The accounting policies adopted by the Group to conform to HK GAAP 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 the Cellular Business is estimated based on the expected stabilised churn rates. On this basis, the weighted average customer service period based on current estimation considering the prevailing market environment is approximately 6 years (2000: 10 years). The effect of this change of estimate was to increase the net income by approximately RMB26 million for the year ended 31 December 2001.

(b) Employee housing schemes

Prior to the establishment of Guoxin and China Unicom, both China Telecom and Unicom Group, 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.

(e) **Impairment of long-lived assets (Cont'd)**

Under US GAAP Statements of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS 121"), 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, which is determined based on the estimated future discounted net cash flows expected to be generated by the asset held for continuous use. Assets impaired or to be disposed of are reported at the lower of the carrying amounts or fair values less costs to sell, which result in a new cost basis for the impaired assets. This new cost basis is not adjusted for subsequent recoveries in value.

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. When goodwill is identified with assets that are subject to impairment, the carrying amount of the identified goodwill is eliminated before any reduction of the carrying amounts of impaired long-lived assets.

As impairment of assets is evaluated using undiscounted net cash flow method under US GAAP, the impairment provisions for equipment and goodwill recognised under US GAAP were lower than those recognised under HK GAAP by RMB12,382,000 and RMB62,948,000, respectively for the year ended 31 December 2001. No such difference existed in prior years.

(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's share warrants granted to the CJVs or their designees as part of the compensation for terminations of CCF Arrangements did not result in an expense. The proceeds received from share warrants would be recognised as an increase to capital upon the exercise of the share warrants. Under US GAAP, an additional charge to income statement was 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) **Share option scheme**

Under HK GAAP, the proceeds received from the exercise of the share options granted under the fixed award Share Option Scheme and Pre-Global Offering Share Option Scheme are to be recognised as an increase to capital upon the exercise of the share options as stated in Note 31.

(g) Share option scheme (Cont'd)

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 options granted did not exceed the market price of the underlying stock on the date of grant, no compensation cost for options has been recognised in the reconciliation of net income to US GAAP. Required disclosures under Statement of Financial Accounting Standards No. 123 , "Accounting for Stock-Based Compensation"("SFAS 123") are provided below.

(h) 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 write-downs 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 year ended 31 December 2001, the recovery in the value of investments in equity securities amounted to approximately RMB12,305,000 (2000: Nil).

(i) Derivative instruments

In June 1998, the Financial Accounting Standard Board ("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 revised by SFAS 137 and SFAS 138, is effective for fiscal years beginning after 15 June 2000. There were no material impacts of the adoption of these new standards on the Group's operating results and financial position.

(j) Recently issued accounting standards

During the year, FASB issued Statement of Financial Accounting Standards No. 141, “Business Combinations” (“SFAS 141”), Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”), Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations (“SFAS 143") and Statement of Financial Accounting Standards No. 144 “Accounting for the Impairment or Disposal of Long-lived Assets” (“SFAS 144”).

(a) SFAS 141 addresses financial accounting and reporting for business combinations and requires that the purchase method of accounting to be used for all business combinations after 30 June 2001. SFAS 141 is effective for fiscal years beginning after 15 December 2001 except for those goodwill and intangible assets acquired after 30 June 2001 or arising from combinations between mutual enterprises.

(b) Under SFAS142, goodwill and certain other intangible assets will no longer be systematically amortised, but instead will be reviewed for impairment annually and written down and charged to results of operations when their carrying amounts exceed their estimated fair values. SFAS 142 is effective for fiscal years beginning after 15 December 2001 except for those goodwill and intangible assets acquired after 30 June 2001 or arising from combinations between mutual enterprises.

(c) SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS 143 is effective for fiscal years beginning after 15 June 2002.

(d) SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The changes in SFAS 144 improve financial reporting by requiring that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held or used or newly acquired, and by broadening the presentation of discontinued operations to include more disposal transactions. SFAS 144 also resolves significant implementation issues related to impairment. SFAS 144 is effective for fiscal years beginning after 15 December 2001.

The Group has not completed its assessment of the effects of adopting SFAS 141, SFAS 142, SFAS 143 and SFAS 144.

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

	Year ended 31 December	
	2001	2000
	RMB'000	RMB'000
Net income under HK GAAP	**4,456,761**	3,234,051
Impact of US GAAP adjustments:		
- Deferral of upfront non-refundable revenue	**(1,001,637)**	(1,168,822)
- Amortisation of upfront non-refundable revenue	**455,839**	252,520
- Deferral of direct incremental cost	**934,713**	1,071,222
- Amortisation of direct incremental cost	**(358,867)**	(199,497)
- Employee housing benefits	**(18,532)**	(18,532)
- Reversal of depreciation for revalued fixed assets	**7,485**	12,610
- Reversal of revaluation deficit of fixed assets	**—**	28,000
- Differences in provision for impairment loss of equipment	**12,382**	—
- Differences in provision for impairment loss of goodwill	**62,948**	—
- Non-recognition of recovery of impairment provision of investment securities and associated companies	**(17,948)**	—
- Deferred tax impact arising from deferral and amortisation of upfront non-refundable revenue and incremental costs	**63,126**	11,370
- Deferred tax impact arising from differences in provision for impairment loss of equipment and goodwill and non-recognition of recovery of impairment provision of investment securities and associated companies	**(18,936)**	—
- Additional charge relating to the grant of share warrants for the terminations of CCF Arrangements	**—**	(1,131,806)
- Recognition of deferred tax assets in relation to the loss carryforward from a subsidiary	**—**	23,582
- Valuation allowance	**—**	(23,582)
- Recognition of other deferred tax assets	**145,098**	90,213
Net income as restated (US GAAP)	**4,722,432**	2,181,329
Add back: Extraordinary item (loss arising from terminations of CCF Arrangements)		
- cash compensation	**—**	1,193,838
- share warrants compensation	**—**	1,131,806
- less: related tax impact	**—**	(393,967)
	—	1,931,677
Income from continuing operations before extraordinary item (US GAAP)	**4,722,432**	4,113,006
Basic and diluted net income per share after extraordinary item (RMB)	**0.38**	0.19
Basic and diluted net income per ADS after extraordinary item (RMB)	**3.77**	1.94
Basic and diluted net income per share before extraordinary item (RMB)	**0.38**	0.37
Basic and diluted net income per ADS before extraordinary item (RMB)	**3.77**	3.67

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

	Note	Consolidated As of 31 December 2001 RMB'000	2000 RMB'000
Shareholders'equity under HK GAAP		**61,681,163**	57,224,402
Impact of US GAAP adjustments:			
- Deferred upfront non-refundable revenue		**(3,675,556)**	(2,673,919)
- Accumulated amortisation of upfront non-refundable revenue		**895,544**	439,705
- Deferred direct incremental cost		**2,843,514**	1,908,801
- Accumulated amortisation of direct incremental cost		**(581,497)**	(222,630)
- Reversal of revaluation surplus of fixed assets:			
- Cost		**(176,853)**	(176,853)
- Accumulated depreciation		**21,453**	12,610
- Reversal of revaluation deficit of fixed assets:			
- Cost		**28,000**	28,000
- Accumulated depreciation		**(1,358)**	—
- Differences in provision for impairment loss of equipment		**12,382**	—
- Differences in provision for impairment loss of goodwill		**62,948**	—
- Non-recognition of recovery of impairment provision of investment securities and associated companies		**(17,948)**	—
- Deferred tax impact arising from deferred upfront non-refundable revenue, deferred direct incremental costs and the related accumulated amortisation		**(194,275)**	(257,401)
- Deferred tax impact arising from differences in provision for impairment loss of equipment and goodwill and non-recognition of recovery of impairment provision of investment securities and associated companies		**(18,936)**	—
- Recognition of deferred tax assets in relation to the loss carryforward from a subsidiary	(i)	**107,299**	107,299
- Valuation allowance	(i)	**(107,299)**	(107,299)
- Recognition of other deferred tax assets		**373,159**	228,061
Shareholders' equity as restated (US GAAP)		**61,251,740**	56,510,776

Note:

(i) A valuation allowance was recorded against the deferred tax assets in relation to the loss carryforward from a subsidiary prior to 2001 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 tax laws of the PRC at that time. The operating loss carryforward expire in various years through 2003, if not utilised. Starting from 2001, with the approval of the state tax bureau, loss incurred by this subsidiary can be set off against taxable profits of the Group.

The movement of significant provisions for the years ended 31 December 2001 and 2000 were summarised below:

(a) Provision for deferred taxation valuation allowance was analysed as follows:

	Consolidated	
	As of 31 December	
	2001	2000
	RMB'000	RMB'000
Balance, beginning of year	**107,299**	83,717
Provision for the year	**—**	23,582
Balance, end of year	**107,299**	107,299

(b) There was no other significant movement of provisions for the years ended 31 December 2001 and 2000 except for the provision for impairment loss of equipment amounted to approximately RMB457 million and provision for impairment loss of goodwill amounted to approximately RMB101 million under US GAAP in 2001. (see Note 20 and 21).

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 Comprehensive Income

According to SFAS No. 130 "Reporting of Comprehensive Income", certain items shown as components of common equity must be more prominently reported in a separate statement as components of comprehensive income. For the year ended 31 December 2001 and 2000, apart from the net income and revaluation surplus of land and buildings in 2000, there was no other comprehensive income which should be included in the statement of comprehensive income.

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	
	2001	2000
	RMB'000	RMB'000
Net cash inflows from:		
Operating activities	11,077,875	9,343,867
Investing activities	(46,125,017)	(30,550,946)
Financing activities	8,743,467	59,921,403
Changes in cash and cash equivalents	(26,303,675)	38,714,324
Cash and cash equivalents, beginning of year	44,716,685	6,002,361
Cash and cash equivalents, end of year	18,413,010	44,716,685

Share option scheme

As disclosed in Note 31, information relating to the share options outstanding under the Pre-Global Offering Share Option Scheme and Share Option Scheme as of 31 December 2000 and 2001 is as follows:

	Year ended 31 December			
	2001		2000	
	Options outstanding	Weighted average exercise price HK$	Options outstanding	Weighted average exercise price HK$
Outstanding, beginning of year	27,116,600	15.42	—	—
Granted during the year	6,724,000	15.42	27,116,600	15.42
Outstanding, end of year	33,840,600	15.42	27,116,600	15.42

As of 31 December 2001, 6,724,000 share options (2000: Nil) were exercisable and the weighted average exercise price was HK$15.42. Also, as of 31 December 2001, the weighted average remaining contractual life of the options outstanding were approximately 8.5 years (2000: 9.5 years).

The SFAS No. 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 estimated fair value of each option granted to the employees of the Group on the date of grant using the Black-Scholes option pricing method with the assumptions as follows:

	Year ended 31 December	
	2001	**2000**
Estimated fair value (in HK dollars)	**4.90**	8.14
Risk free interest rate	**6%**	6%
Expected life (in years)	**8**	5
Expected dividend yield	**0%**	0%
Volatility	**52%**	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 Group's net income and net income per share on a pro forma basis for the years ended 31 December 2001 and 2000 would have been as follows:

	Year ended 31 December	
	2001	**2000**
Net income:		
As reported (RMB'000)	**4,722,432**	2,181,319
Pro forma (RMB'000)	**4,568,479**	2,121,670
Basic and net income per share:		
As reported (RMB)	**0.38**	0.19
Pro forma (RMB)	**0.36**	0.19
Basic and diluted net income per ADS		
As reported (RMB)	**3.77**	1.94
Pro forma (RMB)	**3.64**	1.89