1 GENERAL INFORMATION

Tencent Holdings Limited (the "Company") was incorporated in the Cayman Islands. The shares of the Company have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (defined as the "SEHK") since 16 June 2004.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the "Group") are principally engaged in the provision of Internet and mobile value-added services and online advertising services to users in the People's Republic of China (the "PRC").

The operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited ("Tencent Computer"), a limited liability company established in the PRC by certain shareholders of the Company on 11 November 1998. Tencent Computer is legally owned by the core founders of the Company who are PRC citizens (the "Registered Shareholders").

The PRC laws and regulations limit foreign ownership of companies providing value-added telecommunications services, which included activities and services operated by Tencent Computer. In order to enable certain foreign companies to make investments into the business of the Group, the Company established a subsidiary, Tencent Technology (Shenzhen) Company Limited ("Tencent Technology"), which is a wholly foreign owned enterprise incorporated in the PRC on 24 February 2000. The foreign investors of the Company then subscribed to additional equity interests of the Company.

Certain contractual arrangements have been made among the Company, Tencent Technology, Tencent Computer and the Registered Shareholders so that the decision-making rights and operating and financing activities of Tencent Computer are ultimately controlled by the Company. The Company and Tencent Technology are also entitled to substantially all of the operating profits and residual benefits generated by Tencent Computer under these arrangements. In particular, the Registered Shareholders are required under their contractual arrangements with the Group to transfer these interests in Tencent Computer to the Group or the Group's designee upon the Group's request at a pre-agreed nominal consideration.

As a result, Tencent Computer is accounted for as a subsidiary and the formation of the Group was accounted for as a business combination between entities under common control under a method similar to the uniting of interests method for recording all assets and liabilities at predecessor carrying amounts. The financial statements are presented as if these three entities had always been combined. This approach was adopted because in management's belief it best reflects the substance of the formation.

1 GENERAL INFORMATION (Cont'd)

During 2004, the Registered Shareholders established another company in the PRC, Shiji Kaixuan, in order to carry out certain business operations of the Group similar to Tencent Computer. The Company also incorporated another wholly foreign owned enterprise, Shidai Zhaoyang Technology (Shenzhen) Company Limited ("Shidai Zhaoyang"). Similar contractual arrangements have been made among the Company, Shidai Zhaoyang, Shiji Kaixuan and the Registered Shareholders. Shiji Kaixuan is also accounted for as a subsidiary of the Group for accounting purposes.

These consolidated balance sheet of the Group and balance sheet of the Company as at 31 December 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity for the year then ended (collectively defined as the "Financial Statements") have been approved for issue by the board of directors of the Company on 22 March 2006.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of the Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation and presentation

The Financial Statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS"), under the historical cost convention, as modified by the revaluation of available-for-sale investments and financial assets held for trading.

The preparation of the Financial Statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the Financial Statements are disclosed in Note 4.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation and presentation (Cont'd)

i) Adoption of revised/new IFRS, interpretation and amendments

In 2005, the Group adopted the following revised/newly released IFRS, interpretation and amendments to public standard which should be applied for periods beginning on or after 1 January 2005 and are relevant to its operations. The audited consolidated financial statements for the year ended 31 December 2004 have been restated as required, in accordance with the relevant requirements.

IAS 1 (revised 2003)	Presentation of Financial Statements
IAS 2 (revised 2003)	Inventories
IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003)	Events after the Balance Sheet Date
IAS 16 (revised 2003)	Property, Plant and Equipment
IAS 17 (revised 2003)	Leases
IAS 21 (revised 2003)	The Effects of Changes in Foreign Exchange Rates
IAS 24 (revised 2003)	Related Party Disclosures
IAS 27 (revised 2003)	Consolidated and Separate Financial Statements
IAS 32 (revised 2003)	Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003)	Earnings per Share
IAS 39 (revised 2003)	Financial Instruments: Recognition and Measurement
IFRS 2 (issued 2004)	Share-based Payment
IFRS 3 (revised 2004)	Business Combinations
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments
SIC 12 (Amendment)	Consolidation - Special Purpose Entities
IAS 39 (Amendment)	Transition and Initial Recognition of Financial Assets and Financial Liabilities

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation and presentation (Cont'd)

i) Adoption of revised/new IFRS, interpretation and amendments (Cont'd)

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 24, 27, 32, 33 and 39 (all revised in 2003), IFRIC 2, SIC 12 (Amendment) and IAS 39 (Amendment) did not result in substantial changes to the Group's accounting policies. In summary:

- IAS 1 (revised 2003) has affected the presentation of minority interest and other disclosures.
- IAS 21 (revised 2003) has no material effect to the Group's policy. The functional currency of each of the consolidated entities has been re-valuated based on the guidance laid down in the revised standard. All the Group entities have the same functional currency which is also used as the presentation currency.
- IAS 39 (revised 2003) has affected the classification of financial assets at fair value through profit and loss.

The adoption of IFRS 3 (revised 2004) requires simultaneous adoption with IAS 36 "Impairment of Assets" (revised 2004) and IAS 38 "Intangible Assets" (revised 2004), which are effective on or after 31 March 2004. The adoption of IFRS 3 (revised 2004), IAS 36 (revised 2004) and IAS 38 (revised 2004) form the accounting policies for goodwill arising from business combination (Note 2.6(a)) and other intangible assets recognised by the Group (Note 2.6(b)) during the year.

The adoption of IFRS 2 (issued 2004) has resulted in a change in the accounting policy for share-based payments. Prior to this, the provision of share options to employees did not result in a charge in the income statement. Subsequent to the adoption of IFRS 2 (issued 2004), the Group charges the cost of share options to the income statement (Note 2.15(c)).

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation and presentation (Cont'd)

i) Adoption of revised/new IFRS, interpretation and amendments (Cont'd)

The adoption of IFRS 2 (issued 2004) requires retrospective application to all the share options granted to employees after 7 November 2002 which remained unvested as at 1 January 2005, the resulting accounting impact is as follows:

	Group		Company	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Increase in share-based compensation reserve	**40,109**	5,583	**40,109**	5,583
Increase in investments in subsidiaries	**—**	—	**40,109**	5,583
Decrease in retained earnings brought forward as previously reported	**5,583**	—	**—**	—
Increase in cost of revenues	**7,785**	1,909	**—**	—
Increase in selling and marketing expenses	**5,720**	1,035	**—**	—
Increase in general and administrative expenses	**21,021**	2,639	**—**	—
Decrease in basic EPS (RMB)	**0.0195**	0.0037	**—**	—
Decrease in diluted EPS (RMB)	**0.0190**	0.0036	**—**	—

ii) Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory applied for accounting periods beginning on or after 1 January 2006 or later periods but which the Group has not early adopted. The Group is in the process of making an assessment of the impact of these new IFRS and is not yet in a position to state what impact all these new IFRS would have on its results of operations and financial position.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (Note 2.6(a)). If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("functional currency"). The Financial Statements are presented in Renminbi ("RMB"), which is both the functional currency of the Company and its subsidiaries and presentation currency of the financial statements of the Group.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.4 Foreign currency translation (Cont'd)

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security, and other changes in the carrying amount of the security. Translation differences are recognised in profit or loss, and other changes in carrying amount are recognised in equity.

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are included in the fair value reserve in equity.

(c) Group companies

The results and financial position of all group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency of RMB are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.4 Foreign currency translation (Cont'd)

(c) Group companies (Cont'd)

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.5 Fixed assets

All fixed assets are stated at historical cost less accumulated depreciation and accumulated impairment charge. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated on the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	20 - 50 years
Computer equipment	3 - 5 years
Furniture and office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	the shorter of their useful lives or over the lease terms

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.7).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

(b) Other intangible assets

Other intangible assets mainly include domain name, computer software and technology and non-compete agreements acquired from a business combination. They are initially recognised and measured at estimated fair value upon acquisition.

Cost of computer software and technology purchased are being amortised on a straight-line basis over their estimated economic lives of three to five years; and non-compete agreements are being amortised on a straight-line basis over the non-competition period.

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the software development employee costs and an appropriate portion of relevant overheads. Computer software development costs recognised as assets are amortised over their estimated useful lives.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.7 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets. Loans and receivables are classified as "accounts receivable" or "other receivables" in the balance sheet.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.8 Financial assets (Cont'd)

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and the Group's management has the positive intention and ability to hold to maturity.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of investments are recognised on trade-date - the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the "Financial assets at fair value through profit or loss" category, including interest and dividend income, are presented in the income statement within "Other gains/(losses), net" in the period in which they arise.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in income statement, and other changes in carrying amount are recognised in equity. Changes in the fair value of monetary securities classified as available-for-sale and non-monetary securities classified as available-for-sale are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as "Gains and losses from investment securities". Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.8 Financial assets (Cont'd)

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of accounts receivable is described in Note 2.11.

2.9 Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

During the year, the Group did not hold any derivative instruments designated as a hedging instrument but held certain derivative instruments which did not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the derivative financial instrument at fair value, which shall be stated at cost.

2.10 Inventories

Inventories are commodities purchased from third parties, and mainly consist of low value consumable gifts. Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.11 Accounts receivable

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of accounts receivable is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement within general and administrative expenses.

2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities within three months, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet, if any.

2.13 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where the Company purchases the Company's equity share capital, the shares are to be cancelled and the consideration to be paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders.

2.14 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.15 Employee benefits

(a) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to sick and maternity leave are not recognised until the time of leave.

(b) Pension obligations

The Group contributes on a monthly basis to various defined contribution benefit plans organised by the relevant governmental authorities. The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these plans are expensed as incurred. Assets of the plans are held by government authorities and are separate from those of the Group.

(c) Share-based compensation benefits

The Group adopted two share option schemes (see Note 18). The fair value of the employee services received in exchange for the grant of options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted by using an option-pricing model, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.16 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.17 Revenue recognition

The Group principally derives revenues from provision of Internet value-added services, mobile and telecommunications value-added services and online advertising services in the PRC.

(a) Internet value-added services and mobile and telecommunications value-added services

Revenue from Internet value-added services are derived from subscriptions received/receivable from the provision of a comprehensive customer service platform that utilises instant messaging and online entertainment services to create a virtual community over the Internet.

Mobile and telecommunication value-added services revenues are derived principally from providing users with mobile instant messaging services, mobile chat services, and other mobile value-added services such as mobile interactive voice response services, ringback tone services, music and image/picture downloads, mobile news and information content services and mobile game services.

Internet value-added services and mobile and telecommunications value-added services are either billed on a monthly subscription basis or on a per transaction/message basis. Certain of these services are delivered to the Group's customers through the platforms of various subsidiaries of mobile operators in the PRC mainly China Mobile Communications Corporation ("China Mobile") and China United Communications Corporation ("China Unicom"), and these operators also collect certain service fees (the "Internet and Mobile Service Fees") on behalf of the Group.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.17 Revenue recognition (Cont'd)

(a) Internet value-added services and mobile and telecommunications value-added services (Cont'd)

In order to derive the Internet and Mobile Service Fees collected on behalf of the Group by China Mobile and China Unicom, the two mobile operators are entitled to a fixed commission, which is calculated based on agreed percentages of the Internet and Mobile Service Fees received/receivable by them, plus, in certain cases, a fixed per-message adjustment for the excess of messages sent over messages received between the platforms of the Group and these operators (collectively defined as "Mobile and Telecom Charges"). The Mobile and Telecom Charges are withheld and deducted from the gross Internet and Mobile Service Fees collected by the two operators from the users, with the net amounts remitted to the Group.

The Internet and Mobile Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by subsidiaries of China Mobile and China Unicom to the Group on a monthly basis.

For the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on historical data and developing trends in customer payment delinquencies. Historical data used in estimating revenues include the most recent three-month history of the Internet and Mobile Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between the network gateways of the Group and the mobile operators. Adjustments are made in subsequent periods in the event that the actual revenue amounts are different from the original estimates.

In addition, the Internet value-added services can also be subscribed through prepaid cards and tokens sold by the Group through non-mobile channels such as sales agents appointed by the Group and banks. Receipts from the sales of prepaid cards and tokens are deferred and recorded as "deferred revenue" in the consolidated balance sheet. The amounts are recognised as revenue of the Group based on the actual utilization for consumption of the respective services (see also Note 21).

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.17 Revenue recognition (Cont'd)

(b) Online advertising

Online advertising revenues are derived from fees for selling advertising space on the Group's websites and instant messaging windows in the forms of banners, links and logos, etc. and delivery of advertisements by various means throughout the community created by the Group.

All the advertising contracts are based on the actual time period that the advertisements appear on the Group's websites or instant messaging windows and the revenues are recognised ratably over the period in which the advertisements are displayed.

(c) Interest income

Interest income is recognised on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the Group.

2.18 Government grants/subsidies

Grants/subsidies from government are recognised at their fair value where there is a reasonable assurance that the grants/subsidies will be received and the Group will comply with all attached conditions.

Under these circumstances, the grants/subsidies are recognised as income or matched with the associated costs which the grants/subsidies are intended to compensate.

2.19 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by lessors are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

2.20 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.21 Research and development expenses

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technical feasibility and its costs can be measured reliably. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its useful life, not exceeding five years.

Development assets are tested for impairment annually.

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, and price risk), credit risk and interest rate risk. The Group's overall risk management strategy seeks to minimise the potential adverse effects on the financial performance of the Group.

(a) Market risk

i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government.

The proceeds derived from the IPO are all denominated in Hong Kong Dollars ("HKD"). A large portion of them has already been invested into various investments denominated in US Dollars ("USD"). In addition, the Group is required to pay dividends in HKD in the future when dividends are declared.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

i) Foreign exchange risk (Cont'd)

The Group had USD and HKD monetary assets as at 31 December 2005 as stated below.

		As at 31 December	
Monetary assets	**Currency denomination**	**2005**	2004
		RMB'000	RMB'000
Non-current assets			
Held-to-maturity investments	USD	**244,581**	167,374
Current assets			
Financial assets held for trading	USD	**383,887**	666,900
Term deposits with original maturities of over three months	USD	**20,409**	576,227
Term deposits with original maturities of over three months	HKD	**316**	122,826
Cash and cash equivalents	USD	**858,974**	325,593
Cash and cash equivalents	HKD	**86,982**	40,736

The Group may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with its deposits and investments. The Group has not used any means to hedge the exposure to foreign exchange risk.

On 21 July 2005, the PRC government announced that RMB is to be floated in line with a basket of certain selected currencies and not to be pegged with USD on or after that day. As a result, RMB appreciated by approximately 2% as compared to USD based on the exchange rate announced on that day and the Group suffered exchange losses of approximately RMB47,304,000 as a result of RMB appreciation. The losses were recorded as finance costs in the income statement for the year ended 31 December 2005.

ii) Price risk

The Group is exposed to price risk because of investments held by the Group and classified as financial assets held for trading. They are stated at fair value through profit or loss. The Group is not exposed to commodity price risk.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(b) Credit risk

As mentioned in Note 2.17(a), the Internet and Mobile Service Fees are substantially derived from co-operative arrangements with China Mobile and China Unicom. If the strategic relationship with either mobile operator is terminated or scaled-back; or if the mobile operators alter the co-operative arrangements; or if they experience financial difficulties in paying us, the Group's mobile and telecommunication value-added services and Internet value-added services might be adversely affected in terms of recoverability of receivables.

However, in view of our history of cooperation with the mobile operators and the sound collection history of the receivables due from them, the management believes that there is no material credit risk inherent in the Group's outstanding accounts receivable balances.

(c) Interest rate risk

The Group has no interest-bearing borrowings. The Group's exposure to changes in interest rates is mainly attributable to its interest-bearing assets including held-to-maturity investments, term deposits with original maturities of over three months and cash and cash equivalents, details of which have been disclosed in Notes 9, 14 and 15 to the Financial Statements. Interest rates on these investments and deposits have been fixed in the relevant contracts. Other financial assets and liabilities do not have material interest rate risk.

3.2 Fair value estimation

The fair value of financial instruments traded in active markets (such as trading securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

The nominal value less estimated credit adjustments of accounts receivable and payable are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purpose is estimated by discounting the future contractual cash flows at the current market interest rate that is applicable for similar financial instruments.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Recognition of Internet value-added services and mobile and telecommunications value-added services

As mentioned in Note 2.17(a), for the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on historical data and developing trends in customer payment delinquencies.

As at 31 December 2005, the balance of accounts receivable due from China Mobile and China Unicom, which had not been confirmed, was estimated at RMB50,112,000 (2004: RMB66,894,000).

(b) Recognition of share-based compensation expenses

As mention in Note 2.15(c), the Company has granted share options to its employees. The directors have used the Black-Scholes valuation model (the "BS Model") to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement, such as risk free rate, dividend yield, expected volatility and turnover rate of grantees, is required to be made by the directors as the parameters for applying the BS Model (Note 18).

The fair value of options granted for the year ended 31 December 2005 determined using the BS Model was approximately RMB127,000,000 (2004: RMB46,000,000).

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Cont'd)

4.2 Critical judgements in applying the Group's accounting policies

(a) Recognition of deferred tax assets

Certain intragroup software and technology sales have been transacted within the Group. The costs of the self-developed software and technology purchased have been amortised by two subsidiary companies, Tencent Computer and Shiji Kaixuan, over their contracted useful lives (the "Amortisation").

According to an approval document issued by the local tax bureau in 2005, the directors believe that the Amortisation can be treated as a deductible expense in ascertaining the assessable profits of Tencent Computer and Shiji Kaixuan (the "Tax Deduction Claims"), and consider that it is appropriate for the Group to start to recognise deferred tax assets relating to such intragroup software and technology sales. The amount of the deferred tax assets was calculated based on temporary differences arising from the accounting bases (at the Group level) and the tax bases of the software and technology involved in the intragroup transactions reported by Tencent Computer and Shiji Kaixuan at their enacted enterprise income tax rates.

As at 31 December 2005, the relevant deferred tax assets were approximately RMB96,362,000 (2004: Nil) (Note 22).

(b) Recognition of derivative financial instruments

During the year, a subsidiary of the Company, Shiji Kaixuan, entered into an agreement with Shenzhen Domain Computer Network Company Limited ("Shenzhen Domain") and its owners (the "Sellers") to subscribe for/acquire in aggregate 19.9% of Shenzhen Doman's equity interests. The Group has paid RMB29,850,000 while the total consideration is determined with reference to future profits of Shenzhen Domain. According to the agreement, the Company is entitled to certain options to acquire additional equity interests up to 60% ("Call options") in Shenzhen Domain from the Sellers, within a specified period, at consideration payable based on the future profit that would be achieved by Shenzhen Domain ("Predetermined Considerations"). In addition, upon the occurrence of certain triggering events, the Sellers may also require the Company to acquire the remaining outstanding equity interests of Shenzhen Domain (the "Put Option") at the Predetermined Considerations (Note 10).

The directors of the Company consider that, based on the results of an assessment made by an external valuer according to the requirements of IFRS, the Company cannot reasonably determine and separate the fair values of the Call Options and the Put Option from the total consideration paid by the Group. The effect to the Financial Statements is considered to be immaterial.

5 SEGMENT INFORMATION

5.1 Primary reporting format – business segments

For the year ended 31 December 2005, the Group was principally engaged in the provision of the following services:

- Internet value-added services
- Mobile and telecommunications value-added services
- Online advertising

Other operations of the Group mainly comprised provision of trademark licensing and instant messaging services in business enterprise solution. Neither of these constitutes a separately reportable segment.

5 SEGMENT INFORMATION (Cont'd)

5.1 Primary reporting format – business segments (Cont'd)

The segment results and other segment items of the Group for the years ended 31 December 2005 and 2004 are presented as follows:

Year ended 31 December 2005	Internet value-added services RMB'000	Mobile and telecommunications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	786,680	517,265	112,826	9,624	1,426,395
Gross profit/(loss)	555,200	328,001	78,065	(4,740)	956,526
Other gains, net					73,145
Selling and marketing expenses					(197,627)
General and administrative expenses					(347,685)
Operating profit					484,359
Finance costs					(47,304)
Profit before income tax					437,055
Income tax benefit					48,307
Profit for the year					485,362
Segment assets	262,311	105,796	22,759	5,450	396,316
Unallocated assets					3,030,806
Total assets					3,427,122
Segment liabilities	281,883	24,412	11,004	3,556	320,855
Unallocated liabilities					177,854
Total liabilities					498,709
Other segment items					
Capital expenditure	90,170	22,322	3,507	3,504	119,503
Unallocated capital expenditure					182,485
Total capital expenditure					301,988
Depreciation	20,848	5,894	936	909	28,587
Unallocated depreciation					26,390
Total depreciation					54,977
Amortisation	—	—	—	—	—
Unallocated amortisation					2,343
Total amortisation					2,343

5 SEGMENT INFORMATION (Cont'd)

5.1 Primary reporting format – business segments (Cont'd)

Year ended 31 December 2004	Internet value-added services	Mobile and telecommunications value-added services	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues	439,041	641,190	54,801	8,501	1,143,533
Gross profit/(loss)	295,616	396,260	37,188	(3,656)	725,408
Other gains, net					25,915
Selling and marketing expenses					(109,517)
General and administrative expenses					(173,110)
Profit from operations					468,696
Finance costs					(5,043)
Profit before income tax					463,653
Income tax expenses					(22,534)
Profit for the year					441,119
Segment assets	151,084	132,213	9,617	5,965	298,879
Unallocated assets					2,564,442
Total assets					2,863,321
Segment liabilities	76,666	9,614	982	3,078	90,340
Unallocated liabilities					120,743
Total liabilities					211,083
Other segment items					
Capital expenditure	43,968	13,510	1,799	2,914	62,191
Unallocated capital expenditure					28,345
Total capital expenditure					90,536
Depreciation	14,520	4,540	605	987	20,652
Unallocated depreciation					7,157
Total depreciation					27,809

5 SEGMENT INFORMATION (Cont'd)

5.1 Primary reporting format – business segments (Cont'd)

There were no transactions between the business segments. Unallocated costs represent corporate expenses.

Segment assets consist primarily of fixed assets and receivables. Segment liabilities comprise operating liabilities and exclude items such as tax and other current liabilities. Capital expenditures represent additions to fixed assets and intangible assets. Unallocated assets consist primarily of corporate assets such as held-to-maturity investments, financial assets held for trading, available-for-sale investments, prepayments, deposits and other receivables, term deposits with original maturities of over three months and cash and cash equivalents. Unallocated liabilities consist primarily of other payables and accruals and tax liabilities.

5.2 Secondary reporting format – geographical segments

The Group mainly operates its businesses in the PRC (excluding Hong Kong) and all related assets are located in the PRC. The Group also held financial instruments as investments which were traded in other territories.

	Revenue		Total assets		Capital expenditure	
	2005	2004	**2005**	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Operating assets						
- The PRC	**1,426,395**	1,143,533	**1,821,898**	1,036,581	**301,988**	90,536
Investments						
- Hong Kong	**—**	—	**282,157**	589,831	**—**	—
- United States	**—**	—	**862,921**	542,598	**—**	—
- Europe	**—**	—	**376,891**	519,874	**—**	—
- Other countries	**—**	—	**83,255**	174,437	**—**	—
Consolidated	**1,426,395**	1,143,533	**3,427,122**	2,863,321	**301,988**	90,536

Revenue is presented based on the countries/geographical regions in which the services are provided. Segment assets are presented according to where the risks and returns of these assets are located. Assets located in the PRC mainly relate to provision of Internet and mobile value-added services and online advertising. Assets outside PRC are mainly held-to-maturity investments, financial assets held for trading, term deposits and cash and cash equivalents. Capital expenditures are presented according to where the assets are physical located.

6 FIXED ASSETS

	Buildings	Computer equipment	Furniture and office equipment	Motor vehicles	Leasehold improvements	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004						
Cost	—	91,354	5,434	1,801	6,728	105,317
Accumulated depreciation	—	(17,376)	(837)	(237)	(6,728)	(25,178)
Net book amount	—	73,978	4,597	1,564	—	80,139
Year ended 31 December 2004						
Opening net book amount	—	73,978	4,597	1,564	—	80,139
Additions	—	69,653	4,983	791	15,109	90,536
Disposals	—	(181)	(605)	—	—	(786)
Depreciation charge	—	(23,786)	(1,356)	(327)	(2,340)	(27,809)
Closing net book amount	—	119,664	7,619	2,028	12,769	142,080
At 31 December 2004						
Cost	—	160,565	9,703	2,591	16,118	188,977
Accumulated depreciation	—	(40,901)	(2,084)	(563)	(3,349)	(46,897)
Net book amount	—	119,664	7,619	2,028	12,769	142,080

6 FIXED ASSETS (Cont'd)

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
Year ended 31 December 2005						
Opening net book amount	—	119,664	7,619	2,028	12,769	142,080
The Foxmail Acquisition (Note 36)	—	200	—	—	—	200
Additions	65,762	178,528	5,403	1,131	27,189	278,013
Disposals	—	(103)	(166)	—	—	(269)
Depreciation charge	—	(41,886)	(2,009)	(544)	(10,538)	(54,977)
Closing net book amount	65,762	256,403	10,847	2,615	29,420	365,047
At 31 December 2005						
Cost	65,762	338,462	14,678	3,722	43,307	465,931
Accumulated depreciation	—	(82,059)	(3,831)	(1,107)	(13,887)	(100,884)
Net book amount	65,762	256,403	10,847	2,615	29,420	365,047

Depreciation of RMB27,752,000 (2004: RMB17,967,000) were recorded as cost of revenues, RMB4,154,000 (2004: RMB1,619,000) as selling and marketing expenses and RMB23,071,000 (2004: RMB8,223,000) as general and administrative expenses for the year ended 31 December 2005.

7 INTANGIBLE ASSETS

	Goodwill RMB'000	Domain name RMB'000	Computer software and technology RMB'000	Non-compete agreement RMB'000	Total RMB'000
Year ended 31 December 2005					
Opening net book amount	—	—	—	—	—
The Foxmail Acquisition (Note 36)	3,010	67	6,715	5,865	15,657
Additions	—	409	7,709	—	8,118
Amortisation charge	—	—	(1,203)	(1,140)	(2,343)
Closing net book amount	3,010	476	13,221	4,725	21,432
At 31 December 2005					
Cost	3,010	476	14,424	5,865	23,775
Accumulated amortisation and impairment	—	—	(1,203)	(1,140)	(2,343)
Net book amount	3,010	476	13,221	4,725	21,432

Amortisation of RMB2,343,000 (2004: Nil) has been charged to general and administrative expenses for the year ended 31 December 2005.

There was no impairment charge made against goodwill for the year ended 31 December 2005.

8 INTERESTS IN SUBSIDIARIES

(a) Investment in subsidiaries

The amount represents investments in equity interests of subsidiaries of the Company. Details are as follows:

	2005 RMB'000	2004 RMB'000
Investments in equity interests of subsidiaries:		
- at cost, unlisted	**8**	4
- investments arising from share-based compensation (Note i)	**40,109**	5,583
- amount due from subsidiaries (Note iii)	**28,272**	—
	68,389	5,587

The following is a list of principal subsidiaries of the Company as at 31 December 2005:

Name	Place and date of establishment and nature of legal entity	Particulars of issued/registered share capital	Percentage of equity/interest attributable to the Company				Principal activities
			2005		2004		
			Direct	Indirect	Direct	Indirect	
Tencent Computer	Established on 11 November 1998 in the PRC, private limited liability company	RMB20,000,000	**—**	**100% (Note ii)**	—	100% (Note ii)	Provision of Internet instant messaging and value-added services and of Internet advertisement service
Tencent Technology	Established on 24 February 2000 in the PRC, wholly foreign owned enterprise	USD2,000,000	**—**	**100%**	—	100%	Development of computer software and provision of Internet information service
Tencent Limited	Established on 14 March 1997 in BVI, private limited liability company	USD1	**100%**	**—**	100%	—	Investment holding

8 INTERESTS IN SUBSIDIARIES (Cont'd)

(a) Investment in subsidiaries (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/registered share capital	Percentage of equity/interest attributable to the Company				Principal activities
			2005		2004		
			Direct	**Indirect**	Direct	Indirect	
Realtime Century Technology Limited	Established on 14 March 1997 in BVI, private limited liability company	USD1	**100%**	**—**	100%	—	Investment holding
Shiji Kaixuan	Established on 13 January 2004 in the PRC, private limited liability company	RMB11,000,000	**—**	**100% (Note ii)**	—	100% (Note ii)	Provision of Internet instant messaging and value-added services and of Internet advertisement service
Shidai Zhaoyang	Established on 8 February 2004 in the PRC, wholly foreign owned enterprise	USD500,000	**—**	**100%**	—	100%	Provision of technical and management consultancy services
Tencent Asset Management Limited	Established on 7 July 2004 in BVI, private limited liability company	USD100	**100%**	**—**	100%	—	Assets management
Best Logistic Developments Limited	Established on 5 May 2004 in BVI, private limited liability company	USD 100	**100%**	**—**	100%	—	Investment holding
TCH Alpha Limited	Established on 15 October 2004 in BVI, private limited liability company	USD 100	**100%**	**—**	100%	—	Investment holding
TCH Beta Limited ("TCH Beta")	Established on 15 October 2004 in BVI, private limited liability company	USD 100	**100%**	**—**	100%	—	Holder of certain intellectual properties

8 INTERESTS IN SUBSIDIARIES (Cont'd)

(a) Investment in subsidiaries (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/registered share capital	Percentage of equity/interest attributable to the Company				Principal activities
			2005		2004		
			Direct	Indirect	Direct	Indirect	
TCH Sigma Limited	Established on 15 October 2004 in BVI, private limited liability company	USD 100	100%	—	100%	—	Holder of certain intellectual properties
TCH Delta Limited	Established on 25 February 2005 in BVI, private limited liability company	USD 100	100%	—	—	—	Investment holding
TCH Gamma Limited	Established on 25 February 2005 in BVI, private limited liability company	USD 100	100%	—	—	—	Holder of certain intellectual properties
Tencent Technology (Beijing) Company Limited ("Tencent Beijing")	Established on 30 March 2005 in the PRC, wholly foreign owned enterprise	USD 1,000,000	—	100%	—	—	Development of computer software and provision of Internet information service
TCH Lambada Limited	Established on 30 August 2005 in BVI, private limited liability company	USD 100	100%	—	—	—	Dormant
TCH Theta Limited	Established on 30 August 2005 in BVI, private limited liability company	USD 100	100%	—	—	—	Investment holding
TCH Zeta Limited	Established on 30 August 2005 in BVI, private limited liability company	USD 100	100%	—	—	—	Investment holding

8 INTERESTS IN SUBSIDIARIES (Cont'd)

(a) Investment in subsidiaries (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/registered share capital	Percentage of equity/interest attributable to the Company				Principal activities
			2005		2004		
			Direct	Indirect	Direct	Indirect	
Aceville Pte Limited	Established on 21 July 2005 in Singapore, private limited liability company	SGD 1	—	100%	—	—	Investment holding
High Morale Developments Limited	Established on 13 October 2005 in Hong Kong, private limited liability company	HKD 2	100%	—	—	—	Dormant

Note i: The amount represents share-based compensation expenses arising from grant of share options of the Company to employees of subsidiaries in exchange for their services offered to the subsidiaries.

Note ii: As described in Note 1, the Company lacks equity ownership in these two subsidiaries. Nevertheless, under certain contractual agreements enacted among the registered owners, the Company and its other subsidiaries, the Company controls these companies by way of controlling more than one half of the voting rights of them, governing their financial and operating policies and appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. In addition, such contractual agreements also transfer the risks and rewards of the two companies to the Company. As a result, they are presented as consolidating subsidiaries of the Company.

Note iii: The amounts due from subsidiaries mainly represent advances made for investments in Shidai Zhaoyang, Tencent Beijing and the Foxmail Acquisition (defined in Note 36). All these balances are unsecured and interest free and their settlements are neither planned nor likely to occur in the foreseeable future. The directors consider that it is appropriate to treat the balances as quasi equities in these companies and record them as non-current assets of the Company.

(b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries represent current account balances within the Group. All balances are unsecured and interest free and are expected to be repayable within one year.

9 HELD-TO-MATURITY INVESTMENTS

The amount as at 31 December 2005 represents two 3-Year notes and one 2-Year note issued by banks (the "Notes") with interest at variable annual coupon rates over the period of the Notes and with maturity in 2007. Embedded in the Notes are call options (the "Option") which entitle the issuers to repurchase the Notes at par from the Group after specified periods are lapsed until maturity of the Notes. Upon the exercise of the Option, the issuers are required to pay to the Group the principal together with the accrued interest.

There were no disposals or impairment provision made against held-to-maturity investments for the year ended 31 December 2005.

10 AVAILABLE-FOR-SALE INVESTMENTS

	2005	2004
	RMB'000	RMB'000
Beginning of the year	**—**	—
Additions:		
- equity interests in Shenzhen Domain (Note 4.2(b))	**29,850**	—
- equity interests in GoPets Ltd. ("GoPets") (Note)	**6,223**	—
End of the year	**36,073**	—
Current portion	**—**	—
Non-current portion	**36,073**	—

Note: The amount represents equity investment made by a subsidiary of the Company, Aceville Pte Limited, in GoPets, a limited liability company incorporated in Korea. The equity investment comprises 0.219% of the ordinary shares and 8.108% of the preferred shares in GoPets. The preferred shares are redeemable and convertible into ordinary shares.

The directors are of the opinion that there is no active market to assess the fair value of the investments given the two investee companies are private companies. The purchase considerations paid under arm's length negotiations should be the initial fair values for the investments. In addition, the directors consider that there had not been any material changes occurred which would lead to a change in the fair values of these available-for-sale investments from the dates of their acquisition to 31 December 2005. Therefore, no revaluation difference was required to be recognised in the Financial Statements and no impairment provision was required to be made as at 31 December 2005.

11 ACCOUNTS RECEIVABLE

	2005 RMB'000	2004 RMB'000
0 - 30 days	**125,323**	130,297
31 days - 60 days	**30,637**	25,340
61 days - 90 days	**17,362**	15,711
Over 90 days but less than a year	**49,432**	21,377
	222,754	192,725

The Group has no formal credit periods communicated to its major customers but the customers usually settle the amounts due to it within a period of 30 to 90 days. A substantial balance of the receivable balances as at 31 December 2005 and 31 December 2004 were due from China Mobile, China Unicom and China Telecommunications Corporation and their respective branches, subsidiaries and affiliates. Management considers that the net book value of the receivable balance approximates its fair value as at 31 December 2005.

12 PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	2005 RMB'000	2004 RMB'000
Prepaid expenses	**9,318**	8,535
Advance to suppliers	**5,897**	6,078
Rental deposits and other deposits	**7,800**	3,207
Interest receivable	**3,569**	3,785
Staff advance	**908**	2,359
Refundable value added tax ("VAT") (Note)	**—**	17,922
Others	**5,078**	8,461
	32,570	50,347

Note: According to a notice of the relevant government authorities in the PRC, Caishui 2000 No. 25, the portion of VAT paid in excess of 3% of the consideration of the software products developed and sold by an ordinary VAT payer would be immediately refunded by the tax bureau ("Tax Rebate"). During the year, certain intragroup software sales had been transacted within the Group, and this resulted in Tax Rebate of approximately RMB7,000,000 (2004: RMB57,132,000). The amount, together with the unsettled balance brought forward from 2004, had been fully settled by the local tax authority to the Group in cash for the year ended 31 December 2005.

In addition, the respective VAT paid/payable in these intragroup transactions, net of the amounts of Tax Rebate receivable, in the amount of approximately RMB1,500,000 (2004: RMB12,243,000) (Note 25), had been recorded as part of the general and administrative expenses of the Group during the year.

13 FINANCIAL ASSETS HELD FOR TRADING

	2005	2004
	RMB'000	RMB'000
Investment portfolio (Note i)	302,948	666,900
Floating rate debt instruments (Note ii)	80,939	—
	383,887	666,900

Note i: The fair values of the respective underlying financial instruments in the portfolio as at 31 December 2005 were determined with reference to the respective published price quotations in an active market.

Note ii: The fair value of these instruments as at 31 December 2005 were determined with reference to the published price quotations in an active market.

Changes in fair values of financial assets held for trading are recorded in other gains, net and finance costs in the income statement. Movements in financial assets held for trading have been presented as changes in operating activities in the consolidated cash flow statement of the Group (Note 33).

14 TERM DEPOSITS WITH ORIGINAL MATURITIES OF OVER THREE MONTHS

The effective interest rates of the term deposits of the Group and the Company with original maturities of over three months for the year ended 31 December 2005 were 2.15% (2004: 1.70%) and 2.75% (2004: 1.23%), respectively.

As at 31 December 2005, the Group had term deposits with original maturities of over three months denominated in USD and HKD as presented in Note 3.1(a). The deposit balance of the Company denominated in USD as at 31 December 2005 was RMB20,176,000 (2004: RMB33,156,000).

15 CASH AND CASH EQUIVALENTS

	Group		Company	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cash at bank and in hand	**1,170,360**	382,282	**52,672**	41,915
Short-term deposits with original maturities within three months	**405,684**	477,559	**9,684**	4,144
	1,576,044	859,841	**62,356**	46,059

The effective interest rates of the short-term deposits of the Group and the Company with original maturities within three months for the year ended 31 December 2005 were 1.66% (2004: 1.59%) and 3.15% (2004: 0.84%), respectively.

Details of the balances maintained by the Group which were denominated in USD and HKD as at 31 December 2005 are presented in Note 3.1(a). Approximately RMB630,088,000 (2004: RMB493,512,000) of the total balance was denominated in RMB and deposited with banks in the PRC. The balances maintained by the Company denominated in USD and HKD were RMB11,281,000 (2004: RMB5,887,000) and RMB51,075,000 (2004: RMB40,106,000), respectively as at 31 December 2005. The Company had no material balance denominated in RMB.

16 SHARE CAPITAL, SHARE PREMIUM AND SHARE-BASED COMPENSATION RESERVE

	Number of ordinary shares	Issued share capital	Share premium	Share-based compensation reserve	Total
		RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004	18,006,868	138	15,261	—	15,399
Increase in number of shares upon a share split (Note (a))	1,242,473,892	—	—	—	—
Shares issued during the IPO of the Company (Note (b))	420,160,500	45	1,516,425	—	1,516,470
Additional shares issued with respect to over-allotment option of the IPO (Note (c))	63,024,000	7	237,264	—	237,271
Employees share option scheme:					
- value of employee services	—	—	—	5,583	5,583
- number of shares issued and proceeds received (Note (d))	21,239,150	2	8,771	—	8,773
At 31 December 2004/ 1 January 2005	**1,764,904,410**	**192**	**1,777,721**	**5,583**	**1,783,496**
Employees share option scheme:					
- value of employee services	**—**	**—**	**—**	**34,526**	**34,526**
- number of shares issued and proceeds received (Note (e))	**18,605,658**	**1**	**11,408**	**—**	**11,409**
Repurchase and cancellation of shares (Note (f))	**(14,266,000)**	**(1)**	**(123,085)**	**—**	**(123,086)**
At 31 December 2005	**1,769,244,068**	**192**	**1,666,044**	**40,109**	**1,706,345**

The authorised share capital of the Company as at 1 January 2004 was 53,941,626 shares with no par value each. On 24 March 2004, the Company undertook a share split whereby each then issued ordinary share was split into 70 shares. In addition, the board of directors also resolved to increase the authorised share capital to 10,000,000,000 ordinary shares and a par value of HKD0.0001 was re-assigned to each share. The shares and per share information presented in the Financial Statements have taken into account the effects of the share split as if it had taken place on 1 January 2004.

16 SHARE CAPITAL, SHARE PREMIUM AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

Notes:

(a) On 24 March 2004, the Company undertook a share split whereby 1 then issued ordinary share was split into 70 shares, while the relative rights of each shareholder remained unchanged.

(b) On 16 June 2004, a total of 420,160,500 shares of HKD0.0001 per share were issued at HKD3.70 each and were fully paid up in the form of cash. The issuance consisted of (1) a public offering of 210,080,000 shares in Hong Kong and (2) a placement of 210,080,500 shares to institutional investors outside Hong Kong and the United States in reliance on Regulation S under the Securities Act and those in the United States in reliance on Rule 144A or another exemption under the Securities Act.

(c) On 8 July 2004, a total of 63,024,000 additional ordinary shares of HKD0.0001 per share were issued at HKD3.70 each after the exercise of an over-allotment option in full by the sponsor of the IPO on behalf of certain international purchasers.

(d) During the year of 2004, 21,239,150 Pre-IPO options (Note 18) of the Company granted in 2001 and 2002, at an exercise price of USD0.0497 each, were exercised.

(e) During the year of 2005, 16,465,650, 1,541,128 and 182,932 Pre-IPO options were exercised at exercise prices of USD0.0497, USD0.1967 and USD 0.4396 each, respectively. In addition, 415,948 Post-IPO options (Note 18) were exercised at an exercise price of HKD3.6650.

(f) During the year of 2005, the Company repurchased 14,266,000 of its own ordinary shares traded on the Main Board of the Stock Exchange. The total amount paid to acquire the shares was RMB123,086,000 and was deducted against shareholders' equity. These shares were then cancelled.

As at 31 December 2005, all issued shares were fully paid.

17 OTHER RESERVES

(a) Group

		PRC statutory reserves			
	Capital reserve	Statutory surplus reserve fund (Note)	Statutory public welfare fund (Note)	Reserve fund (Note)	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Balance at 1 January 2004	20,000	500	3,122	31	23,653
Profit appropriations to statutory reserves	—	9,500	11,053	8,236	28,789
Balance at 31 December 2004/ 1 January 2005	**20,000**	**10,000**	**14,175**	**8,267**	**52,442**
Profit appropriations to statutory reserves	**—**	**171**	**13,996**	**—**	**14,167**
Balance at 31 December 2005	**20,000**	**10,171**	**28,171**	**8,267**	**66,609**

Note:

In accordance with the Companies Laws of the PRC and the provisions of the articles of association of two subsidiaries of the Group in the PRC, namely Tencent Computer and Shiji Kaixuan, appropriation of net profit (after offsetting accumulated losses from prior years) should be made by Tencent Computer and Shiji Kaixuan to their respective Statutory Surplus Reserve Funds, the Statutory Public Welfare Funds and the Discretionary Reserve Funds before distributions are made to the owners. The percentages of appropriation to Statutory Surplus Reserve Fund and Statutory Public Welfare Fund are 10% and 5 - 10%, respectively. The amount to be transferred to the Discretionary Reserve Fund is determined by the equity owners meetings of Tencent Computer and Shiji Kaixuan. When the balance of the Statutory Surplus Reserve Fund reaches 50% of the paid up/registered capital, such transfer needs not be made. Both the Statutory Surplus Reserve Fund and Discretionary Reserves Fund can be capitalised as capital of an enterprise, provided that the remaining Statutory Surplus Reserve Fund shall not be less than 25% of the registered capital. However, the Statutory Public Welfare Fund is only available to provide collective staff welfare benefits. As at 31 December 2005, the balance of the Statutory Surplus Reserve Fund of Tencent Computer reaches 50% of the paid up/registered capital.

17 OTHER RESERVES (Cont'd)

(a) Group (Cont'd)

In addition, in accordance with the Law of the PRC on Enterprises with Foreign Investments and the provisions of the articles of association of three other subsidiaries of the Group in the PRC, namely Tencent Technology, Shidai Zhaoyang and Tencent Beijing, appropriation from net profit (after offsetting accumulated losses brought forward from prior years) should be made by these three companies to their respective Reserve Funds and Staff Bonus and Welfare Funds before distributions are made to the owners. The percentage of net profit to be appropriated to the Reserve Fund is not less than 10% of the net profit. The percentage to be appropriated to the Staff Bonus and Welfare Fund is determined by the boards of directors of these three companies. When the balance of the Reserve Fund reaches 50% of the paid up share capital, such transfer needs not be made. As at 31 December 2005, the balance of the Reserve Fund of Tencent Technology reaches 50% of the paid up share capital.

The Staff Bonus and Welfare Fund is designated for funding the payments of special bonuses approved for employees and collective staff welfare benefits. With an approval obtained from their respective boards of directors of these companies, the Reserve Fund can be used to offset accumulated deficit or to increase capital.

During the year, the equity owners meetings of Tencent Computer and Shiji Kaixuan and the boards of directors of Tencent Technology approved the 2004 profit appropriations and these appropriations were recognised in their financial statements for the year ended 31 December 2005, respectively. In addition, no profit appropriations had been made by Shidai Zhaoyang for the year ended 31 December 2004 since it reported losses.

(b) Company

During the year ended 31 December 2004, the Company transferred all its equity investment (the "Transfer") in its wholly owned subsidiary, Tencent Technology, to another wholly owned subsidiary at a consideration of USD1 (equivalent to approximately RMB8). Since it is a reorganisation under common control of the same shareholder, the difference between the original cost of investment in Tencent Technology and the consideration received by the Company for the Transfer in the amount of RMB16,534,000 was recorded as a debit to the capital reserve of the Company and no gain or loss had been recognised by the Company in the transaction.

18 SHARE OPTION

(a) Share option schemes

The Company adopted two share option schemes for the purpose of providing incentives to its directors, eligible employees and consultants:

(i) Pre-IPO Share Option Scheme (the "Pre-IPO Option Scheme")

Under the Pre-IPO Option Scheme, the board of directors of the Company granted options to eligible employees of the Group, including executive directors of the Company, to subscribe for shares in the Company. The Pre-IPO Option Scheme will expire on 31 December 2011.

The total number of shares in respect of which options were granted under the Pre-IPO Option Scheme was not permitted to exceed 7.5% of the shares in issue on the date the offer of the grant of an option was made. The number of ordinary shares in respect of which options were granted to any individual was not permitted to exceed 10% of the number of ordinary shares issued and issuable under the scheme. Options granted had to be taken up within 15 days of the date of grant, upon payment of RMB1 per grant. As at the effective date of the IPO of the Company on 16 June 2004, all options under this scheme had been granted.

The options vest in four equal tranches either after the expiration of a 12-month, 24-month, 36-month and 48-month period beginning on the date of the grant, respectively, or after the expiration of a 24-month, 36-month, 48-month and 60-month period beginning from the commencement date of employment, respectively. All the options are exercisable by installments from the commencement of the relevant vesting period until 31 December 2011.

(ii) Post-IPO Share Option Scheme (the "Post-IPO Option Scheme")

The Post-IPO Option Scheme was adopted by the Company on 24 March 2004. The board of directors of the Company may, at its discretion, invite any employee, consultant or director of any company in the Group to take up options to subscribe for shares at a price determined by it pursuant to the terms of the Post-IPO Option Scheme.

The options vest in four equal tranches either after the expiration of a 12-month, 24-month, 36-month and 48-month period beginning on the date of the grant, respectively, or after the expiration of a 24-month, 36-month, 48-month and 60-month period beginning from the commencement date of employment or the date of grant, respectively. The Post-IPO Option Scheme will remain in force for a period of ten years, commencing on the adoption date.

18 SHARE OPTION (Cont'd)

(a) Share option schemes (Cont'd)

(ii) Post-IPO Share Option Scheme (the "Post-IPO Option Scheme")(Cont'd)

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme, and under any other share option scheme of the Company (including the Pre-IPO Option Scheme), shall not exceed 10% of the relevant class of securities of the Company in issue as at the date of the IPO.

In the event of any alterations made to the capital structure of the Company whilst any options granted remain exercisable, whether by way of capitalisation of profits or reserves, rights issue, consolidation, sub-division, or reduction of the share capital of the Company or otherwise howsoever in accordance with legal requirements or in any event of any distribution of the Company's capital assets to its shareholders on a pro rata basis (whether in cash or in species) other than dividends paid out of the net profits attributable to its shareholders for each financial year of the Company, such corresponding alterations shall be made to: (i) the number or nominal amount of shares subject to the options of the scheme so far unexercised; (ii) the subscription price; or (iii) the method of exercise of the option.

(b) Movements in share options

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	Pre-IPO Option Scheme		Post-IPO Option Scheme		Total
	Average exercise price	No. of options	Average exercise price	No. of options	number of options
At 1 January 2004	USD 0.0497	62,088,600	—	—	62,088,600
Granted	USD 0.2253	10,464,230	HKD 3.665	6,311,520	16,775,750
Exercised	USD 0.0497	(21,239,150)	—	—	(21,239,150)
Lapsed	USD 0.1192	(906,763)	HKD 3.665	(10,559)	(917,322)
At 31 December 2004	USD 0.0849	50,406,917	HKD 3.665	6,300,961	56,707,878
At 1 January 2005	**USD 0.0849**	**50,406,917**	**HKD 3.665**	**6,300,961**	**56,707,878**
Granted	—	—	**HKD 6.3772**	**48,209,268**	**48,209,268**
Exercised	**USD 0.0661**	**(18,189,710)**	**HKD 3.665**	**(415,948)**	**(18,605,658)**
Lapsed	**USD 0.2069**	**(642,850)**	**HKD 4.6071**	**(2,800,635)**	**(3,443,485)**
At 31 December 2005	**USD 0.0933**	**31,574,357**	**HKD 6.1627**	**51,293,646**	**82,868,003**

During the year ended 31 December 2005, no share options were granted to the directors of the Company or any consultants (2004: Nil).

18 SHARE OPTION (Cont'd)

(c) Outstanding share options

Out of the 82,868,003 options outstanding as at 31 December 2005 (2004: 56,707,878 options), 23,278,348 options (2004: 23,842,925 options) were currently exercisable. Options exercised for the year ended 31 December 2005 resulted in 18,605,658 ordinary shares issued (Note 16(e)). The related weighted average price of share at the time of exercise was HKD6.8323 (equivalent to approximately RMB7.1179) per share.

Details of the expiry dates, exercise price and the respective number of share options which remained outstanding as at 31 December 2005 and 2004 are as follows:

Expiry Date	Range of exercise price	Number of options	
		2005	2004
31 December 2011	USD0.0497	**23,774,550**	40,371,450
(Pre-IPO options)	USD0.1967-USD0.4396	**7,799,807**	10,035,467
10 years commencing from the adoption date of 24 March 2004 (Post-IPO options)	HKD3.665-HKD8.35	**51,293,646**	6,300,961
		82,868,003	56,707,878

18 SHARE OPTION (Cont'd)

(d) Fair values of options

The fair values of the options granted to the employees, determined using the BS Model, during the period from 1 January 2004 to 31 December 2005 are as follows:

Date of grant	Fair value of options	No. of options granted	Exercise price	Closing share price at date of grant	Risk free rate (Note (ii))	Dividend yield (Note (iii))	Expected volatility (Note (iv))	Exercisable date
10/2/2004	RMB31,741,000	8,730,960	USD 0.1967	HKD 4.3235 (Note (i))	4.43%	0.6%	62.75%	Based on option grant date (Note (vi))
24/3/2004	HKD3,509,000	1,733,270	USD 0.1967 or 0.4396	HKD 3.4292 (Note (i))	3.300%	1.4%	80%	Based on the commencement date of employment (Note (v))
14/9/2004	HKD9,688,000	6,311,520	HKD 3.6650	HKD 3.6000	3.633%	1.4%	60%	Based on the commencement date of employment or based on option grant date (Note (v)&(vi))
26/1/2005	HKD27,864,000	16,006,530	HKD 4.4850	HKD 4.4750	3.305%	1.4%	55%	Based on the commencement date of employment or based on option grant date (Note (v)&(vi))
3/2/2005	HKD8,360,000	4,513,600	HKD 4.8000	HKD 4.8000	3.349%	1.4%	55%	Based on option grant date (Note (vi))

18 SHARE OPTION (Cont'd)

(d) Fair values of options (Cont'd)

Date of grant	Fair value of options	No. of options granted	Exercise price	Closing share price at date of grant	Risk free rate (Note (ii))	Dividend yield (Note (iii))	Expected volatility (Note (iv))	Exercisable date
23/3/2005	HKD1,489,000	660,000	HKD 5.5500	HKD 5.5500	4.199%	1.4%	55%	Based on option grant date or based on the commencement date of employment (Note(v) & (vi))
6/4/2005	HKD1,954,000	810,918	HKD 5.6700	HKD 5.5500	4.086%	1.4%	55%	Based on the commencement date of employment (Note(v))
19/5/2005	HKD1,222,000	500,000	HKD 5.6000	HKD 5.6000	3.793%	1.4%	55%	Based on the commencement date of employment (Note(v))
7/7/2005	HKD9,961,000	4,799,920	HKD 6.0100	HKD 5.9000	3.463%	1.4%	50%	Based on option grant date (Note (vi))
19/10/2005	HKD16,535,000	5,365,000	HKD 8.2400	HKD 8.0000	4.176%	1.4%	55%	Based on option grant date (Note (vi))
20/12/2005	HKD51,437,000	15,053,300	HKD 8.3500	HKD 8.3500	4.219%	1.4%	58%	Based on option grant date (Note (vi))
20/12/2005	HKD1,920,000	500,000	HKD 8.3500	HKD 8.3500	4.219%	1.4%	58%	Based on option grant date (Note (vii))

18 SHARE OPTION (Cont'd)

(d) Fair values of options (Cont'd)

Note:

(i) The fair values of the options of the Company determined by a third party valuer were used in the BS Model adopted in order to determine the fair values of the share options granted before the IPO of the Company which took place on 16 June 2004.

(ii) The risk free rate for the options granted on 10 February 2004 was determined based on the yield of the Chinese Government International Bond maturing in 2011 as at the date of valuation. The risk free rate for the options granted after February 2004 was determined based on the yield to maturity of Hong Kong Government Bonds with maturity in June 2012 as at the date of valuation.

(iii) Dividend yield is calculated using the average price to earnings ratio of 17 of comparable companies and a dividend payout ratio ranging from 10% to 25%.

(iv) Volatility, measured as the standard deviation of expected share price returns, is determined based on the average daily trading price volatility of the shares of the Company and comparable companies since their IPO to the valuation date.

(v) For options granted with exercisable date determined based on the commencement date of employment, the first 25% of the options can be exercised two years after the commencement date, and 25% each of the total options will become exercisable in each subsequent year.

(vi) For options granted with exercisable date determined based on the grant date of the options, the first 25% of the option can be exercised one year after the grant date, and 25% each of the total options will become exercisable in each subsequent year.

(vii) For options granted with exercisable date determined based on the grant date of the options, the first 25% of the option can be exercised two year after the grant date, and 25% each of the total options will become exercisable in each subsequent year.

(e) Expected turnover rate of grantees

The expected yearly percentage of employees that will stay within the Group at the end of the vesting period is estimated with reference to the historical employee information, which is assessed to be 87%. The rate has been used to determine the amount of share-based compensation expenses reported in the Financial Statements.

19 ACCOUNTS PAYABLES

Accounts payable and their ageing analysis are as follows:

	2005	2004
	RMB'000	RMB'000
0 - 30 days	**8,704**	694
31 days - 60 days	**15,126**	297
61 days - 90 days	**25**	23
Over 90 days but less than a year	**1,700**	1,492
	25,555	2,506

20 OTHER PAYABLES AND ACCRUALS

	2005	2004
	RMB'000	RMB'000
Staff costs and welfare accruals	**100,097**	42,944
Marketing and administrative expenses accruals	**40,062**	13,452
Prepayments received from customers	**25,153**	4,007
Professional fees accruals	**10,223**	6,360
Others	**20,652**	13,149
	196,187	79,912

21 DEFERRED REVENUE

Deferred revenue mainly represents service fees prepaid by customers in the forms of prepaid cards and tokens of which the related services have not been rendered.

22 DEFERRED INCOME TAXES

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The gross movements of the deferred income tax account were as follows:

	2005	2004
	RMB'000	RMB'000
At beginning of year	**—**	988
Credit to income statement	**(110,234)**	(988)
Charge to income statement	**14,682**	—
At end of year (Note 30(a))	**(95,552)**	—

As mentioned in Note 4.2(a), the Group recognised deferred tax assets in respect of the temporary differences arising from certain intragroup software and technology sales transactions undertaken. The credits to income statement during the year represent originating temporary differences arising from these software sales while the charge to income statement represents the reversal of the temporary differences. The movements of deferred tax assets were as follows:

	2005	2004
	RMB'000	RMB'000
At beginning of year	**—**	—
Credit to income statement	**(110,020)**	—
Charge to income statement	**13,658**	—
At end of year	**(96,362)**	—

The Group recognises deferred tax liabilities in respect of the relevant taxes that may arise from the transfer of profits derived from Tencent Computer and Shiji Kaixuan, subsidiaries in which the Company has indirect beneficial interests, to the Company. The movements of deferred tax liabilities were as follows:

	2005	2004
	RMB'000	RMB'000
At beginning of year	**—**	988
Credit to income statement	**(214)**	(988)
Charge to income statement	**1,024**	—
At end of year	**810**	—

23 COST OF REVENUES

Cost of revenues mainly comprises the Mobile and Telecom Charges (mentioned in Note 2.17(a)), bandwidth and server custody fees, staff costs, sharing and content subscription costs incurred in deriving the revenues.

24 OTHER GAINS, NET

	2005	2004
	RMB'000	RMB'000
Interest income	**45,355**	14,876
Fair value gains on financial assets held for trading	**17,308**	3,788
Government subsidy	**9,750**	7,233
Others	**732**	18
	73,145	25,915

25 EXPENSES BY NATURE

	2005	2004
	RMB'000	RMB'000
Employee benefits expenses (Note i) (Note 26)	**344,460**	156,707
Mobile and Telecom Charges and bandwidth and server custody fees	**279,699**	316,409
Promotion and advertising expenses	**91,066**	55,403
Travelling and entertainment expenses	**51,884**	30,887
Depreciation of fixed assets (Note i)	**54,977**	27,809
Amortisation of intangible assets	**2,343**	—
Operating lease rentals in respect of office buildings	**23,143**	15,597
VAT paid upon transfer of software within the Group (Note 12)	**1,500**	12,243
Loss/(gain) on disposals of fixed assets	**108**	(2)
Other expenses	**166,001**	85,699
Total cost of revenues, selling and marketing expenses and general and administrative expenses	**1,015,181**	700,752
Average number of full-time employees during the year	**1,752**	883

25 EXPENSES BY NATURE (Cont'd)

Note i: Research and development expenses for the year ended 31 December 2005 were RMB162,544,000 (2004: RMB56,410,000) which included employee benefit expenses and depreciation totalling RMB156,997,000 (2004: RMB44,611,000).

The Group did not capitalise any research and development expenses for the year ended 31 December 2005 (2004: Nil).

26 EMPLOYEE BENEFITS EXPENSES (INCLUDING DIRECTORS' EMOLUMENTS)

	2005 RMB'000	2004 RMB'000
Wages, salaries and bonuses	278,025	135,918
Welfare, medical and other expenses	20,256	9,664
Share-based compensation expenses (Note 2.1)	34,526	5,583
Contributions to pension plans (Note)	9,703	3,662
Training expenses	1,950	1,880
	344,460	156,707

Note: All local employees of the subsidiaries in the PRC participate in employee social security plans enacted in the PRC, which cover pension, medical and other welfare benefits. The plans are organised and administered by the governmental authorities. Except for the welfare benefits provided by these social security plans, the Group has no other material commitments owing to the employees. According to the relevant regulations, the portion of premium and welfare benefit contributions that should be borne by the companies within the Group as required by the above social security plans are principally determined based on percentages of the basic salaries of employees, subject to a certain ceiling, and are paid to the respective labour and social welfare authorities. Contributions to the plans are expensed as incurred. The applicable percentages used to provide for insurance premium and welfare benefit funds are listed below.

	Percentage
Pension insurance	9% - 23%
Medical insurance	6.5% - 12%
Unemployment insurance	0.4% - 2%

27 DIRECTORS' EMOLUMENTS

The aggregate amounts of emoluments paid/payable to directors of the Company for the year are as follows:

	2005	2004
	RMB'000	RMB'000
Fees - independent non-executive directors	**624**	477
Salaries, bonuses, allowances and benefits in kind	**8,310**	7,816
Contributions to pension plans	**30**	24
	8,964	8,317
Number of directors		
- with emoluments	**5**	5
- without emoluments	**2**	2
Number of directors	**7**	7

During the year, no share options had been granted to the directors (2004: Nil).

The remuneration of every director for the year ended 31 December 2005 is set out below.

Name of director	**Fees**	**Salaries, bonuses, allowances and benefits in kind**	**Contribution to pension plans**	**Total**
	RMB'000	RMB'000	RMB'000	RMB'000
Ma Huateng	—	4,155	15	4,170
Zhang Zhidong	—	4,155	15	4,170
Iain Ferguson Bruce	208	—	—	208
Ian Charles Stone	208	—	—	208
Li Dong Sheng	208	—	—	208
Antonie Andries Roux	—	—	—	—
Charles St Leger Searle	—	—	—	—
	624	8,310	30	8,964

27 DIRECTORS' EMOLUMENTS (Cont'd)

The remuneration of every director for the year ended 31 December 2004 is set out below:

Name of director	Fees	Salaries, bonuses, allowances and benefits in kind	Contribution to pension plans	Total
	RMB'000	RMB'000	RMB'000	RMB'000
Ma Huateng	—	3,908	12	3,920
Zhang Zhidong	—	3,908	12	3,920
Iain Ferguson Bruce	159	—	—	159
Ian Charles Stone	159	—	—	159
Li Dong Sheng	159	—	—	159
Antonie Andries Roux	—	—	—	—
Charles St Leger Searle	—	—	—	—
	477	7,816	24	8,317

No director received any emolument from the Group as an inducement to join or leave the Group or compensation for loss of office. No director waived or has agreed to waive any emoluments during the year (2004: Nil).

28 FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Group during the year included two (2004: two) directors whose details have been reflected in the analysis presented above (Note 27). The emoluments payable to the remaining three (2004: three) individuals during the year are as follows:

	2005	2004
	RMB'000	RMB'000
Salaries, bonuses, allowances and benefits in kind	**10,764**	10,547
Contribution to pension plans	**45**	36
Share-based compensation expenses charged to income statement	**3,652**	—
	14,461	10,583

28 FIVE HIGHEST PAID INDIVIDUALS (Cont'd)

The emoluments fell within the following bands:

	Number of individuals	
	2005	2004
Emolument bands		
RMB2,601,501 – RMB3,121,800 (equivalent to HKD2,500,001 - HKD3,000,000)	—	1
RMB3,121,801 – RMB3,642,100 (equivalent to HKD3,000,001 - HKD3,500,000)	—	1
RMB3,642,101 - RMB4,162,400 (equivalent to HKD3,500,001 - HKD4,000,000)	**1**	1
RMB4,162,401 - RMB4,682,700 (equivalent to HKD4,000,001 - HKD4,500,000)	**1**	—
RMB6,243,601 - RMB6,763,900 (equivalent to HKD6,000,001 – HKD6,500,000)	**1**	—

29 FINANCE COSTS

Finance costs for the year ended 31 December 2005 mainly include foreign exchange losses arising from translation of non-RMB denominated monetary assets (Note 3.1(a)).

30 TAX EXPENSES

(a) Income tax

(i) Cayman Islands and British Virgin Islands Profits Tax

The Group has not been subject to any taxation in these jurisdictions for the year ended 31 December 2005 (2004: Nil).

(ii) Hong Kong Profits Tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising in Hong Kong for the year ended 31 December 2005 (2004: Nil).

(iii) PRC Enterprise Income Tax ("EIT")

EIT is provided on the assessable income of entities within the Group incorporated in the PRC, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

There are five subsidiaries of the Company in the PRC, namely, Tencent Computer, Tencent Technology, Shiji Kaixuan, Shidai Zhaoyang and Tencent Beijing.

Tencent Computer, Tencent Technology, Shiji Kaixuan and Shidai Zhaoyang were established in the Shenzhen Special Economic Zone of the PRC where they conduct their operations. Accordingly, they are subject to EIT at a rate of 15%.

According to the provisions stipulated in the tax circular, Shendishuierhan 2002 No. 128, Tencent Computer is exempt from EIT for one year commencing from the first year of profitable operations after offsetting prior years' tax losses, followed by a 50% reduction for the next two years. The first profit-making year of Tencent Computer was 2002. Accordingly, EIT was levied at 15% on its assessable profits for the year ended 31 December 2005 (2004: 7.5%).

Tencent Technology was approved by the relevant tax authorities as an enterprise with foreign investment with productive sales income under the provisions stipulated in the tax circular, Shendishuiwaihan 2003 No. 413. Accordingly, Tencent Technology is exempt from EIT for two years commencing from the first year of profitable operations after offsetting prior years' tax losses, followed by a 50% reduction for the next three years if its annual productive sales income exceeds 50% of its reported total sales income. 2003 is the first profit-making year of Tencent Technology. During the current year, it adopts a rate of 15% in accruing its EIT liability (2004: Nil).

30 TAX EXPENSES (Cont'd)

(a) Income tax (Cont'd)

(iii) PRC Enterprise Income Tax ("EIT") (Cont'd)

Shiji Kaixuan is exempt from EIT for two years starting from the first year of operations according to the provisions stipulated in the tax circular, Shenguoshuifu jianmian 2004 No. 0272. 2004 is the first year of operations of Shiji Kaixuan and accordingly, no provision for EIT has been made in its financial statements for the year ended 31 December 2005.

No provisions for EIT has been made by Shidai Zhaoyang since it has no assessable profits for the year ended 31 December 2005 (2004: Nil).

Tencent Beijing was incorporated in Zhongguancun Technology Park, Beijing, the PRC as a hi-tech enterprise. According to the special tax incentives granted by the local tax authority in Beijing, Tencent Beijing is exempt from EIT for three years starting from the first year of commercial operations followed by a 50% reduction for the next three years. 2005 is the first year of the operations for Tencent Beijing and accordingly, no provision for EIT was required for the current year.

The income tax (credits)/charges of the Group for the year ended 31 December 2005 are analysed as follows:

	2005 **RMB'000**	2004 RMB'000
PRC current tax	**47,245**	23,522
Deferred income taxes (Note 22)	**(95,552)**	(988)
	(48,307)	22,534

30 TAX EXPENSES (Cont'd)

(a) Income tax (Cont'd)

(iii) PRC Enterprise Income Tax ("EIT") (Cont'd)

The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the tax rate of 15%, the tax rate enacted in Shenzhen, the PRC, where the principal activities of the Group are conducted, as follows:

	2005 **RMB'000**	2004 RMB'000
Profit before income tax	**437,055**	463,653
Tax calculated at a tax rate of 15% (2004: 15%)	**65,558**	69,548
Effect of different tax rates available to different companies of the Group	**7,363**	(1,799)
Effects of tax holiday on assessable profits of subsidiaries incorporated in the PRC	**(38,021)**	(111,556)
Expenses not deductible for tax purposes	**9,463**	2,411
Utilisation of previously unrecognised tax assets/ deferred tax assets not recognised	**(6,760)**	61,596
Recognition of previously unrecognised deferred tax assets (Note 4.2(a))	**(88,638)**	—
Unrecognised tax losses	**2,728**	2,334
Income tax (benefit)/expenses	**(48,307)**	22,534

(b) VAT, business tax and related taxes

The operations of the Group are also subject to the following taxes in the PRC:

Category	**Tax rate**	**Basis of levy**
VAT	17%	Sales value of goods sold, offsetting by VAT on purchases
Business tax ("BT")	3-5%	Services fee income
City construction tax	1%	Net VAT and BT payable amount
Educational surcharge	3%	Net VAT and BT payable amount

31 EARNINGS PER SHARE

Basic

Basic EPS are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2005	2004
Profit attributable to the equity holders of the Company for the year (RMB'000) (Note a)	**485,362**	441,119
Weighted average number of ordinary shares in issue (thousands) (Note b)	**1,772,495**	1,523,376
Basic EPS (RMB per share)	**0.274**	0.290

Diluted

Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options granted by the Company (collectively forming the denominator for computing the diluted EPS). A calculation is done to determine the number of shares that could have been acquired at fair value (determined as to be the average market price of the Company's shares during the periods) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares so calculated is compared against the number of shares that would have been issued assuming the exercise of the share options. The difference is added to the denominator as an issue of ordinary shares for no consideration. No adjustment is made to earnings (numerator).

	2005	2004
Profit attributable to the equity holders of the Company for the year (RMB'000) (Note a)	**485,362**	441,119
Weighted average number of ordinary shares in issue (thousands) (Note b)	**1,772,495**	1,523,376
Adjustments for share options (thousands) (Note b)	**46,482**	30,652
Weighted average number of ordinary shares for the calculation of diluted earnings per share (thousands)	**1,818,977**	1,554,028
Diluted EPS (RMB per share)	**0.267**	0.284

Note a: Profit attributable to the equity holders of the Company for the year ended 31 December 2004 has been restated to reflect the retrospective adjustments on the effects of share-based payment by the adoption of IFRS2 (issued 2004).

Note b: All per share information has been adjusted retrospectively as if the effect of the split of the Company's shares had taken place on 1 January 2004 (Note 16(a)).

32 DIVIDENDS

Pursuant to a resolution passed by board of directors, dividends in respect of 2004 have been declared and paid. The amounts were HKD0.07 per share.

Pursuant to a resolution passed by the board of directors dated 22 March 2006, a final dividend for 2005 of HKD0.08 per share was proposed, subject to the approval of the shareholders in the annual general meeting to be held on 24 May, 2006. Such proposed dividend has not been shown as an appropriation in the Financial Statements. The Financial Statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2006.

33 CONSOLIDATED CASH FLOW STATEMENTS

(a) Reconciliation of net profit to net cash inflow/(outflow) from operating activities:

	2005	2004
	RMB'000	RMB'000
Profit for the year	**485,362**	441,119
Adjustments for:		
Income tax (benefit)/expenses	**(48,307)**	22,534
Depreciation of fixed assets	**54,977**	27,809
Amortisation of intangible assets	**2,343**	—
Loss/(gain) on disposals of fixed assets	**108**	(2)
Fair value gains on financial assets held for trading	**(17,308)**	(3,788)
Interest income	**(45,355)**	(14,876)
Share-based compensation expenses	**34,526**	5,583
Exchange losses on cash and cash equivalents	**19,713**	—
Changes in working capital:		
Inventories	**2,647**	—
Accounts receivable	**(30,029)**	(92,999)
Prepayments, deposits and other receivables	**14,846**	(11,307)
Financial assets held for trading	**300,321**	(663,112)
Accounts payable	**466**	2,506
Other payables and accruals and other tax liabilities	**72,410**	44,400
Deferred revenue	**170,913**	59,546
Cash generated from/(used in) operations	**1,017,633**	(182,587)

33 CONSOLIDATED CASH FLOW STATEMENTS (Cont'd)

In the consolidated cash flow statement, proceeds from disposals of fixed assets comprise:

	2005	2004
	RMB'000	RMB'000
Net book amount	**269**	786
(Loss)/gain on disposals of fixed assets	**(108)**	2
Proceeds from disposals of fixed assets	**161**	788

(b) Analysis of changes in financing during the years are as follows:

	Dividends payable	**Share capital including premium**	**Total**
	RMB'000	RMB'000	RMB'000
At 1 January 2004	—	15,317	15,317
Proceeds from issue of shares and share options	—	1,914,020	1,914,020
Payments for share issuance expenses	—	(148,325)	(148,325)
Received from shareholders	—	82	82
Proposed dividends	28,935	—	28,935
Payment of dividends	(28,790)	—	(28,790)
At 31 December 2004/1 January 2005	**145**	**1,781,094**	**1,781,239**
Proceeds from issue of shares and share options	**—**	**11,409**	**11,409**
Payments for share issuance expenses	**—**	**(3,181)**	**(3,181)**
Payments for repurchase of issued shares	**—**	**(123,086)**	**(123,086)**
Proposed dividends	**132,036**	**—**	**132,036**
Payment of dividends	**(132,181)**	**—**	**(132,181)**
At 31 December 2005	**—**	**1,666,236**	**1,666,236**

(c) Major non-cash transactions

There were no material non-cash transactions for the year ended 31 December 2005.

34 CONTINGENCIES

The Group has no material contingent liabilities.

35 COMMITMENTS

(a) Capital commitments

Capital commitments as at the balance sheet date is analysed as follows:

	2005	2004
	RMB'000	RMB'000
Contracted:		
Purchase of fixed assets	**13,491**	12,150
Authorised but not contracted:		
Purchase of land use rights and construction of buildings	**80,702**	—
	94,193	12,150

(b) Operating lease commitments

The future aggregate minimum lease payments committed or authorised under operating leases in respect of buildings are as follows:

	2005	2004
	RMB'000	RMB'000
Not later than one year	**20,519**	17,328
Later than one year and not later than five years	**5,458**	15,713
	25,977	33,041

35 COMMITMENTS (Cont'd)

(c) Other commitments

The future aggregate minimum lease payments under bandwidth and server custody leases are as follows:

	2005 RMB'000	2004 RMB'000
Contracted:		
Not later than one year	**37,190**	14,616
Later than one year and not later than five years	**81**	3,250
	37,271	17,866
Authorised but not contracted:		
Not later than one year	**—**	48,035
	37,271	65,901

36 BUSINESS COMBINATIONS

On 16, March 2005, TCH Beta, a subsidiary of the Company, entered into an agreement with Boda Investments Holdings Limited ("Boda Investments") to acquire certain intangible assets (including domain name, technology and non-compete agreements) and fixed assets owned by Boda Investments and its affiliate (together referred as the "Foxmail Group") (the "Foxmail Acquisition"). The Foxmail Group was mainly engaged in the provision of e-mail technology services under the trade-name of Foxmail.

After the completion of the Foxmail Acquisition, all the substantial operational assets owned by the Foxmail Group had been transferred to the Group. In addition, the Foxmail Group and their original founders are also subject to non-competition obligations for a period of 3 years. As a result, the directors of the Company are of the opinion that the Foxmail Acquisition is a business combination in substance.

Details of assets acquired and the resultant goodwill are analysed as follows:

	2005
	RMB'000
Purchase consideration:	
- cash paid	**13,517**
- included in other payables	**2,340**
	15,857
Fair value of assets acquired:	
- fixed assets (Note 6)	**(200)**
- intangible assets (Note 7)	
domain name	**(67)**
technology	**(6,715)**
non-compete agreements	**(5,865)**
Goodwill (Note 7)	**3,010**

In the opinion of the directors of the Company, the goodwill is attributable to the significant synergies expected to arise after the business combination mentioned above.

37 RELATED PARTIES TRANSACTIONS

Except as disclosed in Note 27 (Directors' emoluments) and Note 18 (Share option) to the Financial Statements, the Group had no other material transactions with related parties for the year ended 31 December 2005.

38 COMPARATIVES

As mentioned in Note 2.1, the comparative figures have been restated as a result of the adoption of IFRS 2. Moreover, interest income previously included under "Finance (costs)/income, net" is now presented as part of "Other gains, net" in the Financial Statements of the Group because management believes that it is a more fair representation of the Group's activities.

39 SUBSEQUENT EVENTS

Business combinations

In January 2006, the Group entered into an agreement with the owners of Joymax Development Ltd. ("Joymax") in order to acquire 100% of the equity interests in Joymax. Joymax (including its subsidiaries) is a provider of mobile value-added services in the PRC. The initial purchase consideration will be with reference to Joymax's audited net asset value as at 31 December 2005, with adjustments made to it based on the operating performance to be achieved by Joymax for the years ending 31 December 2006 and 2007.