

1. BASIS OF PRESENTATION

Pursuant to the reorganisation of the People's Insurance Company of China (the "Reorganisation"), which took effect as of 30 September 2002, the Company was incorporated on 7 July 2003 as a joint stock company with limited liability in the People's Republic of China (the "PRC"). Further details of the Reorganisation are set out in the Company's prospectus dated 27 October 2003 issued in respect of the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "HKSE").

The prior period comparative figures included in these financial statements are prepared for the period from 7 July 2003 (date of incorporation) to 31 December 2003. Consequently, the comparative amounts for the profit and loss account, the statement of changes in equity, the cash flow statement and related notes are not comparable with those of the current fiscal twelve month period. The prior year pro forma comparative figures included in these financial statements are prepared as if the Company had been in existence throughout the year ended 31 December 2003 and as if the Reorganisation was effective prior to the earliest date presented therein.

2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Company has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. Certain of these new HKFRSs, in particular, HKFRS 2 "Share-based Payment", HKFRS 4 "Insurance Contracts", HKAS32 "Financial Instruments: Disclosure and Presentation" and HKAS 39 "Financial Instruments: Recognition and Measurement" may have a significant impact on the results of operations, financial positions or disclosures in the financial statements in the future.

3. CORPORATE INFORMATION

The registered office of the Company is located at 69 Dongheyanjie, Xuanwumen, Beijing 100052, the PRC.

The Company is a provider of commercial insurance coverage in the PRC, and provides a wide range of property and casualty ("P&C") insurance consisting of property loss and damage insurance, liability insurance, credit and guarantee insurance, accidental injury insurance, short term health insurance and other P&C insurance as well as related reinsurance.

In the opinion of the directors, the ultimate holding Company is PICC Holding Company, which is incorporated in the PRC.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic remeasurement of trading and non-trading investments in securities as further explained below.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Company and when the revenue can be measured reliably, on the following basis:

- (a) premium income, at the inception of risk resulting from a policy being written;
- (b) rental income, on a time proportion basis over the lease terms;
- (c) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and
- (d) dividend income, when the shareholders' right to receive payment has been established.

Reinsurance

Assets and liabilities related to reinsurance contracts are reported on a gross basis unless a right of offset exists. Reinsurance premiums ceded and reinsurance recoveries on loss incurred are deducted from the respective revenue and expense accounts. Unearned premium reserves – reinsurers' share represents the ceded portion of unearned premium reserves. Payable to reinsurers includes ceded premiums retained by the Company to fund ceded losses as they become due pursuant to reinsurance agreements. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured risks. Accordingly, revenues and expenses related to reinsurance agreements are recognised consistently with the underlying risk of the business reinsured.

Unearned premium reserves

Unearned premium reserves are recognised to cover the unexpired portion of the premiums written. Premiums are earned on a time-apportioned basis over the terms of the related insurance contracts.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loss and loss adjustment expense reserves

The loss and loss adjustment expense reserves are for future payment obligations under insurance loss.

The loss and loss adjustment expense reserves are recorded on an undiscounted basis and comprise estimated provisions for losses reported at the balance sheet date, losses incurred but not yet reported at the balance sheet date, and loss adjustment expenses that can be directly attributable to individual claims.

The loss and loss adjustment reserves are calculated at the realistically estimated amount considered necessary to settle the loss in full less a deduction for the estimated value of salvage and other recoveries, using recognised actuarial methods. Past experience is taken into account as well as current and future expected social and economic factors.

Changes in estimates of the loss and loss adjustment expense reserves are recognised in the profit and loss account in the period in which the estimates are changed. The directors believe that the loss and loss adjustment expense reserves at the balance sheet date are adequate to cover the ultimate cost of all incurred losses and direct loss adjustment expenses to that date, but the reserves are necessarily based on estimates and no representation is made that the ultimate liability may not exceed or be less than such estimates.

Net claims incurred

Net claims incurred represents the actual amount of claims paid and payable plus claims handling expenses, net of claims recovered from reinsurance, and adjusted by changes in net loss and loss adjustment expenses reserves and net provision for premium deficiency.

Provision for premium deficiency

A provision for premium deficiency is recognised if the sum of expected losses and loss adjustment expenses, unamortised deferred acquisition costs and maintenance costs exceeds related unearned premium reserves. The premium deficiency is first recognised by writing off deferred acquisition costs to the extent required to eliminate the deficiency. If the premium deficiency is greater than the unamortised deferred acquisition costs, a provision is made for the excess deficiency. The amount of provision is made for each class of business individually.

Deferred acquisition costs

Policy acquisition costs which vary with and are primarily related to the production of new and renewal business (consisting principally of commission expenses and underwriting personnel expenses), net of reinsurance commissions, are deferred and amortised on a time-apportioned basis over the terms of the related insurance policies. Deferred acquisition costs are limited to the excess of unearned premium reserves over the sum of expected claim expenses, related claim adjustment expenses and policy maintenance expenses.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Company is the lessor, assets leased by the Company under operating leases are included in fixed assets and rentals receivable under the operating leases are credited to the profit and loss account on a straight-line basis over the lease terms. Where the Company is the lessee, rentals payable under the operating leases are charged to the profit and loss account on a straight-line basis over the lease terms.

Employee benefits

The Company's contributions to the defined contribution plans administered by the PRC government are recognised as an expense in the profit and loss account as incurred.

Share appreciation rights are recognised in the profit and loss account when they are exercised.

Related parties

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. Related parties may be individuals or corporate entities.

Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the profit and loss account, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences and the carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised, except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income tax (continued)

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 profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date and interpretations and practices in respect thereof.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim or special dividends are simultaneously proposed and declared. Consequently, interim or special dividends are recognised immediately as a liability when they are proposed and declared.

Profit appropriation

Under the PRC Company Law and the Company's articles of association, net profit after tax, as determined in accordance with PRC accounting standards and regulations ("PRC GAAP"), can only be distributed as dividends after making up prior years' cumulative losses, if any, and making allowance for the following statutory reserve funds, which cannot be used for purposes other than those for which they are created and are not distributable as cash dividends:

(a) *Statutory surplus reserve*

In accordance with the PRC Company Law and the Company's articles of association, the Company is required to appropriate 10% of the annual statutory net profit after tax (after offsetting any prior years' losses), determined in accordance with PRC GAAP, to the statutory surplus reserve. When the balance of such reserve fund reaches 50% of the capital, any further appropriation is optional. The statutory surplus reserve can be utilised to offset prior years' losses or to increase capital. However, such balance of the statutory surplus reserve must be maintained at a minimum of 25% of the capital after any such usage.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Profit appropriation (continued)

(b) Statutory public welfare fund

In accordance with the PRC Company Law and the Company's articles of association, the Company is required to appropriate 5% to 10% of the annual statutory net profit after tax (after offsetting any prior years' losses), determined in accordance with PRC GAAP, to the statutory public welfare fund, which will be utilised to build or acquire capital items, such as dormitories and other facilities for the employees of the Company, and cannot be used to settle staff welfare expenses.

In accordance with the PRC relevant regulations and the Company's articles of association, the retained profits of the Company for the purpose of profit distribution are deemed to be the lower of the amount determined in accordance with PRC GAAP, and the amount determined in accordance with generally accepted accounting principles in Hong Kong.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired.

Foreign currencies

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

Trading securities

Trading securities are investments in securities held for trading purposes and are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security are credited or charged to the profit and loss account in the period in which they arise.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Non-trading securities

Non-trading securities are investments in listed and unlisted securities intended to be held on a long term basis.

Listed securities are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. Unlisted securities are stated at their estimated fair values, on an individual basis. The estimated fair values of unlisted investments are determined by the directors having regard to, inter alia, the prices of the most recent reported sales or purchases of the securities, or comparison of price/earnings ratios and dividend and interest yields of the securities with those of similar listed securities, with allowance made for the lower liquidity of the unlisted securities.

The gains or losses arising from changes in the fair value of a security are dealt with as movements in the non-trading investment securities revaluation reserve, until the security is sold, collected, or otherwise disposed of, or until the security is determined to be impaired, when the cumulative gain or loss derived from the security recognised in the non-trading investment securities revaluation reserve, together with the amount of any further impairment, is charged to the profit and loss account in the period in which the impairment arises.

Securities purchased under purchase and resale agreements are recorded at their cost. The difference between the purchase cost and the reselling price is credited as interest income over the period from the date of purchase to the date of resale using the effective interest method.

Securities sold under sale and repurchase agreements in which the Company maintains effective control of the securities are accounted for as secured borrowings. Such securities are maintained on the balance sheet with the proceeds of the sale included in other liabilities and accruals. The difference between the selling price and the repurchase price is amortised as interest expense over the period from the date of sale to the date of repurchase using the effective interest method.

Held-to-maturity securities

Held-to-maturity securities are investments in dated debt securities which the Company has the expressed intention and ability to hold to maturity, and are stated at amortised costs less any impairment losses which reflect their credit risk. Amortised cost is cost plus or minus the cumulative amortisation of the difference between the purchase price and the maturity amount. An impairment loss is charged to the investment and profit and loss account in the period in which it arises, on an individual investment basis. In situations where the circumstances and events which led to an impairment of a held-to-maturity security cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future, the reversal of the impairment is credited to the profit and loss account, on an individual investment basis, to the extent of the amount previously charged.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**Premiums receivable and agents' balances**

Premiums receivable and agents' balances represent amounts due from policyholders and agents and are stated at cost less allowance for doubtful accounts. An allowance for doubtful accounts is provided based on an evaluation of the recoverability of these accounts at the balance sheet date.

Fixed assets, construction in progress and depreciation

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of a fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on a straight-line basis after taking into account the estimated residual value, to write off the cost of each asset over its estimated useful life, as follows:

Land and buildings	30 – 70 years
Motor vehicles	4 – 9 years
Office equipment, furniture and fixtures	3 – 14 years

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents a building under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

Impairment of assets

Internal and external sources of information are reviewed at each balance sheet date to determine whether fixed assets, construction in progress and investments in securities are impaired or an impairment loss previously recognised no longer exists or has decreased. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised as a charge to the profit and loss account when the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e., a cash-generating unit).

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of assets (continued)

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. A reversal of impairment losses is recognised as a credit to the profit and loss account.

Policyholders' deposits

Policyholders' deposits represent deposits received from policyholders which are refundable under maturity refund type commercial insurance policies. Interest credited to these deposits is recognised as an expense in the profit and loss account.

Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made.

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

Subordinated loan

Subordinated loan is included in the balance sheet at the value of the net proceeds received upon issue, adjusted for the amortisation of any premium or discount arising on issue.

Interest on subordinated loan is charged to the profit and loss account at the coupon rate adjusted for the amortisation of any premium or discount arising on issue, so as to achieve a constant rate of charge over the period from the date of issue to the date of redemption.

When subordinated loan issued is settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the profit and loss account.

31 December 2004

5. SEGMENT INFORMATION

Line of business segments have been presented as the Company's primary segment reporting basis. No analysis of the Company's turnover and contribution to profit from operations by geographical segment has been prepared as all the Company's operating activities are carried out in the PRC.

Summary details of the business segments are as follows:

- (a) the motor vehicle segment provides insurance products covering motor vehicles;
- (b) the commercial property segment provides insurance products covering commercial properties;
- (c) the homeowners segment provides insurance products covering homes and their contents;
- (d) the cargo segment provides insurance products covering vessels, crafts or conveyances;
- (e) the liability segment provides insurance products covering policyholders' liability;
- (f) the accidental injury segment provides insurance products covering accidental injury; and
- (g) the "other" segment mainly represents insurance products related to marine hull, aviation and oil and gas.

Information on the Company's reportable business segments is as follows:

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Turnover			
Motor vehicle	42,898	15,466	35,294
Commercial property	7,987	2,789	8,090
Homeowners	1,257	670	1,425
Cargo	2,724	1,072	2,657
Liability	2,051	967	2,406
Accidental injury	1,890	871	1,745
Other	3,196	1,808	3,351
	62,003	23,643	54,968
Net premiums earned			
Motor vehicle	35,802	13,525	26,930
Commercial property	6,402	2,915	6,437
Homeowners	452	429	1,045
Cargo	2,940	1,106	2,314
Liability	1,850	977	2,116
Accidental injury	1,688	464	514
Other	1,494	507	1,053
	50,628	19,923	40,409
Interest and dividend income, net			
Homeowners	179	(73)	26
Net gains/(losses) on trading and non-trading securities			
Homeowners	(95)	6	64

5. SEGMENT INFORMATION (CONTINUED)

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Net claims incurred			
Motor vehicle	(30,713)	(10,641)	(21,618)
Commercial property	(3,981)	(1,639)	(3,285)
Homeowners	(236)	(158)	(340)
Cargo	(985)	(520)	(1,107)
Liability	(1,080)	(591)	(1,401)
Accidental injury	(923)	(299)	(338)
Other	(987)	(596)	(974)
	(38,905)	(14,444)	(29,063)
Amortisation of deferred acquisition costs			
Motor vehicle	(2,691)	(1,140)	(2,053)
Commercial property	(262)	(64)	(125)
Homeowners	(29)	(56)	(134)
Cargo	(227)	(84)	(147)
Liability	(111)	(81)	(124)
Accidental injury	(65)	(76)	(80)
Other	(175)	74	184
	(3,560)	(1,427)	(2,479)
Insurance protection expense			
Motor vehicle	(409)	(150)	(323)
Commercial property	(66)	(17)	(59)
Homeowners	(12)	(10)	(17)
Cargo	(25)	(9)	(22)
Liability	(18)	(8)	(20)
Accidental injury	(16)	(12)	(19)
Other	(17)	2	(8)
	(563)	(204)	(468)
Interest expense credited to policyholders' deposits			
Homeowners	(144)	(65)	(123)
Segment profit before unallocated income and expenses			
Motor vehicle	1,989	1,594	2,936
Commercial property	2,093	1,195	2,968
Homeowners	115	73	521
Cargo	1,703	493	1,038
Liability	641	297	571
Accidental injury	684	77	77
Other	315	(13)	255
	7,540	3,716	8,366

31 December 2004

5. SEGMENT INFORMATION (CONTINUED)

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Unallocated operating income and expenses			
Interest and dividend income, net	1,073	462	664
Net gains/(losses) on trading and non-trading securities	(853)	24	196
General and administrative expenses	(7,135)	(3,837)	(6,903)
Finance costs	(120)	(23)	(35)
	(7,035)	(3,374)	(6,078)
Profit before tax	505	342	2,288
Tax	(297)	(235)	(837)
Net profit attributable to shareholders	208	107	1,451

Interest and dividend income and net gains/(losses) on trading and non-trading securities attributed to the homeowners insurance product (see note 29), which can be separately identified based on the results of its designated pool of investments, are separately disclosed. The remaining amounts that are not attributed to particular insurance products are not allocated and are included under unallocated operating income and expenses.

5. SEGMENT INFORMATION (CONTINUED)

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Segment assets		
Motor vehicle	7,122	6,764
Commercial property	3,547	3,567
Homeowners	4,921	3,712
Cargo	412	564
Liability	437	572
Accidental injury	419	253
Other	3,416	4,338
	20,274	19,770
Unallocated assets	67,988	64,802
Total assets	88,262	84,572
Segment liabilities		
Motor vehicle	36,048	30,622
Commercial property	6,391	9,688
Homeowners	11,861	8,789
Cargo	1,246	1,972
Liability	1,640	2,022
Accidental injury	1,657	1,335
Other	4,429	6,792
	63,272	61,220
Unallocated liabilities	6,472	4,595
Total liabilities	69,744	65,815

Assets that are used by more than one segment have not been allocated as their related expenses cannot be separately identified and allocated to particular insurance products. They are included under unallocated assets.

31 December 2004

6. TURNOVER AND REVENUE

Turnover represents direct premiums written and reinsurance premiums assumed, net of government levies and surcharges.

An analysis of turnover, interest and dividend income and net gains/(losses) on trading and non-trading securities is as follows:

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Turnover			
Direct premiums written	65,577	24,969	58,074
Reinsurance premiums assumed	6	7	11
	65,583	24,976	58,085
Less: Government levies and surcharges	(3,580)	(1,333)	(3,117)
	62,003	23,643	54,968
Net premiums earned			
Turnover	62,003	23,643	54,968
Less: Reinsurance premiums ceded	(9,283)	(5,289)	(11,116)
Net premiums written	52,720	18,354	43,852
Less: Changes in net unearned premium reserves	(2,092)	1,569	(3,443)
Net premiums earned	50,628	19,923	40,409
Interest and dividend income, net			
Interest income from trading and non-trading securities	436	35	164
Interest income from deposits with banks and other financial institutions	504	332	474
Interest income from held-to-maturity securities	68	–	–
Dividend income from trading and non-trading securities	244	22	52
	1,252	389	690
Net gains/(losses) on trading and non-trading securities			
Realised gains/(losses) on trading securities – Mutual funds	(12)	3	11
Realised gains/(losses) on trading securities – Debt	(14)	(4)	3
Unrealised gains/(losses) on trading securities – Mutual funds	(745)	22	192
Unrealised gains/(losses) on trading securities – Debt	(67)	(17)	10
Net gains/(losses) on disposals of non-trading securities:			
Realisation of revaluation reserve previously recognised	(5)	(5)	–
Recognised gains arising in the year/period	62	31	44
Impairment loss on trading and non-trading securities	(167)	–	–
	(948)	30	260

7. NET CLAIMS INCURRED

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Gross claims expenses	42,257	17,295	35,114
Less: Loss recovered from reinsurance	(6,994)	(4,067)	(7,444)
Net claims expenses	35,263	13,228	27,670
Add: Change in net loss and loss adjustment expense reserves (<i>note 28</i>)	3,642	1,217	1,395
Add: Change in net provision for premium deficiency	–	(1)	(2)
Net claims incurred	38,905	14,444	29,063

8. GENERAL AND ADMINISTRATIVE EXPENSES

The Company's operating profit is arrived at after charging:

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Personnel expenses	1,422	515	921
Depreciation	1,348	680	1,560
Office expenses	1,943	806	1,516
Provision for doubtful accounts	81	63	66
Repairs and maintenance	293	141	259
Impairment loss on construction in progress	6	21	21
Net loss on disposals of fixed assets	17	6	7
Minimum lease payments under operating leases – land and buildings	293	172	221
Auditors' remuneration	13	9	9
Others	1,719	1,424	2,323
	7,135	3,837	6,903

31 December 2004

8. GENERAL AND ADMINISTRATIVE EXPENSES (CONTINUED)

Total personnel expenses of the Company for the year/period are as follows:

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Included in net claims incurred	966	310	794
Included in deferred acquisition costs	2,022	604	1,538
Included in general and administrative expenses	1,422	515	921
Total personnel expenses	4,410	1,429	3,253

9. FINANCE COSTS

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Interest on bank loans wholly repayable within five years	–	14	25
Interest on subordinated loan (<i>note 35</i>)	105	9	9
Other finance costs	15	–	1
	120	23	35

10. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year/period, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	2004 <i>RMB'000</i>	7 July to 31 December 2003 <i>RMB'000</i>	Pro forma 2003 <i>RMB'000</i>
Fees	1,838	1,739	1,739
Other emoluments:			
Salaries, allowances and benefits in kind	2,394	1,215	1,638
Performance related bonuses	4,175	2,111	2,969
Pension scheme contributions	98	41	99
	8,505	5,106	6,445

10. DIRECTORS' AND SUPERVISORS' REMUNERATION (CONTINUED)

The number of directors and supervisors whose remuneration fell within the following bands is as follows:

	2004	7 July to 31 December 2003	Pro forma 2003
Nil to HK\$1,000,000 (equivalent to approximately RMB1,065,700)	12	14	14
HK\$1,000,000 to HK\$1,500,000 (equivalent to approximately RMB1,065,700 to RMB1,598,500)	3	–	–
	15	14	14

There was no arrangement under which a director or a supervisor waived or agreed to waive any remuneration during 2004 and 2003.

Fees include approximately RMB637,740 (2003: RMB639,000) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during 2004 (2003: Nil).

On 22 July 2004, the Company granted 8.31 million units of share appreciation rights to 11 directors and supervisors at an exercise price of HK\$1.8 each under the share appreciation rights scheme (*note 15*).

11. FIVE HIGHEST PAID EMPLOYEES

All of the five (2003: three) highest paid employees during the year are directors and supervisors of the Company, details of whose remuneration are set out in note 10 above. Details of the remuneration of the remaining two highest paid employees in the prior year are as follows:

	2004 <i>RMB'000</i>	7 July to 31 December 2003 <i>RMB'000</i>	Pro forma 2003 <i>RMB'000</i>
Salaries, allowances and benefits in kind	–	331	470
Performance related bonuses	–	559	861
Pension scheme contributions	–	12	18
	–	902	1,349

31 December 2004

11. FIVE HIGHEST PAID EMPLOYEES (CONTINUED)

The remaining two highest paid employees whose remuneration fell within the following bands in the prior year are as follows:

	2004	Number of employees 7 July to 31 December 2003	Pro forma 2003
Nil to HK\$1,000,000 (equivalent to approximately RMB1,065,700)	–	2	2

There was no arrangement under which any of these highest paid employees waived or agreed to waive any remuneration during 2004 and 2003.

12. TAX

	2004 RMB million	7 July to 31 December 2003 RMB million	Pro forma 2003 RMB million
Current – PRC			
Charge for the year/period	379	323	367
Deferred (note 33)	(82)	(88)	470
Total tax charge for the year/period	297	235	837

A reconciliation of the tax expense applicable to profit before tax using the statutory rate for the PRC, in which the Company is domiciled, to the tax expense at the effective tax rate is as follows:

	2004		7 July to 31 December 2003		Pro forma 2003	
	RMB million	%	RMB million	%	RMB million	%
Profit before tax	505		342		2,288	
Tax at the statutory tax rate of 33% (note (i))	167	33.0	113	33.0	755	33.0
Income not subject to tax (note (ii))	(144)	(28.5)	(13)	(3.8)	(59)	(2.6)
Expenses not deductible for tax (note (iii))	274	54.3	135	39.5	141	6.2
Tax charge for the year/period	297	58.8	235	68.7	837	36.6

Notes:

- (i) The provision for PRC income tax is calculated based on the statutory rate of 33% in accordance with the relevant PRC income tax rules and regulations for all periods presented.
- (ii) This primarily comprises interest income from government bonds and distributions from open-ended mutual funds which are not subject to PRC income tax.
- (iii) This primarily represents expenses in excess of statutory deductible amounts which are not tax deductible.

13. DIVIDEND

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Special	—	650	650

Pursuant to the Reorganisation and the “Provisional Regulation Relating to Corporate Reorganisation of Enterprises and Related Management of State-owned Capital and Financial Treatment,” which was issued by the PRC Ministry of Finance and became effective on 27 August 2002, the Company agreed to distribute special dividends equivalent to the net profit arising from the commercial insurance business injected into the Company pursuant to the Reorganisation for the period from 1 October 2002 (being the first day after the effective date of the Reorganisation) to 6 July 2003 (being the day immediately prior to the date of its incorporation) determined in accordance with PRC GAAP in two installments as follows:

- The Company distributed RMB5.4 million on 28 October 2003 in cash, representing the net profit under PRC GAAP for the three-month period ended 31 December 2002, to PICC Holding Company; and
- During the year, the Company distributed RMB644 million in cash to PICC Holding Company, representing the net profit for the period from 1 January 2003 to 6 July 2003 calculated as 187/365 of the net profit for 2003 under PRC GAAP.

The board of directors did not recommend the payment of a dividend for the year ended 31 December 2004 (2003: Nil).

31 December 2004

14. EARNINGS PER SHARE

The calculations of basic earnings per share for the year ended 31 December 2004, the period from 7 July to 31 December 2003 and the year ended 31 December 2003, are based on:

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
Earnings			
Net profit attributable to shareholders used in the basic earnings per share calculation	208	107	1,451
Number of shares			
	2004 <i>million</i>	7 July to 31 December 2003 <i>million</i>	Pro forma 2003 <i>million</i>
Weighted average number of ordinary shares used in the basic earnings per share calculation	11,142	9,000	8,482

The weighted average number of ordinary shares in issue used for the year ended 31 December 2003 have taken into account the issue of 8,000 million ordinary shares upon the incorporation of the Company, as if such shares had been outstanding since 1 January 2003. The Company had no dilutive potential shares outstanding from 1 January 2003.

15. EMPLOYEE BENEFITS**Retirement benefits**

As stipulated by the labour regulations of the PRC, the Company participates in various defined contribution retirement plans organised by provincial and municipal governments for its employees. The Company is required to make contributions to the retirement plans at rates ranging from 13% to 39.5% of the aggregate amount of salaries, bonuses and certain allowances payable to its employees. Under the plans, the Company's employees are entitled to a pension equal to a fixed proportion of the salary prevailing at his or her retirement date. The Company has no other material obligation for the payment of its employees' retirement and other post-retirement benefits other than the contributions described above. The Company's contributions for the year ended 31 December 2004, the period from 7 July to 31 December 2003, and the year ended 31 December 2003 were RMB440 million, RMB191 million and RMB362 million, respectively.

15. EMPLOYEE BENEFITS (CONTINUED)

Share appreciation rights

The shareholders of the Company approved the adoption of a scheme of share appreciation rights for senior management on 30 July 2003. The scheme is designed to link the interest of the Company's senior management with the Company's results of operations and the Company's share value (market price of its H Shares). The Board of Directors of the Company is responsible for making decisions under the scheme and administering the scheme. No shares will be issued under the scheme. Therefore, the shareholdings of shareholders will not be diluted as a result of the issuance of share appreciation rights.

Under the share appreciation rights scheme, members of the Board of Directors (excluding independent non-executive directors) and the Supervisory Committee, president, vice presidents, chief financial officer, division managers of the Company, presidents of provincial/municipal level branch offices, employees with special contribution to the Company as determined by the Company's Nomination, Remuneration and Review Committee, and other senior management at equivalent levels are eligible to receive share appreciation rights.

Share appreciation rights will be granted in units with each unit representing one H Share. Share appreciation rights granted in aggregate may not exceed 10% of the issued share capital from time to time, and share appreciation rights granted to any individual may not exceed 1% of the issued share capital in any 12-month period. The number of share appreciation rights units granted to a person may also be adjusted in accordance with the result of his or her performance evaluation.

Under the share appreciation rights scheme, all share appreciation rights are valid for five years, but are not exercisable in the first year after the date of grant. As of each of the second, third, fourth and fifth anniversary of the date of grant, the total number of units of share appreciation rights exercised may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total number of units of share appreciation rights granted to such person. Thereafter, share appreciation rights which have not been exercised will lapse. If a grantee deceases or becomes severely disabled during the five-year period, his or her share appreciation rights will be fully vested immediately.

The exercise price of the share appreciation rights initially granted was equal to the offer price of the initial public offering of the company. The exercise price of the share appreciation rights subsequently granted is equal to the higher of (i) the closing price of the H Shares on the date of grant and (ii) the average closing price of the H Shares on the five consecutive trading days before the date of grant. Upon exercise of the share appreciation rights, the person will receive cash payment, subject to any applicable withholding tax, equal to the product of the number of units of share appreciation rights exercised and the difference between the exercise price and market price of H Shares at the time of exercise.

On 22 July 2004, the Company granted 28,928,000 share appreciation rights to 76 senior management personnel at an exercise price of HK\$1.8 each under the share appreciation rights scheme. The estimated value of these share appreciation rights was RMB32 million as at the date of the grant. After the aforesaid share appreciation rights were granted, 300,000 Share appreciation rights were exercised as a result of the decease of a senior management person and RMB0.3 million was charged to the profit and loss account. Apart from this, no value in respect of the share appreciation rights granted during the year has been charged to the profit and loss account.

31 December 2004

16. CASH AND CASH EQUIVALENTS AND TERM DEPOSITS

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Demand deposits	14,942	11,529
Cash in hand	25	32
Securities purchased under resale agreements with original maturity of less than three months	50	3,327
Deposits with banks and other financial institutions with original maturity of less than three months	1,258	3,116
Cash and cash equivalents	16,275	18,004
Deposits with banks and other financial institutions with original maturity of more than three months	11,723	12,562
Total	27,998	30,566

At 31 December 2004, RMB1,099 million (2003: RMB522 million) was included in deposits with banks and other financial institutions as accrued insurance protection fund. The amount was maintained in accordance with relevant PRC insurance law and regulations for insurance protection and restricted in use. Details of the restrictions are disclosed in note 31 to the financial statements.

At 31 December 2004, included in deposits with banks and other financial institutions was a clearing account deposit of RMB57 million (2003: Nil) deposited with a PRC securities company, the details of which are set out in note 17 to the financial statements.

17. TRADING SECURITIES

	2004	2003
	<i>RMB million</i>	<i>RMB million</i>
Listed investments:		
Debt securities issued by the PRC central government, net (<i>note</i>)	583	1,813
Debt securities issued by corporate entities	117	66
Mutual funds	2,781	3,690
	3,481	5,569
Unlisted investments:		
Debt securities issued by the PRC central government	47	525
Debt securities issued by corporate entities	1,453	–
	1,500	525
Total	4,981	6,094

None of the above listed investments are listed in Hong Kong.

The maturity profile of trading debt securities analysed by the remaining period according to their contractual maturity date is as follows:

	2004	2003
	<i>RMB million</i>	<i>RMB million</i>
Less than 3 months but not on demand	1	199
Less than 1 year but more than 3 months	1,453	326
Less than 5 years but more than 1 year	687	1,813
More than 5 years	59	66
	2,200	2,404

31 December 2004

17. TRADING SECURITIES (CONTINUED)*Note:*

In September 2004, a PRC securities company engaged by the Company's investment manager, PICC Assets Management Company Limited ("PICC AMC", a fellow subsidiary of the Company), was placed under operational control by a special manager as instructed by the China Securities Regulatory Commission. As at 31 December 2004, the Company had an outstanding amount of RMB415 million deposited at this securities company, comprising trading and non-trading debt securities and their accrued interest amounting to RMB110 million and RMB248 million, respectively, and a clearing account deposit of RMB57 million.

As at 31 December 2004, certain debt securities of the Company were registered under the exchange trading seats of another PRC securities company. The total amounts of debt securities classified as trading and non-trading securities at 31 December 2004 were RMB546 million (2003: RMB967 million) and RMB53 million (2003: RMB102 million), respectively. During 2004, the Company and PICC AMC have instructed the securities company to either dispose of the debt securities, or to transfer the registration of the debt securities to the exchange trading seats of PICC AMC. The securities company has confirmed in writing to the Company that it would execute the said instructions and, as at the date of approving the Company's financial statements for the year ended 31 December 2004, debt securities totalling RMB16 million were disposed of by the securities company. The Company's management believe that the abovementioned debt securities will be fully recovered, and is continuously monitoring the progress of execution by the securities company.

The Company's management has assessed the expected net recoverable amount of the abovementioned debt securities and their accrued interest and necessary provisions have been made to cover any potential shortfall between the expected net recoverable amount and the carrying amount as at 31 December 2004.

18. NON-TRADING SECURITIES

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Listed investments:		
Debt securities issued by the PRC central government, net (<i>note 17</i>)	2,983	1,864
Debt securities issued by corporate entities	842	280
	3,825	2,144
Unlisted investments:		
Debt securities issued by the PRC central government	4,313	4,441
Debt securities issued by banks and other financial institutions	2,397	1,142
Debt securities issued by corporate entities	1,914	1,373
Mutual funds	2,787	1,665
	11,411	8,621
	15,236	10,765

18. NON-TRADING SECURITIES (CONTINUED)

None of the above listed investments are listed in Hong Kong.

The unlisted non-trading investments are traded on over-the-counter markets in the PRC.

The maturity profile of non-trading debt securities analysed by the remaining period according to their contractual maturity dates is as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Less than 1 year but more than 3 months	205	201
Less than 5 years but more than 1 year	5,317	3,696
More than 5 years	6,927	5,203
	12,449	9,100

19. HELD-TO-MATURITY SECURITIES

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Unlisted investments: Subordinated debt securities issued by banks and other financial institutions	2,910	–

The maturity profile of held-to-maturity debt securities analysed by the remaining period according to their contractual maturity dates is as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Less than 5 years but more than 1 year	1,220	–
More than 5 years	1,690	–
	2,910	–

31 December 2004

20. PREMIUMS RECEIVABLE AND AGENTS' BALANCES, NET

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Premiums receivable and agents' balances	2,633	2,095
Less: Allowance for doubtful accounts	(161)	(83)
	2,472	2,012

An aged analysis of the premiums receivable and agents' balances as at the balance sheet date, based on payment due date, and net of provisions, is as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Within 3 months	2,249	1,622
Over 3 months but less than 6 months	140	345
Over 6 months	83	45
	2,472	2,012

Movement in the allowance for doubtful accounts are as follows:

	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>	Pro forma 2003 <i>RMB million</i>
At beginning of the year/period	83	14	11
Provision for the year/period	78	69	72
At end of the year/period	161	83	83

21. RECEIVABLE FROM REINSURERS

An aged analysis of the receivable from reinsurers as at the balance sheet date is as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Within 3 months	755	536
Over 3 months but less than 6 months	80	70
Over 6 months	154	50
	989	656

21. RECEIVABLE FROM REINSURERS (CONTINUED)

As at 31 December 2004 and 2003, the amount of receivable from reinsurers net of reinsurance premiums ceded was current and in accordance with the terms of the relevant reinsurance contracts. None of the Company's reinsurance contracts contains any contractual provisions for the delay of any reimbursement of incurred losses to the Company. The Company did not receive any reinsurance adjustment commission and profit commission for the year ended 31 December 2004. Reinsurance adjustment commission and profit commission amounting to RMB318 million as at 31 December 2003 were included in the receivable from reinsurers. Such amounts were due from certain reinsurers when the underwriting year of account closed, which under the terms of the relevant reinsurance contracts was normally on a three-year basis.

22. PREPAYMENTS AND OTHER RECEIVABLE

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Amount due from provincial and municipal governments (<i>note (i)</i>)	1,210	1,210
Amount due from PICC Holding Company (<i>note (ii)</i>)	138	–
Amounts due from other third parties	27	151
Interest receivable	444	190
Prepayments and deposits	115	77
Others	581	439
	2,515	2,067

Notes:

- (i) During 1999, pursuant to the instruction from the State Council as part of the restructuring of the PRC insurance industry, the Company acquired the commercial insurance business of certain provincial and municipal governments. On the date of the acquisition, the net liabilities assumed amounted to RMB1,210 million, which mainly consisted of unearned premium reserves and loss and loss adjustment expense reserves, net of cash and cash equivalents.

PICC Holding Company has undertaken to the Company that the amount will be fully recovered by the Company. In July 2004, PICC Holding Company, which represents the Company in negotiating the settlement of the amount, received a notice from the Ministry of Finance approving the settlement of such amount by offsetting against the Company's accrued insurance protection fund. In addition, the China Insurance Regulatory Commission (the "CIRC") set out in its notice to PICC Holding Company that the Company is permitted to utilise the accumulated insurance protection fund, to the extent not exceeding the balance accumulated up to 30 June 2005, to offset the amount due from provincial and municipal governments. The Company is in the process of negotiating the settlement arrangement in detailed terms. It is anticipated that the amount will be fully recovered by 31 December 2005, and accordingly, no provision has been made against this amount as at 31 December 2004 (2003: Nil).

- (ii) The amount due from PICC Holding Company is unsecured, interest-free and repayable on demand.

31 December 2004

23. CAPITAL SECURITY FUND

In accordance with the PRC Insurance Law, the Company is required to maintain a deposit equivalent to 20% of its registered capital with banks designated by the CIRC as a security fund. The use of the security fund is subject to the approval of the CIRC.

24. FIXED ASSETS

	Land and buildings	Motor vehicles	Office equipment, furniture and fixtures	Total
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
Cost:				
At 1 January 2004	14,103	1,477	1,909	17,489
Additions	70	118	546	734
Transfers (<i>note 25</i>)	165	–	–	165
Disposals	(12)	(123)	(300)	(435)
At 31 December 2004	14,326	1,472	2,155	17,953
Accumulated depreciation:				
At 1 January 2004	(578)	(631)	(635)	(1,844)
Depreciation	(450)	(364)	(534)	(1,348)
Disposals	4	115	289	408
At 31 December 2004	(1,024)	(880)	(880)	(2,784)
Net book value:				
As 31 December 2004	13,302	592	1,275	15,169
As 31 December 2003	13,525	846	1,274	15,645

The land and buildings are all located in the PRC and are held under medium term leases.

24. FIXED ASSETS (CONTINUED)

The gross carrying amounts, accumulated depreciation and net book value of fixed assets which are leased out for rental income are as the follows:

2004	Cost <i>RMB million</i>	Accumulated depreciation <i>RMB million</i>	Net book value <i>RMB million</i>
Land and buildings	228	29	199

2003	Cost <i>RMB million</i>	Accumulated depreciation <i>RMB million</i>	Net book value <i>RMB million</i>
Land and buildings	228	23	205

As at 31 December 2004, the title certificates of certain newly acquired land and buildings with a net book value of RMB141 million (2003: RMB1,062 million) were in the process of obtaining title registration.

25. CONSTRUCTION IN PROGRESS

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
At beginning of the year	642	714
Additions	478	112
Transfers (<i>note 24</i>)	(165)	(163)
Impairment	(6)	(21)
At end of the year	949	642

The buildings under construction are all located in the PRC and are held under medium term leases.

31 December 2004

26. DEFERRED ACQUISITION COSTS

The movements in deferred acquisition costs during the year ended 31 December 2004, the period from 7 July 2003 to 31 December 2003 and for the year ended 31 December 2003 are as follows:

	Gross <i>RMB million</i>	Reinsurance <i>RMB million</i>	Net <i>RMB million</i>
At 1 January 2004	3,382	(2,098)	1,284
Deferred acquisition costs	7,338	(2,809)	4,529
Amortisation	(6,314)	2,754	(3,560)
At 31 December 2004	4,406	(2,153)	2,253
At 7 July 2003	3,219	(1,936)	1,283
Deferred acquisition costs	3,109	(1,681)	1,428
Amortisation	(2,946)	1,519	(1,427)
At 31 December 2003	3,382	(2,098)	1,284
Pro forma			
At 1 January 2003	3,091	(2,015)	1,076
Deferred acquisition costs	6,242	(3,555)	2,687
Amortisation	(5,951)	3,472	(2,479)
At 31 December 2003	3,382	(2,098)	1,284

27. UNEARNED PREMIUM RESERVES

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Gross unearned premium reserves	30,803	30,422
Less: Unearned premium reserves reinsurers' share	(4,319)	(6,030)
Net unearned premium reserves	26,484	24,392

Unearned premium reserves and loss and loss adjustment expense reserves (note 28) of the Company's commercial insurance business as at 31 December 2003 and 31 December 2004, respectively, were reviewed by a firm of independent internationally based consulting actuaries. Save for RMB3,102 million as at 31 December 2004 (2003: RMB1,985 million), all of the unearned premium reserves are expected to be realised within one year from the balance sheet date.

28. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

	Gross loss and loss adjustment expense reserves <i>RMB million</i>	Reinsurance recoverable on unpaid losses <i>RMB million</i>	Net loss and loss adjustment expense reserves <i>RMB million</i>
At 1 January 2004	17,956	(6,283)	11,673
Incurring loss and loss adjustment expenses:			
– Current year	43,365	(6,914)	36,451
– Prior year	2,208	246	2,454
Loss and loss adjustment expenses paid:			
– Current year	(26,296)	2,942	(23,354)
– Prior year	(15,961)	4,052	(11,909)
At 31 December 2004	21,272	(5,957)	15,315
At 7 July 2003	17,467	(7,011)	10,456
Incurring loss and loss adjustment expenses:			
– Current period	16,278	(2,406)	13,872
– Prior period	981	(924)	57
Loss and loss adjustment expenses paid:			
– Current period	(6,752)	1,552	(5,200)
– Prior period	(10,018)	2,506	(7,512)
At 31 December 2003	17,956	(6,283)	11,673
Pro forma			
At 1 January 2003	16,597	(6,319)	10,278
Incurring loss and loss adjustment expenses:			
– Current year	34,641	(7,015)	27,626
– Prior year	473	(429)	44
Loss and loss adjustment expenses paid:			
– Current year	(20,528)	3,910	(16,618)
– Prior year	(13,227)	3,570	(9,657)
At 31 December 2003	17,956	(6,283)	11,673

31 December 2004

28. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES (CONTINUED)

The Company establishes reserves for claims and claims expense on reported and unreported claims of insured losses. These reserve estimates are based on known facts and interpretations of circumstances and internal factors including the Company's experience with similar cases, historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims, loss management programs and product mix. In addition, the reserve estimates are influenced by external factors including law changes, changes to regulatory requirements, economic conditions, and public attitudes. The Company, in the normal course of business, may also supplement its claims processes by utilising third party adjusters, appraisers, engineers, inspectors, other professionals and information sources to assess and settle. The effects of inflation are implicitly considered in the reserving process.

Because reserves are estimates of losses that have occurred, including incurred but not reported losses, the establishment of appropriate reserve is an inherently uncertain and complex process. The ultimate cost of losses may vary materially from recorded amounts, which are based on management's best estimates. The Company regularly updates its reserve estimates as new information becomes available and as events unfold that may affect the resolution of unsettled claims.

Net claims incurred for the year ended 31 December 2004 increased by RMB2,454 million as a result of adverse development of reserves from prior years, primarily on motor insurance business, due to claim settlement patterns being slower than originally expected.

Save for RMB1,778 million as at 31 December 2004 (2003: RMB1,801 million), all of the loss and loss adjustment expense reserves are expected to be settled within one year.

29. POLICYHOLDERS' DEPOSITS

Policyholders' deposits consist of interest-bearing and non-interest-bearing deposits placed by policyholders. The remaining maturities of policyholders' deposits are analysed as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Due within 1 year	794	1,964
Due after 1 year but within 5 years	6,869	4,430
Due after 5 years or more	1,123	2,896
	7,992	7,326
	8,786	9,290

29. POLICYHOLDERS' DEPOSITS (CONTINUED)

Certain commercial insurance policies offered by the Company require that the policyholders place a deposit with the Company which is refundable upon maturity or termination and bears no interest. Policy terms range from one year to perpetuity. A policyholder can terminate the insurance policy before the maturity date without penalties. The main feature of this insurance product is that the insurance coverage is fixed at the inception of the policy and remains in effect during the policy period or until terminated by the policyholder.

From 2002, the Company has underwritten policies of another kind of homeowners insurance product containing both insurance and investment features. Policyholders deposit a fixed principal amount which is only refundable upon the maturity of the policy of three years or five years and the policyholder receives a fixed rate of interest. Penalties on early termination are charged according to the terms stated in the insurance contract. The amount of interest credited to policyholder deposits for the year ended 31 December 2004, the period from 7 July to 31 December 2003, and for the year ended 31 December 2003 were RMB144 million, RMB65 million and RMB123 million, respectively. The balances of this type of insurance deposit product as at 31 December 2004 and 31 December 2003 amounted to RMB5,938 million and RMB6,142 million, respectively.

30. PAYABLE TO REINSURERS

Payable to reinsurers are analysed as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Reinsurance balances payable	641	1,132
Reinsurance funds withheld	670	846
	1,311	1,978

Amounts payable to reinsurers as at 31 December 2004 and 31 December 2003 are due within three months from the balance sheet date or are repayable on demand. The reinsurance funds withheld as at 31 December 2004 and 31 December 2003 are repayable upon the expiration of the related reinsurance contracts.

Amounts due to American International Group and its subsidiaries (collectively known as "AIG", a 9.9% strategic shareholder of the Company) included in the above amounted to RMB56 million at 31 December 2004 (31 December 2003: Nil)

31 December 2004

31. ACCRUED INSURANCE PROTECTION FUND

The Company is obligated to pay into an insurance protection fund based on 1% of its annual retained premiums in accordance with the relevant PRC insurance law and regulations. No further provision is required once the accumulated balance has reached 6% of the Company's total assets determined in accordance with the PRC GAAP. The amount provided for is payable to the CIRC to finance the resolution of failed insurance companies in the PRC and is required to be set aside by investments in debt securities issued by the central government of the PRC and placements of deposits with the four state-owned national commercial banks.

As at 31 December 2004 and 2003, the Company's accrued insurance protection amount maintained in accordance with relevant PRC insurance law and regulations was held in form of deposits with banks. The deposits with banks are restricted in use until the accrual has been settled with the CIRC. The balance as at balance sheet date represented the amounts accrued for since 1 October 2002 and the accrued related interest income.

All of the accrued insurance protection amounts are payable at the request of the CIRC. Pursuant to a new regulation (CIRC[2004] No.16) issued by the CIRC, which became effective on 1 January 2005, all insurance companies in the PRC are required to deposit their accumulated insurance protection fund in CIRC's designated bank account. Notwithstanding this, as explained in note 22(i) to the financial statements, the Company is permitted by the CIRC to utilise the accumulated insurance protection fund, to the extent not exceeding the balance accumulated up to 30 June 2005, to offset the Company's the amount due from provincial and municipal governments.

32. OTHER LIABILITIES AND ACCRUALS

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Amount due to PICC Holding Company (<i>note (i)</i>)	–	616
Amount due to a fellow subsidiary (<i>note (ii)</i>)	8	4
Salaries and staff welfare payable	1,402	1,549
Securities sold under agreements to repurchase	611	300
Accrued capital expenditure	109	178
Premiums received in advance	2,222	952
Others	1,801	1,548
	6,153	5,147

Notes:

- (i) The amount due to PICC Holding Company at 31 December 2003 included a special dividend payable of RMB644 million (note 13).
- (ii) The amount due to a fellow subsidiary is unsecured, interest-free and has no fixed repayment terms.

33. DEFERRED TAX

The movements in deferred tax liabilities and assets during the year are as follows:

Deferred tax liabilities

	Deferred income recognition of trading securities RMB million	Deferred acquisition costs RMB million	Total RMB million
At 1 January 2004	1	424	425
Deferred tax charged to the profit and loss account during the year	34	320	354
Gross deferred tax liabilities at 31 December 2004	35	744	779

Deferred tax assets

	Revaluation/ provision of trading securities RMB million	Revaluation/ provision of non-trading securities RMB million	Depreciation of fixed assets RMB million	Others RMB million	Total RMB million
At 1 January 2004	(29)	3	149	(31)	92
Deferred tax credited to the profit and loss account/ reserve during the year	310	248	60	40	658
Gross deferred tax assets at 31 December 2004	281	251	209	9	750
Net deferred tax liabilities at 31 December 2004					29

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

The change in respect of the deferred tax asset recognised arising from the revaluation of non-trading securities is taken to the non-trading securities revaluation reserve.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities as they relate to the same tax authority.

31 December 2004

33. DEFERRED TAX (CONTINUED)**Deferred tax liabilities**

	Revaluation of trading securities	Deferred income recognition of trading securities	Deferred acquisition costs	Others	Total
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
At 7 July 2003	(24)	31	422	(5)	424
Deferred tax (credited)/charged to the profit and loss account during the period	53	(30)	2	36	61
Gross deferred tax liabilities at 31 December 2003	29	1	424	31	485

Deferred tax assets

	Revaluation of non-trading securities	Depreciation of fixed assets	Total
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
At 7 July 2003	19	–	19
Deferred tax (charged)/credited to the profit and loss account/reserve during the period	(16)	149	133
Gross deferred tax assets at 31 December 2003	3	149	152
Net deferred tax liabilities at 31 December 2003			333

33. DEFERRED TAX (CONTINUED)**Pro forma****Deferred tax liabilities**

	Revaluation of trading securities	Deferred income recognition of trading securities	Deferred acquisition cost	Others	Total
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
At 1 January 2003	(37)	39	355	–	357
Deferred tax (credited)/charged to the profit and loss account during the year	66	(38)	69	31	128
Gross deferred tax liabilities at 31 December 2003	29	1	424	31	485

Deferred tax assets

	Revaluation of non-trading securities	Tax value of losses carried forward	Depreciation of fixed assets	Total
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
At 1 January 2003	46	491	–	537
Deferred tax (charged)/credited to the profit and loss account/reserve during the year	(43)	(491)	149	(385)
Gross deferred tax assets at 31 December 2003	3	–	149	152
Net deferred tax liabilities at 31 December 2003				333

31 December 2004

34. ISSUED CAPITAL

	2004 <i>million</i>	2003 <i>million</i>
Shares		
Registered, issued and fully paid:		
7,685,820,000 domestic shares of RMB1.00 each	7,686	7,686
3,455,980,000 H Shares of RMB1.00 each	3,456	3,456
	11,142	11,142

The Company does not have a share option scheme.

A summary of the transactions from 7 July 2003 to 31 December 2003 analysing the movements in the Company's share capital is as follows:

	Number of shares in issue		Issued share capital		
	Domestic shares	H Shares	Domestic shares <i>RMB'000</i>	H Shares <i>RMB'000</i>	Total <i>RMB'000</i>
Upon incorporation on 7 July 2003 (<i>note (a)</i>)	8,000,000,000	–	8,000,000	–	8,000,000
Issue of H Shares upon listing (<i>note (b)</i>)	–	2,732,000,000	–	2,732,000	2,732,000
Sale of domestic shares by the ultimate holding Company and conversion into H Shares upon listing (<i>note (b)</i>)	(273,200,000)	273,200,000	(273,200)	273,200	–
Issue of H Shares upon exercise of over-allotment option (<i>note (c)</i>)	–	409,800,000	–	409,800	409,800
Sale of domestic shares by the ultimate holding Company and conversion into H Shares upon exercise of over-allotment option (<i>note (c)</i>)	(40,980,000)	40,980,000	(40,980)	40,980	–
At 31 December 2003	7,685,820,000	3,455,980,000	7,685,820	3,455,980	11,141,800

There was no movement in issued capital during the year.

Notes:

- (a) As part of the Reorganisation (note 1), the Company issued 8,000 million domestic shares at a par value of RMB1.00 each to PICC Holding Company, and the Company's registered and paid-up capital became RMB8,000 million accordingly.
- (b) The Company's shares were listed on the HKSE on 6 November 2003 and 3,005.2 million H Shares with a par value of RMB1.00 each were issued to the public by way of a placement and offer at a price HK\$1.80 (equivalent to approximately RMB1.92) per share. The domestic shares and the H Shares rank pari passu with each other in all respects and, in particular, rank equally for all dividends or distributions declared, paid or made except for the distribution of the special dividends set out in note 13.
- (c) The Company's shares were oversubscribed in its initial public offering and hence a further 450.8 million H Shares with a par value of RMB1.00 each were issued to the public pursuant to an over-allotment option.

35. SUBORDINATED LOAN

On 10 October 2003, the Company signed a loan agreement with China Development Bank which advanced a subordinated loan of RMB2,000 million to the Company. The loan is unsecured, bears interest at 90% of the People's Bank of China five-year borrowing interest rate per annum and is repayable in November 2023.

36. NOTES TO THE CASH FLOW STATEMENT

(a) Major non-cash transactions

	7 July to 31 December 2003 <i>RMB million</i>
Net assets acquired upon the Reorganisation (note 1 to the financial statements)	
Investment in securities	2,331
Trading securities	11,896
Deposits with banks and other financial institution with original maturity more than three months	10,344
Cash and cash equivalents	17,797
Premium receivable and agents' balance, net	2,874
Unearned premium reserves – reinsurers' share	7,162
Receivable from reinsurers	463
Reinsurance recoverable on unpaid losses	7,011
Prepayments and other receivable	2,388
Fixed assets	15,728
Construction in progress	791
Deferred acquisition costs	1,283
Other non-current assets	248
Unearned premium reserves	(33,112)
Loss and loss adjustment expenses reserves	(17,467)
Provision for premium deficiency	(1)
Policyholders' deposits	(8,021)
Payable to reinsurers	(2,309)
Accrued insurance protection fund	(340)
Tax payable	(44)
Other liabilities and accruals	(6,922)
Deferred tax liabilities	(405)
	11,695
Satisfied by:	
Shares issued	8,000
Share premium account	2,271
Other reserves	1,424
	11,695

31 December 2004

36. NOTES TO THE CASH FLOW STATEMENT (CONTINUED)

- (b) An analysis of the net inflow of cash and cash equivalents in respect of the net assets acquired upon the Reorganisation is as follows:

	7 July to 31 December 2003 <i>RMB million</i>
Cash and cash equivalent acquired	17,797
Net cash inflow of cash and cash equivalents in respect of the net assets acquired upon the Reorganisation	17,797

37. CONTINGENT LIABILITIES

- (a) Pursuant to the Reorganisation, except for liabilities constituting or arising out of or relating to business undertaken by the Company after the Reorganisation, no other liabilities were assumed by the Company and the Company is not liable, whether severally or jointly and severally, for debts and obligations incurred prior to the Reorganisation. PICC Holding Company has also undertaken to indemnify the Company in respect of any loss or damage incurred in connection with or arising from the transfer of the assets and liabilities to the Company in the Reorganisation, any loss or damage suffered or incurred by the Company in relation to the novation of insurance contracts and reinsurance contracts from PICC Holding Company to the Company, and as a result of any breach by PICC Holding Company of any provision of the Reorganisation.
- (b) Owing to the nature of insurance business, the Company is involved in legal proceedings in the ordinary course of business, including being the plaintiff or the defendant in litigation and arbitration. Such legal proceedings mostly involve claims on the Company's insurance policies. While the outcome of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Company.

38. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Company leases its land and buildings under operating lease arrangements, with leases negotiated for terms ranging from one to four years. The terms of the leases generally also require the tenants to provide for periodic rent adjustments according to the then prevailing market conditions.

At 31 December 2004, the Company had total future minimum lease receivable under non-cancellable operating leases with its tenants falling due as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Within one year	25	21
In the second to fifth years, inclusive	38	49
	63	70

(b) As lessee

The Company leases certain of its land and buildings and motor vehicles under operating lease arrangements. Leases for properties are negotiated for terms ranging from one to twenty years, and those for motor vehicles for terms ranging between one to three years.

At 31 December 2004, the Company had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Within one year	310	296
In the second to fifth years, inclusive	466	681
After five years	40	54
	816	1,031

31 December 2004

39. COMMITMENTS

In addition to the operating lease commitments detailed in note 38(b) above, the Company had the following capital commitments at the balance sheet date:

	2004 <i>RMB million</i>	2003 <i>RMB million</i>
Contracted, but not provided for		
Land and buildings	1,471	81
Plant and machinery	2	–
	1,473	81
Authorised, but not contracted for		
Land and buildings	72	236
Plant and machinery	13	–
	85	236

40. RELATED PARTY TRANSACTIONS

The Company conducts businesses with enterprises directly or indirectly owned or controlled by the PRC government (“State-owned enterprises”). Furthermore, the PRC government itself represents a significant customer of the Company both directly through its numerous authorities and indirectly through its numerous affiliates and other organisations. The Company considers that the sale of insurance products to the PRC government authorities and affiliates and other State-owned enterprises are in the ordinary and normal course of business in the PRC and has not disclosed such transactions as related party transactions.

40. RELATED PARTY TRANSACTIONS (CONTINUED)

In addition to the transactions and balances detailed elsewhere in these financial statements, the Company and PICC Holding Company, PICC Asset Management Company Limited and American International Group (“AIG”), a strategic shareholder of the Company, entered into a number of agreements during the period in connection with the Reorganisation. These agreements impact the results of the operations of the Company beginning from the respective dates. The terms of the principal agreements are summarised as follows:

	<i>Notes</i>	2004 <i>RMB million</i>	7 July to 31 December 2003 <i>RMB million</i>
Property rental expenses to PICC Holding Company	(a)	211	106
Property rental income from PICC Holding Company	(a)	11	5
Motor vehicle rental expenses to PICC Holding Company	(b)	22	11
Motor vehicle rental income from PICC Holding Company	(b)	4	2
Management fee to PICC Asset Management Company Limited	(c)	34	4
Services fees income from PICC Holding Company	(d)	4	2
Management fees income from PICC Holding Company	(e)	3	–
Special dividends to PICC Holding Company (<i>note 13</i>)		–	650
Reinsurance premiums ceded to AIG	(f)	266	–
Claims recoverable from AIG	(f)	21	–
Reinsurance commission received/receivable from AIG	(f)	53	–

Notes:

- (a) The Company entered into a Property Leasing Agreement with PICC Holding Company on 9 October 2003 under which the Company rented certain properties from PICC Holding Company and PICC Holding Company rented certain properties from the Company. The rental charges in respect of these properties are based on market rates. The term of the Property Leasing Agreement is four years and it became effective on 7 July 2003.
- (b) The Company entered into a Motor Vehicle Rental Agreement with PICC Holding Company on 9 October 2003 under which the Company rented certain motor vehicles from PICC Holding Company and PICC Holding Company rented certain motor vehicles from the Company. The rental charges for the motor vehicles are based on market rates. The term of the Motor Vehicle Rental Agreement is four years and it became effective on 7 July 2003.
- (c) On 10 October 2003, the Company and PICC Asset Management Company Limited, a wholly-owned subsidiary of PICC Holding, entered into an asset management agreement which became effective on the same date. Pursuant to the asset management agreement, PICC Asset Management Company Limited provides investment management services in respect of certain cash assets of the Company. The Company pays an annual management fee to PICC Asset Management Company Limited, which is calculated based on the average daily net asset value of the assets under the management of PICC Asset Management Company Limited in a particular year and the applicable annual rate. The term of the asset management agreement is four years.

31 December 2004

40. RELATED PARTY TRANSACTIONS (CONTINUED)

Notes: (continued)

- (d) The Company entered into an Information System Services Agreement with PICC Holding Company on 9 October 2003, pursuant to which the Company agreed to provide PICC Holding Company with certain information services, including (i) facilities leasing services and network services; (ii) software and application services; (iii) other computer-related facilities maintenance services; and (iv) other information system services agreed by both parties. The services fee payable to the Company by PICC Holding Company are to be no less than market rates, and are determined with reference to the costs associated with the labour and the equipment required to provide the services and support pursuant to the Information System Services Agreement between the Company and PICC Holding Company. The term of the Information System Services Agreement is four years.
- (e) The Company entered into an agreement with PICC Holding Company on 9 August 2004, under which the Company took the responsibility of managing the payments of retirement benefits to the retired employees of PICC Holding Company's provincial and municipal offices. Management fee is calculated based on RMB300 per retired employee of PICC Holding Company. The term of the agreement is three years and it became effective on 1 January 2004.
- (f) The Company entered into a Technical Assistance and Co-operation Agreement with AIG on 29 September 2003, pursuant to which the Company and one of AIG's wholly-owned subsidiaries will co-operate in the development of accident and health insurance products and the Company will cede quota share reinsurance at fixed cession percentages. This obligation was reflected in a separate reinsurance agreement, which was entered in the Company's ordinary and usual course of business. The intention of the parties is for the co-operation to continue indefinitely. Either party may request to review the key terms of the co-operation six months prior to the 15th anniversary of the date of the Technical Assistance and Co-operation Agreement and every 15 years thereafter, and unless the parties disagree to these terms, the agreement automatically renews for a further 15 years. Moreover, the Company entered into a quota share reinsurance arrangement with AIG in respect of its aviation and accidental injury business on a normal and commercial basis.

Other than the above agreements, the Company also entered into a Trademark Licence Agreement with PICC Holding Company on 9 October 2003, under which the Company has been granted the right to use the trademark bearing the "PICC" logo. The use of the trademark is on a royalty-free basis. The term of the Trademark Licence Agreement is 10 years and the agreement automatically renews for a further 10 years after the expiry of each 10 year term.

Balances with PICC Holding Company and AIG outstanding at the balance sheet date are summarised in notes 22 and 30 to the financial statements, respectively.

The transactions mentioned in (a) to (e) above also constitute connected transactions under the HKSE Listing Rules. For items (a) to (d) above, a waiver has been granted by the HKSE to the Company from strict compliance with requirements of connected transaction rules of the HKSE Listing Rules in respect of the connected transactions set out above.

41. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 22 April 2005.