1. GENERAL

The Company is a public limited company incorporated in Hong Kong and its shares are listed on The Stock Exchange of Hong Kong Limited (the ''Stock Exchange'').

The Company's parent and ultimate holding company is Shijiazhuang Pharmaceutical Group Company Limited (''SPG''), a state-owned enterprise incorporated in the People's Republic of China (the ''PRC''). SPG, together with the companies under its control, other than the Company and its subsidiaries (collectively referred to as the ''Group''), will hereinafter be referred to as the ''SPG Group''. The addresses of the registered office and principal place of business of the Company are disclosed in the ''Corporate Information'' section to the annual report.

The Company acts as an investment holding company and its subsidiaries are principally engaged in the manufacture and sale of pharmaceutical products.

The financial statements are presented in Hong Kong dollars (''HKD''), which is the same as the functional currency of the Company.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (''HKFRS(s)''), Hong Kong Accounting Standards (''HKAS(s)'') and Interpretations (hereinafter collectively referred to as the ''new HKFRSs'') issued by the Hong Kong Institute of Certified Public Accountants that are effective for accounting periods beginning on or after January 1, 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, consolidated balance sheet and consolidated statement of changes in equity. In particular, the presentation of minority interests and share of tax of the jointly controlled entity have been changed. The changes in presentation have been applied retrospectively. The application of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current or prior accounting years are prepared and presented:

Business Combinations

In the current year, the Group has applied HKFRS 3 ''Business Combinations'' which is effective for business combinations for which the agreement date is on or after January 1, 2005 and goodwill previously recognised and brought forward as at January 1, 2005. The principal effects of the application of transitional provisions of HKFRS 3 to the Group are summarised below:

Goodwill

In previous years, goodwill arising on acquisitions prior to January 1, 2001 was held in goodwill reserve, and goodwill arising on acquisitions after January 1, 2001 was capitalised and amortised over its estimated useful life. The Group has applied the relevant transitional provisions in HKFRS 3. Goodwill previously recognised in goodwill reserve of HK$167,254,000 as at January 1, 2005 continues to be held in goodwill reserve and will be transferred to the retained profits of the Group at the time when the business to which the goodwill relates is disposed of or when a cash-generating unit (''CGU'') to which the goodwill relates becomes impaired. With respect to goodwill previously capitalised on the balance sheet, the Group on January 1, 2005 eliminated

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES – continued

Goodwill – continued

the carrying amount of the related accumulated amortisation of HK$7,897,000 with a corresponding decrease in the cost of goodwill (see note 21). The Group has discontinued amortising such goodwill from January 1, 2005 onwards and such goodwill will be tested for impairment at least annually. Goodwill arising on acquisitions after January 1, 2005 is measured at cost less accumulated impairment loss (if any) after initial recognition. As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current year. Comparative figures for 2004 have not been restated (see note 3 for financial impact).

In the current year, the Group has also applied HKAS 21 ''The Effects of Changes in Foreign Exchange Rates'' which requires goodwill to be treated as assets and liabilities of the foreign operation and translated at closing rate at each balance sheet date. Previously, goodwill arising on acquisitions of foreign operations was reported at the historical rate at each balance sheet date. In accordance with the relevant transitional provisions in HKAS 21, goodwill arising on acquisitions prior to January 1, 2005 is treated as a non-monetary foreign currency item. Therefore, no prior period adjustment has been made.

Owner-occupied Leasehold Interest in Land

In previous years, owner-occupied leasehold land and buildings were included in property, plant and equipment and measured using the cost model. In the current year, the Group has applied HKAS 17 ''Leases''. Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively (see note 3 for financial impact).

Share-based Payments

In the current year, the Group has applied HKFRS 2 ''Share-based Payment'' which requires an expense to be recognised where the Group buys goods or obtains services in exchange for shares or rights over shares (''equity-settled transactions''), or in exchange for other assets equivalent in value to a given number of shares or rights over shares (''cash-settled transactions''). The principal impact of HKFRS 2 on the Group is in relation to the expensing of the fair value of share options granted to directors and employees of the Company, determined at the date of grant of the share options, over the vesting period. Prior to the application of HKFRS 2, the Group did not recognise the financial effect of these share options until they were exercised. As no option has been granted or agreed to be granted under the Company's share option scheme since its adoption, the adoption of HKFRS 2 has had no effect on the results of the Group.

Financial Instruments

In the current year, the Group has applied HKAS 32 ''Financial Instruments: Disclosure and Presentation'' and HKAS 39 ''Financial Instruments: Recognition and Measurement''. HKAS 32 requires retrospective application and the adoption of HKAS 32 has had no material impact on how the financial instruments of the Group are presented for the current or prior accounting periods. HKAS 39, which is effective for annual periods beginning on or after January 1, 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS 39 are summarised below:

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES – continued

Financial Instruments – continued

From January 1, 2005 onwards, the Group has classified and measured its financial assets and financial liabilities in accordance with the requirements of HKAS 39. Financial assets under HKAS 39 are classified as ''financial assets at fair value through profit or loss'', ''available-for-sale financial assets'', ''loans and receivables'' or ''held-to-maturity financial assets''. Financial liabilities are generally classified as ''financial liabilities at fair value through profit or loss'' or ''other financial liabilities''. Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in profit or loss directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

Prior to the application of HKAS 39, an interest-free non-current loan from ultimate holding company was stated at the nominal amount. HKAS 39 requires all financial assets and financial liabilities to be measured at fair value on initial recognition. Such interest-free loan is measured at amortised cost determined using the effective interest method at subsequent balance sheet dates. The Group has applied the relevant transitional provisions in HKAS 39. As a result of this change in the accounting policy, the carrying amount of the loan as at January 1, 2005 has been decreased by HK$847,000 in order to state the loan at amortised cost in accordance with HKAS 39. The Group's retained profits as at January 1, 2005 has been decreased by HK$515,000. Capital contribution as at January 1, 2005 has been increased by HK$1,362,000, which represents the deemed contribution from ultimate holding company made on the recognition of the loan. Profit for the year has been decreased by HK$278,000 due to the recognition of imputed interest expense (see note 3 for financial impact).

Interest in a jointly controlled entity

In previous years, interests in jointly controlled entities were accounted for using the equity method. HKAS 31 ''Interests in Jointly Controlled Entities'' allows entities to use either proportionate consolidation or the equity method to account for its interests in jointly controlled entities. Upon the application of HKAS 31, the Group has elected to account for its interest in a jointly controlled entity using the equity method as used in previous years and the adoption of the standard has had no effect on the Group.

3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described in note 2 on the results are as follows:

	Effect of adopting	**2005**	2004
		HK$'000	*HK$'000*
Non-amortisation of goodwill (included in administrative expenses)	HKFRS 3	**3,183**	–
Imputed interest expense on non-current interest-free loan from ultimate holding company (included in finance costs)	HKAS 39	**(278)**	–
Share of results of a jointly controlled entity	HKAS 1	**–**	(589)
Income tax	HKAS 1	**–**	589
Increase in profit for the year		**2,905**	–

3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES – continued

The cumulative effects of the changes in accounting policies on December 31, 2004 and January 1, 2005 are summarised below:

	At December 31, 2004 (Originally stated)	HKAS 1 and HKAS 27 Adjustment	HKAS 17 Adjustment	At December 31, 2004 (Restated)	HKAS 39 Adjustments	At January 1, 2005 (Restated)
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Balance sheet items affected:						
Property, plant and equipment	3,012,604	–	(104,287)	2,908,317	–	2,908,317
Prepaid lease payments	–	–	104,287	104,287	–	104,287
Interest-free portion of loan from ultimate holding company	(8,045)	–	–	(8,045)	847	(7,198)
Total effects on assets and liabilities	3,004,559	–	–	3,004,559	847	3,005,406
Retained profits	(876,728)	–	–	(876,728)	515	(876,213)
Capital contribution	–	–	–	–	(1,362)	(1,362)
Minority interests	–	(10,058)	–	(10,058)	–	(10,058)
Total effects on equity	(876,728)	(10,058)	–	(886,786)	(847)	(887,633)
Minority interests	(10,058)	10,058	–	–	–	–

As a result of the application of HKAS 1 ''Presentation of Financial Statements'' and HKAS 27 ''Consolidated and Separate Financial Statements'', minority interests amounting to HK$8,272,000 as at January 1, 2004 is presented within equity.

4. POTENTIAL IMPACT ARISING ON THE NEW ACCOUNTING STANDARDS NOT YET EFFECTIVE

The Group has not early applied the following new standards and interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these standards or interpretations will have no material impact on the financial statements of the Group.

HKAS 1 (Amendment)	Capital disclosures [1]
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures [2]
HKAS 21 (Amendment)	The effects of changes in foreign exchanges rates – Net investment in a foreign operation [2]
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions [2]
HKAS 39 (Amendment)	The fair value option [2]
HKAS 39 & HKFRS 4 (Amendments)	Financial guarantee contracts [2]
HKFRS 6	Exploration for and evaluation of mineral resources [2]
HKFRS 7	Financial instruments: Disclosures [1]
HK(IFRIC) – INT 4	Determining whether an arrangement contains a lease [2]

4. POTENTIAL IMPACT ARISING ON THE NEW ACCOUNTING STANDARDS NOT YET EFFECTIVE – continued

HK(IFRIC) – INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds [2]
HK(IFRIC) – INT 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment [3]
HK(IFRIC) – INT 7	Applying the restatement approach under HKAS 29 ''Financial Reporting in Hyperinflationary Economies'' [4]

[1] Effective for annual periods beginning on or after January 1, 2007.
[2] Effective for annual periods beginning on or after January 1, 2006.
[3] Effective for annual periods beginning on or after December 1, 2005.
[4] Effective for annual periods beginning on or after March 1, 2006.

5. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with HKFRSs. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange (the ''Listing Rules'') and by the Companies Ordinance.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Goodwill

Goodwill represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

5. SIGNIFICANT ACCOUNTING POLICIES – continued

Goodwill – continued

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant CGUs, or groups of CGUs, that are expected to benefit from the synergies of the acquisition. A CGU to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the CGU to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the CGU is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of a subsidiary, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment losses.

Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

(i) Financial assets

The Group's financial assets are classified into loans and receivables. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of the relevant category of financial assets to the Group are set out below.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including loan receivable, trade and other receivables, bills receivable, trade receivables due from related companies, amount due from a jointly controlled entity and bank balances) are carried

5. SIGNIFICANT ACCOUNTING POLICIES – continued

Financial instruments – continued

(i) Financial assets – continued

Loans and receivables – continued

at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

(ii) Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments relevant to the Group are set out below.

Financial liabilities

Financial liabilities including trade and other payables, bills payable, amounts due to related companies, trade payable due to a jointly controlled entity, bank loans and loans from ultimate holding company are subsequently measured at amortised cost, using the effective interest rate method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Property, plant and equipment

Property, plant and equipment, other than construction in progress, are stated at cost less subsequent accumulated depreciation and accumulated impairment loss.

Construction in progress is stated at cost which includes all development expenditure and other direct costs attributable to such projects including borrowing costs capitalised in accordance with the Group's accounting policy. Construction in progress is not depreciated until completion of construction and the asset is put into use. The cost of completed construction works is transferred to the appropriate category of assets.

Depreciation is provided to write off the cost of items of property, plant and equipment, other than construction in progress, over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method.

5. SIGNIFICANT ACCOUNTING POLICIES – continued

Property, plant and equipment – continued

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognised.

Jointly controlled entity

Joint venture arrangement that involves the establishment of a separate entity in which venturers have joint control over the economic activity of the entity is referred to as a jointly controlled entity.

The results and assets and liabilities of the jointly controlled entity are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investment in a jointly controlled entity is carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the jointly controlled entity, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity, the Group discontinues recognising its share of further losses.

When a group entity transacts with a jointly controlled entity of the Group, unrealised profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealised losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognised.

Intangible assets

On initial recognition, intangible assets acquired are recognised at cost. After initial recognition, intangible assets with finite useful lives are carried at costs less accumulated amortisation and any accumulated impairment loss. Amortisation for intangible assets with finite useful lives is provided on a straight-line basis over their estimated useful lives.

Gains or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its useful life, and carried at cost less subsequent accumulated amortisation and any accumulated impairment loss.

Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

5. SIGNIFICANT ACCOUNTING POLICIES – continued

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

Impairment losses, other than goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

5. SIGNIFICANT ACCOUNTING POLICIES – continued

Share-based payment transactions

Equity-settled share-based payment transactions

Share options granted to employees of the Company and its subsidiaries

The fair value of services received determined by reference to the fair value of share options granted at the grant date is expensed on a straight-line basis over the vesting period, with a corresponding increase in equity (the ''share option reserve'').

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited or are still not exercised at the expiry date, the amount previously recognised in share option reserve will be transferred to retained profits.

Share options granted to consultants

Share options issued in exchange for services are measured at the fair values of the services received. The fair values of the services received are recognised as expenses immediately, unless the services qualify for recognition as assets. Corresponding adjustment will be made to the share option reserve.

Revenue recognition

Revenue represents the fair value of the amounts received and receivable for goods sold and services rendered by the Group to outside customers, and is stated net of value-added tax and sales returns.

Sales of goods are recognised when goods are delivered and title has passed.

Service income is recognised when services are rendered.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (''foreign currencies'') are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.