

## 1 Significant accounting policies

The significant accounting policies adopted in the preparation of the financial statements are set out below:

### (a) Statement of compliance

The financial statements of Sinopec Shanghai Petrochemical Company Limited (“the Company”) and its subsidiaries (collectively “the Group”) have been prepared in accordance with International Financial Reporting Standards (“IFRS”) promulgated by the International Accounting Standards Board (“IASB”). IFRS includes International Accounting Standard (“IAS”) and related interpretations. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

### (b) Basis of preparation

The consolidated financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment where stated in note 1(d). The accounting policies have been consistently applied by the Group.

The International Accounting Standards Board has issued a number of new and revised IFRS and IAS (“new IFRS”) which are effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new IFRS in the financial statements for the year ended 31 December 2004. The Group has commenced an assessment of the impact of these new IFRS but is not yet in a position to state whether these new IFRS would have a significant impact on its results of operations and financial position.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

### (c) Basis of consolidation

#### (i) Subsidiaries

The consolidated financial statements of the Group include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are those enterprises controlled by the Company. Control exists when the company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The results of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The share of results attributable to minority interests is deducted from or added to profit after tax.

## 1 Significant accounting policies (continued)

### (c) Basis of consolidation (continued)

#### (ii) Associates

Associates are those enterprises in which the Company or the Group has significant influence, but not control, over the financial and operating policies. The Company's financial statements and the Group's consolidated financial statements include the Company's and the Group's share of the total recognised gains and losses of the principal associates on an equity accounted basis respectively, from the date that significant influence commences until the date that significant influence ceases. When the Company's or the Group's share of losses exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Company or the Group has incurred legal or constructive obligations or made payment on behalf of an associate.

#### (iii) Transactions eliminated on consolidation

All material intercompany transactions and balances, and any unrealised gains arising from intercompany transactions, are eliminated on consolidation.

#### (iv) Goodwill

Goodwill arising on acquisition represents the excess of the cost of acquisition over the fair value of their net identifiable assets on acquisition. Goodwill is stated at cost less amortisation and impairment losses (see note 1(t)). Amortisation is charged on a straight-line basis to the income statement over its economic useful life.

Negative goodwill arising on acquisition represents the excess of the fair value of the net identifiable assets of subsidiaries acquired over the cost of acquisition. Negative goodwill is, where material, credited to deferred income which is recognised in the income statement on a systematic basis.

### (d) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost or valuation (see note 12(d)) less accumulated depreciation and impairment losses (see note 1(t)). Revaluations are performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

#### (i) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

## 1 Significant accounting policies (continued)

### (d) Property, plant and equipment (continued)

#### (ii) Depreciation and amortisation

Depreciation is provided to write off the costs/revalued amount of property, plant and equipment over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values, as follows:

Buildings	15 to 40 years
Plant, machinery, equipment and others	5 to 26 years

#### (iii) Retirement or disposal

Gains or losses arising from the retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the assets and are recognised in the income statement on the date of retirement or disposal.

### (e) Investment property

Investment property is property which is held either to earn rental income or for capital appreciation or for both.

Investment property is stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 1(t)). Depreciation is provided over its estimated useful lives on a straight-line basis, after taking into account their estimated residual values. Estimated useful life of the investment property is 40 years.

### (f) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's land bureau. Land use rights are carried at cost and amortised on a straight-line basis over the respective periods of the rights.

### (g) Construction in progress

Construction in progress represents buildings, various plant and equipment under construction and pending installation, and is stated at cost less government grants that compensate the Company for the cost of construction, and impairment losses (see note 1(t)). Cost comprises direct costs of construction as well as interest charges, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the period of construction.

Construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

## 1 Significant accounting policies (continued)

### (h) Interests in subsidiaries

In the Company's financial statements, interests in subsidiaries are accounted for using the equity method.

### (i) Investments

Investments in unlisted equity securities are stated at cost less provision for impairment losses (see note 1(t)). A provision is made where, in the opinion of management, the carrying amount of the investments exceeds its recoverable amount.

### (j) Inventories

Inventories, other than spare parts and consumables, are carried at the lower of cost and net realisable value. Cost includes the cost of materials computed using the weighted average method and expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of work in progress and finished goods, cost includes direct labour and an appropriate proportion of production overheads. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of the inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Spare parts and consumables are stated at cost less any provision for obsolescence.

### (k) Trade and other receivables

Trade debtors are stated at cost less allowance for doubtful accounts. An allowance for doubtful accounts is provided based upon the evaluation of the recoverability of these accounts at the balance sheet date.

### (l) Cash and cash equivalents

Cash equivalents consist of time deposits with financial institutions with an initial term of less than three months when purchased. Cash equivalents are stated at cost, which approximates fair value.

## 1 Significant accounting policies (continued)

### (m) Translation of foreign currencies

Transactions in foreign currencies are translated into Renminbi at the applicable exchange rates ruling at the transaction dates.

Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at rates quoted by the People's Bank of China at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Renminbi at the foreign exchange rate ruling at the date of the transaction.

Foreign currency translation differences relating to funds borrowed to finance the construction of property, plant and equipment to the extent that they are regarded as an adjustment to interest costs are capitalised during the construction period. All other exchange differences are dealt with in the income statement.

### (n) Revenue recognition

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue excludes value added tax and is after deduction of any trade discounts and returns. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due to the possible return of goods, or when the amount of revenue and the costs incurred or to be incurred in respect of the transaction cannot be measured reliably.

Revenue from the rendering of services is recognised in the income statement upon performance of the services.

Dividend income is recognised when the shareholder's right to receive payment is established.

### (o) Grants

Capital-based government grants consist of grants for the purchase of equipment used for technology improvements. Such grants are offset against the cost of asset to which the grant related and are recognised in the income statement on a systematic basis over the useful life of the asset.

### (p) Net financing costs

Net financing costs comprise interest expense on borrowings, interest income on bank deposits, foreign exchange gains and losses and bank charges.

Interest income from bank deposits is accrued on a time-apportioned basis by reference to the principal outstanding and at the rate applicable.

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of net financing costs, except to the extent that they are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

## 1 Significant accounting policies (continued)

### (q) Repairs and maintenance expenses

Repairs and maintenance expenses, including cost of major overhaul, are charged to the income statement as and when they are incurred.

### (r) Research and development costs

Research and development costs comprise all costs that are directly attributable to research and development activities or that can be allocated on a reasonable basis to such activities. Because of the nature of the Group's research and development activities, no development costs satisfy the criteria for the recognition of such costs as an asset. Both research and development costs are therefore recognised as expenses in the period in which they are incurred.

### (s) Retirement benefits

The contributions payable under the Group's retirement plans are charged to the income statement according to the contribution determined by the plans. Further information is set out in note 28.

### (t) Impairment loss

The carrying amounts of the Group's long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the assets are discounted to their present value. The amount of the reduction is recognised as an expense in the income statement.

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist. An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognised as income. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.

### (u) Deferred income

Deferred income is amortised on a straight-line basis to the income statement over 10 years.

## 1 Significant accounting policies (continued)

### (v) Dividends

Dividends are recognised as a liability in the period in which they are declared.

### (w) Income tax

Income tax on the income statement for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, except differences relating to goodwill not deductible for tax purposes and the initial recognition of assets or liabilities which affect neither accounting nor taxable income. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. The effect on deferred tax of any changes in tax rates is charged to the income statement.

A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the assets can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### (x) Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

### (y) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

### (z) Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments.

## 2 Turnover

The Group's principal activity is the processing of crude oil into petrochemical products for sale and substantially all of its products are sold in the PRC domestic markets.

Turnover represents the sales value of goods sold to customers, net of value added tax and is after deduction of any sales discounts and returns.

## 3 Other operating income

	2004 RMB'000	2003 RMB'000
Income from rendering of services	130,298	74,040
Gain on disposal of property, plant and equipment	58,913	-
Income from joint ventures and other unlisted investments	62,800	18,059
Amortisation of deferred income (Note 21)	12,367	12,367
Others	12,627	16,613
	<b>277,005</b>	121,079

## 4 Other operating expenses

	2004 RMB'000	2003 RMB'000
Employee reduction expenses (Note 5)	112,526	64,108
Loss on disposal of property, plant and equipment	68,457	57,571
Impairment loss of property, plant and equipment (Note 12)	34,345	24,600
Amortisation of goodwill (Note 18)	13,448	13,448
Service fee	37,715	37,593
Donations	9,992	10,080
Others	7,681	9,032
	<b>284,164</b>	216,432

## 5 Employee reduction expenses

In accordance with the Group's voluntary employee reduction plan, the Group recorded employee reduction expenses of RMB 112,526,000 (2003: RMB 64,108,000) during the year ended 31 December 2004 in respect of the voluntary resignation of approximately 1,500 employees.



## 6. Net financing costs

	2004 RMB'000	2003 RMB'000
Interest on bank loans and advances	348,834	430,030
Less: Amount capitalised as construction in progress*	(23,801)	(14,095)
Interest expenses, net	325,033	415,935
Interest income	(42,830)	(27,419)
Foreign exchange loss, net	9,805	3,505
	<b>292,008</b>	392,021

\*Borrowing costs have been capitalised at a rate of between 2.98% and 5.58% per annum (2003: 2.98% - 5.31%) for construction in progress.

## 7. Profit before tax

Profit before tax is arrived at after charging:

	2004 RMB'000	2003 RMB'000
Cost of inventories#	33,223,604	26,396,224
Depreciation of property, plant and equipment#	1,794,120	1,850,013
Amortisation of lease prepayment#	21,191	22,822
Repairs and maintenance expenses#	920,490	787,246
Research and development costs#	74,663	101,223
Employer's pension costs#		
- Municipal retirement scheme costs	167,640	168,276
- Supplementary retirement scheme costs	42,379	39,153
Staff costs#	1,172,442	1,090,687
Auditors' remuneration	5,478	4,552

# Cost of inventories includes RMB 4,132,798,000 (2003: RMB 4,001,297,000) relating to staff costs, depreciation, repairs and maintenance expenses, research and development costs and pension costs, which amount is also included in the respective total amounts disclosed separately above for each of these types of expenses.

The profit attributable to shareholders of RMB 3,971,103,000 (2003: RMB 1,401,690,000) has been dealt with in the financial statements of the Company.