

## I. GENERAL

Guangdong Kelon Electrical Holdings Company Limited (hereinafter referred to as the “Company”) is a joint stock limited company incorporated in the PRC on 16 December 1992. The Company’s 459,589,808 overseas listed public shares (the “H Shares”) were listed on The Stock Exchange of Hong Kong Limited on 23 July 1996. In 1998, the Company obtained approval to issue 110,000,000 domestic shares (the “A Shares”), which were listed on the Shenzhen Stock Exchange on 13 July 1999.

In October 2001 and March 2002, the former single largest shareholder of the Company, Guangdong Kelon (Rongsheng) Group Company Limited (hereinafter referred to as “Rongsheng Group”, previously held 34.06% interest in the Company) entered into a share transfer agreement and a supplementary agreement with Shunde Greencool Enterprise Development Company Limited (it was renamed as “Guangdong Greencool Enterprises Development Company Limited in 2004, hereinafter referred to as “Guangdong Greencool”), in connection with the transfer of 20.64% of the total share capital of the Company to Guangdong Greencool. In April 2002, Rongsheng Group transferred its shareholding of 6.92%, 0.71% and 5.79% of the total share capital of the Company to Shunde Economic Consultancy Company, Shunde Dong Heng Development Company Limited and Shunde Xin Hong Enterprise Company Limited, respectively. After the above-mentioned share transfers, Rongsheng Group, the former single largest shareholder of the Company, no longer held any shares of the Company.

On 14 October 2004, Guangdong Greencool, as transferee, had been transferred 5.79% of the total share capital of the Company held by Shunde Xin Hong Enterprise Company. Upon completion of the share transfer, the percentage of total share capital of the Company held by Guangdong Greencool increased to 26.43%.

On 9 September 2005, Qingdao Hisense Air-Conditioner Company Limited (hereinafter referred to as “Hisense”) entered into a share transfer agreement with Guangdong Greencool, pursuant to which Hisense proposed to purchase 26.43% of the total share capital of Kelon Electrical. Up to 31 December 2005, the registration of the share transfer was not yet completed.

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

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

### 1. Accounting regulations and standards

The accounting policies adopted by the Company are in accordance with “Accounting Standards for Business Enterprises” and “Accounting System for Business Enterprises” and the supplementary regulations.

### 2. Accounting year

The Company adopts the Gregorian calendar year as its accounting year, i.e. from 1 January to 31 December of each year.

### 3. Basis of accounting and principle of measurement

The Company maintains its accounting records on accrual basis. Assets are recorded at historical cost. However, certain fixed assets were restated at assessed value from 1999.

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 4. Reporting currency

The reporting currency of the Company is Renminbi (“RMB”).

### 5. Foreign exchange translation

Transactions in foreign currencies are translated into RMB at the applicable rates of exchange (“market exchange rate”) prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are translated into RMB at the market exchange rate prevailing at the balance sheet date. Gains and losses arising on exchange are included in financial expenses, except from those arising from the special foreign borrowings for the acquisition and construction of fixed assets which were included in the cost of assets before they are ready for use, and those arising in the pre-operating period which were recorded as long term deferred expenditures for amortisation.

### 6. Basis of consolidation

#### (1) Consolidation scope

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to the period ended 31 December each year. A subsidiary is an enterprise in which the Company, directly or indirectly, holds more than half of the equity, or where the Company controls the operation of the investee enterprise via other methods.

However, for those subsidiaries whose total assets, operating revenue and net profit are of an amount not material in accordance with the regulatory document “Answer to the Question about Consolidation Scope” (CKZ (96) No. 2) issued by the Ministry of Finance, their results are not included in consolidation. The Company accounts for the unconsolidated subsidiaries by using equity methods.

#### (2) Consolidation method

The principal accounting policies adopted by the subsidiaries are not completely consistent with the Company’s policy. In preparing the consolidated financial statements, the Company made necessary adjustments to the financial statements of these subsidiaries according to the accounting policies.

The operating results of subsidiaries during the year are included in the consolidated income statement and the consolidated cash flow statement from the effective date of acquisition as appropriate.

All significant intercompany transactions and balances are eliminated on consolidation.

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 7. Method for translation of foreign currency financial statements

The foreign currency financial statements of the Group's overseas subsidiaries are translated into RMB for consolidation by adopting the following methods:

Assets and liabilities are translated into RMB at the market exchange rate prevailing at the balance sheet date. Shareholders' equity, except for retained earnings, are translated into RMB at the market rates at transaction dates. All items in the statements of income and profit appropriation are translated at the applicable average exchange rates for the accounting period of the consolidated financial statements. Retained earnings at the beginning of the year represent the translated closing balance brought forward from the previous year; retained earnings at year end are arrived at after the translation of all other items in the income statement. The difference between translated assets and translated liabilities plus equity is shown separately in the balance sheet as exchange differences arising from the translation of the foreign currency in the financial statements under the item "Unappropriated profit".

The translation of cash flow has been made at the average foreign exchange rate. The effect of foreign exchange rate changes on cash will be treated as adjustments and is shown separately as "Effect of foreign exchange rate changes on cash" in the cash flow statement.

### 8. Cash equivalents

Cash equivalents are short-term (usually less than three months), highly liquid investments that are readily convertible to known amounts of cash and which are held by enterprises and subject to insignificant risk on changes in value.

### 9. Provision for bad debts

#### (1) *Criteria for recognition of bad debts*

- a. The irrecoverable amount for a debtor who becomes bankrupt after pursuing the statutory recovery procedures;
- b. The irrecoverable amount for a debtor who dies and has no offsetting estate and obligatory undertakers;
- c. The amount for a debtor who does not comply with repayment obligation after the debt becomes due, with sufficient evidence showing that such amount is irrecoverable or unlikely to be recovered.

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 9. Provision for bad debts *(continued)*

#### *(2) Accounting for provision for bad debts*

Provision for bad debts is accounted for using the allowance method and provided based on with the recoverability of accounts receivable as at year end.

Provision for bad debts against the account receivables for domestic customers is accounted for with reference to the aging analysis and the provision percentage is as follows:

Age	Provision percentage
Within 3 months	–
Over 3 months and within 6 months	10%
Over 6 months and within one year	50%
Over one year	100%

Bad debt provision is made against trade receivable from overseas customers by individually analysing large-amount receivables and then bad debts are calculated by using the aging analysis of accounts.

The provision for bad debts of other debtors is provided for individually based on the nature of current accounts and the past experiences of the Company, the actual financial position and cash flows condition of the debtor, and other information.

### 10. Inventories

Inventories are stated at actual cost of acquisition. Inventories include raw materials, work-in-progress and finished goods.

Standard cost is applied for the record of raw materials movement. At the end of each period, amortisation for cost variances is made to the standard cost to arrive at the actual cost.

Actual cost is applied for the record of movement of work-in-progress and finished goods, and is recognised on a weighted average basis.

Inventories are kept on a periodic inventory system. Inventories at year-end are measured at the lower of cost and net realisable value. Provision for impairment loss of inventories is made when the cost of inventories is higher than the net realisable value because of damage, partially or totally obsolete or the sale price falling below the cost, etc. Provision for impairment loss of inventories is made on an individual basis for the difference between the cost and the net realisable value.

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 11. Long-term investments

#### (1) *Accounting for long-term equity investments*

Long-term equity investments is stated at acquisition cost.

The cost method is used to account for long-term equity investments when the Company does not have control, joint control or significant influence over the investee enterprise. The equity method is used to account for long-term equity investments when the Company has control, joint control or has significant influence over the investee enterprise.

When the cost method is adopted, the amount of investment income recognised by the investing enterprise is limited to the amount distributed out of accumulated net profits after the investment made by the investing enterprise. The amount of profits or cash dividends declared by the investee enterprise in excess of the above threshold are regarded as return on investment and deducted from the carrying amount of investments accordingly.

When the equity method is adopted, the investment gain or loss is a portion of the investee's net income for the year by reference to the investor's interest in investee enterprise. Generally speaking, the Company recognises net losses incurred by an investee enterprise to the extent which the carrying amount of the investment is reduced to zero, except where the Company has committed financial support to the investee enterprise. If the investee enterprise realises net profit in subsequent periods, the carrying amount of the investment will be increased by the excess of the attributable share of profit over the share of unrecognised losses.

When a long-term equity investment is accounted for using the equity method, the difference between the initial investment cost of the Company and the Company's share of equity of the investee enterprise is shown as "long-term equity investment difference". The excess of the initial investments cost over the share of equity of the investee enterprise should be debited to the "long-term equity investment – equity investment difference" and amortised evenly over a specified investment period. Where the investment period is specified in the contract, it should be amortised over that investment period. If the investment period is not specified in the contract, the excess of the investment cost over the share of equity of the investee enterprise should generally be amortised over a period not more than 10 years. The shortfall of the initial investment cost over the share of equity of the investee enterprise, which has occurred prior to the issuance of document Caikuai [2003] No. 10, should be credited to the "long-term equity investment – equity investment difference" and amortised evenly over a specified period. Where the investment period is specified in the contract, it should be amortised over the investment period. If the investment period is not specified in the contract, the shortfall of the investment cost over the share of equity of the investee enterprise should generally be amortised over a period not less than 10 years. The shortfall of the initial investments cost over the share of equity of the investee enterprise, which occurred after the issue of document Caikuai [2003] No. 10, should be credited to "capital reserve – provision for equity investment".

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 11. Long-term investments *(continued)*

#### *(2) Provision for impairment of long-term investment*

At the end of each year, the Company determines whether an impairment should be recognised for a long-term investment by considering the indications that such a loss may have been incurred. Where the recoverable amount of long-term investment is lower than its book value, provision for impairment of long-term investment is recognised for the difference.

For Long-term equity investment accounted for by using the equity method, where difference between equity investment credit has been recognised previously and accounted for as capital reserve, impairment loss will first be used to offset capital reserve and shortcoming will be accounted for as current period profit and loss. Where difference between equity investment credit has been recognised during investment and amortised as an investment deduction, the impairment loss will first be used to offset the equity investment credit and the shortcoming will be accounted for as current profits and losses. Where difference between equity investment debit has been recognised during investment and amortised by stages, impairment loss will be fully accounted for the current profits and losses and at the same time eliminated the difference of equity investment. The shortcoming will be credited to the impairment provision of long-term investment.

### 12. Calculation of recoverable amount

Recoverable amount represents the higher of the net selling price of the asset and the estimated discounted future cash flow generated from the continuing use of the asset and from the disposal of such asset at the end of its useful life.

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 13. Fixed assets and depreciation

Fixed assets are tangible assets held by the Company for production, provision of services, lease or operation, with useful life exceeding one year and with a relatively higher unit cost.

Fixed assets are recorded at actual cost on acquisition. Depreciation is provided to write off the cost of each category of fixed assets over their estimated useful lives using straight-line method from the month after they are put into use. The estimated residual values, estimated useful lives and annual depreciation rates of each category of fixed assets are as follows:

Category	Estimated rate of residual value	Estimated useful life	Annual depreciation rate
Buildings and structures	0-5%	20-50 years	2%-4.75%
Machinery and equipment	5%	10 years	9.50%
Furniture, fixtures and office equipment	5%	5 years	19%
Motor vehicles	5%	5 years	19%
Moulds	0%	3 years	33.33%

#### *Provision for impairment of fixed assets*

At the end of each year, the Company assesses if there is any indication that fixed assets suffered from an impairment loss and determines whether provision for impairment of fixed assets should be made accordingly. When the recoverable amount of any fixed assets is lower than its carrying amount, an impairment loss on fixed assets will be recognised for the difference.

### 14. Construction in progress

Construction in progress is stated at actual cost incurred for the construction. Cost comprises construction expenditure incurred during the construction period, capitalised borrowing costs incurred on a specific borrowing for the construction of fixed assets before it has reached the working condition for its intended use and other relevant expenses. The construction in progress is transferred to fixed assets when it has reached the working condition for its intended use. No depreciation is provided for construction in progress.

Provision for impairment on construction in progress is made when the following situation exist (1) construction project is suspended for a long period and is not expected to be resumed within three years; (2) construction project is technically and physically obsolete and its economic benefits to the Company is uncertain, (3) other evidences can prove the existence of the decline in value of construction project. An impairment loss is recognised for the shortfall of the recoverable amount of construction in progress below its carrying amount.

## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 15. Intangible assets

Intangible assets are stated at actual cost. The actual cost of the intangible assets injected by the investors is determined by the value having been recognised by each party. The actual cost of acquired intangible assets is determined on the basis of the actual consideration paid. Intangible asset obtained with receivables is recognised at the book value of the receivables plus the cash compensation payable and the related tax expenses which are payable.

Intangible assets shall be amortised evenly by instalments within the estimated tenure of use from the month of acquisition and shall be stated in the profit and loss. Where the estimated tenure of use exceeds the benefited tenure provided in the relevant contract or the valid tenure required by law, the term of amortisation shall not be longer than the benefited tenure or the valid tenure whichever is the shorter. Where there is no benefited tenure in the contract nor valid tenure required by law, the tenure of amortisation shall be 10 years.

#### *Provision for impairment of intangible assets*

At the end of each year, the Company determines whether an impairment loss should be recognised for intangible assets by considering the indication that such a loss may have occurred. Where the recoverable amount of any intangible asset is lower than its carrying amount, an impairment loss on intangible assets is recognised for the difference.

### 16. Long-term deferred expenditures

Unless related to the acquisition or construction of fixed assets, all expenditure incurred during the pre-operating period is recognised as an expense in the month in which the enterprise commences operation.

Long-term deferred expenditures are recorded at cost when incurred, and amortised evenly over the expected benefited period.

### 17. Provision

Provision is recognised when obligations related to contingent items satisfy the following conditions: (1) such obligation is a present obligation of the enterprise, (2) it is probable that an outflow of economic benefits will be required to settle the obligation, and (3) a reliable estimate can be made of the amount of the obligation.

To the extent the amount payable for any provision will be compensated partly or wholly by a third party, such compensation will be recognised only when it is reasonably certain that the amount will be received.



## II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

### 18. Borrowing costs

Borrowing costs represent costs incurred in connection with the borrowing of funds, including interest charges, amortisation of discount and premium, auxiliary costs, and exchange differences. Borrowing costs are capitalised if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalisation of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalised until the assets are ready for their intended use. Other borrowing costs are recorded as financial expenses when incurred.

### 19. Basis of revenue recognition

*Sales revenue:* Sales revenue is recognised when the Company and the subsidiaries have transferred the significant risk and rewards of ownership to the buyer; and the Company neither retains the continuous managing rights usually related to the ownership nor control over the goods sold; the economic benefits associated with the transactions will flow into the Company; and relevant revenue and cost can be reliably measured.

*Service income:* Service income is recognised when the amount of revenue can be measured reliably; the stage of completion can be measured reliably; the economic benefits associated with the transaction will flow to the enterprise and the costs incurred in respect of the transaction can be measured reliably.

*Interest income:* Interest income is recognised on a time proportion basis at the applicable interest rates.

### 20. Leases

Finance lease is the lease having actually transferred all the risks and rewards related to the ownership of assets. The leases other than the finance lease are operating leases.

Rental payment for operating leases are recognised as an expense at the straight line method over the lease term.

Rental income from operating leases are recognised as income at the straight line method over the relevant term.

### 21. Income tax

Income tax is provided under tax payable method.

Income tax provision is calculated based on the accounting results for the year after adjustments in accordance with relevant tax laws.

### III. RECTIFICATION OF SIGNIFICANT ACCOUNTING ERRORS

Certain accounting records confirmed by the former management of the Company are not in line with the actual operational activities. The Company found that, in 2004, the Company inflated revenue from principal activities by RMB513,402,667 and profit from sales of scrap materials by RMB22,537,714, deflated advertising and other operating expenses by RMB24,058,136.23, and deflated loss from enterprise income tax ("EIT") by RMB17,435,805; in and prior to 2003, the Company inflated profit from sales of scrap materials by RMB21,900,316 and deflated loss from EIT by RMB5,615,218; each of the accrued other receivables and payables not recognised in 2003 and 2004 was RMB65,000,000.00. In preparing the accounting statements comparable between last year and the current year, the Company rectified the said significant accounting errors. As a result of the effect from the said accounting errors, the Company's opening balance of retained earnings for the year was inflated by an amount of RMB209,153,478.

The following sets forth the Company's accounting statements for 2004 prior to the rectification of the said accounting errors (combined figures):

Accounting items	Original amount	Adjusted amount	Restated amount
<b>Asset items</b>			
Trade receivables	1,178,037,096.00	(586,369,789.00)	591,667,307.00
Other receivables	203,943,804.00	62,066,370.00	266,010,174.00
Inventories	2,996,855,338.00	323,260,972.00	3,320,116,310.00
<b>Liability items</b>			
Advance from customers	852,637,382.00	9,366,720.00	862,004,102.00
Taxes payables	50,711,661.00	(59,505,869.00)	(8,794,208.00)
Other payables	282,707,583.00	172,378,687.00	455,086,270.00
Accrued charges	226,123,563.00	(114,128,507.00)	111,995,056.00
<b>Equity items</b>			
Revenue from principal operations	8,436,403,435.00	(513,402,667.00)	7,923,000,768.00
Cost of sales	6,612,276,473.00	(349,863,690.00)	6,262,412,783.00
Other operating profit	42,986,073.00	(22,537,714.00)	20,448,359.00
Distribution costs	1,206,454,256.00	(24,058,136.23)	1,182,396,119.77
Administrative expenses	522,860,315.00	(1,373,170.00)	521,487,145.00
Non-operating expenses	5,940,955.00	3,556,755.00	9,497,710.00
Income tax	6,282,249.00	17,435,805.00	23,718,054.00
Unappropriated profits at the beginning of the year	184,436,195.00	(27,515,534.00)	156,920,661.00

The above adjustments have the following effects on the financial position and operation results of the Company in 2004:

Total assets	11,361,393,597.00	(201,042,447.00)	11,160,351,150.00
Net assets	2,803,156,761.00	(209,153,478.00)	2,594,003,282.00
Net profit	(64,160,206.00)	(181,637,944.77)	(245,798,150.77)

#### IV. TAXATION

##### 1. Value-added Tax

Output tax was calculated based on the 17% of sales revenue for products and industrial services sold in the domestic market, and was charged according to the balance after the deduction of input tax. Products sold to foreign countries are subject to the value-added tax ("VAT") rate of 0%, with 13% of the VAT included in purchased raw materials refunded.

##### 2. Enterprise Income Tax

The Company was established in Foshan, Guangdong Province and located in Shunde High New Technology Development Zone. The Company was classified as a high new technology enterprise by Department of Science and Technology of Guangdong Province in June 2003. As recognised by the managing tax authority – National Tax Bureau of Shunde, the Company is subject to EIT at a rate of 15%. Together with the local EIT rate of 3%, the aggregate effective EIT rate is 18% in 2005.

The Company's sino-foreign joint venture subsidiaries established in coastal open economic zones in Foshan, Yingkou, Hangzhou are subject to an effective EIT rate of 27%.

The Company's sino-foreign joint venture subsidiaries established in special economic zones in Shenzhen and Zhuhai are subject to an effective EIT rate of 15%.

The Company's subsidiaries classified as high new technology enterprises are subject to an effective EIT rate of 15%.

The Company's sino-foreign joint venture subsidiaries established in the economy and technology development zones in cities such as Yangzhou, Nanchang, Wuhu, Kaifeng and Xi'an are subject to an effective EIT rate of 15-18%.

The effective EIT rate applicable for the sino-foreign subsidiaries established in Nanchang and Chengdu is 33% and 24%, respectively.

The Company's other subsidiaries established in Mainland China are subject to an EIT rate of 33%.

Profits tax for the Company's subsidiaries in Hong Kong has been provided at a rate of 17.5% on estimated assessable profit which was earned in or derived from Hong Kong.

##### 3. Other tax

Sales tax at a rate of 5% on the assessable income.

Urban construction tax at a rate of 1%-7% on the assessable circular tax.

## V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR

1. As at 31 December 2005, particulars of the subsidiaries of the Company are as follows:

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Pearl River Electric Refrigerator Company Limited ("Pearl River Refrigerator")	Hong Kong	HK\$400,000	-	100%	100%	Trading in raw materials and parts for refrigerators	Limited liability company	Yes
Kelon Electric Appliances Co., Ltd. ("Kelon Electric Appliances")	Hong Kong	HK\$10,000	-	100%	100%	Property investment	Limited liability company	Yes
Shunde Rongsheng Plastic Products Co., Ltd. ("Rongsheng Plastic Products")	Foshan	US\$15,800,000	45%	25%	70%	Manufacture of plastic parts	Sino-foreign joint venture enterprise	Yes
Kelon Development Company Limited ("Kelon Development")	Hong Kong	HK\$5,000,000	100%	-	100%	Investment holdings	Limited liability company	Yes
Guangdong Kelon Mould Co., Ltd. ("Kelon Mould")	Foshan	US\$15,000,000	40%	30%	70%	Manufacture of moulds	Sino-foreign joint venture enterprise	Yes
Guangdong Kelon Refrigerator Ltd. ("Kelon Refrigerator")	Foshan	US\$26,800,000	70%	30%	100%	Manufacture and sale of refrigerators	Sino-foreign joint venture enterprise	Yes
Guangdong Kelon Air-Conditioner Co., Ltd. ("Kelon Air-Conditioner")	Foshan	US\$36,150,000	60%	-	60%	Manufacture and sales of air-conditioners	Sino-foreign joint venture enterprise	Yes
Chengdu Kelon Refrigerator Co., Ltd. ("Chengdu Kelon")	Chengdu	RMB200,000,000	45%	25%	70%	Manufacture and sale of refrigerators	Sino-foreign joint venture enterprise	Yes
Yingkou Kelon Refrigerator Co., Ltd. ("Yingkou Kelon")	Yingkou	RMB200,000,000	42%	36.79%	78.79%	Manufacture and sale of refrigerators	Sino-foreign joint venture enterprise	Yes
Wetherell Development Limited ("Wetherell Development")	British Virgin Islands	US\$1	-	100%	100%	Advertising agency	Foreign company	Yes
Kelon International Incorporation ("Kelon International")	British Virgin Islands	US\$50,000	-	100%	100%	Investment holding and sales of household electrical appliance	Foreign company	Yes
Guangdong Kelon Fittings Co., Ltd. ("Kelon Fittings")	Foshan	US\$5,620,000	70%	30%	100%	Manufacture and sale of components for refrigerators and air-conditioners	Sino-foreign joint venture enterprise	Yes
Shunde Kelon Jiake Electronic Company Limited ("Kelon Jiake")	Foshan	RMB60,000,000	70%	30%	100%	IT and communication technology, and micro-electronics technology development	Limited liability company	Yes

## V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR *(continued)*

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Guangdong Kelon Freezer Co., Ltd. ("Kelon Freezer")	Foshan	RMB237,000,000	44%	56%	100%	Manufacture and sale of freezers	Sino-foreign joint venture enterprise	Yes
Shunde Kelon Household Electrical Appliance Company Limited ("Kelon Household Electrical Appliance")	Foshan	RMB10,000,000	25%	75%	100%	Manufacture and sales of electrical household appliances	Limited liability company	Yes
Shunde Wangao Import & Export Co., Ltd. ("Wangao Company")	Foshan	RMB3,000,000	20%	80%	100%	Import and export business	Limited liability company	Yes
Shunde Qifei Service Co., Ltd. (Qifei Service")	Foshan	RMB1,000,000	-	100%	100%	Corporate management consultancy, catering services, household decoration designs	Limited liability company	Yes
Jiangxi Kelon Industrial Development Co., Ltd. ("Jiangxi Kelon")	Nanchang	US\$29,800,000	60%	40%	100%	Manufacture and sale of household and commercial air-conditioners, refrigerators, freezers and small electrical appliances	Sino-foreign joint venture enterprise	Yes
Shunde Huao Electronics Co., Ltd. ("Huao Electronics")	Foshan	RMB10,000,000	-	70%	70%	Research and development, manufacture and sale of electronic products	Limited liability company	Yes
Jilin Kelon Electric Co., Ltd. ("Jilin Kelon")	Jilin	RMB200,000,000	90%	10%	100%	Development, manufacture and sale of refrigerator, airconditioner, freezer and household electrical appliances	Limited liability company	Yes
Kelon (USA) Inc. ("Kelon (USA)")	USA	US\$100	-	100%	100%	Business liaison	Foreign company	Yes
Hangzhou Kelon Electrical Company Limited ("Hangzhou Kelon")	Hangzhou	US\$24,100,000	40%	30%	70%	Research and development of the technology for environmental friendly refrigerators, production of high efficiency, energy saving and environmental friendly refrigerators, information consultation, warehousing, and sale of the products made by the Company	Sino-foreign joint venture enterprise	Yes

## V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR *(continued)*

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Yangzhou Kelon Electrical Company Limited ("Yangzhou Kelon")	Yangzhou	US\$29,800,000	30%	70%	100%	Production of energy saving and environmental friendly refrigerators and other energy saving cooling appliances, and sale of products made by the Company	Sino-foreign joint venture enterprise	Yes
Zhuhai Kelon Industrial Development Co., Ltd ("Zhuhai Kelon")	Zhuhai	US\$29,980,000	75%	25%	100%	Research and development of electric refrigerator, air-conditioner, freezer, small household electrical appliances and related accessories	Sino-foreign joint venture enterprise	Yes
Shangqiu Kelon Electrical Company Limited ("Shangqiu Kelon")	Shangqiu	RMB150,000,000	-	100%	100%	Research, development, production and sale of household and commercial air-conditioners, refrigerators, freezers, small household electrical appliances and parts and accessories, and provision of relevant information and technical consultancy services	Limited liability company	Yes
Jiangxi Kelon Combine Electrical Appliances Co., Ltd. ("Jiangxi Combine")	Nanchang	RMB20,000,000	-	55%	55%	Research and development, manufacture and sale of household and commercial air-conditioners, refrigerators, freezers and small household electrical appliances	Sino-foreign joint venture enterprise	No
Xi'an Kelon Refrigeration Co., Ltd. ("Xi'an Kelon")	Xi'an	RMB202,000,000	60%	-	60%	Development, manufacture, design, production of chlorofluorocarbon-free refrigerator (freezer) cooling compressor products; sale of products and conducting after-sale services, research and manufacture, development and production of new cooling compressor products subject to the market demands	Sino-foreign joint enterprise	Yes

### V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR *(continued)*

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Kaifeng Kelon Air-Conditioner Co., Ltd. ("Kaifeng Kelon")	Kaifeng	RMB60,000,000	-	70%	70%	Production, sale, research and development of air-conditioner products	Limited liability company	Yes
Wuhu Ecan Motors Company Limited ("Wuhu Motors")	Wuhu	US\$7,210,000	40%	40%	80%	Production and sale of motor starter and permanent-magnet current brushless motor, micro alternating current machine and electrical equipment Domestic commerce, Supply and sale of supplies (excluding specific marketing, specific control and specific sale products)	Sino-foreign joint venture enterprise	Yes
Shenzhen Kelon Purchase Company Limited ("Shenzhen Kelon")	Shenzhen	RMB200,000,000	95%	5%	100%	Import and export, provision of warehouse and storage, information consultation and technology services (excluding those items limited)	Limited liability company	Yes
Guangdong Kelon Weili Electrical Appliances Company Limited ("Weili Electrical Appliances")	Zhongshan	RMB200,000,000	55%	25%	80%	Production of intelligent washing machine, air-conditioner and after-sale services and technology consultation for other products, 70% products for domestic sale	Sino-foreign joint venture enterprise	Yes
Kelon (Japan) Limited ("Kelon Japan")*1	Japan	JPY1,100,000,000	-	100%	100%	Technical research and trading in electrical household appliances	Foreign company	No
Kelon Europe Industrial Design Limited ("Kelon Europe")*2	United Kingdom	-	-	100%	100%	Business liaison	Foreign company	No
Sichuan Rongsheng Kelon Refrigerator Sales Company Limited ("Sichuan Kelon Sales")	Chengdu	RMB2,000,000	76%	-	76%	Sale of refrigerator	Limited liability company	Yes

## V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR (continued)

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Beijing Hengsheng Xin Chuang Technology Company ("Beijing Hengsheng")	Beijing	RMB 30,000,000	80%	-	80%	Research, development of industrial and commercial intelligent system	Limited liability company	Yes
Beijing Kelon Tiandi IT Network Limited ("Beijing Tiandi")	Beijing	RMB5,000,000	-	78%	78%	Operation items are under free-option, excluding those prohibited by laws and regulations	Limited liability company	Yes
Beijing Kelon Shikong Information Technology Company Limited ("Beijing Shikong")	Beijing	RMB5,000,000	-	78%	78%	Operation items are under free-option, excluding those prohibited by laws and regulations	Limited liability company	Yes

\*1 The Company's investments made in Kelon Japan and Jiangxi Combine were RMB31.7167 million and RMB11.00 million, respectively.

\*2 Kelon Europe, Kelon Japan and Jiangxi Combine were not included into consolidation as their asset scales were relatively small.

\*3 The Company's accounting statements for 2005 has included its subsidiary Jiangxi Kelon into consolidation. As Jiangxi Kelon was sued for default in payment of loans, its tangible assets were sequestered by the court.

Details of the accounting statements of Jiangxi Kelon which is included into consolidation for 2005 are as follows (before the consolidation and offset):

Item	31 December 2005	For the year 2005
Current assets	265,609,620.07	
Long-term investments	189,714,360.10	
Fixed assets and construction in progress	59,888,089.60	
Intangible Assets	70,644,529.51	
Total assets	585,856,599.28	
Current liabilities	465,768,196.66	
Net assets	120,088,402.62	
Revenue from principal operations		1,236,324,884.93
Profit from principal operations		44,257,862.33
Net profit		(199,654,286.27)

Particulars of associates of the Company are set forth below:

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Consolidated in the period
			Directly	Indirectly	Total		
Huayi Compressor Holdings Company Limited ("Huayi Compressor")	PRC	RMB260,854,000	22.725%	-	22.725%	Manufacture and sale of compressors	Joint stock limited company
Chongqing Kelon Rongsheng Refrigerator Sales Co., Ltd. ("Chongqing Kelon")	PRC	RMB1,000,000	-	28%	28%	Sale and after-sale service of refrigerators	Limited liability company
Guangzhou Antaida Logistic Co., Ltd. ("Antaida")	PRC	RMB10,000,000	20%	-	20%	Logistic and storage	Limited liability company



## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES)

### 1. Bank balances and cash

Items		At the end of the year			At the beginning of the year		
		Currencies	Exchange rate	RMB equivalent	Currencies	Exchange rate	RMB equivalent
Cash	RMB	442,216.60	1.00	442,216.60	2,858,463.00	1.00	2,858,463.00
	HKD	368,711.31	1.04	383,570.38	30,688.00	1.06	32,667.00
	USD	0.75	8.07	6.05	8,331.00	8.28	68,951.00
	Others			234.88			
	Sub-total			826,027.91			2,960,081.00
Bank deposit	RMB	143,793,089.85	1.00	143,793,089.85	786,030,623.00	1.00	786,030,623.00
	HKD	5,115,163.35	1.04	5,321,304.43	11,076,838.00	1.06	11,791,294.00
	USD	3,392,670.36	8.07	27,379,528.37	24,818,726.00	8.28	205,412,189.00
	JPY	896,194.00	0.07	61,582.87	38,610,895.00	0.08	3,108,177.00
	EUR	720,533.43	9.58	6,902,494.10	732,366.00	11.15	8,165,368.00
	Others						65,770.00
	Sub-total			183,457,999.62			1,014,573,421.00
Other monetary assets	RMB	99,976,166.40	1.00	99,976,166.40	1,174,826,788.00	1.00	1,174,826,788.00
	HKD	148.24	1.04	154.22			
	USD	351,484.93	8.07	2,836,553.72	15,436,506.00	8.28	127,760,242.00
	Others			641.06			
	Sub-total			102,813,515.40			1,302,587,030.00
Total				287,097,542.93			2,320,120,532.00

\* Other cash at bank and on hand represents pledged deposits that are used to issue bank acceptance notes, commercial acceptance notes, letter of credits and bank borrowings.

\*\* The significant decrease in cash at bank and on hand at the end of the year as compared with the beginning of the year was due to declining sales and a large amount of bill becoming payable after September 2005.

### 2. Notes receivable

Type	At the end of the year	At the beginning of the year
Bank acceptance notes		
– discounted	3,185,560.00	–
– pledged	21,900,000.00	161,900,000.00
– non-pledged	99,233,385.54	443,243,769.00
Commercial acceptance notes		
– discounted	–	–
– pledged	–	–
– non-pledged	16,499,999.90	187,759,249.00
Total	140,818,945.44	792,903,018.00

\* The reason for the significant decrease in the amount of notes receivable at the end of the year as compared with that at the beginning of the year is that, since September 2005, the Company has regulated its notes financing procedures by eradicating any notes without transactional backgrounds and has cleared up the notes financing activities of the former management without transactional backgrounds.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

3. Trade receivables

The combined figures of trade receivables are as follows:

Age	At the end of the year			At the beginning of the year		
	Amount	Percentage of total amount	Provision for bad debt	Amount	Percentage of total amount	Provision for bad debt
Within three months	368,794,662.95	48.39%	145,430.30	-	-	-
Three months to six months	47,337,689.83	6.21%	4,284,700.26	-	-	-
six months to one year	112,812,961.94	14.80%	58,399,997.16	-	-	-
sub total	528,945,314.72	69.40%	62,830,127.72	573,097,635.77	74.09%	17,921,822.96
Within one year						
One to two years	34,755,426.24	4.56%	34,755,426.24	52,918,815.60	6.84%	52,418,846.00
Two to three years	51,617,880.60	6.77%	51,617,880.60	43,487,559.00	5.62%	43,487,559.00
Over three years	146,842,480.75	19.27%	146,842,480.75	104,035,812.32	13.45%	68,044,288.00
Total	762,161,102.31	100%	296,045,915.31	773,539,822.69	100%	181,872,515.96

\* The total figures of the five largest trade receivables were as follows:

	At the end of the year		At the beginning of the year	
	Amount	Percentage of the total	Amount	Percentage of the total
Total of the five largest	277,839,652.48	36.45%	-	-

\*\* There was no amount due from shareholders whose shareholding is no less than 5% at the end of the year.

\*\*\* There were a series of related party transactions and abnormal cash flows between Greencool Companies and the Company during the period between October 2001 and July 2005, and moreover, during the period, the Greencool Companies also had a series of abnormal cash flows with the Company through the specified third-party companies such as Tianjin Lixin Trading Development Company Limited (hereinafter referred to as the "Specified Third-Party Companies"). Set out below is the breakdown of the special bad debts provision made to the trade receivable from the Greencool Companies and the aforesaid Specified Third-Party Companies:

Name of related companies	At the date of the year	
	Amount	Provision for bad debts
Hefei Weixi Electrical Appliance Co., Ltd ("Hefei Weixi")	15,610,189.24	7,805,094.62
Wuhan Changrong Electrical Appliance Company Limited ("Wuhan Changrong")	29,843,694.04	14,921,847.02
Zhejiang Yuhuan Compressor Fty. ("Zhejiang Yuhuan")	2,398,099.55	2,398,099.55
Total	47,851,982.83	25,125,041.19

## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 3. Trade receivables (continued)

\*\*\*\* The provision for the bad debts of trade receivables at the end of the year increased by 62.78% as compared with that at the beginning of the year, mainly due to the former management being suspected of economic crimes and the customers' delay in making payment.

Furthermore, due to improper financial control, the Company is not able to determine if the amount at the beginning of the year and the aging classification are correct. Only when the Company's account clear-up is finished, can it determine whether it is necessary to make any further adjustments to the amount at the beginning of 2005.

The Company's figures of trade receivables are as follows:

Age	At the end of the year			At the beginning of the year		
	Amount	Percentage of total amount	Provision for bad debt	Amount	Percentage of total amount	Provision for bad debt
Within three months	235,538,671.08	42.52%	-	-	-	-
Three months to six months	27,774,533.00	5.01%	1,789,594.24	-	-	-
six months to one year	100,365,975.56	18.12%	50,182,987.78	-	-	-
sub total	363,679,179.64	65.65%	51,972,582.02	394,480,138.72	69.76%	9,258,661.00
Within one year						
One to two years	20,857,885.37	3.77%	20,857,885.37	32,546,032.59	5.75%	16,672,711.00
Two to three years	31,463,873.43	5.68%	31,463,873.43	31,106,898.00	5.50%	31,106,898.00
Over three years	137,931,748.90	24.90%	137,931,748.90	107,388,146.35	18.99%	62,480,769.00
Total	553,932,687.34	100%	242,226,089.72	565,521,215.66	100%	119,519,039.00

\* At the end of the year, there was no amount due from shareholders holding 5% or more of shares.

### 4. Other receivables

The aging analysis of other receivables is as follows:

Age	At the end of the year			At the beginning of the year		
	Amount	Percentage of total amount	Provision for bad debt	Amount	Percentage of total amount	Provision for bad debt
Within one year	919,340,719.45	86.61%	434,909,165.10	147,262,576.71	53.68%	40,595.00
One to two years	17,666,674.69	1.66%	13,042,207.69	68,839,542.37	25.09%	1,137,111.00
Two to three years	68,839,542.37	6.49%	3,451,576.46	52,391,546.99	19.10%	1,664,424.00
Over three years	55,636,665.39	5.24%	15,469,678.86	5,850,446.00	2.13%	5,491,808.00
Total	1,061,483,601.90	100%	466,872,628.11	274,344,112.07	100%	8,333,938.00

## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 4. Other receivables (continued)

The total figures of the five largest other receivables were as follows:

	Figure at the end of the year		Figure at the beginning of the year	
	Amount	Percentage of the total	Amount	Percentage of the total
Total of the five largest	534,887,296.08	50.39%	–	–

- (1) The amount due from shareholders whose shareholding is no less than 5% at the end of the year was RMB15,925,922.93. Please see note 7.
- (2) As a result of improper financial control by its former management, the Company has identified defects in its internal control system prevailing during the early period, i.e. late delivery and invoice issuance, late account reconciliation, improper reconciliation methods, which led to material differences in inter-company balances between the Company and its subsidiaries, and moreover, there is a mismatch in the transactions and inter-company balances between the Company and its regional sales branches. Therefore, the Company booked the debit difference of RMB80,043,221.73 as at 31 December 2005 in other receivables, while charging the credit difference of RMB51,504,170.08 in other payables and will make necessary adjustments when the credit clear-up is completed and the causes of such differences have been identified.
- (3) The Company has made provision for the bad debts of other receivables from the related parties and the Specified Third-Party Companies as follows:

Among which: Greencool companies and Specified Third Party Companies parties:

Name of companies	At the end of the year	
	Amount	Provision for bad debts
Guangdong Greencool	15,925,922.93	7,962,961.47
Hainan Greencool Environmental Protection Engineering Co., Ltd. ("Hainan Greencool")	12,289,357.71	11,313,119.16
Jiangxi Kesheng Trading Company Limited ("Jiangxi Kesheng")	25,572,776.72	21,390,370.86
Jinan San Ai Fu Chemical Co., Ltd. ("San Ai Fu")	121,496,535.45	64,813,858.20
Tianjin Xiangrun Trading Development Company Limited ("Tianjin Xiangrun")	96,905,328.00	48,706,110.00
Tianjin Lixin Trading Development Company Limited ("Tianjin Lixin")	89,600,300.00	44,800,150.00
Jiangxi Keda Plastic Technology Co., Ltd ("Jiangxi Keda")	13,000,200.00	6,500,100.00
Zhuhai Longjia Refrigerating Plant Co., Ltd. ("Zhuhai Longjia")	28,600,000.00	14,300,000.00
Zhuhai Defa Air-Conditioner Fittings Company Limited ("Zhuhai Defa")	21,400,000.00	10,700,000.00
Wuhan Changrong	20,000,000.00	10,000,000.00
Zhejiang Yuhuan	7,105,456.00	7,105,456.00
Beijing Deheng Solicitors ("Beijing Deheng")	4,000,000.00	3,000,000.00
Finance Bureau of Yangzhou Economic Development Zone	40,000,000.00	40,000,000.00
Shangqiu Bin Xiong Frozen Equipment Co., Ltd.	58,030,000.00	58,030,000.00
<b>Total</b>	<b>553,925,876.81</b>	<b>348,622,125.69</b>

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

4. Other receivables (continued)

Other related parties:

Name of related companies	At the end of the year	
	Amount	Provision for bad debts
Shunde Yuelong Consultancy	4,685,832.74	4,685,832.74

- (4) Among which, provision for bad debts related to Foshen Shunde Jiegao Investments Co., Ltd. is set out as follow:

Company name	At the end of the year	
	Amount	Provision for bad debts
Foshen Shunde Jiegao Investments Co., Ltd	168,855,132.63	84,427,566.32

The accounts receivable due from Foshen Shunde Jiegao Investments Co., Ltd was the payment for the transfer of the land of 254,600 square meters in Shunde transferred by the Company. The Company has not received the relevant payment as at the date of this report. See Item 4 of Note 10 for further information.

- (5) Provision for bad debts of other receivables at the end of the year increased by 5,502% compared with the amount at the beginning of the year, which was mainly due to the fact that the Company's substantial shareholder, Guangdong Greencool Enterprise Development Company Limited, and its related parties or "Specified Third Party Companies" have a series of related party transactions and irregular cash inflow/outflow during the period from October 2001 to July 2005. The aforesaid transactions, irregular cash inflow/outflow and suspected misappropriation of funds have been formally investigated by relevant authorities. The Company's funds misappropriated by the Greencool Companies and Specified Third Party Companies were reclassified by the Company this year from prepayment amounts to other receivables, which led to the substantial increase in other receivables of the Company. Special provision for bad debts related to the aforesaid Greencool Companies such as Jinan San Ai Fu, Tianjin Xiangrun, Tianjin Lixin etc. and Specified Third Party Companies amounting to RMB348,622,125.69 was made by the Company this year.

The Company's figures of other receivables are as follows:

Aging	At the end of the year			At the beginning of the year		
	Amount	Percentage of the total	Provision for bad debts	Amount	Percentage of the total	Provision for bad debts
Within one year	2,439,412,490.27	99.16%	94,309,996.43	1,690,687,847.70	99.50%	-
One to two years	11,941,396.68	0.49%	10,942,351.69	1,722,443.46	0.10%	-
Two to three years	1,722,443.46	0.07%	1,722,443.46	1,370,964.84	0.08%	1,327,925.00
Over three years	6,862,772.84	0.28%	6,862,772.84	5,491,808.00	0.32%	5,491,808.00
Total	2,459,939,103.25	100%	113,837,564.42	1,699,273,064.00	100%	6,819,733.00

- \* At the end of the year, amount due from shareholders' holding shares of 5% (inclusive) or more amounted to RMB15,925,922.93, please refer to note 7.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

5. Prepayments

Age	At the end of the year		At the beginning of the year	
	Amount	Percentage of total amount	Amount	Percentage of total amount
Within one year	112,833,977.75	85.17%	190,592,540.00	96.35%
One to two years	13,316,924.00	10.05%	6,332,896.17	3.20%
Two to three years	5,452,196.97	4.12%	878,288.83	0.45%
Over three years	878,288.83	0.66%	–	–
<b>Total</b>	<b>132,481,387.55</b>	<b>100%</b>	<b>197,803,725.00</b>	<b>100%</b>

\* Total amount of top five debtors is as follows:

Age	At the end of the year		At the beginning of the year	
	Amount	Percentage of total amount	Amount	Percentage of total amount
Total of top five	81,284,072.54	61.36%	–	–

\*\* During the year, there is no prepayment due from shareholders holding of 5% or more of shares (inclusive).

6. Subsidy receivables

Item	At the end of the year	At the beginning of the year
Export tax receivables	39,221,876.72	20,796,124.00

7. Inventories and provision for inventories

Category	At the end of the year		At the beginning of the year	
	Carrying value	Provision	Carrying value	Provision
Raw materials	802,960,662.66	193,361,294.09	1,152,561,573.00	32,595,020.00
Work-in-progress	96,280,958.85	13,871,951.17	207,835,417.00	83,935.00
Storage goods	758,544,585.89	201,787,062.63	2,093,487,680.27	101,089,405.00
<b>Total</b>	<b>1,657,786,207.40</b>	<b>409,020,307.89</b>	<b>3,453,884,670.27</b>	<b>133,768,360.00</b>

## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 7. Breakdown of provision for inventory:

Category	Balance at the beginning of the year	Increase during the year	Reversal due to recover of realised value	Other reduction during the year	Total	Balance at the end of the year
Raw materials	32,595,020.00	160,766,274.09	-	-	-	193,361,294.09
Work-in-progress	83,935.00	13,788,016.17	-	-	-	13,871,951.17
Storage goods	101,089,405.00	100,697,657.63	-	-	-	201,787,062.63
Total	133,768,360.00	275,251,947.89	-	-	-	409,020,307.89

\* The amount of inventory at the end of the year decreased by 52.00% compared with the amount at the beginning of the year, which was due to the decrease in stock of finished products and the efforts to promote sales during the year.

\*\* The sharp increase in provision for inventory is due to (1) when the Company inspected the inventory, a large amount of raw materials used for production of export products were found to have become obsolete according to requirements of international environment protection; (2) some export finished products were unable to be sold at an agreed price due to delay of delivery. Thus the Company made provision for the shortfall of realisable net value over the carrying amount of inventory.

\*\*\* The Company found that part of the accounting records confirmed by the former management of the Company were not in line with its actual operations, there were defects in the internal accounting control system, and the cost accounting system did not match the in and out record of warehouse, thus the Company was not able to calculate the cost of principal operation pursuant to normal accounting methods. In this connection the Company adopted an accounting policy pursuant to which the inventory is calculated with a year-end stock-take of finished products and the weighted purchase unit price, to assure the reasonable reflection of year-end inventory on account. Therefore, the figure of year-end inventory is not comparable with that at the beginning of the year.

Since September 2005, the management of the Company has gradually reduced the unreasonable occupation of funds by inventories by adopting appropriate accounting methods and taking appropriate measures. In particular, the management has taken measures to reduce the irrational stock of many old products and inferior products to increase inventory turnover and reduce the inefficient occupation of funds.

### 8. LONG-TERM INVESTMENTS

(1) Details of long-term investments are as follows:

Category	at the end of the year			at the beginning of the year		
	Carrying balance	Provision for impairment	Carrying value	Carrying balance	Provision for impairment	Carrying value
Investment in associates	92,186,163.51	-	92,186,163.51	124,138,359.00	-	124,138,359.00
Investment in subsidiaries	42,716,666.40	11,000,000.00	31,716,666.40	-	-	-
Difference of equity investment	6,572,677.40	67,219,525.00	(60,646,847.60)	29,777,773.00	67,219,525.00	(37,441,752.00)
Other equity investment	-	-	-	7,249,050.00	-	7,249,050.00
Long-term debenture investment	-	-	-	-	-	-
Total	141,475,507.31	78,219,525.00	63,255,982.31	161,165,182.00	67,219,525.00	93,945,657.00

\* Kelon (Japan) and Combine, controlling subsidiaries of the Company, are not consolidated as they are too small in size.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. LONG-TERM INVESTMENTS (continued)

(1) Details of long-term investments are as follows: (continued)

a. Investments in associates

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Chongqing Kelon Rongsheng Refrigerator Sales Co., Ltd.	28%	280,000.00	344,367.00	-	64,367.00	344,367.00
Guangzhou Antaida Logistic Co., Ltd	20%	2,000,000.00	2,830,317.00	725,921.76	1,556,238.76	3,556,238.76
Huayi Compressor Holdings Company Limited	22.725%	118,013,641.00	120,963,675.00	(32,678,117.25)	(29,728,083.25)	88,285,557.75
Total		120,293,641.00	124,138,359.00	(31,952,195.49)	(28,107,477.49)	92,186,163.51

b. Investments in subsidiaries

Name of investee	Percentage of registered capital of investee	Original investment cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Japan Kelon	100%	31,716,666.40	31,716,666.40	-	-	31,716,666.40
Combine	55%	11,000,000.00	11,000,000.00	-	-	11,000,000.00
Total		42,716,666.40	42,716,666.40	-	-	42,716,666.40

c. Changes in provision for impairment

Provision for impairment of long-term investment	At the beginning of the year	Increase during the year	Reversal during the year	At the end of the year
Kelon Air-Conditioner	59,381,641.00	-	-	59,381,641.00
Jiangxi Combine	-	11,000,000.00	-	11,000,000.00
Wangao Company	2,629,693.00	-	-	2,629,693.00
Huaao Electronics	5,208,191.00	-	-	5,208,191.00
Total	67,219,525.00	11,000,000.00	-	78,219,525.00



## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 8. LONG-TERM INVESTMENTS (continued)

(1) Details of long-term investments are as follows: (continued)

#### d. Equity investment difference

Name of investee	Amortisation period	Original investment cost	At the beginning of the year	Amortisation charge for the year	Accumulated amortisation	Balance after accumulated amortisation
Guangdong Kelon Air-Conditioner Co., Ltd.	10 years	66,596,234.00	59,381,641.00	-	7,214,593.00	59,381,641.00
Yingkou Kelon Refrigerator Co., Ltd.	10 years	1,010,737.00	610,737.00	100,000.00	500,000.00	510,737.00
Guangdong Kelon Freezer Co., Ltd.	18.5 years	(88,611,120.00)	(76,636,643.00)	(4,789,790.30)	(16,764,267.30)	(71,846,852.70)
Shunde Wangao Import & Export Co., Ltd.	10 years	2,744,027.00	2,629,693.00	-	114,334.00	2,629,693.00
Shunde Kelon Household Electrical Appliance Company Limited	10 years	34,694,631.00	26,599,217.00	26,599,217.00	34,694,631.00	-
Shunde Huao Electronics Co., Ltd.	10 years	5,434,634.00	5,208,191.00	-	226,443.00	5,208,191.00
Xi'an Kelon Refrigeration Co., Ltd.	10 years	12,956,689.00	11,984,937.00	1,295,668.90	2,267,420.90	10,689,268.10
Total		34,825,832.00	29,777,773.00	23,205,095.60	28,253,154.60	6,572,677.40

As Guangdong Kelon Air-Conditioner Co., Ltd., Shunde Wangao Import & Export Co., Ltd. and Shunde Huao Electronics Co., Ltd. suffered excessive loss and the carrying value of long-term equity investments of the Company in these subsidiaries was reduced to zero, the Company ceased to amortise the equity investment difference of these three subsidiaries and made full amount provision for impairment of long-term investment.

(2) Details of long-term investment companies are as follows:

Items	At the end of the year			At the beginning of the year		
	Cost	Provision for impairment	Book value	Cost	Provision for impairment	Book value
<b>Long-term equity investment</b>						
Consist of:						
Investments in subsidiaries	939,257,170.13	59,381,641.00	879,875,529.13	1,703,272,779.28	59,381,641.00	1,643,891,138.28
Investments in associates	91,841,796.51	-	91,841,796.51	123,793,992.00	-	123,793,992.00
Equity investment difference	(12,465,211.70)	-	(12,465,211.70)	(17,255,002.00)	-	(17,255,002.00)
Other equity investment	-	-	-	7,249,050.00	-	7,249,050.00
Total	1,018,633,754.94	59,381,641.00	959,252,113.94	1,817,060,819.28	59,381,641.00	1,757,679,178.28

#### a. Investments in associates

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Huayi Compressor Holdings Company Limited	22.725%	118,013,641.00	120,963,675.00	(32,678,117.25)	(29,728,083.25)	88,285,557.75
Guangzhou Antaida Logistic Co., Ltd	20%	2,000,000.00	2,830,317.00	725,921.76	1,556,238.76	3,556,238.76
Total		120,013,641.00	123,793,992.00	(31,952,195.49)	(28,171,844.49)	91,841,796.51

## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 8. LONG-TERM INVESTMENTS (continued)

(2) Details of long-term investment companies are as follows: (continued)

#### b. Investments in subsidiaries

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Guangdong Kelon Refrigerator Co., Ltd.	70%	155,552,426.00	367,688,740.73	(160,969,569.96)	51,166,744.77	206,719,170.77
Guangdong Kelon Air-Conditioner Co., Ltd.	60%	214,403,766.00	(180,483,280.21)	(264,570,550.66)	(659,457,596.87)	(445,053,830.87)
Guangdong Kelon Fittings Co., Ltd.	70%	32,634,554.00	65,015,761.34	(62,764,423.62)	(30,383,216.28)	2,251,337.72
Guangdong Kelon Mould Co., Ltd.	40%	49,860,000.00	57,853,456.00	1,300,098.75	9,293,554.75	59,153,554.75
Shunde Rongsheng Plastic Products Co., Ltd.	45%	53,270,064.00	128,511,829.00	28,381,521.17	103,623,286.17	156,893,350.17
Chengdu Kelon Refrigerator Co., Ltd.	45%	90,000,000.00	82,955,811.00	(35,407,139.16)	(42,451,328.16)	47,548,671.84
Yingkou Kelon Refrigerator Co., Ltd.	42%	84,000,000.00	76,217,127.00	(38,335,655.53)	(46,118,528.53)	37,881,471.47
Beijing Hengsheng Xin Chuang Technology Company	80%	24,000,000.00	15,346,359.00	(2,231,138.15)	(10,884,779.15)	13,115,220.85
Kelon Development Co., Ltd.	100%	11,200,000.00	80,007,469.00	(425,947,208.80)	(357,139,739.80)	(345,939,739.80)
Shunde Kelon Jiake Electronic Co., Ltd.	70%	42,000,000.00	2,775,528.00	(38,682,091.48)	(77,906,563.48)	(35,906,563.48)
Sichuan Rongsheng Kelon Refrigerator Sales Company Limited	76%	1,520,000.00	835,353.00	0.24	(684,646.76)	835,353.24
Guangdong Kelon Freeze Co., Ltd.	44%	104,280,000.00	87,949,291.39	(54,928,747.65)	(71,259,456.26)	33,020,543.74
Shunde Wangao Import & Export Co., Ltd.	20%	600,000.00	(2,606,159.00)	(15,641,208.70)	(18,847,367.70)	(18,247,367.70)
Shunde Kelon Household Electrical Appliance Company Limited	25%	2,500,000.00	(2,668,884.00)	(71,881,876.17)	(77,050,760.17)	(74,550,760.17)
Jiangxi Kelon Industrial Development Co., Ltd.	60%	147,763,896.00	144,782,067.82	(136,769,696.77)	(139,751,524.95)	8,012,371.05
Jilin Kelon Electric Co., Ltd.	90%	180,000,000.00	151,207,373.00	(69,802,478.57)	(98,595,105.57)	81,404,894.43
Hangzhou Kelon Electrical Co., Ltd.	40%	24,000,000.00	31,571,208.00	(15,100,862.27)	(7,529,654.27)	16,470,345.73
Yangzhou Kelon Electrical Co., Ltd.	30%	24,666,950.00	21,482,898.00	(111,066,803.75)	(114,250,855.75)	(89,583,905.75)
Zhuhai Kelon Industrial Development Co., Ltd.	75%	189,101,850.00	189,101,850.00	(19,714,976.66)	(19,714,976.66)	169,386,873.34
Xi'an Kelon Refrigeration Co., Ltd.	60%	107,729,620.00	92,912,975.00	(39,634,360.46)	(54,451,005.46)	53,278,614.54
Shenzhen Kelon Purchase Company Limited	95%	95,000,000.00	95,000,000.00	(44,187,009.91)	(44,187,009.91)	50,812,990.09
Wuhu Ecan Motors Co., Ltd.	40%	12,428,893.00	12,057,682.00	(9,585,274.95)	(9,956,485.95)	2,472,407.05
Guangdong Kelon Weili Electrical Appliances Co., Ltd.	55%	-	-	(7,521,462.22)	(7,521,462.22)	(7,521,462.22)
Subtotal		1,646,512,019.00	1,517,514,456.07	(1,595,060,915.28)	(1,724,058,478.21)	(77,546,459.21)
Add: Accrued liability of investee enterprise			185,758,323.21			1,016,803,629.34
Total		1,646,512,019.00	1,703,272,779.28	(1,595,060,915.28)	(1,724,058,478.21)	939,257,170.13

\* The amount at the end of the year includes equity increase/decrease of indirectly controlled shares.

Note: The subsidiaries of the Company Kelon Air-Conditioner, Wangao Company, Kelon Household Electrical Appliance, Kelon Development, Kelon Jiake and its subsidiary Huao Electronics recorded excessive losses and the net assets dropped below their liabilities. The Company had committed to the subsidiaries aforesaid to provide financial supports to enable them to implement future business plans and repay the debts in maturity. The bank loans of Yangzhou Kelon were guaranteed by the Company. The Company continues to debit its long-term equity investment in subsidiaries that recorded excessive losses when the carrying value decreases to nil, the credit balance of long-term equity investment occurred therefrom will be reflected as liabilities under a separately set item "accrual liabilities of investee enterprise" in balance sheets.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. LONG-TERM INVESTMENTS (continued)

(2) Details of long-term investment companies are as follows: (continued)

c. Changes in provision for impairment of long-term investment

Name of investee	At the beginning of the year	Increase during the current year	Reversal during the current year	At the end of the year
Guangdong Kelon Air-Conditioner Co., Ltd.	59,381,641.00	-	-	59,381,641.00

d. Equity investment difference

Name of investee	Amortisation period	Original investment cost	At the beginning of the year	Amortisation charge for the year	Accumulated amortisation	Balance after accumulated amortisation	
Guangdong Kelon Air-Conditioner Co., Ltd.	10 years	66,596,234.00	59,381,641.00	-	7,214,593.00	59,381,641.00	
Guangdong Kelon Freezer Co., Ltd.	18.5 years	(88,611,120.00)	(76,636,643.00)	(4,789,790.30)	(16,764,267.30)	(71,846,852.70)	
			(22,014,886.00)	(17,255,002.00)	(4,789,790.30)	(9,549,674.30)	(12,465,211.70)

9. FIXED ASSETS, ACCUMULATED DEPRECIATION AND PROVISION FOR IMPAIRMENT LOSS

Fixed assets, at cost	At the beginning of the year	Increase during the year	Decrease during the year	Less: reclassification	At the end of the year
Buildings and structures	1,561,434,803.00	18,403,099.41	71,649,053.53	(123,287,711.74)	1,631,476,560.62
Machinery and equipment	2,080,677,056.00	88,277,491.22	395,432,590.20	143,044,788.10	1,630,477,168.92
Electronic equipment, fixtures and furniture	357,411,542.00	13,944,436.36	38,538,982.03	(22,040,682.34)	354,857,678.67
Motor vehicles	79,097,971.00	534,014.22	6,833,642.98	1,691,457.51	71,106,884.73
Moulds	211,376,206.00	101,019,292.58	117,458,370.31	592,148.47	194,344,979.80
Total	4,289,997,578.00	222,178,333.79	629,912,639.05	-	3,882,263,272.74

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

9. FIXED ASSETS, ACCUMULATED DEPRECIATION AND PROVISION FOR IMPAIRMENT LOSS (continued)

Accumulated depreciation	At the beginning of the year	Increase during the year	Decrease during the year	Less: reclassification	At the end of the year
Buildings and structures	468,237,822.00	109,619,392.99	8,979,795.49	133,210,921.12	435,666,498.38
Machinery and equipment	1,332,877,991.00	166,659,578.26	337,959,945.13	(65,348,830.76)	1,226,926,454.89
Electronic equipment, fixtures and furniture	228,475,489.34	13,814,991.40	31,749,624.23	(57,891,045.67)	268,431,902.18
Motor vehicles	45,894,203.00	6,372,321.87	6,987,954.72	(9,971,045.37)	55,249,615.52
Moulds	89,731,028.66	72,847,798.17	66,710,941.39	0.68	95,867,884.76
<b>Total</b>	<b>2,165,216,534.00</b>	<b>369,314,082.69</b>	<b>452,388,260.96</b>	<b>-</b>	<b>2,082,142,355.73</b>

  

Provision for impairment	At the beginning of the year	Increase during the year	Reversal during the year	Other reduction	At the end of the year
Buildings and structures	51,759,156.78	5,858,267.16	-	24,974,122.49	32,643,301.45
Machinery and equipment	12,243,692.22	134,583,169.99	3,110,274.64	2,207,522.22	141,509,065.35
Electronic equipment, fixtures and furniture	9,000.00	8,948,058.48	-	-	8,957,058.48
Motor vehicles	-	1,042,610.89	-	-	1,042,610.89
Moulds	-	26,290,182.56	-	-	26,290,182.56
<b>Total</b>	<b>64,011,849.00</b>	<b>176,722,289.08</b>	<b>3,110,274.64</b>	<b>27,181,644.71</b>	<b>210,442,218.73</b>

  

<b>Net</b>	<b>2,060,769,195.00</b>				<b>1,589,678,698.28</b>
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\* The increase in fixed assets during the period includes transfer from construction in progress of RMB51,021,403.94.

\*\* As at December 31, 2005, the buildings and structures with a net value of RMB625,468,674.45 under fixed assets was pledged for bank loans.

\*\*\* The fixed assets of the Company includes the revaluation surplus of RMB133,284,123.42 over cost and the revaluation surplus of RMB96,154,813.34 over net value recognized at the valuation of company system reform in 1999. The Company failed to classify the specific lists of these fixed assets or the corresponding physical assets due to having not maintained a ledger at the valuation and reconciliation.

\*\*\*\* The followings are included in the decrease during the period:

- (1) The decreased amount due to the exclusion of Kelon Japan in the scope of consolidation in the period, of which the original fixed asset was RMB56,749,216, accumulated depreciation was RMB3,339,635.00 and provision for impairment of fixed assets was RMB24,447,968.00;
- (2) The original revaluation surplus of RMB163,896,990.00 was included in the valuation surplus of fixed assets at the company system reform in 1999. The accumulated depreciation of such valuation surplus has been fully provided (namely the net value is nil), and considered there was no breakdown list and corresponding tangible assets, the Company reduced the original value of fixed assets and the accumulated depreciation in full amount;
- (3) Wetherell Development, a subsidiary of the Company, recognised advertising boards of light boxes in fixed assets as the original value of RMB56,144,839.01 and the net value of 9,564,817.89 in previous periods. Since there is no longer such physical items, the Company reduced the original value of these fixed assets and the accumulated depreciation in full amount.

\*\*\*\*\* Due to the shortage of fund, certain subsidiaries of the Company ceased their businesses, the machineries and equipments were unable to operate in gear, and provision for impairment of fixed assets increased significantly.

## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 10. CONSTRUCTION IN PROGRESS

Project Name	At the beginning of the year	Increase during the year	Transfer to fixed assets during the year	Other reduction during the year	At the end of the year	Source of capital
Project for reconstruction of Yangzhou Kelon factories*	244,468,673.61	53,259,671.86	176,824.00	55,273,860.00	242,277,661.47	Self-raised
Project for Jiangxi Kelon production line	19,124,205.05	69,786,310.34	7,045,902.08	-	81,864,613.31	Self-raised
Project for Zhuhai refrigerator production line	21,289,128.62	9,540,919.02	-	613,886.12	30,216,161.52	Self-raised
Project for Xi'an Power Control Company compressor production line	11,445,430.66	1,410,725.12	2,607,428.58	33,342.00	10,215,385.2	Self-raised
Others	53,162,742.06	29,583,550.21	41,191,249.28	2,440,840.76	39,114,202.23	Self-raised
<b>Total</b>	<b>349,490,180.00</b>	<b>163,581,176.55</b>	<b>51,021,403.94</b>	<b>58,361,928.88</b>	<b>403,688,023.73</b>	

\* The land use right of RMB46,800,000 under the project for reconstruction of Yangzhou Kelon factories was pledged for bank loans. The actual cost of land use right reduced by RMB55,273,860.00 during the period. Please see note 10.3 for the actual acquisition cost.

\*\* There is no capitalisation of borrowing costs in increase of construction in progress during the year.

\*\*\* Provision for impairment of construction in progress is set out below:

Project name	Balance at the beginning of the year	Increase during the year	Decrease in the year		Total	Balance at the end of the year
			Amount reversed for increase in as set value	Amount transferred out for other reasons		
Project for reconstruction of Yangzhou Kelon factories	-	19,749,323.80	-	-	-	19,749,323.80
Project for Jiangxi Kelon production line	-	33,335,052.85	-	-	-	33,335,052.85
Project for Zhuhai refrigerator production line	-	16,146,704.15	-	-	-	16,146,704.15
Others	-	15,571,341.00	-	-	-	15,571,341.00
<b>Total</b>	<b>-</b>	<b>84,802,421.80</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>84,802,421.80</b>

\*\*\*\* Provision for impairment of construction in progress amounted to RMB84,802,421.80 was made for this year, which mainly comprises the followings:

- (1) Reconstruction of Yangzhou Kelon factories: since the production line of Yangzhou Kelon remains uncompleted and the purchased equipments of production line have become obsolete, part of which are not able to be used or need replacement, the Company made the provision of impairment for machinery and equipment amounting to RMB19,749,323.80;
- (2) Project for Jiangxi Kelon production line, located in the land and buildings owned by Jiangxi Greencool, remains uncompleted. The land is subject to auction due to the suspected breach of regulations relating to the Greencool Companies. Zhuhai Kelon has established its small refrigerator manufacturing facility in the land and buildings of the Company's substantial shareholder Greencool and its manufacture has been terminated. As at 31 December 2005, Jiangxi Kelon and Zhuhai Kelon had not signed any asset rent agreement with the counter party.

The Company plans to clear up the aforesaid two companies and made provisions for impairments of production lines of Jiangxi Kelon and Zhuhai Kelon amounted to RMB33,335,052.85 and RMB16,146,704.15 respectively.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

11. INTANGIBLE ASSETS

Category	Initial cost	At the beginning of the year	Increase for the year	Transferred out for the year	Amortisation for the year	At the end of the year
Trademarks	521,857,698.95	456,625,486.44	-	-	52,185,770.04	404,439,716.40
Non-patent technology	548,200.00	433,991.70	-	-	137,049.96	296,941.74
Land use rights	725,856,322.65	606,230,717.80	-	156,870,886.29	19,866,566.23	429,493,265.28
Software systems	30,675,370.47	15,875,326.06	2,099,768.00	0	4,031,491.88	13,943,602.18
Others	9,100.00	9,100.00	-	-	4,200.00	4,900.00
<b>Total</b>	<b>1,278,946,692.07</b>	<b>1,079,174,622.00</b>	<b>2,099,768.00</b>	<b>156,870,886.29</b>	<b>76,225,078.11</b>	<b>848,178,425.60</b>

\* As at 31 December 2005, the land use right with a carrying amount of RMB305,814,334.49 was pledged for bank loans.

\*\* Certain land use right (with an original value of RMB254,737,741) and trademarks were acquired by the Company in 2003 through the accounts due from the former substantial shareholder Rongsheng Group and its labor union and the payment of certificates handling charges as well as tax and fees. The trademarks have been amortised over ten years since October 2003, the remaining amortisation term of the land use right was 9 to 67 years.

An independent third party was entrusted by the Company to value the brands "Kelon" and "Rongsheng", according to the "Project Assets Valuation Report of Guangdong Kelon Electrical Holdings Company Limited Concerning the Value Certification on Trademarks and Intangible Assets", as at 31 December 2005, the value of the brands "Rongsheng" and "Kelon" were RMB118,378,600.00 (of which "Rongsheng" was RMB79,905,500.00, and "Kelon" was RMB38,473,100.00), valuation impairment was RMB286,061,116.40. The management of the Company is of the view that the valuation gave a true view of the value of these trade marks.

\*\*\* Shangqiu Kelon, a subsidiary of the Company, made a provision of RMB18,207,006.81 for impairment of a land use right for the land of 200 mu, please see note 10.1 for details.

Provision for impairment of intangible assets is set out below:

Project name	At the beginning of the year	Increase for the year	Decrease in the year		Total	At the end of the year
			Amount reversed for increase in asset value	Amount transferred out for other reasons		
Trademarks	-	286,061,116.40	-	-	-	286,061,116.40
Non-patent technology	5,214,752.00	18,207,006.81	-	-	-	23,421,758.81
Software systems	2,892,939.00	429,909.29	-	-	-	3,322,848.29
<b>Total</b>	<b>8,107,691.00</b>	<b>304,698,032.50</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>312,805,723.50</b>

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

12. LONG-TERM DEFERRED EXPENDITURES

Category	At the beginning of the year	Increase for the year	Amortisation for the year	At the end of the year	Remaining term for amortisation
Leasehold Improvements	982,595.19	617,410.03	789,146.23	810,858.99	1-5 years
Others	11,055,062.72	5,722,959.22	15,288,942.56	1,489,079.38	1-3 years
Illuminated advertising displays	25,255,993.09	-	25,255,993.09	-	-
Total	37,293,651.00	6,340,369.25	41,334,081.88	2,299,938.37	

13. SHORT TERM LOANS

Nature of loan	Currency	At the end of the year		At the beginning of the year	
		Original amount	RMB equivalent	Original amount	RMB equivalent
Guaranteed loan	RMB	570,722,025.01	570,722,025.01	592,000,000.00	592,000,000.00
	USD	-	-	10,000,000.00	82,765,000.00
Secured loan	RMB	632,211,627.57	632,211,627.57	590,000,000.00	590,000,000.00
	HKD	36,998,889.56	38,489,944.81	-	-
Pledged loan	RMB	149,070,873.12	149,070,873.12	-	-
	USD	-	-	25,026,501.00	207,131,832.00
Credit loan	RMB	214,750,000.00	214,750,000.00	170,700,000.00	170,700,000.00
	USD	-	-	12,761,846.00	105,623,417.00
Overdue bank acceptance notes	RMB	233,346,490.85	233,346,490.85	-	-
Bank acceptance notes financing	RMB	35,714,203.98	35,714,203.98	-	-
Commercial notes financing	RMB	188,500,000.00	188,500,000.00	1,163,494,919.00	1,163,494,919.00
Domestic L/C	RMB	13,328,596.00	13,328,596.00	-	-
Inward bills	USD	10,456,873.34	84,389,059.22	-	-
Total			2,160,522,820.56		2,911,715,168.00

The substantial decrease in short term loans was mainly the result that the Company had strengthened fund management, proactively liquidised the inefficient occupation of fund and enhanced the efficiency of fund utilisation since September 2005.

As at December 31, 2005, the balance of overdue loans was RMB1,233,237,604.98.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

14. NOTES PAYABLE

Category	At the end of the year	At the beginning of the year
Bank acceptance notes	122,739,055.85	1,046,475,243.00
Commercial acceptance notes	60,725,971.66	673,085,394.00
Total	183,465,027.51	1,719,560,637.00

This included no amount due to shareholders holding 5% or more (including 5%) of the share capital of the Company.

\* The balance at the end of the year sharply decreased by 89.33% compared to that at the beginning of the year, mainly due to (1) the sharp decrease of notes issued without trading background this year; (2) the sharp decrease in commercial note financing since September 2005.

15. TRADE PAYABLES

The year-end balance of trade payables was RMB2,068,885,828.19, of which no amount was due to shareholders holding 5% or more (including 5%) of the share capital of the Company.

16. ADVANCE FROM CUSTOMERS

The year-end balance of advance from customers was RMB301,318,221.63, of which no amount was due to shareholders holding 5% or more (including 5%) of the share capital of the Company.

17. TAXES PAYABLES

Tax	At the end of the year	At the beginning of the year
Value-added tax	146,969,330.15	(47,510,667.70)
Business tax	(14,980.18)	3,786,295.00
Enterprise Income tax	26,845,581.44	29,842,158.70
Real estate tax	392,857.34	4,439,259.00
Others	147,414.26	648,747.00
Total	174,340,203.01	(8,794,208.00)



## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 18. OTHER PAYABLES

The year-end balance of other payables was RMB734,951,850.68, of which no amount was due to shareholders holding 5% or more (including 5%) of the share capital of the Company.

The balance of Other Payables included a difference on inter-company balances of RMB51,504,170.08 (please see Item 4 of Note VI).

### 19. ACCRUED CHARGES

Items	At the end of the year	At the beginning of the year	Reasons for not settled
Installation costs	63,743,988.70	31,931,696.00	Provision made for the unpaid installation cost of sold products
Sales discounts	96,030,139.85	59,775,725.00	Occurred but not paid
Transportation costs	8,011,859.63	–	Occurred but not paid
Audit fee	7,150,220.00	6,149,350.00	Occurred but not paid
Entertainment expenses	22,188,399.88	–	Occurred but not paid
Interest repayment and penalty interest	22,206,757.05	–	Occurred but not paid
Bonus	31,526,778.51	–	Occurred but not paid
Agent fee and price difference**	13,402,831.68	–	Occurred but not paid
Fund occupation fee	3,409,550.50	–	Made for the occupation of fund of Hisense
Others	20,015,979.92	14,138,285.00	Occurred but not paid
<b>Total</b>	<b>287,686,505.72</b>	<b>111,995,056.00</b>	

\* The accrued charges at the end of the year increased by RMB175,691,449.27 or 156.87% compared to that at the beginning of the year, mainly due to the poor financial management of the Company prior to September 2005, which led to the poor match between accounting records and operating activities and a lot of unrecorded accruals payable. After the clearing of the Company's accruals payable, the Company found that the provision at previous period was insufficient, therefore additional provision was made according to the actual situation of business.

\*\* Fund occupation charge, fees and price difference payable to Hisense Agent, details of which are referred to 2(4) of Note VII.

### 20. PROVISION

Items	Balance at the end of the year	Balance at the beginning of the year
Litigation costs	5,737,064.34	–
Provision for maintenance	204,178,681.55	119,337,512.00
<b>Total</b>	<b>209,915,745.89</b>	<b>119,337,512.00</b>

\* Provision for maintenance represents the expected provision for warranty. The Company offers 3 years warranty for all products sold. During the warranty period, customers are entitled to maintenance services free of charge. In line with common practice of the industry and the past data, provision for maintenance is determined on the basis of the warranty years, estimated repairing rate and the average repairing cost.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

21. LONG-TERM LOANS DUE WITHIN ONE YEAR

Type of loan	Currency	At the end of the year		At the beginning of the year	
		Original currency	RMB equivalent	Original currency	RMB equivalent
Credit loan	HKD	-	-	3,960,000.00	4,215,420.00

22. LONG TERM LOANS

Type of loan	Currency	At the end of the year		At the beginning of the year	
		Original currency	RMB equivalent	Original currency	RMB equivalent
Secured loan	HKD	-	-	15,710,000.00	16,723,295.00

23. LONG-TERM PAYABLES

Items	At the end of the year	At the beginning of the year
Pension liabilities	46,993,026.79	53,095,547.00
Special long-term payables	26,427,148.47	16,866,558.00
Others	503,249.18	-
Total	73,923,424.44	69,962,105.00

\* Pension liabilities represent the contributions paid by the employees and the Company, which are payable to the employees after their retirement or resignation.

\*\* Special long-term payables mainly represent the state debenture projects capital for technical advancement and industry upgrade and other government exclusive financial grant.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

24. SHARE CAPITAL

Items	At the beginning of the year	Increase (decrease) during the year			At the end of the year
		Number of bonus shares	Increase	Decrease	
A. Unlisted shares					
1. Promoter shares					
domestic legal person shares	337,915,755.00	-	-	-	337,915,755.00
Total unlisted shares	337,915,755.00	-	-	-	337,915,755.00
B. Listed shares					
1. Domestic listed ordinary shares denominated in RMB	194,501,000.00	-	-	-	194,501,000.00
2. Overseas listed foreign shares	459,589,808.00	-	-	-	459,589,808.00
Total listed shares	654,090,808.00	-	-	-	654,090,808.00
C. Total number of shares	992,006,563.00	-	-	-	992,006,563.00

\* The face value of the above shares is RMB1.00 each.

25. CAPITAL RESERVE

Items	At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
Share premium	1,468,501,786.00	-	-	1,468,501,786.00
Provision for donation of non-cash assets	17,696,745.00	-	-	17,696,745.00
Price difference between related party transactions	17,712,651.00	-	-	17,712,651.00
Equity investment reserve	68,659,679.00	2,071,742.56	-	70,731,421.56
Others	4,113,368.00	2,343,677.19	-	6,457,045.19
Total	1,576,684,229.00	4,415,419.75	-	1,581,099,648.75

26. SURPLUS RESERVE

Items	At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
Statutory common reserve	114,580,901.49	-	-	114,580,901.49
Consist of:				
Discretionary reserve	-	-	-	-
Statutory common welfare fund	114,580,901.49	-	-	114,580,901.49

\* Statutory common reserve can be utilised for staff welfare.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

27. UNAPPROPRIATED PROFITS

At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
(88,877,490.00)	(3,693,615,437.69)	-	(3,782,492,927.69)

28. REVENUE FROM PRINCIPAL OPERATIONS AND COST

(1) by product segment

Classification	2005		2004	
	Revenue	Cost	Revenue	Cost
Sales of refrigerators	2,542,838,900.40	2,571,065,120.71	3,213,580,440.47	2,419,182,867.36
Sales of air-conditioners	3,600,489,209.12	3,423,931,356.14	4,049,279,005.27	3,279,271,892.71
Sales of freezers	261,112,606.19	237,960,719.98	335,190,433.25	277,929,910.66
Others	573,931,000.92	581,286,362.00	324,950,889.00	286,028,112.00
Total	6,978,371,716.63	6,814,243,558.83	7,923,000,767.99	6,262,412,782.73

\* The aggregate amount sales income of the top five was as follows:

	2005		2004	
	Amount	% to the aggregate	Amount	% to the aggregate
The aggregate amount of the top five	2,223,701,282.27	31.87%	-	-

(2) by geographic segment

Classification	2005		2004	
	Revenue	Cost	Revenue	Cost
Domestic	4,154,956,841.33	3,957,233,763.29	4,464,075,332.99	3,409,463,982.73
Overseas	2,823,414,875.30	2,857,009,795.54	3,458,925,435.00	2,852,957,800.00
Total	6,978,371,716.63	6,814,243,558.83	7,923,000,767.99	6,262,421,782.73

## VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

### 28. REVENUE AND COST OF PRINCIPAL OPERATIONS (continued)

#### (2) by geographic segment (continued)

Recognition method for cost of principal operations of the Company: due to the deficiency in the execution of the internal control by the former management, the financial system for the recognition of cost was not consistent with the in and out records of warehouse, thus the Company was unable to determine the cost of sales pursuant to the regulated financial methods. Therefore the Company adopted a method of calculating the inventory at year-end based on the result of stock take at year-end and weighted purchase unit prices, upon which the cost of principal operations in 2005 was back-calculated; and due to the mistake in the inventory at the beginning of the year and the deficiency of the in and out system, this calculating method may lead to inclusion of the cost accrual of the previous year in the cost of principal operations of this year.

Details of Company's revenue and cost of principal operations are as follows:

Classification	2005		2004	
	Revenue	Cost	Revenue	Cost
Sales of refrigerators	1,673,302,169.29	1,595,688,793.28	2,492,031,807.47	2,056,680,872.36
Sales of air-conditioners	2,040,451,807.54	1,989,694,300.64	3,300,992,201.27	2,799,619,215.71
Sales of freezers	66,394,782.04	69,914,018.63	38,598,131.26	30,440,678.66
Others	82,561,359.77	128,911,542.07	109,342,789.00	83,621,495.00
Total	3,862,710,118.64	3,784,208,654.62	5,940,964,929.00	4,970,362,261.73

### 29. OTHER OPERATING PROFIT

Classification	2005	2004
Materials	(11,993,443.00)	17,092,154.72
Leases	926,328.54	(55,009.00)
Moulds	2,478,309.35	–
Others	–	3,411,213.00
Total	(8,588,805.11)	20,448,358.72

Other operating profit has recorded a loss, which was mainly due to the overall clearing of inventories of the Company conducted by the new management from September 2005 to December 2005. The Company found a lot of raw materials which had been stocked for a long time or whose components were aged or unable to be used. To avoid a larger loss of the Company due to delay of clearing of the accounts, the Company disposed of the raw materials which had been stocked for too long or damaged in accordance with the relevant management regulations.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

30. INVESTMENT PROFIT

Details of combined investment profit are as follows:

Classification	2005	2004
Profit on share of results of investments in associates	(31,570,522.33)	882,869.00
Amortisation of long-term equity investment difference	3,394,121.40	(84,886,083.00)
Dividends received from investees	–	–
Profit on dealing with equity	–	894,917.00
Provision for impairment of long-term investments	(11,000,000.00)	–
Other investment profits	(6,904,850.00)	–
<b>Total</b>	<b>(46,081,250.93)</b>	<b>(83,108,297.00)</b>

Details of the Company's investment profit are as follows:

Classification	2005	2004
Profit on share of results of investments in subsidiaries	(1,632,524,398.54)	115,449,143.98
Profit on share of results of investments in associates	(31,952,195.49)	865,676.00
Amortisation of long-term equity investment difference	4,789,790.30	(85,134,659.00)
Provision for impairment of long-term equity investments	–	–
Profit on dealing with equity	–	(2,824,329.00)
Other investment profits	(6,904,850.00)	–
<b>Total</b>	<b>(1,666,591,653.73)</b>	<b>28,355,831.98</b>

31. FINANCIAL EXPENSES

Classification	2005	2004
Interest expenses	125,715,310.56	155,053,113.00
Less: Interest income	29,442,938.48	38,831,794.00
Exchange gain/loss	35,309,059.05	3,770,596.00
Discount interests	32,125,489.46	–
Others	2,971,693.24	7,465,917.00
<b>Total</b>	<b>166,678,613.83</b>	<b>127,457,832.00</b>

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

32. NON-OPERATING INCOME/EXPENSES

1. Non-operating income

Classification	2005	2004
Gain on disposal of fixed assets	5,609,333.73	123,836.00
Penalty income	2,831,475.11	1,903,583.00
Insurance compensation income	185,840.00	307,234.00
Land transfer income*	11,984,246.34	—
Others	1,962,470.65	1,946,690.00
Total	22,573,365.83	4,281,343.00

\* The Company originally owned the land use right of the land with an area of 266,668m<sup>2</sup> under the land use right certificate (Shunfuguoyong (2004) No.1002282). On 22 June 2005, the Company transferred part of the land with an area of 254,629.68m<sup>2</sup> to Foshan Shunde Jiegao Investments Co., Ltd. at a consideration of RMB168,855,132.63 (see note 10.4 for details).

2. Non-operating expenses

Items	2005	2004
Net losses on disposal of fixed assets	51,014,477.86	3,074,283.00
Losses on count deficit of fixed assets	2,423,661.63	—
Amercement outlay	3,345,381.75	—
Tax overdue fine	7,627,962.57	—
Provision for impairment of construction in progress	84,802,421.80	—
Provision for impairment of fixed assets	173,612,014.44	—
Provision for impairment of intangible assets	304,698,032.50	—
Others	62,905,152.29	6,423,427.09
Total	690,429,104.84	9,497,710.09

\* The substantial increase in non-operating expenses was due to the provisions for impairment of construction in progress, fixed assets and intangible assets (see item 9, 10 and 11 for details). Net loss on disposal of fixed assets was mainly due to the disposal of spare and obsolete fixed assets at prices lower than the carrying amounts. Tax overdue fine represents the fine for failure to timely pay taxes in previous years.

33. INCOME TAX

Classification	2005	2004
Income tax payable by the Company (note)	—	—
Income tax payable by subsidiaries	1,020,742.69	23,718,054.21
Total	1,020,742.69	23,718,054.21

Note: No income tax is provided as the Company incurred estimated tax loss for the year.

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

34. CASH AND CASH EQUIVALENTS

Group

Classification	2005	2004
Bank balances and cash	287,097,542.93	2,320,120,532.00
Less: Pledged deposits	102,813,515.40	1,302,587,030.00
	184,284,027.53	1,017,533,502.00

Company

Classification	2005	2004
Bank balances and cash	66,230,863.58	1,177,175,655.00
Less: Pledged deposits	1,035,605.39	946,041,722.00
	65,195,258.19	231,133,933.00

35. OTHER CASH RECEIVED FROM INVESTING ACTIVITIES

Items	The current year	Last year
Interest income	29,442,938.48	38,831,794.00

36. OTHER CASH RECEIVED FROM FINANCING ACTIVITIES

Items	The current year	Last year
Government grant	—	2,859,369.00
Pledged deposit at the beginning of the year	1,302,587,030.00	1,393,133,621.00
Less: Pledged deposit at the end of the year	102,813,515.40	1,302,587,030.00
	1,199,773,514.60	93,405,960.00



## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Guangdong Greencool Enterprise Development Company Limited, the Company's substantial shareholder, and its related parties (hereinafter referred to "Greencool Companies") had a series of transactions and irregular cash inflow/outflow during the period from October 2001 to July 2005, the transactions and misappropriation of funds above have been formally investigated by relevant authorities. The matters involve the receivables and payables of the Company and Greencool Companies as at 31 December 2005. Meanwhile, the Company and Tianjin Lixin (details of which are set out in note 7.1(4)) have a series of irregular cash inflow/outflow during the period from October 2001 to July 2005.

Details of transactions between the Company and Greencool Companies and the above Specified Third Party Companies in 2005 are set out in note 7.2.

### 1. Related party relationships

#### (1) Related parties with controlling interests include:

Name of related parties	Nature	Legal Person	Registered Capital	Business Scope	Shares or interests held	Relationship
Greencool Enterprise	Limited liability company	Gu Chujun	1,200,000,000	*	26.43%	Controlling shareholder
Qingdao Hisense Air-Conditioner Company Limited ("Hisense")	Sino-Foreign joint venture company	Tang Ye Guo	6,747,900,000	**	26.43% to be transferred	Beneficial controlling shareholders of the company
Combine	Limited liability company	Fang Zhi Guo	20,000,000	***	55.00%	Unconsolidated subsidiary of the company

\* Research, manufacture and sale of refrigeration equipment, fittings and chlorofluorocarbon.

\*\* Manufacture of air-conditioners, moulds and after-sale service.

\*\*\* Research, manufacture and sale of air-conditioners, household electrical appliances and after-sale service.

#### (2) Greencool Companies

Name of related parties	Relationship
Greencool Environmental Protection Engineering (Shenzhen) Co., Ltd. ("Greencool Technology Environmental Protection (Shenzhen)")	Related party of Guangdong Greencool
Greencool Technology Development (Shenzhen) Company Limited ("Greencool Technology Development (Shenzhen)")	Related party of Guangdong Greencool
Greencool Procurement (Shenzhen) Co., Ltd. ("Greencool Procurement")	Related party of Guangdong Greencool
Hainan Greencool	Related party of Guangdong Greencool
Jiangxi Greencool Electrical Appliance Company Limited ("Jiangxi Greencool")	Related party of Guangdong Greencool
Hefei Meiling Holdings Limited ("Meiling Holdings")	Related party of Guangdong Greencool
Yangzhou Yaxing Motor Coach Company Limited ("Yangzhou Yaxing")	Related party of Guangdong Greencool

## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

### 1. Related party relationships *(continued)*

(3) *Related parties with no controlling interests include:*

Name of related parties	Relationship
Huayi Compressor	Associate of the Company
Chongqing Kelon	Associate of the Company
Antaida	Associate of the Company
Kelon Employee Union	Entity organised and owned by employees of the Company
Chengdu Engine (Group) Company Limited ("Chengdu Engine")	Minority shareholder of Chengdu Kelon
Chengdu Xinxing Electrical Appliance Holdings Company Limited ("Chengdu Xinxing")	Subsidiary of the minority shareholder of Chengdu Kelon
Xi'an Gaoke Group Company	Minority shareholder of Xi'an Kelon
Hangzhou Xileng Group Company Limited ("Hangzhou Xileng")	Minority shareholder of Hangzhou Kelon
Jiaxibeila Compressor Company Limited ("Jiaxibeila")	Subsidiary of an associate
Shunde Yunlong Consultancy ("Shunde Yunlong")	Minority shareholder of Huaao Electronics
Hisense Agent	Subsidiary of controlling shareholders of Haixin Air-conditioners
Hisense Electric Co.,Ltd. ("Hisense Electric")	Subsidiary of controlling shareholders of Haixin Air-conditioners

(4) *The Greencool Companies had a series of transactions or abnormal cash inflow/outflow through the following "Specified Third Party Companies"*

Name of companies	Relationship with the Company
Jiangxi Kesheng Trading Company Limited ("Jiangxi Kesheng")	Specified third party companies
Zhongshan Dongyue Electrical Co., Ltd. (Dongyue Zhongshan)	Specified third party companies
Jinan San'ai'fu	Specified third party companies
Tianjin Xiangrun Trading Development Company Limited ("Tianjin Xiangrun")	Specified third party companies
Tianjin Lixin Trading Development Company Limited ("Tianjin Lixin")	Specified third party companies
Jiangxi Keda Plastic Technology Company Limited ("Jiangxi Keda")	Specified third party companies
Refrigerant Production Consultants Limited	Specified third party companies
Hefei Weixi Electrical Appliance Company Limited ("Hefei Weixi")	Specified third party companies
Zhejiang Guoda Trading Company Limited ("Zhejiang Guoda")	Specified third party companies
Zhuhai Longjia Refrigerating Plant Company Limited ("Zhuhai Longjia")	Specified third party companies
Zhuhai Defa Air-conditioner Fittings Company Limited ("Zhuhai Defa")	Specified third party companies
Wuhan Changrong Electrical Appliance Company Limited ("Wuhan Changrong")	Specified third party companies
Tianjin Taijin Yunye Company Limited ("Tianjin Taijin Yunye")	Specified third party companies
Zhejiang Yuhuan Compressor Factory ("Zhejiang Yuhuan")	Specified third party companies
Chengdu Refrigerating Components Factory ("Chengdu Refrigerating")	Specified third party companies
Beijing De Heng Solicitors	Specified third party companies
Shangqiu Bingxiong Freezing Facilities Company Limited ("Shangqiu Bingxiong")	Specified third party companies

**VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS** (continued)**1. Related party relationships** (continued)(5) *Movements in the Company's share capital or equity held by related parties with controlling interest*

Name of related party	At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
Greencool Enterprise	262,212,194	–	–	262,212,194
Hisense Air-Conditioner	–	–	–	–

**2. Transactions with related parties and "Specified Third Party Companies"**(1) *Purchases from the related parties*

Items	Name of related parties	2005	2004
Purchases from:	Chengdu Xinxing Electrical Appliance Holdings Company Limited	<b>28,804,895.81</b>	6,142,006.00
	Chengdu Engine (Group) Company Limited	<b>4,389,881.55</b>	5,271,167.00
	Shanghai Yilian Electric Business Limited	–	3,182,255.00
	Huayi Compressor Holdings Company Limited	<b>19,453,868.42</b>	155,262,137.00
	Hefei Meiling	–	47,599.00
	Jixi Beila	<b>85,834,349.26</b>	–
	Hisense Air-Conditioner	<b>2,570,769.23</b>	–
In total		<b>141,053,764.27</b>	169,905,164.00

In addition, the goods purchased from Greencool and "Specified Third Party Companies" are as follows:

1. A subsidiary of the Company, Kelon Air-Conditioner, signed a procurement agreement with Hainan Greencool on 10 March 2005, which specifies that Kelon Air-Conditioner shall purchase 100 tonnes of R411 coolant from Hainan Greencool at the price of RMB135,000 per tonne and the total amount is RMB13.5 million. Kelon Air-Conditioner paid the full amount on 29 April and has received the majority of the goods. The contract price was 10 times the market price.
2. Kelon Air-Conditioner signed a coolant procurement agreement with Jiangxi Kesheng on 20 February 2005, which specifies that Kelon Air-Conditioner shall purchase 270 tonnes of coolant from Jiangxi Kesheng of a total amount of RMB18.63 million. Kelon Air-Conditioner paid the full amount through telegraphic transfer in April 2005, but by 31 December 2005, Jiangxi Kesheng had only provided 57.89 tonnes of coolant to Kelon Air-Conditioner.
3. Kelon Air-Conditioner signed an industrial products procurement agreement with Jinan San'ai'fu Chemical Company Limited on 28 January 2005, which specifies that Kelon Air-Conditioner shall purchase 300 tonnes of green coolant from Jinan San'ai'fu at the price of RMB136,000 per tonne and the total amount is RMB40.80 million. Kelon Air-Conditioner paid the full amount in April 2005, but by 31 December 2005, Jinan San'ai'Fu had only provided Kelon Air-Conditioner with 78.30 tonnes of coolant. The contract price was 10 times the market price.

## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

### 2. Transactions with related parties and “Specified Third Party Companies” *(continued)*

#### (1) Purchases from the related parties *(continued)*

4. A subsidiary of the Company, Jiangxi Kelon, signed an industrial products procurement agreement with Jinan San'ai'fu Chemical Company Limited on 28 January 2005, which specifies that Jiangxi Kelon shall purchase 600 tonnes of green coolant from San'ai'fu of a total amount of RMB81.6 million. Jiangxi Kelon paid the full amount in April 2005, but by 31 December 2005, San'ai'fu had not provided any coolant to Jiangxi Kelon pursuant to the agreement.
5. A subsidiary of the Company, Kelon Fittings, signed raw material procurement agreements with Tianjin Xiangrun on 28 March 2005 and 11 April 2005, which specify that Kelon Fittings shall purchase 13,820 tonnes of steel from Tianjin Xiangrun at a consideration of RMB97,412,220. Kelon Fittings has paid the full amount, but by 31 December 2005, Tianjin Xiangrun had not provided any steel to Kelon Fittings.
6. A subsidiary of the Company, Shenzhen Kelon signed a raw material procurement agreement with Tianjin Lixin on 20 April 2005, which specifies that Tianjin Lixin shall provide Shenzhen Kelon with 12,700 tonnes of steel from May 2005 to August 2005 at a consideration of RMB89,600,300. After the signing of the agreement, Shenzhen Kelon has prepaid the full amount. Tianjin Lixin had not provided any steel to Shenzhen Kelon.
7. An assets transfer agreement was entered into by Shangqiu Kelon and Shangqiu Bingxiong on 6 July 2004 which was signed by their respective legal representatives Mr. Gu Chu Jun and Mr. Wang Zhan Min. Pursuant to the agreement, Shangqiu Bingxiong transferred the assets purchased from Henan Bingxiong Ice Maker Company Limited (“Bingxiong Ice Maker”) and Henan Bingxiong Air-Conditioner Company Limited and the stated 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.

As at 31 December 2005, Shangqiu Kelon had fully paid Shangqiu Bingxiong the above amounts of RMB58,030,000, and has completed the relevant procedures of the ownership title transfer and the assets handover. Details of the land impairment of Shangqiu Kelon is set out in note 10.1.

As Shangqiu Bingxiong failed to pay Bingxiong Ice Maker and other companies the amounts in respect of the purchase of equipment and land, it was sued by Bingxiong Ice Maker and other companies which resulted in Shangqiu Kelon being sued as the second defender.

**VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS** (continued)**2. Transactions with related parties and “Specified Third Party Companies”** (continued)

## (2) Sales of products to the related parties

Items	Name of related parties	2005	2004
Sales of products to	Chengdu Xinxing Electrical Appliance Holdings Company	26,522,096.00	26,152,527.00
	Chongqing Kelon Rongsheng Refrigerator Sales Co., Ltd.	760,851.62	57,626,641.00
	Hefei Meiling Holdings Limited	98,803.42	—
	Hisense Agent	868,234,609.82	—
In total		895,616,360.86	83,779,168.00
Percentage of total sales		12.83%	1.06%

## (3) Sales of moulds to related party

Items	Name of Related Party	2005	2004
Sales of moulds to	Hisense Electric	2,081,196.58	—

## (4) Sales Agent

The Company signed the Sales Agency Agreement and the Supplemental Agreement with Hisense Marketing on 16 September 2005 and 26 September 2005, respectively. On 1 April 2006, the Company signed the Supplemental Agreement II to Sales Agency Agreement with Hisense Agent, which specifies that from the date when the agreement was signed to 10 May 2006, Hisense Marketing would act as a sales agent of the Company and could sell no more than RMB2.8 billion worth of domestic sales products, of which no more than RMB0.8 billion could be sold by the end of 2005. By 31 December 2005, the Company had already sold Hisense Marketing domestic sales products worth RMB868,234,609.82.

The main terms of the Sales Agency Agreement and Supplemental Agreement are as follows:

- (1) Hisense Marketing shall prepay no more than RMB0.6 billion to the Company for purchasing its products, wherein RMB0.3 billion shall be paid within 10 working days after the signing of the agreement. Within one month after the date of the first payment, Hisense Marketing shall prepay no more than RMB0.3 billion according to the Company's actual financial need for starting its production, marketing and sales. During the term of the agreement, Hisense Agent shall not ask the Company to refund the amount of no more than RMB0.6 billion prepaid by Hisense Marketing to the Company.

## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

### 2. Transactions with related parties and “Specified Third Party Companies” *(continued)*

#### (4) *Sales Agent (continued)*

- (2) The Company shall start providing Hisense Agent with products and deliver them to the warehouses designated by Hisense Agent on the date of receiving prepayment. Upon the products arrive at the warehouses designated by Hisense Agent, the ownership of these products shall transfer to Hisense Agent. Both parties shall complete a loan procedure when the amount of delivered products exceeds the prepayment of Hisense. The actual capital period of Kelon Electric's products occupied by Hisense Agent is 60 days.
- (3) The Company shall, after the signing of this agreement and in accordance with the relevant terms of this agreement, persuade all distributors to sign the Three-Party Agreement with the Company and Hisense Agent, which specifies that all distributors shall get products from Hisense Marketing and make payments to Hisense Agent; Hisense Agent shall strictly collect sales proceeds in accordance with the foresaid Three-Party Agreement and make payments to Kelon Electric within three working days after these proceeds are collected.
- (4) The settlement price of the products that Hisense Agent get from Kelon Electric shall be equal to the settlement price of the products that the distributors get from Hisense Agent, which price is to be determined by Kelon Electric and the distributors.

Kelon Electric shall check and pay all marketing fee, including but not limited to the discount of retailers, price difference, slotting allowance, advertising fee, stand construction cost, rent of the products' warehouse, load and unload cost, logistic cost (including main lines and sublines) and labour cost, etc.

- (5) During the effective period of the agreement, Hisense Agent pre-charged the Company the capital utilisation fee, which is calculated in the following formula and charged on a quarterly basis:

Capital Utilisation Fee = Prepayment Amount x Effective Days of Capital Utilisation x Interest Rate as quoted by the People's Bank of China for one-year loans ÷ 360

As at 31 December 2005, Hisense Marketing had sent sales payments of RMB812,724,143.04 to the Company. Pursuant to the agency agreement, the estimated commission and price difference amount to RMB13,402,831.68 and the capital utilisation fee amounts to RMB3,409,550.50.

#### (5) *Use of land and buildings*

A subsidiary of the Company, Jiangxi Kelon, has since October 2003 used the land and buildings of Jiangxi Greencool located in Jiangxi Kelon Greencool Industrial Park. Another subsidiary of the Company, Zhuhai Kelon, has established its small refrigerator manufacturing facility in the land and buildings of the Company's substantial shareholder Greencool. As at 31 December 2005, Jiangxi Kelon and Zhuhai Kelon had not signed any asset rent agreement with the counterparty.

**VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS** *(continued)***2. Transactions with related parties and “Specified Third Party Companies”** *(continued)**(6) Use of trademark*

The Company signed a trademark licensing agreement (“Licensing Agreement”) with Greencool (China) on 3 April 2003, which allows the Company and its subsidiaries to use the trademark “COMBINE” without paying licensing fees. The Company and its subsidiaries have already used the trademark “COMBINE” on several types of refrigerators and air-conditioners in this year.

*(7) Other transactions*

Items	2005	2004
Other income (expenses) received from (paid to) related parties		
– Interest income from Chengdu Xinxing	1,985,940.00	1,985,940.00
– Logistics management fee paid to Guangzhou Antaida	6,374,827.70	7,972,038.00
– Electric and water utilities paid to Chengdu Engine (Group) Company Limited	5,072,120.05	–
– Equipment rent paid to Hangzhou Xileng	6,000,000.00	4,000,000.00

*(8) Guarantees*

As at 31 December 2005, Guangdong Greencool, the controlling shareholder of the Company, provided the Company with guarantees for the remaining borrowings of RMB327,971,300.

**3. Transactions with related companies and “Specified Third Party Companies”***(1) Transactions with the related companies under control of the Company*

Items	Name of related companies	At the end of the year
Other receivables	Guangdong Greencool Enterprise	RMB15,925,922.93
Other payables	Combine	RMB5,099,880.00

## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

### 3. Transactions with related companies and “Specified Third Party Companies” *(continued)*

#### *(2) Transactions with Greencool Companies*

Items	Name of related companies	At the end of the year	At the beginning of the year
Trade receivables	Hefei Meiling	RMB115,600.00	–
Prepayments	Hefei Meiling	–	RMB6,001.00
Other receivables	Greencool Technology Environmental Protection Engineering (Shenzhen) Co., Ltd.	RMB33,000,000.00	RMB33,000,000.00
	Shenzhen Greencool Technology	RMB32,000,000.00	RMB32,000,000.00
	Hainan Greencool	RMB12,789,357.71	–
Trade payables	Hefei Meiling	RMB17,385.31	RMB50,125.00
Other payables	Jiangxi Greencool	RMB13,000,000.00	–
	Yangzhou Yaxing	–	RMB220,000.00

\* Kelon Air-Conditioner, a subsidiary of the Company, opened an off-book account, and conducted a series of transactions during the period from March 2003 to February 2004, the following amounts involved in the above account were not disclosed in the 2004's financial statements of the Company:

An amount due from Greencool Technology Development (Shenzhen) Company Limited: RMB32,000,000.00;

An amount due from Greencool Technology Environmental Protection Engineering (Shenzhen) Co., Ltd.: RMB33,000,000.00;

An amount due to Tianjin Taijin Yunye Company Limited: RMB65,000,000.00.



## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS (continued)

## 3. Transactions with related companies and "Specified Third Party Companies" (continued)

## (3) Transactions with the related companies not controlled by the Company

Items	Name of related companies	At the end of the year	At the beginning of the year
Trade receivables	Chongqing Kelon	RMB137,136.40	-
	Hisense Agent	RMB204,349,247.04	-
Prepayment	Chengdu Xinxing	RMB1,802,308.16	RMB6,270,775.00
Other receivables	Antaida	RMB2,613.20	-
	Chengdu Engine	RMB26,780.00	RMB26,780.00
	Chengdu Xinxing	RMB34,000,000.00	RMB173,322.00
	Chongqing Kelon	-	RMB223,485.00
	Shunde Yunlong	RMB4,685,832.74	-
Trade payables	Huayi Compressor	RMB17,766,207.52	RMB1,405,024.00
	Chengdu Engine	RMB433,940.00	-
	Chengdu Xinxing	RMB2,538,151.87	RMB2,241,292.00
	Jiaxi Beila	RMB57,541,612.28	-
	Hisense Agent	RMB7,800.00	-
Advance from customers	Chongqing Kelon	-	RMB4,595,911.00
	Hisense Agent	RMB436,478.09	-
Other payables	Antaida	RMB24,463.43	-
	Xi'an Gaoke	RMB1,785,476.00	RMB2,358,044.00
	Hangzhou Xileng	RMB9,773,892.29	RMB4,000,000.00
	Chengdu Engine (Group)	-	RMB433,940.00
	Chongqing Kelon	-	RMB50,000.00

## VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

### 3. Transactions with related companies and “Specified Third Party Companies” *(continued)*

#### (4) Transactions with specified third party companies

Items	Name of companies	At the end of the year
Trade receivables	Hefei Weixi	15,610,189.24
	Wuhan Changrong Electrical Appliance Company Limited	29,843,694.04
	Zhejiang Yuhuan	2,398,099.55
Prepayment	Hefei Weixi	465,213.00
Other receivables	Jiangxi Kesheng	25,572,776.72
	Zhongshan Dongyue	12,678,281.25
	San'ai'fu	121,496,535.45
	Tianjin Xiangrun	96,905,328.00
	Tianjin Lixin	89,600,300.00
	Jiangxi Keda	13,000,200.00
	Zhuhai Longjia	28,600,000.00
	Zhuhai Defa	21,400,000.00
	Wuhan Changrong Electrical Appliance Company Limited	20,000,000.00
	Zhejiang Yuhuan	7,105,456.00
	Beijing De Heng	4,000,000
	Finance Bureau of Yangzhou Economic Development Zone	40,000,000.00
	Shangqin Bingxiong	58,030,000.00
Trade payables	Jiangxi Keda	621,968.35
	Zhejiang Yingguang	223,062.76
	Zhejiang Yuhuan	2,593,644.03
Other payables	Zhuhai Longjia	28,316,425.03
	Zhuhai Defa	21,400,000.00
	Tianjin Taijin Yunye Company Limited	65,000,000.00

**VIII. LITIGATION AND OTHER CONTINGENT MATTERS**

1. As at 31 December 2005, the pending litigations involved in the Company are summarized as follows:

(1) *The case with the Company as the plaintiff*

Plaintiff	Defender	Reason	Total amounts involved
The Company	Guangzhou Youyicheng Trading Co., Ltd	Outstanding amount for completed construction	RMB4,500,000.00
The Company	Greencool and Gu Chu Jun	Deceptive procurement and Megal capital possession	493,042,500.00
The Company	Others		5,564,495.57
Total			503,106,995.57

(2) *The cases with the Company as the defender*

Plaintiff	Defender	Reason	Total amounts involved
Materials supplier	The Company	Outstanding amount for delivered products	358,700,356.89
Zhejiang Hangxiao Steel Structure Co., Ltd	The Company	Outstanding amount for completed construction	19,853,000.00
Domestic Commercial Bank	The Company	Outstanding borrowings	208,018,000.00
Others	The Company		9,351,950.44
Total			595,923,307.33

2. **Other contingent events**

As agreed in the Sales Agency Agreement and the Supplemental Agreement entered into between the Company and Hisense Agent, the Company will persuade all distributors to enter into the Three-Party Agreement with the Company and Hisense Agent, pursuant to which all the distributors shall purchase the Company's products for sales from Hisense Agent and pay the relevant amounts to Hisense Agent. As such, the Company will be exposed to the related default risk when a third party has paid Hisense Agent for its ordered products, but Hisense Agent fails to deliver the products in time.

## IX. SUBSEQUENT EVENTS

The Greencool Companies and “Specified Third Party Companies” illegally appropriated the Company’s capital by the way of entering into purchase contracts with the Company, which constituted an infringement of the Company’s legal interests. For details please see note 7.2(1). On February 2006, Jiangxi Kelon, Shenzhen Kelon, Kelon Air-conditioners and Kelon Fittings, being the subsidiaries of the Company, respectively initiated respective proceedings at the Intermediate People’s Court of Foshan City, requesting return of the payments which amount to RMB 328.04 million.

In June 2006, Jiangxi Kelon initiated proceedings against the Greencool Companies at the Intermediate People’s Court of Foshan City, requesting the return of the misappropriated funds amounting to RMB165 million.

## X. OTHER SIGNIFICANT EVENTS

### 1. Land use right of Shangqiu Kelon

Shangqiu Kelon’s minority shareholder Shangqiu Bing Xiong Freezing Facilities Company Limited (hereinafter named “Shangqiu Bingxiong”) entered into the Land Transfer Agreement with Shangqiu Kelon and the Administration Committee of Shangqiu Economic and Technology Development Zone in July 2004, which stipulated that Shangqiu Bingxiong shall transfer the land use right of the land totaling 200 mu located to the south of Nanjing Road in Shangqiu City, and that Shangqiu Kelon shall construct a project on the land while taking it over from Shangqiu Bingxiong to produce 2 million ice-making machines and sell them for RMB2.5 billion annually and to produce 1.6 million freezers and sell them for RMB1.2 billion. If the project is not completed, the Administration Committee of Shangqiu Economic and Technology Development Zone will reserve its right to recover the remaining land. Shangqiu Kelon has obtained the land use certificate, but as it has not completed “three connections and one leveling”, Shangqiu Kelon has never used the land, and has not achieved the output as stipulated in the agreement.

In addition, Shangqiu Kelon received the notice from the local court in August 2005 that the Administration Committee of Shangqiu Economic and Technology Development Zone has lodged a claim to the court against Shangqiu Kelon, requesting to recover the 200 mu of land located in Shangqiu Economic and Technology Development Zone which was transferred from Shangqiu Bingxiong to Shangqiu Kelon. Meanwhile the Court has seized the above mentioned land use right. Shangqiu Kelon has made impairment provision of RMB18,207,006.81 for the land use right.

### 2. Chengdu Kelon

In 1998, Chengdu Kelon entered into a borrowing agreement with Chengdu Xinxing Electrical Appliance Holdings Company Limited (hereinafter named “Chengdu Xinxing”) which is a subsidiary of Chengdu Kelon’s minority shareholder Chengdu Engine (Group) Company Limited, pursuant to which Chengdu Kelon provided Chengdu Xinxing with an operating fund of RMB34,000,000. The operating fund is guaranteed by Chengdu Engine (Group) Company Limited. As the consideration for Chengdu Kelon in providing the operating fund to Chengdu Xinxing, Chengdu Xinxing agreed to repay the operating fund to Chengdu Kelon by supplying an agreed number of refrigerator accessories. If Chengdu Xinxing does not repay the fund, Chengdu Kelon has the right to deduct the outstanding amount from the dividend due to Chengdu Engine (in whatsoever form). Chengdu Xinxing has never repaid the fund because of its poor operations.

**X. OTHER SIGNIFICANT EVENTS** *(continued)***3. Yangzhou Kelon**

In June 2003, the Company entered into the Project Investment and Cooperation Contract with Yangzhou Economic Development Zone, stipulating that Yangzhou Economic Development Zone shall provide 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 on 12 December 2003. In August 2003, the Company's subsidiary Yangzhou Kelon entered into the State-owned Land Use Right Transfer Contract with Yangzhou State Land Resources Bureau Development Zone Branch, stipulating that the transferor shall transfer the land of 729,000 square meters at a consideration of RMB102,073,860.00. In November 2003, Yangzhou Kelon has paid RMB45 million land amount 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.

Yangzhou Kelon originally recognised the cost of land as RMB102,073,860 in its account. On 31 December 2005, Yangzhou Kelon, as advised by lawyers, was of the opinion that the actual purchase price of the above land was RMB45 million and, adding to the relevant tax charges of RMB1.8 million, the carrying value of the above land should be RMB46.8 million. In this connection, Yangzhou Kelon reduced the cost of land by RMB55,273,860 in adjustment.

**4. The land use right of the Company**

The Company originally owned the Shun Fu Guo Yong (2004) No.1002282 Land Use Certificate which was for the land of 266,668 square meters. In 22 June 2005, the Company transferred 254,629.68 square meters of it at a consideration of RMB168,855,132.63 to Foshan Shunde Jiegao Investments Company Limited. The Company has not received the relevant land transfer amount till now. The Company had provided an amount of RMB84,427,566.32 for such bad debt.

5. Hisense Air-Conditioner and Guangdong Greencool entered into The Agreement In Relation to the Share Transfer of Guangdong Kelon Electrical Holdings Company Limited entered into between Guangdong Greencool Enterprise Development Company Limited and Qingdao Hisense Air-Conditioner Company Limited" and its supplemental agreements on 9 September 2005, 28 September 2005 and 18 April 2006, respectively. Hisense Air-Conditioner proposed to acquire 26.43% equity interest of Kelon Electrical, and the consideration of the transfer which has been agreed on was RMB680 million, with RMB500 million being the first installment.

**XI. EXPLANATIONS OF THE GOING CONCERN****1. Major issues which may affect the Company's ability to continue as a going concern**

The Company's net asset as at 31 December 2005 amounted to -1.09 billion. In addition, RMB 1.233 billion of short term loans was overdue, and a large number of debts was litigated. If such events could not be removed soon, the Company's ability to continue as a going concern would be affected.

The uncertainty of the Company's ability to continue as a going concern may affect asset realisations and debt repayments of the Company in ordinary operation.

**XI. EXPLANATIONS OF THE GOING CONCERN (continued)****2. Improvement measures the Company's management intended to adopt**

Accordingly, the Company will adopt the following improvement measures:

- (1) Hisense Air-conditioner will become the controlling shareholder of the Company. The management of the Company will leverage the management experience of Hisense to implement an overall reform, strengthen the operating management and completely improve its operation quality.
- (2) Upon the change in the single largest shareholder, the Company will immediately negotiate with Hisense Air-conditioner, the new shareholder of the Company, to formulate and implement the assets and operation reconstruction plan with Hisense as soon as possible. If the reconstruction is implemented, the quality assets and operations from Hisense Air-conditioner will apparently improve the assets and financial status of the Company, and this will help improve the business scale, competitive edges, creditworthiness of the Company, which in turn will create favourable conditions for financing.
- (3) The Company will, based on the requirement of its strategic development, focus on handling the problem of excessive investments occurred in prior years, place most resources on the principal operations, reduce the outflow of the capital to the largest extent, lower the capital occupation rate and improve the efficiency of capital utilisation, so as to ensure that the Company has the necessary capital for the normal operation of its principal operations.
- (4) The Company will improve the planning management, rationalise the production and sales, strictly control capital occupation, speed up the turnover of capital and upgrade the efficiency of capital utilisation.
- (5) The Company will proactively seek for various supports to obtain more working capitals. By end of July 2006, the Company has achieved an understanding with major banks, and most of overdue loans have been or are in the process of being converted to normal loans. The Company will get greater support from major creditors such as banks and suppliers in its course of business in the future.

The Company believes that the impact of the above matters on the continuing operation will be relieved by adopting the above methods.

**XII RETURN ON NET ASSETS AND EARNINGS PER SHARE**

	Return on net assets		Earnings per share	
	Fully Weighted	diluted average	Fully Weighted	diluted average
Profit for the period				
Profit derived from principal operations	N/A	N/A	0.1647	0.1647
Operating profits	N/A	N/A	(3.0713)	(3.0713)
Net profit	N/A	N/A	(3.7234)	(3.7234)
Net profit less of extraordinary items	N/A	N/A	(3.6178)	(3.6178)

The above figures were calculated as required by "No.9 Document of Regulations of Information Disclosure for Public Companies" issued by China Securities Regulatory Commission.

**XIII EXTRAORDINARY LOSS AND PROFIT**

Items	2005
Non-operating income:	(667,855,739.01)
add: Provision for impairment of construction in progress	84,802,421.80
add: Provision for impairment of fixed assets	173,612,014.44
add: Provision for impairment of intangible assets	304,698,032.50
Extraordinary loss and profit before income tax	(104,743,270.27)
Effect on income tax	0
Extraordinary loss and profit after income tax	(104,743,270.27)

The Company has confirmed the extraordinary loss and profit items in accordance with Kuaiji Zi No.4 (2005) "No. 1 Questions and answers on information disclosure standards of listed securities companies" issued by the China Securities Regulatory Commission.

**XIV COMPARATIVE INFORMATION**

The Company has corrected the material accounting errors of the prior years and re-prepared the financial statement of 2004, of which the comparative information has been regrouped to conform to those presented in the financial statements of 2005. Part of the accounting records confirmed by the previous management of the Company has material difference with the actual operating activities. With the restrictions of objective conditions, the above material accounting errors may be incomplete. Upon completion of the financial settlements by the Company, we may need to restate the information of the above period.

**XV COMPARISON OF DIFFERENCES ARISING FROM THE FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH PRC ACCOUNTING STANDARD AND INTERNATIONAL FINANCIAL REPORTING STANDARDS**

The financial statement is prepared under the PRC accounting standard, and different from those prepared in accordance with the International financial reporting standard.

	2005 Net Profit RMB'000	31 December 2005 Net Asset RMB'000
Amount per financial statement prepared in accordance with the PRC accounting standard	(3,693,615)	(1,089,852)
Adjustment under the International financial reporting standard:		
– Adjustment on fixed asset revaluation and related depreciation	(3,530)	(10,348)
– Adjustment on amortization of equity investment difference	(4,790)	
– Adjustment on impairment of goodwill	(11,200)	(11,200)
– Adjustment on governmental assistance funds	2,471	
– Adjustment on profits of the minority shareholders of the subsidiary	–	(26,684)
– Adjustment on negative goodwill	–	71,846
– Adjustment on preliminary expenses	9,938	
– Others	(1,446)	
Amount per financial statement prepared in accordance with the International financial reporting standard	(3,702,172)	(1,066,238)

## XVI APPROVAL OF THE FINANCIAL STATEMENT

The Company's financial statement will be approved by the Board on 11 August 2006.