

The information set out in this Appendix is extracted from the registration statement document of the US offering and does not form part of the Accountants' Report prepared by KPMG, Certified Public Accountants, Hong Kong, the independent reporting accountants of the Company, as set out in Appendix I, and is included herein for information purposes only.

(I) SIGNIFICANT DIFFERENCES BETWEEN IFRS AND US GAAP

The Group's accounting policies conform with IFRS which differ in certain significant respects from US GAAP. Differences which have a significant effect on net profit and owner's equity are set out below.

(a) Revaluation of property, plant and equipment

In connection with the Restructuring, the property, plant and equipment of the Group were revalued as at December 31, 2001 (Section V Note 3 of Appendix I). The net revaluation deficit has been reflected in the combined financial statements as at December 31, 2001. Such revaluation resulted in an increase directly to owner's equity of RMB4,154 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB11,930 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

Under US GAAP, property, plant and equipment are stated at their historical cost less accumulated depreciation unless an impairment loss has been recorded. An impairment loss on property, plant and equipment is recorded under US GAAP if the carrying amount of such asset exceeds its future undiscounted cash flows resulting from the use of the asset and its eventual disposition. The future undiscounted cash flows of the Group's property, plant and equipment, whose carrying amount was reduced in connection with the Restructuring, exceed the historical cost carrying amount of such property, plant and equipment and, therefore, impairment of such assets is not appropriate under US GAAP. Accordingly, the revaluation reserve recorded directly to owner's equity and the charge to income recorded under IFRS as a result of the Restructuring are reversed for US GAAP purposes.

However, as a result of the tax deductibility of the net revaluation deficit, a deferred tax liability related to the net revaluation deficit is created under US GAAP with a corresponding decrease in owner's equity.

(b) Related party transactions

Under IFRS, transactions with state-controlled enterprises other than China Telecommunications Corporation and its affiliates are not required to be disclosed as related party transactions. Furthermore, government departments and agencies are deemed not to be related parties to the extent that such transactions are in the normal course of business. Therefore, related party transactions as disclosed in Section V Note 27 of Appendix I only refer to transactions with China Telecom Group.

Under US GAAP, there are no similar exemptions. The Group's transactions with state-controlled enterprises were primarily with the PRC's telecommunication operators as follows:

	Years ended December 31,			Six-month periods ended June 30,	
	1999	2000	2001	2001	2002
	RMB million	RMB million	RMB million	RMB million	RMB million
Interconnection revenue	4,779	4,869	3,814	2,009	1,259
Interconnection charge	754	1,172	1,290	724	255
Leased line revenue	4,259	3,961	2,839	1,351	1,496

The amounts set out in the tables above represent the historical costs incurred by the related parties in carrying out such transactions.

(c) Recently issued accounting standards

SFAS No. 141 and SFAS No. 142

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Intangible Assets". SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also specifies the types of acquired intangible assets that are required to be recognised and reported separately from goodwill and those acquired intangible assets that are required to be included in goodwill. SFAS No. 142 will require that goodwill no longer be amortised, but instead tested for impairment at least annually. SFAS No. 142 will also require recognised intangible assets be amortised over their respective estimated useful lives and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Any recognised intangible asset determined to have an indefinite useful life will not be amortised, but instead tested for impairment in accordance with the Standard until its life is determined to no longer be indefinite.

The provisions of SFAS Nos. 141 and 142 shall be applied for fiscal years beginning after December 15, 2001, to all goodwill and other intangible assets recognised in an entity's statement of financial position at the beginning of that fiscal year, regardless of when those previously recognised assets were initially recognised, with the exception of the immediate requirement to use the purchase method of accounting for all future business combinations completed after June 30, 2001. However, any goodwill and any intangible asset determined to have an indefinite useful life that is acquired in a business combination completed after June 30, 2001 will not be amortised, but instead will be reviewed for impairment in accordance with APB No. 17 or SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", until the date SFAS No. 142 is applied in its entirety.

SFAS No. 141 will require the Group to evaluate its existing intangible assets and goodwill and to make any necessary reclassifications in order to conform to the new separation requirements at the date of adoption. Upon adoption of SFAS No. 142, the Group will be required to reassess the useful lives and residual values of all intangible assets and make any necessary amortisation period adjustments.

In connection with the transitional impairment evaluation, SFAS No. 142 will require the Group to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. The adoption of these Statements did not have a material impact on the Group's combined financial statements.

SFAS No. 143

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143 requires the Group to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. The Group also records a corresponding asset which is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Group is required to adopt SFAS No. 143 on January 1, 2003. The Group has not determined the potential effects that adoption of this Statement will have on the Group's combined financial statements.

SFAS No. 144

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes both SFAS No. 121, and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" (Opinion 30), for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS No. 121. For example, SFAS No. 144 provides guidance on the accounting for a long-lived asset that will be disposed of other than by sale. SFAS No. 144 retains the basic provisions of Opinion 30 on how to present discontinued operations in the statement of income but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike SFAS No. 121, an impairment assessment under SFAS No. 141 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under SFAS No. 142, "Goodwill and Other Intangible Assets".

The Group is required to adopt SFAS No. 144 no later than the fiscal year beginning after December 15, 2001. Management does not expect the adoption of SFAS No. 144 for long-lived assets held for use to have a material impact on the Group's combined financial statements because the impairment assessment under SFAS No. 144 is largely unchanged from SFAS No. 121. The provisions of the Statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities. Therefore, management cannot determine the potential effects that adoption of SFAS No. 144 will have on the Group's combined financial statements.

SFAS No. 145

In April 2002, the FASB issued SFAS No. 145, which rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that Statement, SFAS

No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements". SFAS No. 145 also rescinds SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers". SFAS No. 145 amends SFAS No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions.

The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 shall be applied in fiscal years beginning after May 15, 2002. The provisions in paragraphs 8 and 9(c) of SFAS No. 145 related to Statement 13 shall be effective for transactions occurring after May 15, 2002. All other provisions of SFAS No. 145 shall be effective for financial statements issued on or after May 15, 2002. The Group does not expect the adoption of SFAS No. 145 will have a material impact on the Group's combined financial statements.

SFAS No. 146

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. SFAS No. 146 requires an entity to record a liability for cost associated with an exit or disposal activity when that liability is incurred and can be measured at fair value. Commitment to an exit plan or a plan of disposal expresses only management's intended future actions and does not meet the requirement for recognising a liability and the related expense. An entity is required to disclose information about its exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit or disposal activity is initiated and in any subsequent period until the activity is completed. The Group is required to adopt SFAS No. 146 on January 1, 2003. The provisions of SFAS No. 146 are required to be applied prospectively after the adoption date to newly exit or disposal activities. Therefore, management cannot determine the potential effects that adoption of SFAS No. 146 will have on the Group's combined financial statements.

The effect on net profit of significant differences between IFRS and US GAAP for the years ended December 31, 2000 and 2001 and for the six-month periods ended June 30, 2001 and 2002 is as follows:

	Years ended December 31,		Six-month periods ended June 30,	
	2000	2001	2001	2002
	RMB million	RMB million	RMB million	RMB million
Net profit under IFRS	19,219	6,883	8,137	8,483
US GAAP adjustments:				
Reversal of deficit on revaluation of property, plant and equipment, net of minority interests	—	11,838	—	—
Depreciation on revalued property, plant and equipment	—	—	—	(823)
Deferred tax effect of US GAAP adjustment	—	(3,936)	—	271
Net profit under US GAAP	<u>19,219</u>	<u>14,785</u>	<u>8,137</u>	<u>7,931</u>
Basic earnings per share under US GAAP (in RMB)	<u>0.28</u>	<u>0.22</u>	<u>0.12</u>	<u>0.12</u>

The effect on owner's equity of significant differences between IFRS and US GAAP as at December 31, 2000 and 2001 and June 30, 2002 is as follows:

	December 31,		June 30,
	2000	2001	2002
	RMB million	RMB million	RMB million
Owner's equity under IFRS	101,619	97,485	105,968
US GAAP adjustments:			
Revaluation of property, plant and equipment, net of minority interests	—	7,684	6,861
Deferred tax effect of US GAAP adjustment	—	(2,566)	(2,295)
Owner's equity under US GAAP	<u>101,619</u>	<u>102,603</u>	<u>110,534</u>

(II) INTRODUCTION TO UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION

The information set out below does not form part of the Accountants' Report prepared by KPMG, the independent reporting accountants of the Company, as set out in Appendix I, and is included herein for information purpose only. KPMG expresses no opinion on the following information.

The Company was established in the PRC on September 10, 2002 as part of the Restructuring of China Telecommunications Corporation. Prior to the Restructuring, the wireline telecommunication and related operations of the Group were carried out by subsidiaries of China Telecommunications Corporation in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province (the "Predecessor Operations").

Pursuant to the Restructuring, China Telecommunications Corporation transferred to the Company the wireline telecommunication and related operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province together with the related assets and liabilities in consideration for 68,317 million ordinary domestic shares of the Company. The shares issued to China Telecommunications Corporation have a par value of RMB1.00 each and represented the entire authorised and issued share capital of the Company. In preparing the Group's combined financial statements, the assets, liabilities, revenues and expenses of the Predecessor Operations are reflected in the combined financial statements. In addition, the combined financial statements include certain assets historically associated with the Predecessor Operations that were not transferred to the Company and were retained by China Telecommunications Corporation. These assets related primarily to investments in non-telecommunication industries, inter-provincial transmission optic fibres and properties. As a result of the segregation and separate management of these assets by China Telecommunications Corporation beginning December 31, 2001, the assets retained by China Telecommunications Corporation have been reflected as a distribution to owner in the combined statements of owner's equity as at December 31, 2001.

Since the Restructuring, the Company operates as a stand-alone entity. The Company and China Telecom Group have entered into new agreements for a range of services which may be required and requested by either party. The Restructuring, as well as

other related events, will have an impact on the Group's overall results of operations. The unaudited pro forma combined statements of income for the year ended December 31, 2001 under IFRS and US GAAP have been prepared based on the historical combined statements of income of the Group, after giving effect to the pro forma adjustments described in the accompanying notes thereto, as if the Restructuring and other related events had been in effect on January 1, 2001.

A narrative description of the pro forma effects of the Restructuring that are (i) directly attributable to the transactions; (ii) expected to have a continuing impact on the Group; and (iii) factually supportable, are summarised in the notes to the unaudited pro forma combined financial information. The expected effects of the new service agreements (other than the optic fibres and property leasing agreements) are not reflected in the pro forma combined financial information because the effects of such change cannot be factually supported, reasonably estimated and/or do not result in any material change to the results of operations. The expected effects of the new interconnection agreement with China Telecommunications Corporation in respect of calculating interconnection revenues and charges are not reflected in the pro forma combined financial information due to a lack of sufficient historical data.

The unaudited pro forma combined financial information is based on a number of assumptions, estimates, uncertainties and currently available information. As a result of these assumptions, estimates and uncertainties, the accompanying unaudited pro forma combined financial information does not purport to describe the actual financial position or results of the Group's operations that would have been achieved had the Restructuring and the effects of the agreements occurred on January 1, 2001, nor does it purport to predict the Group's future financial position or results of operations.

The unaudited pro forma combined financial information should be read in conjunction with the Financial Information set out in Appendix I—"Accountants' Report" and the other financial information included elsewhere in this prospectus.

**UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2001**

	<u>Historical</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma IFRS</u>
	<u>RMB million</u>	<u>RMB million</u>	<u>RMB million</u>
Operating revenues	68,546		68,546
Operating expenses			
Depreciation and amortisation	(19,451)	1,419 ⁽¹⁾ 107 ⁽²⁾ 122 ⁽³⁾	(17,803)
Network operations and support	(20,269)	(75) ⁽²⁾	(20,344)
Selling, general and administrative	(9,401)	(234) ⁽³⁾	(9,635)
Other operating expenses	(1,327)		(1,327)
Total operating expenses	(50,448)		(49,109)
Operating profit	18,098		19,437
Deficit on revaluation of property, plant and equipment	(11,930)		(11,930)
Net finance income	293		293
Investment income	310	(289) ⁽⁴⁾	21
Share of profit from associates	22		22
Profit before taxation and minority interests	6,793		7,843
Taxation	69	(347) ⁽⁵⁾	(278)
Profit before minority interests	6,862		7,565
Minority interests	21		21
Net profit	6,883		7,586
Basic earnings per share (in RMB)	0.10		0.11
			<u>RMB million</u>
Pro forma net profit under US GAAP			
Pro forma net profit under IFRS			7,586
US GAAP adjustments			
Reversal of deficit on revaluation of property, plant and equipment, net of minority interests		(6)	11,838
Depreciation on revalued property, plant and equipment		(6)	(1,419)
Deferred tax effects of above US GAAP adjustments		(6)	(3,469)
Pro forma net profit under US GAAP			14,536
Pro forma basic earnings per share under US GAAP (in RMB)			0.21

See accompanying notes to unaudited pro forma combined financial information.

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION

- (1) In connection with the Restructuring, the property, plant and equipment of the Group were revalued as at December 31, 2001 which resulted in a net revaluation deficit of RMB7,776 million. The pro forma adjustment reflects the reduction in depreciation charge resulting from the revaluation of the Group's property, plant and equipment as if the results of the revaluation had been recorded on January 1, 2001.
- (2) In connection with the Restructuring, the inter-provincial transmission optic fibres associated with the Predecessor Operations were not transferred to the Company but were retained by China Telecommunications Corporation. Pursuant to an optic fibres leasing agreement, the Company will lease the inter-provincial transmission optic fibres from China Telecommunications Corporation. The amount to be paid by the Group to China Telecommunications Corporation for the leasing of the optic fibres will be based on the depreciation charge of the optic fibres. The pro forma adjustment reflects the effects of the reduction in depreciation charge relating to the optic fibres and an increase in leasing expense as if the Restructuring occurred and the leasing agreement took effect on January 1, 2001.
- (3) In connection with the Restructuring, certain properties and buildings associated with the Predecessor Operations were not transferred to the Company but were retained by China Telecommunications Corporation. Pursuant to property leasing agreements between the Group and China Telecom Group, the Group will lease the properties and buildings from China Telecom Group. The amount to be paid by the Group to China Telecom Group will be based on market rates, with reference to amounts stipulated by local price bureaux. The pro forma adjustment reflects the effects of the reduction in depreciation charge relating to these properties and buildings and an increase in rental expense as if the Restructuring occurred and the property leasing agreements took effect on January 1, 2001.
- (4) In connection with the Restructuring, certain long term investments and interests in associates that are unrelated to the telecommunication industry were not transferred to the Company but were retained by China Telecommunications Corporation. The pro forma adjustment reflects the reduction in investment income generated from these investments as if the Restructuring occurred on January 1, 2001.
- (5) The pro forma adjustment reflects the tax effect of the above pro forma adjustments using the statutory tax rate of 33%.
- (6) The pro forma adjustments under US GAAP reflect the effects of the reversal of deficit on revaluation of the Group's property, plant and equipment, net of amount attributable to minority interests, the reversal of the reduction in depreciation charge as referred to in Note 1 above, and the related tax effect.