1. Background of the Company

Sinopec Shanghai Petrochemical Company Limited ("the Company"), formerly Shanghai Petrochemical Company Limited, was established in the People's Republic of China ("the PRC") on 29 June 1993 as a joint stock limited company to hold the assets and liabilities of the production divisions and certain other units of the Shanghai Petrochemical Complex ("SPC"), a State-owned enterprise. SPC was under the direct supervision of China Petrochemical Corporation ("CPC").

CPC finished its reorganisation on 25 February 2000. After the reorganisation, China Petroleum & Chemical Corporation ("Sinopec Corp") was established. As a part of the reorganisation, CPC transferred its 4,000,000,000 of the Company's state-owned legal shares, which represented 55.56 percent of the issued share capital of the Company, to Sinopec Corp. Sinopec Corp became the largest shareholder of the Company.

The Company changed its name to Sinopec Shanghai Petrochemical Company Limited on 12 October 2000.

The Company and its subsidiaries ("the Group") is a highly integrated entity which processes crude oil into synthetic fibres, resins and plastics, intermediate petrochemicals and petroleum products.

Details of the Company's principal subsidiaries are set out in note 9(d) "Long-term equity investments".

2. Significant accounting policies

The significant accounting policies adopted in the preparation of the financial statements are in conformity with the Accounting Standards for Business Enterprises and "Accounting Regulations for Business Enterprises" and other relevant regulations issued by the MOF of the PRC.

(a) Accounting year

The accounting year of the Group is from 1 January to 31 December.

(b) Basis of consolidation

The Group prepared the consolidated financial statements according to "Accounting Regulations for Business Enterprises" and Cai Kuai Zi [1995] No.11"Provisional regulations on consolidated financial statements" issued by the MOF.

The consolidated financial statements include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are those entities held by the Company, directly or indirectly, over 50% of the equity interests (not including 50%), or less than 50% but the Company has the power to effectively control the entities. The consolidated income statement of the Company only includes the results of subsidiaries during the period when the Company holds, directly or indirectly, over 50% of the equity interests or the Company has effective control over the subsidiaries. The effect of minority interests on equity and profit/loss attributable to minority interests are separately shown in the consolidated financial statements. For those subsidiaries whose assets and results of operation are not significant and have no significant effect on the Group's consolidated financial statements, the Company does not consolidate these subsidiaries, but includes in the long-term equity investments.

Where the accounting policies adopted by the subsidiaries are different from the policies adopted by the Company, the financial statements of the subsidiaries have been adjusted in accordance with the accounting policies adopted by the Company on consolidation. All significant inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, have been eliminated on consolidation.

(c) Basis of accounting and principle of valuation

The Group's financial statements are prepared on an accrual basis under the historical cost convention, unless otherwise stated.

(d) Reporting currency

The Group's financial statements are prepared in Renminbi.

2. Significant accounting policies *(continued)*

(e) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at exchange rates quoted by the People's Bank of China ("PBOC rates") prevailing at the transaction dates. Foreign currency monetary assets and liabilities are translated into Renminbi at the PBOC rates at the balance sheet date. Exchange differences, other than those arising from foreign currency loans using to finance the construction of fixed assets (see note 2 (j)) before they are ready for their intended use are capitalised, are recognised as income or expenses in the income statement.

(f) Cash equivalents

Cash equivalents are short-term and highly liquid investments which are readily convertible into known amounts of cash and are subject to an insignificant risk of change in value.

(g) Provision for bad debts

Trade accounts receivable showing signs of uncollectibility are idenitified individually and allowance is then made based on the probability of being uncollectible and the aging analysis. Allowances for other receivables are determined based on the nature and corresponding collectibility.

(h) Inventories

Inventories, other than spare parts and consumables, are stated at the lower of cost and net realisable value. Difference between the cost and net realisable value of each category of inventories is recognised as provision for diminution in value of Inventories. Cost of inventories includes the cost of purchase of raw materials, processing and other costs. Inventories are measured at their actual cost upon acquisition. The cost of inventories is calculated using the weighted average method. In addition to the purchase cost of raw material, work in progress and finished goods include 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 and related taxes necessary to make the sales.

Spare parts and consumables are expensed when being consumed.

Inventories are recorded by perpetual method.

(i) Long-term equity investments

The Group's investments in entities in which the Group has control, joint control or exercise significant influence are accounted for in the long-term equity investment using the equity method. Equity method is to recognise the initial investment costs, subsequently adjusted in accordance with the share of shareholders' equity in respective investee companies.

2. Significant accounting policies *(continued)*

(i) Long-term equity investments *(continued)*

Equity investments difference, which is the difference between investment cost and the share of shareholders' funds of the investee companies is accounted for as follow:

Any excess of the initial investment cost over the share of shareholders' equity of the investee is amortised on a straight-line basis. The amortisation period is determined according to the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investment at period end.

Any shortfall of the initial investment cost over the share of shareholders' funds of the investee is recognised in capital reserve – reserve for equity investment acquired after the issuance of Cai Kuai [2003] No.10 "Questions and answers on implementing Accounting Regulations for Business Enterprises and related accounting standards (II)". If the investment was acquired before the issuance of Cai Kuai [2003] No.10 "Questions and answers on implementing Accounting Regulations for Business Enterprises and related accounting standards (II)", such shortfall is amortised on a straight-line basis over the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investments at the period end.

An associate is a company in which the Group holds, for long-term purposes, not less than 20% but not more than 50% of its equity interests and exercises significant influence in its management.

Long-term investments in entities in which the Group does not have control, joint control or does not exercise significant influence in their management are stated at cost, stating it at the initial investment cost. Investment income is recognised when an investee company declares cash dividend or distributes profit.

Disposals of long-term equity investments are recognised as profit or loss based on the difference between the disposal proceeds and the carrying amount of the investments.

The Group makes provision for impairment losses on long-term equity investments (see note 2(m)).

(j) Fixed assets and construction in progress

Fixed assets represent the assets held by the Group for production of products, providing service and administrative purpose with useful life over 1 year and comparatively high unit value.

Fixed assets are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 2(m)). Construction in progress is stated in the balance sheet at cost less impairment losses (see note 2(m)). Valuation is carried out in accordance with the relevant rules and regulations in the PRC and fixed assets and construction in progress are adjusted to the revalued amounts accordingly.

2. Significant accounting policies *(continued)*

(j) Fixed assets and construction in progress *(continued)*

All direct and indirect costs related to the purchase or construction of fixed assets, incurred before the assets are ready for its intended use, are capitalised as construction in progress. Those costs included borrowing costs, which include foreign exchange gains or losses on specific borrowings for the construction of the fixed assets during the construction period.

Construction in progress is transferred to fixed assets when the asset is ready for its intended use. No depreciation is provided in respect of construction in progress.

Depreciation is provided to write off the cost of fixed assets over their estimated useful lives on a straight-line basis, the respective estimated useful lives, residual values and annual depreciation rates on fixed assets are as follows:

	Useful life	Residual value	Depreciation rate
Land and buildings	15 to 40 years	3%-5%	2.4%-6.5%
Plant, machinery, equipment and others	5 to 26 years	3%-5%	3.7%-19.4%

(k) Intangible assets

Intangible assets are carried in the balance sheet at cost or valuation less accumulated amortisation and provision for impairment losses (see note 2(m)). Amortisation is provided on a straight-line basis. Amortisation period is the shorter of the beneficial period as specified in the related agreement and the legal life of the intangible assets. Amortisation is provided over 10 years if it is not specified in agreements or stipulated by law.

(l) Long-term deferred expenses

Long-term deferred expenses are amortised on a straight-line basis over their beneficial periods.

(m) Provision for impairment

The carrying amounts of assets (including long-term equity investments, fixed assets, construction in progress, intangible assets and other assets) are reviewed regularly to determine whether their recoverable amounts have declined below their carrying amounts. 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. The amount by which the carrying amount is reduced is the impairment loss.

2. Significant accounting policies *(continued)*

(m) Provision for impairment *(continued)*

The recoverable amount is the greater of the net selling price and the present value of the estimated future cash flows arising from the continuous use of the asset and from the disposal of the asset at the end of its useful life.

Provision for impairment loss is calculated on an item by item basis and recognised as an expense in the income statement. However, when a deficit between the initial investment cost and the Group's share of the shareholders' funds of the investee enterprise has been credited to the capital reserve, any impairment losses for long-term equity investment are firstly set off against the difference initially recognised in the capital reserve relating to the investment and any excess impairment losses are then recognised in the income statement.

If there is an indication that there has been a change in the estimates used to determine the recoverable amount and as a result the estimated recoverable amount is greater than the carrying amount of the asset, the impairment loss recognised in prior years is reversed. Reversals of impairment losses are recognised in the income statement. Impairment losses are reversed to the extent of the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. In respect of the reversal of an impairment loss for a long-term equity investment, the reversal starts with the impairment losses that had previously been recognised in the income statement and then the impairment losses that had been charged to capital reserve.

(n) Short-term debentures payable

Short-term debentures payable are reeorded in the balance sheet based on the proceeds received upon issuance. The interest expenses are accrued based on effective interest rate.

The discount on debentures is amortised on a straight-line basis, over the period from the issue date to the maturity date.

(o) Taxation

The principal taxes and the related rates are as follows:

(i) *Income tax*

Income tax is the provision for income tax recognised in the income statement for the period using the tax-effect accounting method. It comprises current and deferred tax.

Current 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.

2. Significant accounting policies *(continued)*

(o) Taxation *(continued)*

(i) Income tax (continued)

Pursuant to the relevant PRC tax regulations, the income tax rate applicable to the Company is 15% in 2006. Except for the subsidiaries granted with tax concessions as set out in the below table, the subsidiaries are subject to 33% income tax pursuant to the relevant PRC tax regulations.

The subsidiaries granted with tax concession are set out below:

Name of subsidiaries	Applicable tax rate	Reasons for granting concession
Shanghai Golden Phillips Petrochemical Company Limited	27%	A Sino-foreign Joint-equity manufacturing enterprise in old urban district
Shanghai Golden Way Petrochemical Company Limited	27%	A Sino-foreign Joint-equity manufacturing enterprise in old urban district
Shanghai Jinchang Engineering Plastics Company Limited	27%	A Sino-foreign Joint-equity manufacturing enterprise in old urban district

Deferred tax

Deferred tax is provided using the liability method, for timing differences between accounting profit before tax and the taxable income arising from the differences in the tax and accounting treatment of income and expenses or loss.When the tax rate changes or a new type of tax is levied, no adjustment is made to the amounts originally recognised for the timing differences under the deferral method. The original tax rates are used in arriving at the reversal amounts when the timing differences are reversed.

The tax value of losses expected to be available for utilisation against future taxable income is set off against the deferred tax liability within the same legal tax unit and jurisdiction. A valuation allowance is provided for the tax value of losses to reduce the deferred tax asset to the amount that is more likely than not to be realised through future taxable income.

(ii) Value-added tax ("VAT")

The VAT rate applicable to the Group is 17%.

(iii) Consumption tax

Pursuant to the relevant PRC tax regulations, the Group's sales of gasoline and diesel oil are subject to the consumption tax at a rate of RMB277.6 per tonne and RMB117.6 per tonne respectively.

2. Significant accounting policies *(continued)*

(p) Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligations and a reliable estimate can be made.

Where it is not probable that the settlement of the above obligation will cause an outflow of economic benefits, or the amount of the outflow cannot be estimated reliably, the obligation is disclosed as a contingent liability.

(q) Deferred income

Deferred income is amortised on a straight-line basis over its beneficial periods.

(r) Revenue recognition

When it is probable that the economic benefits will flow to the Company and the revenue and costs can be measured reliably, revenue is recognised in the income statement according to the following methods:

i) Sale of goods
Sales revenue is recognised when the significant risks and rewards of the ownership of goods have been transferred to the buyers. No revenue is recognised if there are significant uncertainties regarding the receipt of the consideration and the return of goods, or when the revenue and the costs incurred or to be incurred in respect of the transaction cannot be measured reliably.

ii) Rendering of services
Revenue from the rendering services which begins and finishes in the same accounting period is recognised upon performance of the services.

iii) Interest income
Interest income is recognised on a time proportion basis with reference to the principal outstanding and the applicable rate.

(s) Research and development costs

Research and development costs are recognised as expenses in the period in which they are incurred.

2. Significant accounting policies *(continued)*

(t) Borrowing cost

Borrowing costs incurred on specific borrowings for the construction of fixed assets are capitalised into the cost of the fixed assets during the construction period which brings the assets to their intended uses.Except for the above, other borrowing costs are recognised as financial expenses in the income statement when incurred.

(u) Repairs and maintenance expenses

Repairs and maintenance expenses are recognised as expenses in the period in which they are incurred.

(v) Retirement benefits

Pursuant to the relevant laws and regulations in the PRC, the Group has joined a defined contribution retirement plan for the employees arranged by a governmental organisation. The Group makes contributions to the retirement scheme at the applicable rate(s) based on the employees' salaries. The required contributions under the retirement plans are charged to the income statement on an accrual basis. After contribution made to the retirement scheme, the company has no other payment obligation. Further information is set out in note 34.

(w) Profit distribution and dividends

Profit distribution is made in accordance with the relevant rules and regulations set out in the Company Law of the PRC and the Articles of Association of the Company and its subsidiaries.

Dividends appropriated to shareholders are recognised in the profit appropriation statement when approved. Dividends proposed or approved after the balance sheet date but before the date on which the financial statements are authorised for issue are separately disclosed under shareholders' equity on the balance sheet.

(x) Related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to 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 or entities.

3. Cash at bank and in hand

The Group's and the Company's cash at bank and in hand as at 31 December are analysed as follows:

	31 December 2006 Exchange rate	The Group Original currency '000	2006 RMB'000	2005 RMB'000	The Company Original currency '000	2006 RMB'000	2005 RMB'000
Cash in hand							
Renminbi			114	185		57	107
Cash at bank							
Renminbi		761,463	761,463	1,062,457	470,436	470,436	603,235
Hong Kong Dollars	1.0047	11,779	11,834	46,095	-	-	36,962
United States Dollars	7.8087	5,138	40,121	55,329	281	2,199	428
Swiss Francs	-	-	-	792	-	-	792
Euro	10.2665	117	1,201	1,111	-	-	-
Japan	0.0656	67	4	2	-	-	-
Cash at bank and in hand			814,737	1,165,971		472,692	641,524
Deposits at related party (note 33(f))							
Renminbi			79,913	181,266		79,001	180,040
			894,650	1,347,237		551,693	821,564

Deposits at related party represent bank deposits placed at Sinopec Finance Company Limited. Deposits interest is calculated at market rate.

4. Bills receivable

	The Group		The Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Bank bills	1,246,611	709,027	964,326	497,954
Commercial bills	26,622	30,767	15,700	20,000
Total	1,273,233	739,794	980,026	517,954

Bills receivable are due in six months. As at 31 December 2006, there are no significant bills receivable at discount or pledged.

Except for the balances disclosed in note 33(e), there is no amount due from major shareholders who held 5% or more shareholding included in the above balance.

5. Trade debtors

The Group

	2006				2005			
	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %
Within one year	615,087	93.79	-	0.00	513,350	90.08	504	0.10
Between one and two years	14,212	2.17	4,409	31.02	31,252	5.48	43	0.14
Between two and three years	6,793	1.04	6,793	100.00	3,918	0.69	3,918	100.00
Over three years	19,709	3.00	19,709	100.00	21,380	3.75	21,380	100.00
Total	655,801	100.00	30,911		569,900	100.00	25,845	
Trade debtors,net	624,890				544,055			

The Company

	2006				2005			
	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %
Within one year	338,854	92.36	-	0.00	369,390	89.85	-	0.00
Between one and two years	12,806	3.49	4,030	31.47	21,050	5.12	-	0.00
Between two and three years	5,793	1.58	5,793	100.00	3,774	0.92	3,774	100.00
Over three years	9,443	2.57	9,443	100.00	16,917	4.11	16,917	100.00
Total	366,896	100.00	19,266		411,131	100.00	20,691	
Trade debtors,net	347,630				390,440			

5. Trade debtors *(continued)*

	The Group		The Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Balance at the beginning of the year	25,845	45,282	20,691	19,610
Add: Additions for the year	8,513	13,683	773	13,683
less: Provision written back	-	(33,120)	-	(12,602)
Provision written off	(3,447)	-	(2,198)	-
Balance at the end of the year	30,911	25,845	19,266	20,691

The aggregate amount and proportion of the five largest trade debtors at 31 December 2006 are shown below:

	2006 RMB'000	2005 RMB'000
Amount	382,329	302,461
Percentage of total trade debtors	58.30%	53.07%

Except for balances disclosed in Note 33 (e), there is no amount due from major shareholders who held 5% or more shareholding included in the above balance.

During the year, the Group and the Company had no individually significant write off or write back of doubtful debts which had been fully or substantially provided for in prior years. At 31 December 2006, the Group and the Company did not have individually significant trade debtors that aged over three years.

6. Other debtors

	The Group							
	2006				2005			
	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %
Within one year	232,545	92.72	5,201	2.24	486,398	84.54	5,000	1.03
Between one and two years	4,590	1.83	921	20.07	64,532	11.22	9	0.01
Between two and three years	5,134	2.05	32	0.62	7,335	1.27	-	0.00
Over three years	8,535	3.40	8,423	98.69	17,091	2.97	3,116	18.23
Total	250,804	100.00	14,577		575,356	100.00	8,125	
Other debtors,net	236,227				567,231			

6. Other debtors *(continued)*

The Company

	2006				2005			
	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %	Amount RMB'000	Proportion %	Bad debt provision RMB'000	Provision proportion %
Within one year	233,624	94.11	-	0.00	617,691	91.40	-	0.00
Between one and two years	4,520	1.82	903	19.98	46,486	6.88	-	0.00
Between two and three years	4,662	1.88	20	0.43	675	0.10	-	0.00
Over three years	5,447	2.19	5,395	99.05	10,924	1.62	2,422	22.17
Total	248,253	100.00	6,318		675,776	100.00	2,422	
Other debtors,net	241,935				673,354			

Bad debt provision

	The Group 2006 RMB'000	The Group 2005 RMB'000	The Company 2006 RMB'000	The Company 2005 RMB'000
Balance at the beginning of the year	8,125	9,692	2,422	4,355
Add: Additions for the year	9,702	366	3,896	-
less: Provision written back	-	(1,933)	-	(1,933)
Provision written off	(3,250)	-	-	-
Balance at the end of the year	14,577	8,125	6,318	2,422

The aggregate amount and proportion of the five largest other debtors at 31 December 2006 are shown below:

	2006 RMB'000	2005 RMB'000
Amount	157,256	361,129
Percentage of total other debtors	62.70%	62.77%

Except for balances disclosed in Note 33(e), there is no amount due from major shareholders who held 5% or more shareholding included in the above balance.

During the year, the Group and the Company had no individually significant write off or write back of doubtful debts which have been fully or substantially provided for in prior years. At 31 December 2006, the Group and the Company did not have individually significant other debtors that aged over three years.

7. Advance payments

All advance payments are within one year.

Except for the balances disclosed in Note 33(e),there is no amount due from major shareholders who held 5% or more shareholding included in the balance of advance payments.

8. Inventories

	The Group				The Company			
	2006		2005		2006		2005	
	Amount	Provision for diminution in value	Amount	Provision for diminution in value	Amount	Provision for diminution in value	Amount	Provision for diminution in value
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Raw materials	873,130	-	1,050,904	-	703,528	-	829,000	-
Work in progress	1,661,487	-	1,592,298	-	1,571,581	-	1,505,739	-
Finished goods	1,014,225	-	895,951	-	794,466	-	719,040	-
Spare parts and consumables	655,769	41,355	625,895	50,070	555,760	40,904	533,078	49,186
Total	4,204,611	41,355	4,165,048	50,070	3,625,335	40,904	3,586,857	49,186
Inventories, net	4,163,256		4,114,978		3,584,431		3,537,671	

Provision for diminution in value of inventories is analysed as follows:

	The Group				The Company			
	2006		2005		2006		2005	
	Finished goods	Spare parts and consumbles	Finished goods	Spare parts and consumbles	Finished goods	Spare parts and consumbles	Finished goods	Spare parts and consumbles
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January	-	50,070	3,780	52,890	-	49,186	-	47,550
Additions	33,407	-	-	1,636	33,407	-	-	1,636
Transfer out due to sales	(33,407)	(8,715)	(3,780)	(4,456)	(33,407)	(8,282)	-	-
At 31 December	-	41,355	-	50,070	-	40,904	-	49,186

All inventories were acquired through purchase or production.

The cost of inventories of the Group and the Company recognised as an expense in the consolidated income statement amounted to RMB 47,922,431,000 and RMB 42,796,172,000 for the year ended 31 December 2006 respectively (2005: RMB 41,605,113,000 and RMB 38,598,193,000 respectively).