1 Significant accounting policies

The significant accounting policies adopted in the preparation of the financial statements are set out below:

(a) Statement of compliance

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

(b) Basis of preparation of the financial statements

The consolidated financial statements are prepared on the historical cost basis except for certain property, plant and equipment which are modified by the revaluation as stated in note 1(f). The accounting policies have been consistently applied by the Group.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements 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.

Key assumptions and estimation made by management in the application of IFRSs that have significant effect on the financial statements and have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities in the next financial year are disclosed in Note 34.

1 Significant accounting policies *(continued)*

(c) Basis of consolidation

(i) Subsidiaries and minority interests

The consolidated financial statements of the Group include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to equity 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 shareholders 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.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 1(u)).

(ii) Associates and jointly controlled entities

An associate is an entity in which the Group or the Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or the Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a jointly controlled entity is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets.

1 Significant accounting policies *(continued)*

(c) Basis of consolidation *(continued)*

(ii) Associates and jointly controlled entities *(continued)*

When the Group's share of losses exceeds its interest in an associate or a jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or the jointly controlled entity.

Unrealised profits and losses resulting from transactions between the Group and its associates and jointly controlled entities are eliminated to the extent of the Group's interest in the associate or jointly controlled entity, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the profit or loss.

In the Company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 1(u)).

(d) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate or a jointly controlled entity over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 1(u)). In respect of associates and jointly controlled entities, the carrying amount of goodwill is included in the carrying amount of the interest in the associate or jointly controlled entities.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate or a jointly controlled entity is recognised immediately in profit or loss.

1 Significant accounting policies *(continued)*

(e) Investments

Investments in available-for-sale equity securities are carried at fair value with any change in fair value, other than impairment losses (see note 1(u)), recognised directly in equity. When these investments are derecognised or impaired, the cumulative gain or loss previously recognised directly in equity is recognised in the income statement. Investments in equity securities, that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the balance sheet at cost less impairment losses (see note 1(u)).

(f) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost or valuation (see note 13(d)) less accumulated depreciation and impairment losses (see note 1(u)). Revaluations are performed with sufficient regularity to ensure that the carrying amount of these assets does not differ materially from that which would be determined using fair value at balance sheet date.

The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs.

Depreciation is provided to write off the costs/revalued amount of property, plant and equipment over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values, as follows:

Buildings	15 to 40 years
Plant, machinery, equipment and others	5 to 26 years

Where parts of an item of property, plant and equipment have different useful lives the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value are reviewed annually.

Gains or losses arising from the retirement or disposal of items of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the items and are recognised in the income statement on the date of retirement or disposal.

1 Significant accounting policies *(continued)*

(g) Investment property

Investment properties are properties which are owned or held under a leasehold interest either to earn rental income or for capital appreciation or for both.

Investment properties are stated in the balance sheet at cost less accumulated depreciation. Depreciation is provided over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values. Estimated useful life of the investment property is 40 years.

(h) Lease prepayments and other assets

Lease prepayments and other assets represent land use rights paid to the PRC's Land Bureau and catalysts used in production. They are carried at cost less accumulated amortisation and impairment losses (see note 1(u)). Amortisation is provided to write off the cost of lease prepayment and other assets on a straight-line basis over the respective periods of the rights and the estimated useful lives of the catalysts.

(i) Construction in progress

Construction in progress represents buildings, various plant and equipment under construction and pending installation, and is stated at cost less government grants that compensate the Company for the cost of construction, and impairment losses (see note 1(u)). Cost comprises direct costs of construction as well as interest charges, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the period of construction.

Construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

(j) Inventories

Inventories, other than spare parts and consumables, are carried at the lower of cost and net realisable value. Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. In the case of work in progress and finished goods, cost includes direct labour and an appropriate proportion of production overheads. Net realisable value is 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.

When inventories are sold, the carrying amount of the inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Spare parts and consumables are stated at cost less any provision for obsolescence.

1 Significant accounting policies *(continued)*

(k) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 1(u)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 1(u)).

(l) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(m) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand and time deposits with financial institutions with an initial term of less than three months when purchased. Cash equivalents are stated at cost, which approximates fair value.

(n) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at the applicable exchange rates ruling at the transaction dates.

Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at rates quoted by the People's Bank of China at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Renminbi at the foreign exchange rate ruling at the date of the transaction.

Foreign currency translation differences relating to funds borrowed to finance the construction of property, plant and equipment to the extent that they are regarded as an adjustment to interest costs are capitalised during the construction period. All other exchange gains and losses are dealt with in the income statement.

1 Significant accounting policies *(continued)*

(o) Revenue recognition

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue excludes value added tax and is after deduction of any trade discounts and returns. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due to the possible return of goods, or when the amount of revenue and the costs incurred or to be incurred in respect of the transaction cannot be measured reliably.

Revenue from services rendered is recognised in the income statement upon performance of the services.

Dividend income is recognised in the income statement on the date the entity's right to receive payments is established.

Rental income from investment property is recognised in the income statement on a straight-line basis over the term of the lease.

(p) Government grants

Government grants are recognised in the balance sheet initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in profit or loss on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are deducted in arriving at the carrying amount of the asset and consequently are recognised in profit and loss over the useful life of the asset.

(q) Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest income on bank deposits, foreign exchange gains and losses and bank charges.

Interest income from bank deposits is recognised in the income statement as it accrues using the effective interest method.

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of net financing costs, except to the extent that they are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

1 Significant accounting policies *(continued)*

(r) Repairs and maintenance expenses

Repairs and maintenance expenses are charged to the income statement as and when they are incurred.

(s) Research and development costs

Research and development costs comprise all costs that are directly attributable to research and development activities or that can be allocated on a reasonable basis to such activities. Because of the nature of the Group's research and development activities, no development costs satisfy the criteria for the recognition of such costs as an asset. Both research and development costs are therefore recognised as expenses in the period in which they are incurred.

(t) Retirement benefits

The contributions payable under the Group's retirement plans are charged to the income statement on an accrual basis according to the contribution determined by the plans. Further information is set out in note 29.

(u) Impairment loss

(i) Impairment of trade accounts receivable, other receivables and investments in equity securities other than investments in associates and jointly controlled entities are accounted as follows:

Trade accounts receivable, other receivables and investments in equity securities other than investments in associates and jointly controlled entities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, an impairment loss is determined and recognised. The impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows, discounted at the current market rate of return for a similar asset where the effect of discounting is material. Impairment losses for trade accounts and other receivables are reversed if in a subsequent period the amount of the impairment loss decreases. Impairment losses for investments in equity securities are not reversed.

(ii) Impairment of other long-lived assets is accounted as follows:

The carrying amounts of other long-lived assets, including property, plant and equipment, construction in progress, lease prepayment, other assets and investments in associates and jointly controlled entities, are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. For goodwill, the recoverable amount is estimated at each balance sheet date.

1 Significant accounting policies *(continued)*

(u) Impairment loss *(continued)*

(ii) Impairment of other long-lived assets is accounted as follows: ***(continued)***

The recoverable amount is the greater of the fair value less costs to sell and the value in use. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

The amount of the reduction is recognised as an expense in the income statement unless the asset is carried at revalued amount for which an impairment loss is recognised directly against any related revaluation reserve to the extent that the impairment loss does not exceed the amount held in the revaluation reserve for that same asset. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit and then, to reduce the carrying amount of the other assets in the unit on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognised for an asset, except in the case of goodwill, in prior years may no longer exist. An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognised as income unless the asset is carried at revalued amount. Reversal of an impairment loss on a revalued asset is credited to the revaluation reserve except for impairment loss which was previously recognised as an expense in the income statement; a reversal of such impairment loss is recognised as an income. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred. An impairment loss in respect of goodwill is not reversed.

(v) Dividends

Dividends are recognised as a liability in the period in which they are declared.

1 Significant accounting policies *(continued)*

(w) Income tax

Income tax on the income statement for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, except differences relating to goodwill not deductible for tax purposes and the initial recognition of assets or liabilities which affect neither accounting nor taxable income. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. The effect on deferred tax of any changes in tax rates is charged to the income statement.

A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the assets can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(x) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made.

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, whose existence 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.

1 Significant accounting policies *(continued)*

(y) Related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control or jointly control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(z) Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments.

2 Turnover

The Group's principal activity is the processing of crude oil into petrochemical products for sale and substantially all of its products are sold in the PRC domestic markets.

Turnover represents the sales value of goods sold to customers, net of value added tax and is after deduction of any sales discounts and returns.

3 Other income

The Group received a cash government grant from the Ministry of Finance of the PRC of RMB 282,141,800 (2005: RMB 632,820,000) as a compensation of loss incurred due to the distortion of the correlation of domestic refined petroleum product prices and the crude oil prices during the year ended 31 December 2006. There are no unfilled conditions and other contingencies attached to the receipt or usage of this government grant. There is no assurance that the Group will continue to receive such grant in the future.

4 Other operating income

	2006 RMB'000	2005 RMB'000
Income from rendering of services	35,068	57,421
Gain on disposal of property, plant and equipment	83,386	42,233
Rental income from investment property	42,643	18,681
Income from other unlisted investments	97,179	101,350
Amortisation of deferred income	23,033	11,518
Others	16,085	7,408
	297,394	238,611

5 Other operating expenses

	2006 RMB'000	2005 RMB'000
Employee reduction expenses (Note 6)	83,603	109,410
Loss on disposal of property, plant and equipment	63,817	26,935
Impairment loss of property, plant and equipment (i)	50,000	-
Service fee	20,174	47,320
Donations	380	8,079
Others	22,556	9,750
	240,530	201,494

(i) Impairment loss recognised on property, plant and equipment of synthetic fibres segment was RMB 50 million (2005: nil) for the year ended 31 December 2006. The impairment loss relates to certain polypropylene fibre and compound fibre facilities that have ceased production during the year. In measuring the amounts of impairment charges, the carrying amounts of these assets were compared to the present value of the expected future cash flows of the assets, as well as information about their fair values less costs to sell.

6 Employee reduction expenses

In accordance with the Group's voluntary employee reduction plan, the Group recorded employee reduction expenses of RMB 83,603,000 during the year ended 31 December 2006 (2005: RMB 109,410,000) in respect of the voluntary resignation of approximately 1,280 employees (1,645 employees in 2005).

7. Net financing costs

	2006 RMB'000	2005 RMB'000
Interest on loans and borrowings	367,716	309,357
Less: borrowing costs capitalised as construction in progress*	(64,330)	(33,183)
Interest expenses, net	303,386	276,174
Interest income	(56,827)	(39,631)
Foreign exchange gain, net	(81,170)	(57,145)
	165,389	179,398

* The borrowing costs during 2006 have been capitalised at a rate of 5.18% - 5.85% per annum (2005: 2.98% - 5.56%) for construction in progress.

8. Profit before taxation

Profit before taxation is arrived at after charging/ (crediting):

	2006 RMB'000	2005 RMB'000
Cost of inventories sold#	49,182,232	42,887,742
Depreciation for property, plant and equipment#	1,810,990	1,692,213
Depreciation for investment property	12,678	12,847
Amortisation of lease prepayments#	29,400	13,441
Repairs and maintenance expenses#	874,461	896,022
Research and development costs#	51,610	54,451
Employee's pension costs#		
- Municipal retirement scheme costs	207,071	165,046
- Supplementary retirement scheme costs	61,692	65,685
Staff costs#	1,210,266	1,168,461
Rental income from investment property	42,643	18,681
Impairment losses		
- Trade and other receivables	18,215	14,049
- Property, plant and equipment	50,000	-
Share of profits / (losses) of associates	572,655	(60,968)
Share of profits of jointly controlled entities	4,027	-
Auditors' remuneration - audit services	7,721	6,150

Cost of inventories sold includes RMB 4,248,968,000 (2005: RMB 4,059,398,000) relating to staff costs, depreciation and amortisation, repairs and maintenance expenses, research and development costs and pension costs, which amount is also included in the respective total amounts disclosed separately above for each of these types of expenses.

The consolidated profit attributable to equity shareholders of the Company includes a profit of RMB 148,083,000 (2005: RMB 1,814,374,000) which has been dealt with in the financial statements of the Company.

9 Directors' and supervisors' emoluments

(i) Directors' and supervisors' emoluments:

	2006			
	Salaries and other benefits RMB'000	Retirement scheme contributions RMB'000	Discretionary bonus RMB'000	Total RMB'000
Rong Guangdao	161	7	288	456
Du Chongjun	161	7	288	456
Han Zhihao	137	7	252	396
Li Honggen	189	7	159	355
Gao Jinping	137	6	243	386
Shi Wei	137	7	243	387
Dai Jinbao	71	7	105	183
Zhang Chenghua	83	7	124	214
Wang Yanjun	70	6	120	196
Chen Xinyuan	80	-	-	80
Sun Chiping	80	-	-	80
Jiang Zhiquan	80	-	-	80
Zhou Yunnong	80	-	-	80
	1,466	61	1,822	3,349

	2005			
	Salaries and other benefits RMB'000	Retirement scheme contributions RMB'000	Discretionary bonus RMB'000	Total RMB'000
Rong Guangdao	74	7	196	277
Du Chongjun	74	7	193	274
Han Zhihao	60	6	158	224
Wu Haijun	60	6	159	225
Gao Jinping	60	6	165	231
Shi Wei	60	6	165	231
Dai Shuming	60	7	164	231
Zhang Chenghua	72	6	98	176
Wang Yanjun	61	6	91	158
Lu Yiping	74	7	197	278
Zhu Weiyan	67	6	104	177
Chen Xinyuan	40	-	-	40
Sun Chiping	40	-	-	40
Jiang Zhiquan	40	-	-	40
Zhou Yunnong	40	-	-	40
Gu Chuanxun	40	-	-	40
Wang Yongshou	40	-	-	40
Wang Xingyu	40	-	-	40
	1,002	70	1,690	2,762