# Notes to the Consolidated Financial Statements

(All amounts in Renminbi thousands unless otherwise stated)

## 1. General information

Kingdee International Software Group Company Limited (the "Company") was incorporated in the Cayman Islands in 1999 as an exempted company with limited liability. The address of its office is 4th Level, Zone B, Block W1, Hi-tech Industrial Park, Shennan Highway, Nanshan District, Shenzhen, Guangdong Province, the People's Republic of China (the "PRC").

The Company is an investment holding company. The principal activities of its subsidiaries are developing, manufacturing and selling of software products and provision of software-related technical services in the PRC.

The Company has its primary listing on The Stock Exchange of Hong Kong Limited.

These consolidated financial statements are presented in thousands of Renminbi (RMB'000), unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 30 March 2007.

## 2. Summary of significant accounting policies

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

### 2.1 Basis of preparation

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

*Standards, amendments and interpretations effective in 2006 but not relevant for the Group's operations*

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to or have no significant impact on the Group's operations:

- IAS 19 (Amendment), Actuarial Gains and Losses, Group Plans and Disclosures;
- IAS 21 (Amendment), Net Investment in a Foreign Operation;
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 (Amendment), The Fair Value Option;
- IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts;
- IFRS 6, Exploration for and Evaluation of Mineral Resources;
- IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
- IFRIC 4, Determining whether an Arrangement contains a Lease;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

## 2. Summary of significant accounting policies *(continued)*

### 2.1 Basis of preparation *(continued)*

*Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Group*

The following standards, amendments and interpretations have been published but are not effective for 2006 and have not been early adopted:

- IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006). IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. The Group will apply IFRIC 8 from 1 January 2007, but it is not expected to have any impact on the Group's financial statements;
- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply IFRIC 10 from 1 January 2007, but it is not expected to have any impact on the Group's financial statements; and
- IFRS 7, Financial Instruments: Disclosures (effective for annual periods beginning on or after 1 January 2007). IAS 1, Amendments to capital disclosures (effective for annual periods beginning on or after 1 January 2007). The Group assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and capital disclosures required by the amendment of IAS 1. The Group will apply IFRS 7 and the amendment to IAS 1 from 1 January 2007.

*Interpretations to existing standards that are not yet effective and not relevant for the Group's operations*

- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). IFRIC 7 provides guidance on how to apply requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the group entities have a currency of a hyperinflationary economy as its functional currency, IFRIC 7 is not relevant to the Group's operations; and
- IFRIC 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1 June 2006). IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. As none of the group entities have changed the terms of their contracts, IFRIC 9 is not relevant to the Group's operations.

## Notes to the Consolidated Financial Statements

(All amounts in Renminbi thousands unless otherwise stated)

## 2. Summary of significant accounting policies *(continued)*

### 2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31 December.

*(a) Subsidiaries*

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses (Note 2.8). The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

*(b) Associates*

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition (Note 2.7).

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

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

In the Company's balance sheet the investments in associated companies are stated at cost less provision for impairment losses (Note 2.8). The results of associated companies are accounted for by the Company on the basis of dividend received and receivable.

## 2. Summary of significant accounting policies *(continued)*

### 2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

### 2.4 Foreign currency translation

*(a) Functional and presentation currency*

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

*(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

*(c) Group companies*

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken to shareholders' equity. When a foreign operation is sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

### 2.5 Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation and impairment, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged in the income statement during the financial period in which they are incurred.

# Notes to the Consolidated Financial Statements

(All amounts in Renminbi thousands unless otherwise stated)

## 2. Summary of significant accounting policies *(continued)*

### 2.5 Property, plant and equipment *(continued)*

Depreciation is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives, as follows:

| | |
|---|---|
| – Buildings | 30 years |
| – Computer and related equipment | 5 years |
| – Other office equipment | 5 years |
| – Motor vehicles | 5 years |
| – Leasehold improvements | over the lease term of 2 to 5 years |

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

Construction in the progress represents properties and plant under construction and is stated at cost. This includes cost of construction and other direct costs. Construction in progress is not depreciated until the relevant assets are completed and put into operational use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.8).

Gains and losses on disposals are determined by comparing proceeds with carrying amount, and included in the income statement.

### 2.6 Lease prepayments

Lease prepayments represent lease payments paid or payable for the land use rights less accumulated charges and are recognised as an expense in the income statement on a straight-line basis over the lease period of the land use rights.

### 2.7 Intangible assets

*(a) Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and is tested annually for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing.

*(b) Research and development expenditure*

Research expenditures is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new and improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technical feasibility and its costs can be measured reliably. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development cost previously recognised as an expense is not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its useful life, not exceeding 30 months.

*(c) Computer software*

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives, not exceeding 2 years.

## 2. Summary of significant accounting policies *(continued)*

### 2.8 Impairment of investments in subsidiaries, associates and non-financial assets

Assets that have an indefinite useful life or have not yet available for use are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

### 2.9 Financial assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

The Group only has financial assets classified as "loans and receivables" and "available-for-sale financial assets" during the year.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date, which are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2.12).

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of investments are recognised on trade-date which is the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available for-sale financial assets are subsequently carried at fair value and loans and receivables are carried at amortised cost using the effective interest method.

Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

Fair values for unlisted equity securities are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the investees.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss, which is measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade and other receivables is described in Note 2.12.

## 2. Summary of significant accounting policies *(continued)*

### 2.10 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on weighted average basis. The cost of finished goods comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and applicable variable selling expenses.

### 2.11 Implementation contracts

An implementation contract is a contract specifically negotiated for the implementation of a software or a combination of software that are closely interrelated or interdependent in terms of their design, technology and functions or their ultimate purpose or use.

When the outcome of an implementation contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised when incurred.

When the outcome of an implementation contract can be estimated reliably, contract revenue and contract costs are recognised over the period of the contract, respectively, as revenues and expenses. The Group uses the percentage of completion method to determine the appropriate amount of revenue and costs to be recognised in a given period; the stage of completion is measured by reference to labour hours incurred to date as a percentage of total estimated labour hours for each contract and the proportion that contract costs incurred for work performed to date bear to the estimated total costs for the contract. When it is probable total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

The aggregate of the costs incurred and the profit/loss recognised on each contract is compared against the progress billings up to the year-end. Where costs incurred and recognised profits (less recognised losses) exceed progress billings, the balance is shown as due from customers on implementation contracts, under current assets. Where progress billings exceed costs incurred plus recognised profits (less recognised losses), the balance is shown as due to customers on implementation contracts, under current liabilities.

### 2.12 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

### 2.13 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of 3 months or less.

### 2.14 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

### 2.15 Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

## 2. Summary of significant accounting policies *(continued)*

### 2.16 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any differences between proceeds (net of transaction cost) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

### 2.17 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax, is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

### 2.18 Employee benefits

*(a) Retirement benefits*

The Group provides defined contribution retirement plans based on local laws and regulations. The plans cover full-time employees and provide for contributions at certain percentage of salary as determined by the respective local government authorities. The Group's contributions to defined contribution plans are charged to the income statement in the year to which they relate.

*(b) Share-based compensation*

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to rest. At each balance sheet date, the entity revises its estimates of the number of options that are expected to rest. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

## Notes to the Consolidated Financial Statements

(All amounts in Renminbi thousands unless otherwise stated)

## 2. Summary of significant accounting policies *(continued)*

### 2.19 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

### 2.20 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminated sales within the Group. Revenue is recognised as follows:

*(a) Sales of goods*

Sales of goods are recognised when a group entity has delivered products to the customer; the customer has accepted the products and collectibility of the related receivables is reasonably assured.

*(b) Sales of services*

Sales of services are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transactions assessed on the basis of the actual service provided as a proportion of the total services to be provided.

*(c) Interest income*

Interest income is recognised on a time-proportion basis using the effective interest method.

### 2.21 Operating leases

Lease in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating lease (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

### 2.22 Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grants will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the income statement on a straight-line basis over the expected lives of the related assets.

### 2.23 Dividend distribution

Dividends distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

## 3. Financial risk management

### 3.1 Financial risk factors

*Credit risk*

The carrying amount of cash and cash equivalents and trade receivables represent the Group's maximum exposure to credit risk in relation to financial assets.

The majority of the Group's trade receivables relates to sales of software products and render of services to third party customers. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on trade receivables. No single customer accounted for greater than 5% of total revenues during the year.

The Group has policies that limit the amount of credit exposure to any one financial institution in the PRC.

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

*Currency risk*

Substantially all of the revenue-generating operations of the Group are transacted in RMB. The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government. The Group is not significantly exposed to currency risk.

*Interest rate risk*

The Group has no significant interest bearing assets but borrowed loans from banks for short-term finance. The interest rates and terms of repayment of loans of the Group are disclosed in Note 21.

### 3.2 Fair value estimation

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques, such as estimated discounted cash flows. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date.

## 4. Critical accounting estimates and judgments

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

### 4.1 Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value of the cash-generating unit to which goodwill has been allocated. The recoverable amount of the cash-generating unit has been determined based on a value-in-use calculation, which uses cash flow projection based on a financial forecast approved by management covering a ten-year period and a discount rate of 7.11%. Based on the calculation, management recognised an impairment loss of RMB9,338,000 as at 31 December 2006 (Note 8).

### 4.2 Impairment of development costs

Determining whether development cost is impaired requires an estimation of the value of the developed projects. The recoverable amount of developed projects has been determined based on a value-in-use calculation, which uses cash flow projection based on a financial forecast approved by management covering a ten-year period and a discount rate of 7.11%. Based on the calculation, management determined that there was no impairment of any of its development projects as at 31 December 2006.

(All amounts in Renminbi thousands unless otherwise stated)

## 5. Segment information

No segment information is presented as the Group operates in one single industry and one single segment. The Group operates within one geographic segment as its revenues are primarily generated in the PRC and its major assets are located in the PRC.

## 6. Property, plant and equipment — Group

| | Buildings | Computer and related equipment | Other office equipment | Motor vehicles | Leasehold improvements | Construction in progress | Total |
|---|---|---|---|---|---|---|---|
| **At 1 January 2005** | | | | | | | |
| Cost | 13,798 | 50,882 | 1,183 | 6,737 | 12,449 | 917 | 85,966 |
| Accumulated depreciation | (3,169) | (23,073) | (990) | (3,009) | (10,271) | – | (40,512) |
| Net book amount | 10,629 | 27,809 | 193 | 3,728 | 2,178 | 917 | 45,454 |
| **Year ended 31 December 2005** | | | | | | | |
| Opening net book amount | 10,629 | 27,809 | 193 | 3,728 | 2,178 | 917 | 45,454 |
| Additions | – | 8,530 | 332 | 751 | – | 12,271 | 21,884 |
| Disposals (Note 33) | (1,535) | (509) | – | (267) | – | – | (2,311) |
| Depreciation (Note 26) | (371) | (8,056) | (171) | (884) | (2,178) | – | (11,660) |
| Closing net book amount | 8,723 | 27,774 | 354 | 3,328 | – | 13,188 | 53,367 |
| **At 31 December 2005** | | | | | | | |
| Cost | 12,164 | 58,254 | 1,300 | 6,639 | 12,449 | 13,188 | 103,994 |
| Accumulated depreciation | (3,441) | (30,480) | (946) | (3,311) | (12,449) | – | (50,627) |
| Net book amount | 8,723 | 27,774 | 354 | 3,328 | – | 13,188 | 53,367 |
| **Year ended 31 December 2006** | | | | | | | |
| Opening net book amount | 8,723 | 27,774 | 354 | 3,328 | – | 13,188 | 53,367 |
| Additions | – | 11,214 | 507 | 8,475 | – | 36,935 | 57,131 |
| Disposals (Note 33) | – | (239) | (1) | (391) | – | – | (631) |
| Depreciation (Note 26) | (437) | (8,509) | (285) | (1,278) | – | – | (10,509) |
| Closing net book amount | 8,286 | 30,240 | 575 | 10,134 | – | 50,123 | 99,358 |
| **At 31 December 2006** | | | | | | | |
| Cost | 12,164 | 67,498 | 1,805 | 14,458 | 11,699 | 50,123 | 157,747 |
| Accumulated depreciation | (3,878) | (37,258) | (1,230) | (4,324) | (11,699) | – | (58,389) |
| Net book amount | 8,286 | 30,240 | 575 | 10,134 | – | 50,123 | 99,358 |

Depreciation expense of RMB4,813,000 (2005: RMB4,265,000) has been charged in selling and marketing expenses and RMB5,696,000 (2005: RMB7,395,000) in administrative expenses.

## 7. Lease prepayments – Group

| | **2006** | 2005 |
|---|---|---|
| Opening net book amount | **16,246** | 16,630 |
| Additions | **2,584** | – |
| Income statement charge (Note 33) | **(463)** | (384) |
| | **18,367** | 16,246 |
| Represented by: | | |
| Cost | **19,292** | 16,708 |
| Accumulated charges | **(925)** | (462) |
| | **18,367** | 16,246 |

Amounts were paid for obtaining land use rights in the PRC, which were granted for a period of 50 years.

RMB463,000 (2005: RMB384,000) of lease prepayments has been charged in administrative expenses in the income statement.

(All amounts in Renminbi thousands unless otherwise stated)

## 8. Intangible assets

| | Group | | | | | Company |
|---|---|---|---|---|---|---|
| | Goodwill | Negative goodwill | Development costs | Computer software | Total | Computer software |
| **At 1 January 2005** | | | | | | |
| Cost | 25,560 | (115) | 105,365 | 5,012 | 135,822 | – |
| Accumulated amortisation and impairment | (1,206) | 69 | (51,195) | (4,484) | (56,816) | – |
| Net book amount | 24,354 | (46) | 54,170 | 528 | 79,006 | – |
| **Year ended 31 December 2005** | | | | | | |
| Opening net book amount | 24,354 | (46) | 54,170 | 528 | 79,006 | – |
| Derecognition of negative goodwill | – | 46 | – | – | 46 | – |
| Impairment of goodwill | (998) | – | – | – | (998) | – |
| Additions | – | – | 39,128 | – | 39,128 | – |
| Amortisation charge (Note 26) | – | – | (31,785) | (528) | (32,313) | – |
| Closing net book amount | 23,356 | – | 61,513 | – | 84,869 | – |
| **At 31 December 2005** | | | | | | |
| Cost | 25,560 | – | 144,493 | 5,012 | 175,065 | – |
| Accumulated amortisation and impairment | (2,204) | – | (82,980) | (5,012) | (90,196) | – |
| Net book amount | 23,356 | – | 61,513 | – | 84,869 | – |
| **Year ended 31 December 2006** | | | | | | |
| Opening net book amount | 23,356 | – | 61,513 | – | 84,869 | – |
| Additions | – | – | 53,356 | 4,403 | 57,759 | 2,411 |
| Impairment of goodwill | (9,338) | – | – | – | (9,338) | – |
| Amortisation charge (Note 26) | – | – | (43,005) | (1,349) | (44,354) | (603) |
| Closing net book amount | 14,018 | – | 71,864 | 3,054 | 88,936 | 1,808 |
| **At 31 December 2006** | | | | | | |
| Cost | 25,560 | – | 197,849 | 9,415 | 232,824 | 2,411 |
| Accumulated amortisation and impairment | (11,542) | – | (125,985) | (6,361) | (143,888) | (603) |
| Net book amount | 14,018 | – | 71,864 | 3,054 | 88,936 | 1,808 |

Amortisation charge of RMB44,354,000 (2005: RMB32,313,000) and impairment loss of RMB9,338,000 (2005: RMB998,000) against goodwill are included in administrative expenses in the income statement.

## 9. Investments in subsidiaries – Company

| | **2006** | 2005 |
|---|---|---|
| Unlisted shares (a) | | |
| Cost | **183,033** | 128,496 |
| Provision for impairment | **(5,300)** | (5,300) |
| | **177,733** | 123,196 |
| Loans to subsidiaries (b) | **15,000** | 15,000 |
| | **192,733** | 138,196 |

(a) The following is a list of the principal subsidiaries at 31 December 2006, all of which are limited liability company:

| **Name** | **Place of incorporation** | **Registered and paid-up capital** | **Interest held** |
|---|---|---|---|
| **Directly held** | | | |
| Kingdee Software (China) Co., Ltd. ("Kingdee China") | PRC | RMB175,000,000 | 100% |
| Kingdee International Software Group (H.K) Co., Ltd. ("Kingdee HK") | Hong Kong | HKD1,000,000 | 100% |
| **Indirectly held** | | | |
| Shenzhen Kingdee Middleware Co., Ltd. | PRC | RMB10,000,000 | 65% |
| Shanghai Kingdee Software Co., Ltd. | PRC | RMB10,000,000 | 90% |
| Beijing Case Software Technology Co., Ltd. | PRC | USD540,000 | 100% |
| Kingdee Information Technology (Beijing) Co., Ltd. | PRC | RMB5,000,000 | 100% |
| Xiamen Kingdee Software Co., Ltd. | PRC | RMB300,000 | 70% |

The above subsidiaries operate in their respective place of incorporation and are engaged in development, manufacturing and selling of software and hardware products and provision of software-related services.

(b) The loans to subsidiaries are unsecured, interest free and made as part of the owner's fund.

## 10. Investments in associate – Group

| | **2006** | 2005 |
|---|---|---|
| **At beginning of year** | **2,617** | 2,409 |
| Additions | **–** | 100 |
| Share of (loss)/profit | **(90)** | 108 |
| Impairment of goodwill | **(1,920)** | – |
| **At end of year** | **607** | 2,617 |
| Represented by: | | |
| Share of net assets | **607** | 697 |
| Goodwill | | |
| – Cost | **1,920** | 1,920 |
| – Impairment provision | **(1,920)** | – |
| | **–** | 1,920 |
| | **607** | 2,617 |

(All amounts in Renminbi thousands unless otherwise stated)

## 10. Investments in associates – Group *(continued)*

The Group's interests in an unlisted associate were as follows:

| **Name** | **Place/ country of incorporation** | **Registered and paid-up capital** | **Interest held %** | **Principal activities** |
|---|---|---|---|---|
| Asia21-Cybics Technology Limited | Hong Kong | HKD1,333,333 | 37% | Selling of software and computer products |

## 11. Deferred income tax

| | **2006** | 2005 |
|---|---|---|
| At beginning of year | **5,096** | 3,839 |
| Recognised in income statement | **(1,563)** | 1,257 |
| At end of year | **3,533** | 5,096 |
| Deferred income tax assets: | | |
| – to be recovered after more than 12 months | **2,224** | 2,695 |
| – to be recovered within 12 months | **1,309** | 2,401 |
| | **3,533** | 5,096 |

Movements in deferred tax assets/(liabilities) are as follows:

| | At 1 January 2005 | Credited/ (charged) to the income statement | At 31 December 2005 | Credited/ (charged) to the income statement | **At 31 December 2006** |
|---|---|---|---|---|---|
| Provision for bad and doubtful debts | 4,440 | 1,612 | 6,052 | 36 | **6,088** |
| Deferred income | 3,163 | 1,322 | 4,485 | 146 | **4,631** |
| Provisions | 369 | (15) | 354 | (354) | **–** |
| Deferred development costs | (4,133) | (1,662) | (5,795) | (1,391) | **(7,186)** |
| Deferred income tax assets, net | 3,839 | 1,257 | 5,096 | (1,563) | **3,533** |

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefits through the future taxable profits is probable. The Group didn't recognise deferred income tax assets of RMB23,941,000 (2005: RMB23,802,000) in respect of losses amounting to RMB72,889,000 (2005: RMB77,698,000) that can be carried forward against future taxable income.

## 12. Available-for-sale financial assets

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Unlisted investments: | | | | |
| At beginning of year | **66** | 255 | **6** | – |
| Deemed additions | **–** | 954 | **–** | 954 |
| Fair value changes transferred to equity (Note 19) | **–** | (1,143) | **–** | (948) |
| At end of year | **66** | 66 | **6** | 6 |

These investments are companies established in the PRC and principally engaged in selling of software products and provision of software-related technical services. The Group has 3% to 19% equity interests in these companies.

## 13. Inventories – Group

| | **2006** | 2005 |
|---|---|---|
| Raw materials | **1,450** | 1,845 |
| Finished goods | **2,209** | 2,115 |
| | **3,659** | 3,960 |

The cost of inventories recognised as expense and included in cost of sales amounted to RMB25,882,000 (2005: RMB18,217,000) (Note 26).

## 14. Trade and other receivables

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Trade receivables (Note (a)) | **143,329** | 129,762 | **–** | – |
| Less: provision of receivables (Note (b)) | **(77,084)** | (65,658) | **–** | – |
| Trade receivables – net | **66,245** | 64,104 | **–** | – |
| Notes receivable | **1,828** | 794 | **–** | – |
| Advances to employees (Note (c)) | **5,803** | 3,885 | **80** | – |
| Prepayments | **4,561** | 5,483 | **–** | – |
| VAT recoverable | **20,358** | 22,208 | **–** | – |
| Re-investment refund receivable | **3,706** | – | **3,706** | – |
| Amounts due from subsidiaries (Note (d)) | **–** | – | **50,107** | 42,060 |
| Others | **10,472** | 7,309 | **–** | 731 |
| | **112,973** | 103,783 | **53,893** | 42,791 |

(All amounts in Renminbi thousands unless otherwise stated)

## 14. Trade and other receivables *(continued)*

(a) Sales of the Group are generally on the 90 days' credit terms. The ageing analysis of trade receivables is as follows:

| | **2006** | 2005 |
|---|---|---|
| 0 – 180 days | **66,859** | 59,602 |
| 181 – 360 days | **13,548** | 22,301 |
| Over 360 days | **62,922** | 47,859 |
| | **143,329** | 129,762 |

(b) Movement on the provision for impairment of trade receivables are as follows:

| | **2006** | 2005 |
|---|---|---|
| At 1 January | **(65,658)** | (47,174) |
| Provision for impairment | **(24,076)** | (19,560) |
| Write off as uncollectible | **12,650** | 1,076 |
| At 31 December | **(77,084)** | (65,658) |

(c) The amount advanced to employees is interest free, unsecured and repayable on demand.

(d) Amounts due from subsidiaries are unsecured, interest free and repayable on demand.

The Group factored receivable balances amounting to RMB10,010,000 (2005: Nil) to a bank for loans totaling RMB7,150,000 (2005: Nil). The transaction has been accounted for as a collateralised borrowing (Note 21).

## 15. Implementation contracts – Group

| | **2006** | 2005 |
|---|---|---|
| Contract costs incurred | **42,213** | 34,700 |
| Contract profit recognised | **70,558** | 58,693 |
| Billings | **(127,342)** | (99,959) |
| Work in progress at end of the year | **(14,571)** | (6,566) |
| Represented by: | | |
| Due to customers on implementation contracts | **(23,221)** | (14,297) |
| Due from customers on implementation contracts | **8,650** | 7,731 |
| | **(14,571)** | (6,566) |
| Advances received on implementation contracts included in customers' deposits | **2,654** | 2,848 |
| Due from customers on implementation contracts billed included in trade receivables | **34,344** | 24,379 |

## 16. Cash and cash equivalents

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Cash at bank and in hand (Note (a)) | **390,271** | 286,622 | **6,501** | 5,359 |
| Less: Short-term bank deposits (Note (b)) | **(24,633)** | (39,569) | **–** | – |
| Pledged bank deposits (Note (c)) | **(6,793)** | (5,000) | **–** | – |
| | **358,845** | 242,053 | **6,501** | 5,359 |

(a) Cash at bank and in hand are mainly denominated in RMB.

(b) The effective interest rate on short-term bank deposits was 2.25% per annum (2005: 2.07% per annum). These deposits have an average maturity of six months.

(c) The bank deposits were pledged to bank as a security for contract performance.

## 17. Share capital

| | Number of issued shares (thousands) | Ordinary shares | Share premium | Total |
|---|---|---|---|---|
| **At 1 January 2005** | 443,259 | 47,424 | 45,016 | 92,440 |
| Employee share option scheme | | | | |
| – Value of services provided | – | – | 5,589 | 5,589 |
| – Exercise of share options | 338 | 36 | 475 | 511 |
| Share options granted to business partners | – | – | 112 | 112 |
| **At 31 December 2005** | 443,597 | 47,460 | 51,192 | 98,652 |
| Employee share option scheme | | | | |
| – Value of services provided | – | – | 6,448 | 6,448 |
| – Exercise of share options | 8,009 | 822 | 14,973 | 15,795 |
| Share options granted to related parties | – | – | 2,392 | 2,392 |
| **At 31 December 2006** | 451,606 | 48,282 | 75,005 | 123,287 |

The total authorised number of ordinary shares is 1,000 million shares (2005: 1,000 million shares) with a par value of HK$0.1 per share (2005: HK$0.1 per share). All issued shares are ranked pari passu in all respects.

## Notes to the Consolidated Financial Statements

(All amounts in Renminbi thousands unless otherwise stated)

### 18. Share options

Details of the share options granted and movement in the number of share options outstanding are as follows:

| Date of grant | 27/09/2001 | 15/05/2002 | 20/02/2003 | 08/08/2003 | 23/03/2004 | 01/06/2004 | 27/12/2004 | 21/04/2005 | 15/2/2006 | 28/04/2006 | 4/05/2006 | 22/06/2006 | 22/06/2006 | 18/07/2006 | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Exercise price | HK$1.49 | HK$1.78 | HK$1.39 | HK$2.05 | HK$3.18 | HK$2.65 | HK$2.05 | HK$1.55 | HK$2.235 | HK$2.61 | HK$2.63 | HK$2.625 | HK$2.625 | HK$2.895 | |
| Granted to | 33 employees | 2 directors and 20 employees | 2 directors and 74 employees | 2,370 employees employees | 1 director and 177 employees | 1 director and 154 partners | 1 director and 3 business | 1 director | 1 employee | 75 employees | 1 director | 1 director | 2 related parties | 3 employees | |
| Exercisable period | 10 years | 10 years | 10 years | 10 years | 10 years | 10 years | 10 years | 5 years | 10 years | 10 years | 10 years | 10 years | 10 years | 10 years | |
| Note | (a) | (b) | (b) | (c) | (d) | (e) | (f) | (g) | (h) | (i) | (i) | (i) | (h) | (j) | |
| At 1 January 2005 | 792,500 | 3,095,000 | 4,851,500 | 3,324,000 | 4,000,000 | 10,107,500 | 3,352,500 | – | – | – | – | – | – | – | 29,523,000 |
| Granted | – | – | – | – | – | – | – | 3,240,000 | – | – | – | – | – | – | 3,240,000 |
| Exercised | – | (30,000) | (305,500) | (2,000) | – | – | – | – | – | – | – | – | – | – | (337,500) |
| Lapsed due to resignation | (145,000) | (445,000) | (722,500) | (650,000) | – | (1,932,500) | (627,500) | – | – | – | – | – | – | – | (4,522,500) |
| At 31December 2005 | 647,500 | 2,620,000 | 3,823,500 | 2,672,000 | 4,000,000 | 8,175,000 | 2,725,000 | 3,240,000 | – | – | – | – | – | – | 27,903,000 |
| Granted | – | – | – | – | – | – | – | – | 1,000,000 | 22,600,000 | 1,900,000 | 1,900,000 | 8,800,000 | 1,600,000 | 37,800,000 |
| Exercised | (412,500) | (970,000) | (2,132,000) | (792,000) | – | (1,648,220) | (1,894,000) | (160,000) | – | – | – | – | – | – | (8,008,720) |
| Lapsed due to resignation | (30,000) | (25,000) | (192,500) | (186,000) | – | (562,500) | (75,000) | – | – | – | – | – | – | – | (1,071,000) |
| **At 31December 2006** | **205,000** | **1,625,000** | **1,499,000** | **1,694,000** | **4,000,000** | **5,964,280** | **756,000** | **3,080,000** | **1,000,000** | **22,600,000** | **1,900,000** | **1,900,000** | **8,800,000** | **1,600,000** | **56,623,280** |

(a) All of these options have duration of 10 years from the date of grant, provided that the options may not be exercised in respect of more than 25%, 50% and 75% of the options within 12 months, 24 months and 36 months respectively from the date of grant.

(b) All of these options have duration of 10 years from the date of grant, provided that the options may not be exercised within 12 months from the date of grant and that the options may not be exercised in respect of more than 25%, 50% and 75% of the options within 12 months, 24 months and 36 months respectively from 1 year after the date of grant.

(c) All of these options have duration of 10 years from the date of grant, provided that the options can only be exercised from the date of 8 August 2004.

(d) All of these options have duration of 10 years from 23 March 2004, provided that the options may not be exercised in respect of more than 50% of the options prior to the date of 31 December 2004.

(e) All of these options have duration of 10 years from the date of grant, provided that

(1) The options cannot be exercised within 1 year from the date of grant;

(2) The number of options that can be exercised within 2 years from the date of grant cannot be more than 25% of the revenue ratio for the financial year of 2004;

(3) The number of options that can be exercised within 3 years from the date of grant cannot be more than 25% of the aggregate revenue ratios for the financial years of 2004 and 2005;

(4) The number of options that can be exercised within 4 years from the date of grant cannot be more than 25% of the aggregate revenue ratios for the financial years of 2004, 2005 and 2006; and

(5) The number of options that can be exercised after 4 years from the date of grant cannot be more than 25% of the aggregate revenue ratios for the financial years of 2004, 2005, 2006 and 2007. "Revenue Ratio" shall equal to the actual revenue of the Group divided by the estimated revenue of the Group as determined by the Board for a particular financial year.

(f) All of these options have duration of 10 years from the date of grant and the options can be exercised from the date of grant.

(g) All of these options have duration of 5 years from the date of grant and the options can be exercised from the date of grant.

(h) All of these options have duration of 10 years from the date of grant, provided that the options may not be exercised within 12 months from the date of grant and that the options may not be exercised in respect of more than 25%, 50% and 75% of the options within 12 months, 24 months and 36 months respectively from 1 year after the date of grant.

## 18. Share options *(continued)*

(i) All of these options have duration of 10 years from the date of grant and the options can be exercised upon the conditions.

(j) All of these options have duration of 10 years from the date of grant, provided that the options may not be exercised within 12 months from the date of grant and that the options may not be exercised in respect of more than 30%, 60% of the options within 12 months and 24 months respectively from 1 year after the date of grant.

Movement in the number of share options outstanding and their related weighted average exercise prices are as follows:

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Average exercise price in HK$ per share** | **Options (thousands)** | Average exercise price in HK$ per share | Options (thousands) |
| **At 1 January** | **2.20** | **27,903** | 2.26 | 29,523 |
| Granted | **2.62** | **37,800** | 1.55 | 3,240 |
| Exercised | **1.93** | **(8,009)** | 1.43 | (338) |
| Lapsed | **2.62** | **(1,071)** | 2.15 | (4,522) |
| **At 31 December** | **2.52** | **56,623** | 2.20 | 27,903 |

Out of the 56,623,000 outstanding options (2005: 27,903,000 options), 18,324,000 options (2005: 15,037,000 options) were exercisable. The related weighted average share price at the time of exercise was HK$3.02 (2005: HK$1.81) per share.

Share options outstanding at the end of the year have the following expiry date and exercise prices:

| | | **Share options** | |
|---|---|---|---|
| **Expiry date within** | **Range of exercise prices** (HK$ per share) | **2006 (thousands)** | 2005 (thousands) |
| 2010 | 1.55 | **3,080** | 3,240 |
| 2011 | 1.49 | **205** | 3,267 |
| 2012 | 1.78 | **1,625** | 3,824 |
| 2013 | 1.39 – 2.05 | **3,193** | 2,672 |
| 2014 | 2.05 – 3.81 | **10,720** | 14,900 |
| 2016 | 2.235 – 2.895 | **37,800** | – |
| | | **56,623** | 27,903 |

The weighted average fair value of options granted during the period determined using the Black-Scholes valuation model was HK$1.16 per option (2005: HK$0.52 per option). The significant inputs into the model were a weighted average share price of HK$2.61 (2005: HK$1.52) at the grant date, the exercise price shown above, volatility of 46% (2005: 47%), expected dividend paid out of HK$0.058 per share (2005: HK$0.04 per share), an expected option life of 8 years (2005: 3 years) and an annual risk-free interest rate of 4.20% (2005: 2.28%). The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the period from the ending of the locking period to the grant date of share options.

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(All amounts in Renminbi thousands unless otherwise stated)

## 19. Other reserves

| Group | Merger reserve Note (a) | Capital reserve Note (b) | Fare value reserve | Statutory surplus reserve fund Note (c) | Exchange fluctuation reserve | Total |
|---|---|---|---|---|---|---|
| Balance at 1 January 2005 | 6,570 | 107,197 | – | 24,246 | (788) | 137,225 |
| Capitalisation of retained earnings of a subsidiary | – | 25,000 | – | – | – | 25,000 |
| Revaluation losses | | | | | | |
| – Recognised | – | – | (1,143) | – | – | (1,143) |
| – Transferred to income statement | – | – | 1,143 | – | – | 1,143 |
| Appropriation to reserve fund | – | – | – | 13,313 | – | 13,313 |
| Currency translation difference | – | – | – | – | (859) | (859) |
| **Balance at 31 December 2005 and at 1 January 2006** | 6,570 | 132,197 | – | 37,559 | (1,647) | 174,679 |
| Capitalisation of retained earnings of a subsidiary | – | 50,000 | – | – | – | 50,000 |
| Appropriation to reserve fund | – | – | – | 9,565 | – | 9,565 |
| Currency translation difference | – | – | – | – | (2,164) | (2,164) |
| **Balance at 31 December 2006** | 6,570 | 182,197 | – | 47,124 | (3,811) | 232,080 |

| Company | Fair value reserve | Exchange fluctuation reserve | Total |
|---|---|---|---|
| **Balance at 1 January 2005** | – | (795) | (795) |
| Currency translation difference | – | (1,017) | (1,017) |
| Revaluation losses | – | – | – |
| – Recognised | (948) | – | (948) |
| – Transferred to income statement | 948 | – | 948 |
| **Balance at 31 December 2005 and at 1 January 2006** | – | (1,812) | (1,812) |
| Currency translation difference | – | (1,915) | (1,915) |
| **Balance at 31 December 2006** | – | (3,727) | (3,727) |

(a) The merge reserve represents the difference between the amount of the capital of the subsidiaries at the date on which they were acquired by the Company and the nominal amounts of the Company's share issued as consideration for the acquisition.

(b) The capital reserve represents mainly the amounts of retained earnings capitalised on re-investment in subsidiaries.

(c) The Company's subsidiaries in the PRC are required to follow the laws and regulations of the PRC and their articles of association. These subsidiaries are required to allocate at least 10% of their net profit to the reserve fund until the balance of such fund has reached 50% of their registered capital. The reserve fund can only be used, upon approval by the relevant authorities, to offset accumulated losses or increase capital.

## 20. Trade and other payables

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Trade payables (Note (a)) | **21,578** | 10,991 | **1,206** | – |
| Salary and staff welfare payable | **14,408** | 10,682 | **–** | – |
| Customers' deposits | **44,006** | 35,341 | **–** | – |
| VAT and business tax payable | **22,289** | 16,926 | **–** | – |
| Amounts due to subsidiaries (Note (b)) | **–** | – | **–** | 663 |
| Accrued expenses | **12,383** | 6,346 | **–** | – |
| Other | **8,348** | 7,041 | **15** | – |
| | **123,012** | 87,327 | **1,221** | 663 |

(a) At 31 December 2006, the ageing analysis of the trade payables is as follows:

| | **2006** | 2005 |
|---|---|---|
| Within 180 days | **20,648** | 9,512 |
| 181 – 360 days | **86** | 554 |
| Over 360 days | **844** | 925 |
| | **21,578** | 10,991 |

(b) Amounts due to subsidiaries are unsecured, interest free and repayable on demand.

## 21. Borrowings

| | **2006** | 2005 |
|---|---|---|
| Unsecured bank borrowings | **30,000** | 30,000 |
| Collateralised bank borrowings | **7,150** | – |
| | **37,150** | 30,000 |

The interest rate exposure of the borrowings of the Group is as follows:

| | **2006** | 2005 |
|---|---|---|
| Bank borrowings | | |
| – at fixed rates | **27,150** | 30,000 |
| – interest free (Interest subsidised by PRC government) | **10,000** | – |
| | **37,150** | 30,000 |
| Weighted average effective annual interest rates | **4.06%** | 4.91% |

Collateralised bank borrowings amounting to RMB7,150,000 (2005: nil) are obtained by factoring of trade receivables (Note 14).

The carrying amount of short-term borrowings is denominated in RMB and approximates their fair value.

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### 22. Deferred income

| | **2006** | 2005 |
|---|---|---|
| Deferred sales (Note (a)) | **57,216** | 40,994 |
| Deferred government grant (Note (b)) | **3,200** | 3,854 |
| | **60,416** | 44,848 |

(a) The amount represents revenues billed to or received from customers in relation to software technical service which were not yet recognised by the Group as the service periods covered were beyond the financial year end.

(b) Movement of deferred government grant is as follows:

| | **2006** | 2005 |
|---|---|---|
| **At 1 January** | **3,854** | 238 |
| Additions | **1,800** | 7,760 |
| Recognised in the income statement (Note 25) | **(2,454)** | (4,144) |
| **At 31 December** | **3,200** | 3,854 |

Amount represents various subsidies granted by and received from local government authorities in the PRC for research and development projects.

### 23. Provisions

| | **2006** | 2005 |
|---|---|---|
| **At 1 January** | **3,537** | 3,691 |
| Additional provisions | **–** | 4,495 |
| Utilised during the year | **(3,537)** | (4,649) |
| **At 31 December** | **–** | 3,537 |

### 24. Turnover

Turnover is stated net of applicable value-added tax ("VAT") in the PRC and comprises the following:

| | **2006** | 2005 |
|---|---|---|
| Sales of software | **413,114** | 377,105 |
| Software implementation service | **125,390** | 102,441 |
| Software solution consulting and support service | **60,754** | 44,696 |
| Sales of computer and related products | **12,185** | 5,101 |
| | **611,443** | 529,343 |

## 25. Other income

| | 2006 | 2005 |
|---|---|---|
| Subsidy income | | |
| VAT refund (Note (a)) | **61,558** | 51,802 |
| Subsidy for research and development projects (Note 22) | **2,454** | 4,144 |
| Tax refund for re-investments (Note (b)) | **5,329** | – |
| Others | **3,905** | 2,306 |
| | **73,246** | 58,252 |
| Interest income | **2,951** | 1,330 |
| Gain on disposal of equity interest in a subsidiary | **–** | 1,285 |
| Others | **362** | 230 |
| | **76,559** | 61,097 |

(a) According to the current tax regulations in the PRC, the development and sales of computer software are subject to VAT with an applicable rate of 17%. In September 2000, the Ministry of Finance, the State Administration of Taxation and the General Administration of Customs of the PRC jointly issued a circular regarding the Taxation Policy for Encouraging the Development of the Software and Integrated Circuits Industries (Cai Shui Zi [2000] No.25). Pursuant to the Circular, for the period from 24 June 2000 to 31 December 2010, software enterprises which engage in the sale of self-developed software in the PRC are entitled to a preferential taxation treatment which provides for the payment of VAT at the rate of 17% and the refund of any VAT paid for the sale of the software in the PRC which exceeds the VAT rate of 3%.

(b) Amount represented income tax refund for re-investment in a subsidiary by way of capitalisation of dividend.

# Notes to the Consolidated Financial Statements

(All amounts in Renminbi thousands unless otherwise stated)

## 26. Expenses by nature

Expenses included in cost of sales, selling and marketing expenses and administrative expenses are analysed as follows:

| | **2006** | 2005 |
|---|---|---|
| Research and development costs | | |
| Amounts incurred | **80,209** | 57,819 |
| Less: amounts capitalised (Note 8) | **(53,356)** | (39,128) |
| Add: amortisation of capitalised costs (Note 8) | **43,005** | 31,785 |
| | **69,858** | 50,476 |
| Employee benefit expense (Note 27) | **301,328** | 262,910 |
| Less: amount included in research and development costs | **(63,697)** | (45,357) |
| | **237,631** | 217,553 |
| Cost of inventories consumed (Note 13) | **25,882** | 18,217 |
| Depreciation (Note 6) | **10,509** | 11,660 |
| Amortisation of computer software (Note 8) | **1,349** | 528 |
| Charge of lease prepayments (Note 7) | **463** | 384 |
| Impairment of goodwill (Note 8) | **9,338** | 998 |
| Impairment of receivables (Note 14) | **24,076** | 19,560 |
| Impairment of available-for-sale financial assets (Note 19) | **–** | 1,143 |
| Loss on disposals of PPE (Note 33) | **238** | 795 |
| Warranty provisions (Note 23) | **–** | 4,495 |
| Auditor's remuneration | **1,600** | 1,230 |
| Advertising costs | **38,001** | 35,221 |
| Sales promotion costs | **31,799** | 25,282 |
| Share options granted to business partners (Note 17) | **–** | 112 |
| Share options granted to related parties (Note 17) | **2,392** | – |
| Professional service costs | **12,413** | 10,386 |
| Traveling costs | **22,613** | 17,149 |
| Rental and utilities | **26,173** | 21,656 |
| Others | **66,714** | 73,475 |
| | **581,049** | 510,320 |

## 27. Employee benefit expense

| | **2006** | 2005 |
|---|---|---|
| Wages, salaries and bonus | **226,707** | 200,555 |
| Commission | **36,977** | 32,290 |
| Staff welfare | **9,138** | 8,136 |
| Pension scheme contributions (Note (a)) | **22,058** | 16,340 |
| Share options granted to directors and employees (Note 17) | **6,448** | 5,589 |
| | **301,328** | 262,910 |

## 27. Employee benefit expense *(continued)*

(a) The Group participates in defined contribution retirement schemes organised by the relevant local government authorities in the PRC. The Group is required to make monthly contributions to the retirement scheme at rates ranging from 8% to 22.5%, depending on the location of the subsidiaries, based on the eligible employees' basic salaries. The local government authorities are responsible for the pension liabilities to retired employees. Forfeited contributions made by the Group on behalf of employees who leave the scheme prior to full vesting of the contributions may not be used by the employer to reduce the existing level of contributions.

(b) Directors' and senior management's emoluments

The remuneration of every Director for the year ended 31 December 2006 is set out below:

| **Name of Director** | **Fees** | **Salary** | **Discretionary bonuses** | **Share options** | **Employer's contribution to pension scheme** |
|---|---|---|---|---|---|
| Mr. Xu Shao Chun | **100** | **888** | **468** | **1,688** | **17** |
| Mr. Chen Deng Kun | **50** | **387** | **163** | **282** | **17** |
| Mr. James Ming King | **50** | **–** | **–** | **–** | **–** |
| Mr. Zhao Yong | **50** | **–** | **–** | **–** | **–** |
| Mr. Hugo Shong | **50** | **–** | **–** | **–** | **–** |
| Ms. Yang Zhou Nan | **100** | **–** | **–** | **–** | **–** |
| Mr. Wu Cheng | **50** | **–** | **–** | **–** | **–** |
| Mr. Yeung Kwok On | **100** | **–** | **–** | **–** | **–** |
| Mr. Gary Clark Biddle | **100** | **–** | **–** | **–** | **–** |

The remuneration of every Director for the year ended 31 December 2005 is set out below:

| Name of Director | Fees | Salary | Discretionary bonuses | Share options | Employer's contribution to pension scheme |
|---|---|---|---|---|---|
| Mr. Xu Shao Chun | 50 | 851 | 300 | 1,397 | 15 |
| Mr. Chen Deng Kun | 5 | 27 | – | 16 | 1 |
| Mr. James Ming King | 38 | 448 | 220 | – | 10 |
| Mr. Zhao Yong | 50 | – | – | – | – |
| Mr. Hugo Shong | 50 | – | – | – | – |
| Ms. Yang Zhou Nan | 100 | – | – | – | – |
| Mr. Wu Cheng | 50 | – | – | – | – |
| Mr. Yeung Kwok On | 104 | – | – | – | – |
| Mr. Gary Clark Biddle | 104 | – | – | – | – |

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(All amounts in Renminbi thousands unless otherwise stated)

## 27. Employee benefit expense *(continued)*

(c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include one (2005: two) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining four (2005: three) individuals during the year are as follows:

| | **2006** | 2005 |
|---|---|---|
| Basic salaries, housing allowances, other allowances and benefits in kind | **2,779** | 1,884 |
| Bonuses | **1,167** | 933 |
| Pension scheme contributions | **55** | 43 |
| Share options | **1,623** | 683 |
| | **5,624** | 3,543 |

The emoluments fell within the following bands:

| | **2006** | 2005 |
|---|---|---|
| Emolument bands | | |
| HK$0 – HK$1,000,000 | **–** | 1 |
| HK$1,000.001 – HK$1,500,000 | **2** | 2 |
| HK$1,500,001 – HK$2,000,000 | **2** | – |

## 28. Finance costs

| | **2006** | 2005 |
|---|---|---|
| Interest expense on bank borrowings | **70** | 517 |
| Net foreign exchange loss/(gains) | **79** | (129) |
| | **149** | 388 |

## 29. Income tax expense

| | **2006** | 2005 |
|---|---|---|
| PRC income tax | | |
| – Current income tax | **8,451** | 8,881 |
| – Over-provision in previous year | **(2,551)** | (1,072) |
| – Deferred income tax (Note 11) | **1,563** | (1,257) |
| | **7,463** | 6,552 |

(a) No provision for profits tax in the Cayman Islands and Hong Kong has been made as the Group has no income assessable for profits tax for the years in those jurisdictions.

(b) Majority of the subsidiaries and associates of the Group is established in the PRC and subject to Enterprise Income Tax (“EIT”) at a rate of 33%, unless preferential rates are applicable in the cities where the subsidiaries are located.

(c) Certain subsidiaries and associates of the Group are foreign investment enterprises and are entitled to full exemption from EIT for two years and a 50% reduction in the following three years thereafter starting from the first profit making year after offsetting prior years’ losses.

(d) According to the document Guo Fa [2000] No.18 issued by the State Council, those subsidiaries recognised as important software enterprises but are not in their tax holiday period are entitled to a preferential tax rate of 10% in the year.

## 29. Income tax expense *(continued)*

The reconciliation of the effective tax rate to the statutory tax rate is as follows:

| | **2006** | 2005 |
|---|---|---|
| Profit before tax | **104,794** | 79,840 |
| Tax at the statutory tax rate of 33% (2005: 33%) | **34,582** | 26,347 |
| – Effect of preferential tax rates | **(24,103)** | (18,363) |
| – Tax losses not recognised | **6,464** | 6,532 |
| – Expenses not deductible for tax purposes | **2,693** | 1,086 |
| – Income not subject to tax | **(5,594)** | (5,087) |
| – Additional deductible allowance for research and development expenses | **(4,028)** | (2,891) |
| – Over-provision of income tax in previous year | **(2,551)** | (1,072) |
| | **7,463** | 6,552 |

## 30. Profit attributable to equity holders of the Company

The profit attributable to equity holders of the Company is dealt within the financial statements of the Company to the extent of RMB66,154,000 (2005: RMB53,941,000).

## 31. Earnings per share

(a) Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

| | **2006** | 2005 |
|---|---|---|
| Profit attributable to equity holders of the Company | **97,377** | 72,290 |
| Weighted average number of ordinary shares in issue (thousands) | **447,867** | 443,596 |
| Basic earnings per share (RMB per share) | **0.22** | 0.16 |

(b) Diluted

Diluted earnings per share is calculated by adjusting the weighted number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has just one category of dilutive potential ordinary shares: share options. For the share options, a calculation is made in order to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

| | **2006** | 2005 |
|---|---|---|
| Profit attributable to equity holders of the Company | **97,377** | 72,290 |
| Weighted average number of ordinary shares in issue (thousands) | **447,867** | 443,596 |
| Adjustments for — share options (thousands) | **8,555** | 1,055 |
| Weighted average number of ordinary shares for diluted earnings per share (thousands) | **456,422** | 444,651 |
| Diluted earnings per share (RMB per share) | **0.21** | 0.16 |

(All amounts in Renminbi thousands unless otherwise stated)

## 32. Dividends

The dividends paid in 2006 and 2005 were RMB20,843,000 (HK$20,036,000) (RMB0.047 per share (HK$0.045 per share)) and RMB18,810,000 (HK$17,734,000) (RMB0.04 per share (HK$0.04 per share)) respectively. A dividend in respect of the year ended 31 December 2006 of RMB0.064 per share (HK$0.065 per share), amounting to a total dividend of RMB29,150,000 (HK$29,447,000), is to be proposed at the Annual General Meeting on 26 April 2007. These financial statements do not reflect this dividend payable.

## 33. Cash generated from operations

| | **2006** | 2005 |
|---|---|---|
| Profit before income tax | **104,794** | 79,840 |
| Adjustments for: | | |
| – Depreciation (Note 6) | **10,509** | 11,660 |
| – Loss on disposals of PPE | **238** | 795 |
| – Share of loss/(profit) from associates (Note 10) | **2,010** | (108) |
| – Charge of lease prepayments (Note 7) | **463** | 384 |
| – Amortisation of intangible assets (Note 8) | **44,354** | 32,313 |
| – Impairment of goodwill (Notes 8) | **9,338** | 998 |
| – Interest income (Note 25) | **(2,951)** | (1,330) |
| – Interest expense (Note 28) | **70** | 517 |
| – Share option expenses | | |
| Granted to directors and employees (Note 17) | **6,448** | 5,589 |
| Granted to business partners (Note 17) | **–** | 112 |
| Granted to related parties (Note 17) | **2,392** | – |
| – Gain on disposal of equity interest in a subsidiary (Note 25) | **–** | (1,285) |
| – Impairment of available-for-sale financial assets (Note 19) | **–** | 1,143 |
| | **177,665** | 130,628 |
| Changes in working capital (excluding the effects of acquisition and exchange differences on consolidation): | | |
| – Inventories | **301** | (219) |
| – Trade and other receivables | **(8,940)** | (4,146) |
| – Provisions | **(3,537)** | (154) |
| – Deferred income | **15,568** | 13,216 |
| – Trade and other payables | **27,968** | 8,301 |
| – Due from/to customers on implementation contracts | **8,005** | (2,482) |
| Cash generated from operations | **217,030** | 145,144 |

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

| | **2006** | 2005 |
|---|---|---|
| Net book amount (Note 6) | **631** | 2,311 |
| Loss on disposals of PPE | **(238)** | (795) |
| Proceeds from disposals of PPE | **393** | 1,516 |

## 34. Commitments — Group

### Capital commitments

Capital expenditure contracted for at the balance sheet date but not yet incurred is as follows:

| | **2006** | 2005 |
|---|---|---|
| PPE | **98,102** | 21,476 |

### Operating lease commitments – group company as lessee

The Group had total minimum future lease payments under non-cancelable operating leases in respect of buildings as follows:

| | **2006** | 2005 |
|---|---|---|
| Not later than one year | **15,510** | 14,286 |
| Later than one year and no later than five years | **17,615** | 7,590 |
| | **33,125** | 21,876 |

## 35. Related party transactions

In June 2006, the Group granted 4,400,000 share options respectively to Shenzhen Kingdee Software Accessories Co., Ltd. and Project China Limited, both of which are held by employee of unions and employee representatives of the Group.

## 36. Ultimate holding company

The directors regard the Company has no ultimate holding company.