Notes to the Financial Statements

for the year ended 31 December 2005
(Expressed in Renminbi)

1 Principal activities and organisation

Principal activities

China Shenhua Energy Company Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") are principally engaged in: (i) the production and sale of coal; and (ii) the generation and sale of power in the People's Republic of China (the "PRC"). The Group operates coal mines as well as an integrated railway network and a seaport that are primarily used to transport the Group's coal sales. The primary customers of the Group's coal sales include power plants and metallurgical producers in the PRC. The Group also operates power plants in the PRC, which are engaged in the generation and sale of coal-based power to provincial/regional electric grid companies.

Organisation

The Company was established in the PRC on 8 November 2004 as a joint stock limited company as part of the Restructuring (as defined below) of Shenhua Group Corporation Limited ("Shenhua" or the "Parent Company"), a state-owned enterprise under the direct supervision of the State Council of the PRC. Prior to the establishment of the Company, the coal production and power generation operations were carried on by various mining companies and power plant entities wholly owned or controlled by Shenhua (the "Predecessor Operations").

In connection with the Restructuring (as defined below), Shenhua's principal coal production and power generation operations together with the related assets and liabilities that were transferred to the Company were segregated and separately managed effective on 31 December 2003 (the "Restructuring"). Pursuant to the Restructuring, property, plant and equipment related to the operations and businesses that were transferred to the Company were revalued as at 31 December 2003 as required by the PRC rules and regulations.

The specific assets and liabilities Shenhua transferred to the Company include:

- substantially all of the operating assets and liabilities relating to coal production at Shenhua's Shendong mines and Wanli mines, including, among others, mining rights for the operating mines and planned mines as well as Shenhua's equity interests in certain mining companies;

- all operating assets and liabilities relating to coal transportation, including, among others, Shenhua's equity interests in rail line and port related companies;

- assets and liabilities relating to coal sales and marketing operations;

- substantially all of the core operating assets and liabilities relating to power generation, including, among others, Shenhua's equity interests in certain operating power plants and power plants under development; and

- other assets and liabilities (relating to information system and communication and research and development institutions), contractual rights and obligations, employees, licenses and approvals, business and financial records, books and data and technological data and know-how relating to the coal production and power generation operations.

1 Principal activities and organisation *(continued)*

Organisation *(continued)*

As Shenhua wholly owned or controlled the coal mining and power generating businesses and operations that were transferred to the Company before the Restructuring and continues to control and own 100% of the Company after the effective date of the Restructuring, the Restructuring is considered as a business combination under common control.

On 8 November 2004, in consideration for Shenhua transferring the coal mining and power generating assets and liabilities to the Company, the Company issued 15 billion domestic state-owned ordinary shares with a par value of RMB1.00 each to Shenhua. The shares issued to Shenhua represented the entire registered and paid-up share capital of the Company at that date.

In June 2005, the Company issued 2,785,000,000 H shares with a par value of RMB1.00 each, at a price of HK$7.50 per H share by way of a global initial public offering to Hong Kong and overseas investors. As part of the global initial public offering, 278,500,000 domestic state-owned ordinary shares of RMB1.00 each owned by Shenhua were converted into H shares and sold to Hong Kong and overseas investors. In July 2005, the Company issued 304,620,455 H shares with a par value of RMB1.00 each, at a price of HK$7.50 per H share upon the exercise of the over-allotment option in connection with the global initial public offering. As part of the exercise of the over-allotment option, 30,462,045 domestic state-owned ordinary shares of RMB1.00 each owned by Shenhua were converted into H shares and sold to Hong Kong and overseas investors. A total of 3,398,582,500 H shares were listed on the Stock Exchange of Hong Kong Limited ("Stock Exchange").

2 Significant accounting policies

(a) Statement of compliance

The financial statements have been prepared in accordance with all applicable International Financial Reporting Standards ("IFRSs") promulgated by the International Accounting Standards Board ("IASB"). IFRSs include International Accounting Standards ("IAS") and 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.

Details of the impact of adopting new and revised IFRSs with effective from 1 January 2005 to the financial statements are set out in Note 3.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2005 comprise the Company and its subsidiaries and the Group's interest in associates.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that certain property, plant and equipment are stated at valuation and that the derivative financial instruments are stated at fair value.

2 Significant accounting policies *(continued)*

(b) Basis of preparation of the financial statements *(continued)*

The preparation of financial statements in conformity with IFRSs 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 judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these 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.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next financial year are disclosed in Note 38.

(c) Subsidiaries

A subsidiary is a company directly or indirectly controlled by the Company. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

A subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

2 Significant accounting policies *(continued)*

(c) Subsidiaries *(continued)*

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see Note 2(m)).

(d) Associates

An associate is an entity in which the Group or the Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment in associates recognised for the year (see Notes 2(e) and 2(m)).

When the Group's share of losses exceeds its interest in the associate, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For this purpose, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

In the Company's balance sheet, its investments in associates are stated at cost less impairment losses (see Note 2(m)).

2 Significant accounting policies *(continued)*

(e) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see Note 2(m)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in the associate.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in profit or loss.

On disposal of a cash-generating unit or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

(f) Other investments in debt and equity securities

The Group's and the Company's policies for investments in debt and equity securities, other than investments in subsidiaries and associates, are as follows:

Investments in securities held for trading are classified as current assets and are initially stated at fair value. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised in profit or loss.

Dated debt securities that the Group and/or the Company have the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are initially recognised in the balance sheet at fair value plus transaction costs. Subsequently, they are stated in the balance sheet at amortised cost less impairment losses (see Note 2(m)).

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the balance sheet at cost less impairment losses (see Note 2(m)).

Other investments in securities are classified as available-for-sale securities and are initially recognised at fair value plus transaction costs. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except for impairment losses (see Note 2(m)) and, in the case of monetary items such as debt securities, foreign exchange gains and losses which are recognised directly in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss.

2 Significant accounting policies *(continued)*

(f) Other investments in debt and equity securities *(continued)*

Investments are recognised/derecognised on the date the Group and/or the Company commits to purchase/sell the investments or they expire.

(g) Derivative financial instruments

Derivative financial instruments are recognised initially at fair value. At each balance sheet date the fair value is remeasured. The gain or loss on remeasurement to fair value is charged immediately to profit or loss, except where the derivatives qualify for cash flow hedge accounting or hedge the net investment in a foreign operation, in which case recognition of any resultant gain or loss depends on the nature of the item being hedged.

(h) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

(i) Property, plant and equipment

Property, plant and equipment, which consist of buildings, mining structures and mining rights, mining related machinery and equipment, generators and related machinery and equipment, railway and port transportation structures and furniture, fixtures, motor vehicles and other equipment, are initially stated at cost, less accumulated depreciation and impairment losses (see Note 2(m)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to its present working condition and location for its intended use, the cost of borrowed funds used during the period of construction and, when relevant, the costs of dismantling and removing the items and restoring the site on which they are located, and changes in the measurement of existing liabilities recognised for these costs resulting from changes in the timing or outflow of resources required to settle the obligation or from changes in the discount rate.

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other cost is recognised as an expense in the income statement in the period in which it is incurred.

2 Significant accounting policies *(continued)*

(i) Property, plant and equipment *(continued)*

When proved and probable coal reserves have been determined, costs incurred to develop coal mines are capitalised as part of the cost of the mining structures. All other expenditures, including the cost of repairs and maintenance and major overhaul, are expensed as they are incurred. Mining exploration costs, such as expenditures related to locating coal deposits and determining the economic feasibility, and the costs of removing waste materials or "stripping costs" are expensed as incurred.

Subsequent to the revaluation which was required by the PRC rules and regulations in connection with the Restructuring and which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation, less subsequent accumulated depreciation and impairment losses (see Note 2(m)).

When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately 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. When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is revalued simultaneously. When an asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to shareholder's equity as a component of revaluation reserve. However, a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense in the income statement. However, a revaluation decrease is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Revaluations are to be performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

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 asset and are recognised as income or expense in the income statement on the date of disposal. On disposal of a revalued asset, the related revaluation surplus is transferred from revaluation reserve to retained earnings.

2 Significant accounting policies *(continued)*

(i) Property, plant and equipment *(continued)*

Depreciation is provided to write off the cost/revalued amount of each part of an item of property, plant and equipment, other than mining structures and mining rights, over its estimated useful life on a straight-line basis, after taking into account its estimated residual value. The estimated useful lives of property, plant and equipment are as follows:

	Depreciable life
Buildings	20-50 years
Mining related machinery and equipment	5-18 years
Generators and related machinery and equipment	20-30 years
Railway and port transportation structures	30-45 years
Furniture, fixtures, motor vehicles and other equipment	5-10 years

Mining structures and mining rights are depreciated on a units-of-production method utilising only proved and probable coal reserves in the depletion base.

The Group's mining rights are of sufficient duration (or convey a legal right to renew for sufficient duration) to enable all reserves to be mined in accordance with current production schedules.

(j) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's governmental authorities. Land use rights are carried at cost less impairment losses (see Note 2(m)) and are charged to the income statement on a straight-line basis over the respective periods of the rights which range from 30 years to 50 years.

(k) Construction in progress

Construction in progress is stated at cost less impairment losses (see Note 2(m)). Cost comprises direct costs of construction, borrowing costs 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.

Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when substantially all the activities necessary to prepare the asset for its intended use are completed. No depreciation is provided in respect of construction in progress until it is completed and ready for its intended use.

(l) Intangible assets

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses (see Note 2(m)) and are charged to the income statement on a straight-line basis over the estimated useful life of 20-45 years.

2 Significant accounting policies *(continued)*

(m) Impairment losses

(i) Impairment of investments in debt and equity securities and other receivables

Investments in debt and equity securities and other current and non-current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

- For unquoted equity securities and current receivables that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for current receivables are reversed if in a subsequent period the amount of the impairment loss decreases. Impairment losses for equity securities are not reversed.

- For financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets).

  If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

- For available-for-sale securities, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

  Impairment losses recognised in profit or loss in respect of available-for-sale equity securities are not reversed through profit or loss. Any subsequent increase in the fair value of such assets is recognised directly in equity.

  Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

2 Significant accounting policies *(continued)*

(m) Impairment losses *(continued)*

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment;
- construction in progress;
- intangible assets;
- investments in subsidiaries and associates; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

- Calculation of recoverable amount

  The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

- Recognition of impairment losses

  An impairment loss is recognised in profit or loss whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro-rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

2 Significant accounting policies *(continued)*

(m) Impairment losses *(continued)*

(ii) Impairment of other assets (continued)

– Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

(n) Inventories

Coal inventories are stated at the lower of weighted average cost and net realisable value. 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 coal inventories are sold, the carrying amount of those 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 is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Inventories of ancillary materials, spare parts and small tools used in production are stated at cost less impairment losses for obsolescence.

(o) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in profit or loss over the period of the borrowings using the effective interest method.

(p) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

2 Significant accounting policies *(continued)*

(q) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see Note 2(m)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see Note 2(m)).

(r) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(s) Revenue recognition

Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the Group and the revenue can be measured reliably as follows:

(i) Revenues associated with the sale of coal and other goods are recognised when the title to the goods has been passed to the customer which is at the date that the customer receives and accepts the goods. Acceptance occurs when the customer agrees to the amount and quality of the delivered goods. Export coal sales are recognised as revenues when the customers receive and accept the goods at the port and pay for freight costs.

(ii) Revenue from sale of power is recognised upon the transmission of electric power to the power grid companies, as determined based on the volume of electric power transmitted and the applicable fixed tariff rates agreed with the respective electric power grid companies annually.

(iii) Revenue from the rendering of transportation and other services is recognised upon the delivery or performance of the services.

2 Significant accounting policies *(continued)*

(t) Borrowing costs

Borrowing costs are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

(u) Translation of foreign currencies

The Group's functional and presentation currency is Renminbi ("RMB"). Foreign currency transactions during the year are translated into RMB at the applicable rates of exchange quoted by the People's Bank of China ("PBOC") prevailing on the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into RMB at the applicable PBOC rates ruling at the balance sheet dates. Foreign currency differences, other than those capitalised as construction in progress, are recognised as income or expense in the income statement.

(v) Obligations for land reclamation

The Group's obligations for land reclamation consist of spending estimates at both surface and underground mines in accordance with the PRC rules and regulations. The Group estimates its liabilities for final reclamation and mine closure based upon detailed calculations of the amount and timing of the future cash spending for a third party to perform the required work. Spending estimates are escalated for inflation, then discounted at a discount rate that reflects current market assessments of the time value of money and the risks specific to the liability such that the amount of provision reflects the present value of the expenditures expected to be required to settle the obligation. The Group records a corresponding asset associated with the liability for final reclamation and mine closure. The obligation and corresponding asset are recognised in the period in which the liability is incurred. The asset is depreciated on the units-of-production method over its expected life and the liability is accreted to the projected spending date. As changes in estimates occur (such as mine plan revisions, changes in estimated costs, or changes in timing of the performance of reclamation activities), the revisions to the obligation and asset are recognised at the appropriate discount rate.

(w) Operating leases

Operating lease payments are charged to the income statement on a straight-line basis over the period of the respective leases.

2 Significant accounting policies *(continued)*

(x) Employee benefits

The Group's contributions to defined contribution retirement plans administered by the PRC government are recognised as an expense when incurred according to the contribution determined by the plans.

Share appreciation rights ("SARs") are granted to employees of the Company. The fair value of the amount payable to the employee is recognised as an expense with a corresponding increase in liabilities. The fair value initially is measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value of the SARs is measured based on the binomial option pricing model, taking into account the terms and conditions upon which the instruments were granted. The liability is remeasured at each balance sheet date and at settlement date. Any changes in the fair value of the liability are recognised in the income statement.

(y) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

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

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

2 Significant accounting policies *(continued)*

(y) Income tax *(continued)*

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes and the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination). For temporary differences relating to investments in subsidiaries, they are recognised except to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, they are recognised only to the extent that it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  - the same taxable entity; or

  - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

2 Significant accounting policies *(continued)*

(z) Research and development costs

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources and the intention to complete development. The expenditure capitalised includes the costs of materials, direct labour and an appropriate proportion of overheads. Captalised development costs are stated at cost less accumulated amortisation and impairment losses (see Note 2(m)). Other development expenditure is recognised as an expense in the period in which it is incurred.

(aa) Dividends

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

(ab) 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 or jointly 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. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(ac) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements. The Group has two reportable business segments which are (i) coal operations; and (ii) power operations, and three reportable geographical segments which are (i) the PRC domestic markets; (ii) Asia Pacific markets-export sales; and (iii) other markets-export sales.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade receivables and property, plant and equipment. Segment revenue, expenses, assets, and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

2 Significant accounting policies *(continued)*

(ac) Segment reporting *(continued)*

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses.

3 New and revised IFRSs

The IASB has issued a number of new and revised IFRSs that are effective for accounting periods beginning on or after 1 January 2005.

The accounting policies of the Group and/or the Company after the adoption of these new and revised IFRSs have been summarised in Note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see Note 42).

(a) Change in presentation of minority interests

The adoption of revised IAS 1, *Presentation of financial statements* and revised IAS 27, *Consolidated and separate financial statements* has resulted in a change in presentation of minority interests in the financial statements.

In prior years, minority interests at the balance sheet date were presented in the consolidated balance sheet separately from liabilities and as a deduction from net assets. Minority interests in the results of the Group for the year were also separately presented in the consolidated income statement as a deduction before arriving at the profit attributable to shareholders (the equity shareholders of the Company).

With effect from 1 January 2005, in order to comply with IAS 1 and IAS 27, minority interests at the balance sheet date are presented in the consolidated balance sheet within equity, separately from the equity attributable to the equity shareholders of the Company, and minority interests in the results of the Group for the year are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between the minority interests and the equity shareholders of the Company.

The presentation of minority interests in the consolidated balance sheet, consolidated income statement and consolidated statement of changes in equity for the comparative period has been restated accordingly.

3 New and revised IFRSs *(continued)*

(b) Presentation of shares of associates' taxation (IAS 1, Presentation of financial statements)

In prior years, the Group's share of taxation of associates accounted for using the equity method was included as part of the Group's income tax in the consolidated income statement. With effect from 1 January 2005, in accordance with the implementation guidance in IAS 1, the Group has changed the presentation and includes the share of taxation of associates accounted for using the equity method in the respective shares of profit or loss reported in the consolidated income statement before arriving at the Group's profit or loss before tax. These changes in presentation have been applied retrospectively with comparatives restated.

(c) Accounting for investments in subsidiaries, jointly controlled entities and associates in separate financial statements

IAS 27, *Consolidated and separate financial statements*, replaced IAS 27 (revised 2000), *Consolidated financial statements and accounting for investments in subsidiaries* and related interpretations. The Company has elected to account for investments in subsidiaries, jointly controlled entities and associates at cost with effect from 1 January 2005 when separate financial statements are prepared. In prior years, these investments were accounted for using the equity method. The balance sheet of the Company has been restated accordingly.

The following table discloses the adjustments that have been made in accordance with IAS 27 to each of the line items in the balance sheet of the Company as previously reported as at 31 December 2004.

	2004 (as previously reported) *RMB million*	**Effect of new policy (decrease in net assets)** *RMB million*	**2004 (restated)** *RMB million*
Investments in subsidiaries	17,604	(1,516)	16,088
Interest in associates	2,472	(140)	2,332
Effect on the reserves	(20,076)	1,656	(18,420)

(d) Scope of related parties (IAS 24, Related party disclosures)

As a result of the adoption of revised IAS 24, *Related party disclosures*, the definition of related parties as disclosed in Note 2(ab) has been expanded such that state-controlled entities are included. The revised IAS 24 also requires the compensation of key management personnel to be disclosed. The Group has included these additional disclosures in the financial statements.

4 Revenues

The Group is principally engaged in the production and sale of coal, generation and sale of power and the provision of transportation services in the PRC. Revenues represent the aggregate of the invoiced value of goods sold and services provided, net of sales taxes.

5 Other revenues

	2005 *RMB million*	2004 *RMB million*
Rendering of transportation and other services	**1,357**	1,221
Sale of ancillary materials and other goods	**57**	91
Others	**23**	10
	1,437	1,322

6 Cost of revenues – others

	2005 *RMB million*	2004 *RMB million*
Operating lease charges	**222**	317
Dredging expenses	**294**	418
Sales taxes and surcharges	**404**	296
Cost of sale of ancillary materials and other goods	**53**	95
Coal selection and minery fees	**557**	313
Public utilities expenses	**75**	76
Others	**1,590**	1,193
	3,195	2,708

7 Total operating expenses

	2005 *RMB million*	2004 *RMB million*
Personnel expenses	**3,100**	2,217
– including contribution to retirement plans	**347**	283
– share appreciation rights expense	**1**	–
Depreciation and amortisation	**5,374**	4,949
Loss on disposal of property, plant and equipment	**187**	75
Cost of inventories (Note)	**20,719**	16,830
Research and development costs	**24**	12
Auditors' remuneration	**27**	20
– audit services	**25**	4
– tax services	**2**	2
– other services	**–**	14
Operating lease charges on properties	**285**	379
Provisions for accounts receivable, other receivables and inventories	**32**	283
Impairment losses on property, plant and equipment	**41**	–

Note:

Cost of inventories includes RMB4,929 million (2004: RMB4,025 million) for the year ended 31 December 2005, relating to personnel expenses, depreciation and amortisation and operating lease charges, which amounts are also included in the respective amounts disclosed separately above for each of these types of expenses.

8 Net financing costs

	2005 RMB million	2004 RMB million
Interest on loans from banks and other financial institutions, and other borrowings wholly repayable within five years	**3,178**	2,742
Less: Interest expense capitalised*	**(601)**	(305)
Net interest expense	**2,577**	2,437
Interest income	**(266)**	(72)
Foreign exchange (gain)/loss	**(619)**	138
Loss/(gain) on remeasurement of derivative financial instruments to fair value	**368**	(145)
	2,060	2,358
* Interest expense was capitalised in construction in progress at the following rates per annum	**1.8%-5.508%**	1.8%-6.12%

9 Income tax

Income tax in the consolidated income statement represents:

	2005 RMB million	2004 RMB million (restated – Note 3)
Provision for PRC income tax	**3,987**	2,310
Deferred taxation (Note 25)	**96**	463
	4,083	2,773

9 Income tax *(continued)*

A reconciliation of the expected tax with the actual tax expense is as follows:

	2005	2004
	RMB million	*RMB million*
		(restated – Note 3)
Profit before income tax	**22,095**	13,339
Expected PRC income tax expense at a statutory tax rate of 33% (Note i)	**7,291**	4,402
Differential tax rate on subsidiaries' income (Note i)	**(3,060)**	(1,860)
Non-deductible expenses (Note ii)	**209**	223
Non-taxable income	**(2)**	(5)
Tax losses not recognised	**–**	106
Others	**(355)**	(93)
	4,083	2,773

Notes:

(i) The provision for PRC current income tax is based on a statutory rate of 33% of the assessable profit of the entities comprising the Group as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain branches, subsidiaries and associates of the Company, which are exempted or taxed at preferential rates of 7.5% or 15%.

(ii) Non-deductible expenses mainly represent personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose.

10 Directors' and supervisors' emoluments

The amounts of emoluments paid and payable to the directors and supervisors of the Company by the Group are as follows:

	2005					
	Fees *RMB million*	Basic salaries, housing and other allowances and benefits in kind *RMB million*	Discretionary bonuses *RMB million*	Share appreciation rights (Note) *RMB million*	Retirement scheme contributions *RMB million*	Total *RMB million*
Executive directors						
Chen Biting	–	0.23	0.56	0.16	0.10	1.05
Wu Yuan	–	0.19	0.44	0.13	0.09	0.85
Ling Wen	–	0.18	0.40	0.11	0.08	0.77
Non-executive directors						
Zhang Xiwu	–	–	–	0.14	–	0.14
Zhang Yuzhuo	–	–	–	0.11	–	0.11
Han Jianguo	–	–	–	0.11	–	0.11
Independent non-executive directors						
Huang Yicheng	0.40	–	–	–	–	0.40
Anthony Francis Neoh	0.40	–	–	–	–	0.40
Chen Xiaoyue	0.40	–	–	–	–	0.40
Supervisors						
Xu Zufa	–	0.18	0.40	0.11	0.08	0.77
Wu Gaoqian	–	0.13	0.20	–	0.05	0.38
Li Jianshe	–	0.09	0.21	–	0.05	0.35
	1.20	1.00	2.21	0.87	0.45	5.73

Note: Please refer to Note 34 for details of the share appreciation rights.

10 Directors' and supervisors' emoluments *(continued)*

	2004				
	Fees *RMB million*	Basic salaries, housing and other allowances and benefits in kind *RMB million*	Discretionary bonuses *RMB million*	Retirement scheme contributions *RMB million*	Total *RMB million*
Executive directors					
Chen Biting	–	0.16	0.54	0.10	0.80
Wu Yuan	–	0.13	0.40	0.06	0.59
Ling Wen	–	0.13	0.40	0.05	0.58
Non-executive directors					
Zhang Xiwu	–	0.16	0.52	0.06	0.74
Zhang Yuzhuo	–	0.13	0.40	0.06	0.59
Han Jianguo	–	0.13	0.40	0.06	0.59
Independent non-executive directors					
Huang Yicheng	–	–	–	–	–
Anthony Francis Neoh	–	–	–	–	–
Chen Xiaoyue	–	–	–	–	–
Supervisors					
Xu Zufa	–	0.13	0.40	0.05	0.58
Wu Gaoqian	–	0.13	0.15	0.04	0.32
Li Jianshe	–	0.09	0.21	0.03	0.33
	–	1.19	3.42	0.51	5.12

11 Individuals with highest emoluments

Of the five highest paid individuals of the Group, four (2004: four) are directors of the Company for the year ended 31 December 2005 whose emoluments are included in Note 10 above.

The following table sets out the emoluments of the Group's remaining one (2004: one) highest paid individual for the year ended 31 December 2005 who is not a director nor a supervisor of the Company:

	2005	2004
	RMB million	*RMB million*
Basic salaries, housing and other allowances and benefits in kind	**0.16**	0.36
Discretionary bonuses	**0.34**	0.18
Share appreciation rights	**0.08**	–
Retirement scheme contributions	**0.07**	0.10
	0.65	0.64

The emoluments of this individual is within the following band:

	Number of individual	
	2005	2004
Nil – RMB1,040,000 (equivalent to HK$1,000,000)	**1**	1

12 Profit attributable to equity shareholders of the Company

The consolidated profit attributable to equity shareholders of the Company includes a profit of RMB13,840 million (2004 (restated): RMB7,279 million) which has been dealt with in the financial statements of the Company.

13 Dividends

(a) Dividends payable to equity shareholders of the Company attributable to the year

	2005	2004
	RMB million	*RMB million*
Special dividend to Shenhua resolved after the balance sheet date	**5,143**	–
Final dividend proposed after the balance sheet date of RMB0.125 per ordinary share	**2,261**	7,549
	7,404	7,549

13 Dividends *(continued)*

(a) Dividends payable to equity shareholders of the Company attributable to the year *(continued)*

On 27 March 2005, the directors proposed and the sole shareholder approved that the distributable profit of the Group for the period from 1 January 2005 to the date immediately preceding the date of its listing on the Stock Exchange (i.e. 14 June 2005) be entirely distributable to Shenhua. Pursuant to a resolution passed at the directors' meeting on 10 March 2006, the directors resolved to pay a special dividend to Shenhua amounting to RMB5,143 million (being the distributable profit of the Group for the period from 1 January 2005 to 14 June 2005). On the same date, the directors also proposed a final dividend of RMB0.125 per share totalling RMB2,261 million to all equity shareholders of the Company for shareholders' approval at the forth-coming annual general meeting.

The dividends resolved and proposed after the balance sheet date have not been recognised as a liability at the balance sheet date.

(b) Dividend payable to Shenhua attributable to the previous financial year, approved and paid during the year

	2005	2004
	RMB million	*RMB million*
Final dividend in respect of the previous financial year approved and paid during the year (2004: nil)	**7,549**	–

14 Earnings per share

The calculation of basic earnings per share for the year ended 31 December 2005 was based on the profit attributable to equity shareholders of the Company for the year of RMB15,632 million (2004: RMB8,935 million) and the weighted average number of shares in issue during the year ended 31 December 2005 of 16,678 million (2004: 15,000 million). The weighted average number of shares in issue during the year ended 31 December 2004 represents the number of shares issued and outstanding upon the legal formation of the Company on 8 November 2004, as if such shares have been outstanding for the above entire year.

Weighted average number of ordinary shares

	2005	2004
	million	*million*
Ordinary shares issued at 1 January	**15,000**	–
Capitalisation upon legal establishment (Note 31)	**–**	15,000
Effect of shares issued in June 2005 (Note 31)	**1,534**	–
Effect of shares issued in July 2005 (Note 31)	**144**	–
Weighted average number of ordinary shares at 31 December	**16,678**	15,000

The Company had no dilutive potential shares outstanding for both years presented.

15 Property, plant and equipment, net

The Group

	Buildings	Mining structures and mining rights	Mining related machinery and equipment	Generators and related machinery and equipment	Railway and port transportation structures	Furniture, fixtures, motor vehicles and other equipment	Total
	RMB million	*RMB million*	*RMB million*	*RMB million*	*RMB million*	*RMB million*	*RMB million*
Cost/valuation:							
At 1 January 2004	8,268	7,067	9,081	22,260	30,895	2,450	80,021
Additions	90	80	67	22	736	195	1,190
Transferred from construction in progress	1,120	166	2,524	1,354	4,610	132	9,906
Disposals	(31)	(81)	(58)	(28)	(47)	(20)	(265)
At 31 December 2004	9,447	7,232	11,614	23,608	36,194	2,757	90,852
Representing:							
Cost	1,210	246	2,591	1,376	5,346	327	11,096
Valuation – 2003 (Note (b))	8,237	6,986	9,023	22,232	30,848	2,430	79,756
	9,447	7,232	11,614	23,608	36,194	2,757	90,852
Accumulated depreciation:							
At 1 January 2004	1,477	352	2,741	3,770	3,801	1,048	13,189
Charge for the year	390	271	952	1,388	1,531	278	4,810
Written back on disposals	(7)	(17)	(26)	(1)	(6)	(13)	(70)
At 31 December 2004	1,860	606	3,667	5,157	5,326	1,313	17,929
Net book value:							
At 31 December 2004	7,587	6,626	7,947	18,451	30,868	1,444	72,923
Cost/valuation:							
At 1 January 2005	9,447	7,232	11,614	23,608	36,194	2,757	90,852
Additions	7	3,124	253	18	576	269	4,247
Transferred from construction in progress	1,111	179	3,035	3,365	2,783	172	10,645
Disposals	(46)	(33)	(239)	(23)	(92)	(156)	(589)
At 31 December 2005	10,519	10,502	14,663	26,968	39,461	3,042	105,155
Representing:							
Cost	2,328	3,549	5,879	4,759	8,705	768	25,988
Valuation – 2003 (Note (b))	8,191	6,953	8,784	22,209	30,756	2,274	79,167
	10,519	10,502	14,663	26,968	39,461	3,042	105,155
Accumulated depreciation and impairment losses:							
At 1 January 2005	1,860	606	3,667	5,157	5,326	1,313	17,929
Charge for the year	458	288	1,182	1,296	1,594	279	5,097
Impairment losses (Note (e))	1	–	–	–	10	30	41
Written back on disposals	(2)	(5)	(97)	(13)	(31)	(122)	(270)
At 31 December 2005	2,317	889	4,752	6,440	6,899	1,500	22,797
Net book value:							
At 31 December 2005	8,202	9,613	9,911	20,528	32,562	1,542	82,358

15 Property, plant and equipment, net *(continued)*

The Company

	Buildings	Mining structures and mining rights	Mining related machinery and equipment	Generators and related machinery and equipment	Railway and port transportation structures	Furniture, fixtures, motor vehicles and other equipment	Total
	RMB million	*RMB million*	*RMB million*	*RMB million*	*RMB million*	*RMB million*	*RMB million*
Cost/valuation:							
Transferred from the Parent Company in connection with the Restructuring	1,817	5,932	5,683	15	8,991	562	23,000
Additions	55	2	18	1	669	128	873
Transferred from construction in progress	148	166	2,361	–	514	14	3,203
Disposals	(31)	(22)	(57)	(10)	(5)	(8)	(133)
At 31 December 2004	1,989	6,078	8,005	6	10,169	696	26,943
Representing:							
Cost	203	168	2,379	1	1,183	142	4,076
Valuation – 2003 (Note (b))	1,786	5,910	5,626	5	8,986	554	22,867
	1,989	6,078	8,005	6	10,169	696	26,943
Accumulated depreciation:							
Transferred from the Parent Company in connection with the Restructuring	326	304	996	5	1,447	245	3,323
Charge for the year	47	219	744	–	657	92	1,759
Written back on disposals	(7)	(5)	(12)	(1)	(1)	(7)	(33)
At 31 December 2004	366	518	1,728	4	2,103	330	5,049
Net book value:							
At 31 December 2004	1,623	5,560	6,277	2	8,066	366	21,894
Cost/valuation:							
At 1 January 2005	1,989	6,078	8,005	6	10,169	696	26,943
Additions	6	2,951	169	–	393	91	3,610
Transferred from construction in progress	108	156	2,984	–	516	83	3,847
Disposals	(43)	(33)	(170)	(1)	(3)	(45)	(295)
At 31 December 2005	2,060	9,152	10,988	5	11,075	825	34,105
Representing:							
Cost	317	3,275	5,532	1	2,092	316	11,533
Valuation – 2003 (Note (b))	1,743	5,877	5,456	4	8,983	509	22,572
	2,060	9,152	10,988	5	11,075	825	34,105
Accumulated depreciation:							
At 1 January 2005	366	518	1,728	4	2,103	330	5,049
Charge for the year	80	283	1,003	2	554	75	1,997
Written back on disposals	(2)	(5)	(83)	(1)	(2)	(18)	(111)
At 31 December 2005	444	796	2,648	5	2,655	387	6,935
Net book value:							
At 31 December 2005	1,616	8,356	8,340	–	8,420	438	27,170

15 Property, plant and equipment, net *(continued)*

(a) All of the Group's buildings and plant and equipment are located in the PRC.

(b) As required by the relevant PRC rules and regulations with respect to the Restructuring, the property, plant and equipment of the Group as at 31 December 2003 were revalued for each asset class by China Enterprise Appraisal Co., Ltd. (the "PRC valuers"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of property, plant and equipment was determined at RMB66,832 million. The net surplus on the revaluation of RMB8,260 million was incorporated in the consolidated balance sheet as at 31 December 2003.

The Group's properties were also valued separately by American Appraisal China Limited, independent qualified valuers in Hong Kong, on a depreciated replacement cost basis, as at 15 March 2005. The value arrived at by these valuers is approximately the same as that arrived by the PRC valuers as adjusted for the depreciation for the period from 1 January 2004 to 15 March 2005.

(c) Had property, plant and equipment been carried at cost less accumulated depreciation, the historical carrying amounts as at 31 December 2005 would have been as follows:

	2005	2004
	RMB million	*RMB million*
Buildings	**7,842**	7,209
Mining structures and mining rights	**4,848**	1,767
Mining related machinery and equipment	**9,468**	7,462
Generators and related machinery and equipment	**20,449**	18,368
Railway and port transportation structures	**30,528**	28,769
Furniture, fixtures, motor vehicles and other equipment	**1,736**	1,680
	74,871	65,255

(d) Up to the date of this report, the Group was in the process of applying for or changing registration of the title certificates of certain of its properties with an aggregate carrying value of approximately RMB827 million as at 31 December 2005 (2004: RMB271 million), of which RMB646 million related to newly acquired properties in 2005. The directors are of the opinion that the Group is entitled to lawfully and validly occupy or use the above mentioned properties.

(e) Certain railway and port transportation structures and furniture, fixtures, motor vehicles and other equipment which were obsolete, damaged or that could not generate future economic benefits were provided for impairment for the year ended 31 December 2005.

16 Construction in progress

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
At the beginning of the year	**12,352**	8,655	**1,649**	–
Transferred from the Parent Company in connection with the Restructuring	**–**	–	**–**	1,064
Additions	**17,453**	13,603	**3,878**	3,788
Transferred to property, plant and equipment	**(10,645)**	(9,906)	**(3,847)**	(3,203)
At the end of the year	**19,160**	12,352	**1,680**	1,649

The construction in progress as at 31 December 2005 are mainly related to mining, generators and related machinery and equipment.

17 Intangible assets

Intangible assets mainly represent the cost of acquiring railway route access and use rights. The movement of intangible assets is as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
At the beginning of the year	**1,210**	1,113	**343**	–
Transferred from the Parent Company in connection with the Restructuring	**–**	–	**–**	357
Additions	**360**	242	**20**	–
Write off	**–**	(6)	**–**	–
Amortisation	**(277)**	(139)	**(19)**	(14)
At the end of the year	**1,293**	1,210	**344**	343

The amortisation charge for the year is included in cost of revenues in the consolidated income statement.

18 Investments in subsidiaries

	The Company	
	2005	2004
	RMB million	*RMB million*
		(restated – Note 3)
Unlisted shares, at cost	**17,610**	16,088

The Company's subsidiaries are unlisted and established in the PRC. Details of the Company's principal subsidiaries as at 31 December 2005 are as follows:

Name of the company	Type of legal entity	Particulars of registered capital	% held by the Company	Principal activities
Shenhua Zhunge'er Energy Co., Ltd.	Limited company	Registered capital RMB7,102 million	58%	Coal mining and development
Shuohuang Railway Development Co., Ltd.	Limited company	Registered capital RMB5,880 million	53%	Provision of transportation services
Shenhua Huanghua Harbor Administration Co., Ltd.	Limited company	Registered capital RMB1,820 million	70%	Provision of harbour and port services
Shenhua Baoshen Railway Co., Ltd.	Limited company	Registered capital RMB602 million	88%	Provision of transportation services
Guangdong Guohua Yuedian Taishan Power Co., Ltd.	Limited company	Registered capital RMB2,587 million	80%	Generation and sale of electricity
CLP Guohua Power Co., Ltd.	Limited company	Registered capital RMB1,637 million	51%	Generation and sale of electricity

19 Interest in associates

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
				(restated – Note 3)
Unlisted shares, at cost	**–**	–	**2,982**	2,332
Share of net assets	**3,686**	2,731	**–**	–
	3,686	2,731	**2,982**	2,332

19 Interest in associates *(continued)*

The Group's interest in associates are individually and in aggregate not material to the Group's financial conditions or results of operations for the year. The Group's associates are unlisted and established in the PRC. Details of the Group's principal associates as at 31 December 2005 are as follows:

Name of the company	Type of legal entity	Particulars of registered capital	Proportion of ownership interest: Group's effective interest	% held by the Company	% held by the Company's subsidiaries	Principal activities
Hebei Guohua Dingzhou Power Co., Ltd.	Limited company	Registered capital RMB931 million	41%	41%	–	Power generation
Zhejiang Jiahua Power Co., Ltd.	Limited company	Registered capital RMB2,055 million	20%	20%	–	Power generation
Inner-Mongolia Haibowan Power Co., Ltd.	Limited company	Registered capital RMB280 million	40%	40%	–	Power generation
Northern United Power Co., Ltd.	Limited company	Registered capital RMB10,000 million	20%	20%	–	Investment in power plants
Inner-Mongolia Jingda Power Co., Ltd.	Limited company	Registered capital RMB455 million	30%	30%	–	Power generation
Shenhua Finance Co., Ltd.	Limited company	Registered capital RMB700 million	33%	21%	19%	Provision of financial services

20 Other investments

Other investments comprise unlisted equity securities and certain subsidiaries which are individually and in aggregate not material to the Group's financial position and results of operations for the year. As there is no quoted market price in an active market for these investments, they are stated at cost less impairment losses.

21 Inventories

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Coal	**1,140**	698	**751**	332
Materials and supplies	**2,432**	1,993	**1,213**	1,196
	3,572	2,691	**1,964**	1,528

21 Inventories *(continued)*

The analysis of the amount of inventories recognised as an expense is as follows:

	The Group	
	2005	2004
	RMB million	*RMB million*
Carrying amount of inventories sold	**20,746**	16,547
Write down of inventories	**–**	283
Reversal of write down of inventories	**(27)**	–
	20,719	16,830

The reversal of write-down of inventories made in prior years arose due to an increase in the estimated net realisable value of certain inventories.

22 Accounts and bills receivable, net

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Accounts receivable	**2,531**	2,744	**1,276**	1,447
Impairment losses for bad and doubtful accounts	**(23)**	(25)	**(13)**	(15)
	2,508	2,719	**1,263**	1,432
Bills receivable	**174**	194	**61**	30
	2,682	2,913	**1,324**	1,462

Credit of up to 60 days is granted to customers with established trading history, otherwise sales on cash terms are required.

The following is the ageing analysis of accounts and bills receivable, net of impairment losses for bad and doubtful accounts:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Current	**2,639**	2,725	**1,286**	1,289
Within one year	**39**	169	**35**	161
Between one and two years	**2**	11	**1**	9
Between two and three years	**2**	2	**2**	–
Over three years	**–**	6	**–**	3
	2,682	2,913	**1,324**	1,462

22 Accounts and bills receivable, net *(continued)*

Included in accounts and bills receivable are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	*million*	***million***	*million*
United States Dollars	**USD76**	USD90	**USD76**	USD90

23 Prepaid expenses and other current assets

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Amounts due from Shenhua	**107**	970	**71**	899
Fair value of derivative financial instruments	**–**	145	**–**	145
Prepayments in connection with construction work and equipment purchases	**585**	1,440	**401**	1,176
Prepaid expenses and deposits	**374**	430	**229**	205
Amounts due from subsidiaries	**–**	–	**8,443**	9,687
Amounts due from associates	**104**	–	**100**	–
Other receivables	**73**	221	**54**	216
Advances to staff	**31**	33	**19**	18
	1,274	3,239	**9,317**	12,346

In the Company's balance sheet, the balances with subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

24 Time deposits with original maturity over three months and cash and cash equivalents

Included in time deposits with original maturity over three months and cash and cash equivalents are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	*million*	***million***	*million*
United States Dollars	**USD9**	USD25	**–**	USD3
Hong Kong Dollars	**HK$487**	–	**HK$486**	–

25 Deferred tax assets and liabilities

Deferred tax assets and deferred tax liabilities are attributable to the items set out below:

	The Group					
	Assets		Liabilities		Net balance	
	2005	2004	**2005**	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*	***RMB million***	*RMB million*
Current						
Allowances, primarily for receivables and inventories	**64**	69	**–**	–	**64**	69
Non-current						
Property, plant and equipment	**169**	247	**(601)**	(412)	**(432)**	(165)
Lease prepayments	**877**	894	**–**	–	**877**	894
Tax losses carried forward, net of valuation allowance	**118**	22	**–**	–	**118**	22
Others	**203**	10	**(143)**	(47)	**60**	(37)
Deferred tax assets/ (liabilities)	**1,431**	1,242	**(744)**	(459)	**687**	783

	The Company					
	Assets		Liabilities		Net balance	
	2005	2004	**2005**	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*	***RMB million***	*RMB million*
Current						
Allowances, primarily for receivables and inventories	**40**	40	**–**	–	**40**	40
Non-current						
Property, plant and equipment	**28**	24	**(123)**	(127)	**(95)**	(103)
Lease prepayments	**544**	554	**–**	–	**544**	554
Others	**162**	23	**(121)**	(45)	**41**	(22)
Deferred tax assets/ (liabilities)	**774**	641	**(244)**	(172)	**530**	469

25 Deferred tax assets and liabilities *(continued)*

Movements in temporary differences are as follows:

The Group

	At 1 January 2005 RMB million	Recognised in consolidated income statement RMB million	At 31 December 2005 RMB million
Current			
Allowances, primarily for receivables and inventories	69	(5)	64
Non-current			
Property, plant and equipment	(165)	(267)	(432)
Lease prepayments	894	(17)	877
Tax losses carried forward, net of valuation allowances (Note)	22	96	118
Others	(37)	97	60
Net deferred tax assets	783	(96)	687

	At 1 January 2004 RMB million	Recognised in consolidated income statement RMB million	At 31 December 2004 RMB million
Current			
Allowances, primarily for receivables and inventories	24	45	69
Non-current			
Property, plant and equipment	81	(246)	(165)
Lease prepayments	915	(21)	894
Tax losses carried forward, net of valuation allowances (Note)	30	(8)	22
Others	196	(233)	(37)
Net deferred tax assets	1,246	(463)	783

Note: As at 31 December 2005, no valuation allowance was provided for by the Group (2004: RMB194 million).

25 Deferred tax assets and liabilities *(continued)*

The Company

	At 1 January 2005 *RMB million*	Recognised in income statement *RMB million*	At 31 December 2005 *RMB million*
Current			
Allowances, primarily for receivables and inventories	40	–	40
Non-current			
Property, plant and equipment	(103)	8	(95)
Lease prepayments	554	(10)	544
Others	(22)	63	41
Net deferred tax assets	469	61	530

	Transferred from the Parent Company in connection with the Restructuring *RMB million*	Recognised in income statement *RMB million*	At 31 December 2004 *RMB million*
Current			
Allowances, primarily for receivables and inventories	–	40	40
Non-current			
Property, plant and equipment	–	(103)	(103)
Lease prepayments	569	(15)	554
Others	170	(192)	(22)
Net deferred tax assets	739	(270)	469

26 Borrowings

The Group's and the Company's short-term borrowings comprise:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Borrowings from banks and other financial institutions	**5,751**	7,100	**2,000**	4,655
Loans from an associate	**–**	1,141	**–**	650
Loans from subsidiaries	**–**	–	**300**	–
Current portion of long-term borrowings	**3,692**	5,616	**1,180**	3,054
	9,443	13,857	**3,480**	8,359

The Group's and the Company's interest rates per annum on short-term borrowings were:

	The Group		The Company	
	2005	2004	**2005**	2004
Borrowings from banks and other financial institutions	**4.698%-5.301%**	3.98%-5.76% L+0.55%-0.63%	**5.022%**	4.48%-5.31% L+0.55%-0.63%
Loans from an associate	**–**	3.51%-5.58%	**–**	3.51%-5.58%
Loans from subsidiaries	**–**	–	**2.277%**	–
Current portion of long-term borrowings	**2.30%-5.508% L+0.6%-1.35%**	2.30%-6.59% L+0.6%-1.35%	**2.30%-5.508% L+0.6%**	2.30%-6.59% L+0.6%

26 Borrowings *(continued)*

The Group's and the Company's long-term borrowings comprise:

		The Group		The Company	
		2005	2004	**2005**	2004
		RMB million	*RMB million*	***RMB million***	*RMB million*
Loans from banks and other financial institutions*					
Renminbi denominated	Interest rates ranging from 3.60% to 5.508% per annum with maturities through 28 December 2023	**36,943**	40,794	**9,624**	17,456
US Dollars denominated	Interest rate at L+0.6% per annum with maturities through 2 January 2008	**568**	959	**567**	871
Japanese Yen denominated	Interest rates ranging from 1.80% to 2.60% or L+1.35% per annum with maturities through 20 March 2031	**6,114**	7,315	**5,857**	6,917
		43,625	49,068	**16,048**	25,244
Loan from the Parent Company					
Renminbi denominated	Interest rate at 3.51% per annum with maturities on 22 July 2005	**–**	1,006	**–**	1,037
Loans from an associate					
Renminbi denominated	Interest rates ranging from 5.02% to 5.27% per annum with maturities through 27 October 2008	**–**	1,874	**–**	1,615
		43,625	51,948	**16,048**	27,896
Less: current portion of long-term borrowings		**(3,692)**	(5,616)	**(1,180)**	(3,054)
		39,933	46,332	**14,868**	24,842

* At 31 December 2005, the balance includes an entrusted loan from the Parent Company amounted to RMB1,000 million (2004: Nil).

Interest rates comprise fixed rates and floating rates based on the London Interbank Offered Rate ("LIBOR"/"L").

The above borrowings are unsecured.

26 Borrowings *(continued)*

The long-term borrowings were repayable as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Within one year or on demand	**3,692**	5,616	**1,180**	3,054
After one year but within two years	**6,154**	4,950	**2,921**	2,289
After two years but within five years	**14,739**	21,869	**3,809**	10,206
After five years	**19,040**	19,513	**8,138**	12,347
	43,625	51,948	**16,048**	27,896

As at 31 December 2005, no bank loan was guaranteed by the Parent Company (2004: RMB4,327 million) (Note 33).

Included in borrowings are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	*million*	***million***	*million*
United States Dollars	**USD82**	USD270	**USD70**	USD259
Japanese Yen	**JPY88,980**	JPY91,779	**JPY85,231**	JPY86,789

The Group had unsecured banking facilities amounting to RMB4,350 million as at 31 December 2005 (2004: RMB979 million). As at 31 December 2005, the unutilised banking facilities amounted to RMB3,919 million (2004: RMB369 million). Such banking facilities would be drawn down in accordance with the level of working capital and planned capital expenditure of the Company and its subsidiaries.

27 Accounts and bills payable

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Accounts payable	**5,225**	3,670	**2,596**	2,160
Bills payable	**1,376**	741	**–**	53
	6,601	4,411	**2,596**	2,213

The following is the ageing analysis of accounts and bills payable:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Within one year	**6,189**	3,866	**2,274**	1,961
One to two years	**368**	440	**315**	252
Two to three years	**24**	93	**7**	–
Over three years	**20**	12	**–**	–
	6,601	4,411	**2,596**	2,213

Included in accounts and bills payable are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	*million*	***million***	*million*
United States Dollars	**USD69**	USD34	**USD52**	USD34

RMB463 million (2004: RMB367 million) of the accounts and bills payable are expected to be settled after more than one year.

28 Accrued expenses and other payables

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Accrued staff wages and welfare benefits	**1,200**	1,034	**696**	602
Accrued interest payable	**46**	12	**32**	2
Accrued taxes other than income tax	**1,202**	825	**958**	552
Other accrued expenses and payables	**1,857**	1,944	**1,160**	1,526
Fair value of derivative financial instruments	**223**	–	**223**	–
Customer deposits and receipts in advances	**1,069**	889	**760**	428
	5,597	4,704	**3,829**	3,110

At 31 December 2005, the Group had amounts payable to related parties amounting to RMB83 million (2004: RMB430 million). The Company had amounts payable to related parties amounting to RMB126 million as at 31 December 2005 (2004: RMB990 million).

Accrued expenses and payables with an amount of RMB117 million (2004: RMB446 million) are expected to be settled after more than one year.

29 Accrued reclamation obligations

The accrual for reclamation costs has been determined based on management's best estimates. However, so far as the effect on the land from current mining activities becomes apparent in future periods, the estimate of the associated costs may be subject to change in the near term. The Group believes that the accrued reclamation obligations at 31 December 2005 are adequate. The accrual is necessarily based on estimates and therefore, the ultimate liability may exceed or be less than such estimates.

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
At the beginning of the year	**650**	628	**470**	–
Transferred from the Parent Company in connection with the Restructuring	**–**	–	**–**	470
Addition	**172**	–	**–**	–
Accretion expense	**30**	22	**27**	–
At the end of the year	**852**	650	**497**	470

30 Long-term payable

Long-term payable represents payable for acquisition of mining rights which is to be settled over the period of production on an annual basis. The annual payment is determined by fixed rates on a per tonne basis with reference to the annual production volume of the acquired mines (Note 32(b)).

31 Share capital

	2005 **RMB million**	2004 RMB million
Registered, issued and fully paid:		
14,691,037,955 (2004: 15 billion) domestic state-owned ordinary shares of RMB1.00 each	**14,691**	15,000
3,398,582,500 (2004: Nil) H shares of RMB1.00 each	**3,399**	–
	18,090	15,000

	2005 **No. of shares** **million**	2004 No. of shares million
At 1 January	**15,000**	–
Issue of domestic state-owned ordinary shares	**–**	15,000
Conversion of domestic state-owned ordinary shares into H shares	**(309)**	–
Issue of H shares	**3,399**	–
At 31 December	**18,090**	15,000

The Company was incorporated on 8 November 2004 with a registered share capital of 15,000,000,000 domestic state-owned ordinary shares with a par value of RMB1.00 each. Such shares were issued to Shenhua in consideration for the assets and liabilities transferred from Shenhua (Note 1).

In June 2005, the Company issued 2,785,000,000 H shares with a par value of RMB1.00 each, at a price of HK$7.50 per H Share by way of a global initial public offering to Hong Kong and overseas investors. As part of the global initial public offering, 278,500,000 domestic state-owned ordinary shares of RMB1.00 each owned by Shenhua were converted into H shares and sold to Hong Kong and overseas investors. In July 2005, the Company issued 304,620,455 H shares with a par value of RMB1.00 each, at a price of HK$7.50 per H share upon the exercise of the over-allotment option in connection with the global initial public offering. As part of the exercise of the over-allotment option, 30,462,045 domestic state-owned ordinary shares of RMB1.00 each owned by Shenhua were converted into H shares and sold to Hong Kong and overseas investors. A total of 3,398,582,500 H shares were listed on the Stock Exchange during the year.

32 Commitments and contingent liabilities

(a) Capital commitments

As at 31 December 2005, the Group had capital commitments for acquisition and construction of land and buildings and equipment, and for the acquisition of investments and associates as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Authorised and contracted for				
– Land and buildings	**4,302**	5,679	**200**	129
– Equipment	**4,772**	9,625	**1,973**	636
– Investments and associates	**450**	1,050	**450**	1,050
	9,524	16,354	**2,623**	1,815
Authorised but not contracted for				
– Land and buildings	**10,018**	7,831	**2,794**	1,504
– Equipment	**17,357**	4,255	**8,485**	809
	27,375	12,086	**11,279**	2,313

(b) Operating lease commitments

The Group leases business premises through non-cancellable operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the rental agreements contain escalation provisions that may require higher future rental payments nor impose restrictions on dividends, additional debt and/or further leasing. As at 31 December 2005, future minimum lease payments under non-cancellable operating leases on business premises having initial or remaining lease terms of more than one year are payable as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Within one year	**48**	48	**37**	37
After one year but within five years	**184**	186	**141**	143
After five years	**178**	184	**137**	143
	410	418	**315**	323

32 Commitments and contingent liabilities *(continued)*

(b) Operating lease commitments *(continued)*

At 31 December 2004, the Group operated certain leased mines with expected economic lives of 15-20 years, as contracted for between Shenhua and the owners. Royalties were paid by Shenhua to the owners at fixed rates on a per tonne basis with reference to the annual production volume of such leased mines. Such royalty expenses were re-charged at nil margin by Shenhua to the Group. The amounts of operating lease commitments for leased mines are not included in the above figures in 2004 as the payments are made on a per tonne basis and cannot be quantified for future years.

Pursuant to the purchase agreements signed by the Company and the respective owners in March 2005, the Company acquired the mining rights of such leased mines at a consideration based on the reserves of such mines. The royalty contracts entered by Shenhua and the owners were then terminated (see Note 30).

(c) Contingent liabilities

As at 31 December 2005, the undiscounted maximum amount of potential future payments under guarantees given to banks in respect of banking facilities granted to the parties below were as follows:

	The Group		**The Company**	
	2005	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*
Subsidiaries	**–**	–	**2,478**	4,636
Associates	**310**	130	**–**	–
Third party	**–**	109	**–**	–
	310	239	**2,478**	4,636

The Group monitors the conditions that are subject to the guarantees to identify whether it is probable that a loss has occurred, and recognises any such losses under guarantees when those losses can be estimated. At 31 December 2005, it was not probable that the Group would be required to make payments under these guarantees. Thus no liability was accrued for losses related to the Group's obligations under these guarantee arrangements.

(d) Legal contingencies

The Group is a defendant in certain lawsuits as well as the plaintiff in other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Group.

32 Commitments and contingent liabilities *(continued)*

(e) Environmental contingencies

To date, the Group has not incurred any significant expenditures for environmental remediation, is currently not involved in any environmental remediation, and apart from the provision for land reclamation costs, has not accrued any further amounts for environmental remediation relating to its operations. Under the existing legislation, management believes that there are no probable liabilities that will have a material adverse effect on the financial position or operating results of the Group. The PRC government, however, has moved, and may move further towards the adoption of more stringent environmental standards. Environmental liabilities are subject to considerable uncertainties which affect the Group's ability to estimate the ultimate cost of remediation efforts. These uncertainties include (i) the exact nature and extent of the contamination at various sites including, but not limited to coal mines and land development areas, whether operating, closed or sold, (ii) the extent of required cleanup efforts, (iii) varying costs of alternative remediation strategies, (iv) changes in environmental remediation requirements, and (v) the identification of new remediation sites. The amount of such future cost is indeterminable due to such factors as the unknown magnitude of possible contamination and the unknown timing and extent of the corrective actions that may be required. Accordingly, the outcome of environmental liabilities under future environmental legislation cannot reasonably be estimated at present, and could be material.

33 Related party transactions

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company

The Group is controlled by the Parent Company and has significant transactions and relationships with the Parent Company and its affiliates. Related parties refer to enterprises over which the Parent Company is able to exercise significant influence or control. The Company also has entered into transactions with its associates, over which the Company can exercise significant influence. Because of the above relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

33 Related party transactions *(continued)*

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company *(continued)*

The Group had the following transactions with Shenhua Group and the associates of the Company that were carried out in the normal course of business:

		2005 RMB million	2004 RMB million
Interest income	*(i)*	**10**	32
Purchases of ancillary materials and spare parts	*(ii)*	**(423)**	(353)
Ancillary and social services	*(iii)*	**(303)**	(139)
Transportation services income	*(iv)*	**78**	93
Interest expense	*(v)*	**(98)**	(150)
Purchase of coal	*(vi)*	**(927)**	(775)
Sale of coal	*(vii)*	**1,133**	519
Property leasing	*(viii)*	**(49)**	(49)
Transportation services expense	*(ix)*	**(175)**	(138)
Net deposits withdrawn from/(placed with) related party	*(x)*	**3,728**	(1,226)
Net loans (repaid to)/obtained from related party	*(xi)*	**(4,022)**	411
Repairs and maintenance services expense	*(xii)*	**(31)**	(49)
Agency income	*(xiii)*	**16**	4
Repairs and maintenance services income	*(xiv)*	**3**	5
Coal export agency expense	*(xv)*	**(70)**	(9)
Entrusted loan from a related party	*(xvi)*	**1,000**	–
Entrusted loan to a related party	*(xvii)*	**(100)**	–
Sales of ancillary materials and spare parts	*(xviii)*	**24**	–
Management fee income	*(xix)*	**17**	–
Tunnel income	*(xx)*	**32**	–

(i) Interest income represents interest earned from deposits placed with its associate. The applicable interest rate is determined in accordance with the prevailing savings deposit rate.

(ii) Purchases of ancillary materials and spare parts represent purchase of materials and utility supplies from Shenhua Group related to the Group's operations.

(iii) Ancillary and social services represent expenditures for social welfare and support services such as property management, water and electricity supply, and canteen paid to Shenhua Group.

(iv) Transportation services income represents income earned from its associate and Shenhua Group in respect of coal transportation services.

33 Related party transactions *(continued)*

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company *(continued)*

(v) Interest expense represents interest incurred in respect of borrowings from Shenhua Group. The applicable interest rate is determined in accordance with the prevailing borrowing rate.

(vi) Purchase of coal represents coal purchased from Shenhua Group.

(vii) Sale of coal represents income from sale of coal to its associates and Shenhua Group.

(viii) Property leasing represents rental charge in respect of properties leased from Shenhua Group.

(ix) Transportation services expense represents expense related to coal transportation services provided by its associates.

(x) Net deposits withdrawn from/placed with related party represent deposits withdrawn from/placed with its associate.

(xi) Net loans repaid to/obtained from related party represent loans repaid to/obtained from Shenhua Group.

(xii) Repairs and maintenance services expense represents expense related to machinery repairs and maintenance services provided by Shenhua Group.

(xiii) Agency income represents income earned from Shenhua Group in respect of providing agency service.

(xiv) Repairs and maintenance services income represents income earned from its associate in respect of machinery repairs and maintenance services.

(xv) Coal export agency expense represents expense related to coal export agency services provided by Shenhua Group.

(xvi) Entrusted loan from a related party represents entrusted loan from the Parent Company.

(xvii) Entrusted loan to a related party represents entrusted loan to its associate.

(xviii) Sales of ancillary materials and spare parts represents sales of materials and utility supplies to its associate and Shenhua Group related to the Group's operations.

(xix) Management fee income represents income earned from Shenhua Group in respect of rolling stock management.

(xx) Tunnel income represents income earned from Shenhua Group in respect of tunnel service.

33 Related party transactions *(continued)*

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company *(continued)*

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business, on normal commercial terms and in accordance with the agreements governing such transactions.

In connection with the Restructuring, the Company and Shenhua Group entered into a number of agreements effective as at 1 January 2004, which were subsequently revised as stated below. The terms of the principal agreements impacting the results of operations of the Company are summarised as follows:

(a) The Company entered into a three-year mutual supply agreement expiring 31 December 2006 which was subsequently extended to 31 December 2007 in the revised agreement with the Parent Company for the mutual provision of production supplies and ancillary services. Pursuant to the agreements, Shenhua Group provides the Company with the production supplies, such as explosives, fuses, oil products, and other related or similar production supplies and services; ancillary production services including security, logistics and support services, tendering services, other related or similar services and use of the information network system; and ancillary administrative services, such as social security and pension management service and staff data recording services. On the other hand, the Company provides Shenhua Group with water supplies, rolling stock management, rail transportation and other related or similar production supplies or services and use of the information network system.

The products and services provided under the agreement, other than the social security, pension management services, and staff data recording services which are provided by Shenhua Group free of charge and the sharing of use of the information network system, are provided in accordance with the following pricing policy:

- price prescribed by the state (including any price prescribed by any relevant local government), if applicable;

- where there is no state-prescribed price but where there is a state-guidance price, then the state-guidance price;

- where there is neither a state-prescribed price nor a state-guidance price, the market price; or

- where none of the above is applicable or where it is not practical to apply the above pricing policies in reality, the price agreed between the relevant parties shall be the reasonable costs incurred in providing the goods or services plus a profit margin of 5% of such costs.

33 Related party transactions *(continued)*

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company *(continued)*

Each party may terminate the provision of production supplies and ancillary services on six months' prior written notice unless the other party is unable to obtain similar production supplies and ancillary services from third parties.

(b) The Company entered into a three-year coal supply agreement expiring 31 December 2006 which was subsequently extended to 31 December 2007 in the revised agreement with the Parent Company. Pursuant to the agreements, the Group and Shenhua Group supply coal to each other in accordance with their needs. The coal supplied is charged at the prevailing market price. Each party is entitled to purchase coal from any independent third party if such a third party is able to provide coal to it on better terms and conditions than those offered by the other party.

Each party may terminate the supply of coal by giving six months' prior written notice to the other party. However, if the Company cannot conveniently purchase coal from a third party, Shenhua Group may not terminate the supply of coal under any circumstances.

(c) The Company entered into a three-year financial services agreement expiring 31 December 2006 which was subsequently terminated on 24 May 2005 with Shenhua Finance Company Limited, or Shenhua Finance, a subsidiary of Shenhua which was retained by the Shenhua Group upon the date of Restructuring. Pursuant to the agreement, Shenhua Finance provides financial services to the Group. The terms and conditions of such services should not be less favourable than the terms and conditions of financial services rendered by other financial institutions. The interest rate for the Group's deposit with Shenhua Finance should not be lower than the lowest limit fixed by the PBOC for the same type of deposit. The interest rate for loans made by Shenhua Finance to the Company should not be higher than the highest limit fixed by the PBOC for the same type of loan.

(d) The Company entered into a ten-year property leasing agreement expiring 31 December 2013 which was subsequently extended to 31 December 2014 in the revised agreement with the Parent Company. Pursuant to the agreements, the Group leases certain properties from Shenhua Group and vice versa. No rent is payable by the Company before Shenhua Group obtains the relevant certificate of property ownership for that piece of property. The rental charges will be based on comparable market rates. If Shenhua Group negotiates to sell a leased property to a third party, the Company has a pre-emptive right to purchase such property under terms no less favourable to the Company. The lessee may sub-let any of the properties with the consent of lessor. The Group may at any time during the term of the property leasing agreement enter into or terminate the lease of the properties under the property leasing agreement by providing three months' written notice.

33 Related party transactions *(continued)*

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company *(continued)*

(e) The Company entered into a ten-year land leasing agreement expiring 31 December 2013 which was subsequently extended to 31 December 2024 in the revised agreement with the Parent Company, which may be renewed upon request by the Company for another 20 years on the same terms (subject to the prevailing market rent) by giving one month's written notice prior to expiry of the land leasing agreement. No rent is payable before Shenhua Group has obtained the relevant land use rights certificate for that parcel of land, but thereafter, the annual rent is determined between the parties based on the relevant laws and regulations then in force and the local market rate. The rights of the Group to use land under the land leasing agreement may not be sub-let. The Group may at any time during the term of the land leasing agreement terminate the lease of any parcel of land leased under the land leasing agreement by providing three months' written notice.

(f) The Company entered into a three-year agency agreement expiring 31 December 2006 which was subsequently extended to 31 December 2007 in the revised agreement with the Parent Company for the export of coal on the Company's behalf. Shenhua Group is appointed as a non-exclusive export agent of the Company in priority over other export agencies if the terms of export services offered by it are equal or more favourable than other export agencies. Pursuant to the agreements, Shenhua Group is entitled to receive an agency fee based on the relevant market rates or lower rates. Currently, the rate is 0.7% of the free on board price of each tonne of coal exported by Shenhua Group on the Company's behalf.

(g) The Company and one of its subsidiaries entered into a three-year agency agreement expiring 31 December 2006 which was subsequently extended to 31 December 2007 in the revised agreement with the Parent Company for the sale of coal by the Company's subsidiary on behalf of Shenhua Group to minimise any potential competition between Shenhua Group and the Company. The Company's subsidiary is appointed as the exclusive sales agent for Shenhua Group for thermal coal and non-exclusive sales agent for coking coal. The unit selling price for sales the Company's subsidiary makes as agent will be determined by the Company's subsidiary according to the spot market price, subject to confirmation by Shenhua Group. Pursuant to the agreements, the Company's subsidiary is entitled to receive an agency fee which is based on its related costs incurred plus a profit margin of 5% for sale of coal outside the Inner Mongolia Autonomous Region. The Company's subsidiary does not charge any fee for sales of coal within the Inner Mongolia Autonomous Region.

33 Related party transactions *(continued)*

(a) Transactions with Shenhua and its affiliates ("Shenhua Group") and the associates of the Company *(continued)*

(h) The Company entered into a ten-year trademark license agreement expiring 31 December 2013 which was subsequently amended by a supplemental agreement with the Parent Company. Pursuant to the agreements, Shenhua Group has granted the Group a non-exclusive licence to use the registered trademarks in the PRC. The trademarks licensed under the trademark license agreement may be used by the Group on a royalty-free basis for a term of ten years, which is renewable for another term of ten years if so agreed by both parties. Shenhua Group has agreed to maintain at its own cost the registration of such trademarks during the term of the trademarks license agreement. Shenhua Group has also agreed to be responsible for the expenses for enforcement against any infringement of the licensed trademarks by third parties.

(i) A subsidiary of the Company entered into a three-year coal supply agreement expiring 31 December 2006 which was subsequently extended to 31 December 2007 in the revised agreement with Heibei Guohua Dingzhou Power Generation Co., Ltd. ("Dingzhou", an associate of the Company). Pursuant to the agreements, the Company's subsidiary supplies coal to Dingzhou. The coal supplied is determined in accordance with the prevailing market price. Each party may terminate the supply of coal at any time by providing six months' prior written notice to the other party.

(j) A subsidiary of the Company entered into a one-year maintenance agreement with effect from 1 January 2004 which was subsequently renewed for two more years to 31 December 2006 in the renewed agreement with Dingzhou. Pursuant to the agreements, the Company's subsidiary provides rail line maintenance services to Dingzhou on a daily basis.

33 Related party transactions *(continued)*

(b) Amounts due from/to and deposit with Shenhua Group and the associates of the Company

Amounts due from/to and deposit with Shenhua Group and the associates of the Company included in the respective account captions are summarised as follows:

	Note	**2005** **RMB million**	2004 RMB million
Cash and cash equivalents		**–**	3,728
Trade accounts receivable		**48**	35
Prepaid expenses and other current assets	23	**211**	970
Total amounts due from and deposit with Shenhua Group and the associates of the Company		**259**	4,733
Trade accounts payable and bills payable		**113**	51
Accrued expenses and other payables	28	**83**	430
Short-term borrowings		**–**	1,141
Long-term borrowings	26	**1,000**	2,880
Total amounts due to Shenhua Group and the associates of the Company		**1,196**	4,502

The deposits placed with Shenhua Group generated interest based on prevailing bank interest rates published by the PBOC. The terms and conditions associated with short-term borrowings and long-term borrowings to Shenhua Group and the associates of the Company are set out in Note 26. Amounts due from/to Shenhua Group and the associates of the Company, bear no interest, are unsecured and are repayable in accordance with normal commercial terms.

As at 31 December 2005, no bank loan was guaranteed by Shenhua (2004: RMB4,327 million).

(c) Key management personnel emoluments

Key management personnel receive compensation in the form of fees, salaries, housing and other allowances, benefits in kind, discretionary bonuses and retirement scheme contributions. Key management personnel received total compensation of RMB5.7 million for the year ended 31 December 2005 (2004: RMB5.1 million), details of which are disclosed in Note 10. Total remuneration is included in “personnel expenses” as disclosed in Note 7. Key management personnel also participate in the Group’s plan for share appreciation rights (Note 34).

33 Related party transactions *(continued)*

(d) Contributions to post-employment benefit plans

The Group participates in various defined contribution post-employment benefit plans organised by municipal and provincial governments for its employees. Further details of the Group's post-employment benefit plans are disclosed in Note 34.

(e) Transactions with other state-owned entities in the PRC

The Group is a state-owned entity and operates in an economic regime currently predominated by state-owned entities. Apart from transactions with Shenhua Group and the associates of the Company, the Group conducts a majority of its business activities with entities directly or indirectly owned or controlled by the PRC government and numerous government authorities and agencies (collectively referred to as "state-owned entities") in the ordinary course of business. These transactions, which include sales and purchase of goods and ancillary materials, rendering and receiving services, lease of assets, purchase of property, plant and equipment and obtaining finance, are carried out at terms similar to those that would be entered into with non-state-owned entities and have been reflected in the financial statements. The Group believes that it has provided meaningful disclosure of related party transactions as summarised above.

34 Employee benefits plan

As stipulated by the regulations of the PRC, the Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the retirement plans at rates ranging from 17% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. The Group's contributions for the year ended 31 December 2005 were RMB347 million (2004: RMB283 million).

On 19 November 2005, the Company's board of directors approved a scheme of share appreciation rights for the senior management of the Group with a term of 10 years with effect from 15 June 2005. No shares will be issued under this scheme. The rights will be granted in units with each unit representing one H share of the Company.

The rights to the units will have an exercise period of six years from the date of grant and can be exercised after the second, third and fourth anniversary of the date of grant and the total number of the rights exercised by an individual may not in aggregate exceed one-third, two-thirds and 100% respectively, of the total rights granted to the individual.

Upon exercise of the said rights, the exercising participant will, subject to the restrictions under the scheme, receive a payment in RMB, after deducting any applicable withholding tax, equal to the product of the number of rights exercised and the difference between the exercise price and market price of the H shares of the Company at the time of exercise.

34 Employee benefits plan *(continued)*

The Company granted 2.8 million share appreciation rights during the year ended 31 December 2005 and recognised a compensation expense over the applicable vesting period. The compensation expense recognised for the year ended 31 December 2005 amounted to RMB1 million for the year (2004: Nil). The exercise price of such share appreciation rights as approved by the board of directors on 19 November 2005 is HK$7.90, being the closing price of the Company's shares at the thirtieth trading day after its listing. As at 31 December 2005, 2.8 million (2004: Nil) share appreciation rights were outstanding.

Changes in the subjective input assumptions when applying the binomial option pricing model could materially affect the fair value estimate of the share appreciation rights.

35 Segment information

The Group's risks and rates of return are affected predominantly by differences in the products and services it produces. The Group's primary format for reporting segment information is business segments with geographical segments as its secondary format.

Business segments:

The Group has two reportable segments as follows:

(1) Coal operations – which produces coal from surface and underground mines, and the sale and transportation of coal to external customers and the power segment. The Group primarily sells its coal under long-term coal supply contracts which typically allow the parties to make annual price adjustments.

(2) Power operations – which uses coal, sourced from coal mining segment of the Group and purchased from external suppliers, to generate the electric power for sale to external power grid companies and to the coal segment. The sales of power are not subject to long-term minimum power supply obligations. Electric power is sold to the power grid companies in accordance with planned power output at the tariff rates as approved by the relevant government authorities. Electric power produced in excess of the planned power output is sold at the tariff rate as agreed upon with the respective power grid companies which are generally lower than the tariff rates for planned power output.

The segments were determined primarily because the Group manages its coal and power generation businesses separately. The reportable segments are each managed separately due to differences in their operating, distribution and production processes and gross margin characteristics.

The Group evaluates the performance and allocates resources to its reportable segments on an income from operations basis, without considering the effects of finance costs or investment income. The accounting policies of the Group's reportable segments are the same as those described in the significant accounting policies (see Note 2). Corporate administrative costs and assets are not allocated to the operating segments; instead, operating segments are charged for direct corporate services. Inter-segment transfer pricing is based on market prices or prices pre-determined by the relevant governmental authority.

35 Segment information *(continued)*

(a) Income statement

The following table presents segmental information:

	Coal		Power		Corporate and others (Note i)		Eliminations		Total	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004	**2005**	2004
	RMB million	*RMB million*	***RMB million***	*RMB million*	***RMB million***	*RMB million*	***RMB million***	*RMB million*	***RMB million***	*RMB million (restated – Note 3)*
Revenues										
External sales	**41,344**	29,369	**10,898**	9,898	**–**	–	**–**	–	**52,242**	39,267
Inter-segment sales	**4,156**	3,002	**53**	40	**–**	–	**(4,209)**	(3,042)	**–**	–
Total operating revenues	**45,500**	32,371	**10,951**	9,938	**–**	–	**(4,209)**	(3,042)	**52,242**	39,267
Cost of revenues										
Cost of coal production	**(9,627)**	(7,383)	**–**	–	**–**	–	**1,190**	910	**(8,437)**	(6,473)
Cost of coal transportation	**(11,297)**	(9,481)	**–**	–	**–**	–	**804**	726	**(10,493)**	(8,755)
Cost of power sales	**–**	–	**(7,517)**	(6,419)	**–**	–	**2,195**	1,398	**(5,322)**	(5,021)
Others	**(853)**	(946)	**(14)**	(27)	**–**	–	**–**	–	**(867)**	(973)
Total cost of revenues	**(21,777)**	(17,810)	**(7,531)**	(6,446)	**–**	–	**4,189**	3,034	**(25,119)**	(21,222)
Selling, general and administrative expenses	**(2,215)**	(1,792)	**(855)**	(600)	**(219)**	(100)	**–**	–	**(3,289)**	(2,492)
Other operating (expenses)/income, net	**(207)**	(74)	**57**	20	**–**	–	**–**	–	**(150)**	(54)
Profit/(loss) from operations	**21,301**	12,695	**2,622**	2,912	**(219)**	(100)	**(20)**	(8)	**23,684**	15,499
Reconciliation of profit from operations to profit for the year:										
Net financing costs									**(2,060)**	(2,358)
Investment income									**10**	–
Share of profits of associates (Note ii)									**461**	198
Income tax									**(4,083)**	(2,773)
Profit for the year									**18,012**	10,566

Note: (i) "Corporate and others" represents miscellaneous revenue and expenses that are immaterial.

(ii) The amount was shown net of tax of RMB160 million (2004: RMB47 million).

35 Segment information *(continued)*

(b) Balance sheet

Assets and liabilities dedicated to a particular segment's operations are included in that segment's total assets and liabilities. Assets which benefit more than one segment are considered to be corporate assets and are not allocated. "Unallocated assets" consists primarily of cash and cash equivalents, time deposits, investments and deferred tax assets. "Unallocated liabilities" consists primarily of short-term and long-term borrowings, income tax payable and deferred tax liabilities.

Interests in and earnings from associates are included in the segments in which the associates operate. Information on interest in associates is included in Note 19.

	2005 **RMB million**	2004 RMB million
Assets		
Segment assets		
Coal	**69,576**	61,057
Power	**43,081**	36,442
Combined segment assets	**112,657**	97,499
Interest in associates		
Coal	**544**	469
Power	**3,142**	2,262
Total interest in associates	**3,686**	2,731
Unallocated assets	**22,917**	10,139
Total assets	**139,260**	110,369
Liabilities		
Segment liabilities		
Coal	**(11,094)**	(6,781)
Power	**(3,270)**	(2,563)
Combined segment liabilities	**(14,364)**	(9,344)
Unallocated liabilities	**(52,407)**	(62,544)
Total liabilities	**(66,771)**	(71,888)

35 Segment information *(continued)*

(c) Other segment information

	Coal		Power		Corporate and others *(Note i)*		Total	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004
	RMB million	*RMB million (restated – Note 3)*	***RMB million***	*RMB million (restated – Note 3)*	***RMB million***	*RMB million*	***RMB million***	*RMB million (restated – Note 3)*
Capital expenditure	**13,609**	8,816	**8,447**	6,217	**4**	2	**22,060**	15,035
Depreciation and amortisation	**3,593**	3,048	**1,780**	1,901	**1**	–	**5,374**	4,949
Share of profits of associates (Note ii)	**85**	77	**376**	121	**–**	–	**461**	198
Impairment losses on property, plant and equipment	**41**	–	**–**	–	**–**	–	**41**	–

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year.

Note:

(i) "Corporate and others" represents miscellaneous revenue and expenses that are immaterial.

(ii) The amount was shown net of tax of RMB160 million (2004: RMB47 million).

Geographical segments:

The Group has three geographical segments by location of customers as follows:

(1) Domestic markets – external customers which are located in the PRC.

(2) Asia Pacific markets – export sales to customers which are located outside the PRC and primarily to customers in Korea and Japan.

(3) Other markets – export sales to customers which are located outside the PRC and the Asia Pacific region.

(i) Income statement

	2005	2004
	RMB million	*RMB million*
Domestic markets	**42,606**	31,155
Export sales – Asia Pacific markets	**9,351**	7,815
Export sales – other markets	**285**	297
Total operating revenues	**52,242**	39,267

(ii) Balance sheet

The location of all the Group's production or service facilities and other assets is in the PRC.

36 Distributable reserves

The movement of shareholders' equity of the Company is as follows:

	Share capital RMB million (Note 31)	Share premium RMB million	Statutory reserves RMB million	Capital and other reserves RMB million	Retained earnings RMB million	Total RMB million
Capitalisation upon legal establishment of the Company (Note 1)	15,000	–	–	1,461	–	16,461
Profit for the year	–	–	–	–	8,935	8,935
Appropriations	–	–	230	338	(568)	–
Revaluation surplus realised	–	–	–	(17)	17	–
At 31 December 2004	15,000	–	230	1,782	8,384	25,396
At 1 January 2005 (as previously reported at 31 December 2004)	15,000	–	230	1,782	8,384	25,396
Prior period adjustments arising from changes in accounting policies (Note 3)	–	–	–	(66)	(1,590)	(1,656)
At 1 January 2005, as restated	15,000	–	230	1,716	6,794	23,740
Issuance of shares upon public listing	3,090	21,568	–	–	–	24,658
Shares issue expenses	–	(755)	–	–	–	(755)
Profit for the year	–	–	–	–	13,840	13,840
Appropriations	–	–	2,898	499	(3,397)	–
Dividend for 2004 (Note 13)	–	–	–	–	(7,549)	(7,549)
Realisation of deferred tax	–	–	–	(10)	10	–
Revaluation surplus realised	–	–	–	(2)	2	–
At 31 December 2005	18,090	20,813	3,128	2,203	9,700	53,934

36 Distributable reserves *(continued)*

According to the Company's Articles of Association, the amount of retained profits available for distribution to equity shareholders of the Company is the lower of the amount determined in accordance with the PRC Accounting Rules and Regulations and the amount determined in accordance with IFRSs after the appropriation to reserves as detailed in Note (v) to the consolidated statement of changes in equity.

At 31 December 2005, the aggregate amount of reserves available for distribution to equity shareholders of the Company was RMB9,700 million (2004: RMB6,794 million (as restated – see Note 3)).

37 Financial instruments

Financial assets of the Group include cash and cash equivalents, time deposits, other investments, accounts and bills receivable and other receivables. Financial liabilities of the Group include borrowings, accounts and bills payable and derivative financial instruments. The Group does not hold nor issue financial instruments for trading purposes.

(a) Credit risk

The carrying amounts of cash and cash equivalents, time deposits, other investments, accounts and bills receivable and other receivables represent the Group's maximum exposure to credit risk in relation to these financial assets. Substantially all of the Group's cash and cash equivalents are held in major financial institutions located in the PRC, which management believes are of high credit quality. The Group's major customers are power plants, metallurgical companies and power grid companies, which accounted for significant amounts of the Group's total operating revenues during the year. The Group has no significant credit risk with any of these customers since the Group maintains long-term and stable business relationships with these large customers in the coal and power industries. Accounts receivable are typically unsecured and denominated in RMB, and are derived from revenues earned from operations arising in the PRC. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on accounts receivable. The impairment losses on bad and doubtful accounts have been within management's expectations.

(b) Currency risk

Except for export sales which are transacted in US Dollars, all of the revenue-generating operations of the Group are transacted in RMB, which is not fully convertible into foreign currencies. On 1 January 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted by the PBOC. However, the unification of the exchange rate does not imply convertibility of RMB into Hong Kong Dollars or other foreign currencies. All foreign exchange transactions must take place through the PBOC or other institutions authorised to buy and sell foreign exchange. Approval of foreign currency payments by the PBOC or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

37 Financial instruments *(continued)*

(b) Currency risk *(continued)*

In addition, the Group incurs foreign currency risk on borrowings that are denominated in a currency other than RMB. The currencies giving rise to this risk are primarily US Dollars and Japanese Yen. To reduce the risk, the Group has entered into forward exchange contracts, details of which are set out in Note (d) below.

(c) Interest rate risk

The interest rates and terms of repayment of the Group's borrowings are disclosed in Note 26. To reduce the interest rate exposure to fixed rate borrowings, the Group has entered into interest rate swaps, details of which are set out in Note (d) below.

(d) Fair values

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of IAS 32. Fair value estimates, methods and assumptions, set forth below for the Group's financial instruments, are made solely to comply with the requirements of IAS 32 and should be read in conjunction with the financial statements. The estimated fair value amounts have been determined by the Group using market information and valuation methodologies considered appropriate. However, considerable judgement is required to interpret market data to develop the estimates of fair values. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following summaries the major methods and assumptions used in estimating the fair values of the Group's and the Company's financial instruments.

37 Financial instruments *(continued)*

(d) Fair values *(continued)*

Long-term borrowings: The fair values of long-term borrowings are estimated by discounting future cash flows using current market interest rates offered to the Group for borrowings with substantially the same characteristics and maturities. As at 31 December 2005, the carrying amounts and fair values of the Group's and the Company's long-term borrowings are as follows:

	The Group				The Company			
	2005		2004		**2005**		2004	
	Carrying amount	**Fair value**	Carrying amount	Fair value	**Carrying amount**	**Fair value**	Carrying amount	Fair value
	RMB million	***RMB million***	*RMB million*	*RMB million*	***RMB million***	***RMB million***	*RMB million*	*RMB million*
Long-term borrowings	**43,625**	**43,973**	51,948	52,266	**16,048**	**16,400**	27,896	28,250

Derivatives: Forward exchange contracts are either marked to market using listed market prices or by discounting the contractual forward price and deducting the current spot rate. For interest rate swaps broker quotes are used. Those quotes are back tested using pricing models or discounted cash flow techniques. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument having a similar maturity at the balance sheet date. Where other pricing models are used, inputs are based on market related data at the balance sheet date.

Derivatives outstanding at 31 December 2005 in connection with the fixed rate borrowings denominated in Japanese Yen are as follows:

Remaining term to maturity	**The Group receives** *(notional amount Japanese Yen million)*	**Interest revenues**	**The Group pays** *(notional amount US Dollars million)*	**Interest charges**
Within one year	–		–	
After one year but within five years	8,951	Fixed 2.3%	83	Fixed 3.58% or 6 month L-1.14% to 6 month L-1.12%
After five years	11,088	Fixed 2.5% to 2.6%	99	Fixed 4.29% or 4.45% or 6 month L-0.39% to 6 month L-0.29%
	20,039		182	

37 Financial instruments *(continued)*

(d) Fair values *(continued)*

Derivatives outstanding at 31 December 2004 in connection with the fixed rate borrowings denominated in Japanese Yen are as follows:

Remaining term to maturity	The Group receives *(notional amount Japanese Yen million)*	Interest revenues	The Group pays *(notional amount US Dollars million)*	Interest charges
Within one year	–		–	
After one year but within five years	9,574	Fixed 2.3%	89	6 month L-1.14% to 6 month L-0.82%
After five years	12,320	Fixed 2.5% to 2.6%	112	Fixed 4.29% or 6 month L-0.39% to 6 month L-0.28%
	21,894		201	

The carrying amount and the fair value of the Group's and the Company's derivative financial instruments are as follows:

	The Group and the Company			
	2005		2004	
	Carrying amount *RMB million*	**Fair value** *RMB million*	Carrying amount *RMB million*	Fair value *RMB million*
Derivative financial instruments – (liabilities)/assets	**(223)**	**(223)**	145	145

Change in fair value is recognised as net financing costs in the consolidated income statement.

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

The fair values of all other financial instruments approximate their carrying amounts due to the nature or short-term maturity of these instruments.

38 Accounting estimates and judgements

The Group's financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of critical accounting policies, the judgements and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the financial statements. The principal accounting policies are set forth in Note 2. The Group believes the following critical accounting policies involve the most significant judgements and estimates used in the preparation of the financial statements.

Coal reserves

Engineering estimates of the Group's coal reserves are inherently imprecise and represent only approximate amounts because of the subjective judgements involved in developing such information. There are authoritative guidelines regarding the engineering criteria that have to be met before estimated coal reserves can be designated as "proved" and "probable". Proved and probable coal reserve estimates are updated at regular basis and have taken into account recent production and technical information about each mine. In addition, as prices and cost levels change from year to year, the estimate of proved and probable coal reserves also changes. This change is considered a change in estimate for accounting purposes and is reflected on a prospective basis in related depreciation rates.

Despite the inherent imprecision in these engineering estimates, these estimates are used in determining depreciation expenses and impairment loss. Depreciation rates are determined based on estimated proved and probable coal reserve quantity (the denominator) and capitalised costs of mining structures and mining rights (the numerator). The capitalised cost of mining structures and mining rights are amortised based on the units of coal produced.

Impairments

In considering the impairment losses that may be required for certain of the Group's assets which include property, plant and equipment, construction in progress and investments in its subsidiaries and associates (Note 2(m)(ii)), recoverable amount of the asset needs to be determined. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for these assets may not be readily available. In determining the value in use, expected cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to items such as level of sale volume, selling price and amount of operating costs. The Group uses all readily available information in determining an amount that is reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of items such as sale volume, selling price and amount of operating costs.

38 Accounting estimates and judgements *(continued)*

Impairments *(continued)*

In considering the impairment losses that may be required for current receivables, future cashflows need to be determined. One of the key assumptions that has to be applied is about the ability of the debtors to settle the receivables. Despite that the Group has used all available information to make this estimation, inherent uncertainty exists and actual write-offs may be higher than the amount estimated.

Depreciation

Other than the mining structures and mining rights, property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets regularly. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Obligations for land reclamation

The estimation of the liabilities for final reclamation and mine closure involves the estimates of the amount and timing for the future cash spending as well as the discount rate used for reflecting current market assessments of the time value of money and the risks specific to the liability. The Group considers the factors including future production volume and development plan, the geological structure of the mining regions and reserve volume to determine the scope, amount and timing of reclamation and mine closure works to be performed. Determination of the effect of these factors involves judgements from the Group and the estimated liabilities may turn out to be different from the actual expenditure to be incurred. The discount rate used by the Group may also be altered to reflect the changes in the market assessments of the time value of money and the risks specific to the liability, such as change of the borrowing rate and inflation rate in the market. As changes in estimates occur (such as mine plan revisions, changes in estimated costs, or changes in timing of the performance of reclamation activities), the revisions to the obligation will be recognised at the appropriate discount rate.

Derivative financial instruments

In determining the fair value of the derivative financial instruments, considerable judgement is required to interpret market data used in the valuation techniques. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

39 Subsequent events

The following significant transactions took place subsequent to 31 December 2005:

(a) After the balance sheet date, the directors resolved a special dividend payable to Shenhua and proposed a final dividend payable to all equity shareholders of the Company. Further details are disclosed in Note 13(a).

(b) On 10 March 2006, the directors have resolved to acquire a 70% stake in Jinjie Energy Corporation ("Jinjie") from Beijing Guohua Power Company Limited, a fellow subsidiary, at a consideration of RMB1,162 million. The principal activities of Jinjie are power generation and coal mining. As at 31 December 2005, Jinjie had not commenced operations. The acquisition is subject to the approval to be obtained from the relevant authorities in the PRC.

40 Comparative figures

Certain comparative figures have been adjusted or reclassified as a result of the changes in accounting policies. Further details are disclosed in Note 3.

41 Ultimate holding company

The directors consider the ultimate holding company of the Group at 31 December 2005 to be Shenhua Group Corporation Limited, a stated-owned enterprise established in the PRC.

42 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2005

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended 31 December 2005 and which have not been adopted in these financial statements:

	Effective for accounting period beginning on or after
IFRS 6, Exploration for and evaluation of mineral resources	1 January 2006
IFRS 7, Financial instruments: disclosures	1 January 2007
IFRIC 4, Determining whether an arrangement contains a lease	1 January 2006
IFRIC 5, Rights to interests arising from decommissioning, restoration environmental rehabilitation funds	1 January 2006
IFRIC 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005

42 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2005 *(continued)*

	Effective for accounting period beginning on or after
IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies	1 March 2006
IFRIC 8, Scope of IFRS 2	1 May 2006
Amendment to IAS 1, Presentations of financial statements: capital disclosures	1 January 2007
Amendment to IAS 19, Employee benefits – Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
Amendment to IAS 21, Net investment in a foreign operation	1 January 2006
Amendments to IAS 39, Financial instruments: Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments to IFRS 1, First-time Adoption of International Financial Reporting Standards	1 January 2006

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far the Group believes that the adoption of IFRIC 4, IFRIC 5, IFRIC 6, IFRIC 7, IFRIC 8, and the amendments to IAS 19, IAS 21 and IFRS 1 are not applicable to any of the Group's operations and that the adoption of the rest of the above amendments, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.