1. GENERAL INFORMATION

Guangdong Kelon Electrical Holdings Company Limited (the "Company") was incorporated in the People's Republic of China (hereinafter referred to as the "PRC") on 16 December 1992. Its H shares were listed on The Stock Exchange of Hong Kong Limited on 23 July 1996 and its A shares were listed on the Shenzhen Stock Exchange on 13 July 1999.

Guangdong Greencool Enterprise Development Company Limited ("Greencool Enterprise"), a company incorporated in the PRC, was the single largest shareholder of the Company. As at 31 December 2005, Greencool Enterprise held 262,212,194 domestic legal person shares of the Company, representing 26.43% of the Company's total share capital.

On 9 September 2005, Greencool Enterprise entered into an equity transfer agreement with Qingdao Hisense Air-Conditioner Company Limited ("Hisense Air-Conditioner") in connection with the transfer of 262,212,194 shares of domestic legal person shares of the Company, representing 26.43% of total share capital of the Company. As at the date of this report, the equity transfer is still in process.

The Group is principally engaged in the manufacture and sale of refrigerators and air-conditioners.

The address of the registered office of the Company is No.8 Ronggang Road, Ronggui, Shunde, Foshan, the PRC.

The English names by which some of the companies are referred to in these financial statements represent management's best efforts in translating their Chinese names as no English names have been registered for these companies.

The financial statements are presented in Renminbi ("RMB"), which is the same as the functional currency of the Group.

2. RETROSPECTIVE RESTATEMENT OF ERRORS

The Company has been formally investigated by the China Securities and Regulatory Commission (the "CSRC") since 5 April 2005. On 1 August 2005, the Company was informed that five of the Company's former senior management, including the Company's former chairman, a former executive director and a former vice president, and other former senior management responsible for finance (collectively "Relevant Persons") became formally investigated by the police department of the PRC (the "PRC Police Department) and subject to procedures adopted by the PRC Police Department in connection with criminal offences for alleged economic crime. Against this background and at the request of the CSRC, the Company conducted an in-depth investigation for the purpose of identifying, as far as possible, the possible financial impact to the Group that might arise in respect of the allegation. The result of the investigation revealed that the Relevant Persons had caused the Company to enter into a series of fraudulent activities/transactions in the current year and prior periods including but not limited to unauthorised use of the Group's funds, fictitious sales of goods and scrap materials, misstatement in distribution costs, administrative expenses, other operating expenses and income tax expense and non disclosure of related party transactions.

2. RETROSPECTIVE RESTATEMENT OF ERRORS *(continued)*

(a) The financial statements for the year ended 31 December 2005 include a restatement of the 2004 financial statements to correct the errors noted by the Company. The effects of the restatement on the 2004 financial statements are summarised below:

	Effect on 2004 *RMB'000*
Income statement:	
(Decrease) in sales revenue	(513,403)
Decrease in cost of sales	349,864
(Decrease) in other operating income	(22,538)
Decrease in distribution costs	24,058
Decrease in administrative expenses	1,376
(Increase) in other operating expenses	(3,557)
(Increase) in income tax expense	(17,436)
(Increase) in loss for the year	(181,636)
	RMB
(Increase) in basic loss per share	(0.183)

	Effect on 2004 *RMB'000*
Balance sheet:	
Increase in intangible assets	12,903
Increase in inventories	323,261
(Decrease) in trade and other receivables	(470,800)
(Decrease) in total assets	(134,636)
(Increase) in trade and other payables	(51,465)
(Increase) in taxation payable	(23,051)
(Increase) in total liabilities	(74,516)
(Decrease) in net assets	(209,152)
(Decrease) in retained earnings at 1 January	(27,516)
(Increase) in loss for the year	(181,636)
(Decrease) in equity at 31 December	(209,152)

2. RETROSPECTIVE RESTATEMENT OF ERRORS *(continued)*

(b) Restatement of disclosure of related party transactions (Note 33)

The management determined that the following additional disclosures should have been made and restatement has been made in the 2005 notes to the financial statements.

Disclosure of related party transaction:

(i) Transactions with Greencool Enterprise and its affiliates as set out in Note 33 II (a) (iv) and (v).

(ii) Transactions with companies suspected to be connected with Mr. Gu as set out in Note 33 II (b) (vii), (viii) and (ix).

Disclosure of balances with related parties:

(a) Balances with Greencool Enterprise and its affiliates

	2004 *RMB'000*
Included in trade and other receivables:	
– Shenzhen Greencool Technology (as defined in Note 33 I)	32,000
– Shenzhen Greencool Environmental (as defined in Note 33 I)	33,000
	65,000

The amounts due from Greencool Enterprise and its affiliates are unsecured, interest, free and repayable on demand. No impairment loss for bad and doubtful debts was recorded in respect of the amounts due from Greencool Enterprise and its affiliates.

(b) Balances with companies (as defined in Note 33 I) suspected to be connected with Mr. Gu

	2004 *RMB'000*
Included in trade and other receivables:	
– Hefei Weixi	15,610
– Wuhan Changrong	29,844
	45,454
Included in trade and other payables:	
– Chengdu Refrigerating	4,606
– Tianjin Taijin Yunye	65,000
– Zhejiang Guoda	104
– Zhongshan Dongyue	9,791
– Zhuhai Longjia	23,737
– Zhuhai Defa	34,372
– Zhejiang Yuhuan	223
	137,833

The amounts due from/to companies suspected to be connected with Mr. Gu are unsecured, interest-free and repayable on demand. No impairment loss for bad and doubtful debts was recorded in respect of the amounts due from companies suspected to be connected with Mr. Gu.

3. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") promulgated by the International Accounting Standards Board ("IASB"). IFRSs include International Accounting Standards ("IAS") and interpretations. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

(b) Basis of preparation

The Group incurred losses of approximately RMB3,767 million and RMB237 million (restated) for the year ended 31 December 2005 and year ended 31 December 2004 respectively. As at 31 December 2005, the Group's current liabilities exceeded its current assets by approximately RMB3,307 million. In addition, the Group has outstanding short-term loans in the aggregate of approximately RMB2,161 million of which approximately RMB1,233 million were overdue as at 31 December 2005. The management has implemented various measures including: (1) streamlining operational processes and improving internal management mechanism; (2) introducing cost reduction plans; (3) rationalising business structures of the Group; and (4) rebuilding the image and reputation of the Group. In addition, the Group is in the process of negotiating with certain banks to restructure the amounts due to them and the Company's management confirmed that most of the Group's bankers have expressed their intention to reschedule overdue bank borrowings and/or renew/grant credit facilities to the Group. Further, the successor single largest shareholder of the Company, Hisense Air-Conditioner Company Limited has expressed its intention to provide necessary financial support to the Group so as to enable it to continue as a going concern. Based on the above assessments, the directors are of the opinion that the Group will have sufficient working capital to finance its normal operations and to meet its financial obligations as they fall due for the foreseeable future and have prepared the consolidated financial statements on a going concern basis.

The consolidated financial statements for the year ended 31 December 2005 comprise the Company and its subsidiaries and the Group's interests in associates. The measurement basis used in the preparation of the financial statements is the historical cost basis, as modified by the revaluation of property, plant and equipment and financial instruments at fair value. The accounting policies and bases adopted in the preparation of these financial statements differ from those used in the statutory accounts of the Group which are prepared in accordance with generally accepted accounting principles and relevant financial regulations in the PRC ("PRC GAAP"). The differences arising from the restatement of the results of operations for compliance with IFRS, if any, are adjusted in these financial statements but will not be taken up in the accounting books of the Group.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(b) Basis of preparation *(continued)*

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next financial year are disclosed in Note 41.

In 2005, the Group adopted the following revised and newly released IFRSs which are generally effective for accounting periods beginning on or after 1 January 2005 that are relevant to its operations. The 2004 comparatives have been restated as required, in accordance with the relevant requirements.

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Balance Sheet Date
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IFRS 3	Business Combinations

IAS 1 has affected the presentation of minority interests, share of results of associates and other disclosures.

IASs 2, 7, 8, 10, 12, 16, 18, 19, 23, 27, 28, 32, 33, 36, 37, 39 and 40 had no material effect on the policies of the Group.

IAS 21 had no material effect on the policy of the Group. The functional currency of each of the entities of the Company and its subsidiaries has been re-evaluated based on the guidance in the revised standard.

IAS 24 has extended the identification of related parties and disclosure of related parties to include state-owned enterprises. The revised IAS 24 also requires the compensation of key management personnel to be disclosed. The Group has included these additional disclosures in the financial statements.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(b) Basis of preparation *(continued)*

The effects of the adoption of the other IFRSs are summarised as follows:

IAS 17 – Leases

On adoption of IAS 17, where leasehold properties are held for own use and where the land and buildings elements can be allocated reliably as at inception of the lease, the land element is treated as an operating lease and is disclosed separately. As such, land premiums or other costs for acquiring the leasehold land are stated at cost and amortised over the term of the lease. Where the land and buildings elements cannot be allocated reliably at the inception of the lease, the land and building elements will continue to be treated as a single unit of property under finance lease and recognised on inception at their fair value.

IAS 38 – Intangible assets

In prior years, trademarks were amortised over their estimated useful lives of 10 years. With effect from 1 January 2005 and in accordance with the provisions of IAS 38:

- trademarks are assessed to have indefinite useful lives, as there is no foreseeable limit to the period over which the trademarks are expected to generate net cash inflows for the Group, and therefore are not amortised;

- trademarks are tested for impairment at each reporting date and whenever an indicator of impairment occurs.

IFRS 3 – Business combinations

In the previous year, the Group adopted the accounting treatment of IFRS 3 “Business Combinations” to business combinations for which the agreement date was on or after 31 March 2004. For business combinations for which the agreement date was before 31 March 2004, goodwill and negative goodwill arising on those acquisitions were accounted for in accordance with IAS 22 “Business Combinations”.

With effect from 1 January 2005 and in accordance with the provisions of IFRS 3 and IAS 36:

- negative goodwill is derecognised as at 1 January 2005 with a corresponding adjustment to the opening balance of accumulated losses (restated);

- the Group ceased amortisation of goodwill;

- accumulated amortisation as at 31 December 2004 is eliminated with a corresponding decrease in goodwill; and

- goodwill arising from all acquisitions is tested annually for impairment, as well as when there are indications of impairment.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(c) Summary of the effects of the changes in accounting policies

(i) The effects of the changes in the accounting policies described above on the consolidated income statements for the years ended 31 December 2005 and 2004 are summarised below:

	Effect of IAS 1	Effect of IAS 17	Effect of IAS 38 and IFRS 3	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Year ended 31 December 2005				
Increase (decrease) in administrative expenses:				
– discontinuation of amortisation of trademarks	–	–	(52,186)	(52,186)
– discontinuation of amortisation of goodwill	–	–	(4,866)	(4,866)
– discontinuation of recognition of negative goodwill as income	–	–	4,790	4,790
– reduction of depreciation charge due to reclassification of interests in leasehold land held for own use under operating leases	–	(20,422)	–	(20,422)
– amortisation charge arising from the reclassification of interests in leasehold land held for own use under operating leases	–	20,422	–	20,422
Decrease in share of results of associates	(2,372)	–	–	(2,372)
Decrease in income tax expense	2,372	–	–	2,372
Increase (decrease) in loss for the year	–	–	(52,262)	(52,262)
	RMB	*RMB*	*RMB*	*RMB*
Increase (decrease) in basic loss per share	–	–	(0.053)	(0.053)

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(c) Summary of the effects of the changes in accounting policies *(continued)*

(i) *(continued)*

	Effect of IAS 1	Effect of IAS 17	Total
	RMB'000	*RMB'000*	*RMB'000*
Year ended 31 December 2004			
Increase (decrease) in administrative expenses:			
– reduction of depreciation charge due to reclassification of interests in leasehold land held for own use under operating leases	–	(17,571)	(17,571)
– amortisation charge arising from the reclassification of interests in leasehold land held for own use under operating leases	–	17,571	17,571
Decrease in share of results of associates	(2,025)	–	(2,025)
Decrease in income tax expense	2,025	–	2,025
Increase (decrease) in loss for the year	–	–	–
	RMB	*RMB*	*RMB*
Increase (decrease) in basic loss per share	–	–	–

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(c) Summary of the effects of the changes in accounting policies *(continued)*

(ii) The effects of the changes in the accounting policies described above on the consolidated balance sheets as at 31 December 2005, 1 January 2005 and 31 December 2004 are summarised below:

	Effect of IAS 17 *RMB'000*	Effect of IAS 38 and IFRS 3 *RMB'000*	Total *RMB'000*
At 31 December 2005			
Increase (decrease) in assets:			
Property, plant and equipment	(63,689)	–	(63,689)
Interest in leasehold land held for own use under an operating lease	470,280	–	470,280
Intangible assets	(406,591)	–	(406,591)
Negative goodwill	–	76,636	76,636
Increase (decrease) in equity:			
Accumulated losses	–	76,636	76,636

	Effect of IAS 17 *RMB'000*	Effect of IAS 38 and IFRS 3 *RMB'000*	Total *RMB'000*
At 1 January 2005			
Increase (decrease) in assets:			
Property, plant and equipment	(388,426)	–	(388,426)
Interest in leasehold land held for own use under an operating lease	720,754	–	720,754
Intangible assets	(332,328)	–	(332,328)
Negative goodwill	–	76,636	76,636
Increase (decrease) in equity:			
Retained earnings	–	76,636	76,636

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(c) Summary of the effects of the changes in accounting policies *(continued)*

	Effect of IAS 17 *RMB'000*	**Total** *RMB'000*
At 31 December 2004		
Increase (decrease) in assets:		
Property, plant and equipment	(388,426)	(388,426)
Interests in leasehold land held for own use under operating leases	720,754	720,754
Intangible assets	(332,328)	(332,328)

(d) Basis of consolidation

Where the Company has the power, either directly or indirectly, to govern the financial and operating policies of another entity or business so as to obtain benefits from its activities, that entity or business is classified as a subsidiary. The consolidated financial statements present the results of the Company and its subsidiaries ("the Group") as if they formed a single entity. Inter-company transactions and balances between group companies are therefore eliminated in full.

On acquisition, the assets and liabilities of the relevant subsidiaries are measured at their fair values at the date of acquisition. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised.

Minority interests in the net assets of consolidated subsidiaries are identified as a separate component within the Group's equity. Minority interests 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.

(e) Associates

Where the Group has the power to participate in (but not control) the financial and operating policy decisions of another entity, that entity is classified as an associate. Associates are initially recognised in the consolidated balance sheet at cost and thereafter adjusted for Group's share of the post-acquisition change in the associate's net assets. The Group's share of post-acquisition after tax profits and losses is recognised in the consolidated income statement, except that losses in excess of the Group's investment in the associate are not recognised unless there is an obligation to make good those losses.

Profits and losses arising on transactions between the Group and its associates are recognised only to the extent of unrelated investors' interests in the associate. The investor's share in the associate's profits and losses resulting from these transactions is eliminated against the carrying value of the associate.

Any premium paid for an associate above the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired is capitalised and included in the carrying amount of the associate and subject to impairment testing in the same way as goodwill arising on a business combination described below.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(f) Goodwill

Goodwill represents the excess of the cost of a business combination over the interest in the fair value of identifiable assets, liabilities and contingent liabilities acquired. Cost comprises the fair values of assets given, liabilities assumed and equity instruments issued, plus any direct costs of acquisition. Where the fair value of identifiable assets, liabilities and contingent liabilities exceed the fair value of consideration paid, the excess is credited in full to the income statement.

Goodwill is initially recognised in the consolidated balance sheet as an asset at cost and subsequently measured at cost less any impairment losses. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value of goodwill may be impaired. An impairment loss recognised for goodwill is not reversed in the subsequent period. On subsequent disposal of a subsidiary or associate, the carrying amount of goodwill relating to the entity sold is included in determining the amount of gain or loss on disposal.

(g) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes. Sales of goods are recognised when goods are delivered and title has passed.

Interest income 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 estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Rental income under operating leases is recognised on a straight-line basis over the term of the relevant lease.

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

(h) Property, plant and equipment

Property, plant and equipment are stated at cost or valuation less accumulated depreciation and accumulated impairment losses.

Certain property, plant and equipment held for use in the production or supply of goods or services, or for administrative purposes are stated in the balance sheet at their revalued amounts, being the fair value on the basis of their existing use at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially for that which would be determined using fair values at the balance sheet date.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(h) Property, plant and equipment *(continued)*

Any revaluation increase arising on the revaluation of such property, plant and equipment is credited to the property revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of property, plant and equipment is charged as an expense to the extent that it exceeds the balance, if any, held in the property revaluation reserve relating to a previous revaluation of that asset.

Depreciation is charged to write off the carrying value of property, plant and equipment other than construction in progress over their estimated useful lives, after taking into account their estimated residual value, using the straight-line method. The estimated useful lives are as follows:

Leasehold land and buildings	20 to 50 years
Plant, machinery and equipment	5 to 10 years
Moulds	3 years
Motor vehicles	5 years

No depreciation is provided in respect of construction in progress until it is completed and is ready for its intended use.

The gain or loss on disposal of an asset item other than leasehold land and buildings is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement.

(i) Investment properties

Investment properties, principally comprising office buildings, are held for long-term rental yields and are not occupied by the Group. Investment properties are carried at cost less accumulated depreciation and accumulated impairment losses, if any.

Depreciation is provided using the straight-line method to write off the cost of the investment properties over their estimated useful lives of 20 to 50 years. Where the carrying amount of an investment property is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

(j) Intangible assets (other than goodwill)

Intangible assets are recognised initially at cost. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the economic useful life and assessed for impairment whenever there is indication that the intangible asset may be impaired. Intangible assets with indefinite useful lives are not amortised but tested for impairment annually either individually or at the cash-generating unit level.

(k) Inventories

Inventories are initially recognised at cost, and subsequently at the lower of cost and net realisable value. Cost comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Weighted average cost is used to determine the cost of ordinarily interchangeable items.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(l) Impairment of non-financial assets

Impairment tests on goodwill and other intangible assets with indefinite economic useful lives are undertaken annually on 31 December. Other non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount (i.e. the higher of value in use and fair value less costs to sell), the asset is written down accordingly.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit (i.e. the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows). Goodwill is allocated on initial recognition to each of the Group's cash-generating units that are expected to benefit from the synergies of the combination giving rise to the goodwill.

Impairment charges are included in the administrative and other operating expenses line items in the income statement, except to the extent they reverse gains previously recognised in the statement of changes in equity.

(m) Financial assets

The Group classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Group's accounting policy for each category is as follows:

Fair value through profit or loss

This category comprises the financial assets that have been acquired for the purpose of selling or repurchasing in the short-term or if so designated by management. This category includes derivatives which are not qualified for hedge accounting. Debt securities and bank deposits with embedded derivatives for yield enhancement whose economic characteristics and risks are not closely related to the host securities and deposits are designated as financial assets at fair value through profit or loss. They are carried in the balance sheet at fair value with changes in fair value recognised in the income statement.

Loans and receivables

These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise principally through the provision of goods and services to customers (trade debtors), but also incorporate other types of contractual monetary asset. At each balance sheet date subsequent to initial recognition, they are carried at amortised cost using the effective interest rate method, less any identified impairment losses.

Held-to-maturity investments

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. At each balance sheet date subsequent to initial recognition, held-to-maturity investment are measured at amortised cost using effective interest rate method, less any identified impairment losses.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(m) Financial assets *(continued)*

Available-for-sale

Non-derivative financial assets not included in the above categories are classified as available-for-sale and comprise the Group's strategic investments in entities not qualifying as subsidiaries, associates or jointly controlled entities. They are carried at fair value with changes in fair value recognised directly in equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognised in the income statement.

Derecognition

The Group derecognises a financial asset when the contractual rights to the future cash flows in relation to the investment expire or when the financial asset has been transferred and the transfer meets the criteria for derecognition in accordance with IAS 39.

(n) Financial liabilities

The Group classifies its financial liabilities into one of two categories, depending on the purpose for which the asset was acquired. The Group's accounting policy for each category is as follows:

Fair value through profit or loss

This category comprises only out-of-the-money derivatives. They are carried in the balance sheet at fair value with changes in fair value recognised in the income statement.

Other financial liabilities

Other financial liabilities include the following items:

- Trade payables and other short-term monetary liabilities are recognised initially at their nominal value and subsequently measured at amortised cost using the effective interest rate method.

- Bank borrowings are initially recognised at the amount advanced net of any transaction costs directly attributable to the issue of the instrument. Such interest bearing liabilities are subsequently measured at amortised cost using the effective interest rate method, which ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the balance sheet. "Interest expense" in this context includes initial transaction costs and premium payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

(o) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, which will probably result in an outflow of economic benefits that can be reasonably estimated.

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, the existence of which 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.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(p) Warranty obligation

The Group provides free repairing services for its products and free replacement of the major components of its products for one or three years after sales.

The costs of the warranty obligation under which the Group agrees to remedy defects in its products are accrued at the time the related sales are recognised. Provision for warranty is accrued based on the estimated costs of fulfilling the total obligation, including handling and transportation costs. The costs are estimated by management based on past experience. The assumptions used to estimate the warranty provision are reviewed periodically in light of actual results.

(q) Taxation

Income taxes for the year comprise current tax and deferred tax.

Current tax is based on the profit or loss from ordinary activities adjusted for items that are non-assessable or disallowable for income tax purposes and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax arises from temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the corresponding amounts used for tax purposes and is accounted for using the balance sheet liability method. Except for recognised assets and liabilities that affect neither accounting nor taxable profits, deferred tax liabilities are recognised for all temporary differences. 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. Deferred tax is measured at the tax rates expected to apply in the period when the liability is settled or the asset is realised based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Income taxes are recognised in the income statement except when they relate to items directly recognised to equity in which case the taxes are also directly recognised in equity.

(r) 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 the Group's e-business development is recognised only if all of the following conditions are met:

- an asset is created that can be identified (such as software and new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Internally-generated intangible assets are amortised on a straight-line basis over their estimated useful lives. Where no internally-generated intangible asset can be recognised, development expenditure is charged to the income statement in the period in which it is incurred.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(s) Pension costs

Pursuant to the PRC laws and regulations, the Company and its subsidiaries established in the PRC makes monthly contributions to the basic old age pension for the local staff to a government agency. The contributions are made at a specific percentage on the standard salary set by the provincial government, of which 10% is borne by the Company and the remainder is borne by the staff. The government agency is responsible for the pension liabilities relating to such staff on their retirement.

In addition, the Group manages a defined contribution pension scheme for its employees. The Group makes contributions based on a percentage of the eligible employees' salaries plus a pre-determined amount funded by the Group and are charged to the income statement as they become payable in accordance with the rules of the scheme. When an employee leaves the scheme before his/her interest in the employer contributions is fully vested, the ongoing contributions payable by the Group may be reduced by the relevant amount of forfeited contributions.

The Group accounts for pension contributions on an accrual basis. Accrued contributions are shown as pension liabilities in the balance sheet.

(t) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the income statement in the period in which they are incurred.

(u) Government grants

Government grants are recognised when there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

(v) Operating leases

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

Interests in leasehold land held for own use under operating leases are up-front payments to acquire long-term interests in land. These payments are stated at cost and amortised over the period of the lease on a straight-line basis.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(w) Foreign currency

Transactions entered into by Group entities in a currency other than the currency of the primary economic environment in which it operates (the "functional currency") are translated at the rates ruling when the transactions occur. Foreign currency monetary assets and liabilities are translated at the rates ruling at the balance sheet date. Exchange differences arising on the retranslation of unsettled monetary assets and liabilities are similarly recognised immediately in the income statement, except for foreign currency borrowings qualifying as a hedge of a net investment in a foreign operation.

On consolidation, the results of overseas operations are translated into Renminbi ("RMB") at rates approximating to those ruling when the transactions took place. All assets and liabilities of overseas operations, including goodwill arising on the acquisition of those operations, are translated at the rate ruling at the balance sheet date. Exchange differences arising on translating the opening net assets at opening rate and the results of overseas operations at actual rate are recognised directly in equity (the "translation reserve"). Exchange differences recognised in the income statement of group entities' separate financial statements on the translation of long-term monetary items forming part of the Group's net investment in the overseas operation concerned are reclassified to the translation reserve if the item is denominated in the functional currency of the Group or the overseas operation concerned.

On disposal of a foreign operation, the cumulative exchange differences recognised in the translation reserve relating to that operation up to the date of disposal are transferred to the income statement as part of the profit or loss on disposal.

4. REVENUE

Revenue represents the net amounts received and receivable for goods sold during the year. An analysis of the Group's revenue for the year is as follows:

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Sales of refrigerators	**2,542,839**	3,213,581
Sales of air-conditioners	**3,600,489**	4,049,279
Sales of freezers	**261,113**	335,190
Sales of product components	**573,931**	324,951
	6,978,372	7,923,001

5. BUSINESS AND GEOGRAPHICAL SEGMENTS

Business segments

For management purposes, the Group is currently organised into four main operating divisions – refrigerators, air-conditioners, freezers and product components. These divisions are the basis on which the Group reports its primary segment information.

Segment information about these businesses is presented below:

Year ended 31 December 2005

(i) Income statement

	Refrigerators	Air-conditioners	Freezers	Product components	Elimination	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
TURNOVER						
External sales	2,542,839	3,600,489	261,113	573,931	–	6,978,372
Inter-segment sales	–	–	–	1,190,854	(1,190,854)	–
Total revenue	2,542,839	3,600,489	261,113	1,764,785	(1,190,854)	6,978,372

Inter-segment sales are charged at prevailing market rates.

	Refrigerators	Air-conditioners	Freezers	Product components	Elimination	Consolidated
RESULT						
Segment result	(1,446,362)	(1,584,482)	(94,024)	(413,735)	–	(3,538,603)
Unallocated corporate expenses						(32,994)
Loss from operations						(3,571,597)
Share of results of associates	(11,504)	(16,289)	(1,181)	(2,597)	–	(31,571)
Finance costs						(162,524)
Loss before tax						(3,765,692)
Income tax expense						(1,021)
Loss for the year						(3,766,713)

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

Year ended 31 December 2005 *(continued)*

(ii) Balance sheet

	Refrigerators	Air-conditioners	Freezers	Product components	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
ASSETS					
Segment assets	2,147,174	2,090,895	227,588	882,484	5,348,141
Interests in associates	33,535	47,639	3,444	7,568	92,186
Unallocated corporate assets					93,703
Consolidated total assets					5,534,030
LIABILITIES					
Segment liabilities	1,665,300	1,671,604	180,271	581,140	4,098,315
Unallocated corporate liabilities					2,217,563
Consolidated total liabilities					6,315,878

(iii) Other information

	Refrigerators	Air-conditioners	Freezers	Product components	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Additions of property, plant and equipment	119,416	150,626	17,331	47,363	334,736
Additions of intangible assets	1,688	279	10	123	2,100
Depreciation of property, plant and equipment	139,213	131,513	17,324	95,804	383,854
Amortisation and impairment of intangible assets	143,467	173,670	7,306	18,785	343,228
Amortisation of interests in leasehold land held for own use under operating leases	8,387	8,233	921	2,881	20,422
Net (gain) loss on disposal of property, plant and equipment	12,083	82,683	406	5,501	100,673
Revaluation decrease	106,384	94,593	11,377	49,170	261,524
Impairment loss on trade and other receivables	160,209	197,817	690	120,290	479,006
Write down of inventories recognised as an expense	33,468	182,903	38,813	37,792	292,976

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

Year ended 31 December 2004 (Restated)

(i) Income statement

	Refrigerators *RMB'000*	Air-conditioners *RMB'000*	Freezers *RMB'000*	Product components *RMB'000*	Elimination *RMB'000*	Consolidated *RMB'000*
REVENUE						
External sales	3,213,581	4,049,279	335,190	324,951	–	7,923,001
Inter-segment sales	–	–	–	1,433,329	(1,433,329)	–
Total revenue	3,213,581	4,049,279	335,190	1,758,280	(1,433,329)	7,923,001

Inter-segment sales are charged at prevailing market rates.

	Refrigerators *RMB'000*	Air-conditioners *RMB'000*	Freezers *RMB'000*	Product components *RMB'000*	Elimination *RMB'000*	Consolidated *RMB'000*
RESULT						
Segment result	83,224	32,822	(751)	(64,185)	–	51,110
Unallocated corporate expenses						(20,752)
Profit from operations						30,358
Share of results of associates	(34,173)	(43,059)	(3,564)	(3,456)	–	(84,252)
Finance costs						(159,138)
Loss before tax						(213,032)
Income tax expense						(23,718)
Loss for the year						(236,750)

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

Year ended 31 December 2004 (Restated) *(continued)*

(ii) Balance sheet

	Refrigerators RMB'000	Air-conditioners RMB'000	Freezers RMB'000	Product components RMB'000	Consolidated RMB'000
ASSETS					
Segment assets	4,373,270	5,702,360	437,463	873,898	11,386,991
Interests in associates	50,351	63,444	5,252	5,091	124,138
Unallocated corporate assets					186,252
Consolidated total assets					11,697,381
LIABILITIES					
Segment liabilities	2,042,639	2,747,634	164,746	453,920	5,408,939
Unallocated corporate liabilities					3,375,064
Consolidated total liabilities					8,784,003

(iii) Other information

	Refrigerators RMB'000	Air-conditioners RMB'000	Freezers RMB'000	Product components RMB'000	Consolidated RMB'000
Additions of property, plant and equipment	298,930	215,189	4,708	107,753	626,580
Additions of intangible assets	3,136	1,625	471	15,186	20,418
Additions of interests in leasehold land held for own use under operating leases	40,000	14,119	24,385	37,665	116,169
Depreciation of property, plant and equipment	181,441	109,863	17,192	39,787	348,283
Amortisation and impairment of intangible assets	22,029	31,510	342	4,607	58,488
Amortisation of interests in leasehold land held for own use under operating leases	7,607	7,265	886	1,813	17,571
Amortisation of goodwill	1,254	1,809	239	1,239	4,541
Discount on acquisition of a subsidiary release to income	–	12,429	–	–	12,429
Release of negative goodwill to income	–	–	4,790	–	4,790
Loss on disposal of property, plant and equipment	1,321	605	–	1,024	2,950
Impairment loss on trade and other receivables	4,360	383	29,718	5,944	40,405
Write down of inventories recognised as an expense	18,134	18,469	2,141	2,668	41,412

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

The average number of employees for the year for each of the Group's principal divisions was as follows:

	2005	**2004**
Refrigerators	**6,814**	6,896
Air-conditioners	**2,969**	3,509
Freezers	**250**	395
Product components	**3,242**	1,660
	13,275	12,460

Geographical segments

The following table provides an analysis of the Group's turnover by geographical market, irrespective of the origin of the goods/services:

	Revenue by geographical market	
	2005	**2004**
	RMB'000	***RMB'000***
		(Restated)
The PRC		
Mainland China	**4,154,957**	4,464,075
Hong Kong	**19,518**	118,762
	4,174,475	4,582,837
Europe	**1,258,611**	1,481,458
America	**824,541**	1,002,743
Others	**720,745**	855,963
	6,978,372	7,923,001

The Group's operations are carried out in the PRC and almost all of the production facilities of the Group are located in the PRC.

6. OTHER OPERATING INCOME

	2005 RMB'000	2004 RMB'000 (Restated)
An analysis of the Group's other operating income is as follows:		
Sales of scrap materials	–	16,828
Interest income	29,443	38,832
Gain on disposal of property, plant and equipment	5,609	–
Gain on disposal of interests in leasehold land held for own use under operating leases	11,984	–
Penalty income	2,831	–
Subsidy income	4,780	–
Others	18,681	17,444
	73,328	73,104

7. OTHER OPERATING EXPENSES

	2005 RMB'000	2004 RMB'000 (Restated)
An analysis of the Group's other operating expenses is as follows:		
Loss on disposal of property, plant and equipment	106,282	2,950
Revaluation decrease	261,524	–
Impairment loss on interests in leasehold land held for own use under operating leases	18,207	–
Impairment loss on intangible assets	338,677	2,372
Impairment loss on investment in a deconsolidated subsidiary	11,000	–
Impairment loss on goodwill	39,195	–
Loss on disposal of scrap materials	12,032	–
Penalty	12,712	487
Others	8,166	3,565
	807,795	9,374

8. DEPRECIATION AND AMORTISATION

	2005 RMB'000	2004 RMB'000 (Restated)
An analysis of the Group's depreciation is as follows:		
Amount charged as cost of sales	266,622	226,762
Amount included in distribution costs	59,362	82,085
Amount included in administrative expenses	57,870	39,436
	383,854	348,283
An analysis of the Group's amortisation is as follows:		
Amount included in administrative expenses	24,973	78,228
Amount included in share of results of associates	–	13,734
	24,973	91,962

9. FINANCE COSTS

	2005 *RMB'000*	2004 *RMB'000*
Interest on:		
– bank borrowings wholly repayable within five years	**122,306**	89,851
– discounted note receivables	**32,125**	65,202
Total borrowing costs	**154,431**	155,053
Others	**8,093**	4,085
	162,524	159,138

10. LOSS BEFORE TAX

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Loss before tax is stated after charging:		
Cost of sales	**6,817,774**	6,265,943
Staff costs, including directors' and supervisors' remuneration	**562,167**	497,174
Defined contribution pension cost	**25,129**	19,518
Depreciation of property, plant and equipment (Note 8)	**383,854**	348,283
Amortisation of interests in leasehold land held for own use under operating leases (Note 8)	**20,422**	17,571
Amortisation of goodwill of associates (Note 8)	**–**	13,734
Amortisation of goodwill of subsidiaries (Note 8)	**–**	4,541
Amortisation of intangible assets (Note 8)	**4,551**	56,116
Auditors' remuneration	**5,824**	5,500
Research and development costs	**8,025**	6,147
Impairment loss on goodwill of an associate	**–**	71,400
Impairment loss on trade and other receivables (i)	**479,006**	40,405
Write down of inventories recognised as an expense (i)	**292,976**	41,412
Operating lease charges		
– land and buildings	**64,153**	56,816
– plant and machinery	**6,000**	4,000
Share of associates' taxation	**2,372**	2,025
and after crediting:		
Discount on acquisition of a subsidiary release to income	**–**	12,429
Gain on disposal of associates	**–**	656
Release of negative goodwill of subsidiaries to income	**–**	4,790
Rental income from investment properties	**1,289**	–

(i) The impairment loss on trade and other receivables and write down of inventories recognised as an expense for the year are included in "Administrative expenses" on the face of the consolidated income statement.

11. DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The amounts of emoluments paid and payable to the directors and supervisors of the Company by the Group are as follows:

	2005			
	Fees	Basic salaries, housing and other allowances and benefits in kind	Discretionary bonuses	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors				
Liu Cong Meng	–	1,891	–	1,891
Li Zhen Hua	–	1,891	–	1,891
Fang Zhi Guo	–	1,009	–	1,009
Gu Chu Jun (i)	–	2,627	–	2,627
Yan You Song (i)	–	735	–	735
Zhang Hong (i)	–	588	–	588
Independent non-executive directors				
Li Kung Man	378	–	–	378
Xu Xiao Lu	378	–	–	378
Chan Pei Cheong, Andy (ii)	378	–	–	378
Supervisors				
He Si	–	111	176	287
Bai Yun Feng	–	85	137	222
Zeng Jun Hong (i)	–	53	–	53
	1,134	8,990	313	10,437

11. DIRECTORS' AND SUPERVISORS' EMOLUMENTS *(continued)*

	2004			
	Fees *RMB'000*	Basic salaries, housing and other allowances and benefits in kind *RMB'000*	Discretionary bonuses *RMB'000*	Total *RMB'000*
Executive directors				
Liu Cong Meng	–	1,913	–	1,913
Li Zhen Hua	–	1,913	–	1,913
Fang Zhi Guo	–	861	–	861
Gu Chu Jun (i)	–	6,695	–	6,695
Yan You Song (i)	–	1,275	–	1,275
Zhang Hong (i)	–	861	–	861
Independent non-executive directors				
Li Kung Man	383	–	–	383
Xu Xiao Lu	383	–	–	383
Chan Pei Cheong, Andy (ii)	382	–	–	382
Supervisors				
He Si	–	237	–	237
Bai Yun Feng	–	293	–	293
Jiang Bao Jun	–	780	–	780
	1,148	14,828	–	15,976

(i) On 1 August 2005, the Company announced that Mr. Gu Chu Jun, Mr. Yan You Song and Mr. Zhang Hong have been formally investigated by the PRC police department and are subject to procedures adopted by the PRC police department in connection with criminal offences for alleged economic crime. Since then and up to the date of this report, none of them could be contacted. In addition, the Company was also unable to contact Mr. Zeng Jun Hong. No emolument was paid to Mr. Gu Chun Jun subsequent to May 2005 and no emoluments were paid to Mr. Yan You Song, Mr. Zhang Hong and Mr. Zeng Jun Hong subsequent to July 2005.

(ii) Mr. Chan Pei Cheong, Andy resigned on 23 January 2006.

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

12. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five highest paid individuals of the Group, three (2004: four) are directors of the Company for the year ended 31 December 2005 whose emoluments are included in Note 11 above.

The following table sets out the emoluments of the Group's remaining two (2004: one) highest paid individuals for the year ended 31 December 2005 who is not a director nor a supervisor of the Company:

	2005 *RMB'000*	2004 *RMB'000*
Basic salaries, housing and other allowances and benefits in kind	**2,858**	1,119
Discretionary bonuses	**–**	–
	2,858	1,119

The emoluments of these individuals are within the following band:

	Number of individual	
	2005	**2004**
RMB 1,050,700 – RMB 1,576,050 (equivalent to HKD 1,000,000 – HKD 1,500,000)	**1**	1
RMB 1,576,051 – RMB 2,101,400 (equivalent to HKD 1,500,001 – HKD 2,000,000)	**1**	–
	2	1

13. INCOME TAXES

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Income taxes consist of:		
Current tax		
– PRC enterprise income tax ("EIT")	**1,006**	24,505
– Hong Kong Profits Tax	**15**	(787)
Deferred tax	**–**	–
	1,021	23,718

The Company and its subsidiaries provide for taxation on the basis of its statutory profit for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes after considering all available tax benefits.

13. INCOME TAXES *(continued)*

The Company was established in Shunde, Guangdong Province and, pursuant to the "Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises" ("Income Tax Law"), is normally subject to EIT at a rate of 24%, which is applicable to enterprises located in coastal open economic zones. Together with the local enterprise income tax rate of 3%, the aggregate EIT rate is 27%. In June 2003, the Company is classified as a high new technology enterprise and is subject to an EIT of 15%. Together with the local enterprise income tax rate of 3%, the aggregate EIT rate is 18%.

The Company's subsidiaries, Guangdong Kelon Refrigerator Ltd. ("Kelon Refrigerator"), Guangdong Kelon Air-Conditioner Co., Ltd. ("Kelon Air-Conditioner"), Hangzhou Kelon Electrical Co. Ltd. ("Hangzhou Kelon"), Guangdong Kelon Fittings Co., Ltd. ("Kelon Fittings"), Shunde Rongsheng Plastic Products Co., Ltd. ("Rongsheng Plastic") and Yingkou Kelon Refrigerator Co. Ltd. ("Yingkou Kelon"), established in coastal open economic zones, are subject to an EIT rate of 24%. Together with the 3% local enterprise income tax, the aggregate EIT rate is 27%. Pursuant to Income Tax Law, they are entitled to preferential tax treatment with full exemption from EIT for two years starting from the first profitable year of operations, after offsetting all tax losses brought forward from the previous years (for a maximum period of five years), followed by a 50% reduction in tax rate for the next three years.

The Company's subsidiaries, Chengdu Kelon Refrigerator Co., Ltd. ("Chengdu Kelon") and Jiangxi Kelon Industrial Development Co., Ltd. are subject to an EIT rate of 30%. Together with the 3% local enterprise income tax, the aggregate EIT rate is 33%. Pursuant to the Income Tax Law, they are also entitled to preferential tax treatment, with full exemption from income tax for two years starting from the first profitable year of operations, after offsetting all tax losses brought forward from the previous years (for a maximum period of five years), followed by a 50% reduction in tax rate for the next three years.

Other subsidiaries of the Group which are established and operating in the PRC are subject to EIT at a standard rate of 33% based on their assessable income for the year.

Hong Kong Profits Tax has been provided at the rate of 17.5% (2004: 17.5%) on the estimated assessable profit for the year.

Kelon USA Inc., a wholly owned subsidiary incorporated in Delaware, USA, is subject to overseas income tax. The taxation is calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

13. INCOME TAXES *(continued)*

Reconciliation between income tax expense and accounting loss at applicable tax rate is as follows :

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Loss before tax	**(3,765,692)**	(213,032)
Tax at the applicable tax rate of 27% (note)	**(1,016,737)**	(57,519)
Tax effect of non-deductible expenses	**162,979**	55,231
Tax effect of non-taxable revenue	**(964)**	(22,595)
Tax effect of unused tax losses not recognised	**816,712**	114,799
Tax effect of utilisation of tax losses previously not recognised	**–**	(67,868)
Other temporary differences not recognised	**39,031**	1,670
Income tax expense	**1,021**	23,718

Note: The applicable tax rate represents the domestic tax rate in the jurisdiction where the operation of the Group is substantially based.

At the balance sheet date, deductible temporary differences not recognised in the financial statements were analysed into:

	2005 *RMB'000*	2004 *RMB'000*
Tax losses	**2,294,364**	854,299
Other temporary differences	**678,219**	490,408
	2,972,583	1,344,707

No deferred tax asset has been recognised in relation to such deductible temporary differences due to the unpredictability of future profit streams. The tax losses can only be carried forward for a maximum period of five years. The cumulative tax losses as at 31 December 2005 and 2004, amounting to RMB2,174,636,000 and RMB763,775,000 respectively, will expire in years 2010 and 2009, respectively. The remaining balances can be carried forward indefinitely.

14. BASIC LOSS PER SHARE

The calculation of basic loss per share attributable to equity holders of the Company for the year is based on the net loss attributable to equity holders of the Company for the year of RMB3,702,172,000 (2004: net loss attributable to equity holders of the Company for the year of RMB226,294,000 (restated)) and on 992,006,563 shares (2004: 992,006,563 shares) outstanding during the year.

No diluted earnings per share have been presented as there were no dilutive potential ordinary shares in issue in both years.

15. PROPERTY, PLANT AND EQUIPMENT

	Leasehold land and buildings RMB'000	Plant, machinery and equipment RMB'000	Moulds RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
Year ended 31 December 2005						
Cost or valuation						
At 1 January 2005 (as previously stated)	1,862,438	2,588,136	211,376	79,643	349,489	5,091,082
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(404,997)	–	–	–	(102,073)	(507,070)
At 1 January 2005 (restated)	1,457,441	2,588,136	211,376	79,643	247,416	4,584,012
Exchange differences	(1,936)	–	–	–	–	(1,936)
Additions at cost	203	69,400	101,018	534	163,581	334,736
Disposals	(12,284)	(530,807)	(117,458)	(6,834)	(3,088)	(670,471)
Transfer to investment properties (Note 16)	(29,881)	–	–	–	–	(29,881)
Revaluation decrease	(5,858)	(143,531)	(26,290)	(1,043)	(84,802)	(261,524)
Reclassification	141,487	(88,182)	(592)	(1,692)	(51,021)	–
At 31 December 2005	1,549,172	1,895,016	168,054	70,608	272,086	3,954,936
Comprising:						
At cost	141,690	–	–	–	–	141,690
At directors' valuation	1,407,482	1,895,016	168,054	70,608	272,086	3,813,246
	1,549,172	1,895,016	168,054	70,608	272,086	3,954,936
Accumulated depreciation and impairment						
At 1 January 2005 (as previously stated)	566,994	1,680,275	89,730	56,203	–	2,393,202
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(118,644)	–	–	–	–	(118,644)
At 1 January 2005 (restated)	448,350	1,680,275	89,730	56,203	–	2,274,558
Exchange differences	(492)	–	–	–	–	(492)
Depreciation for the year	110,393	194,241	72,848	6,372	–	383,854
Elimination on disposals	(4,482)	(460,115)	(66,711)	(6,988)	–	(538,296)
Transfer to investment properties (Note 16)	(1,513)	–	–	–	–	(1,513)
Reclassification	(133,211)	123,240	–	9,971	–	–
At 31 December 2005	419,045	1,537,641	95,867	65,558	–	2,118,111
Net book value						
At 31 December 2005	1,130,127	357,375	72,187	5,050	272,086	1,836,825

15. PROPERTY, PLANT AND EQUIPMENT *(continued)*

	Leasehold land and buildings *RMB'000*	Plant, machinery and equipment *RMB'000*	Moulds *RMB'000*	Motor vehicles *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
Year ended 31 December 2004						
Cost or valuation						
At 1 January 2004 (as previously stated)	1,769,475	2,384,360	609,024	71,856	117,845	4,952,560
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(404,997)	–	–	–	(62,073)	(467,070)
At 1 January 2004 (restated)	1,364,478	2,384,360	609,024	71,856	55,772	4,485,490
Exchange differences	(110)	(83)	–	(2)	–	(195)
Additions at cost	33,489	59,738	95,157	7,685	237,262	433,331
Acquired through business combinations	59,497	124,668	–	697	8,387	193,249
Disposals	(1,544)	(32,411)	(492,805)	(1,103)	–	(527,863)
Reclassification	1,631	51,864	–	510	(54,005)	–
At 31 December 2004 (restated)	1,457,441	2,588,136	211,376	79,643	247,416	4,584,012
Comprising:						
At cost (restated)	–	–	211,376	–	247,416	458,792
At directors' valuation (restated)	1,457,441	2,588,136	–	79,643	–	4,125,220
	1,457,441	2,588,136	211,376	79,643	247,416	4,584,012
Accumulated depreciation and impairment						
At 1 January 2004 (as previously stated)	485,111	1,516,837	490,079	53,299	–	2,545,326
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(104,734)	–	–	–	–	(104,734)
At 1 January 2004 (restated)	380,377	1,516,837	490,079	53,299	–	2,440,592
Exchange differences	(9)	(56)	–	(1)	–	(66)
Depreciation for the year	68,125	191,577	84,924	3,657	–	348,283
Eliminated on disposals	(143)	(28,083)	(485,273)	(752)	–	(514,251)
At 31 December 2004 (restated)	448,350	1,680,275	89,730	56,203	–	2,274,558
Net book value						
At 31 December 2004 (restated)	1,009,091	907,861	121,646	23,440	247,416	2,309,454

The directors' valuation at 2005 on plant, machinery and equipment, moulds, motor vehicles and construction in progress was made by reference to independent valuations carried out at 31 December 2005 by Dalian Zhong Hua Asset Appraisal Company Limited and Beijing Liuhe Zhengxu Asset Appraisal Company Limited on the basis of fair market value in continued use.

The directors' valuation at 2005 on leasehold land and buildings was made by reference to an independent valuation carried out at 31 December 2002 by Greater China Appraisals Limited on the basis of fair market value in continued use.

15. PROPERTY, PLANT AND EQUIPMENT *(continued)*

The directors' valuation at 2004 was made by reference to an independent valuation carried out at 31 December 2002 by Greater China Appraisals Limited on leasehold land and buildings, and plant, machinery and equipment. For land and buildings, and plant, machinery and equipment for production use, the valuation was made on the basis of fair market value in continued use. The valuation of other property, plant and equipment was made on the basis of open market value. In the opinion of the directors, the carrying amount did not differ materially from that which would be determined using the fair values at the balance sheet date.

Had the property, plant and equipment been carried at cost less accumulated depreciation and impairment, their carrying value would have been stated as follows:

	Leasehold land and buildings *RMB'000*	Plant, machinery and equipment *RMB'000*	Moulds *RMB'000*	Motor vehicles *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
Cost	1,680,828	1,949,599	194,345	70,367	356,888	4,252,027
Accumulated depreciation and impairment	(489,858)	(1,610,088)	(122,158)	(55,552)	(84,802)	(2,362,458)
Net book value at 31 December 2005	1,190,970	339,511	72,187	14,815	272,086	1,889,569
Net book value at 31 December 2004 (restated)	1,327,788	889,263	121,646	33,204	262,690	2,634,591

The net book value of the Group's leasehold land and buildings comprise properties situated on land held under medium-term leases in:

	2005 ***RMB'000***	**2004** ***RMB'000*** (Restated)
PRC, other than in Hong Kong	**1,057,450**	905,080
Hong Kong	**44,874**	75,628
Japan	**27,803**	28,383
	1,130,127	1,009,091

Land and buildings, plant, machinery and equipment and construction in progress with a net book value of approximately RMB625,469,000 (2004: RMB153,191,000 (restated)), RMB21,712,000 (2004: RMB227,283,000) and RMB Nil (2004: RMB Nil (restated)) respectively were pledged as security for the Group's bank borrowings.

16. INVESTMENT PROPERTIES

	2005 *RMB'000*	2004 *RMB'000*
Cost		
At 1 January	–	–
Reclassification from property, plant and equipment (Note 15)	29,881	–
Exchange differences	(680)	–
At 31 December	29,201	–
Accumulated depreciation and impairment		
At 1 January	–	–
Reclassification from property, plant and equipment (Note 15)	1,513	–
Exchange differences	(35)	–
At 31 December	1,478	–
Carrying amount at 31 December	27,723	–
Directors' valuation	38,959	–

The Group's investment properties are situated in Hong Kong under medium term leases. The valuation for the investment properties at 31 December 2005 were determined by the directors on an open market value basis.

17. INTERESTS IN LEASEHOLD LAND HELD FOR OWN USE UNDER OPERATING LEASES

The Group's interests in leasehold land held for own use under operating leases comprises:

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Leasehold land in PRC:		
– Medium-term lease	470,080	720,754

17. INTERESTS IN LEASEHOLD LAND HELD FOR OWN USE UNDER OPERATING LEASES *(continued)*

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Carrying amount at 1 January	**720,754**	622,156
Acquired through business combinations	**–**	14,237
Additions	**–**	101,932
Amortisation charge	**(20,422)**	(17,571)
Impairment loss	**(18,207)**	–
Other adjustment	**(55,274)**	–
Disposals	**(156,771)**	–
Carrying amount at 31 December	**470,080**	720,754

(i) Included in interests in leasehold land held for own use under operating leases at 31 December 2005 was a right to use a piece of land situated in Yangzhou, the PRC. The land use right was acquired in 2003 and its acquisition was evidenced by two stand-alone agreements dated 3 June 2003 and 5 August 2003 with contract sums of RMB45 million and RMB102 million respectively. The land use right was initially recorded at RMB102 million. In 2005, the management (having sought legal advice) considered that the cost of the land use right should be RMB45 million plus incidental cost of approximately RMB1.8 million to acquire the land. The difference of approximately RMB55 million was adjusted to the amount as a reduction in land cost.

(ii) Included in interests in leasehold land held for own use under operating leases is a land use right on land in Kaifeng which was acquired as capital contribution by a minority interest of a subsidiary. As at 31 December 2005, this land use right with carrying amount of approximately RMB13.6 million has not yet been registered in the name of the subsidiary.

(iii) Included in this account is land use right with carrying value of approximately RMB28 million which has been frozen by the court of Shangqiu since August 2005. In July 2004, Shangqiu Kelon Electrical Company Limited ("Shangqiu Kelon"), Shangqiu Bing Xiong Freezing Facilities Company Limited ("Shangqiu Bing Xiong"), the minority interest shareholder of Shangqiu Kelon and the Administration Committee of Shangqiu Economic and Technological Development Zone (商丘經濟技術開發區管委會) entered into a three-party land transfer agreement under which all parties agreed that Shangqiu Kelon acquires land use right (200 acres) from Shangqiu Bing Xiong at a consideration of approximately RMB36 million. Under the land transfer agreement, it was agreed that Shangqiu Kelon develops the land and meets minimum production and sales requirements after the development is completed. At date of this report, the land has not yet been developed nor has Shangqiu Kelon met the minimum production and sales requirements.

In August 2005, Shangqiu Kelon received a notice from 商丘經濟技術開發區管委會claiming that it has breached the three-party land transfer agreement for not fulfilling the minimum production and sales requirements and requesting that Shangqiu Kelon surrenders the land use right (200 acres). The local court froze the land accordingly.

At date of this report, the case is being handled by the Group's lawyer and has not yet been resolved. The Company has made an impairment loss of approximately RMB18 million against the possible loss of the land use right.

(iv) At 31 December 2005, the carrying amount of interests in leasehold land held for own use under operating leases pledged as security for the Group's bank borrowings amounted to approximately RMB352,614,000 (2004: RMB306,123,000 (restated)).

18. INTERESTS IN SUBSIDIARIES

Details of the Company's principal subsidiaries as at 31 December 2005 are as follows:

Name of subsidiary	Place and date of incorporation/ establishment	Issued capital/ registered capital	Percentage of equity interest attributable to the Company		Principal activities
			Directly	Indirectly	
Entities operating in the PRC:					
Shunde Rongsheng Plastic Products Co., Ltd.	PRC (i) 18 October 1991	US$15,800,000	45%	25%	Manufacture of plastic parts
Guangdong Kelon Mould Co., Ltd.	PRC (i) 20 July 1994	US$15,000,000	40%	30%	Manufacture of moulds
Guangdong Kelon Refrigerator Ltd.	PRC (i) 25 December 1995	US$26,800,000	70%	30%	Manufacture and sale of refrigerators
Guangdong Kelon Freezer Co., Ltd.	PRC (i) 25 December 1995	RMB237,000,000	44%	56%	Manufacture and sale of freezers
Guangdong Kelon Air-Conditioner Co., Ltd.	PRC (i) 19 March 1996	US$36,150,000	60%	–	Manufacture and sale of air-conditioners
Chengdu Kelon Refrigerator Co., Ltd.	PRC (i) 19 November 1996	RMB200,000,000	45%	25%	Manufacture and sale of refrigerators
Yingkou Kelon Refrigerator Co., Ltd.	PRC (i) 15 December 1996	RMB200,000,000	42%	36.79%	Manufacture and sale of refrigerators
Yangzhou Kelon Electrical Company Limited	PRC (i) 23 December 1996	US$29,800,000	30%	70%	Manufacture and sale of refrigerators
Shunde Kelon Household Electrical Appliance Company Limited	PRC (ii) 16 July 1999	RMB10,000,000	25%	75%	Manufacture and sale of electrical household appliances
Guangdong Kelon Fittings Co., Ltd.	PRC (i) 24 November 1999	US$5,620,000	70%	30%	Manufacture and sale of spare parts for air-conditioners and refrigerators
Shunde Huaao Electronics Co., Ltd.	PRC (ii) 23 November 2000	RMB10,000,000	–	70%	Manufacture and sale of electronic products
Shunde Wangao Import & Export Co., Ltd.	PRC (ii) 7 June 2001	RMB3,000,000	20%	80%	Import and export business

18. INTERESTS IN SUBSIDIARIES *(continued)*

Name of subsidiary	Place and date of incorporation/ establishment	Issued capital/ registered capital	Percentage of equity interest attributable to the Company Directly	Indirectly	Principal activities
Entities operating in the PRC *(continued)*:					
Shunde Jiake Electronic Company Limited	PRC (i) 12 October 2001	RMB60,000,000	70%	30%	IT and communication technology and micro-electronics technology development
Xi'an Kelon Refrigeration Co., Ltd. ("Xi'an Kelon")	PRC (i) 20 March 2002	RMB202,000,000	60%	–	Manufacture and sale of refrigerators
Jiangxi Kelon Industrial Development Co., Ltd. ("Jiangxi Kelon")	PRC (i) 24 June 2003	US$29,800,000	60%	40%	Manufacture and sale of refrigerators, air-conditioners and other household appliances
Shangqiu Kelon Electrical Company Limited	PRC (i) 23 September 2003	RMB150,000,000	–	100%	Manufacture and sale of refrigerators
Zhuhai Kelon Industrial Development Co., Ltd.	PRC (i) 3 December 2003	US$29,980,000	75%	25%	Manufacture and sale of refrigerators
Entities operating in Hong Kong:					
Pearl River Electric Refrigerator Company Limited	Hong Kong 26 July 1985	HK$400,000	–	100%	Trading in materials and parts for refrigerators and import and export business
Kelon Electric Appliances Co., Ltd.	Hong Kong 29 August 1991	HK$10,000	–	100%	Property investment
Kelon Development Company Limited	Hong Kong 17 August 1993	HK$5,000,000	100%	–	Investment holding
Kelon International Inc.	British Virgin Islands 13 January 1999	US$50,000	–	100%	Investment holding and sale of refrigerators and air-conditioners

(i) Established as a sino-foreign equity joint venture in the PRC.

(ii) Established as a limited liability company in the PRC.

18. INTERESTS IN SUBSIDIARIES *(continued)*

(iii) The financial statements of Jiangxi Combine Electrical Appliance Co., Ltd. ("Jiangxi Combine") were excluded from the consolidated financial statements as from 1 January 2005 as Jiangxi Combine has not commenced active business since its establishment, the management considers that the impact of not consolidating Jiangxi Combine is insignificant to the Group as a whole. Details of the assets and liabilities of Jiangxi Combine as at 31 December 2005 are as follows:

	RMB'000
Trade and other receivables	18,693
Cash and cash equivalents	1,307
Minority interests	(9,000)
Net assets attributable to the Company reclassified to investment in an unconsolidated subsidiary	11,000
Impairment loss	(11,000)
	–

None of the subsidiaries had issued any debt securities at the end of the year.

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results or assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

19. INTERESTS IN ASSOCIATES

	2005 *RMB'000*	**2004** *RMB'000*
Share of net assets	**92,186**	124,138
Goodwill (note)	–	–
	92,186	124,138
Fair value of listed investment	**49,474**	79,636

Note:

	RMB'000
Cost	
At 1 January 2005 and 31 December 2005	137,346
Amortisation and impairment	
At 1 January 2005 and 31 December 2005	137,346
Carrying amount	
At 31 December 2005 and 31 December 2004	–

19. INTERESTS IN ASSOCIATES *(continued)*

Details of the Group's principal associates as at 31 December 2005 are as follows:

Name of associate	Place and date of incorporation/ establishment	Issued capital/ registered capital	Percentage of equity interest attributable to the Company Directly	Indirectly	Principal activities
Huayi Compressor Holdings Company Limited ("Huayi")	PRC (i) 13 June 1996	RMB260,854,000	22.73%	–	Manufacture and sale of compressors
Guangzhou Antaida Logistic Co., Ltd. ("Guangzhou Antaida")	PRC (ii) 11 July 2001	RMB10,000,000	20%	–	Provision of logistics and storage services

(i) Established as a joint stock limited company.

(ii) Established as a limited liability company.

The above table lists the associates of the Group which, in the opinion of the directors, principally affected the results of the year or formed a substantial portion of the net assets of the Group. To give details of other associates would, in the opinion of the directors, result in particulars of excessive length.

The summarised financial information in respect of the Group's associates is set out below:

	2005 ***RMB'000***	**2004** ***RMB'000*** (Restated)
Total assets	**1,825,999**	1,792,191
Total liabilities	**(1,279,730)**	(1,113,055)
Net assets	**546,269**	679,136
Group's share of net assets of associates	**92,186**	124,138
Revenue	**1,306,092**	1,022,172
(Loss) profit for the year	**(129,652)**	16,848
Group's share of result of associates for the year	**(31,571)**	2,164

20. OTHER INVESTMENTS

	2005 RMB'000	2004 RMB'000
Unquoted long-term equity investments, at cost	**7,249**	7,249
Impairment loss	**(7,249)**	–
	–	7,249

21. INTANGIBLE ASSETS

	Land use rights RMB'000	Trademarks (i) RMB'000	Non-patented technologies (ii) RMB'000	Software systems (ii) RMB'000	Total RMB'000
Year ended 31 December 2005					
Cost					
At 1 January 2005 (as previously stated)	337,035	521,858	557	–	859,450
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(337,035)	–	–	–	(337,035)
Transfer from other receivables	–	–	–	30,578	30,578
At 1 January 2005 (restated)	–	521,858	557	30,578	552,993
Additions at cost	–	–	–	2,100	2,100
Disposals	–	–	(20)	(98)	(118)
At 31 December 2005	–	521,858	537	32,580	554,975
Amortisation and impairment					
At 1 January 2005 (as previously stated)	4,707	65,233	104	–	70,044
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(4,707)	–	–	–	(4,707)
Transfer from other receivables	–	–	–	17,675	17,675
At 1 January 2005 (restated)	–	65,233	104	17,675	83,012
Charge for the year	–	–	137	4,414	4,551
Impairment loss	–	338,247		430	338,677
Elimination on disposals	–	–	–	(47)	(47)
At 31 December 2005	–	403,480	241	22,472	426,193
Carrying amount					
At 31 December 2005	–	118,378	296	10,108	128,782

21. INTANGIBLE ASSETS *(continued)*

	Land use rights *RMB'000*	Trademarks (i) *RMB'000*	Non-patented technologies (ii) *RMB'000*	Software systems (ii) *RMB'000*	Total *RMB'000*
Year ended 31 December 2004					
Cost					
At 1 January 2004 (as previously stated)	260,866	521,858	–	–	782,724
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(260,866)	–	–	–	(260,866)
Transfer from other receivables	–	–	–	10,717	10,717
At 1 January 2004 (restated)	–	521,858	–	10,717	532,575
Acquired through business combinations	–	–	537	14,799	15,336
Additions at cost	–	–	20	5,062	5,082
At 31 December 2004 (restated)	–	521,858	557	30,578	552,993
Amortisation and impairment					
At 1 January 2004 (as previously stated)	1,046	13,047	–	–	14,093
Transfer to interests in leasehold land held for own use under operating leases (Note 17)	(1,046)	–	–	–	(1,046)
Transfer from other receivables	–	–	–	6,544	6,544
At 1 January 2004 (restated)	–	13,047	–	6,544	19,591
Acquired through business combinations	–	–	–	4,933	4,933
Charge for the year	–	52,186	104	3,826	56,116
Impairment loss	–	–	–	2,372	2,372
At 31 December 2004 (restated)	–	65,233	104	17,675	83,012
Carrying amount					
At 31 December 2004 (restated)	–	456,625	453	12,903	469,981

(i) Trademarks represent the rights of using「科龍」,「容聲」and「容升」brands in producing refrigerators recognised in October 2003.

Prior to 1 January 2005, the cost of trademarks is amortised on a straight-line basis over their estimated useful lives of 10 years. With effect from 1 January 2005 and in accordance with the provisions of IAS 38, trademarks are assessed to have indefinite useful lives and therefore are not amortised but tested for impairment for each reporting date and where an indicator of impairment exists.

Due to the significant loss incurred in the current year and the business interruption in May 2005, the management conducted an impairment assessment on the trademarks. The recoverable amount of trademarks is determined based on value-in-use calculations with the support of valuation performed by independent third party valuer. As a result of such assessment, trademarks had been assessed to be impaired by approximately RMB338 million.

(ii) Non-patented technologies and software systems are amortised over their estimated useful lives of 4 years.

22. GOODWILL

	RMB'000
Year ended 31 December 2005	
Cost	
At 1 January 2005 (as previously stated)	123,437
Opening balance adjustment to eliminate accumulated amortisation	(76,404)
At 1 January 2005 (restated) and 31 December 2005	47,033
Amortisation and impairment	
At 1 January 2005 (as previously stated)	84,242
Eliminated against cost at 1 January 2005	(76,404)
At 1 January 2005 (restated)	7,838
Impairment loss	39,195
At 31 December 2005	47,033
Carrying amount	
At 31 December 2005	–
Year ended 31 December 2004	
Cost	
At 1 January 2004	110,480
Arising on business combinations	15,499
Released upon deemed disposal of a subsidiary	(2,542)
At 31 December 2004	123,437
Amortisation and impairment	
At 1 January 2004	79,701
Charge for the year	4,541
At 31 December 2004	84,242
Carrying amount	
At 31 December 2004	39,195

The above goodwill arose from the acquisition of subsidiaries. Prior to 1 January 2005, goodwill was amortised over their estimated useful life ranging from 10 to 20 years. With effect from 1 January 2005 and in accordance with IFRS 3, the goodwill is not amortised but is tested for impairment on an annual basis.

Goodwill is allocated to the cash-generating units for impairment testing. The recoverable amounts of the cash-generating units have been determined based on value in use calculations. These calculations use cash flow projections based on financial budgets approved by the management covering a financial year period. Cash flows beyond the financial year period are extrapolated using the estimates made by management. The discount rate applied to the cash flow projections beyond a one-year period is 5.6%. As a result of such testing, the goodwill was assessed to be impaired in full and additional impairment provision amounting to approximately RMB39,195,000 has been made.

23. NEGATIVE GOODWILL

	RMB'000
Year ended 31 December 2005	
Gross amount	
At 1 January 2005 (as previously stated)	88,611
Derecognised upon adoption of IFRS 3	(88,611)
At 1 January 2005 (restated) and 31 December 2005	–
Release to income	
At 1 January 2005 (as previously stated)	11,975
Derecognised upon adoption of IFRS 3	(11,975)
At 1 January 2005 (restated) and 31 December 2005	–
Carrying amount	
At 31 December 2005	–
Year ended 31 December 2004	
Gross amount	
At 1 January 2004 and 31 December 2004	88,611
Release to income	
At 1 January 2004	7,185
Release in the year	4,790
At 31 December 2004	11,975
Carrying amount	
At 31 December 2004	76,636

In accordance with IFRS 3, negative goodwill is derecognised as at 1 January 2005 with a corresponding adjustment to the opening balance of accumulated losses (restated).

24. INVENTORIES

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Raw materials	**609,599**	1,119,967
Work in progress	**82,411**	207,751
Finished goods	**556,756**	1,992,398
	1,248,766	3,320,116

At 31 December 2005, the carrying amount of inventories pledged for bank borrowings amounted to approximately RMB41,899,000 (2004: Nil).

25. TRADE AND OTHER RECEIVABLES

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Trade receivables	**238,786**	546,213
Notes receivable (i)	**140,819**	1,228,417
Other receivables (ii)	**508,964**	537,346
Amounts due from Greencool Enterprise and its affiliates (Note 33 III a)	**74,055**	65,006
Amounts due from companies suspected to be connected with Mr. Gu (Note 33 III b)	**232,235**	45,454
Amounts due from Hisense Group (Note 33 III c)	**204,349**	–
Amounts due from associates (Note 33 III d)	**140**	–
Amounts due from other related companies (Note 33 III e)	**41,748**	6,471
	1,441,096	2,428,907

(i) At 31 December 2005, included in notes receivable was an amount of approximately RMB11,217,000 (2004: RMB560,393,000) of notes discounted to banks with recourse. The transaction has been accounted for as short term bank borrowings.

(ii) At 31 December 2005, included in other receivables was an amount of approximately RMB80,043,000 of intra-group receivables resulted from an inability to eliminate balances among companies within the Group on consolidation.

25. TRADE AND OTHER RECEIVABLES *(continued)*

The aging analysis of trade receivables is as follows:

	Gross amount *RMB'000*	Impairment loss *RMB'000*	Net amount *RMB'000*
As at 31 December 2005			
Within one year	301,586	(62,830)	238,756
One to two years	12,058	(12,028)	30
Two to three years	51,618	(51,618)	–
Over three years	144,444	(144,444)	–
	509,706	(270,920)	238,786
As at 31 December 2004 (Restated)			
Within one year	488,553	(14,922)	473,631
One to two years	78,001	(55,419)	22,582
Two to three years	43,488	(43,488)	–
Over three years	118,044	(68,044)	50,000
	728,086	(181,873)	546,213

The Group allows a credit period of up to one year for large and well established customers. Sales are usually settled by cash on delivery for small and new customers. Trade receivables are non-interest bearing.

26. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group is exposed through its operations to one or more of the following financial risks:

- Interest rate risk
- Foreign currency risk
- Liquidity risk
- Credit risk

The Group does not hold or issue any financial derivatives for trading purpose nor use any derivative or other instruments for hedging purpose.

Interest rate risk

The Group is exposed to interest rate risks due to changes in interest rates of interest-bearing financial assets and liabilities. Interest-bearing financial assets are mainly deposits with banks which are mostly short-term in nature whereas interest-bearing financial liabilities are primarily short-term bank borrowings. As at 31 December 2005, approximately RMB38.5 million of the Group's short-term bank borrowing was carried at floating interest rate and approximately RMB2,122 million of the Group's short-term bank borrowing was carried at fixed rates ranged from 4.35% to 6.91% per annum. The Group is therefore exposed to both fair value and cash flow interest rate risks. The Group's policy is to obtain the most favourable interest rates available without increasing its foreign exchange exposure.

26. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

Foreign exchange risk

Foreign exchange risk is the risk of loss due to adverse movements in exchange rates relating to investments and transactions denominated in foreign currencies. The Group's monetary assets and transactions are denominated in RMB, HKD and USD. Though the exchange rates among RMB, HKD and USD are not pegged, there is little fluctuation of exchange rates among RMB, HKD and USD. As at 31 December 2005, the Group has trade receivables denominated in HKD and USD of approximately RMB102 million and RMB13 million, respectively. As at 31 December 2005, the Group has short-term bank borrowings denominated in HKD and USD of approximately RMB38 million and RMB84 million, respectively. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arise.

Liquidity risk

In the management of liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by management to finance the Group's operations and mitigate the effects of short-term fluctuations in cash flows. The Group's treasury department is responsible for maintaining a balance between continuity and flexibility of funding through the use of bank facilities in order to meet the Group's liquidity requirements both in the short and long term. Most of debts of the Group would mature in less than one year as at 31 December 2005.

Credit risk

It is the risk that a counterparty is unable to pay amount in full when due. It arises primarily from the Group's trade receivables and amounts due from related parties. The Group limits its exposure to credit risk by vigorously selecting counterparties. The Group mitigates its exposure to risk relating to accounts receivable by dealing with diversified customers with sound financial standing. Certain new customers are required to place cash deposits with the Group to reduce the maximum exposure to credit risk. The Group seeks to maintain strict control over its outstanding receivables and has a credit control policy to minimise credit risk. In addition, all receivable balances are monitored on an ongoing basis and overdue balances are followed up by senior management.

Fair value

All financial instruments are carried at amounts not materially different from their fair values.

27. TRADE AND OTHER PAYABLES

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Trade payables	**1,993,906**	1,843,724
Notes payable	**159,650**	1,619,686
Other payables (i)	**822,540**	487,297
Accruals	**324,303**	137,720
Amounts due to Greencool Enterprise and its affiliates (Note 33 III a)	**13,017**	270
Amounts due to companies suspected to be connected with Mr. Gu (Note 33 III b)	**118,155**	137,833
Amounts due to Hisense Group (Note 33 III c)	**17,257**	–
Amounts due to associates (Note 33 III d)	**75,331**	112,195
Amounts due to other related companies (Note 33 III e)	**19,631**	9,824
	3,543,790	4,348,549

(i) At 31 December 2005, included in other payables were intra-group payables of approximately RMB51,504,000 resulting from an inability to eliminate balances among companies within the Group on consolidation.

The aging analysis of trade payables is as follows:

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Within one year	**1,645,415**	1,512,382
One to two years	**83,768**	331,342
Two to three years	**59,097**	–
Over three years	**205,626**	–
	1,993,906	1,843,724

Trade payables within normal credit period are non-interest bearing.

28. PROVISIONS

	Warranty (i) *RMB'000*	**Legal** (ii) *RMB'000*	**Total** *RMB'000*
At 1 January 2005	**119,338**	**–**	**119,338**
Additional provision in the year	**167,874**	**5,737**	**173,611**
Utilisation of provision	**(83,033)**	**–**	**(83,033)**
At 31 December 2005	**204,179**	**5,737**	**209,916**
At 1 January 2004	**89,557**	**–**	**89,557**
Additional provision in the year	**94,420**	**–**	**94,420**
Utilisation of provision	**(64,639)**	**–**	**(64,639)**
At 31 December 2004	**119,338**	**–**	**119,338**

(i) The Group provides free repairing services on its products and free replacement of the major components of its products for one or three years after date of sale. The warranty provision is estimated by management based on past experience. The assumptions used to estimate the warranty provision are reviewed periodically in light of actual results.

(ii) The Group is currently involved in a number of legal disputes. The amount provided represents the directors' best estimate of the Group's liability having taken legal advice. Uncertainties exist as to whether claims will be settled out of court or if not whether the Group is successful in defending any action.

29. OTHER LIABILITIES

	2005 *RMB'000*	**2004** *RMB'000*
Pension liabilities (i)	**44,026**	53,096
Government grants (ii)	**29,898**	16,867
	73,924	69,963
Amounts due within one year:		
– Pension liabilities (i)	**13,208**	–
– Government grants (ii)	**29,898**	–
	43,106	–
Amounts due after one year	**30,818**	69,963

(i) The amounts represent accrued contributions to a defined contribution pension scheme for its employees during the period from 1993 to 2001. In 2005, the Company received a proposal from the committee of the Company's staff union regarding the payment of pension benefits. Based on the proposal, approximately 30% of the pension liabilities is payable within one year.

(ii) The amounts represent government grants received for the Group's research and development activities. Government grants recognised as income for the year amounted to approximately RMB3,657,000 (2004: RMB16,867,000).

30. BANK BORROWINGS

	2005 *RMB'000*	2004 *RMB'000*
Medium-term and long-term bank loans	–	20,939
Short-term bank loans	**2,160,523**	3,347,229
	2,160,523	3,368,168
Less: Amount due within one year included under current liabilities	**(2,160,523)**	(3,351,445)
Amount due after one year	–	16,723
Analysed as:		
Secured	**819,772**	2,219,949
Unsecured	**1,340,751**	1,148,219
	2,160,523	3,368,168
The bank borrowings are repayable as follows:		
Within one year	**2,160,523**	3,351,445
Between one to two years	–	4,215
Between two to five years	–	12,508
	2,160,523	3,368,168

The Group is now in the process of negotiating with bankers to refinance the short-term bank loans which are due in 2005. Based on discussion with the Group's bankers to date, the directors expect that these borrowings will be renewed in due course.

The bank borrowings carry interest at rates ranging from 4.35% to 6.91% (2004: 1.99% to 5.58%) per annum. Bank borrowings of approximately RMB819,772,000 (2004: RMB2,219,949,000) were secured by pledge of property, plant and equipment (see note 15), inventories (see note 24) and notes discounted to banks (see note 25). Bank borrowings of RMB327,971,000 (2004: RMB180,000,000) were guaranteed by Guangdong Greencool Enterprise Development Company Limited, the major shareholder of the Company during the year.

31. SHARE CAPITAL

	2005 & 2004 *RMB'000*
Shares of RMB1 each	
337,915,755 Domestic shares	337,916
459,589,808 H shares	459,590
194,501,000 A shares	194,501
	992,007

Except for the currency in which dividends are paid and the restrictions as to whether the shareholders can be PRC investors or foreign investors, domestic shares, H shares and A shares rank pari passu in all respects with each other.

32. LEASES

The Group leases certain of its leasehold land and buildings under operating lease arrangements with lease terms ranging from one to five years.

The total future of minimum lease payments are due as follows:

	2005 *RMB'000*	2004 *RMB'000*
Not later than one year	**25,625**	16,229
Later than one year and not later than five years	**9,740**	5,214
Later than five years	**–**	–
	35,365	21,443

33. RELATED PARTY TRANSACTIONS

Transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

As at 31 December 2005, the Company's single largest shareholder is Guangdong Greencool Enterprise Development Company Limited ("Greencool Enterprise"), which owns 26.43% of the Company's shares. The beneficial owner of Greencool Enterprise is Mr. Gu Chu Jun ("Mr. Gu"), who was also the executive director of the Company as at 31 December 2005. The Group has significant transactions and relationships with Greencool Enterprise and companies controlled by Mr. Gu (collectively refer to "Greencool Enterprise and its affiliates"). The Group also has significant transactions with companies suspected to be connected with Mr. Gu (defined in I (i) below).

On 9 September 2005, Greencool Enterprise entered into an equity transfer agreement with Qingdao Hisense Air-Conditioner Company Limited ("Hisense Air-Conditioner") under which Greencool Enterprise agrees to transfer 262,212,194 domestic legal person shares in the Company to Hisense Air-Conditioner representing 26.43% of the Company's total issued share capital. The aforesaid transfer is expected to complete after the relevant regulatory approvals have been obtained.

On 16 September 2005, the Company entered into a sales agency agreement (as amended by the first supplemental agency agreement on 26 September 2005 and the second supplemental agency agreement on 1 April 2006) with Qingdao Hisense Marketing Company Limited ("Hisense Agent") under which Hisense Agent acts as sales agent of the Company's domestic sales products by way of distribution within the entire PRC domestic market. Both Hisense Air-Conditioner and Hisense Agent are subsidiaries controlled by Hisense Group Company Limited ("Hisense Group").

The principal terms of the sales agency agreement (as amended by the first supplemental agency agreement on 26 September 2005 and the second supplemental agency agreement on 1 April 2006) are as follows:

- Hisense Agent agreed that it would advance an aggregate prepayment for purchases of the Company's products in an amount not exceeding RMB600 million;

- An interest (at the rate equivalent to the annual interest rates on working capital loans announced by the People's Bank of China from time to time) would be calculated by reference to the amount of prepayments received by the Company and would be confirmed and settled upon the expiry of the sales agency agreement.

33. RELATED PARTY TRANSACTIONS *(continued)*

- Upon delivery of the products by the Company to the warehouses designated by Hisense Agent, the title to the products will pass to Hisense Agent, and the Company will recognise the relevant proceeds from such sales as sales revenue;
- In the event that Hisense Agent is unable to recover any proceeds from sale of products under the sales agency agreement to any distributor, Hisense Agent and/or the distributor has no right to claim against the Company pursuant to the sales agency agreement;
- Hisense Agent will receive 1% of the total amount of sales proceeds of products under the sales agency agreement as agency fee from the Company;
- The effective turnover period for the proceeds of products commissioned by the Company to Hisense Agent is 60 days; and
- The price of the products that the Company sells to Hisense Agent will be equivalent to the price Hisense Agent sells to the distributors, which price shall be determined by the Company and the distributors.

Because of the above relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

I. Relationship with related parties

During the year, for the purpose of this report, the directors are of the view that the following companies are related parties of the Group:

Name of related parties	Notes	**Relationship**
Greencool Enterprise		The single largest shareholder of the Company as at 31 December 2005
Mr. Gu		The beneficial owner of Greencool Enterprise and also the executive director of the Company as at 31 December 2005
Greencool Technology Development (Shenzhen) Company Limited ("Shenzhen Greencool Technology")		A company controlled by Mr. Gu
Greencool Environmental Protection Engineering (Shenzhen) Company Limited ("Shenzhen Greencool Environmental")		A company controlled by Mr. Gu
Greencool Refrigerant (China) Company Limited ("Greencool China")		A company controlled by Mr. Gu
Hainan Greencool Environmental Protection Engineering Company Limited ("Hainan Greencool")		A company controlled by Mr. Gu

33. RELATED PARTY TRANSACTIONS *(continued)*

I. Relationship with related parties *(continued)*

Name of related parties	Notes	**Relationship**
Greencool Procurement (Shenzhen) Co., Ltd. ("Greencool Procurement")		A company controlled by Mr. Gu
Hefei Meiling Holdings Limited ("Hefei Meiling")		A company controlled by Mr. Gu
Jiangxi Greencool Electrical Appliance Company Limited ("Jiangxi Greencool")		A company controlled by Mr. Gu
Yangzhou Yaxing Motor Coach Company Limited ("Yangzhou Yaxing")		A company controlled by Mr. Gu
Chengdu Refrigerating Components Factory ("Chengdu Refrigerating")	(i)	A company suspected to be connected with Mr. Gu
Hefei Weixi Electrical Appliance Company Limited ("Hefei Weixi")	(i), (ii)	A company suspected to be connected with Mr. Gu
Jiangxi Keda Plastic Technology Company Limited ("Jiangxi Keda")	(i)	A company suspected to be connected with Mr. Gu
Jiangxi Kesheng Trading Company Limited ("Jiangxi Kesheng")	(i)	A company suspected to be connected with Mr. Gu
Jinan San'ai'fu Chemical Company Limited ("Jinan San'ai'fu")	(i)	A company suspected to be connected with Mr. Gu
Tianjin Lixin Trading Development Company Limited ("Tianjin Lixin")	(i)	A company suspected to be connected with Mr. Gu
Tianjin Taijin Yunye Company Limited ("Tianjin Taijin Yunye)	(i)	A company suspected to be connected with Mr. Gu
Tianjin Xiangrun Trading Development Company Limited ("Tianjin Xiangrun")	(i)	A company suspected to be connected with Mr. Gu
Wuhan Changrong Electrical Appliance Company Limited ("Wuhan Changrong")	(i), (ii)	A company suspected to be connected with Mr. Gu

33. RELATED PARTY TRANSACTIONS *(continued)*

I. Relationship with related parties *(continued)*

Name of related parties	Notes	Relationship
Zhongshan Dongyue Electrical Company Limited ("Zhongshan Dongyue")	(i)	A company suspected to be connected with Mr. Gu
Zhejiang Guoda Trading Company Limited ("Zhejiang Guoda")	(i)	A company suspected to be connected with Mr. Gu
Zhejiang Yuhuan Compressor Factory ("Zhejiang Yuhuan ")	(i)	A company suspected to be connected with Mr. Gu
Beijing De Heng Solicitors ("Beijing De Heng")	(i)	A company suspected to be connected with Mr. Gu
Zhuhai Defa Air-conditioner Fittings Company Limited ("Zhuhai Defa")	(i)	A company suspected to be connected with Mr. Gu
Zhuhai Longjia Refrigerating Plant Company Limited ('Zhuhai Longjia")	(i)	A company suspected to be connected with Mr. Gu
Hisense Air-Conditioner		The successor single largest shareholder of the Company
Hisense Agent		A fellow subsidiary of Hisense Air-Conditioner
Hisense Electric Co., Ltd. ("Hisense Electric")		A fellow subsidiary of Hisense Air-Conditioner
Chongqing Kelon Rongsheng Refrigerator Sales Co., Ltd. ("Chongqing Rongsheng")		An associate of the Group
Guangzhou Antaida Logistic Co., Ltd. ("Guangzhou Antaida")		An associate of the Group
Huayi Compressor Holdings Company Limited ("Huayi")		An associate of the Group
Jiaxibeila Compressor Company Limited ("Jiaxibeila")		A subsidiary of an associate of the Group
Kelon Europe		An unconsolidated subsidiary of the Company

33. RELATED PARTY TRANSACTIONS *(continued)*

I. Relationship with related parties *(continued)*

Name of related parties	Notes	**Relationship**
Jiangxi Combine		An unconsolidated subsidiary of the Company
Chengdu Engine (Group) Company Limited ("Chengdu Engine")		A minority investor of Chengdu Kelon
Chengdu Xinxing Electrical Appliance Holdings Company Limited ("Chengdu Xinxing")		An associate of Chengdu Engine
Hangzhou Xileng Group Company Limited ("Hangzhou Xileng")		A minority investor of Hangzhou Kelon
Xi'an Gaoke (Group) Limited ("Xi'an Gaoke")		A minority investor of Xian Kelon
Shunde Yunlong Consultancy ("Shunde Yunlong")		A minority investor of Huaao Electronics

(i) The directors suspected that these companies are connected with Mr. Gu in view of the following reasons: (a) certain transactions (cash flows) were incurred through some off balance sheet bank accounts or were off balance sheet transactions with some members of the Group, and other dealings in such off balance sheet bank accounts have been proved to be connected with Greencool Enterprise and its affiliates; (b) through interviews and enquiries conducted by an external professional firm, staff of some of the members of the Group have confirmed that certain transactions (cash flows) of these companies are connected with Greencool Enterprise and its affiliates; (c) although there are no documents to prove that certain cash flows of these companies are connected with Greencool Enterprise and its affiliates, such cash flows were incurred pursuant to the instructions of the former members of the management of the Company who are connected with Greencool Enterprise and its affiliates; (d) the raw materials which were the subject of certain prepayments were patented products manufactured by Greencool Enterprise and its affiliates; and (e) according to the members of senior management of certain members of the Group, certain prepayments were transferred to Greencool Enterprise and its affiliates subsequent to such prepayments being made to the relevant suppliers.

(ii) Hefei Weixi and Wuhan Changrong were frequently used by Mr. Gu as the vehicle to manipulate the Group's results in prior years by way of creating abnormal sales transactions and sales returns. The directors considered, by the reference to the findings of an external professional firm, that Hefei Weixi and Wuhan Changrong are suspected to be connected with Mr. Gu.

33. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties

(a) Transactions with Greencool Enterprise and its affiliates

(i) The Group had the following significant transactions with Greencool Enterprise and its affiliates that were carried out in the normal course of business:

	2005 **RMB'000**	2004 *RMB'000*
Sales of goods/raw materials to Hefei Meiling	**99**	–
Loan guarantee provided by Greencool Enterprise		
– maximum amount during the year	**327,971**	295,000
– amount as at 31 December	**327,971**	180,000

(ii) Licence agreement on the use of trademark: Under a licence agreement ("Licence Agreement") dated 3 April 2003 entered into between the Company and Greencool China, Greencool China granted to the Company an exclusive right to use the trademark "Combine" for no consideration (a) as registered in the PRC and Hong Kong; and/or (b) as may from time to time be registered and/or in respect of which applications for registration may be made with the trademarks registry of any other territory by Greencool China; and/or (c) all "Combine" trademark registrations as may be assigned to Greencool China from time to time on freezers, refrigerators and other similar or related products and such other products as may be requested by the Company from time to time which are not objected by Greencool China, on a worldwide basis, for a term equivalent to the period of validity of the relevant registration. With the prior written consent of the Company, Greencool China may use and allow third party to use, such trademarks on production other than the types of products covered by the Licence Agreement. During the year, the Group has been using the trademark of "Combine" on the refrigerators products and air-conditioners products under the Licence Agreement.

(iii) Use of land and buildings: Starting from October 2003, Jiangxi Kelon occupied a piece of land and manufacturing facilities of Jiangxi Greencool free of charge. Part of the production facilities of Zhuhai Kelon were constructed on the land and buildings controlled by Mr. Gu for no consideration. As at 31 December 2005, none of Jiangxi Kelon nor Zhuhai Kelon had entered into lease agreement with the respective related parties.

(iv) A series of transactions were conducted through a bank account of one of the Company's wholly-owned subsidiaries, Kelon Air-Conditioner during the period between March 2003 and February 2004. Such transactions involved the unauthorised use of a company chop of Kelon Air-Conditioner and the relevant chop authorizing financial transactions. The following balances were not reflected in the financial statements of Kelon Air-Conditioner in 2003 and 2004:

- an amount of RMB32 million receivable from Shenzhen Greencool Technology;
- an amount of RMB33 million receivable from Shenzhen Greencool Environmental; and
- an amount of RMB65 million payable to Tianjin Taijin Yunye.

(v) On 10 March 2005, a subsidiary of the Company entered into a purchase agreement relating to refrigerants with Hainan Greencool. The transaction had not been approved by the board of directors of the Company and involved an amount of approximately RMB13.5 million. The purchase price was paid on 29 April 2005 but not in accordance with the Company's normal payment approval procedures. As at 31 December 2005, most of the relevant refrigerants have been received.

33. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(b) Transactions with companies suspected to be connected with Mr. Gu

The Company suspected that Mr. Gu had entered into a series of activities/transactions during the period from 2001 to 2005 which had been harmful to the Group, including but not limited to unauthorised use of the Group's funds, fictitious sales of goods and scrap materials, unreasonable prepayments made to Greencool Enterprise and/or its affiliates and purchase of raw materials and property, plant and equipment at an unreasonable quantity and price from Greencool Enterprise and/or its affiliates.

(i) *Jinan San'ai'fu* – During the period between 6 and 14 April 2005, Jianxi Kelon made advance payment in an amount of RMB81.6 million to Jinan Sanai Fu, a new supplier, for purchase of R411C refrigerants. The goods were to be delivered during the period between 1 May and 31 August 2005 with payment on delivery. As at 31 December 2005, the Group has not received any of the refrigerants. On 7 April 2005, Jiangxi Kelon made advance payment, on behalf of Kelon Air-conditioner, to Jinan San'ai'fu in an amount of RMB40.8 million for purchase of refrigerants. As at 31 December 2005, less than one-third of the refrigerants have been received by the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, suspected that Jinan San'ai'fu is connected with Mr. Gu.

(ii) *Tianjin Xiangrun* – Kelon Fittings had during the period between 26 and 28 April 2005 made five advance payments in an aggregate amount of approximately RMB97.4 million, to Tianjin Xiangrun, a new supplier, for purchase of raw materials. As at 31 December 2005, only a small portion of the goods were delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, revealed that Tianjin Xiangrun has transferred the fund to Greencool Procurement, a company controlled by Mr. Gu. The directors suspected that Tianjin Xiangrun is connected with Mr. Gu.

(iii) *Tianjin Lixin* – On 26 and 27 April 2005, the Company's wholly-owned subsidiary, Shenzhen Kelon Purchase Company Limited made two advance payments in an aggregate amount of RMB89.6 million to a new supplier called Tianjin Lixin. The goods were to be delivered during the period between 1 May 2005 and 31 August 2005 with payment on delivery. As at 31 December 2005, only a small portion of the goods were delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, revealed that Tianjin Lixin has transferred the fund to Greencool Procurement. The directors suspected that Tianjin Lixin is connected with Mr. Gu.

(iv) *Zhongshan Donyue* – Jiangxi Kelon has, on behalf of Kelon Air-conditioner, made two prepayments to Zhongshan Donyue amounted to RMB30 million and RMB50 million for purchase of raw materials on 4 April and 6 April 2005, respectively. As at the balance sheet date, most of the raw materials have been delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance of an external professional firm, revealed that Zhongshan Donyue has transferred the prepayments in an aggregate amount of RMB80 million to Greencool Procurement at the same date.

33. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(b) Transactions with companies suspected to be connected with Mr. Gu (continued)

(v) *Jiangxi Keda* – Jiangxi Kelon has made prepayments amounting to RMB13 million to Jiangxi Keda in May 2005 for purchases of raw materials/parts. As at the balance sheet date, the Group has not received any of the raw materials/parts. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance of an external professional firm, revealed that the prepayments have subsequently been transferred to Greencool Enterprise and/or its affiliates.

(vi) *Jiangxi Kesheng* – Kelon Air-conditioner has made advance payments of approximately RMB12.8 million and RMB18.6 million to Jiangxi Kesheng for purchase of refrigerants on 6 April and 19 April 2005 respectively. As at the balance sheet date, most of the refrigerants were delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, suspected that Jiangxi Kesheng is connected with Greencool and/or its affiliates.

(vii) Certain off book transactions involving the Company's wholly-owned subsidiary, Jiangxi Kelon were conducted in 2003 and 2004 resulting in net outstanding receivables of approximately RMB57 million from the following entities as at 31 December 2005:

* an amount of RMB20 million receivable from Wuhan Changrong;
* an amount of RMB21.4 million receivable from Zhuhai Defa;
* an amount of RMB28.6 million receivable from Zhuhai Longjia; and
* an amount of RMB13 million payable to Jiangxi Greencool.

(viii) In June 2003, the Company entered into the "Project Investment and Cooperation Contract" between Yangzhou Economic Development Zone, stipulating that Yangzhou Economic Development Zone provided the land of 729,000 square meters in area in the Development Zone, that the consideration of the land use right transfer was RMB45 million and that the Company would obtain the Land Use Certificate in 12 December 2003. In August 2003, the Company's subsidiary Yangzhou Kelon entered into "State-owned Land Use Right Transfer Contract" between Yangzhou State Land Resources Bureau Development Zone Branch, stipulating that the transferor transferred the land of 729,000 square meters in consideration of RMB102 million. Yangzhou Kelon has paid RMB45 million land premium to Yangzhou State Land Resources Bureau Development Zone Branch, and in April 2004, Yangzhou Kelon paid RMB40 million to Finance Bureau of Yangzhou Economic Development Zone again. The management (having sought legal advice) consider that the "State-owned Land Use Right Transfer Contract" signed in August 2003 would have been invalid and the management suspected that the RMB40 million paid would have eventually been transferred to companies connected with Mr. Gu.

33. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(b) Transactions with companies suspected to be connected with Mr. Gu (continued)

(ix) An assets transfer agreement was entered into between Shangqiu Kelon and Shangqiu Bing Xiong on 6 July 2004, Mr. Gu Chu Jun and Mr. Wang Zhan Min, were the respective legal representatives. Pursuant to the agreement, Shangqiu Bing Xiong transferred the assets purchased from Henan Bing Xiong Ice Maker Company Limited ("Bing Xiong Ice Maker") and Henan Bing Xiong Air-Conditioner Company Limited and the state-owned land use rights transferred from the Administration Committee of Shangqiu Economic and Technological Development Zone (商丘經濟技術開發區管理委員會) to Shangqiu Kelon at a consideration of RMB58,030,000. The directors, with the assistance of an external professional firm, suspected that Shangqiu Bing Xiong is connected with Mr. Gu.

(c) Transactions with Hisense Group

The Group had the following significant transactions with Hisense Group:

	Notes	**2005** **RMB'000**	2004 RMB'000
Sales of goods/raw materials to			
– Hisense Agent	(i)	**868,235**	–
Agency fee paid/payable to			
– Hisense Agent	(ii)	**8,773**	–
Loan interest payable to			
– Hisense Agent		**3,410**	–
Purchases of goods/raw materials from			
– Hisense Air-Conditioner	(i)	**2,571**	–
Sales of moulds to			
– Hisense Electric	(i)	**2,081**	–

(i) Sales and purchases were conducted in accordance with mutually agreed terms with reference to the market rates.

(ii) Agency fee was based on 1% of the total amount of sales proceeds of products under the sales agency agreement.

33. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(d) Transactions with associates

The Group had the following significant transactions with associates:

	Notes	**2005** **RMB'000**	2004 RMB'000
Sales of goods/raw materials to			
– Chongqing Rongsheng		**761**	57,627
Purchases of goods/raw materials from			
– Huayi and Jiaxibeila	(i)	**105,288**	155,262
Logistics management fee paid to			
– Guangzhou Antaida	(ii)	**6,375**	7,972

(i) Huayi and Jiaxibeila mainly provide compressors to the Group for production of air-conditioners and refrigerators.

(ii) The Group and Guangzhou Antaida entered into a logistics service agreement, pursuant to which Guangzhou Antaida provides transportation service to the Group. The service fee is based on the actual volume of goods and the distance delivered and discharged at a pre-determined rate agreed by both parties.

(e) Transactions with other related parties

The Group had the following significant transactions with other related parties:

	Notes	**2005** **RMB'000**	2004 RMB'000
Sales of goods/raw materials to			
– Chengdu Xinxing		**26,522**	26,153
Purchases of goods/raw materials from			
– Chengdu Xinxing		**28,805**	6,142
– Chengdu Engine		**4,390**	5,271
Interest charged to			
– Chengdu Xinxing	(i)	**1,986**	1,986
Water and electricity expenses paid to			
– Chengdu Engine	(ii)	**5,072**	–
Lease payment in respect of plant and equipment to			
– Hangzhou Xileng	(iii)	**6,000**	4,000

33. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(e) Transactions with other related parties (continued)

(i) The Company made prepayments in an aggregate of RMB34,000,000 indirectly through its subsidiary, Chengdu Kelon, to Chengdu Xinxing, which is an associate of Chengdu Engine, the minority investor of Chengdu Kelon. As consideration for such prepayment, Chengdu Xinxing agreed to repay Chengdu Kelon by supplying an agreed number of refrigeration parts together with interest payments at an annual rate of approximately 5.8%.

(ii) Water and electricity expenses are charged at cost.

(iii) Lease payment in respect of plant and equipment to Hangzhou Xileng is determined by reference to an equipment lease agreement entered into between Hangzhou Kelon and Hangzhou Xileng.

III. Balances with related parties

(a) Balances with Greencool Enterprise and its affiliates

	Notes	2005 *RMB'000*	2004 *RMB'000* (Restated)
Included in trade and other receivables, net			
– Greencool Enterprise		**7,963**	–
– Hainan Greencool	II (a)(v)	**976**	–
– Hefei Meiling		**116**	6
– Shenzhen Greencool Technology	II (a)(iv)	**32,000**	32,000
– Shenzhen Greencool Environmental	II (a)(iv)	**33,000**	33,000
		74,055	65,006
Included in trade and other payables			
– Hefei Meiling		**17**	50
– Jiangxi Greencool	II (b)(vii)	**13,000**	–
– Yangzhou Yaxing		**–**	220
		13,017	270

Amounts due from/to Greencool Enterprise and its affiliates are unsecured, interest-free and repayable on demand.

As at 31 December 2005, impairment loss for bad and doubtful debts of approximately RMB19,276,000 (2004: Nil) were recorded in respect of amounts due from Greencool Enterprise and its affiliates.

33. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

(b) Balances with companies suspected to be connected with Mr. Gu

	Notes	**2005 RMB'000**	2004 RMB'000 (Restated)
Included in trade and other receivables, net			
– Beijing De Heng		**1,000**	–
– Hefei Weixi	I (ii)	**8,270**	15,610
– Jiangxi Keda	II (b)(v)	**6,500**	–
– Jiangxi Kesheng	II (b)(vi)	**4,183**	–
– Jinan San'ai'fu	II (b)(i)	**56,683**	–
– Tianjin Lixin	II (b)(iii)	**44,800**	–
– Tianjin Xiangrun	II (b)(ii)	**48,199**	–
– Wuhan Changrong	I (ii), II (b)(vii)	**24,922**	29,844
– Zhongshan Dongyue	II (b)(iv)	**12,678**	–
– Zhuhai Defa	II (b)(vii)	**10,700**	–
– Zhuhai Longjia	II (b)(vii)	**14,300**	–
		232,235	45,454
Included in trade and other payables			
– Chengdu Refrigerating		**–**	4,606
– Jiangxi Keda	II (b)(v)	**622**	–
– Tianjin Taijin Yunye	II (a)(iv)	**65,000**	65,000
– Zhejiang Guoda		**–**	104
– Zhongshan Dongyue	II (b)(iv)	**2,594**	9,791
– Zhuhai Longjia	(i)	**28,316**	23,737
– Zhuhai Defa	(i)	**21,400**	34,372
– Zhejiang Yuhuan		**223**	223
		118,155	137,833

33. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

(b) Balances with companies suspected to be connected with Mr. Gu (continued)

(i) Certain of the Company's subsidiaries have recorded sales of scrapped materials to Zhuhai Longjia and Zhuhai Defa in aggregate of approximately RMB40 million in 2003 and 2004. The findings of an external professional firm revealed that the amounts have been received by the respective subsidiaries but the materials were never delivered to Zhuhai Longjia and Zhuhai Defa. It was suspected that these transactions were not supported by business substance but for the purpose of manipulation of the Group's results. These transactions were executed by Yan Guo Ru (晏果如) former vice financial controller（前任財務資源部副總監）who, together with the ex-chairman Mr. Gu and certain of the ex-senior management were arrested by the PRC Police Department in connection with criminal offences, for alleged economic crime. Against this background, the directors suspected that Zhuhai Longjia and Zhuhai Defa are connected with Greencool and/or its affiliates and the balances were included in "Amounts due to companies suspected to be connected with Mr. Gu".

Amounts due from/to companies suspected to be connected with Mr. Gu are unsecured, interest-free and repayable on demand.

As at 31 December 2005, impairment loss for bad and doubtful debts of approximately RMB354,724,000 (2004: Nil) were recorded in respect of amount due from Greencool Enterprise and its affiliates.

(c) Balances with Hisense Group

	2005	2004
	RMB'000	*RMB'000*
Included in trade and other receivables		
– Hisense Agent	**204,349**	–
	204,349	–
Included in trade and other payables		
– Hisense Agent	**17,257**	–
	17,257	–

Amounts due from/to Hisense Group are unsecured, interest-free and are repayable in accordance with normal commercial terms.

As at 31 December 2005 and 2004, no impairment losses for bad and doubtful debts were recorded in respect of amounts due from Hisense Group.

33. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

(d) Balances with associates

	2005 RMB'000	2004 RMB'000 (Restated)
Included in trade and other receivables		
– Chongqing Rongsheng	137	–
– Guangzhou Antaida	3	–
	140	–
Included in trade and other payables		
– Guangzhou Antaida	24	–
– Chongqing Rongsheng	–	4,422
– Huayi and Jiaxibeila	75,307	107,773
	75,331	112,195

Amounts due from/to associates are unsecured, interest-free and are repayable in accordance with normal commercial terms.

As at 31 December 2005 and 2004, no impairment losses for bad and doubtful debts were recorded in respect of amounts due from associates.

33. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

(e) Balances with other related parties

	2005 *RMB'000*	2004 *RMB'000* (Restated)
Included in trade and other receivables, net		
– Chengdu Engine	**27**	27
– Chengdu Xinxing	**35,802**	6,444
– Kelon Europe	**5,919**	–
	41,748	6,471
Included in amount due from a related company – non-current		
– Chengdu Xinxing	**–**	34,000
	–	34,000
Included in trade and other payables		
– Chengdu Engine	**434**	434
– Chengdu Xinxing	**2,538**	2,241
– Hangzhou Xileng	**9,774**	4,000
– Jiangxi Combine	**5,100**	
– Xi'an Gaoke	**1,785**	2,358
– Others	**–**	791
	19,631	9,824

Save for the balance of RMB34,000,000 due from Chengdu Xinxing, all amounts due from/to other related companies are unsecured, interest-free and are repayable on demand. The term and conditions associated with the balance of RMB34,000,000 due from Chengdu Xinxing are set out in Note 33 II (e)(i).

As at 31 December 2005 and 2004, impairment losses for bad and doubtful debts of approximately RMB4,686,000 (2004: Nil) were recorded in respect of amounts due from other related companies.

IV. Key management personnel emoluments

	Year ended 31 December 2005 *RMB'000*	 2004 *RMB'000*
Basic salaries, allowances and benefits-in-kind	**15,797**	19,121
Retirement fund contributions	**–**	–
	15,797	19,121

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, including directors and other senior management, totaling 19 individuals (2004: 14 individuals).

34. CAPITAL COMMITMENTS

	2005 *RMB'000*	2004 *RMB'000*
Capital expenditure for acquisition of property, plant and equipment contracted for but not provided in the financial statements	**23,309**	109,884

35. RETIREMENT BENEFITS SCHEMES

The Group contributes mainly to a defined contribution pension scheme, which is administered by the provincial government, in respect of employees of the Group. According to such scheme, the Group shall pay an amount, calculated at a percentage of the total salaries and wages of the employees, to a retirement reserve.

The total cost charged to the income statement of approximately RMB25,129,000 (2004: RMB19,518,000) represents contributions payable to the scheme by the Group at rates specified in the rules of the scheme.

36. RESERVES

(a) Statutory reserves

According to the Articles of Association of the Company, when distributing net profit of each year, the Company shall set aside 10% of its after tax profits for the statutory common reserve fund (except where the fund has reached 50% of the Company's registered capital) and 5% to 10% of after tax profits for the statutory common welfare fund. These reserves cannot be used for purposes other that those for which they are created and are not distributable as cash dividends.

(b) Distributable reserves of the Company

In accordance with the Articles of Association of the Company, the accumulated profits of the Company for the purpose of profit distribution will be deemed to be the lesser of (i) the amount determined in accordance with PRC accounting standards and regulations ("PRC GAAP") and (ii) the amount determined in accordance with IFRS.

As at 31 December 2005, the Company did not have reserve available for distribution to its shareholders due to substantial loss incurred during the year. (2004: Nil (restated)).

37. CONTINGENCIES

In addition to the contingencies set out in note 17 to the financial statements, the Group has the following material contingencies as at 31 December 2005:

The Group is a defendant in certain lawsuits as well as the plaintiff in other proceedings arising in the ordinary course of business. The amount involved in the litigations against the Group relate mainly to bank loans, purchases and expenditures incurred by the Group and most of them were recorded as liabilities of the Group as at the balance sheet date. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have material adverse effect on the financial position or operating results of the Group.

38. SUBSEQUENT EVENTS

The following significant events took place subsequent to 31 December 2005:

(a) On 1 April 2006, the Company signed a second supplemental agency agreement ("Second Supplemental Agency Agreement") with Hisense Agent. The major amendments made by the Second Supplemental Agency Agreement to the sales agency agreement and the first supplemental agency agreement are as follows: (i) to increase the maximum aggregate value of purchases of products from the Company by Hisense Agent and (ii) to extend the effective period of the sales agency agreement from 31 March 2006 to 10 May 2006.

(b) During the extraordinary general meeting held on 26 June 2006, Ms. Yu Shu Min, Mr. Tang Ye Guo, Mr. Xiao Jian Lin, Mr. Zhang Ming, Mr. Su Yu Tao and Mr. Lin Lan were appointed as executive directors, and Mr. Cheung Yui Kai, Mr. Zhang Sheng Ping and Mr. Lu Qing were appointed as independent non-executive directors. Mr. Tang Ye Guo was elected by the board of directors in the board meeting as chairman on the same day.

Mr. Liu Cong Meng, Mr. Li Zhen Hua, Mr. Fang Zhi Guo, Mr. Gu Chu Jun, Mr. Yan You Song, Mr. Zhang Hong, Mr. Li Kung Man and Mr. Xu Xiao Lu resigned as directors on 26 June 2006.

39. COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified as a result of the retrospective restatement of errors as disclosed in Note 2 and the retrospective application of new accounting policies as disclosed in Note 3.

40. POTENTIAL IMPACT ARISING ON THE AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended 31 December 2005 and which have not been adopted in these financial statements:

		Effective for accounting period beginning on or after
IFRS 6	Exploration for and evaluation of mineral resources	1 January 2006
IFRS 7	Financial instruments: disclosures	1 January 2007
IFRIC 4	Determining whether an arrangement contains a lease	1 January 2006
IFRIC 5	Rights to interests arising from decommissioning, restoration environmental rehabilitation funds	1 January 2006
IFRIC 6	Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005
IFRIC 7	Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies	1 March 2006

40. POTENTIAL IMPACT ARISING ON THE AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE *(continued)*

		Effective for accounting period beginning on or after
IFRIC 8	Scope of IFRS 2	1 May 2006
Amendment to IAS 1	Presentations of financial statements: capital disclosures	1 January 2007
Amendment to IAS 19	Employee benefits – Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
Amendment to IAS 21	Net investment in a foreign operation	1 January 2006
Amendments to IAS 39	Financial instruments: Recognition and measurement:	
	– Cash flow hedge accounting of forecast intra-group transactions	1 January 2006
	– The fair value option	1 January 2006
	– Financial guarantee contracts	1 January 2006
Amendments to IFRS 1	First-time Adoption of International Financial Reporting Standards	1 January 2006

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far the Group believes that the adoption of IFRIC 4, IFRIC 5, IFRIC 6, IFRIC 7, IFRIC 8, and the amendments to IAS 19 and IFRS 1 are not applicable to any of the Group's operations and that the adoption of the rest of the above amendments, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

41. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF UNCERTAINTY

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

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

41. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF UNCERTAINTY *(continued)*

Impairment

In considering the impairment losses that may be required for certain of the Group's assets which include property, plant and equipment, construction in progress, interests in leasehold land under operating leases, intangible assets, goodwill and investments in subsidiaries and associates, recoverable amounts of the assets need to be determined. The recoverable amount is the greater of the fair value less costs to sell and the value in use. It is difficult to precisely estimate fair value less costs to sell because quoted market prices for these assets may not be readily available. In determining the value in use, expected cash flows generated by the asset are discounted to their present value, which require significant judgment relating to items such as level of sales, selling price and amount of operating costs. The Group uses all readily available information in determining amounts that are reasonable approximations of recoverable amounts, including estimates based on reasonable and supportable assumptions and projections of items such as sales volume, selling price and amount of operating costs.

In considering the impairment losses that may be required for current receivables, future cash flows need to be determined. One of the key assumptions that has to be applied is the ability of the debtors to settle the receivables. Although the Group has used all available information to make this estimation, inherent uncertainty exists and actual may be different from the amount estimated.

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual values. The Group reviews the estimated useful lives of the assets regularly. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Warranty provision

As explained in noted 28(i), the Group makes provisions under the warranties it gives on sales of its electrical products taking into account the Group's recent claim experience. As the Group is continuously upgrading its product designs and launching new models, it is possible that recent claim experience is not indicative of the future claims that it will receive in respect of past sales. Any increase or decrease in the provision would affect profit or loss in future years.