# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 1. GENERAL INFORMATION

Guangshen Railway Company Limited (the "Company") was established as a joint stock limited company in the People's Republic of China (the "PRC") on March 6, 1996 to take over and operate certain railroad and other related businesses (the "Businesses") which had been carried out by the Company's predecessor, Guangshen Railway Company (the "Predecessor") together with certain of its subsidiaries; and Guangzhou Railway (Group) Company (the "Parent Company") and certain of its subsidiaries prior to the formation of the Company. The Businesses carried out by the Company, the Predecessor and the Parent Company are all under the common control and jurisdiction of the Ministry of Railways (the "MOR") of the PRC.

The Predecessor is controlled by and under the administration of the Parent Company. Pursuant to a restructuring agreement entered into among the Parent Company, the Predecessor and the Company on March 8, 1996 which took effect from March 6, 1996 (the "Restructuring Agreement"), the Company issued to the Parent Company 100% of its equity interest in the form of 2,904,250,000 ordinary shares (the "State-owned Domestic Shares") in exchange for the assets and liabilities of the Businesses (the "Restructuring"). After the Restructuring, the Predecessor changed its name to Guangzhou Railway (Group) Guangshen Railway Enterprise Development Company.

In May 1996, the Company issued 1,431,300,000 shares, represented by 217,812,000 H Shares ("H Shares") and 24,269,760 American Depositary Shares ("ADSs", one ADS represents 50 H Shares) in a global public offering for cash of approximately RMB4,214,000,000 in order to finance the capital expenditures and working capital requirements of the Company and its subsidiaries (collectively defined as the "Group").

The principal activities of the Group are railroad passenger and freight transportation. The Group also operates certain other businesses, which are principally services offered in the railway stations and sales of food, beverages and merchandises on board the trains as well as in the stations.

The registered address of the Company is No.1052 Heping Road, Shenzhen, Guangdong Province, the People's Republic of China.

As of December 31, 2005, the Company had in total 8,882 employees, representing a decrease of 82 compared to that of December 31, 2004.

The English names of all companies listed in the financial statements are direct translations of their registered names in Chinese.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES

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

### (1) Basis of presentation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and the disclosure requirements of the Hong Kong Companies Ordinance (the "Financial Statements"). This basis of accounting differs in certain material respects from that used in the preparation of the statutory financial statements of the Group (the "Statutory Financial Statements") in accordance with the generally accepted accounting principles and relevant financial regulations applicable in the PRC ("PRC GAAP"). In preparing the Financial Statements, appropriate adjustments have been made to the Statutory Financial Statements to conform to IFRS, but such adjustments have not been incorporated into the Statutory Financial Statements.

The principal adjustments made to conform to IFRS include the following:

- Additional depreciation charges on fixed assets, in particular for rail-line track assets;
- Capitalisation of replacement costs of components of rail-line track assets and de-recognition of items being replaced;
- Difference in the recognition policy on housing benefits provided to employees;
- Recognition of government grants through deduction against the carrying value of fixed assets; and
- Recording of share issuance costs to reserves.

The Financial Statements have been prepared under the historical cost convention except that, as disclosed in the accounting policies below, certain fixed assets are stated at valuation less accumulated depreciation and impairment losses *(see Note 2(5) for details)*, and the Company also applies the fair value model to financial assets and liabilities and available-for-sale financial assets *(see Note 2(9) for details)*.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (1) Basis of presentation *(continued)*

The preparation of 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. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

In 2005, the Group adopted the new/revised/amended standards and interpretations of IFRS below, which are relevant to its operations. The 2004 comparatives have been amended 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 28 (revised 2003) | Investments in Associates |
| IAS 32 (revised 2003) | Financial Instruments: Disclosure and Presentation |
| IAS 33 (revised 2003) | Earnings per Share |
| IAS 36 (revised 2004) | Impairment of Assets |
| IAS 38 (revised 2004) | Intangible Assets |
| IAS 39 (revised 2004) | Financial Instruments: Recognition and Measurement |
| IFRS 2 (issued 2004) | Share-based Payments |
| IFRS 3 (issued 2004) | Business Combinations |
| SIC 12 (revised 2004) | Consolidation — Special Purpose Entities |
| IFRIC 2 | Members' Shares in Co-operative Entities and Similar Instruments |
| IAS 39 (Amendment) | Transition and Initial Recognition of Financial Assets and Financial Liabilities |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (1) Basis of presentation *(continued)*

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 32, 33, 36 and 38, IFRS 2 and 3, IFRIC 2 and SIC 12 did not result in substantial changes to the Group's accounting policies. In summary:

- IAS 1 has affected the presentation of minority interest and other disclosures.

- IAS 21 had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard. All entities within the Group adopt Renminbi as their functional currency and financial statement presentation currency.

- IAS 24 has affected the identification of related parties and some other related party disclosures *(see Note 33)*;

- IAS 28 has affected the presentation of the interests in associates in the consolidated income statement that it is presented as the share of results of associates after tax.

The adoption of IAS 27 has resulted in a change in the accounting policy relating to the investment in subsidiaries in the Company's stand alone financial statements that it is recorded at cost, which has to be applied retroactively *(see Note 2(2)(a))*.

The adoption of IAS 39 has resulted in a change in the accounting policy relating to the classification of financial assets at fair value through profit or loss.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards.

The adoption of IAS 27 resulted in:

| **In the Company's financial statements** | **January 1, 2005** *RMB'000* | January 1, 2004 *RMB'000* |
|---|---|---|
| Decrease in interests in subsidiaries | **7,597** | 1,154 |
| Decrease in retained earnings | **7,597** | 1,154 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

**(1) Basis of presentation** *(continued)*

Standards, interpretations and amendments to published standards under IFRS that are not yet effective:

Certain new standards, amendments and interpretations to existing standards have been published, that are mandatory for adoption for accounting periods beginning on or after January 1, 2006 or later periods but which the Company has not early adopted, are as follows:

IAS 19 (Amendment), Employee Benefits
IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions
IAS 39 (Amendment), The Fair Value Option
IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts
IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources
IFRS 6, Exploration for and Evaluation of Mineral Resources
IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements — Capital Disclosures
IFRIC 4, Determining whether an Arrangement contains a Lease
IFRIC 5, Rights to interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6, Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment

**(2) Consolidation**

***(a) Subsidiaries***

Subsidiaries are all entities (including special purpose 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. Details of the Company's subsidiaries are shown in Note 9.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (2) Consolidation *(continued)*

#### *(a)* ***Subsidiaries*** (continued)

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. 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.

In the Company's stand alone balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

#### *(b)* ***Transactions and minority interests***

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

#### *(c)* ***Associates***

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. Details of the Group's associates are set out in Note 10.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (2) Consolidation *(continued)*

#### *(c) Associates* (continued)

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's stand alone balance sheet the investments in associated companies are stated at cost less provision for impairment losses. The results of associated companies are accounted for by the Company on the basis of dividend received and receivable.

### (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 is subject to risks and returns that are different from those of segments operating in other economic environments.

### (4) Foreign currency transactions

#### *(a) Functional and presentation currency*

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Renminbi ("RMB"), which is the functional currency of the Company and all its subsidiaries and it is also the presentation currency of the Group.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (4) Foreign currency transactions *(continued)*

#### *(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.

### (5) Fixed assets

Fixed assets are initially recorded at cost less accumulated depreciation and impairment loss. Cost represents the purchase price of the assets (for the case of fixed assets acquired by the Company from the Predecessor during the Restructuring, based on amounts of valuation determined in the Restructuring as deemed costs) and other costs incurred to bring the assets into existing use.

Subsequent to the initial recognition, fixed assets are stated at cost or valuation less accumulated depreciation and impairment losses. Independent valuations, on a market value basis or depreciated replacement cost basis when there is no evidence of market value for such an item, are performed at least every five years or sooner if considered necessary by the directors. In the intervening years, the directors review the carrying values of the fixed assets and adjustment is made where there has been a material change. Any accumulated depreciation at the date of revaluation is restated proportionately with the change in the gross carrying amount of the assets so that the carrying amounts of the assets after revaluation are equal to their revalued amounts. Increases in the carrying amount arising from revaluation of fixed assets are credited to the shareholders' equity as revaluation surplus. Decreases that offset previous increases of the same asset are charged against reserves directly in equity; all other decreases are charged to the income statement. In each year, the difference between depreciation determined based on the revalued carrying amount of the assets charged to the income statement and the depreciation determined based on the assets' original cost is transferred from the revaluation surplus to retained earnings.

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.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (5) Fixed assets *(continued)*

Depreciation is calculated using the straight-line method to write off the cost or revalued amount, after taking into account the estimated residual value of not more than 4% of cost, of each asset over its estimated useful life. The estimated useful lives are as follows:

| | |
|---|---|
| Buildings | 25 to 40 years |
| Leasehold improvements | over the lease terms |
| Track, bridges and service roads | 55 to 100 years |
| Locomotives and rolling stock | 20 years |
| Communications and signalling systems | 8 to 20 years |
| Other machinery and equipment | 7 to 25 years |

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

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount *(Note 2(8))*.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the income statement. When revalued assets are sold, the amounts included in reserves are transferred to retained earnings.

### (6) Construction-in-progress

Construction-in-progress represents plant and facilities, including railroad stations and maintenance facilities under construction and machinery pending for installation. Construction in progress is stated at cost which includes all expenditures and other direct costs, site restoration costs, prepayments and deposits attributable to the installation and interest charges arising from borrowings used to finance the installation during the installation period. Construction-in-progress is not depreciated until such assets are completed and ready for their intended use.

### (7) Leasehold land payments

All land in the PRC is state-owned and no individual land ownership right exists. The Group acquired the right to use certain land for its rail lines, stations and other businesses. The premium paid for such leasehold land payments represents pre-paid lease payments, which are amortised over the lease terms of 36.5 to 50 years using the straight-line method.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (8) 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 impairment are reviewed for possible reversal of the impairment at each reporting date.

### (9) Financial assets

The Group classifies its financial assets in the following categories: fair value through profit or loss, loans and receivables, 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. 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 are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as 'trade receivables' and "prepayments and other receivables" in the balance sheet.

#### *(c) 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.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (9) Financial assets *(continued)*

#### (c) *Available-for-sale financial assets* *(continued)*

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 are carried at amortised cost using the effective interest method.

A gain or loss on an available-for-sale financial assets is recognized directly in equity, through the statement of changes in equity, until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in equity shall be recognized in profit or loss.

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 considered 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 receivables is described in Note 2(12).

### (10) Deferred staff costs

The Group implemented a scheme (the "Scheme") for the sales of staff quarters to its employees in 2000. Under the Scheme, the Group sold certain staff quarters to their employees at preferential prices in the form of housing benefits provided to these employees. The total housing benefits (the "Benefits"), which represented the difference between the net book value of the staff quarters sold and the proceeds collected from the employees, are expected to benefit the Group over 15 years, which is the estimated remaining average service period of the employees participating in the Scheme. Upon the sales of these staff quarters to the employees, the Benefits incurred were recorded as deferred staff costs and the balance is amortised over the estimated remaining service period of the employees participating in the Scheme.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (10) Deferred staff costs *(continued)*

At each balance sheet date, the Group assesses whether there is any indication of impairment, considering the remaining service period of the employees and other qualitative factors. If such indications exist, an analysis is performed to assess whether the carrying amount of the deferred staff costs are fully recoverable. A write down is made if the carrying amount exceeds the recoverable amount.

### (11) Materials and supplies

Materials and supplies consist mainly of items for repair and maintenance of rail-line tracks, and are stated at lower of cost and net realisable value. Cost is determined using the weighted average method. Materials and supplies are expensed when used, or capitalized as fixed assets when installed, as appropriate. Net realizable value is the estimated selling price in the ordinary course of business, less selling expenses.

### (12) Receivables

Receivables 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 receivables 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. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial re-organisation, and default or delinquency in payments are considered indicators that the receivable is impaired. 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.

### (13) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and deposits placed with deposit centre operated by MOR which is licensed to undertake deposits by the PRC financial authorities, other short-term highly liquid investments with original maturities of three months or less.

### (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 consolidated financial statements. However, if the deferred income tax 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, it is not accounted for. 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.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (14) Deferred income tax *(continued)*

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.

### (15) Employee benefits

Pursuant to the PRC laws and regulations, contributions to the basic old age insurance for the Group's local staff are to be made monthly to a government agency based on 26% of the standard salary set by the provincial government, of which 18% is borne by the Company or its subsidiaries and the remainder 8% is borne by the staff. The government agency is responsible for the pension liabilities due to such staff upon their retirement. The Group accounts for these contributions on an accrual basis and charges the related contributions to income in the year to which the contributions relate.

See also Note 2 (10) above.

### (16) Revenue recognition

Provided it is probable that the economic benefits associated with a transaction will flow to the Group and the revenues and costs, if applicable, can be measured reliably, revenue is recognised on the following basis:

***(a) Rendering of services and sales of goods***

Railroad revenues are recognised when services are performed. Revenues from other businesses are mainly derived from the sales of food, beverages and other merchandise on board the trains and in the railway stations and revenues derived from operating restaurants in major railway stations. Sales on board the trains and in the railway stations are recognised upon delivery of the food items and merchandises, when the significant risks and rewards of ownership of these goods have been transferred to the buyers. Revenues derived from the operations of restaurants are recognised when services are rendered.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 2. PRINCIPAL ACCOUNTING POLICIES *(continued)*

### (16) Revenue recognition *(continued)*

#### *(b) Interest income*

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

#### *(c) Dividend income*

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

### (17) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to the purchase of fixed assets are deducted against the carrying amount of the fixed assets.

### (18) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor 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.

### (19) 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.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 3. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks: currency risk, 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) Currency risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. RMB is not freely convertible into other foreign currencies. 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. In addition, the Group is required to pay dividends in HKD and USD in the future when dividends are declared.

The Group had USD and HKD monetary assets as at December 31, 2005 and 2004 as stated below.

| **Monetary assets** | **Currency denomination** | **As at December 31, 2005** | 2004 |
|---|---|---|---|
| | | ***(RMB'000)*** | *(RMB'000)* |
| *Current assets* | | | |
| Short-term deposits with original maturities of over three months | USD | **503,463** | 755,975 |
| Cash and cash equivalent | USD | **9,049** | 95,612 |
| Cash and cash equivalent | HKD | **110,195** | 89,883 |

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

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 3. FINANCIAL RISK MANAGEMENT *(continued)*

### (a) Currency risk *(continued)*

On July 21, 2005, the PRC government announced that the RMB is to be floated in line with a basket of certain selected currencies and not to be pegged with the 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 RMB21,761,000 as a result of such event. The losses were recorded as finance costs in the income statement for the year ended December 31, 2005.

The directors believe that interest income derived from deposits denominated in foreign currencies will partially offset the Group's exposure to currency risk (see 3(e) for details).

### (b) Price risk

The Group is exposed to equity securities price risk because of investments held by the Group and classified on the consolidated balance sheet either as available-for-sale or at fair value through profit or loss. However, the amounts involved are not significant and management of the Company believes that the exposure is not material.

### (c) Credit risk

The carrying amount of cash and cash equivalents, trade and other receivables (excluding prepayments), short-term deposit, and due from related parties represent the Group's maximum exposure to credit risk in relation to financial assets.

Cash and short term liquid investments are placed with reputable banks and deposit taking centres operated by MOR *(see Notes 18 and 30(b) for details)*, no significant credit risk is expected.

The majority of the Group's accounts receivable balance relate to the rendering of services or sales of products to third party customers. The Group's other receivable balances mainly arise from services other than the main railway transportation services. The Group perform ongoing credit evaluations of their customers/debtors' financial condition and generally do not require collaterals from the customers/debtors account on the outstanding balances. Based on the expected realisability and the timing for collection of the outstanding balances, the Group maintains a provision for doubtful accounts and actual losses incurred have been within management's expectation.

No other financial assets carry a significant exposure to credit risk.

### (d) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents to meet its current use in operations. Management aims to maintain flexibility in funding by keeping committed credit lines available. In addition, the Company is undergoing an A share initial public offering *(see Note 19)*.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 3. FINANCIAL RISK MANAGEMENT *(continued)*

### (e) Interest rate risk

As the Group has no significant interest-bearing assets (except for short term deposits placed with banks and deposit centre of MOR and the restricted cash balance, the weighted average effective interest rate on deposits was 3% per annum) and liabilities, the Group's income and operating cash flows are substantially independent of changes in market interest rates. The directors believe that Group's exposure to interest rate risk of financial assets and liabilities as of December 31, 2005 was minimal since their deviation from their respective fair values was not significant.

Due to the fact the interest rates for deposits denominated in foreign currencies are higher than that of RMB in China, the interest income so derived from these deposits had partially offset the Group's exchange losses of approximately RMB8,260,000 for year ended December 31, 2005.

## 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.

### (a) Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal 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.

The critical accounting estimates and assumptions involved in the preparation of the IFRS Financial Statements include the estimates of the values of fixed assets recorded under the revaluation model, the depreciable lives of fixed assets and the expected service period of employees who have participated in the Scheme for the provision of Benefits mentioned in Note 2(10).

The estimate of the values of the fixed assets was made by the directors of the Company as disclosed in Note 6. The estimate of depreciable lives of fixed assets was made by the directors with reference to the established industry practices, technical assessments made on the durability of the fixed asset items, as well as the historical magnitudes and the trend of repair, maintenance and replacement costs incurred by the Group. The estimate of expected service period of employees was made by the directors based on the average age of employees who have joined the Scheme and the historical attrition rate of employees.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

### (b) Estimated impairment of non-financial assets

The Group tests annually, or when there is any trigger event, whether non-financial assets, mainly including fixed assets, leasehold land payments and investment in associates have suffered any impairment, in accordance with the accounting policy stated in Note 2(8). The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates.

For the impairment assessment made on fixed assets and leasehold land payments, the critical estimates made by management include the expected growth in unit service charges and future business volume growth, which are projected to be maintained at the prevailing 2005 level over the estimated remaining useful lives of the assets. For the impairment assessment made on the realisability of its investment made in an associate, Guangzhou Tiecheng Enterprise Company, please refer to Note 10 for details.

### (c) Fair value of other financial instruments

The Group uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at each balance sheet date. The Group has used discounted cash flow analysis for various available-for-sale financial assets that were not traded in active markets.

## 5. SEGMENT INFORMATION

### (a) Primary reporting format — business segments

As of December 31, 2005, the Group conducts the majority of its business activities in railway transportation ("Railroad Businesses") and other related business operations *(see Note 1)*. These segments are determined primarily because the senior management makes key operating decisions and assesses performance of the segments separately. The accounting policies of the Group's segments are the same as those described in the principal accounting policies in Note 2(3). The Group evaluates performance based on profit from operations.

Segment assets consist primarily of fixed assets, construction-in-progress, leasehold land payments, prepayments for fixed assets, interests in subsidiaries/associates, deferred staff costs, prepayments and other receivables, short-term deposits and cash and cash equivalents, excluding deferred tax assets. Segment liabilities primarily consists of trade payable, payables for construction-in-progress, due to related parties and accruals and other payables, excluding taxes payable and deferred tax liability. Capital expenditure comprises additions to fixed assets *(see Note 6)*, construction-in-progress *(see Note 7)* and prepayment for fixed assets.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 5. SEGMENT INFORMATION *(continued)*

### (a) Primary reporting format — business segments *(continued)*

An analysis by business segment is as follows:

| | Railroad Businesses | | Other businesses | | Unallocated | | Elimination | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| **Segment results** | | | | | | | | | | |
| Revenues | | | | | | | | | | |
| – External | **3,099,466** | 2,871,478 | **177,462** | 166,671 | **–** | – | **–** | – | **3,276,928** | 3,038,149 |
| – Inter-segment | **–** | – | **159,503** | 58,727 | **–** | – | **(159,503)** | (58,727) | **–** | – |
| | **3,099,466** | 2,871,478 | **336,965** | 225,398 | **–** | – | **(159,503)** | (58,727) | **3,276,928** | 3,038,149 |
| Other income, net | **45,408** | 47,025 | **3,097** | 1,168 | **–** | – | **–** | – | **48,505** | 48,193 |
| Segment results | **769,093** | 676,682 | **(9,788)** | 1,684 | **–** | – | **–** | – | **759,305** | 678,366 |
| Finance costs | **–** | – | **–** | – | **(22,738)** | (1,136) | **–** | – | **(22,738)** | (1,136) |
| Share of results of associates | **30** | 46 | **(19,979)** | (12,165) | **–** | – | **–** | – | **(19,949)** | (12,119) |
| Income tax expense | **–** | – | **–** | – | **(104,248)** | (98,373) | **–** | – | **(104,248)** | (98,373) |
| Profit/(loss) for the year | **769,123** | 676,728 | **(29,767)** | (10,481) | **(126,986)** | (99,509) | **–** | – | **612,370** | 566,738 |
| **Other information** | | | | | | | | | | |
| Segment assets | **12,489,918** | 11,175,068 | **218,545** | 215,577 | **–** | – | **–** | – | **12,708,463** | 11,390,645 |
| Deferred tax assets | **–** | – | **–** | – | **35,990** | 18,406 | **–** | – | **35,990** | 18,406 |
| Total assets | | | | | | | | | **12,744,453** | 11,409,051 |
| Segment liabilities | **1,789,264** | 757,510 | **115,388** | 103,477 | **–** | – | **–** | – | **1,904,652** | 860,987 |
| Taxes payable | **–** | – | **–** | – | **102,155** | 75,878 | **–** | – | **102,155** | 75,878 |
| Deferred tax liability | **–** | – | **–** | – | **4,830** | – | **–** | – | **4,830** | – |
| Total liabilities | | | | | | | | | **2,011,637** | 936,865 |
| **Capital expenditure** | **2,248,976** | 315,035 | **9,335** | 11,477 | **–** | – | **–** | – | **2,258,311** | 326,512 |
| **Non-cash expenses** | | | | | | | | | | |
| Depreciation | **325,582** | 334,501 | **2,773** | 1,588 | **–** | – | **–** | – | **328,355** | 336,089 |
| Amortisation of leasehold land payments | **15,581** | 15,704 | **–** | – | **–** | – | **–** | – | **15,581** | 15,704 |
| Amortisation of deferred staff costs | **15,090** | 15,092 | **–** | – | **–** | – | **–** | – | **15,090** | 15,092 |
| Provision for doubtful accounts | **8,550** | 18,668 | **1,190** | 82 | **–** | – | **–** | – | **9,740** | 18,750 |

### (b) Secondary reporting format — geographical segments

For the year ended December 31, 2005 (2004: same), all of the Group's business operations are conducted within the PRC. Accordingly, no analysis of geographical segment information is presented.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 6. FIXED ASSETS

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Buildings | Leasehold improvements | Tracks, bridges and service roads | Locomotives and rolling stock | Communications and signalling systems | Other machinery and equipment | Total |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **At January 1, 2004** | | | | | | | |
| Cost or valuation | 1,887,368 | 38,500 | 4,315,705 | 1,042,892 | 300,078 | 1,969,338 | 9,553,881 |
| Accumulated depreciation | (429,670) | (21,175) | (1,064,797) | (299,524) | (208,687) | (561,880) | (2,585,733) |
| Impairment | — | — | — | (14,284) | — | (986) | (15,270) |
| Net book amount | 1,457,698 | 17,325 | 3,250,908 | 729,084 | 91,391 | 1,406,472 | 6,952,878 |
| **Year ended December 31, 2004** | | | | | | | |
| Opening net book amount | 1,457,698 | 17,325 | 3,250,908 | 729,084 | 91,391 | 1,406,472 | 6,952,878 |
| Additions | 22,644 | — | — | 15,232 | 3,379 | 355 | 41,610 |
| Transfer from Construction-in-progress | 229,261 | — | 26,851 | — | 17,905 | 55,965 | 329,982 |
| Reclassifications* | 162,527 | — | (21,955) | — | 21,215 | (161,787) | — |
| Disposals | (13,301) | — | (360) | — | (12) | (1,429) | (15,102) |
| Depreciation charges | (75,363) | (7,700) | (51,103) | (44,126) | (35,609) | (122,188) | (336,089) |
| Closing net book amount | 1,783,466 | 9,625 | 3,204,341 | 700,190 | 98,269 | 1,177,388 | 6,973,279 |
| **At December 31, 2004** | | | | | | | |
| Cost or valuation | 2,295,810 | 38,500 | 4,317,078 | 1,058,124 | 342,094 | 1,835,480 | 9,887,086 |
| Accumulated depreciation | (512,344) | (28,875) | (1,112,737) | (343,650) | (243,825) | (657,081) | (2,898,512) |
| Impairment | — | — | — | (14,284) | — | (1,011) | (15,295) |
| Net book amount | 1,783,466 | 9,625 | 3,204,341 | 700,190 | 98,269 | 1,177,388 | 6,973,279 |
| **Representing:** | | | | | | | |
| At cost | 457,122 | 38,500 | 187,339 | 37,781 | 68,116 | 325,136 | 1,113,994 |
| At valuation | 1,838,688 | — | 4,129,739 | 1,020,343 | 273,978 | 1,510,344 | 8,773,092 |
| | 2,295,810 | 38,500 | 4,317,078 | 1,058,124 | 342,094 | 1,835,480 | 9,887,086 |
| **Year ended December 31, 2005** | | | | | | | |
| Opening net book amount | 1,783,466 | 9,625 | 3,204,341 | 700,190 | 98,269 | 1,177,388 | 6,973,279 |
| Additions** | 145,981 | — | 65,069 | 28,896 | 1,326 | 39,760 | 281,032 |
| Transfer from Construction-in-progress | 388,217 | — | 2,700 | 3,301 | 14,556 | 121,520 | 530,294 |
| Reclassifications | (87,677) | — | 87,806 | — | 14 | (143) | — |
| Disposals | (23,250) | — | (31,795) | — | (853) | (8,845) | (64,743) |
| Depreciation charges | (32,668) | (7,700) | (92,783) | (47,380) | (21,712) | (126,112) | (328,355) |
| Closing net book amount | 2,174,069 | 1,925 | 3,235,338 | 685,007 | 91,600 | 1,203,568 | 7,391,507 |
| **At December 31, 2005** | | | | | | | |
| Cost or valuation | 2,705,859 | 38,500 | 4,436,935 | 1,090,321 | 355,368 | 1,953,418 | 10,580,401 |
| Accumulated depreciation | (531,790) | (36,575) | (1,201,597) | (391,030) | (263,768) | (748,887) | (3,173,647) |
| Impairment | — | — | — | (14,284) | — | (963) | (15,247) |
| Net book amount | 2,174,069 | 1,925 | 3,235,338 | 685,007 | 91,600 | 1,203,568 | 7,391,507 |
| **Representing:** | | | | | | | |
| At cost | 763,464 | 38,500 | 342,914 | 69,978 | 84,048 | 486,416 | 1,785,320 |
| At valuation | 1,942,395 | — | 4,094,021 | 1,020,343 | 271,320 | 1,467,002 | 8,795,081 |
| | 2,705,859 | 38,500 | 4,436,935 | 1,090,321 | 355,368 | 1,953,418 | 10,580,401 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 6. FIXED ASSETS *(continued)*

| | Company | | | | | | |
|---|---|---|---|---|---|---|---|
| | Buildings RMB'000 | Leasehold improvements RMB'000 | Tracks, bridges and service roads RMB'000 | Locomotives and rolling stock RMB'000 | Communications and signalling systems RMB'000 | Other machinery and equipment RMB'000 | Total RMB'000 |
| **At January 1, 2004** | | | | | | | |
| Cost or valuation | 1,732,904 | 38,500 | 4,285,117 | 1,042,892 | 299,994 | 1,921,143 | 9,320,550 |
| Accumulated depreciation | (359,834) | (21,175) | (1,046,456) | (299,524) | (208,659) | (529,788) | (2,465,436) |
| Impairment | — | — | — | (14,284) | — | (986) | (15,270) |
| Net book amount | 1,373,070 | 17,325 | 3,238,661 | 729,084 | 91,335 | 1,390,369 | 6,839,844 |
| **Year ended December 31, 2004** | | | | | | | |
| Opening net book amount | 1,373,070 | 17,325 | 3,238,661 | 729,084 | 91,335 | 1,390,369 | 6,839,844 |
| Additions | 18,218 | — | — | 15,232 | 3,379 | 315 | 37,144 |
| Transfer from Construction-in-progress | 225,075 | — | 26,851 | — | 17,905 | 55,612 | 325,443 |
| Reclassifications* | 162,527 | — | (21,955) | — | 21,215 | (161,787) | — |
| Disposals | (12,485) | — | (360) | — | — | (4,017) | (16,862) |
| Depreciation charges | (70,875) | (7,700) | (50,435) | (44,126) | (35,606) | (120,493) | (329,235) |
| Closing net book amount | 1,695,530 | 9,625 | 3,192,762 | 700,190 | 98,228 | 1,159,999 | 6,856,334 |
| **At December 31, 2004** | | | | | | | |
| Cost or valuation | 2,133,774 | 38,500 | 4,286,490 | 1,058,124 | 342,036 | 1,784,305 | 9,643,229 |
| Accumulated depreciation | (438,244) | (28,875) | (1,093,728) | (343,650) | (243,808) | (623,295) | (2,771,600) |
| Impairment | — | — | — | (14,284) | — | (1,011) | (15,295) |
| Net book amount | 1,695,530 | 9,625 | 3,192,762 | 700,190 | 98,228 | 1,159,999 | 6,856,334 |
| **Representing:** | | | | | | | |
| At cost | 446,073 | 38,500 | 187,339 | 37,781 | 68,142 | 314,828 | 1,092,663 |
| At valuation | 1,687,701 | — | 4,099,151 | 1,020,343 | 273,894 | 1,469,477 | 8,550,566 |
| | 2,133,774 | 38,500 | 4,286,490 | 1,058,124 | 342,036 | 1,784,305 | 9,643,229 |
| **Year ended December 31, 2005** | | | | | | | |
| Opening net book amount | 1,695,530 | 9,625 | 3,192,762 | 700,190 | 98,228 | 1,159,999 | 6,856,334 |
| Additions** | 144,315 | — | 65,069 | 28,896 | 1,326 | 33,966 | 273,572 |
| Transfer from Construction-in-progress | 387,321 | — | 2,700 | 3,301 | 14,556 | 121,521 | 529,399 |
| Reclassifications | (87,677) | — | 87,806 | — | 14 | (143) | — |
| Disposals | (10,033) | — | (31,795) | — | (853) | (5,388) | (48,069) |
| Depreciation charges | (29,999) | (7,700) | (92,111) | (47,380) | (21,709) | (123,087) | (321,986) |
| Closing net book amount | 2,099,457 | 1,925 | 3,224,431 | 685,007 | 91,562 | 1,186,868 | 7,289,250 |
| **At December 31, 2005** | | | | | | | |
| Cost or valuation | 2,556,614 | 38,500 | 4,406,347 | 1,090,321 | 355,310 | 1,907,306 | 10,354,398 |
| Accumulated depreciation | (457,157) | (36,575) | (1,181,916) | (391,030) | (263,748) | (719,475) | (3,049,901) |
| Impairment | — | — | — | (14,284) | — | (963) | (15,247) |
| Net book amount | 2,099,457 | 1,925 | 3,224,431 | 685,007 | 91,562 | 1,186,868 | 7,289,250 |
| **Representing:** | | | | | | | |
| At cost | 749,853 | 38,500 | 342,914 | 69,978 | 84,074 | 470,315 | 1,755,634 |
| At valuation | 1,806,761 | — | 4,063,433 | 1,020,343 | 271,236 | 1,436,991 | 8,598,764 |
| | 2,556,614 | 38,500 | 4,406,347 | 1,090,321 | 355,310 | 1,907,306 | 10,354,398 |

* During the year ended December 31, 2004, the directors of the Company reclassified certain fixed assets from one category to another based on the results of the assessment reports issued upon the completion of construction of certain projects. Accordingly, the carrying amounts of the fixed assets being reclassified have to be depreciated over their remaining useful lives under the respective new categories.

** As described in Note a of the consolidated statement of changes in equity, the Company recorded an adjustment on the carrying value of fixed assets and the share premium account amounting to RMB140,000,000. Such adjustment was included in the current year additions.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 6. FIXED ASSETS *(continued)*

On March 6, 1996, the fixed assets of the Group were revalued by Vigers Hong Kong Limited (the "Valuer"), a qualified independent valuer in Hong Kong, using the replacement cost approach and open market value approach. The replacement cost approach considers the costs to be incurred in order to replace the assets appraised with similar brand new assets and they include the estimated purchase price, delivery charges and related installation costs. The purchase price is determined based on the estimated open market value. The Valuer also assumed that the assets would be continued to be used in the then existing operations of the Group and had not considered any alternative uses. The total revalued amount of the assets determined based on that valuation was RMB5,318,202,000 and resulted in a revaluation surplus amounting to approximately RMB1,492,185,000 ("Revaluation Surplus") being recorded by the Group as of March 6, 1996 as part of the deemed costs of its fixed assets. Additional depreciation charges have also been provided on the Revaluation Surplus from that date onwards. Upon the Restructuring of the Company, the Revaluation Surplus was capitalised as ordinary shares of the Company allotted to the Parent Company.

On September 30, 2002, the fixed assets were revalued again by Pan-China (Schinda) Certified Public Accountants, a qualified independent valuer registered in the PRC, based on the replacement cost approach and open market value approach, wherever appropriate (the "2002 Valuation"). The 2002 Valuation did not result in any material revaluation surplus or deficit.

During 2005, the directors of the Company had undertaken a review based on the 2002 Valuation results and the relevant changes in market values of the assets and concluded that the fixed assets balance as at December 31, 2005 approximate their fair values (2004: same).

Had the fixed assets been carried at cost less accumulated depreciation and impairment, the carrying amounts of the fixed assets of the Group and the Company would have been as follows:

| | **Group** | | **Company** | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Cost | **8,737,100** | 8,394,901 | **8,541,271** | 8,151,044 |
| Accumulated depreciation and impairment | **(2,390,278)** | (2,151,588) | **(2,296,706)** | (2,054,850) |
| Net book amount | **6,346,822** | 6,243,313 | **6,244,565** | 6,096,194 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 6. FIXED ASSETS *(continued)*

As at December 31, 2005, ownership certificates of certain buildings ("Building Ownership Certificates") of the Group and the Company with an aggregate carrying value of approximately RMB1,297,947,000 (2004: RMB1,529,978,000) had not been obtained by the Group. After consultation made with the Company's legal counsel, the directors of the Company consider that there is no legal restriction for the Group or the Company to apply for and obtain the Building Ownership Certificates and it should not lead to any significant adverse impact on the operations of the Group or the Company. Accordingly, no provision for fixed assets impairment was considered necessary.

In addition, pursuant to Caishui [2004] No. 36 and Caishui [2003] No. 149 issued by MOF and the State Administration of Taxation, the Group is exempt from certain real estate taxes on its properties amounting to approximately RMB15,000,000 for the year ended December 31, 2005 (2004: approximately RMB14,000,000). The grant of such exemption is subject to the acknowledgement of relevant authorities that the Company is a transportation company controlled by MOR. Subsequent to December 31, 2005 on March 8, 2006, the Company obtained such formal approval from the authorities. Accordingly no real estate taxes were accrued for in the Financial Statements.

## 7. CONSTRUCTION-IN-PROGRESS

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| At January 1 | **345,313** | 390,393 | **339,723** | 380,543 |
| Additions | **1,634,339** | 284,902 | **1,633,186** | 284,623 |
| Transfer to fixed assets | **(530,294)** | (329,982) | **(529,399)** | (325,443) |
| At December 31 | **1,449,358** | 345,313 | **1,443,510** | 339,723 |

As of December 31, 2005, no interest expenses had been capitalised in the construction-in-progress balance since the Group had no borrowings.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 8. LEASEHOLD LAND PAYMENTS

| | Group | Company |
|---|---|---|
| | *RMB'000* | *RMB'000* |
| **At January 1, 2004** | | |
| Cost | 770,774 | 755,760 |
| Accumulated amortisation | (118,691) | (118,380) |
| Net book amount | 652,083 | 637,380 |
| **Year ended December 31, 2004** | | |
| Opening net book amount | 652,083 | 637,380 |
| Disposals | — | (5,050) |
| Amortisation charges | (15,704) | (14,772) |
| Closing net book amount | 636,379 | 617,558 |
| **At December 31, 2004** | | |
| Cost | 770,774 | 750,710 |
| Accumulated amortization | (134,395) | (133,152) |
| Net book amount | 636,379 | 617,558 |
| **Year ended December 31, 2005** | | |
| Opening net book amount | 636,379 | 617,558 |
| Amortisation charges | (15,581) | (15,002) |
| Closing net book amount | 620,798 | 602,556 |
| **At December 31, 2005** | | |
| Cost | 770,774 | 750,710 |
| Accumulated amortization | (149,976) | (148,154) |
| Net book amount | 620,798 | 602,556 |

As at December 31, 2005, land use right certificates ("Land Certificates") of certain parcels of land of the Group and the Company with an aggregate area of approximately 3,450,962 square meters (2004: 7,372,000 square meters) had not been obtained. After consultation made with the Company's legal counsel, the directors consider that there is no legal restriction for the Group or the Company to apply for and obtain the Land Certificates and it should not lead to any significant adverse impact on the operations of the Group or the Company. Accordingly, no provision for impairment was considered necessary.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 9. INTERESTS IN SUBSIDIARIES

| | Company | |
|---|---|---|
| | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* |
| | | *Note 2(1)* |
| Unlisted shares, at cost | **162,992** | 167,555 |
| Due from subsidiaries | **13,854** | 18,523 |
| | **176,846** | 186,078 |

The amounts due from subsidiaries were unsecured, interest free and had no fixed repayment terms.

The Company's directors are of the opinion that the recoverable amounts of both its investments and current account balances maintained with the subsidiaries as of December 31, 2005 were not less than their respective carrying values.

As of December 31, 2005, the Company had direct or indirect interests in the following principal subsidiaries which were incorporated/established and are operating in the PRC:

| Name of the entity | Date of incorporation/ establishment | Percentage of equity interest attributable to the Company | Paid-in capital | Principal activities |
|---|---|---|---|---|
| **Directly held by the Company** | | | | |
| Shenzhen Guangshen Railway Civil Engineering Company | March 1, 1984 | 100% | RMB55,000,000 | Construction of railroad properties |
| Shenzhen Fu Yuan Enterprise Development Company | November 1, 1991 | 100% | RMB18,500,000 | Hotel management |
| Shenzhen Guangshen Railway Travel Service Ltd. | August 16, 1995 | 100% | RMB2,400,000 | Travel agency |
| Shenzhen Jing Ming Industrial & Commercial Company Limited | January 18, 1994 | 100% | RMB2,110,000 | Maintenance of water and electrical equipment |
| Shenzhen Jian Kai Trade Company* | December 6, 1993 | 100% | RMB2,000,000 | Construction materials trading |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 9. INTERESTS IN SUBSIDIARIES *(continued)*

| Name of the entity | Date of incorporation/ establishment | Percentage of equity interest attributable to the Company | Paid-in capital | Principal activities |
|---|---|---|---|---|
| **Directly held by the Company** *(continued)* | | | | |
| Shenzhen Railway Station Passenger Services Company | December 18, 1986 | 100% | RMB1,500,000 | Catering services and sales of merchandise |
| Guangzhou East Station Dongqun Trade and Commerce Service Company | November 23, 1992 | 100% | RMB1,020,000 | Sales of merchandise |
| Shenzhen Railway Station Travel Service Company | January 1, 1990 | 75% | RMB2,129,400 | Catering services and sales of merchandise |
| Shenzhen Longgang Pinghu Qun Yi Railway Store Loading and Unloading Company | September 11, 1993 | 55% | RMB10,000,000 | Cargo loading and unloading, warehousing, freight transportation |
| Dongguan Changsheng Enterprise Company | May 22, 1992 | 51% | RMB38,000,000 | Warehousing |
| **Indirectly held by the Company** | | | | |
| Shenzhen Railway Property Management Company Limited | November 13, 2001 | 100% | RMB3,000,000 | Property management |
| Shenzhen Nantie Construction Supervision Company | May 8, 1995 | 100% | RMB2,000,000 | Supervision of construction projects |
| Shenzhen Guangshen Railway Economic and Trade Enterprise Company | March 7, 2002 | 100% | RMB2,000,000 | Culinary management |
| Shenzhen Yuezheng Enterprise Company Limited | June 24, 1996 | 100% | RMB1,000,000 | Freight transport agency, cargo loading and unloading, warehousing |
| Shenzhen Road Multi-modal Transportation Company Limited | March 17, 1994 | 60% | RMB1,000,000 | Freight transportation |

All the above subsidiaries are limited liability companies.

* A public announcement was made that the subsidiary had to be put under liquidation on May 20, 2005 and the formal liquidation process also commenced on that date. As at December 31, 2005, the relevant legal procedures had not been completed but the directors consider that the impact of the liquidation process did not bear any material impact on the Financial Statements as a whole.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 10. INTERESTS IN ASSOCIATES

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Unlisted shares, at cost | **—** | — | **170,814** | 169,514 |
| Share of net assets | **137,578** | 157,527 | **—** | — |
| *Less:* provision for impairment in value* | **(29,689)** | (29,689) | **(65,738)** | (29,689) |
| Interest in associates, net | **107,889** | 127,838 | **105,076** | 139,825 |
| Due from associates | **12,423** | 12,820 | **12,413** | 12,413 |
| *Less:* provision for doubtful accounts** | **(12,312)** | (12,312) | **(12,312)** | (12,312) |
| | **111** | 508 | **101** | 101 |
| | **108,000** | 128,346 | **105,177** | 139,926 |

The movement of interest in associates of the Group and Company during the year is as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Beginning of the year | **127,838** | 139,957 | **139,825** | 140,155 |
| Additions — cost | **—** | — | **1,300** | (330) |
| Less — Provision for impairment in value* | **—** | — | **(36,049)** | — |
| Share of results after tax | **(19,949)** | (12,119) | **—** | — |
| End of the year | **107,889** | 127,838 | **105,076** | 139,825 |

* The provision at the Group level as at December 31, 2005 represents the provision for full impairment losses incurred in the share of net assets of Zengcheng Lihua Stock Company Limited ("Zengcheng Lihua") at approximately RMB29,700,000, which was made in prior years (the "Zengcheng Lihua Provision"). The provision balance at the Company level as at December 31, 2005 include the Zengcheng Lihua Provision and a provision for impairment loss of the Company's investment in Guangzhou Tiecheng Enterprise Company Limited ("Tiecheng") amounting to approximately RMB36,000,000, representing the cumulative equity share of the losses incurred by Tiecheng to December 31, 2005.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 10. INTERESTS IN ASSOCIATES *(continued)*

** The provision for doubtful accounts represents a full impairment loss provision against a receivable balance due from Zengcheng Lihua of approximately RMB12,300,000, which was made in prior years.

As of December 31, 2005, the Company had direct or indirect interests in the following companies which were incorporated/established and are operating in the PRC:

| Name of the entity | Date of incorporation/ establishment | Percentage of equity interest attributable to the Company | Registered capital amount of the associate | Principal activities |
|---|---|---|---|---|
| **Directly held by the Company** | | | | |
| Tiecheng *(Note a)* | May 2, 1995 | 49% | RMB245,000,000 | Properties management and trading of merchandise |
| Zengcheng Lihua | July 30, 1992 | 27% | RMB100,000,000 | Real estate construction, provision of warehousing, cargo uploading and unloading services |
| Guangzhou Tielian Economy Development Company Limited ("Tielian") | December 27, 1994 | 34% | RMB1,000,000 | Warehousing and freight transport agency services |
| **Indirectly held by the Company** | | | | |
| Guangzhou Huangpu Yuehua Freight Transportation Joint Venture Company Limited | July 20, 1990 | 33.3% | RMB6,610,000 | Cargo loading and unloading, warehousing, freight transport agency services |

All the above associates are limited liability companies.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 10. INTERESTS IN ASSOCIATES *(continued)*

The Group's share of the results with its percentage ownership of its principal associates, and its share of the assets are as follows:

| | **Assets** | **Liabilities** | **Revenues** | **Profit/(Loss)** |
|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **2004** | | | | |
| Tiecheng | 178,897 | 55,061 | 3,632 | (12,165) |
| Tielian | 3,613 | 448 | 1,170 | 46 |
| | 182,510 | 55,509 | 4,802 | (12,119) |
| **2005** | | | | |
| Tiecheng | 152,499 | 48,648 | 2,534 | (19,979) |
| Tielian | 3,488 | 287 | 1,253 | 30 |
| | 155,987 | 48,935 | 3,787 | (19,949) |

*Note a:*

As indicated above, the carrying amount of the Company's investment in Tiecheng was approximately RMB103,851,000 as at December 31, 2005.

In 1996, Tiecheng and a third party company jointly established a sino-foreign contractual joint venture, Guangzhou Guantian Real Estate Company ("Guangzhou Guantian"), in Guangzhou in order to develop certain properties near a railway station operated by the Group. On October 27, 2000, Guangzhou Guantian together with two other parties, namely Guangzhou Guanhua Real Estate Company Limited ("Guangzhou Guanhua") and Guangzhou Guanyi Real Estate Company Limited ("Guangzhou Guanyi"), agreed to act as joint guarantors (collectively the "Guarantors") for certain payable balances due from Guangdong Guancheng Real Estate Company Limited ("Guangdong Guancheng") to a third party (the "Creditor").

Guangzhou Guantian, Guangzhou Guanhua, Guangzhou Guanyi and Guangdong Guancheng are related companies to the extent that they have one common chairman. As Guangdong Guancheng failed to settle the payables, the Guarantors were found to be jointly liable to the Creditor an amount of approximately RMB257,000,000 plus accrued interest (collectively the "Damages") according to a court verdict made on November 4, 2001 (the "Verdict"). In the case that Guangzhou Guantian had to honour its joint obligation to settle the Damages, the carrying value of the Company's investment in Tiecheng would have been further impaired.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 10. INTERESTS IN ASSOCIATES *(continued)*

On December 15, 2003, the People's High Court of Guangdong Province (the "High Court") accepted Guangzhou Guantian's application for a re-trial to discharge its obligation under the aforesaid guarantee. As a necessary step for the High Court to decide whether there should be a re-trial, a hearing was held on March 18, 2004. In October 2005, the High Court received an order from the People's Supreme Court to launch a re-trial and certain preparatory procedures were undertaken by the High Court in December 2005. Nevertheless, the date of the re-trial has not been fixed. After consultation made with an independent legal counsel, the directors are of the opinion that there is a high possibility that the above guarantee arrangement would be determined to be invalid according to the relevant rules and regulations of the PRC. Accordingly, the directors consider that, as of the date of approval of the Financial Statements, the possibility that Guangzhou Guantian would be required to settle the above claim is remote, and no provision for impairment loss of the Company's interest in Tiecheng had to be made in the Financial Statements. In addition, in order to avoid any monetary losses that the Company may suffer arising from the litigation, the Company has obtained a letter of undertaking issued by the Parent Company dated December 14, 2004, whereby the Parent Company has undertaken to adopt relevant procedures and actions so that the investment interests of the Company in Tiecheng will not be affected by the litigation.

## 11. AVAILABLE-FOR-SALE INVESTMENTS

| | **Group** | | **Company** | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Beginning of the year | **167,962** | 167,962 | **167,962** | 167,962 |
| Disposals *(Note a)* | **(121,854)** | — | **(121,854)** | — |
| End of the year | **46,108** | 167,962 | **46,108** | 167,962 |

*Note a:*

Pursuant to an instruction, Tiezhengfa (2004) No. 6, jointly issued by the MOR and the State-owned Assets Supervision and Administration Committee of the State Council of the PRC, the Company was required to dispose of its equity investment made in China Railway Communication Company Limited ("China Railcom"), which is a subsidiary of MOR, to the authorities at the original cost of the investment incurred by the Company at approximately RMB121,854,000, resulting in no net gain or loss to the Company. The Parent Company was responsible for making settlement to the Company for the disposal on behalf of the authorities. As at 31 December 2005, the transfer procedures of the investment had been completed and the Company had also received a partial settlement of the consideration amounting to RMB62,700,000 from the Parent Company. The remaining balance of approximately RMB59,154,000 had been recorded as an amount due from related party in the Financial Statements. *(See also Note 33(b) and (c)).*

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 11. AVAILABLE-FOR-SALE INVESTMENTS *(continued)*

The Company's ownership in the equity interests in each of the respective investee companies shown above is less than 10%. The directors of the Company are of the opinion that no quoted market price in an active market is available for these investments and their fair values cannot be reliably measured by alternative valuation methods. In accordance with the requirements under IFRS, the above non-current available-for-sale investments are carried at cost subject to review for impairment loss. As of December 31, 2005, no impairment provision was considered necessary by the directors to write down the carrying amounts of these investments.

## 12. DEFERRED TAX ASSETS/LIABILITIES

Deferred income taxes are calculated in full on temporary differences under the liability method using the applicable tax rates for the respective companies affected.

| | Group and Company | |
|---|---|---|
| | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* |
| Deferred tax assets: | | |
| — Deferred tax asset to be recovered after more than 12 months | **35,990** | 18,406 |
| Deferred tax liability: | | |
| — Deferred tax liability to crystallise after more than 12 months | **(4,830)** | — |
| | **31,160** | 18,406 |

The gross movement on the deferred tax account of the Group and the Company is as follows:

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Beginning of the year | **18,406** | 6,154 |
| Tax charged to income statement | **17,584** | 12,252 |
| End of the year | **35,990** | 18,406 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 12. DEFERRED TAX ASSETS/LIABILITIES *(continued)*

The movement in deferred tax assets and liabilities of the Group and the Company during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

| **Deferred tax assets:** | **At January 1, 2004** *RMB'000* | **Charged to the income statement** *RMB'000* | **At December 31, 2004** *RMB'000* | **Charged to the income statement** *RMB'000* | **At December 31, 2005** *RMB'000* |
|---|---|---|---|---|---|
| Provision for doubtful debts | 472 | 9,991 | 10,463 | 3,627 | **14,090** |
| Impairment provision for fixed assets | 2,946 | — | 2,946 | — | **2,946** |
| Impairment provision for interests in associates | 2,227 | 2,226 | 4,453 | — | **4,453** |
| Write-down of reclaimed track rails to realisable value | — | — | — | 5,776 | **5,776** |
| Adjustments made to carrying values of fixed assets | — | — | — | 5,381 | **5,381** |
| Others | 509 | 35 | 544 | 2,800 | **3,344** |
| | 6,154 | 12,252 | 18,406 | 17,584 | **35,990** |

| **Deferred tax liabilities:** | **At December 31, 2004** *RMB'000* | **Charged to the income statement** *RMB'000* | **At December 31, 2005** ***RMB'000*** |
|---|---|---|---|
| Capitalisation of replacement costs of rail-line track assets | — | 4,830 | **4,830** |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 13. DEFERRED STAFF COSTS

| | Group and Company | |
|---|---|---|
| | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* |
| **At January 1** | | |
| Cost | **226,369** | 226,369 |
| Accumulated amortization | **(75,458)** | (60,366) |
| Net book amount | **150,911** | 166,003 |
| **Year ended December 31** | | |
| Opening net book amount | **150,911** | 166,003 |
| Amortization | **(15,090)** | (15,092) |
| Closing net book amount | **135,821** | 150,911 |
| **At December 31** | | |
| Cost | **226,369** | 226,369 |
| Accumulated amortization | **(90,548)** | (75,458) |
| Net book amount | **135,821** | 150,911 |

## 14. MATERIALS AND SUPPLIES

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Train compartment materials | **34,420** | 30,871 | **34,420** | 30,871 |
| Reusable rail-line track materials | **8,708** | 4,003 | **8,708** | 4,003 |
| Track and track diversion joints materials | **4,735** | 5,164 | **4,735** | 5,164 |
| Construction materials | **4,579** | 4,887 | **—** | — |
| Locomotive materials | **4,063** | 3,824 | **4,063** | 3,824 |
| Electrical materials | **2,909** | 1,742 | **2,909** | 1,742 |
| Others | **5,539** | 10,111 | **2,898** | 2,088 |
| | **64,953** | 60,602 | **57,733** | 47,692 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 14. MATERIALS AND SUPPLIES *(continued)*

The costs of materials and supplies consumed were recognised as "operating expenses" amounting to approximately RMB387,151,000 (2004: RMB341,171,000). As of December 31, 2005, there were no inventories stated at net realisable value.

## 15. TRADE RECEIVABLES

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Trade receivables | **116,877** | 122,075 | **17,234** | 38,706 |
| *Less:* Provision for doubtful accounts | **(10,484)** | (15,423) | **(9,229)** | (13,023) |
| | **106,393** | 106,652 | **8,005** | 25,683 |

The credit period of trade receivables is generally within one year. As at December 31, 2005 and 2004, the aging analysis of trade receivables was as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Within 1 year | **101,729** | 99,297 | **7,944** | 21,409 |
| Over 1 year but within 2 years | **4,645** | 7,332 | **47** | 4,251 |
| Over 2 years but within 3 years | **19** | 23 | **14** | 23 |
| | **106,393** | 106,652 | **8,005** | 25,683 |

Concentrations of credit risk with respect to trade receivables are limited due to the fact that the Group has a large number of customers, which are widely dispersed. Accordingly, management believes that there is no additional credit risk beyond the amount already provided for expected collection losses inherent in the Group's trade receivables.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 16. PREPAYMENTS AND OTHER RECEIVABLES

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Other receivables | **211,969** | 211,068 | **196,793** | 178,945 |
| *Less:* Provision for doubtful accounts* | **(71,717)** | (57,038) | **(71,717)** | (55,504) |
| Other receivables, net | **140,252** | 154,030 | **125,076** | 123,441 |
| Prepayments | **30,355** | 62,543 | **25,869** | 55,892 |
| | **170,607** | 216,573 | **150,945** | 179,333 |

* Included in the provision balance was an amount of approximately RMB31,365,000 which had been set up by the Company in prior years in order to provide against the potential recoverability losses associated with a deposit placed with a deposit-taking agency, Zeng Cheng City Li Cheng Credit Cooperative ("Li Cheng"), at a principal of the same amount ("the Deposit"). The Company has been unable to recover the Deposit upon its maturity from Li Cheng and the Company then initiated several legal proceedings to enforce the recovery but without success. Accordingly, 50% of the outstanding balance had been provided for doubtful debts at approximately RMB15,817,500 in 2002. The remaining balance of the outstanding principal at approximately RMB15,817,500 was also provided for as doubtful debts in 2004.

Other receivables mainly represent miscellaneous deposits and receivables arising from services other than the main railway transportation services undertaken by the Group. Prepayments mainly represent amounts paid in advance to the suppliers for utilities and other operating expenses of the Group.

## 17. RESTRICTED CASH

Restricted cash represents the employees housing fund that the Company has set up pursuant to applicable government policies and regulations for the benefits of its employees and the Company administers on behalf of them. Such benefits are provided at 7% of the aggregate salaries of the employees residing in Guangzhou area or along the Guangzhou-Shenzhen rail-line route and at 13% of the aggregate salaries of the employees residing in Shenzhen area. The money was deposited in designated bank accounts under the names of the respective employees. The Company does not have any right to use the funds for purposes other than making housing welfare payments upon requests made from the respective employees.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
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## 18. SHORT-TERM DEPOSIT

Short-term deposits with original maturities ranging from three months to one year are held for investment purpose and stated at amortised cost.

| | | Group and Company | |
|---|---|---|---|
| | | **2005** | 2004 |
| | *Note* | ***RMB'000*** | *RMB'000* |
| Time deposits with maturities over three months in banks | *(a)* | **598,131** | 1,211,309 |
| Time deposits with maturities over three months in the deposit-taking centre of MOR ("MOR Depositing-taking Centre") | *(b)* | **168,000** | 168,000 |
| | | **766,131** | 1,379,309 |

(a) Time deposits with maturities over three months in banks consist of short-term deposits denominated in RMB, Hong Kong dollars ("HK$"), and US dollars ("USD") (2004: RMB, HK$ and USD) with original maturities of six months placed with banks in the PRC. The annual interest rate of RMB deposits was 2.07% (2004: 1.71% to 2.07%); 1.2% (2004: 1.2%) for HK$ deposits; and LIBOR plus floating rate ranging from -0.2% to 0% (2004: LIBOR plus floating rate ranging from -0.2% to 0%) for USD deposits. Total interest income derived from these deposits amounted to approximately RMB7,968,000 for the year ended December 31, 2005 (2004: approximately RMB15,015,000).

(b) Time deposits with maturities over three months were maintained in the MOR Deposit-taking Centre, which has been licensed by the People's Bank of China to engage in deposit taking activities in the PRC for companies under its control. The balances consist of short-term deposits denominated in RMB (2004: RMB) with original maturities of six months (2004: one year). The annual interest rate was 2.07% in 2005 (2004: 1.98%). Total interest income derived from these deposits amounted to approximately RMB2,885,000 (2004: approximately RMB 3,098,000) for the year ended December 31, 2005 *(see also Note 33(b))*.

# NOTES TO THE FINANCIAL STATEMENTS

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## 19. SHARE CAPITAL

As of December 31, 2005, the authorised capital of the Company consisted of ordinary shares of par value RMB1.00 per share:

| | Number of shares *'000* | Nominal value *RMB'000* | Percentage of share capital |
|---|---|---|---|
| Authorised, issued and fully paid: | | | |
| State-owned domestic shares | 2,904,250 | 2,904,250 | 67% |
| H shares | 1,431,300 | 1,431,300 | 33% |
| | 4,335,550 | 4,335,550 | 100% |

On November 15, 2004 the Company and Guangzhou Railway Group Yangcheng Railway Company (The "Vendor"), a wholly owned subsidiary of the Parent Company, have entered into an agreement (the "Acquisition Agreement") for the acquisition of the railway transportation business between the rail route of Guangzhou and Pingshi currently operated by the Vendor and the assets and liabilities relating to such business (the "Acquisition"). The consideration for the acquisition was determined to be RMB10,264,120,700 (the "Consideration"), subject to confirmation obtained from the relevant PRC authorities and certain adjustments to be made according to the terms of the Acquisition Agreement.

The Company intends to finance the payment of the Consideration with the proceeds of a public offering of its A shares to be issued with any shortfall being financed by internal resources and/or bank borrowings. The A shares so issued are intended to be listed on the Shanghai Stock Exchange of the PRC. In connection therewith, the Company applied to the relevant authorities in China for the issue and allotment of not more than 2.75 billion shares of A shares and submitted its application proposal relating to the offering to the China Securities Regulatory Commission (the "CSRC") on December 31, 2004 (the "A Share Offer").

In addition to the Acquisition Agreement, the Company has entered into various agreements in respect of leasing of equipment and provision of services with the Parent Company or the Vendor (the "Related Party Agreements"). Such agreements shall only be effective upon the completion of the acquisition and shall replace all the existing agreements of similar nature enacted among the parties *(see Note 33(b) for details)*.

On December 30, 2004, the Acquisition, the A Share Offer and the Related Party Agreements were approved by the shareholders of the Company in shareholders meetings. Such approval was further renewed in shareholders meetings held on January 20, 2006.

# NOTES TO THE FINANCIAL STATEMENTS

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*(All amounts expressed in Renminbi unless otherwise stated)*

## 19. SHARE CAPITAL *(continued)*

The completion of the Acquisition Agreement is conditional upon the fulfilment of, among other things, the following remaining conditions: (1) the formal approval of the relevant authorities or bodies in relation to the A Share Issue being obtained; (2) the A Share Issue having completed and raised an amount of not less than 65% of the consideration; (3) the approval of the relevant government bodies responsible for the supervision and management of state owned assets in relation to the Vendor's proposal on disposal of state-owned assets being obtained; and (4) the approval of the National Development and Reform Committee in relation to the price determination for passenger and freight railway transportation services between Guangzhou and Pingshi being obtained.

Save for condition (2) which can be waived by the Company, none of the above conditions can be waived. If the above conditions are not fulfilled within 2 years from the date of signing of the Acquisition Agreement on November 15, 2004, the Acquisition Agreement shall lapse and no party shall have any liability there under. In the event that any party rescinds the Acquisition Agreement for whatever reason after the A Share Issue has been completed, it is expected that the Company will retain the proceeds from the A Share Issue for the use of general working capital financing.

As of the date of approval of the Financial Statements, none of the conditions in the Acquisition Agreement stated above had been fulfilled and accordingly, the Acquisition as well as the A Share Offer had not been completed. Cumulative professional costs specifically incurred for the transactions up to December 31, 2005 amounting to approximately RMB27,007,000 (2004: RMB14,035,000) were presented as share issuance costs as a debit balance in the reserves of the Group.

## 20. RESERVES

According to the provisions of the articles of association of the Company, the Company shall first set aside 10% of its profit attributable to shareholders after tax as indicated in the Company's statutory financial statements for the statutory surplus reserve (except where the reserve has reached 50% of the Company's registered share capital) and 5% to 10% (as determined by the directors) of its profits for the statutory public welfare fund before making any distribution of the profit attributable to the shareholders in each year. The Company may also make appropriations from its profit attributable to shareholders to a discretionary surplus reserve provided it is approved by a resolution passed in a shareholders' general meeting. These reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends without the prior approval obtained from the shareholders in a shareholders' general meeting under specific circumstances.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
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## 20. RESERVES *(continued)*

When the statutory surplus reserve is not sufficient to make good for any losses of the Company from previous years, current year profit attributable to shareholders shall be used to make good the losses before any allocations are set aside for the statutory surplus reserve or the statutory public welfare fund.

The statutory public welfare fund is to be utilised for constructing or acquiring capital assets such as dormitories and other housing facilities for the employees of the Company and it cannot be used to pay for any other employee welfare expenses. Title of these capital assets constructed or acquired will be retained by the Company.

The statutory surplus reserve, the discretionary surplus reserve and the share premium account may be converted into share capital of the Company provided it is approved by a resolution passed in a shareholders' general meeting with the provision that the ending balance of the statutory surplus reserve does not fall below 25% of the registered share capital amount. The Company may either allot newly created shares to the shareholders at the same proportion of the existing number of shares held by these shareholders, or it may increase the par value of each share.

For the years ended December 31, 2005 and 2004, the directors proposed the following appropriations to reserves of the Company:

| | **2005** | | 2004 | |
|---|---|---|---|---|
| | ***Percentage*** | ***RMB'000*** | Percentage | *RMB'000* |
| Statutory surplus reserve | **10%** | **61,060** | 10% | 59,071 |
| Statutory public welfare fund | **5%** | **30,530** | 5% | 29,535 |
| | | **91,590** | | 88,606 |

In accordance with the provisions of the articles of association of the Company, the profit after appropriation to reserves and available for distribution to shareholders shall be the lowest of the retained earnings determined under (a) PRC GAAP, (b) IFRS and (c) the accounting standards of the countries in which its shares are listed. As the Statutory Financial Statements of the Company have been prepared in accordance with PRC GAAP, the retained earnings so reported may be different from the amounts reported in the statement of changes in shareholders' equity prepared under IFRS contained in the Financial Statements.

As of December 31, 2005, the reserve of the Company available for distribution was approximately RMB723,823,000 (2004: approximately RMB686,489,000, as restated).

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 21. TRADE PAYABLES

The aging analysis of trade payables was as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Within 1 year | **114,651** | 36,502 | **65,301** | 29,547 |
| Over 1 year but within 2 years | **3,696** | 333 | **1,123** | 7 |
| Over 2 years but within 3 years | **360** | 301 | **14** | 167 |
| | **118,707** | 37,136 | **66,438** | 29,721 |

## 22. ACCRUALS AND OTHER PAYABLES

| | Group | | Company | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Advance for construction projects carried out for customers | **113,038** | 127,411 | **91,397** | 102,249 |
| Accrued expenses | **23,941** | 74,173 | **23,905** | 74,173 |
| Salary and welfare payables | **17,872** | 24,257 | **17,176** | 23,000 |
| Other payables* | **357,069** | 213,647 | **370,092** | 206,903 |
| | **511,920** | 439,488 | **502,570** | 406,325 |

* Other payables mainly represent the housing fund *(mentioned in Note 17)* which the Company managed on behalf of the employees and various miscellaneous payable balances and deposits received from others in the daily operations of the Group .

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 23. PROFIT FROM OPERATIONS

The following items have been (credited)/charged in arriving at profit before income tax:

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| **Crediting** | | |
| Interest income (included in other income, net) | **(53,409)** | (42,384) |
| Investment loss/(income) (included in other income, net) | **8,302** | (3,273) |
| **Charging** | | |
| Employee benefits expenses *(Note 24)* | **640,925** | 639,284 |
| Cost of materials and supplies | **387,151** | 341,171 |
| Repair costs, excluding material and suppliers | **263,415** | 216,294 |
| Depreciation of fixed assets *(Note 6)* | **328,355** | 336,089 |
| Loss on disposal of fixed assets | **26,508** | 234 |
| Amortisation of leasehold land payments *(Note 8)* | **15,581** | 15,704 |
| Provision for doubtful accounts *(Notes 15, 16)* | **9,740** | 18,750 |
| Operating lease rentals of locomotive, machinery and equipment | **168,875** | 168,645 |
| Amortisation of deferred staff costs *(Note 13)* | **15,090** | 15,092 |
| Auditors' remuneration | **3,400** | 3,200 |

## 24. EMPLOYEE BENEFIT EXPENSES

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Wages and salaries | **302,508** | 282,980 |
| Provision for staff welfare and bonus | **270,623** | 255,644 |
| Contributions to a defined contribution pension scheme *(Note a)* | **52,949** | 42,950 |
| Medical and other employee benefits *(Note b)* | **14,845** | 57,710 |
| | **640,925** | 639,284 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 24. EMPLOYEE BENEFIT EXPENSES *(continued)*

**(a) Pension scheme**

All the full-time employees of the Group were formerly covered by a defined-contribution pension scheme operated by the Parent Company pursuant to the provisions of a circular issued by the Parent Company dated October 24, 1995. The Group was required to pay to the Parent Company an amount equivalent to 19% of the basic salary and certain amounts of bonus payments of the employees as contributions made for their pension benefits. In another circular issued by the Parent Company dated December 21, 2000, the rate of contribution was revised to 18%. The Parent Company was to be held responsible to honour the retirement benefits of the employees.

Since April 2002, the ultimate pension liability of the employees has come under the management of the local government authority. The central government of the PRC is responsible for all retirement benefits of the employees. For administrative purposes, the Group was required to continue to make contributions to the Parent Company for the employees' pension benefits during a transition period from April 2002 to November 2004, and the Parent Company in turn paid such contributions to the relevant government authority on behalf of the Company. From November 2004 onwards, the Group began to pay all the related contributions directly to the relevant government authority.

**(b) Medical and other employee benefits**

An one-off payment amounting to approximately RMB35,000,000 was made by the Group in the year ended December 31, 2004 for the settlement of medical insurance premiums for its employees in accordance with the implementation of a set of revised government policies. The pronouncement of the policies was made as a result of a reform of the PRC medical insurance system in that year.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 24. EMPLOYEE BENEFIT EXPENSES *(continued)*

### (c) Directors' and senior management's emoluments

The remuneration of every Director for the year ended December 31, 2005 is set below (in Renminbi Yuan):

| | 2005 | | | | | |
|---|---|---|---|---|---|---|
| Name of Director | Fees | Salary | Bonus | Employer's contribution to pension scheme | Total | 2004 Total |
| **Directors** | | | | | | |
| Wu, JunGuang | 13,020 | — | — | — | 13,020 | 13,000 |
| Feng, QiFu | — | — | — | — | — | 242,720 |
| Li, KeLie | 13,020 | 26,316 | 289,578 | 3,558 | 332,472 | 51,443 |
| Li, Peng | 4,200 | 11,382 | 89,418 | 1,380 | 106,380 | 220,502 |
| Yang, JinZhong | 5,040 | 20,545 | 75,440 | 2,050 | 103,075 | — |
| Li, QingYun | 8,400 | 21,828 | 230,960 | 2,862 | 264,050 | 220,084 |
| Wu, HouHui | 9,240 | — | — | — | 9,240 | 10,000 |
| Wen, WeiMing | 9,240 | — | — | — | 9,240 | 10,000 |
| Hu, LingLing | 9,240 | — | — | — | 9,240 | 10,000 |
| Chang Loong Cheong | 120,622 | — | — | — | 120,622 | 140,344 |
| Deborah Kong | 120,622 | — | — | — | 120,622 | 140,344 |
| Wilton Chau | 120,622 | — | — | — | 120,622 | 48,940 |
| **Supervisors** | | | | | | |
| Yao, MuMing | 9,240 | — | — | — | 9,240 | 9,000 |
| Chen, YongBao | 9,240 | — | — | — | 9,240 | 10,000 |
| Tang, DingHong | 7,560 | 26,964 | 279,312 | 3,696 | 317,532 | 275,692 |
| Zhao, GenRong | — | — | — | — | — | 10,000 |
| Yang, RongJiu | — | — | — | — | — | 101,132 |
| Chen, YunZhong | 7,560 | 24,804 | 225,306 | 3,378 | 261,048 | 219,422 |
| Wang, JianPing | 7,560 | 23,772 | 224,706 | 3,030 | 259,068 | 217,656 |
| Lu, XiMei | — | 22,526 | 48,142 | 2,872 | 73,540 | — |

No directors and senior management waived or agreed to waive any emoluments during the year.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 24. EMPLOYEE BENEFIT EXPENSES *(continued)*

### (d) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include three (2004: three) directors and two (2004: two) supervisors whose emoluments are reflected in the analysis presented above.

During the year, no emoluments (2004: Nil) were paid to the five highest paid individuals as inducement to join or upon joining the Group or as compensation for loss of office.

The emoluments paid to the five highest paid individuals are all to directors and supervisors of the Company (2004: same). The emolument range is in the band of Nil to HK$1,000,000 (equivalent to RMB1,060,000) (2004: same).

## 25. FINANCE COSTS

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Interest expenses incurred for current account balances maintained with related parties wholly repayable within five years | **654** | 667 |
| Bank charges | **323** | 106 |
| Net foreign exchange losses *(Note 3(a))* | **21,761** | 363 |
| | **22,738** | 1,136 |

## 26. INCOME TAX EXPENSE

Enterprises established in the Shenzhen Special Economic Zone of the PRC are subject to income tax at a reduced preferential rate of 15% as compared with the standard income tax rate for PRC companies of 33%. The Shenzhen Municipal Tax Bureau confirmed in 1996 that the Company is subject to such reduced income tax rate of 15% from that year onwards. Accordingly, the enacted income tax rate of the Company for the year ended December 31, 2005 was 15% (2004: same).

According to the relevant income tax laws of the PRC, the subsidiaries of the Group are subject to income tax rates of 15% or 33%, mainly depending on the places of incorporation/establishment.

Up to the date of approval of the IFRS Financial Statements, the directors of the Company had not been informed of any changes in the enterprise income tax treatment applicable to the Group.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 26. INCOME TAX EXPENSE *(continued)*

| | **2005** **RMB'000** | 2004 RMB'000 |
|---|---|---|
| Current income tax | **121,832** | 110,625 |
| Deferred income tax *(Note 12)* | **(17,584)** | (12,252) |
| | **104,248** | 98,373 |

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate of the home country of the Company as follows:

| | **2005** **RMB'000** | 2004 RMB'000 |
|---|---|---|
| Profit before tax | **716,618** | 665,111 |
| Tax calculated at a statutory rate of 15% (2004: 15%) | **107,493** | 99,767 |
| Tax effect of expenses that are not deductible in determining taxable profit: | | |
| Effect of different tax rates of certain subsidiaries | **1,111** | 2,123 |
| Tax losses for which no deferred tax asset was recognised | **2,992** | 1,818 |
| Expenses not deductible for tax purposes | **3,211** | 4,069 |
| Differences in depreciation charges of fixed assets reported in the Statutory Financial Statements | **1,733** | — |
| Provision of deferred tax for adjustments made to carrying values of fixed assets | **(12,292)** | — |
| Deferred tax benefits resulting from provision for doubtful debts | **—** | (9,404) |
| Income tax expense | **104,248** | 98,373 |

The weighted average applicable tax rate was 14.5% (2004: 14.8%).

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 27. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company for the year at approximately RMB599,569,000 (2004: RMB579,878,000, as restated).

## 28. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit for the year attributable to ordinary shareholders of approximately RMB613,368,000 (2004: RMB567,484,000), divided by the weighted average number of ordinary shares outstanding during the year of 4,335,550,000 shares (2004: 4,335,550,000 shares). No diluted earnings per share were presented as there were no dilutive potential ordinary shares as of year end.

## 29. DIVIDENDS

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Final, proposed, of RMB0.12 (2004: RMB0.11) per ordinary share | **520,266** | 476,911 |

At a meeting of the directors held on March 20, 2006, the directors proposed a final dividend of RMB0.12 per ordinary share for the year ended December 31, 2005. This proposed dividend has not been reflected as a dividend payable in the Financial Statements, but will be reflected as an appropriation of retained earnings for the year ending December 31, 2006.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 30. CASHFLOW GENERATED FROM OPERATION

### (a) Reconciliation from profit attributable to shareholders to cash generated from operations:

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| Profit for the year | 612,370 | 566,738 |
| Adjustments for: | | |
| Income tax expense | 104,248 | 98,373 |
| Depreciation of fixed assets *(Note 6)* | 328,355 | 336,089 |
| Amortisation of leasehold land payments *(Note 8)* | 15,581 | 15,704 |
| Loss on disposal of fixed assets | 26,508 | 234 |
| Amortisation of deferred staff costs *(Note 13)* | 15,090 | 15,092 |
| Share of losses of associates *(Note 10)* | 19,949 | 12,119 |
| Provision for doubtful accounts *(Note 15, 16)* | 9,740 | 18,750 |
| Interest expenses | 654 | 1,030 |
| Interest income | (53,409) | (42,384) |
| Operating profit before working capital changes | 1,079,086 | 1,021,745 |
| Increase/(decrease) in trade receivables | 5,198 | (26,038) |
| Increase in materials and supplies | (4,351) | (21,910) |
| Decrease in prepayments and other current assets | 31,286 | 3,998 |
| Decrease in due from Parent Company | 43,518 | — |
| Decrease in due from related parties | 11,274 | 143,857 |
| Decrease in due from associates | 398 | 29 |
| Increase in trade payables | 81,571 | 21,647 |
| Decrease in due to Parent Company | (24,617) | (12,613) |
| Increase in due to related parties | 224,455 | 51,516 |
| Increase in accrued expenses and other payables | 23,707 | 139,619 |
| Cash generated from operations | 1,471,525 | 1,321,850 |

### (b) Analysis of the balance of cash and cash equivalents

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| Cash at MOR Deposit-taking Centre *(Note i)* | 628,746 | 862,508 |
| Cash at bank and in hand | 113,382 | 97,632 |
| Short-term deposits with maturities no more than three months *(Note ii)* | 370,000 | 84,489 |
| Cash and cash equivalents | 1,112,128 | 1,044,629 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 30. CASHFLOW GENERATED FROM OPERATION *(continued)*

### (b) Analysis of the balance of cash and cash equivalents *(continued)*

*Note i:* The amount of approximately RMB628,746,000 (2004: RMB 862,508,000) was deposited with the MOR Deposit-taking Centre at an annual interest rate of 0.72% (2004: 0.72%), which is commensurate with the prevailing interest rates offered by banks in the PRC.

*Note ii:* Short term time deposits with maturities no more than three months consist of deposits denominated in RMB (2004: RMB and USD). The effective interest rate of RMB deposits is 1.71% (2004: 1.71%) while the effective interest rate of USD deposits was 2.73% in 2004. These deposits have an average maturity of 90 days.

## 31. CONTINGENCY

There were no significant contigent liabilities as at the date of approval of the Financial Statements.

## 32. COMMITMENTS

### (a) Capital commitments

As of December 31, 2005, the Group had the following capital commitments which are authorized but not contracted for, and contracted but not provided for:

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Authorised but not contracted for | **3,985,253** | 451,500 |
| Contracted but not provided for | **3,331,311** | 693,828 |

A substantial amount of these commitments is related to the construction of the fourth rail-line of the Company ("Fourth Rail-Line") and purchase of new locomotives.

### (b) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases were as follows:

| | **2005** | 2004 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Machinery and equipment | | |
| — not more than one year | **75,375** | 108,000 |
| — more than one year but not more than five years | **—** | 75,375 |
| | **75,375** | 183,375 |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 32. COMMITMENTS *(continued)*

### (c) Commitments under the Acquisition Agreement

Please refer to Note 34 for details.

## 33. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

The Company is controlled by the Parent Company, which is a subsidiary of MOR and is ultimately controlled by the PRC government. The PRC government also controls a significant portion of the productive assets and entities in the PRC. In accordance with the requirements of IAS 24, Related Party Disclosures, all other state controlled enterprises and their subsidiaries, other than the Parent Company, MOR and fellow subsidiaries and associates, are also defined as related parties of the Company ("Other State-owned Companies").

For the purpose of related party transactions disclosure, the Group has identified, to the extent practicable, those corporate customers and suppliers which are state-owned enterprises based on their immediate ownership structure. It should be noted, however, that substantially all of the Group's business activities are conducted in the PRC and the influence of the PRC government in the Chinese economy is pervasive. In this regard, the PRC government indirectly holds interests in many companies. Many state-owned enterprises have multi-layered corporate structure and the ownership structures change over time as a result of transfers and privatisation programs. Some of these interests may, in themselves or when combined with other indirect interests, be controlling interests. Such interests, however, would not be known to the Group and are not reflected in the disclosures below. In addition, a portion of the Group's services provided are of a retail nature to end users, which include transactions with the employees of state-owned enterprises on corporate business, their key management personnel and close family members. These transactions are carried out on normal commercial terms that are consistently applied to all customers. Due to the vast volume and the pervasiveness of these transactions, the Group is unable to determine the aggregate amount of these transactions for disclosure. Therefore, the revenue from provision of services disclosed below does not include retail transactions with these related parties. However, the Group believes that meaningful information relating to related party disclosures has been adequately disclosed.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 33. RELATED PARTY TRANSACTIONS *(continued)*

(a) The Group had the following material related parties:

| Name of related parties | Relationship with the Company |
|---|---|
| **Holding company and fellow subsidiaries** | |
| Guangzhou Railway (Group) Company | Parent Company |
| Ministry of Railways ("MOR") of the PRC | The ultimate Parent Company |
| Guangzhou Railway Group Yang Cheng Railway Company ("Yangcheng") | Subsidiary of the Parent Company |
| Guangmeishan Railway Company Limited ("Guangmeishan") | Subsidiary of the Parent Company |
| Guangzhou Railway (Group) Guangshen Railway Enterprise Development Company (the Predecessor as defined in Note 1, "GEDC") | Subsidiary of the Parent Company |
| Guangzhou Railway Material Supply Company | Subsidiary of the Parent Company |
| Guangzhou Railway Engineer Construction Enterprise Development Company ("Engineer Construction Enterprise") | Subsidiary of the Parent Company |
| Guangzhou Guangtie Huake Technology Service Company ("Guangtie Huake") | Subsidiary of the Parent Company |
| MOR's Railroad Deposit-taking Centre | Subsidiary of MOR |
| **Associates of the Group** | |
| Guangzhou Tiecheng Enterprise Company Limited | Associate of the Company |
| Zengcheng Lihua Stock Company Limited | Associate of the Company |
| Guangzhou Tielian Economy Development Company Limited | Associate of the Company |
| Guangzhou Huangpu Yuehua Freight Transportation Company Limited | Associate of the Company |
| **Other State-owned Companies** | |
| Shenyang Train Class Company | |
| Puzhen Train Company | |
| Changchun Tracks and Equipment Company | |
| Sifang Passenger Trains Repair Stock Company | |
| Qixuyan Locomotive and Carriages Company | |
| Dalian Locomotives and Carriages Company | |
| Chengdu Materials Company | |
| Liuzhou Wood Company | |
| Hengyang Mechanism Company | |
| Construction Technique Company of China | |
| Nanfang Railway Repair Center | |
| The Fourth Railway Reconnaissance Design House | |
| Railway Construction Bureaus (including Third bureau, Seventh bureau, Eleventh bureau, Thirteenth bureau and others) | |
| The Forth Construction Bureau of China | |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 33. RELATED PARTY TRANSACTIONS *(continued)*

(b) Save as disclosed in other notes to the Financial Statements, during the year, the Group had the following material transactions undertaken with related parties:

| | **2005** **RMB'000** | 2004 *RMB'000* |
|---|---|---|
| **Recurring Transactions:** | | |
| ***Transactions with MOR and its related entities*** | | |
| ***I. Income*** | | |
| Provision of train transportation and related services to other railway companies controlled by MOR *(i)* | **(304,842)** | (183,399) |
| Revenue received, processed and allocated by MOR *((i) and (vi))* | | |
| — long distance passenger transportation | **(575,849)** | (486,825) |
| — cargo forwarding railway usage fees | **(123,763)** | (128,962) |
| Interest income received/receivable from MOR Deposit-taking Centre *(see Notes 18 and 30(b))* | **(5,530)** | (6,111) |
| ***II. Charges and Payments:*** | | |
| Services charges allocated from MOR for train transportation and related services offered by other railway companies controlled by MOR *((i) and (vi))* | **290,825** | 209,503 |
| Operating lease rentals paid/payable to MOR *(i)* | **50,804** | 65,485 |
| Lease of locomotives and related services provided from Yangcheng *(i)* | **8,449** | 48,179 |
| Social services (employee housing, health care, educational and public security services and other ancillary services) provided by the GEDC under a service agreement *(ii)* | **78,227** | 94,246 |
| Purchase of materials and supplies from Guangzhou Railway Material Supply Company *(iii)* | **73,146** | 65,998 |
| Interest expenses paid/payable to the Parent Company, net *(iv)* | **721** | 553 |
| **Non-Recurring Transactions:** | | |
| ***I. Transactions with MOR and its related entities*** | | |
| Disposal of an available-for-sale investment *(See note 11)* | **(121,854)** | — |
| Provision of repair and maintenance services by subsidiaries held by the Parent company *(i)* | **73,134** | 58,908 |
| Provision of construction management services by the Parent Company in connection with the construction of fixed assets of the Company *(v)* | **6,194** | 5,300 |
| Provision of supplies and materials by subsidiaries of Parent Company *(iii)* | **5,249** | — |
| ***II. Transactions with Other State-owned Companies*** | | |
| Provision of construction project and related service *(iii)* | **1,148,781** | 106,638 |
| Provision of repair and maintenance services *(iii)* | **75,867** | 55,125 |
| Provision of supplies and materials *(iii)* | **5,977** | 5,604 |
| Purchase of fixed assets *(iii)* | **55,803** | — |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 33. RELATED PARTY TRANSACTIONS *(continued)*

(b) *(continued)*

(i) The service charges are determined based on a pricing scheme set by MOR or made reference to current market prices with guidance provided by MOR.

(ii) The service charges are levied based on contracted prices determined based on cost plus a profit margin.

(iii) The prices are based on mutual negotiation between the contract parties with reference to guidance provided by MOR.

(iv) Interest was calculated and levied based on the average balances due from/to Parent Company on a quarterly basis at the prevailing lending interest rates of bank loans borrowed from banks in the PRC.

(v) Pursuant to the provisions of a construction management agreement and several supplementary agreements (collectively, the "Management Agreements") entered into with the Parent Company in 2004 and 2005, the Parent Company has undertaken to provide project management services to the Company on monitoring the construction services provided/to be provided by certain contractors and sub-contractors, which are substantially other State-owned Companies, employed for the construction of certain railway and railway stations of the Company, including the Fourth Rail-Line. The management service fees are determined based on the pricing scheme set by MOR.

(vi) Due to the fact that the railway business is centrally managed by the MOR within the PRC, the Company works in cooperation with MOR and other railway companies owned and controlled by MOR in order to operate certain long distance passenger train transportation and cargo forwarding services within the PRC. The related revenues are collected by other railway companies and centrally collected and processed by MOR. Certain portion of the revenues so collected are allocated to the Company for the use of its rail-lines or for services rendered by the Company in connection with the provision of these services. On the other hand, the Company is also allocated by MOR certain charges for the use of the rail lines and services provided by other railway companies. Such allocations are determined by MOR based on its standard charges applied on a nationwide basis.

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 33. RELATED PARTY TRANSACTIONS *(continued)*

(c) As of December 31, 2005, the Group and the Company had the following material balances maintained with related parties:

| | Group 2005 RMB'000 | Group 2004 RMB'000 | Company 2005 RMB'000 | Company 2004 RMB'000 |
|---|---|---|---|---|
| Cash and cash equivalents maintained in MOR Deposit-taking Centre *(see Note 30(b))* | **628,746** | 862,508 | **612,423** | 820,595 |
| Short-term time deposits in MOR Deposit-taking Centre *(see Note 18)* | **168,000** | 168,000 | **168,000** | 168,000 |
| Due from/(to) the Parent Company *(vi)* | **15,636** | (24,617) | **17,431** | (25,818) |
| — Trade balance *(viii)* | **(43,518)** | (24,617) | **(41,723)** | (25,818) |
| — Non-trade balance *(vii)* *(see Note 11)* | **59,154** | — | **59,154** | — |
| Due from Other State-owned Companies included in prepayments for fixed assets | **55,803** | — | **55,803** | — |
| Due from associates — Non-trade balance, before provision for doubtful debts *(See Note 10)* | **12,423** | 12,821 | **12,412** | 12,412 |
| Due from related parties-subsidiaries of Parent Company and MOR | **64,670** | 56,064 | **60,274** | 53,914 |
| — Trade balance *(viii)* | **25,257** | 36,531 | **23,173** | 36,531 |
| — Non-trade balance *(ix)* | **39,413** | 19,533 | **37,101** | 17,383 |
| Due to related parties | **1,174,101** | 194,699 | **1,165,430** | 193,443 |
| (1) Due to subsidiaries of Parent Company and MOR | **(276,520)** | (83,492) | **(276,520)** | (83,492) |
| — Trade balance *(viii)* | **(276,520)** | (83,492) | **(276,520)** | (83,492) |
| (2) Due to Other State-owned Companies | **(897,581)** | (111,207) | **(888,910)** | (109,951) |
| — Trade balance *(viii)* | **(50,564)** | (19,136) | **(50,563)** | (19,136) |
| — Non-trade balance *(ix)* | **(847,017)** | (92,071) | **(838,347)** | (90,815) |

# NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2005*
*(All amounts expressed in Renminbi unless otherwise stated)*

## 33. RELATED PARTY TRANSACTIONS *(continued)*

(c) *(continued)*

(vii) As of December 31, 2005, the non-trade receivable balance maintained with the Parent Company was due to the unsettled consideration receivable from the Parent Company for the disposal of the Company's equity investment made in China Railcom mentioned in Note 11.

(viii) The trade balances due from/to the Parent Company, subsidiaries of the Parent Company and MOR and other State-owned Companies mainly represented service fees and charges payable and receivable balances arising from the provision of passenger transportation and cargo forwarding businesses jointly with these related parties within the PRC as described in (iv).

(ix) The non-trade balances due to related parties mainly represented payables arising from unsettled fees for construction projects undertaken for the Group, purchase of fixed assets and provision of other services according to various service agreements entered into between the Group and the parties (see note (b) above).

As of December 31, 2005, all the balances maintained with related parties are unsecured, non-interest bearing and are repayable on demand, except for those short-term deposits balances maintained with the MOR Deposit-taking Centre disclosed above.

## 34. BANKING FACILITIES

As at December 31, 2005, the Group had unutilized banking facilities of approximately RMB8,100,000,000 granted from certain banks (2004: approximately RMB8,000,000,000) which are designated for the construction of the Fourth Rail-Line mentioned in Note 32(a)).

## 35. COMPARATIVE FIGURES

The Group adopted new/revised/amended IFRS which are effective for accounting periods commencing on or after January 1, 2005. As mentioned in Note 2(1), this has resulted in changes to the presentation of certain account balances and comparative figures of 2004 have been reclassified. In addition, the Company also reclassified for 2004 certain cash amounts to restricted cash.

## 36. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on March 20, 2006.