

# Management

## Discussion & Analysis



**Vice President, executive director:**

*Mr. Wan Feng (Middle)*

**Vice President:**

*Mr. Lin Dairen (2nd from right)*

*Ms. Liu Yingqi (2nd from left)*

*Mr. Liu Jiade (1st from right)*

**Assistant President:**

*Mr. Su Hengxuan (1st from left)*

### *Operating Results*

*Results of our business operations are subject to a variety of factors. For example, we face increasing competitive pressures from other insurance companies operating in China, which may materially and adversely affect the growth of our business. In addition, our investments are subject to, among other things, volatility in the PRC securities markets, which is still at an early stage of development. Therefore, our operating results of previous financial years may not reflect our current or future operating results. For a full description of the risks affecting our business, see Risk Factors in our prospectus dated December 9, 2003 for our initial public offering, as well as our annual reports on Form 20-F filed with the SEC.*

*Year Ended December 31, 2006 Compared with Year Ended December 31, 2005*

### **NET PREMIUMS EARNED AND POLICY FEES**

Net premiums earned and policy fees increased by RMB18,809 million, or 23.5%, to RMB98,847 million in 2006 from RMB80,038 million in 2005. This increase was primarily due to increases in net premiums earned and policy fees from the individual life insurance and group life insurance businesses. Net premiums earned from participating products of long-term traditional insurance contracts were RMB41,001 million in 2006, an increase of RMB9,985 million, or 32.2%, from RMB31,016 million in 2005. This increase was primarily due to an increased market demand, as well as our increased sales efforts, for participating endowment products. Of total net premiums earned in 2006, RMB2,205 million was attributable to single premium products and RMB78,952 million was attributable to regular premium products (including both first-year and renewal premiums). Of total net premiums earned in 2005, RMB1,896 million was attributable to single premium products and RMB62,027 million was attributable to regular premium products.

#### **Individual Life Insurance Business**

Net premiums earned and policy fees from the individual life insurance business increased by RMB17,770 million, or 25.8%, to RMB86,519 million in 2006 from RMB68,749 million in 2005. This increase was primarily due to increases in renewal premiums, policy fees and new policy premiums.

#### **Group Life Insurance Business**

Net premiums earned and policy fees from the group life insurance business increased by RMB478 million, or 38.0%, to RMB1,735 million in 2006 from RMB1,257 million in 2005. This increase was primarily due to increases in sales of whole-life insurance products and increases in policy fees.

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### Accident and Health Insurance Business

Net premiums earned from the accident and health insurance business (both of which comprise short-term products) increased by RMB561 million, or 5.6%, to RMB10,593 million in 2006 from RMB10,032 million in 2005. Gross written premiums from the accident insurance business increased by RMB13 million, or 0.3%, to RMB5,148 million in 2006 from RMB5,135 million in 2005 and gross written premiums from the health insurance business increased by RMB210 million, or 3.7%, to RMB5,942 million in 2006 from RMB5,732 million in 2005. These increases were primarily due to our increased sales efforts for accident insurance business, but offset in part by our adjustment of our sales strategies for health insurance business to reduce our sales of certain health products with relatively higher risks.

### NET INVESTMENT INCOME

Net investment income increased by RMB8,257 million, or 49.5%, to RMB24,942 million in 2006 from RMB16,685 million in 2005. This increase was primarily due to the growth in investment assets during 2006 and an increase in investment yield.

As at December 31, 2006, total investment assets were RMB686,804 million and the investment yield for the year ended December 31, 2006 was 4.27%. As at December 31, 2005, total investment assets were RMB494,356 million and the investment yield for the year ended December 31, 2005 was 3.86%. This increase was primarily due to increased investments in debt and equity securities, favorable adjustment of our investment portfolio, favorable capital market conditions and expanded investment channels for insurance companies. Our investment income is affected by many factors, including the volatility of the securities markets in China. Changes in the PRC capital markets and volatilities in the PRC securities markets in the future could have an impact on our net investment income, and accordingly an adverse impact on our net profit.

### NET REALISED GAINS/LOSSES ON FINANCIAL ASSETS

Net realised gains on financial assets increased by RMB2,105 million to RMB1,595 million in 2006 from net losses of RMB510 million in 2005. The results in 2006 reflected net realised losses of RMB6 million on debt securities and net realised gains of RMB1,601 million on equity securities, which was primarily due to the favorable China stock market in 2006.

### NET FAIR VALUE GAINS ON ASSETS AT FAIR VALUE THROUGH INCOME (HELD-FOR-TRADING)

We reflect net fair value gains on assets at fair value through income (held-for-trading) in current year income. Our net fair value gains on assets at fair value through income (held-for-trading) were RMB20,044 million in 2006, increased by RMB19,784 million, or 76.09 times from RMB260 million in 2005. The results in 2006 reflected net fair value gains on assets at fair value through income (held-for-trading) of RMB305 million on debt securities, resulting from favorable conditions in debt securities markets in 2006 and increased investments in debt securities. Net fair value gains on assets at fair value through income (held-for-trading) of RMB19,739 million on equity securities, resulting from extremely favorable conditions in equity securities markets and increased investments in equity securities.

### OTHER INCOME

Other income increased by RMB144 million, or 8.3%, to RMB1,883 million in 2006 from RMB1,739 million in 2005. This was primarily due to the fee income received from CLIC as the reward for assisting CLIC to mitigate its business risk arising from non-transferred policies.

### DEPOSITS AND POLICY FEES

Deposits are gross additions to long-term investment-type insurance contracts and investment contracts (collectively, investment-type contracts). Total deposits increased by RMB5,495 million, or 6.4%, to RMB91,441 million in 2006 from RMB85,946 million in 2005. This increase was primarily due to an increase in business volume. Policy fees increased by RMB1,014 million, or 16.7%, to RMB7,097 million in 2006 from RMB6,083 million in 2005. This increase was primarily due to an increase in the proportion of investment-type products with higher policy fee charges. Total deposits from participating products increased by RMB5,785 million, or 7.6%, to RMB81,749 million in 2006 from RMB75,964 million in 2005. Total policy fees from participating products increased by RMB917 million, or 21.4%, to RMB5,193 million in 2006 from RMB4,276 million in 2005.

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### Individual Life Insurance Business

Deposits in the individual life insurance business increased by RMB7,872 million, or 12.6%, to RMB70,355 million in 2006 from RMB62,483 million in 2005. This increase was primarily due to an increase in the sales of investment-type contracts. Policy fees from the individual life insurance business increased by RMB818 million, or 14.4%, to RMB6,501 million in 2006 from RMB5,683 million in 2005. These increases were primarily due to an increase of the proportion of investment-type contracts with higher policy fee charges.

### Group Life Insurance Business

Deposits in the group life insurance business decreased by RMB2,377 million, or 10.1%, to RMB21,086 million in 2006 from RMB23,463 million in 2005. Policy fees from the group life insurance business increased by RMB196 million, or 49.0%, to RMB596 million in 2006 from RMB400 million in 2005. These changes were primarily due to an increase of the proportion of investment-type contracts with higher policy fee charges.

### Accident and Health Insurance Business

There are no deposits in our accident and health insurance business.

## INSURANCE BENEFITS AND CLAIMS

Insurance benefits and claims, net of amounts ceded through reinsurance, increased by RMB14,391 million, or 26.6%, to RMB68,420 million in 2006 from RMB54,029 million in 2005. This increase was due to an increase in insurance benefits and claims of individual life insurance business as a result of an increase in business volume and the accumulation of liabilities. Life insurance death and other benefits increased by RMB2,486 million, or 29.9%, to RMB10,797 million in 2006 from RMB8,311 million in 2005. This increase was principally due to an increase in the number of policies in force and the accumulation of liabilities. Life insurance death and other benefits as a percentage of gross written premiums and policy fees were 10.9% and 10.3% in 2006 and 2005 respectively. Interests credited to long-term investment-type insurance contracts increased by RMB1,492 million, or 30.5%, to RMB6,386 million in 2006 from RMB4,894 million in 2005. This increase primarily reflected an increase in the total policyholder account balance. Insurance benefits and claims, net of amounts ceded through reinsurance, attributable to participating products increased by RMB8,545 million, or 34.2%, to RMB33,551 million in 2006 from RMB25,006 million in 2005. Of these insurance benefits and claims attributable to participating products, life insurance death and other benefits increased by RMB599 million, or 14.8%, to RMB4,652 million in 2006 from RMB4,053 million in 2005, the increase in liability of long-term traditional insurance contracts increased by RMB6,501 million, or 38.6%, to RMB23,345 million in 2006 from RMB16,844 million in 2005, and the interest credited to long-term investment-type insurance contracts increased by RMB1,445 million, or 35.2%, to RMB5,554 million in 2006 from RMB4,109 million in 2005.

### Individual Life Insurance Business

Insurance benefits and claims for the individual life insurance business increased by RMB14,244 million, or 30.9%, to RMB60,405 million in 2006 from RMB46,161 million in 2005. This increase was due to an increase in business volume and the accumulation of liabilities. Of these insurance benefits and claims, life insurance death and other benefits increased by RMB2,381 million, or 30.7%, to RMB10,125 million in 2006 from RMB7,744 million in 2005 and the increase in liability of long-term traditional insurance contracts increased by RMB10,365 million, or 30.9%, to RMB43,915 million in 2006 from RMB33,550 million in 2005. The increase in liability of long-term traditional insurance contracts was primarily due to an increase in business volume and the accumulation of liabilities.

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### Group Life Insurance Business

Insurance benefits and claims for the group life insurance business decreased by RMB5 million, or 0.5%, to RMB1,016 million in 2006 from RMB1,021 million in 2005. This decrease was primarily due to a decrease in the increment of long-term traditional insurance contracts liabilities and interest credited to long-term traditional insurance contracts, but offset in part by an increase in life insurance death and other benefits. Of these insurance benefits and claims, life insurance death and other benefits increased by RMB105 million, or 18.5%, to RMB672 million in 2006 from RMB567 million in 2005 and the increase in long-term traditional insurance contracts liabilities decreased by RMB104 million, or 24.4%, to RMB323 million in 2006 from RMB427 million in 2005. This decrease was primarily due to a decrease in the contracts in force.

### Accident and Health Insurance Business

Insurance benefits and claims for the accident and health insurance business increased by RMB152 million, or 2.2%, to RMB6,999 million in 2006 from RMB6,847 million in 2005. This increase was primarily due to increases in business volume in our accident and health insurance business.

### INTEREST CREDITED TO INVESTMENT CONTRACTS

Interest credited to investment contracts increased by RMB23 million, or 2.4%, to RMB996 million in 2006 from RMB973 million in 2005. This increase primarily reflected an increase in the total policyholder account balance. Interest credited to participating investment contracts increased by RMB12 million, or 1.3%, to RMB951 million in 2006 from RMB939 million in 2005.

### INCREASE IN DEFERRED INCOME

Increase in deferred income includes the deferred profit liability arising from long-term traditional insurance contracts and the unearned revenue liability arising from long-term investment-type insurance contracts and investment contracts. Increase in deferred income increased by RMB3,086 million, or 36.2%, to RMB11,607 million in 2006 from RMB8,521 million in 2005. This increase was primarily due to an increase in business volume.

### POLICYHOLDER DIVIDENDS RESULTING FROM PARTICIPATION IN PROFITS

Policyholder dividends resulting from participation in profits increased by RMB12,258 million, or 228.7%, to RMB17,617 million in 2006 from RMB5,359 million in 2005. This increase was primarily due to an increase in business volume and accordingly, an increase in our reserves for participating products, as well as an increase in investment yield for participating products.

### AMORTISATION OF DEFERRED POLICY ACQUISITION COSTS

Amortisation of deferred policy acquisition costs increased by RMB2,493 million, or 32.1%, to RMB10,259 million in 2006 from RMB7,766 million in 2005. This increase was primarily due to an increase in the number of policies and overall amount of in-force business, as well as an increase in investment income in 2006.

### UNDERWRITING AND POLICY ACQUISITION COSTS

Underwriting and policy acquisition costs primarily reflect the non-deferrable portion of underwriting and policy acquisition costs. Underwriting and policy acquisition costs increased by RMB570 million, or 30.9%, to RMB2,415 million in 2006 from RMB1,845 million in 2005. Underwriting and policy acquisition costs were 2.4% and 2.3% of net premiums earned and policy fees in 2006 and 2005, respectively.

Of this amount, underwriting and policy acquisition costs in the individual life insurance business and group life insurance business together increased by RMB444 million, or 31.3%, to RMB1,862 million in 2006 from RMB1,418 million in 2005. This increase was primarily due to the increase in business volume during the period, as well as an increase in the sales of risk-type insurance contracts and regular-premium products, which have a relatively higher commission. Underwriting and policy acquisition costs in the accident and health insurance business increased by RMB126 million, or 29.5%, to RMB553 million in 2006 from RMB427 million in 2005. This increase was primarily due to the increase in business volume and increased market competition.

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### ADMINISTRATIVE EXPENSES

Administrative expenses include the non-deferrable portion of policy acquisition costs, as well as compensation and other administrative expenses. Administrative expenses increased by RMB2,102 million, or 29.0%, to RMB9,339 million in 2006 from RMB7,237 million in 2005. This increase primarily reflected the increase in business volume.

### OTHER OPERATING EXPENSES

Other operating expenses, which primarily consist of foreign exchange losses and expenses for non-core business, increased by RMB61 million, or 7.6%, to RMB859 million in 2006 from RMB798 million in 2005. This increase primarily reflected an increase in charity donations including RMB50 million for the establishment of a charity foundation.

### INCOME TAX

We pay income tax according to applicable Chinese enterprise income tax regulations and rules. Income tax expense, including current and deferred taxations, increased by RMB3,409 million, or 158.9%, to RMB5,554 million in 2006 from RMB2,145 million in 2005. This increase was primarily due to the increase in business volume. Our effective tax rate for 2006 was 21.7% as compared with a statutory tax rate of 33%.

### NET PROFIT ATTRIBUTABLE TO SHAREHOLDERS OF THE COMPANY

For the reasons set forth above, net profit attributable to shareholders of the Company increased by RMB10,650 million, or 114.4%, to RMB19,956 million in 2006 from RMB9,306 million in 2005. This increase was primarily due to the increases in net profits of individual life and group life insurance businesses.

#### Individual Life Insurance Business

Net profit in the individual life insurance business increased by RMB12,993 million, or 121.8%, to RMB23,663 million in 2006 from RMB10,670 million in 2005. This increase was primarily due to the increases in investment income and business volume of regular payment products.

#### Group Life Insurance Business

Net profit in the group life insurance business increased by RMB1,377 million to RMB864 million in 2006, from a net loss of RMB513 million in 2005. This increase was primarily due to the increases in investment income and business volume of regular payment products.

#### Accident and Health Insurance Business

Net profit in the accident and health insurance business decreased by RMB271 million, or 21.2%, to RMB1,009 million in 2006 from RMB1,280 million in 2005. The decrease in profitability was primarily due to increased market competition, which led to an increase in administrative expenses, offset in part by net fair value gains on assets at fair value through income (held-for-trading) in our accident and health insurance business.

### LIQUIDITY AND CAPITAL RESOURCES

#### Liquidity Sources

Our principal cash inflows come from insurance premiums, deposits, proceeds from sales and maturity of financial assets, and net investment income. The primary liquidity concerns with respect to these cash inflows are the risk of early withdrawals by contract holders and policyholders, as well as the risks of default by debtors, interest rate changes and other market volatilities. We closely monitor and manage these risks.

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Additional sources of liquidity to meet unexpected cash outflows are available from our investment portfolio. As at December 31, 2006, the amount of cash and cash equivalents was RMB50,213 million. In addition, substantially all of our term deposits with banks allow us to withdraw funds on deposit, subject to a penalty interest charge. As at December 31, 2006, the amount of term deposits was RMB175,476 million.

Our investment portfolio also may provide us with a source of liquidity to meet unexpected cash outflows. As at December 31, 2006, investments in debt securities had a fair value of RMB369,631 million. As at December 31, 2006, investments in equity securities had a fair value of RMB95,493 million. However, the People's Republic of China (the "PRC") securities market is still at an early stage of development, and we are subject to market liquidity risk because the market capitalization and trading volumes of the public exchanges are much lower than those in more developed financial markets. We also are subject to market liquidity risk due to the large size of our investments in some of the markets in which we invest. From time to time some of our positions in our investment securities may be large enough to have an influence on the market value. These factors may limit our ability to sell these investments at an adequate price, or at all.

### Liquidity Uses

Our principal cash outflows primarily relate to the liabilities associated with our various life insurance, annuity and accident and health insurance products, dividend and interest payments on our insurance policies and annuity contracts, operating expenses, income taxes and dividends that may be declared and payable to our shareholders. Liabilities arising from our insurance activities primarily relate to benefit payments under these insurance products, as well as payments for policy surrenders, withdrawals and policy loans.

We believe that our sources of liquidity are sufficient to meet our current cash requirements.

### Consolidated Cash Flows

The following sets forth information regarding consolidated cash flows for the periods indicated.

Net cash provided by operating activities was RMB80,352 million in 2006, an increase of RMB48,524 million from 2005. This increase was primarily due to our increased sales and maturity of financial assets at fair value through income (held-for-trading).

Net cash used in investment activities was RMB141,038 million in the year ended December 31, 2006, an increase of RMB49,698 million from 2005. This increase in cash used in investing activities was primarily due to an increase in our debt securities and term deposits.

Net cash provided by financing activities was RMB83,313 million in the year ended December 31, 2006, an increase of RMB22,596 million from 2005. The changes in cash provided by financing activities over these periods were primarily due to the cash proceeds from our initial public offering of A shares in December 2006.

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Our global share offering in December 2003 provided cash proceeds of approximately RMB24,707 million (US\$3,062 million). As at the date of this annual report, a substantial part of the cash proceeds from our global offering was held in bank deposit accounts denominated in foreign currencies in China, part of which were held as structured deposits. We gradually converted approximately US\$300 million of the cash proceeds into Renminbi to reduce foreign exchange risks. In addition, we used approximately US\$250 million of the cash proceeds for investments in H shares of China Construction Bank Corporation in its initial public offering in 2005, a portion of which was sold early 2006, and approximately US\$425 million for investments in foreign-currency dominated debts in China. We used approximately HK\$1,175 million for investments in H shares of Bank of China Limited in its initial public offering in May 2006, approximately HK\$2,000 million for investments in H shares of Industrial and Commercial Bank of China Limited in its initial public offering in October 2006 and approximately US\$433 million for investments in Guangdong Development Bank in December 2006.

Our initial public offering of A shares in December 2006 provided cash proceeds of approximately RMB27,810 million. We received such cash proceeds on December 29, 2006. As at the date of this annual report, the cash proceeds from our A share offering was used to increase our capital.

### INSURANCE SOLVENCY REQUIREMENTS

The solvency ratio of an insurance company is a measure of capital adequacy, which is calculated by dividing the actual solvency margin of the company (which is its admissible assets less admissible liabilities, determined in accordance with relevant rules) by the minimum solvency margin it is required to meet. The following table shows the Company's solvency ratio as at December 31, 2006:

	As at December 31 2006 (RMB in millions, except percentage data)
Actual solvency margin	96,297
Minimum solvency margin	27,549
Solvency ratio	350%

Insurance companies are required to calculate and report annually to the CIRC their solvency margin and twelve additional financial ratios to assist it in monitoring the financial condition of insurers. A "usual range" of results for each of the twelve ratios is used as a benchmark. The departure from the "usual range" of four or more of the ratios can lead to regulatory action being taken by the CIRC.

Our solvency margin as at December 31, 2006 was approximately 3.5 times the minimum regulatory requirement. Among the twelve financial ratios, eleven financial ratios were within their usual ranges and our actual solvency ratio was slightly higher than the usual range provided by the CIRC. The increase in our actual solvency ratio was due to the proceeds received from our initial public offering of A shares.

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### DIFFERENCE IN ACCOUNTING STANDARDS

HKFRS vary in certain significant respects from PRC GAAP. The net profit reconciliation from PRC GAAP to HKFRS is as follows:

	2006 RMB million	2005 RMB million
Net profit under the PRC GAAP	9,601	5,456
<b>Reconciling items:</b>		
<b>Insurance related adjustments</b>	193	6,254
– Deferred policy acquisition costs (a)	5,653	6,308
– Premiums, benefits and reserves of insurance and investment contracts (b)	(5,722)	727
– Claims reserves (c)	(57)	(637)
– Unearned premium reserves (d)	46	(144)
– Other adjustment related to insurances	273	–
<b>Investment related adjustments</b>	15,824	(563)
– Classification difference on investment (e)	15,731	(414)
– Adjustment for effective interest rate (f)	(13)	(47)
– Other adjustment related to investments	106	(102)
Reversal of property, plant and equipment revaluation surplus and its related depreciation (g)	93	59
Stock appreciation rights (h)	(431)	–
Deferred tax effects thereof	(5,321)	(1,899)
Impact to Minority Interest from above items	(3)	(1)
<b>Net profit attributable to shareholders of the Company under HKFRS</b>	<b>19,956</b>	<b>9,306</b>

Notes to the reconciliation items:

(a) **Deferred policy acquisition costs (DAC)**

Under the PRC GAAP, commission, brokerage and operating expenses are recorded in the income statement when incurred. The actuarial reserving method employed under the PRC GAAP makes an implicit allowance for first year expenses in excess of policy loadings. Under HKFRS, the costs of acquiring new and renewal business which vary with and are primarily related to the production of new and renewal business, are deferred. DAC for long-term traditional insurance contracts are amortised over the premium paying period as a constant percentage of expected premiums. DAC for long-term investment type insurance contracts and investment contracts are amortised over the expected life of the contracts as a constant percentage of the present value of estimated gross profits expected to be realised over the life of the contract.

(b) **Premiums, benefits and reserves of insurance and investment contracts**

Under the PRC GAAP, the long-term products comprise life insurance and long-term health insurance, whose premiums received and benefits paid are recognized in current period's income statement. Under HKFRS, the Group classifies its long-term products into four categories: long-term traditional insurance contracts, long-term investment type insurance contracts, investment contracts with DPF and investment contracts without DPF. For the last three categories, premiums and interests earned are accounted as deposits to the related policy accounts while benefits as well as policy fees, mortality and surrender charges are accounted as withdrawals from the related policy accounts. The reconciling item also includes an amount resulting from differences in actuarial reserving methodologies.



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(c) **Claims reserves**

Under the PRC GAAP, outstanding claims reserve represents reserve for reported claims and claims incurred but not reported (“IBNR”). For outstanding claims reserve that is reported, the reserve is set at the claimed amount to the extent that it does not exceed the sum assured; if the amount has not been specified by the claimant, the reserve is set at the sum assured. For IBNR of the short-term accident insurance and short-term health insurance which only cover medical costs caused by accident, the reserve is set no higher than 4% of claims paid for that year. For IBNR of the remaining short-term health insurance (except for those which only cover medical costs caused by accident), the reserve is set in accordance with CIRC’s relevant actuarial regulations. In accordance with HKFRS 4 – Insurance Contract, the liability for unpaid claims shall be based on the estimated ultimate cost of settling the claims, using past experience adjusted for current trends, and any other factors that would modify past experience. Changes in estimates of claim costs resulting from the continuous review process and differences between estimates and payments for claims shall be recognized when the estimates are changed or payments are made, an additional outstanding claims reserve should be recognized depending on the Group’s best estimates for unpaid claims.

(d) **Unearned premium reserves**

Under the PRC GAAP, unearned premium reserve is provided for the future insurance obligations from insurance business with policy terms of no more than one year. For the short-term accident insurance and the short-term health insurance which only cover medical costs caused by accident, unearned premium reserve is provided using 1/24 method of net written premium of these policies. For the remaining of short-term health insurance (except for the insurance obligations which only cover medical costs caused by accident), unearned premium reserve is set in accordance with CIRC’s relevant actuarial regulations. In accordance with HKFRS 4 – Insurance Contract, premiums from short-duration contracts ordinarily shall be recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided.

(e) **Classification difference on investments**

Under the PRC GAAP, investments are classified as short-term and long-term investments based on the liquidity and intended holding period of the Company. Short-term investments are carried at the lower of cost and market value while long-term investments are recognized and measured at its cost. In accordance with HKAS 39 – Financial Instruments: Recognition and Measurement, the Group classifies these investments into four categories: financial assets at fair value through income (held-for-trading), held-to-maturity securities, loans and receivables and available-for-sale securities. Available-for-sale securities and financial assets at fair value through income (held-for-trading) are carried at fair value. Held-to-maturity securities, loans and receivables are carried at amortised cost using the effective interest method. Realised and unrealised gains and losses arising from changes in the fair value of the “financial assets at fair value through income (held-for-trading)” category are included in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of financial assets classified as available-for-sale securities are recognized in equity. When securities classified as available-for-sale securities are sold or impaired, the accumulated fair value adjustments are included in the income statement as realised gains/losses on financial assets.

(f) **Adjustment for effective interest rate**

Under the PRC GAAP, the Group does not amortize premium or discount of short-term debt investments and amortises the premium or discount of long-term bond investment using straight-line method. All the interests received from short-term investments are accounted as a reduction to the carrying value, except those already accounted as receivable at acquisition. According to HKAS39 – Financial Instruments: Recognition and Measurement, the Group uses effective interest rate method to amortize the premium or discount from debt investments.

(g) **Reversal of property, plant and equipment revaluation surplus and its related depreciation**

Under the PRC GAAP, the Group recognized RMB1,624 million capital surplus arising from assets revaluation (mainly property, plant and equipment). Under Hong Kong Accounting Standard 16 – Property, Plant and Equipment, the Company has chosen the cost model as its accounting policy and does not recognize any revaluation relating to property, plant and equipment. The revaluation surplus and its related depreciation under the PRC GAAP are reversed under HKFRS.

(h) **Stock appreciation rights**

Under current PRC GAAP, the Group accounts for costs relating to exercised stock appreciation rights in the income statement in the period they are exercised. In accordance with HKFRS 2 – Share based payment, compensation under the stock appreciation rights is measured based on the fair value of the liabilities incurred and is expensed over the vesting period. The liability is remeasured at each balance date to its fair value until settlement with all changes included in administrative expenses in the consolidated income statement, the related liability is included in other liabilities.