,181,329**
Pro forma (RMB'000)	**2,121,670**
Basic and diluted net income per share:	
As reported (RMB)	**0.19**
Pro forma (RMB)	**0.19**