1. GENERAL INFORMATION

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

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

On 9 September 2005, Greencool Enterprise entered into an equity transfer agreement with Qingdao Hisense Air-Conditioner Company Limited ("Hisense Air-Conditioner") in connection with the transfer of 262,212,194 shares of domestic legal person shares of the Company, representing 26.43% of total share capital of the Company. The equity transfer was completed on 13 December 2006. Therefore, Hisense Air-Conditioner has become the single largest shareholder of the Company as at 31 December 2006.

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

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

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

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

2. RETROSPECTIVE RESTATEMENT OF ERRORS

The financial statements for the year ended 31 December 2006 include a restatement of the 2005 financial statements to correct the errors noted by the Company. The effects of the restatement on the 2005 financial statements are summarised below:

	Effect on 2005 *RMB'000*
Income statement:	
Increase in administrative expenses *(i)*	(15,787)
Increase in other operating expenses *(i)*	(8,136)
Increase in loss for the year	(23,923)
	RMB
Increase in basic loss per share	(0.03)

	Effect on 2005 *RMB'000*
Balance sheet:	
Decrease in inventories *(i)*	(15,787)
Decrease in trade and other receivables *(ii)*	(26,708)
Decrease in property, plant and equipment *(i)*	(8,136)
Decrease in total assets	(50,631)
Decrease in trade and other payables *(ii)*	9,372
Decrease in trade deposits received *(ii)*	23,034
Decrease in total liabilities	32,406
Increase in net liabilities	(18,225)
Decrease in accumulated losses as at 1 January *(ii)*	5,698
Increase in loss for the year *(i)*	(23,923)
Decrease in equity as at 31 December	(18,225)

(i) This represents the effect arising from loss of inventories and property, plant and equipment in a subsidiary, Jiangxi Kelon Industrial Development Co., Ltd. ("Jiangxi Kelon") in 2005 due to the business of Jiangxi Kelon was interrupted after the freezure of its assets by the Higher People's Court of Jiangxi Province in August 2005.

(ii) This represents other operating income in connection with a write back of unidentified net credit balances brought forward from prior years.

3. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") of the IASB. IFRSs include International Accounting Standards ("IAS") and Interpretations (collectively referred to as "IFRSs"). In addition, the consolidated financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

(b) Basis of preparation

As at 31 December 2006, the Group's current liabilities exceeded its current assets by approximately RMB2,952 million (2005: RMB3,317 million (restated)). In addition, the Group has outstanding short-term loans in the aggregate of approximately RMB1,557 million (2005: RMB2,161 million) of which approximately RMB255 million (2005: RMB1,233 million) were overdue as at 31 December 2006. The management has implemented various measures including: (1) streamlining operational processes and improving internal management mechanism; (2) introducing cost reduction plans; (3) rationalising business structures of the Group; and (4) rebuilding the image and reputation of the Group. In addition, the Group negotiated with certain banks to restructure the amounts due to them and the Company's management confirmed that most of the Group's bankers have expressed their intention to reschedule overdue bank borrowings and/or renew/grant credit facilities to the Group. Based on the above assessment, the directors are of the opinion that the Group will have sufficient working capital to finance its normal operations and to meet its financial obligations as they fall due for the foreseeable future and have prepared the consolidated financial statements on a going concern basis.

The consolidated financial statements for the year ended 31 December 2006 comprise the Company and its subsidiaries and the Group's interests in associates. The measurement basis used in the preparation of the financial statements is the historical cost basis, as modified by the revaluation of certain of its property, plant and equipment and financial instruments at fair value. The accounting policies and bases adopted in the preparation of these financial statements differ from those used in the statutory accounts of the Group which are prepared in accordance with generally accepted accounting principles and relevant financial regulations in the PRC ("PRC GAAP"). The differences arising from the restatement of the results of operations for compliance with IFRSs, if any, are adjusted in these financial statements but will not be taken up in the accounting books of the Group.

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

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

Judgments made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next financial year are disclosed in Note 39.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(c) Application of International Financial Reporting Standards

In the current year, the Group has applied all the new and revised standards, amendments and interpretations ("new IFRSs") issued by the IASB, that are relevant to its operation and effective for accounting periods beginning on or after 1 January 2006. The adoption of the new IFRSs had no material effect on how the results for the current or prior accounting periods have been prepared and presented.

(d) Potential impact arising from the new accounting standards not yet effective

The Group has not yet applied the following new standards, amendment or interpretations that have been issued but are not yet effective. The directors of the Company anticipated that the application of these new IFRSs will have no material impact on the financial statements of the Group.

- IFRS 7, "Financial instruments: Disclosures", effective for annual periods beginning or after 1 January 2007. The directors considered that this standard has no significant impact to the Group and the Group will take action to assess the impact of this standard to the Group for the financial year ending 31 December 2007 when they considered appropriate;

- IFRS 8, "Operating segments", effective for annual periods beginning on or after 1 January 2009. The directors considered that this standard has no significant impact to the Group and the Group will take action to assess the impact of this standard to the Group for the financial year ending 31 December 2007 when they considered appropriate;

- Amendment to IAS 1, "Capital disclosures", effective for annual periods beginning on or after 1 January 2007. This amendment would result in more disclosure on the Group's capital management;

- IFRIC – Int 7, "Applying the restatement approach under IAS 29 financial reporting in hyperinflationary economies", effective for annual periods beginning on or after 1 March 2006. This interpretation is not relevant for the Group;

- IFRIC – Int 8, "Scope of IFRS 2", effective for annual periods beginning on or after 1 May 2006. This interpretation is not relevant for the Group;

- IFRIC – Int 9, "Reassessment of embedded derivatives", effective for annual periods beginning on or after 1 June 2006. This interpretation is not relevant for the Group;

- IFRIC – Int 10, "Interim financial reporting and impairment", effective for annual periods beginning on or after 1 November 2006. This interpretation has no significant impact to the Group;

- IFRIC – Int 11, "IFRS 2 – Group and treasury share transactions", effective for annual periods beginning on or after 1 March 2007. This interpretation is not relevant for the Group; and

- IFRIC – Int 12, "Service concession arrangements", effective for annual periods beginning on or after 1 January 2008. This interpretation has no significant impact to the Group.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(e) Basis of consolidation

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

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

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective dates of acquisition or up to the effective dates of disposal, as appropriate.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Company, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity holders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

(f) Associates

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

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

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

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(g) Goodwill

Goodwill represents the excess of the cost of a business combination over the interest in the fair value of identifiable assets, liabilities and contingent liabilities acquired. Cost comprises the fair values of assets given, liabilities assumed and equity instruments issued, plus any direct costs of acquisition.

Goodwill is capitalised as an intangible asset with any impairment in carrying value being charged to the consolidated income statement.

Where the fair value of identifiable assets, liabilities and contingent liabilities exceed the fair value of consideration paid, the excess is credited in full to the consolidated income statement.

For the purpose of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired.

For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount to each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

(h) Property, plant and equipment

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

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

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

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

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

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

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

Construction in progress represents buildings, plant and machinery on which construction work has not been completed and which, upon completion, management intends to hold for production purposes. Construction in progress is carried at costs which include development and construction expenditure incurred and interest and other direct costs attributable to the development less any accumulated impairment losses. On completion, constructions in progress are transferred to other property, plant and equipment at cost or valuation less accumulated impairment losses. No depreciation is provided in respect of construction in progress until it is completed and is ready for its intended use.

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

(i) Investment properties

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

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

(j) Payments for leasehold land held for own use under operating leases

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

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(k) Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised in the consolidated income statement on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight-line basis over the lease term.

The Group as lessee

Where substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred to the Group (a "finance lease"), the asset is treated as if it had been purchased outright. The amount initially recognised as an asset is the present value of the minimum lease payments payable over the term of the lease. The corresponding lease commitment is shown as a liability. Lease payments are analysed between capital and interest. The interest element is charged to the income statement over the period of the lease and is calculated so that it represents a constant proportion of the lease liability. The capital element reduces the balance owed to the lessor.

Where substantially all of the risks and rewards incidental to ownership are retained by the lessor (an "operating lease"), the total rentals payable under the lease are charged to the income statement on a straight-line basis over the lease term.

The land and buildings elements of property leases are considered separately for the purposes of lease classification.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(l) Intangible assets (other than goodwill)

(i) Externally acquired intangible assets

Externally acquired intangible assets are initially recognised at cost. Subsequently, intangible assets with finite useful lives are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is provided on a straight-line basis over their useful lives. Intangible assets with indefinite useful lives are carried at cost less any accumulated losses. The amortisation expense is included within administrative expenses in the income statement.

Intangible assets, separate from goodwill, are recognised on business combinations if they are separable from the acquired entity or give rise to other contractual/legal rights. The amounts ascribed to such intangibles are arrived at by using appropriate valuation techniques.

The significant intangibles recognised by the Group, their useful economic lives and the methods used to determine the cost of intangibles acquired in a business combination are as follows:

Intangible	Useful economic life	Valuation method
Trademarks	Indefinite	Multiple of estimated revenues and profits
Software	4 years	Estimated replacement cost
Non-patent technologies	4 years	Estimated discounted cashflow

(ii) Internally generated intangible assets (research and development costs)

Expenditure on internally developed products is capitalised if it can be demonstrated that:

- It is technically feasible to develop the product for it to be sold;
- Adequate resources are available to complete the development;
- There is an intention to complete and sell the product;
- The Group is able to sell the product;
- Sale of the product will generate future economic benefits; and
- Expenditure on the project can be measured reliably.

Capitalised development costs are amortised over the periods the Group expects to benefit from selling the products developed. The amortisation expense is included within cost of sales in the income statement.

Development expenditure not satisfying the above criteria and expenditure on the research phase of internal projects are recognised in the income statement as incurred.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(m) Impairment of other assets

At each balance sheet date, the Group reviews the carrying amounts of the following assets to determine whether there is any indication that those assets have suffered an impairment loss or an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment (other than properties carried at revalued amounts);
- payments for leasehold land held for own use under operating lease; and
- investments in associates

If the recoverable amount (i.e. the greater of the net selling price and value in use) of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount under another IFRS, in which case the impairment loss is treated as a revaluation decrease under that IFRS.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount under another IFRS, in which case the reversal of the impairment loss is treated as a revaluation increase under that IFRS.

(n) Financial instruments

(i) Financial assets

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

Financial assets at fair value through profit or loss: include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Gains or losses on investments held for trading are recognised in the income statement.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or loss on them on a different basis; (ii) the assets are part of a group of financial assets which is managed and its performance evaluated on a fair value basis according to a documented management strategy; or (iii) the financial asset contains an embedded derivative that would need to be separately recorded.

At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in the income statement in the period in which they arise.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(n) Financial instruments *(continued)*

(i) Financial assets (continued)

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

An impairment loss is recognised in the income statement when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

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

An impairment loss is recognised in the income statement when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

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

Any impairment losses on available-for-sale financial assets are recognised in the income statement on available-for-sale debt investments, impairment losses are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, they are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition. An impairment loss is recognised in the income statement when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(n) Financial instruments *(continued)*

(ii) Financial liabilities

The Group classifies its financial liabilities as other financial liabilities based on the purpose for which the liabilities was incurred.

Other financial liabilities include the following items:

- Trade payables and other short-term monetary liabilities, which are recognised at amortised cost.

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

(iii) Derecognition

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

Financial liabilities are derecognised when the obligation specified in the relevant contact is discharged, cancelled or expires.

(o) Inventories

Inventories are initially recognised at cost, and subsequently at the lower of cost and net realisable value. Cost comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(p) Revenue recognition

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

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

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

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

Subsidy income is recognised when the rights to receive the income is established and approved.

Penalty income is recognised when triggering events to receive payment occur and the amount of payment can be reliably measured.

(q) Income taxes

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

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

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

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

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(r) Foreign currency

Transactions entered into by Group entities in currencies other than the currency of the primary economic environment in which it operates (the "functional currency") are recorded at the rates ruling when the transactions occur. Foreign currency monetary assets and liabilities are translated at the rates ruling at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences arising on the retranslation of unsettled monetary assets and liabilities are similarly recognised immediately in the income statement, except for foreign currency borrowings qualifying as a hedge of a net investment in a foreign operation.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in the income statement in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Company's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financials statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in the income statement for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

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

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

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation on or after 1 January 2005 are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the foreign exchange reserve.

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(s) Employee benefits

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

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

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

(t) Borrowing costs

Borrowing costs attributable directly to the acquisition, construction or production of assets which require a substantial period of time to be ready for their intended use or sale, are capitalised as part of the cost of those assets. Income earned on temporary investments of specific borrowings pending their expenditure on those assets is deducted from borrowing costs capitalised.

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

(u) Government grants

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

3. PRINCIPAL ACCOUNTING POLICIES *(continued)*

(v) Provisions and contingent liabilities

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

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

(w) Warranty obligation

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

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

4. REVENUE

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

	2006	2005
	RMB'000	*RMB'000*
Sales of refrigerators	**3,327,896**	2,542,839
Sales of air-conditioners	**2,533,360**	3,600,489
Sales of freezers	**231,972**	261,113
Sales of product components	**471,029**	573,931
	6,564,257	6,978,372

5. BUSINESS AND GEOGRAPHICAL SEGMENTS

Business segments

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

Segment information about these businesses is presented below:

Year ended 31 December 2006

(i) Consolidated income statement

	Refrigerators	Air-conditioners	Freezers	Product components	Elimination	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Turnover						
External sales	3,327,896	2,533,360	231,972	471,029	–	6,564,257
Inter-segment sales	–	–	–	671,840	(671,840)	–
Total revenue	3,327,896	2,533,360	231,972	1,142,869	(671,840)	6,564,257

Inter-segment sales are charged at prevailing market rates.

	Refrigerators	Air-conditioners	Freezers	Product components	Elimination	Consolidated
Result						
Segment result	150,644	22,395	10,000	(11,834)	–	171,205
Unallocated corporate income						9,801
Profit from operations						181,006
Dilution loss on share reform of an associate						(16,317)
Share of results of associates	1,819	1,385	127	259	–	3,590
Finance costs						(140,672)
Profit before income tax						27,607
Income tax credit						20,871
Profit for the year						48,478

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

Year ended 31 December 2006 *(continued)*

(ii) Consolidated balance sheet

	Refrigerators *RMB'000*	Air-conditioners *RMB'000*	Freezers *RMB'000*	Product components *RMB'000*	Consolidated *RMB'000*
Assets					
Segment assets	**1,909,175**	**1,509,343**	**416,819**	**666,897**	**4,502,234**
Interests in associates	**40,041**	**30,481**	**2,791**	**5,668**	**78,981**
Unallocated corporate assets					**76,187**
Consolidated total assets					**4,657,402**
Liabilities					
Segment liabilities	**1,752,636**	**1,621,186**	**184,471**	**275,021**	**3,833,314**
Unallocated corporate liabilities					**1,563,161**
Consolidated total liabilities					**5,396,475**

(iii) Other information

	Refrigerators *RMB'000*	Air-conditioners *RMB'000*	Freezers *RMB'000*	Product components *RMB'000*	Consolidated *RMB'000*
Additions of property, plant and equipment	**79,256**	**47,244**	**8,261**	**6,716**	**141,477**
Additions of intangible assets	**486**	**443**	**141**	**105**	**1,175**
Depreciation of property, plant and equipment	**153,127**	**66,961**	**15,575**	**12,620**	**248,283**
Depreciation of investment properties	**–**	**–**	**–**	**641**	**641**
Amortisation of intangible assets	**3,232**	**713**	**125**	**56**	**4,126**
Amortisation of payments for leasehold land held for own use under operating leases	**8,099**	**4,522**	**879**	**949**	**14,449**
Revaluation decrease of property, plant and equipment	**12,999**	**12,149**	**6**	**5**	**25,159**
Write down of inventories to net realisable value	**35,867**	**6,434**	**–**	**399**	**42,700**

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

Year ended 31 December 2005 (Restated)

(i) Consolidated income statement

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

Inter-segment sales are charged at prevailing market rates.

	Refrigerators *RMB'000*	Air-conditioners *RMB'000*	Freezers *RMB'000*	Product components *RMB'000*	Elimination *RMB'000*	Consolidated *RMB'000*
Result						
Segment result	(1,451,864)	(1,602,663)	(94,264)	(413,735)	–	(3,562,526)
Unallocated corporate expenses						(32,994)
Loss from operations						(3,595,520)
Share of results of associates	(11,504)	(16,289)	(1,181)	(2,597)	–	(31,571)
Finance costs						(162,524)
Loss before income tax						(3,789,615)
Income tax expense						(1,021)
Loss for the year						(3,790,636)

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Business segments *(continued)*

Year ended 31 December 2005 (Restated) *(continued)*

(ii) Consolidated balance sheet

	Refrigerators	Air-conditioners	Freezers	Product components	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Assets					
Segment assets	2,147,174	2,066,972	227,588	882,484	5,324,218
Interests in associates	33,535	47,639	3,444	7,568	92,186
Unallocated corporate assets					66,995
Consolidated total assets					5,483,399
Liabilities					
Segment liabilities	1,665,300	1,671,603	180,271	581,140	4,098,314
Unallocated corporate liabilities					2,185,158
Consolidated total liabilities					6,283,472

(iii) Other information

	Refrigerators	Air-conditioners	Freezers	Product components	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Additions of property, plant and equipment	119,416	150,626	17,331	47,363	334,736
Additions of intangible assets	1,688	279	10	123	2,100
Depreciation of property, plant and equipment	139,213	131,513	17,324	95,804	383,854
Depreciation of investment property	–	–	–	1,513	1,513
Amortisation and impairment of intangible assets	143,467	173,670	7,306	18,785	343,228
Amortisation of payments for leasehold land held for own use under operating leases	8,387	8,233	921	2,881	20,422
Revaluation decrease of property, plant and equipment	114,520	94,593	11,377	49,170	269,660
Impairment loss on trade and other receivables	160,209	197,817	690	120,290	479,006
Write down of inventories to net realisable value	33,468	182,903	38,813	37,792	292,976
Write off of inventories	3,631	11,998	158	–	15,787

5. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Geographical segments

The following table provides an analysis of the Group's turnover by geographical markets with reference to locations of customers:

	2006	2005
	RMB'000	*RMB'000*
The PRC		
Mainland China	**4,300,110**	4,154,957
Hong Kong	**259,792**	19,518
	4,559,902	4,174,475
Europe	**525,854**	1,258,611
America	**613,349**	824,541
Others	**865,152**	720,745
	6,564,257	6,978,372

The Group's operations are carried out in the PRC and almost all of the production facilities of the Group are located in the PRC. Therefore, presentation of segment assets by geographical locations is not shown.

6. OTHER INCOME AND GAINS

An analysis of the Group's other income and gains is as follows:

	2006	2005
	RMB'000	*RMB'000*
Gain on disposal of raw materials	**114,139**	–
Gain on disposal of property, plant and equipment	**24,588**	5,609
Gain on disposal of payments for leasehold land held for own use under operating leases	**38,597**	11,984
Gain on debts settlement with suppliers	**10,231**	–
Interest income	**5,238**	29,443
Penalty income	**7,843**	2,831
Rental income	**7,723**	6,476
Reversal of impairment loss on trade and other receivables	**61,012**	–
Reversal of provision for sales rebates	**37,593**	–
Subsidy income	**70,511**	4,780
Others	**31,830**	12,205
	409,305	73,328

7. OTHER OPERATING EXPENSES

An analysis of the Group's other operating expenses is as follows:

	2006	2005
	RMB'000	*RMB'000*
		(Restated)
Loss on disposal of property, plant and equipment	**19,408**	106,282
Revaluation decrease of property, plant and equipment	**25,159**	269,660
Impairment loss on payments for leasehold land held for own use under operating leases	**–**	18,207
Impairment loss on intangible assets	**–**	338,677
Impairment loss on investment in a deconsolidated subsidiary	**–**	11,000
Impairment loss on goodwill	**–**	39,195
Loss on disposal of scrap materials	**10,047**	12,032
Penalty	**1,145**	12,712
Others	**1,056**	8,166
	56,815	815,931

8. DEPRECIATION AND AMORTISATION

An analysis of the Group's depreciation of property, plant and equipment and investment properties is as follows:

	2006	2005
	RMB'000	*RMB'000*
Amount charged as cost of sales	**179,174**	266,622
Amount included in distribution costs	**11,749**	59,362
Amount included in administrative expenses	**55,048**	59,383
Amount included in other operating expenses	**2,953**	–
	248,924	385,367

An analysis of the Group's amortisation of intangible assets and payments for leasehold land held for own use under operating lease is as follows:

	2006	2005
	RMB'000	*RMB'000*
Amount included in administrative expenses	**18,575**	24,973

9. FINANCE COSTS

	2006	2005
	RMB'000	*RMB'000*
Interest on:		
– bank borrowings wholly repayable within five years	**100,196**	122,306
– discounted note receivables	**21,125**	32,125
	121,321	154,431
Others	**19,351**	8,093
	140,672	162,524

10. PROFIT/(LOSS) BEFORE INCOME TAX

	2006	2005
	RMB'000	*RMB'000*
		(Restated)
Profit/(loss) before income tax is stated after charging/(crediting):		
Inventories recognised as an expense	**5,465,345**	6,515,161
Staff costs (including directors' and supervisors' remuneration)		
– Basic salaries, housing and other allowances and benefits in kind	**506,843**	562,167
– Defined contribution pension cost	**31,223**	25,129
	538,066	587,296
Depreciation of property, plant and equipment	**248,283**	383,854
Depreciation of investment properties	**641**	1,513
Amortisation of payments for leasehold land held for own use under operating leases	**14,449**	20,422
Amortisation of intangible assets	**4,126**	4,551
Auditors' remuneration	**5,551**	5,824
Research and development costs	**11,925**	8,025
Impairment loss on trade and other receivables	**–**	479,006
Write down of inventories to net realisable value	**42,700**	292,976
Write off of inventories	**–**	15,787
Operating lease charges		
– land and buildings	**63,855**	64,153
– plant and machinery	**6,500**	6,000
Foreign exchange loss, net	**28,619**	35,309
Rental income from investment properties (net of direct operating expenses)	**(7,723)**	(6,476)
Share of income tax of associates	**6,091**	2,372

11. DIRECTORS' AND SUPERVISORS' EMOLUMENTS

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

2006

	Fees	Basic salaries, housing and other allowances and benefits in kind	Defined contribution pension cost	Discretionary bonuses	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Tang Ye Guo	–	**493**	**4**	–	**497**
Yu Shu Min	–	–	–	–	–
Lin Lan	–	**248**	–	–	**248**
Xiao Jian Lin	–	**322**	**3**	–	**325**
Liu Chong Meng *(i)*	–	–	–	–	–
Li Zhen Hua *(i)*	–	–	–	–	–
Fang Zhi Guo *(i)*	–	–	–	–	–
Gu Chu Jun *(i)*	–	–	–	–	–
Yan You Song *(i)*	–	–	–	–	–
Zhang Hong *(i)*	–	–	–	–	–
Zhang Ming *(ii)*	–	**85**	**3**	–	**88**
Su Yu Tao *(iii)*	–	**302**	**3**	–	**305**
Independent non-executive directors					
Zhan Sheng Ping	**30**	–	–	–	**30**
Lu Qing	**30**	–	–	–	**30**
Cheung Yui Kai, Warren	**120**	–	–	–	**120**
Xu Xiao Lu *(i)*	–	–	–	–	–
Li Kung Man *(i)*	–	–	–	–	–
Chan Pei Cheong *(iv)*	–	–	–	–	–
Supervisors					
Guo Qing Cun	–	–	–	–	–
Zhou Zhao Li	–	–	–	–	–
Liu Zhan Cheng	–	**60**	**1**	**133**	**194**
He Si *(v)*	–	**48**	**1**	–	**49**
Bai Yun Feng *(vi)*	–	**50**	–	–	**50**
	180	**1,608**	**15**	**133**	**1,936**

(i) The above individuals resigned on 26 June 2006.

(ii) Mr. Zhang Ming resigned on 13 November 2006.

(iii) Mr. Su Yu Tao resigned on 14 November 2006.

(iv) Mr. Chan Pei Cheong resigned on 23 January 2006.

(v) Mr. He Si resigned on 23 June 2006.

(vi) Mr. Bai Yun Feng resigned on 5 December 2006.

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

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

2005

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

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

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

Bonus granted to directors and supervisors are based on performance and subject to directors' discretion.

There was no arrangement under which a director or a supervisor waived or agreed to waive any remuneration for the years 2005 and 2006.

None of the directors and supervisors received compensation for the loss of office as director or a supervisor of the Group in connection with the management of the affairs of the Group for the years 2005 and 2006.

12. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five highest paid individuals of the Group, four (2005: three) are directors of the Company. The remaining individual (2005: two) is not a director or a supervisor of the Company.

The following table sets out the emoluments of the Group's five (2005: two) highest paid individuals for the year ended 31 December 2006 of which four of these individuals were appointed as directors of the Company during the year and their emoluments paid for the period from the dates of being appointed as directors during the year to the end of the year are included in Note 11 above.

	2006	2005
	RMB'000	*RMB'000*
Basic salaries, housing and other allowances and benefits in kind	**4,695**	2,858
Discretionary bonuses	**–**	–
	4,695	2,858

The emoluments set out above of these individuals are within the following band:

	2006	2005
	Number of staff	*Number of staff*
RMB511,000 – RMB1,022,000 (2005: RMB525,350 – RMB1,050,700) (equivalent to HKD500,000 – HKD1,000,000)	**4**	–
RMB1,022,001 – RMB1,533,000 (2005: RMB1,050,701 – RMB1,576,050) (equivalent to HKD1,000,001 – HKD1,500,000)	**1**	1
RMB1,533,001 – RMB2,044,000 (2005: RMB1,576,051 – RMB2,101,400) (equivalent to HKD1,500,001 – HKD2,000,000)	**–**	1
	5	2

13. INCOME TAX (CREDIT)/EXPENSE

	2006	2005
	RMB'000	*RMB'000*
Income taxes consist of:		
Current tax		
– PRC enterprise income tax ("EIT")	**516**	1,006
– Hong Kong Profits Tax	**–**	15
Deferred tax	**(21,387)**	–
	(20,871)	1,021

Taxation is calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

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

The Company and its subsidiaries which are established and operating in the PRC are subject to EIT at a statutory rate of 33%.

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

The Company's subsidiaries, Guangdong Kelon Refrigerator Ltd. ("Kelon Refrigerator"), Guangdong Kelon Air-Conditioner Co., Ltd. ("Kelon Air-Conditioner"), Guangdong Kelon Freezer Co., Ltd. ("Kelon Freezer"), Guangdong Kelon Fittings Co., Ltd. ("Kelon Fittings"), Shunde Rongsheng Plastic Products Co., Ltd. ("Rongsheng Plastic"), Guangdong Kelon Mould Co., Ltd. ("Kelon Mould") and Yingkou Kelon Refrigerator Co. Ltd. ("Yingkou Kelon"), established in coastal open economic zones, are subject to EIT at a rate of 24%. Together with the local EIT at a rate of 3%, the aggregate EIT is at a rate of 27%. Kelon Mould, as a company established in coastal open economic zones, is also classified as a high new technology enterprise and subject to EIT at a rate of 15%. Together with the local EIT at a rate of 3%, the aggregate EIT is at a rate 18%. Pursuant to Income Tax Law, they are entitled to preferential tax treatment with full exemption from EIT for two years starting from the first profitable year of operations, after offsetting all tax losses brought forward from the previous years (for a maximum period of five years), followed by a 50% reduction in tax rate for the next three years.

Pursuant to the Income Tax Regulations related to Development Strategy of Western Region of Mainland China, Chengdu Kelon Refrigerator Co., Ltd. ("Chengdu Kelon"), a subsidiary of the Company is subject to a preferential EIT at a rate of 24%. Together with the local EIT at a rate of 3%, Chengdu Kelon is subject to the aggregate EIT at a rate of 27%.

13. INCOME TAX (CREDIT)/EXPENSE *(continued)*

Other subsidiaries of the Group which are established and operating in the PRC are subject to EIT at a statutory rate of 33%.

Pursuant to the PRC EIT law passed by the Tenth National People's Congress on 16 March 2007, the new EIT rates for domestic and foreign enterprises are unified at 25% and will be effective from 1 January 2008. The impact of this change in EIT rates on the Group's consolidated financial statements will depend on detailed implementation pronouncements that are to be issued subsequently. The Group is currently assessing the impact on the Group's results of operations and financial position of this change in EIT rates.

No provision for Hong Kong Profits Tax has been made as the subsidiaries in Hong Kong did not generate assessable profits during the year. Hong Kong Profits Tax has been provided at the rate of 17.5% on the estimated assessable profit last year.

A reconciliation between income tax (credit)/expense and accounting profit/(loss) at applicable tax rate is as follows:

	2006	2005
	RMB'000	*RMB'000*
		(Restated)
Profit/(loss) before tax	**27,607**	(3,789,615)
Less: Share of results of associates	**3,590**	(31,571)
	24,017	(3,758,044)
Tax at the PRC statutory rate of 33%	**7,926**	(1,240,155)
Effect of different tax rates of subsidiaries operating in other jurisdictions	**1,560**	23,293
Effect of exemption granted and preferential tax treatment	**(18,718)**	681,311
Tax effect of expenses not deductible for tax purposes	**1,826**	162,979
Tax effect of revenue not taxable for tax purposes	**(290)**	(964)
Tax effect of tax losses and deductible temporary differences not recognised	**166,098**	375,652
Utilisation of tax losses and deductible temporary differences previously not recognised	**(179,273)**	(1,095)
Income tax (credit)/expense	**(20,871)**	1,021

At the balance sheet date, deferred tax assets arising on tax losses carried forward had been recognised to the extent it is probable that future taxable profit will be available against which the unused tax losses can be utilised.

13. INCOME TAX (CREDIT)/EXPENSE *(continued)*

The unused tax losses carried forward and deductible temporary differences not recognised in the consolidated financial statements due to unpredictability of future profit streams are as follows:

	2006	2005
	RMB'000	*RMB'000*
Unused tax losses	**1,846,123**	2,294,364
Deductible temporary differences	**691,429**	678,219
	2,537,552	2,972,583

The PRC tax losses can only be carried forward for a maximum period of five years and the Hong Kong tax losses can be carried forward indefinitely. The expiry of unused tax losses is as follows:

	2006	2005
	RMB'000	*RMB'000*
Tax losses will expire in 2006	**–**	391,513
Tax losses will expire in 2007	**15,179**	15,179
Tax losses will expire in 2008	**25,601**	47,606
Tax losses will expire in 2009	**55,489**	73,440
Tax losses will expire in 2010	**1,315,082**	1,646,898
Tax losses will expire in 2011	**276,859**	–
Tax losses can be carried forward indefinitely	**237,124**	119,728
	1,925,334	2,294,364

14. BASIC EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings per share attributable to equity holders of the Company for the year is based on the net profit attributable to equity holders of the Company for the year of RMB69,218,000 (2005: net loss attributable to equity holders of the Company for the year of RMB3,726,095,000 (restated)) and 992,006,563 shares (2005: 992,006,563 shares) outstanding during the year.

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

15. PROPERTY, PLANT AND EQUIPMENT

Year ended 31 December 2006

	Leasehold land and buildings *RMB'000*	Plant, machinery and equipment *RMB'000*	Moulds *RMB'000*	Motor vehicles *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
Cost or valuation						
At 1 January 2006 (Restated)	1,548,947	1,892,728	168,054	69,811	267,260	3,946,800
Exchange differences	(2,267)	(74)	–	(95)	–	(2,436)
Additions at cost	1,290	22,015	80,707	1,211	36,254	141,477
Disposals	(64,152)	(115,959)	(37,500)	(28,020)	(34,022)	(279,653)
Revaluation decrease	(3,217)	(13,442)	(6,691)	(313)	(1,496)	(25,159)
Reclassification	(240,675)	270,484	265	1,002	(31,076)	–
At 31 December 2006	1,239,926	2,055,752	204,835	43,596	236,920	3,781,029
Comprising:						
At cost	131,457	53,861	80,707	1,211	36,254	303,490
At directors' valuation	1,108,469	2,001,891	124,128	42,385	200,666	3,477,539
	1,239,926	2,055,752	204,835	43,596	236,920	3,781,029
Accumulated depreciation						
At 1 January 2006	419,045	1,537,641	95,867	65,558	–	2,118,111
Exchange differences	(713)	363	–	(80)	–	(430)
Depreciation for the year	76,970	112,406	54,174	4,733	–	248,283
Elimination on disposals	(27,380)	(102,445)	(33,411)	(23,324)	–	(186,560)
Reclassification	2,164	6,732	(100)	(8,796)	–	–
At 31 December 2006	470,086	1,554,697	116,530	38,091	–	2,179,404
Net book value						
At 31 December 2006	769,840	501,055	88,305	5,505	236,920	1,601,625

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

Year ended 31 December 2005

	Leasehold land and buildings *RMB'000*	Plant, machinery and equipment *RMB'000*	Moulds *RMB'000*	Motor vehicles *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
Cost or valuation						
At 1 January 2005	1,457,441	2,588,136	211,376	79,643	247,416	4,584,012
Exchange differences	(1,936)	–	–	–	–	(1,936)
Additions at cost	203	69,400	101,018	534	163,581	334,736
Disposals	(12,284)	(530,807)	(117,458)	(6,834)	(3,088)	(670,471)
Transfer to investment properties *(Note 16)*	(29,881)	–	–	–	–	(29,881)
Revaluation decrease	(5,858)	(143,531)	(26,290)	(1,043)	(84,802)	(261,524)
Retrospective restatement of errors *(Note 2)*	(225)	(2,288)	–	(797)	(4,826)	(8,136)
Reclassification	141,487	(88,182)	(592)	(1,692)	(51,021)	–
At 31 December 2005 (Restated)	1,548,947	1,892,728	168,054	69,811	267,260	3,946,800
Comprising:						
At cost	141,690	–	–	–	–	141,690
At directors' valuation (Restated)	1,407,257	1,892,728	168,054	69,811	267,260	3,805,110
	1,548,947	1,892,728	168,054	69,811	267,260	3,946,800
Accumulated depreciation						
At 1 January 2005 (restated)	448,350	1,680,275	89,730	56,203	–	2,274,558
Exchange differences	(492)	–	–	–	–	(492)
Depreciation for the year	110,393	194,241	72,848	6,372	–	383,854
Elimination on disposals	(4,482)	(460,115)	(66,711)	(6,988)	–	(538,296)
Transfer to investment properties *(Note 16)*	(1,513)	–	–	–	–	(1,513)
Reclassification	(133,211)	123,240	–	9,971	–	–
At 31 December 2005	419,045	1,537,641	95,867	65,558	–	2,118,111
Net book value						
At 31 December 2005 (Restated)	1,129,902	355,087	72,187	4,253	267,260	1,828,689

The directors' valuation at 2006 on plant, machinery and equipment, moulds, motor vehicles and construction in progress was made by reference to independent valuations at 31 December 2005 carried out by Dalian Zhong Hua Asset Appraisal Company Limited and Beijing Luihe Zhengxu Asset Appraisal Company Limited on the basis of fair market value in continued use.

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

The directors' valuation at 2006 on leasehold land and buildings was made by reference to independent valuations at 31 December 2005 carried out by Sallmanns (Far East) Limited and at 31 December 2002 by Greater China Appraisal Limited on the basis of fair market value in continued use.

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

	Leasehold land and buildings	**Plant, machinery and equipment**	**Moulds**	**Motor vehicles**	**Construction in progress**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Cost	1,375,024	2,126,065	237,817	44,467	328,044	4,111,417
Accumulated deprecation and impairment	(544,341)	(1,642,874)	(149,511)	(29,197)	(91,123)	(2,457,046)
Net book value at 31 December 2006	**830,683**	**483,191**	**88,306**	**15,270**	**236,921**	**1,654,371**
Net book value at 31 December 2005	1,190,745	337,223	72,187	14,018	267,260	1,881,433

The management performed self-assessment on impairment of property, plant and equipment as at 31 December 2006 and conclude that no impairment has been identified.

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

	2006	2005
	RMB'000	*RMB'000*
		(Restated)
PRC, other than in Hong Kong	**704,197**	1,057,225
Hong Kong	**41,990**	44,874
Japan	**23,653**	27,803
	769,840	1,129,902

"Leasehold land and buildings" and "Plant, machinery and equipment" with net book values of approximately RMB441,380,000 (2005: RMB625,469,000 (restated)) and RMB134,584,000 (2005: RMB21,712,000) respectively, have been pledged as security for the Group's bank borrowings.

16. INVESTMENT PROPERTIES

	2006	2005
	RMB'000	*RMB'000*
Cost		
At 1 January	**29,201**	–
Reclassification from property, plant and equipment *(Note 15)*	**–**	29,881
Exchange differences	**(1,000)**	(680)
At 31 December	**28,201**	29,201
Accumulated depreciation and impairment		
At 1 January	**1,478**	–
Depreciation for the year	**641**	1,513
Exchange differences	**(62)**	(35)
At 31 December	**2,057**	1,478
Carrying amount at 31 December	**26,144**	27,723
Directors' valuation at fair value	**40,030**	38,959

The Group's investment properties are situated in Hong Kong under medium term leases. The valuation for the investment properties at 31 December 2006 were determined by the directors by reference to a valuation report at 15 July 2006 prepared by Vigers Appraisal & Consulting Ltd..

17. PAYMENTS FOR LEASEHOLD LAND HELD FOR OWN USE UNDER OPERATING LEASES

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

	2006	2005
	RMB'000	*RMB'000*
Leasehold land in PRC:		
– Medium-term leases	**372,533**	470,080

	2006	2005
	RMB'000	*RMB'000*
Carrying amount at 1 January	**470,080**	720,754
Amortisation charge	**(14,449)**	(20,422)
Impairment loss	**–**	(18,207)
Other adjustments	**–**	(55,274)
Disposals	**(83,098)**	(156,771)
Carrying amount at 31 December	**372,533**	470,080

(i) Included in payments for leasehold land held for own use under operating leases is a land use right in Kaifeng which was acquired as capital contribution by a minority interest of a subsidiary. As at 31 December 2006, this land use right with carrying amount of approximately RMB13.4 million (2005: RMB13.6 million) has not yet been registered in the name of the subsidiary. The management is in the process of completing the legal title registration.

(ii) As at 31 December 2006, included in this account is a land use right with carrying value of approximately RMB27.6 million (2005: RMB28 million) which has been frozen by the court of Shangqiu since August 2005. In July 2004, Shangqiu Kelon Electrical Company Limited ("Shangqiu Kelon"), Shangqiu Bing Xiong Freezing Facilities Company Limited ("Shangqiu Bing Xiong"), and the Administration Committee of Shangqiu Economic and Technological Development Zone (商丘經濟技術開發區管委會) ("Shangqiu Administrative Committee") entered into a three-party land transfer agreement under which all parties agreed that Shangqiu Kelon acquires the land use right (200 acres) from Shangqiu Bing Xiong at a consideration of approximately RMB36 million. Under the land transfer agreement, it was agreed that Shangqiu Kelon develops the land and meets minimum production and sales requirements after the development is completed. At date of this report, the land has not yet been developed nor has Shangqiu Kelon met the minimum production and sales requirements.

In August 2005, Shangqiu Kelon received a notice from Shangqiu Administrative Committee claiming that it has breached the three-party land transfer agreement for not fulfilling the minimum production and sales requirements and requesting that Shangqiu Kelon surrenders the land use right (200 acres). The local court froze the land accordingly.

At the date of this report, the case is being handled by the Group's lawyer and has not yet been resolved. The Company has made an impairment loss of approximately RMB18 million against the carrying amount of the land use right for possible loss that may arise as a result of the event.

(iii) At 31 December 2006, the carrying amount of payments for leasehold land held for own use under operating leases pledged as security for the Group's bank borrowings amounted to approximately RMB245,559,000 (2005: RMB352,614,000).

18. INTERESTS IN SUBSIDIARIES

Details of the Company's principal subsidiaries as at 31 December 2006 are listed under a table as follows:

Name	Place and date of incorporation/ establishment	Registered capital	Percentage of ownership interested voting rights/profit share Directly	Indirectly	Principal activities
Entities operating in the PRC:					
Shunde Rongsheng Plastic Products Co., Ltd.	PRC *(i)* 18 October 1991	US$15,800,000	45%	25%	Manufacture of plastic parts
Guangdong Kelon Mould Co,. Ltd.	PRC *(i)* 20 July 1994	US$15,000,000	40%	30%	Manufacture of moulds
Guangdong Kelon Refrigerator Ltd.	PRC (i) 25 December 1995	US$26,800,000	70%	30%	Manufacture and sale of refrigerators
Guangdong Kelon Freezer Co., Ltd.	PRC *(i)* 25 December 1995	RMB237,000,000	44%	56%	Manufacture and sale of freezers
Guangdong Kelon Air-Conditioner Co., Ltd.	PRC *(i)* 19 March 1996	US$36,150,000	60%	–	Manufacture and sale of air-conditioners
Chengdu Kelon Refrigerator Co., Ltd.	PRC *(i)* 19 November 1996	RMB200,000,000	45%	25%	Manufacture and sale of refrigerators
Yingkou Kelon Refrigerator Co., Ltd.	PRC *(i)* 15 December 1996	RMB200,000,000	42%	36.79%	Manufacture and sale of refrigerators
Yangzhou Kelon Electrical Company Limited ("Yangzhou Kelon")	PRC *(i)* 23 December 1996	US$29,800,000	74.33%	25.67%	Manufacture and sale of refrigerators
Shunde Kelon Household Electrical Applicance Company Limited	PRC *(ii)* 16 July 1999	RMB10,000,000	25%	75%	Manufacture and sale of electrical household appliances
Guangdong Kelon Fittings Co., Ltd.	PRC *(i)* 24 November 1999	US$5,620,000	70%	30%	Manufacture and sale of spare parts for air-conditioners and refrigerators
Shunde Huaao Electronics Co., Ltd.	PRC *(ii)* 23 November 2000	RMB10,000,000	–	70%	Manufacture and sale of electronic products
Shunde Wangao Import & Export Co., Ltd.	PRC *(ii)* 7 June 2001	RMB3,000,000	20%	80%	Import and export business

18. INTERESTS IN SUBSIDIARIES *(continued)*

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

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

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

(iii) The financial statements of Jiangxi Combine Electrical Appliance Co., Ltd. ("Jiangxi Combine") and Kelon Europe Industrial Design Limited ("Kelon Europe") were excluded from the consolidated financial statements. Jiangxi Combine has not commenced active business since its establishment and Kelon Europe was insignificant to the Group. The management considers that the impact of not consolidating Jiangxi Combine and Kelon Europe is insignificant to the Group.

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

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

19. INTERESTS IN ASSOCIATES

	2006 RMB'000	2005 RMB'000
Share of net assets	**78,981**	92,186
Goodwill *(Note)*	**–**	–
	78,981	92,186
Listed investment	**74,478**	88,286
Unlisted investment	**4,503**	3,900
	78,981	92,186
Fair value of listed investment	**43,241**	49,474

Note:

Goodwill

	2006 RMB'000	2005 RMB'000
Cost		
At 1 January	**137,346**	137,346
Release on dilution in share reform	**(6,139)**	–
At 31 December	**131,207**	137,346
Impairment		
At 1 January	**137,346**	137,346
Release on dilution in share reform	**(6,139)**	–
At 31 December	**131,027**	137,346
Carrying amount		
At 31 December	**–**	–

Details of the Group's principal associates as at 31 December 2006 are listed under a table as follows:

Name	Place and date of incorporation/ establishment	Registered capital	Percentage of ownership interested voting rights/profit share Directly	Indirectly	Principal activities
Name of associate					
Huayi Compressor Holdings Company Limited ("Huayi")	PRC *(i)* 13 June 1996	RMB324,581,218	18.26% *(iii)*	–	Manufacture and sale of compressors
Attend Logistic Co., Ltd. ("Attend Logistic")	PRC *(ii)* 11 July 2001	RMB10,000,000	20%	–	Provision of logistics and storage services

(i) Established as a joint stock limited company.

(ii) Established as a limited liability company.

(iii) On 20 December 2006, Huayi completed a share reform and converted all of its non-freely transferable shares into listed shares by the allocation of 6.674 newly issued shares to each holder of transferable shares for every 10 shares held by such holder. Accordingly, the shares of Huayi held by the Company, which were previously non-transferable, were converted into freely transferable shares of Huayi and the Company's equity interest in Huayi was reduced from 22.73% to 18.26%. A dilution loss incurred on share reform of the associate arising thereon was charged to the income statement. Notwithstanding the share reform of Huayi, the Company continues to possess the power to participate in the financial and operating policy decision of Huayi and account for its interest in Huayi as an associate.

19. INTERESTS IN ASSOCIATES *(continued)*

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

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

	2006	2005
	RMB'000	*RMB'000*
Total assets	**2,158,965**	1,825,999
Total liabilities	**(1,572,054)**	(1,279,730)
Net assets	**586,911**	546,269
Revenue	**1,842,149**	1,306,092
Profit/(loss) for the year	**16,017**	(129,652)

The financial statements of Huayi and Attend Logistic have been audited by Guang Dong Heng Xin Delu Certified Public Accountants Co., Ltd. and Guangzhou Lantao Certified Public Accountants Co. Ltd., respectively.

20. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2006	2005
	RMB'000	*RMB'000*
Unquoted long-term equity investments, at cost	**7,249**	7,249
Impairment loss	**(7,249)**	(7,249)
	–	–

21. INTANGIBLE ASSETS

	Trademarks *(i)* *RMB'000*	Non-patented technologies *(ii)* *RMB'000*	Software systems *(ii)* *RMB'000*	Total *RMB'000*
Year ended 31 December 2006				
Cost				
At 1 January 2006	**521,858**	**537**	**32,580**	**554,975**
Additions at cost	**–**	**–**	**1,175**	**1,175**
Write off	**–**	**–**	**(4)**	**(4)**
At 31 December 2006	**521,858**	**537**	**33,751**	**556,146**
Amortisation and impairment				
At 1 January 2006	**403,480**	**241**	**22,472**	**426,193**
Charge for the year	**–**	**136**	**3,990**	**4,126**
Elimination on write off	**–**	**–**	**(4)**	**(4)**
At 31 December 2006	**403,480**	**377**	**26,458**	**430,315**
Carrying amount				
At 31 December 2006	**118,378**	**160**	**7,293**	**125,831**

	Trademarks *(i)* *RMB'000*	Non-patented technologies *(ii)* *RMB'000*	Software systems *(ii)* *RMB'000*	Total *RMB'000*
Year ended 31 December 2005				
Cost				
At 1 January 2005	521,858	557	30,578	552,993
Additions at cost	–	–	2,100	2,100
Write off	–	(20)	(98)	(118)
At 31 December 2005	521,858	537	32,580	554,975
Amortisation and impairment				
At 1 January 2005	65,233	104	17,675	83,012
Charge for the year	–	137	4,414	4,551
Impairment loss	338,247	–	430	338,677
Elimination on write off	–	–	(47)	(47)
At 31 December 2005	403,480	241	22,472	426,193
Carrying amount				
At 31 December 2005	118,378	296	10,108	128,782

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

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

21. INTANGIBLE ASSETS *(continued)*

Due to the significant loss incurred in 2005 and the business interruption in May 2005, the management conducted an impairment assessment on the trademarks. The recoverable amount of trademarks was determined based on value-in-use calculations with the support of valuation performed by independent third party valuer. As a result of such assessment, trademarks had been assessed to be impaired by approximately RMB338 million as at 31 December 2005.

As at 31 December 2006, the management performed self-assessment and concluded that there was no further impairment identified.

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

22. GOODWILL

	RMB'000
Year ended 31 December 2006	
Cost	
At 1 January 2006 and 31 December 2006	**47,033**
Impairment	
At 1 January 2006 and 31 December 2006	**47,033**
Carrying amount	
At 31 December 2006	**–**

	RMB'000
Year ended 31 December 2005	
Cost	
At 1 January 2005 and 31 December 2005	47,033
Impairment	
At 1 January 2005	7,838
Impairment loss	39,195
At 31 December 2005	47,033
Carrying amount	
At 31 December 2005	–

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

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

23. INVENTORIES

	2006	2005
	RMB'000	*RMB'000*
Raw materials	**184,013**	597,638
Work in progress	**33,745**	78,762
Finished goods	**702,079**	556,579
	919,837	1,232,979

At 31 December 2006, the carrying amount of inventories pledged for bank borrowings amounted to approximately RMB140,236,000 (2005: RMB41,899,000).

24. TRADE AND OTHER RECEIVABLES

	2006	2005
	RMB'000	*RMB'000*
		(Restated)
Trade receivables	**290,166**	238,786
Notes receivable *(i)*	**77,317**	140,819
Other receivables *(ii)*	**376,838**	489,306
Amounts due from Greencool Enterprise and its affiliates *(Note 32 III a)*	**72,061**	71,879
Amounts due from companies suspected to be connected with Mr. Gu *(Note 32 III b)*	**214,217**	227,361
Amounts due from Hisense Group *(Note 32 III c)*	**2,187**	204,349
Amounts due from associates *(Note 32 III d)*	**40**	140
Amounts due from other related companies *(Note 32 III e)*	**86,907**	41,748
	1,119,733	1,414,388

(i) At 31 December 2006, included in notes receivable was an amount of nil (2005: RMB11,217,000) of notes discounted to banks with recourse. The transaction has been accounted for as short-term bank borrowings. The amount of notes receivable pledged for bank borrowings amounted to approximately RMB28,200,000 (2005: RMB21,900,000).

(ii) At 31 December 2006, included in other receivables was an amount of nil (2005: RMB80,043,000) of intra-group receivables resulted from an inability to eliminate balances among companies within the Group on consolidation.

24. TRADE AND OTHER RECEIVABLES *(continued)*

The aging analysis of trade receivables is as follows:

	Gross amount *RMB'000*	Impairment loss *RMB'000*	Net amount *RMB'000*
As at 31 December 2006			
Within 3 months	**252,966**	**–**	**252,966**
Three to six months	**30,938**	**(954)**	**29,984**
Six months to one year	**9,691**	**(4,854)**	**4,837**
One to two years	**19,591**	**(17,212)**	**2,379**
Two to three years	**66,405**	**(66,405)**	**–**
Over three years	**108,215**	**(108,215)**	**–**
	487,806	**(197,640)**	**290,166**
As at 31 December 2005			
Within 3 months	164,445	–	164,445
Three to six months	47,338	–	47,338
Six months to one year	89,803	(62,830)	26,973
One to two years	12,058	(12,028)	30
Two to three years	51,618	(51,618)	–
Over three years	144,444	(144,444)	–
	509,706	(270,920)	238,786

Normal credit term of 30 days is granted to customers. The Group allows a credit period of up to one year for large and well established customers. Sales are usually settled by cash on delivery for small and new customers. Trade receivables are non-interest bearing.

As at 31 December 2006, the Group has trade and other receivables denominated in USD of approximately RMB179 million (2005: RMB13 million).

25. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

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

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

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

Interest rate risk

The Group is exposed to interest rate risks due to changes in interest rates of interest-bearing financial assets and liabilities. Interest-bearing financial assets are mainly deposits with banks which are mostly short-term in nature whereas interest-bearing financial liabilities are primarily short-term bank borrowings. As at 31 December 2006, the Group's short-term bank borrowing was carried at fixed interest rates ranging from 4.65% to 7.84% per annum. The Group is therefore not significantly exposed to both fair value and cash flow interest rate risks.

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

Foreign currency risk

Foreign exchange risk is the risk of loss due to adverse movements in exchange rates relating to investments and transactions denominated in foreign currencies. The Group's monetary assets and transactions are mainly denominated in RMB and USD. The exchange rates between RMB and USD are not pegged, and there is fluctuation of exchange rates between RMB and USD. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arise.

Liquidity risk

In the management of liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by management to finance the Group's operations and mitigate the effects of short-term fluctuations in cash flows. The Group's treasury department is responsible for maintaining a balance between continuity and flexibility of funding through the use of bank facilities in order to meet the Group's liquidity requirements. All of the debts of the Group would mature in less than one year as at 31 December 2006.

Credit risk

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

Fair value

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

26. TRADE AND OTHER PAYABLES

	2006	2005
	RMB'000	*RMB'000*
		(Restated)
Trade payables	**1,415,803**	1,993,906
Notes payable	**507,918**	159,650
Other payables *(i)*	**486,073**	813,168
Accruals	**140,678**	324,303
Amounts due to Greencool Enterprise and its affiliates *(Note 32 III a)*	**13,050**	13,017
Amounts due to companies suspected to be connected with Mr. Gu *(Note 32 III b)*	**119,316**	118,155
Amounts due to Hisense Group *(Note 32 III c)*	**319,526**	17,257
Amounts due to associates *(Note 32 III d)*	**51,680**	75,331
Amounts due to other related companies *(Note 32 III e)*	**39,912**	19,631
	3,093,956	3,534,418

(i) At 31 December 2006, included in other payables were intra-group payables of nil (2005: RMB51,504,000) resulting from an inability to eliminate balances among companies within the Group on consolidation.

26. TRADE AND OTHER PAYABLES *(continued)*

The aging analysis of trade payables is as follows:

	2006	2005
	RMB'000	*RMB'000*
Within one year	**1,177,093**	1,645,415
One to two years	**196,857**	83,768
Two to three years	**30,937**	59,097
Over three years	**10,916**	205,626
	1,415,803	1,993,906

Normal credit term ranging from 30 to 120 days was granted to the Group. Trade payables within normal credit period are non-interest bearing.

As at 31 December 2006, the Group has trade and other payables denominated in USD of approximately RMB31 million (2005: RMB89 million).

27. PROVISIONS

	Warranty *(i)*	**Legal** *(ii)*	**Total**
	RMB'000	*RMB'000*	*RMB'000*
At 1 January 2006	**204,179**	**5,737**	**209,916**
Additional provision in the year	**90,427**	**5,444**	**95,871**
Utilisation of provision	**(128,823)**	**(6,969)**	**(135,792)**
At 31 December 2006	**165,783**	**4,212**	**169,995**
At 1 January 2005	119,338	–	119,338
Additional provision in the year	167,874	5,737	173,611
Utilisation of provision	(83,033)	–	(83,033)
At 31 December 2005	204,179	5,737	209,916

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

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

28. OTHER LIABILITIES

	2006	2005
	RMB'000	*RMB'000*
Employee benefits *(i)*	**32,620**	44,026
Government grants *(ii)*	**27,952**	29,898
	60,572	73,924
Amounts due within one year:		
– Employee benefits *(i)*	**19,026**	13,208
– Government grants *(ii)*	**27,952**	29,898
	46,978	43,106
Amounts due after one year	**13,594**	30,818

(i) The amounts represent accrued contributions to a defined contribution pension scheme for its employees during the period from 1993 to 2001. Settlement of employee benefits payable was mutually agreed by the Company and the committee of the Company's staff union.

(ii) The amounts represent government grants received for the Group's research and development activities. Government grants recognised as income for the year amounted to approximately RMB70,511,000 (2005: RMB3,657,000).

29. BANK BORROWINGS

	2006	2005
	RMB'000	*RMB'000*
Short-term bank loans due within one year	**1,556,702**	2,160,523
Analysed as:		
Secured	**1,233,294**	819,772
Unsecured	**323,408**	1,340,751
	1,556,702	2,160,523

The Group is now in the process of negotiating with bankers to refinance the short-term bank loans which are due in 2006. Based on discussion with the Group's bankers to date, the directors expect that these borrowings will be renewed in due course.

The bank borrowings carry interest at fixed rates ranging from 4.65% to 7.84% (2005: 4.35% to 6.91%) per annum. Bank borrowings of approximately RMB1,233,294,000 (2005: RMB819,772,000) were secured by pledge of property, plant and equipment (see note 15), inventories (see note 23) and notes receivable (see note 24).

At 31 December 2006, included in bank borrowings was an amount of approximately RMB218,000,000 (2005: RMB286,218,000) in respect of notes discounted to banks with recourse.

30. SHARE CAPITAL

	2006	2005
	RMB'000	*RMB'000*
Share of RMB1 each:		
337,915,755 Domestic shares	**337,916**	337,916
459,589,808 H shares	**459,590**	459,590
194,501,000 A shares	**194,501**	194,501
	992,007	992,007

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

31. LEASES

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

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

	2006	2005
	RMB'000	*RMB'000*
Not later than one year	**2,590**	25,625
Later than one year and not later than five years	**1,116**	9,740
	3,706	35,365

32. RELATED PARTY TRANSACTIONS

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

As at 31 December 2006, the Company's single largest shareholder is Qingdao Hisense Air-Conditioning Company Limited ("Hisense Air-Conditioner"), which exercised the equity transfer agreement with Guangdong Greencool Enterprise Development Company Limited ("Greencool Enterprise") dated 9 September 2005, and completed the share transfer of 262,212,194 domestic legal person shares of the Company, representing 26.43% of the Company's total issued share capital, from Greencool Enterprise to Hisense Air-Conditioner on 13 December 2006. Upon the completion of share transfer, Greencool Enterprise no longer owns any shares in the Company.

The beneficial owner of Greencool Enterprise is Mr. Gu Chu Jun ("Mr. Gu"), who was also the executive director of the Company during the reporting period, had resigned as an executive director of the Company on 22 May 2006. During the period from 2001 to 2005, the Group had significant transactions and relationships with Greencool Enterprise and companies controlled by Mr. Gu (collectively refer to "Greencool Enterprise and its affiliates"). The Group also had entered into a series of activities/transactions with companies suspected to be connected with Mr. Gu (Defined in I(i) below).

On 16 September 2005, the Company entered into a sales agreement with Hisense Agent as amended by the first supplemental agency agreement on 26 September 2005 and the second supplemental agency agreement on 1 April 2006. Under the agreement, Hisense Agent acts as sales agent of the Company's domestic sales products by way of distribution within the entire PRC domestic market. The agency agreement started from 16 September 2005 and ended on 10 May 2006.

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

- Hisense Agent agreed that it would advance an aggregate prepayment for purchases of the Company's products in an amount not exceeding RMB600 million;
- An interest (at the rate equivalent to the annual interest rates on working capital loans announced by the People's Bank of China from time to time) would be calculated by reference to the amount of prepayments received by the Company and would be confirmed and settled upon the expiry of the sales agency agreement;
- Upon delivery of the products by the Company to the warehouses designated by Hisense Agent, the title to the products will pass to Hisense Agent, and the Company will recognise the relevant proceeds from such sales as sales revenue;
- In the event that Hisense Agent is unable to recover any proceeds from sale of products under the sales agency agreement to any distributor, Hisense Agent and/or the distributor has no right to claim against the Company pursuant to the sales agency agreement;
- Hisense Agent will receive 1% of the total amount of sales proceeds of products under the sales agency agreement as agency fee from the Company;
- The effective turnover period for the proceeds of products commissioned by the Company to Hisense Agent is 60 days; and
- The price of the products that the Company sells to Hisense Agent will be equivalent to the price Hisense Agent sells to the distributors, which price shall be determined by the Company and the distributors.

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

32. RELATED PARTY TRANSACTIONS *(continued)*

On 15 September 2006 Kelon Air-Conditioner entered into the Air-Conditioner Production and Supply Framework Agreement with Qingdao Hisense Marketing Company Limited ("Hisense Agent") in connection with manufacture and sale of air conditioners by Kelon Air-Conditioner to Hisense Agent for a term of one year starting from 1 January 2006 to 31 December 2006.

On 15 September 2006 Kelon Air-Conditioner entered into the Air-Conditioner Production and Purchase Framework Agreement with Hisense (Zhejiang) Air-Conditioner Company Limited ("Hisense Zhejiang") for a term of one year ending on 31 December 2006 in connection with manufacture and sale of air-conditioners by Hisense Zhejiang. Kelon Air-Conditioner also entered into the Raw Materials Purchase and Supply Framework Agreement with Hisense Zhejiang for a term of one year ended on 31 December 2006 in connection with the provision of air-conditioners' components by Kelon Air-Conditioner to Hisense Zhejiang.

I. Relationship with related parties

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

Name of related parties	*Notes*	**Relationship**
Greencool Enterprise		The single largest shareholder of the Company as at 31 December 2005
Mr. Gu		The beneficial owner of Greencool Enterprise and also the executive director of the Company as at 31 December 2005
Greencool Technology Development (Shenzhen) Company Limited ("Shenzhen Greencool Technology")		A company controlled by Mr. Gu
Greencool Environmental Protection Engineering (Shenzhen) Company Limited ("Shenzhen Greencool Environmental")		A company controlled by Mr. Gu
Greencool Regrigerant (China) Company Limited ("Greencool China")		A company controlled by Mr. Gu
Hainan Greencool Environmental Protection Engineering Company Limited ("Hainan Greencool")		A company controlled by Mr. Gu
Greencool Procurement (Shenzhen) Co., Ltd. ("Greencool Procurement")		A company controlled by Mr. Gu
Hefei Meiling Holdings Limited ("Hefei Meiling")		A company controlled by Mr. Gu
Jiangxi Greencool Electrical Appliance Company Limited ("Jiangxi Greencool")		A company controlled by Mr. Gu

32. RELATED PARTY TRANSACTIONS *(continued)*

I. Relationship with related parties *(continued)*

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

32. RELATED PARTY TRANSACTIONS *(continued)*

I. Relationship with related parties *(continued)*

Name of related parties	*Notes*	Relationship
Zhejiang Guoda Trading Company Limited ("Zhejiang Guoda")	*(i)*	A company suspected to be connected with Mr. Gu
Zhejiang Yuhuan Compressor Factory ("Zhejiang Yuhuan")	*(i)*	A company suspected to be connected with Mr. Gu
Beijing De Heng Solicitors ("Beijing De Heng")	*(i)*	A company suspected to be connected with Mr. Gu
Zhuhai Defa Air-conditioner Fittings Company Limited ("Zhuhai Defa")	*(i)*	A company suspected to be connected with Mr. Gu
Zhuhai Longjia Refrigerating Plant Company Limited ("Zhuhai Longjia")	*(i)*	A company suspected to be connected with Mr. Gu
Hisense Air-Conditioner		The successor single largest shareholder of the Company
Hisense Group		The holding company of Hisense Air-Conditioner
Hisense Agent		A fellow subsidiary of Hisense Air-Conditioner
Hisense Electric Co., Ltd. ("Hisense Electric")		A fellow subsidiary of Hisense Air-Conditioner
Hisense Zhejiang		A subsidiary of Hisense Air-Conditioner
Hisense (Nanjing) Electric Co., Ltd. ("Hisense Nanjing")		A fellow subsidiary of Hisense Air-Conditioner
Hisense (Beijing) Electric Co., Ltd. ("Hisense Beijing")		A fellow subsidiary of Hisense Air-Conditioner
Hisense (Qingdao) Import & Export Co., Ltd.		A fellow subsidiary of Hisense Air-Conditioner
Hisense Hitachi Air Conditioning Co., Ltd. ("Hisense Hitachi")		A fellow subsidiary of Hisense Air-Conditioner
Chongqing Kelon Rongsheng Refrigerator Sales Co., Ltd. ("Chongqing Rongsheng")		An associate of the Group

32. RELATED PARTY TRANSACTIONS *(continued)*

I. Relationship with related parties *(continued)*

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

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

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

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties

(a) Transactions with Greencool Enterprise and its affiliates

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

	2006	2005
	RMB'000	*RMB'000*
Sales of goods/raw materials of Hefei Meiling	**–**	99
Loan guarantee provided by Greencool Enterprise		
– maximum amount during the year	**327,971**	327,971
– amount as at 31 December	**85,709**	327,971

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

(iii) Use of land and buildings: Starting from October 2003, Jiangxi Kelon occupied a piece of land and manufacturing facilities of Jiangxi Greencool free of charge. Part of the production facilities of Zhuhai Kelon were constructed on the land and buildings controlled by Mr. Gu for no consideration. As at 31 December 2006, none of Jiangxi Kelon nor Zhuhai Kelon had entered into lease agreement with the respective related parties.

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

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

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(a) Transactions with Greencool Enterprise and its affiliates (continued)

(v) On 10 March 2005, a subsidiary of the Company entered into a purchase agreement relating to refrigerants with Hainan Greencool. The transaction had not been approved by the board of directors of the Company and involved an amount of approximately RMB13.5 million. The purchase price was paid on 29 April 2005 but not in accordance with the Company's normal payment approval procedures. As at 31 December 2006, most of the relevant refrigerants have been received.

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

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

(i) Jinan San'ai'fu – During the period between 6 and 14 April 2005, Jianxi Kelon made advance payment in an amount of RMB81.6 million to Jinan San'ai'Fu, a new supplier, for purchase of R411C refrigerants. The goods were to be delivered during the period between 1 May and 31 August 2005 with payment on delivery. As at 31 December 2005, the Group has not received any of the refrigerants. On 7 April 2005, Jiangxi Kelon made advance payment, on behalf of Kelon Air-conditioner, to Jinan San'ai'fu in an amount of RMB40.8 million for purchase of refrigerants. As at 31 December 2006, less than one-third of the refrigerants have been received by the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, suspected that Jinan San'ai'fu was connected with Mr. Gu.

(ii) Tianjin Xiangrun – Kelon Fittings had during the period between 26 and 28 April 2005 made five advance payments in an aggregate amount of approximately RMB97.4 million, to Tianjin Xiangrun, a new supplier, for purchase of raw materials. As at 31 December 2006, only a small portion of the goods were delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, revealed that Tianjin Xiangrun has transferred the fund to Greencool Procurement, a company controlled by Mr. Gu. The directors suspected that Tianjin Xiangrun was connected with Mr. Gu.

(iii) Tianjin Lixin – On 26 and 27 April 2005, the Company's wholly-owned subsidiary, Shenzhen Kelon Purchase Company Limited made two advance payments in an aggregate amount of RMB89.6 million to a new supplier called Tianjin Lixin. The goods were to be delivered during the period between 1 May 2005 and 31 August 2005 with payment on delivery. As at 31 December 2006, only a small portion of the goods were delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, revealed that Tianjin Lixin has transferred the fund to Greencool Procurement. The directors suspected that Tianjin Lixin was connected with Mr. Gu.

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

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

(iv) Zhongshan Dongyue – Jiangxi Kelon has, on behalf of Kelon Air-conditioner, made two prepayments to Zhongshan Dongyue amounted to RMB30 million and RMB50 million for purchase of raw materials on 4 April and 6 April 2005, respectively. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance of an external professional firm, revealed that Zhongshan Dongyue has transferred the prepayments in an aggregate amount of RMB80 million to Greencool Procurement at the same date. As at 31 December 2006, all of the raw materials, in connection to the prepayment made in 2005, have been delivered to the Group. In 2006, the Group purchased raw materials from Zhongshan Dongyue in accordance with the Company's purchase policy and normal procedures.

(v) Jiangxi Keda – Jiangxi Kelon has made prepayments amounting to RMB13 million to Jiangxi Keda in May 2005 for purchases of raw materials/parts. As at 31 December 2006, the Group has not received any of the raw materials/parts. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance of an external professional firm, revealed that the prepayments have subsequently been transferred to Greencool Enterprise and/or its affiliates.

(vi) Jiangxi Kesheng – Kelon Air-Conditioner has made advance payments of approximately RMB12.8 million and RMB18.6 million to Jiangxi Kesheng for purchase of refrigerants on 6 April and 19 April 2005 respectively. As at 31 December 2006, most of the refrigerants have been delivered to the Group. The directors considered that the above transactions were not conducted in accordance with the Company's purchase policy and normal procedures in respect of purchase of goods. The directors, with the assistance with an external professional firm, suspected that Jiangxi Kesheng was connected with Greencool and/or its affiliates.

(vii) Zhejiang Yuhuan – Kelon Refrigerator, Yangzhou Kelon, Chengdu Kelon and Yingkou Kelon has made prepayment amounting to RMB10 million to Zhejiang Yuhuan for purchase of raw materials in 2005. The directors considered that the above transactions were not conducted in accordance with the Company's policy and normal procedure in respect of purchase of goods. The directors, with the assistance of an external professional firm, revealed that prepayments have subsequently been transferred to Greencool Enterprise and/or its affiliates. As at 31 December 2005, Zhejiang Yuhuan was in the process of liquidation.

In 2006, Kelon Refrigerator entered into a settlement agreement with Zhejiang Yuhuan that Zhejiang Yuhuan agreed to settle up to an amount of RMB1.93 million to Kelon Refrigerator and the Group agreed to forfeit its right on further claiming Zhejiang Yuhuan. The settlement was received on 12 December 2006. As at balance sheet date, the Group has no outstanding balance due from Zhejiang Yuhuan.

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

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

(viii) Certain off book transactions involving the Company's wholly-owned subsidiary, Jiangxi Kelon were conducted in 2003 and 2004 resulting in net outstanding receivables of approximately RMB57 million from the following entities as at 31 December 2006:

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

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

(x) An assets transfer agreement was entered into between Shangqiu Kelon and Shangqiu Bing Xiong on 6 July 2004, Mr. Gu Chu Jun and Mr. Wang Zhan Min, were the respective legal representatives. Pursuant to the agreement, Shangqiu Bing Xiong transferred the assets purchased from Henan Bing Xiong Ice Maker Company Limited ("Bing Xiong Ice Maker") and Henan Bing Xiong Air-Conditioner Company Limited and the state-owned land use rights transferred from the Shangqiu Administration Committee to Shangqiu Kelon at a consideration of RMB58,030,000. The directors, with the assistance of an external professional firm, suspected that Shangqiu Bing Xiong was connected with Mr. Gu.

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(c) Transactions with Hisense Group

The Group had the following significant transactions with Hisense Group:

	Notes	**2006** **RMB'000**	2005 *RMB'000*
Sales of goods/raw materials to			
– Hisense Agent	*(i)*	**1,572,695**	868,235
– Hisense Zhejiang	*(i)*	**7,253**	–
– Qingdao Hisense Import & Export Co., Ltd.	*(i)*	**266**	–
– Hisense Hitachi	*(i)*	**286**	–
Sales of equipment to			
– Hisense Zhejiang		**300**	–
Agency fee paid/payable to			
– Hisense Agent	*(ii)*	**13,178**	8,773
Loan interest payable to			
– Hisense Agent		**16,390**	3,410
Purchase of goods/raw materials from			
– Hisense Air-Conditioner	*(i)*	**18**	2,571
– Hisense Agent	*(i)*	**209,729**	–
– Hisense Zhejiang	*(i)*	**69,854**	–
– Hisense Nanjing	*(i)*	**1,830**	–
– Hisense Beijing	*(i)*	**5,520**	–
Sales of moulds to			
– Hisense Electric	*(i)*	**2,554**	2,081
– Hisense Agent	*(i)*	**649**	–

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

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

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(d) Transactions with associates

The Group had the following significant transactions with associates:

	Notes	2006 RMB'000	2005 RMB'000
Sales of goods/raw materials to			
– Chongqing Rongsheng	*(i)*	**39,601**	761
– Huayi and Jiaxibeila	*(i)*	**356**	–
Purchases of goods/raw materials from			
– Huayi and Jiaxibeila	*(ii)*	**127,978**	105,288
Service fee charged to			
– Attend Logistic		**103**	–
Logistics management fee/warehouse rental paid to – Attend Logistic	*(iii)*	**51,538**	6,375

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

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

(iii) The Group and Attend Logistic entered into a logistics service agreement, pursuant to which Attend Logistic provides transportation and warehousing service to the Group. The service fee is based on the actual volume of goods, the distance delivered, the occupancy space of warehouse and discharged at a pre-determined rate agreed by both parties.

32. RELATED PARTY TRANSACTIONS *(continued)*

II. Transactions with related parties *(continued)*

(e) Transactions with other related parties

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

	Notes	**2006** **RMB'000**	2005 *RMB'000*
Sales of goods/raw materials to			
– Chengdu Xinxing		**3,337**	26,522
Purchases of goods/raw materials from			
– Chengdu Xinxing		**25,236**	28,805
– Chengdu Engine		**–**	4,390
Interest charged to			
– Chengdu Xinxing	*(i)*	**–**	1,986
Water and electricity expenses paid to			
– Chengdu Engine	*(ii)*	**6,468**	5,072
Lease payment in respect of plant and equipment to – Hangzhou Xileng	*(iii)*	**6,000**	6,000

(i) The Company made prepayments in an aggregate of RMB34,000,000 indirectly through its subsidiary, Chengdu Kelon, to Chengdu Xinxing, which is an associate of Chengdu Engine, the minority investor of Chengdu Kelon. As consideration for such prepayment, Chengdu Xinxing agreed to repay Chengdu Kelon by supplying an agreed number of refrigeration parts. No interest was charged to Chengdu Xinxing due to mutual agreement in 2006 (2005: interest payment at an annual rate of approximately 5.8%).

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

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

32. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties

(a) Balances with Greencool Enterprise and its affiliates

	Notes	2006 RMB'000	2005 RMB'000 (Restated)
Included in trade and other receivables, net			
– Greencool Enterprise		**6,085**	5,787
– Hainan Greencool	*II(a)(v)*	**976**	976
– Hefei Meiling		**–**	116
– Shenzhen Greencool Technology	*II(a)(iv)*	**32,000**	32,000
– Shenzhen Greencool Environmental	*II(a)(iv)*	**33,000**	33,000
		72,061	71,879
Included in trade and other payables			
– Hefei Meiling		**50**	17
– Jiangxi Greencool		**13,000**	13,000
		13,050	13,017

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

As at 31 December 2006, impairment loss of approximately RMB18,985,000 (2005: RMB19,276,000) were recorded in respect of amounts due from Greencool Enterprise and its affiliates.

32. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

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

	Notes	**2006** **RMB'000**	2005 *RMB'000* (Restated)
Included in trade and other receivables, net			
– Beijing De Heng		**1,000**	1,000
– Hefei Weixi	*I (ii)*	**10,424**	10,890
– Jiangxi Keda	*II(b)(v)*	**6,500**	6,500
– Jiangxi Kesheng	*II(b)(vi)*	**6,072**	6,072
– Jinan San'ai'fu	*II(b)(i)*	**56,683**	56,683
– Tianjin Lixin	*II(b)(iii)*	**44,800**	44,800
– Tianjin Xiangrun	*II(b)(ii)*	**48,199**	48,199
– Wuhan Changrong	*I(ii), II(b)(viii)*	**15,539**	15,539
– Zhongshan Dongyue	*II(b)(iv)*	**–**	12,678
– Zhuhai Defa	*II(b)(viii)*	**10,700**	10,700
– Zhuhai Longjia	*II(b)(viii)*	**14,300**	14,300
		214,217	227,361
Included in trade and other payables			
– Jiangxi Keda	*II(b)(v)*	**–**	622
– Tianjin Taijin Yunye	*II(a)(iv)*	**65,000**	65,000
– Zhongshan Dongyue	*II(b)(iv)*	**4,377**	2,594
– Zhuhai Longjia	*(i)*	**28,316**	28,316
– Zhuhai Defa	*(i)*	**21,400**	21,400
– Zhejiang Yuhuan	*II(b)(vii)*	**223**	223
		119,316	118,155

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

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

As at 31 December 2006, impairment loss of approximately RMB344,968,000 (2005: RMB354,724,000) were recorded in respect of amounts due from Greencool Enterprise and its affiliates.

32. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

(c) Balances with Hisense Group

	2006	2005
	RMB'000	*RMB'000*
Included in trade and other receivables, net		
– Hisense Agent	**540**	204,349
– Hisense Air-Conditioner	**335**	–
– Hisense Zhejiang	**582**	–
– Hisense Nanjing	**730**	–
	2,187	204,349
Included in trade and other payables		
– Hisense Air-Conditioner	**9,281**	3,846
– Hisense Agent	**309,965**	13,411
– Hisense Beijing	**1**	–
– Hisense Nanjing	**279**	–
	319,526	17,257

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

Included in amount due to Hisense Group was an amount of RMB291 million of advance received from Hisense Agent in connection with the sales agency agreement dated on 16 September 2005 (as amended by the first supplemental agency agreement on 26 September 2005 and the second supplemental agency agreement on 1 April 2006). The advance received from Hisense agent is unsecured, interest bearing at the interest rate as quoted by the People's Bank of China for one-year loans and repayable on demand.

All other amounts due to Hisense Group is unsecured, interest-free and repayable on demand.

32. RELATED PARTY TRANSACTIONS *(continued)*

III. Balances with related parties *(continued)*

(d) Balances with associates

	2006	2005
	RMB'000	*RMB'000*
Included in trade and other receivables, net		
– Chongqing Rongsheng	**–**	137
– Attend Logistic	**40**	3
	40	140
Included in trade and other payables		
– Attend Logistic	**20,652**	24
– Chongqing Rongsheng	**4,083**	–
– Huayi and Jiaxibeila	**26,945**	75,307
	51,680	75,331

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

(e) Balances with other related companies

	2006	2005
	RMB'000	*RMB'000*
Included in trade and other receivables, net		
– Chengdu Engine	**47,191**	27
– Chengdu Xinxing	**34,000**	35,802
– Kelon Europe	**5,716**	5,919
	86,907	41,748
Included in trade and other payables		
– Chengdu Engine	**5,309**	434
– Chengdu Xinxing	**11,946**	2,538
– Hangzhou Xileng	**15,772**	9,774
– Jiangxi Combine	**5,100**	5,100
– Xi'an Gaoke	**1,785**	1,785
	39,912	19,631

All amounts due from/to other related companies are unsecured, interest-free and are repayable on demand.

As at 31 December 2006, impairment losses of approximately RMB4,526,000 (2005: RMB4,686,000) were recorded in respect of amounts due from other related companies.

32. RELATED PARTY TRANSACTIONS *(continued)*

IV. Key management personnel emoluments

	2006	2005
	RMB'000	*RMB'000*
Basic salaries, allowances and benefits-in-kind	**7,422**	15,797
Defined contribution pension cost	**34**	–
	7,456	15,797

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, including directors and other senior management, totaling 33 individuals (2005: 19 individuals).

33. CAPITAL COMMITMENTS

	2006	2005
	RMB'000	*RMB'000*
Capital expenditure for acquisition of property, plant and equipment contracted for but not provided in the financial statements	**14,004**	23,309

Other than the above, the Group has the following capital commitments as at year-end:

During the year, the Company entered into agreements with Administrative Committee of Chengdu Economic and Technological Development Zone（成都經濟技術開發區管理委員會）for setting up a subsidiary in Chengdu. The total expected cost of investment is approximately RMB350 million. RMB4 million has been paid during the year and included in trade and other receivables.

The Company has entered into an agreement to acquire an additional 30% of shareholding in Chengdu Kelon from Chengdu Engine at a total consideration of approximately RMB81 million. A deposit for the consideration amounted to RMB47 million has been paid during the year and included in trade and other receivables and the remaining balance will be settled by off-setting the amounts owing to the Group by a subsidiary of the minority shareholder of Chengdu Kelon.

34. RETIREMENT BENEFITS SCHEMES

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

The total cost charged to the consolidated income statement of approximately RMB31,223,000 (2005: RMB25,129,000) represents contributions payable to the scheme by the Group at rates specified in the rules of the scheme.

35. RESERVES

(a) Statutory reserves

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

(b) Distributable reserves of the Company

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

As at 31 December 2006, the Company did not have reserve available for distribution to its shareholders. (2005: Nil).

36. CONTINGENCIES

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

37. SUBSEQUENT EVENTS

The following significant events took place subsequent to 31 December 2006:

(a) In March 2007, Kelon Electric Appliances Co., Ltd., a wholly-owned subsidiary of the Company, entered into a sale and purchase agreement with the purchaser to dispose of a property which was partly recorded as investment properties and partly as land and buildings of the Group of aggregate net carrying value of HK$67,100,000 as at the balance sheet date for a consideration of HK$123,295,400. The transfer of property was completed in March 2007.

(b) In February 2007, the Group entered into a Business Cooperation Framework Agreement with certain subsidiaries of Hisense Group for a term of one year ending on 31 December 2007, which can be terminated before its expiration by mutual agreement of the parties, in connection with the sale of refrigerators, air-conditioners, raw materials and sale of moulds to the subsidiaries of Hisense Group, subject to a maximum cap of RMB212,500,000, RMB580,000,000, RMB35,000,000 and RMB18,000,000, respectively; and purchase of air-conditioners, purchase of refrigerators and purchase of raw materials, and receipt of after-sale maintenance and repair service from the subsidiaries of Hisense Group, subject to a maximum cap of RMB607,500,000, RMB270,000,000, RMB55,000,000 and RMB10,000,000, respectively.

37. SUBSEQUENT EVENTS *(continued)*

(c) The Company has approved in the general meeting of the Company held on 19 March 2007 to provide guarantees in favour of the Group's distributors at an aggregate amount of RMB267,000,000. The amount of guarantee can be used on a revolving basis from the date of approval to 31 December 2007.

(d) In December 2006, the Company announced a proposed share reform including conversion of all the non-freely transferable shares into transferable shares of the Company and allocation of 1.2 newly issued shares to each holders of transferable A shares for every 10 transferable shares held by such holders of A shares and such share reform was completed in March 2007 and immediately after the share reform, the total number of issued shares of the Company are as follows:

Transferable shares that are subject to selling restrictions	314,575,635
H shares	459,589,808
A shares	217,841,120
	992,006,563

As a result of the share reform, the 262,212,194 Domestic shares which are non-freely transferable shares held by Hisense Air-Conditioner was converted into 238,872,074 transferable shares that are subject to certain selling restrictions of the Company, representing 24.08% of the Company's total capital.

(e) Included in trade and other receivables as at 31 December 2006 was a receivable arising from the sale of a piece of land, previously included in payments for leasehold land held for own use under operating lease, in Shunde, the PRC made by the Group in 2005, of gross amount and carrying amount of approximately RMB169 million and RMB85 million respectively. No settlement of receivable has been recorded in the Company's books up to the date of this report. The carrying amount was stated at net of an accumulated impairment loss of approximately RMB84 million. The Company lodged a legal claim against the purchaser in August 2006 and a court order was issued by the Guangdong Provincial Higher People's Court of the PRC in December 2006 in favour of the Company and the Company is entitled to recover from the purchaser the gross amount and interest accrued thereon. After the disposal of the land to the purchaser in 2005, the land became registered under the name of the purchaser. In February 2006, a creditor of the purchaser (the "Creditor") lodged a legal claim against the purchaser and a court order entitling the Creditor all assets not exceeding RMB200,000,000 of the purchaser was issued consequently. In April 2007, the Company and the Creditor agreed in writing that the land will be disposed of at market price and the Company is entitled to 50% of the disposal proceed net of relevant and necessary legal costs incurred by the Creditor. With reference to the prevailing market price, the directors considered that the Company's share of the net proceed from the disposal approximates and will not be less than the carrying value of the underlying receivable as at year-end.

38. COMPARATIVE FIGURES

Certain comparative figures have been adjusted as a result of the retrospective restatement of errors as disclosed in Note 2 and certain comparative figures in the consolidated cash flow statement have been reclassified to conform with current year's presentation.

39. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF UNCERTAINTY

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

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

Impairment

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

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

Depreciation

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

Warranty provision

As explained in noted 27(i), the Group makes provisions under the warranties it gives on sales of its electrical products taking into account the Group's recent claim experience. As the Group is continuously upgrading its product designs and launching new models, it is possible that recent claim experience is not indicative of the future claims that it will receive in respect of past sales. Any increase or decrease in the provision would affect profit or loss in future years.

40. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 26 April 2007.