Supplementary Information for American Depositary Shares Holders

The consolidated financial statements of the Group have been prepared in accordance with Hong Kong GAAP, which differs in certain material respects from U.S.GAAP. Differences between Hong Kong GAAP and U.S.GAAP, which may have significant impacts on the consolidated net income/(loss) and the consolidated shareholders' equity are described below.

The effect on net profit/(loss) of significant differences between Hong Kong GAAP and U.S.GAAP for the years ended December 31, 2003, 2004 and 2005 is as follows:

		Year ended at December 31,			
		2003	2004	**2005**	**2005**
	Note	Restated Notes 2&3	Restated Notes 2&3		
		RMB million except per share data			**US$ million except per share data**
Consolidated net income/(loss) for the year under Hong Kong GAAP		(10,906)	2,699	**13,888**	**1,699**
U.S.GAAP adjustments:					
Revaluation of fixed assets	(a)	25,778	11,318	**—**	**—**
Depreciation of revalued fixed assets	(a)	—	(3,529)	**(5,110)**	**(625)**
Share-based compensation	(b)	(2)	—	**—**	**—**
Others		3	14	**—**	**—**
Tax effect on the above adjustments	(e)	(8,508)	(2,570)	**1,687**	**206**
Consolidated profit for the year under U.S.GAAP		6,365	7,932	**10,465**	**1,280**
Shares used in computing basic earnings per share		5,492	5,623	**6,594**	**6,594**
Shares used in computing diluted earnings per share		5,500	5,630	**6,628**	**6,628**
Basic earnings per share unde U.S.GAAP		RMB1.16	RMB1.41	**RMB1.59**	**USD0.19**
Diluted earnings per share under U.S.GAAP		RMB1.16	RMB1.41	**RMB1.58**	**USD0.19**

Supplementary Information for American Depositary Shares Holders

The effect on shareholders' equity of significant differences between Hong Kong GAAP and U.S.GAAP as at December 31, 2003, 2004 and 2005 is as follows:

		Year ended December 31,			
		2003	2004	**2005**	**2005**
	Note	Restated Note 2&3	Restated Note 2&3		
		RMB million			**US$ in million**
Consolidated shareholders' equity under Hong Kong GAAP		53,659	64,595	**63,010**	**7,808**
U.S.GAAP adjustments:					
Revaluation of fixed assets	(a)	22,796	30,251	**30,251**	**3,749**
Depreciation of revalued fixed assets	(a)	—	(3,529)	**(8,639)**	**(1,071)**
Convertible preference shares and corresponding share premium	(d)	(2,637)	—	**—**	**—**
Difference in distribution to owner upon Listing Reorganization	(f)	—	166	**—**	**—**
Others		(13)	—	**—**	**—**
Tax effect on the above adjustments	(e)	(7,522)	(8,819)	**(7,132)**	**(884)**
Consolidated shareholders' equity under U.S.GAAP		66,283	82,664	**77,490**	**9,602**

In 2005, the Group acquired the fixed line telecommunication service of four northern provinces/autonomous region (Shanxi Province, Neimenggu Autonomous Region, Jilin Province and Heilongjiang Province) from the ultimate holding company, China Netcom Group. Since the Group has adopted merger accounting to account for the Acquisition, 2003 and 2004 comparative figures have been restated as if the Acquisition had been completed before January 1, 2003 (note 2). Also, in 2005, the Group has adopted certain new or revised HKFRSs as set out in Note 3 of the financial statement. Certain 2004 comparatives have been restated as required by the relevant new or revised HKFRSs.

Supplementary Information for American Depositary Shares Holders

(a) Revaluation of fixed assets

In the Listing Reorganization, certain classes of fixed assets of the Group were revalued as at December 31, 2003. The revaluation was performed based on the depreciated replacement costs of the fixed assets and was not based upon the expected future cash flows of the fixed assets. The revaluation resulted in a charge of RMB25,778 million to the Group's consolidated income statement for the year ended 31 December, 2003 with respect to the reduction in carrying amounts of certain fixed assets below their historical cost bases. In addition, a surplus arising from the revaluation of certain other fixed assets totaling RMB2,982 million has been credited to the revaluation reserve.

In 2005, the Group acquired telecommunications business and assets of the four northern provinces/autonomous region from China Netcom Group as set out in Note 1 to the Group's financial statements. The acquired fixed assets were revalued as at December 31, 2004. The revaluation was performed based on the depreciated replacement costs of the fixed assets and was not based upon the expected future cash flows of the fixed assets. The revaluation resulted in a charge of RMB11,318 million to the Group's consolidated income statement for the year ended 31 December, 2004 with respect to the reduction in carrying amounts of certain fixed assets below their historical cost bases. In addition, a surplus arising from the revaluation of certain other fixed assets totaling RMB3,863 million has been credited to the revaluation reserve. The effect of the reduction in depreciation of the revalued assets amounted to RMB5,110 million in the year ended December 31, 2005 (2004: RMB3,529 million).

Under U.S.GAAP, the carrying values of fixed assets are stated at their historical costs less accumulated depreciation and provision for impairment without making reference to their respective depreciated replacement costs. An impairment loss on fixed assets is recorded under U.S.GAAP if the carrying value of such assets exceeds its future undiscounted cash flow resulting from the use of the assets and their eventual disposition. The future undiscounted cash flows of the Group's fixed assets, whose carrying amounts were reduced in connection with the Reorganization, exceed the historical costs of such fixed assets and, therefore, no impairment of such assets is recognized under U.S.GAAP. Accordingly, the deficit on revaluation of fixed assets charged to the Group' consolidated income statements and the surplus credited to revaluation reserve recorded under Hong Kong GAAP and the corresponding effect on the depreciation of the revalued assets in the subsequent periods are reversed for U.S.GAAP purposes.

(b) Share-based compensation in the years ended December 31, 2003

The Group had share-based compensation arrangements in the years ended December 31, 2003. Under Hong Kong GAAP, the Group accounts for shares issued to employees as ordinary share issuance and the difference between the amounts paid by the employees and the par values of the share were recognized as share premium.

Under U.S.GAAP, the Group accounts for share-based compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No.25 ("APB No.25"), "Accounting for Share Issued to Employees" and related interpretations thereof. Accordingly, the difference between the estimated fair values of the ordinary shares issued and the issuance prices at the issuance dates in recorded as deferred stock compensation, which is an item in the equity of the Group, and amortized over two years on a straight-line basis over the service period of each individual employee.

The estimated fair value of the ordinary shares issued to the employees was US$ 2.45 per share, which was based on a valuation report from an independent appraiser dated July 31, 2001 and derived on a non-marketable aggregate minority basis as of February 7, 2001. The directors of the Company believe that the assumption that was used in the valuation report as of February 7, 2001 did not change significantly in the subsequent periods. As at December 31, 2004 the difference between the estimated fair value of the ordinary shares issued and the issuance price at the date has been fully amortized.

Supplementary Information for American Depositary Shares Holders

(c) Grants of share options in the year ended December 31, 2004 and 2005

The Group granted share options to directors and employees in the years ended December 31, 2004 and 2005 pursuant to the Company's Stock Option Scheme as set out in Note 35.

Prior to 1 January 2005, under Hong Kong GAAP, no charge is recorded to the income statement and the proceeds received are recognized as an increase to capital upon the exercise of share options.

Prior to 1 January 2005, under U.S.GAAP, in accordance with the provisions of SFAS No.148, "Accounting for Stock-Based Compensation-Transition and Disclosure", the Group has selected to apply the disclosure only provisions related employee stock and share purchases and follows the provision of Accounting Principles Board Opinion No.25(APB 25) in accounting for stock options issued to employees. Under APB 25, compensation expense, if any, is recognized as the difference between the exercise price and the estimated fair value of the ordinary shares on the measurement date, which is typically the date of grant, and is expensed ratably over the service period, which is typically the vesting period. Since the options exercise price was set to be the share issuance price at the time of initial public offering, there is no expense charged to the income statement.

In 2005, the Group adopted HKFRS 2 – Share-based payment issued by HKICPA. The Group recognizes the fair value of the share options as an expense over the vesting period in the consolidated income statement, or as an asset if the cost qualifies for recognition as an asset under the Group's accounting policy. A corresponding increase is recognized in a capital reserve within equity. This change in accounting policy has been accounted for retrospectively.

In 2005, the Group applied the retroactive restatement method under FAS148 and retrospectively restated the prior year financial statements to recognize the share-based compensation to give effect to the fair-value-based method of accounting for all awards granted on a basis consistent with the pro forma disclosures required for those periods by FAS123. Upon the change of accounting policy, the treatment under U.S.GAAP is consistent with that under Hong Kong GAAP upon the changes in accounting policies.

(d) Convertible preference shares

Under Hong Kong GAAP, the convertible preference shares and the corresponding share premium are classified as equity while under U.S.GAAP they are presented as balances between liabilities and owners' equity because of the mandatorily redeemable feature of the convertible preference shares. This difference resulted in a reduction of the owners' equity by RMB2,637 million as at December 31, 2003 under U.S.GAAP. The convertible preference shares were converted to ordinary shares in 2004 and therefore the GAAP difference ceased to exist from that date.

(e) Deferred income tax

The amounts included in the reconciliation show the income tax effects of the differences between Hong Kong GAAP and U.S.GAAP as described above.

However, HK GAAP requires recognition of deferred tax asset only to the extent that recovery of the deferred tax assets is probable, whereas US GAAP requires full recognition of deferred tax assets and reduced by appropriate valuation allowance if the recovery is less than 50% likely. Recognition of deferred tax previously not recognized under HK GAAP is presented as a reversal of valuation allowance under US GAAP.

Supplementary Information for American Depositary Shares Holders

(f) Goodwill and negative goodwill

Before 1 January 2005, goodwill on acquisition was included in intangible assets and amortized using the straight-line method over its estimated useful life of no more than twelve years. Negative goodwill is presented in the same balance sheet classification as goodwill and recognized in the income statement over the remaining weighted average useful life of the related fixed assets.

On 1 January 2005, the Group adopted HKFRS 3 – Business Combination issued by the HKICPA. Goodwill could no longer be amortized and is tested annually for impairment, as well as when there are indications of impairment. If the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognized immediately in the consolidated income statement as it arises. According to the transitional provision of HKFRS3, the Group should not retrospectively adjust the financial statements issued in previous years.

Under U.S.GAAP, goodwill is not amortized but tested for impairment annually and whenever events or circumstances occur indicating that goodwill might be impaired. When negative goodwill results from an acquisition, the acquirer must reassess whether all acquired assets and assumed liabilities have been identified and properly valued and then allocate negative goodwill to certain acquired non-monetary assets on a pro rata basis as applicable. Any remaining unallocated negative goodwill must be recognized immediately as an extraordinary gain.

Goodwill was recognized from the acquisition of the 49% equity interest in Asia Netcom on December 31, 2003. Accordingly, the amortization of goodwill of RMB10 million during the year ended December 31, 2004 under Hong Kong GAAP is reversed for U.S.GAAP purpose and credited to the owners' equity.

After the Listing Reorganization, the value of the fixed assets transferred to China Netcom Group under Hong Kong GAAP was higher than that under U.S.GAAP by RMB166 million for reason of the different treatment as of the negative goodwill from the acquisition of Asia Global Crossing. The negative goodwill of RMB166 million was included in the balance sheet under Hong Kong GAAP while offset against certain fixed assets under U.S.GAAP and the fixed assets had been distributed to owner in accordance with the Reorganization plan. Accordingly, the amount distributed to owner under U.S.GAAP was lower than that under Hong Kong GAAP by RMB166 million.

On 1 January 2005, the balance of negative goodwill under Hong Kong GAAP was credited directly to the shareholders' equity upon the adoption of HKFRS 3 and the GAAP difference ceased to exist from then.

(g) Presentation of revenue

Under Hong Kong GAAP, revenues are presented net of the PRC business taxes and government levies which amounted to RMB2,392 million, RMB2,493 million and RMB2,421 million for the years ended December 31, 2003, 2004 and 2005 respectively.

Under U.S.GAAP, revenues should be presented gross with these type of taxes classified as a cost of revenue.

Supplementary Information for American Depositary Shares Holders

(h) Presentation of depreciation expenses

Under Hong Kong GAAP, depreciation expense can be excluded from "Network, operations and support" and separately disclosed on the face of income statement.

Under U.S.GAAP, "Network, operations and support" expenses should include charges for depreciation of property, plant and equipment and amortization of intangible assets. Industry practice adopted by the Chinese telecommunications sector is to present these costs of operations net of depreciations charges. In such circumstance, U.S.GAAP requires such fact to be highlighted on the face of the income statement.

(i) Presentation of amortization of subscriber acquisition costs

Under Hong Kong GAAP, amortization of capitalized subscriber acquisition costs, being RMB741 million, RMB2,602 million and RMB1,887 million for the years ended December 31, 2003, 2004 and 2005 respectively is classified as selling expenses due to the marketing and promotional nature of the expenditure.

Under U.S.GAAP, amortization of subscriber acquisition costs needs to be included in the item "Network, operations and support" expense for the Company.

Other U.S.GAAP disclosures

(a) Related party transaction

In previous years, under Hong Kong GAAP, transactions with state-controlled enterprises other than China Netcom Group and its affiliates are not required to be disclosed as related party transactions. In addition, government departments and agencies are deemed not to be related parties to the extent that such transactions are in the normal course of business. No exemptions were provided as that under U.S.GAAP.

In 2005, the Group adopted HKAS 24 – Related Party Disclosures issued by HKICPA in which the related exemption was removed. The GAAP difference ceased to exist by then.

(b) Comprehensive income

U.S.GAAP requires that all items that are required to be recognized as components of comprehensive income (including cumulative translation adjustment) be reported in a separate financial statement. There are no material differences between total recognized gains and losses for the periods shown in the Consolidated Statements of Changes in Equity presented under Hong Kong GAAP and U.S.GAAP comprehensive income, except for the differences between Hong Kong GAAP and U.S.GAAP profit attributable to shareholders shown above.

(c) Recent HK Accounting Pronouncements

The HKICPA has issued a number of new and revised HKFRSs and HKFRS Interpretations ("HKFRS – Ints"), and HKAS and HKAS Interpretations ("HKAS – Ints") as set out in Note 4(x) to the Group's financial statements which are effective for accounting periods beginning on or after January 1, 2006. The Group has not early adopted these new and revised standards and interpretations in the financial statements for the year ended December 31, 2005. The Group has commenced an assessment of the impact of these new and revised standards and interpretations, but is not yet in a position to state whether these new and revised standards and interpretations would have a significant impact on its results of operations and financial position.

Supplementary Information for American Depositary Shares Holders

(d) Recent U.S. Accounting Pronouncements

SFAS No. 123R

Revised SFAS No. 123 ("SFAS No. 123R") is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123") and superseded APB 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant date fair values. SFAS No. 123R is effective as at the beginning of the first interim or annual reporting period that begins after 15 June 2005 for public entities that do not file as small business issuers. The Company is required to adopt SFAS No. 123R in the fiscal year beginning 1 January 2006.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB No. 107") regarding the SEC's interpretation of SFAS No. 123R and the valuation of share-based payments for public companies. SAB No. 107 provides the staff's view regarding the valuation of share-based payment arrangements for public companies. In particular, SAB No. 107 provides guidance related to share-based payment transactions with non-employees, the transition from non public to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first time adoption of SFAS No. 123R, the modification of employee share options prior to the adoption of SFAS No. 123R and disclosure in Management's Discussion and Analysis subsequent to adoption of SFAS No. 123R. The Company does not expect the adoption of SFAS No. 123R and the guidance of SAB No. 107 to have a material impact on the financial condition or operating results of the Company.

Upon the adoption of retrospective restatement transitional method under SFAS No. 148 in the fiscal year 2005, the Company has retrospectively restated the prior year financial statements to recognize the share-based compensation to give effect to the fair-value-based method of accounting for all awards granted on a basis consistent with the pro forma disclosures required for those periods by SFAS No. 123. Accordingly, the Company does not expect to have significant impact upon the adoption of SFAS No. 123R and SAB No. 107 on the financial statements.

SFAS No. 151

SFAS No. 151 amends and clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). It requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during the fiscal years beginning after 15 June 2005. The Company is required to adopt SFAS No. 151 in the fiscal year beginning 1 January 2006. The Company considered the effects of adoption SFAS No. 151 does not have material impact on its financial statements.

(d) Recent U.S. Accounting Pronouncements *(continued)*

SFAS No. 153

SFAS No. 153 amends APB Opinion No. 29 on Accounting for Non-monetary Transactions, to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception of exchanges of nonmonetary assets that do not have commercial substance. It defines à nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after 15 June 2005. The Company is required to adopt SFAS No. 153 in the fiscal year beginning 1 January 2006. The Company considered the effects of adoption SFAS No. 153 does not have material impact on its financial statements.

EITF 05-06

In June 2005, the Emerging Issues Task Force (EITF) issued EITF 05-06, "Amortization periods for leasehold improvements purchased after lease inception or acquired in a business combination". EITF 05-06 provides guidance on determining amortization periods for leasehold improvements purchased after lease inception or acquired in a business combination. Effective for leasehold improvements (within the scope of this Issue) purchased or acquired in reporting periods beginning after 29 June 2005. The Company is required to adopt EITF 05-06 in the fiscal year beginning 1 January 2006. The Company is in the process of assessing the impact of EITF 05-06.

SFAS No. 154

SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. The statement establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. Effective for accounting changes and corrections of errors made in fiscal years beginning after 15 December 2005. The Company is required to adopt SFAS No. 154 in the fiscal year beginning 1 January 2006. The Company considered the effects of adoption SFAS No. 154 does not have material impact on its financial statements.

FSP No. FAS 13-1

In October 2005, FASB Staff Positions (FSP) issued FSP No. FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period" which addresses the accounting for rental costs associated with operating leases that are incurred during a construction period. Given that there is no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period, rental costs associated with ground or building operating leases that are incurred during a construction period shall be recognized as rental expense. The rental costs shall be included in income from continuing operations. The guidance in this FSP shall be applied to the first reporting period beginning after 15 December 2005. The Company is required to adopt FSP No. FAS 13-1 in the fiscal year beginning 1 January 2006. The Company is in the process of assessing the impact of this guidance.