

## REPORT OF THE DIRECTORS

The Board of Directors (the "Board") of China Telecom Corporation Limited (the "Company") is pleased to present its report together with the audited financial statements of the Company and its subsidiaries (the "Group") prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2005.

### PRINCIPAL BUSINESSES

The principal businesses of the Group are: provision of comprehensive wireline telecommunications and other relevant services, including local telephone, domestic long distance telephone, international long distance telephone, Internet and managed data, leased line and other related services to its subscribers within the service area of the Group. The principal business of the Company is investment holding.

### RESULTS

Results of the Group for the year ended 31 December 2005 and the financial position of the Company and the Group as at that date are set out in the audited financial statements on pages 74 to 122 in this annual report.

### DIVIDEND

The Directors propose to declare a final dividend in the amount equivalent to HK\$0.075 per share, totaling approximately RMB6,315 million for the year ended 31 December 2005. The dividend proposal will be submitted for consideration at the Annual General Meeting to be held on 23 May 2006. Dividends will be denominated and declared in Renminbi. Dividends on domestic shares will be paid in Renminbi and dividends on H shares will be paid in Hong Kong dollars. The relevant exchange rate will be the mean of the average rate of Renminbi to Hong Kong dollars as announced by the People's Bank of China for the week prior to the date of declaration of dividends by the Annual General Meeting. The final dividends are expected to be paid around 15 June 2006 after its approval by the Annual General Meeting.

### ISSUE OF SHORT TERM COMMERCIAL PAPER BY THE COMPANY

Pursuant to the resolution passed at the Extraordinary General Meeting held on 18 October 2005, the Company may, before the date on which the annual general meeting of the Company for the year ended 31 December 2005 is held, issue short term commercial paper, in one or more tranches, with a maximum outstanding repayment amount of RMB30 billion.

On 25 October 2005, the Company successfully issued short term commercial paper in the nominal amount of RMB10 billion, due in 6 months with an annual interest rate of 2.54%. The short term commercial paper was issued through a book-building and centralised placing process in the PRC inter-bank debenture market on a discounted basis. All the proceeds from this issue of short term commercial paper will be used to satisfy the Company's funding needs of production and operation. The Company considers that the issue of short term commercial paper will enable it to lower its finance costs, to diversify its capital-raising channels and to improve its market image.

## DIRECTORS AND SENIOR MANAGEMENT OF THE COMPANY

The following table sets out certain information concerning the directors and senior management of the Company as at the date of this Report:

Name	Age	Position in the Company	Date of Appointment
Wang Xiaochu	48	Chairman and Chief Executive Officer	20 December 2004
Leng Rongquan	57	Executive Director, President and Chief Operational Officer	20 December 2004
Wu Andi	51	Executive Director, Executive Vice President and Chief Financial Officer	10 September 2002
Zhang Jiping	50	Executive Director and Executive Vice President	10 September 2002
Huang Wenlin	52	Executive Director and Executive Vice President	10 September 2002
Li Ping	52	Executive Director, Executive Vice President and Joint Company Secretary	10 September 2002
Wei Leping	60	Executive Director	10 September 2002
Yang Jie	44	Executive Director and Executive Vice President	20 October 2004
Sun Kangmin	49	Executive Director and Executive Vice President	20 October 2004
Li Jinming	54	Non-executive Director	20 December 2004
Zhang Youcai	65	Independent Non-executive Director	10 September 2002
Lo Hong Sui, Vincent	58	Independent Non-executive Director	10 September 2002
Shi Wanpeng	69	Independent Non-executive Director	20 June 2003
Xu Erming	56	Independent Non-executive Director	9 September 2005
Tse Hau Yin, Aloysius	58	Independent Non-executive Director	9 September 2005
Wang Qi	51	Controller	10 September 2002
Yung Shun Loy, Jacky	43	Assistant Chief Financial Officer, Qualified Accountant and Joint Company Secretary	1 February 2005

On 9 September 2005, the office term of the First Session of the Board of Directors of the Company expired, and Mr. Cheng Xiyuan and Mr. Feng Xiong ceased to be the executive directors of the Company. On 9 September 2005, all members of the First Session of the Board of Directors, except Mr. Cheng Xiyuan and Mr. Feng Xiong, were reappointed as members of the Second Session of the Board of Directors pursuant to a resolution passed at the Extraordinary General Meeting. The meeting also elected Mr. Xu Erming and Mr. Tse Hau Yin, Aloysius as independent non-executive directors of the Company.

On 22 March 2006, Mr. Wei Leping has resigned from the position of executive vice president of the Company, and proposed to resign from the position of executive director, which will be effective after approval in 2005 Annual General Meeting.

## REPORT OF THE DIRECTORS (continued)

The following table sets out certain information concerning the senior management of the Company's subsidiaries at the provincial level as at the date of this Report:

Name	Age	Position in the Company's subsidiaries at the provincial level	Date of Appointment
Zhang Weihua	45	Chairman of Shanghai Telecom Company Limited	9 December 2005
Wang Wei	41	General Manager of Shanghai Telecom Company Limited	20 October 2004
Feng Xiong	60	Chairman and General Manager of Guangdong Telecom Company Limited	28 September 2002
Sun Jiuming	59	Chairman and General Manager of Jiangsu Telecom Company Limited	19 October 2002
Zhang Xinjian	50	Chairman and General Manager of Zhejiang Telecom Company Limited	2 March 2005
Tao Ping	48	Chairman and General Manager of Anhui Telecom Company Limited	14 February 2006
Liu Yaoming	54	Chairman and General Manager of Fujian Telecom Company Limited	19 August 2003
Ke Ruiwen	42	Chairman and General Manager of Jiangxi Telecom Company Limited	12 September 2003
Zhao Qiang	46	Chairman and General Manager of Guangxi Telecom Company Limited	7 September 2005
Zou Bingxuan	56	Chairman and General Manager of Chongqing Telecom Company Limited	19 August 2003
Liu Hongjian	45	Chairman and General Manager of Sichuan Telecom Company Limited	4 June 2004
Liao Renbin	46	Chairman and General Manager of Hubei Telecom Company Limited	5 March 2004
Wen Huiguo	52	Chairman and General Manager of Hunan Telecom Company Limited	5 March 2004
Jin Dongbin	51	Chairman and General Manager of Hainan Telecom Company Limited	7 September 2005
Liao Kang	43	Chairman and General Manager of Guizhou Telecom Company Limited	5 March 2004
Li Hua	42	Chairman of Yunnan Telecom Company Limited General Manager of Yunnan Telecom Company Limited	5 November 2005 9 March 2005
Yin Yiping	46	Chairman of Shaanxi Telecom Company Limited General Manager of Shaanxi Telecom Company Limited	20 October 2005 3 March 2005
En Guangli	58	Chairman and General Manager of Gansu Telecom Company Limited	5 March 2004
Yang Jianqing	45	Chairman and General Manager of Qinghai Telecom Company Limited	5 March 2004
Ma Linfeng	50	Chairman and General Manager of Ningxia Telecom Company Limited	5 March 2004
Gao Tongqing	42	Chairman and General Manager of Xinjiang Telecom Company Limited	5 March 2004

In September 2005, Zhao Qiang was appointed as the Chairman and the General Manager of Guangxi Telecom Company Limited while Sun Junyan resigned from the position of the Chairman and the General Manager of Guangxi Telecom Company Limited.

In September 2005, Jin Dongbin was appointed as the Chairman and the General Manager of Hainan Telecom Company Limited while Wang Dan resigned from the position of the Chairman and the General Manager of Hainan Telecom Company Limited.

In October 2005, Yin Yiping was appointed as the Chairman of Shaanxi Telecom Company Limited while Zhou Shifu resigned from the position of the Chairman of Shaanxi Telecom Company Limited.

In November 2005, Li Hua was appointed as the Chairman of Yunnan Telecom Company Limited while Wu Yongquan resigned from the position of the Chairman of Yunnan Telecom Company Limited.

In December 2005, Zhang Weihua was appointed as the Chairman of Shanghai Telecom Company Limited while Cheng Xiyuan resigned from the position of the Chairman of Shanghai Telecom Company Limited.

In February 2006, Tao Ping was appointed as the Chairman and the General Manager of Anhui Telecom Company Limited while Zhang Jun'an resigned from the position of the Chairman and the General Manager of Anhui Telecom Company Limited.

## SUPERVISORS OF THE COMPANY

The following table sets out certain information concerning the supervisors of the Company as at the date of this Report:

Name	Age	Position in the Company	Date of Appointment
Zhang Xiuqin	59	Chairperson of the Supervisory Committee	10 September 2002
Zhu Lihao	65	Independent Supervisor	10 September 2002
Li Jian	44	Supervisor	9 September 2005
Xu Cailiao	42	Supervisor	9 September 2005
Ma Yuzhu	52	Supervisor (Employee Representative)	9 September 2005

On 9 September 2005, the office term of the First Session of the Supervisory Committee of the Company expired, and Mr. Wang Huanhui, Mr. Li Jing and Mr. Xie Songguang ceased to be the supervisors of the Company. At the same time, Mr. Li Jian and Mr. Xu Cailiao were elected as supervisors pursuant to the resolution of the Company's extraordinary general meeting held on the same day, and Mr. Ma Yuzhu was elected as a supervisor (employee representative) in the employee representatives meeting.

## REPORT OF THE DIRECTORS (continued)

## SHARE CAPITAL

The share capital of the Company as at 31 December 2005 was RMB80,932,368,321, divided into 80,932,368,321 shares of RMB1.00 each. As at 31 December 2005, the share capital of the Company comprised:

Shares	Number of shares as at 31 December 2005	Percentage of the total number of shares in issue as at 31 December 2005 (%)
Domestic shares (total):	67,054,958,321	82.85
Domestic shares held by:		
China Telecommunications Corporation	57,377,053,317	70.89
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653	6.94
Jiangsu Guoxin Investment Group Co., Ltd.	957,031,543	1.18
Zhejiang Financial Development Company	2,137,473,626	2.64
Fujian State-owned Assets Investment Holdings Co., Ltd.	969,317,182	1.20
Total number of H shares (including ADSs):	13,877,410,000	17.15
Total	80,932,368,321	100.00

## MATERIAL INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2005, the interests or short position of persons who are entitled to exercise or control the exercise of 5% or more of the voting power at any of the Company's general meetings (excluding the Directors and Supervisors) in the shares and underlying shares of equity derivatives of the Company as recorded in the register required to be maintained under Section 336 of the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong) (the "SFO") are as follows:

Name of shareholder	Number of shares held	Type of shares	Percentage of the respective type of shares (%)	Percentage of the total number of shares in issue (%)	Capacity
China Telecommunications Corporation	57,377,053,317	Domestic shares	85.57	70.89	Beneficial owner
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653	Domestic shares	8.37	6.94	Beneficial owner
JPMorgan Chase & Co.	1,080,661,621	H shares	7.79	1.34	Beneficial owner; investment manager; custodian

Save as stated above, as at 31 December 2005, in the register required to be maintained under Section 336 of the SFO, no other persons were recorded to hold any interests or short positions in the shares or underlying shares of the equity derivatives of the Company.

## DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, none of the directors and supervisors of the Company had any interests or short positions in the share, underlying shares of equity derivatives or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be maintained under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at 31 December 2005, the Company had not granted its Directors or Supervisors, or their respective spouses or children below the age of 18 any rights to subscribe for the shares or debentures of the Company or any of its associated corporations and none of them has ever exercised any such right to subscribe for shares or debentures.

**REPORT OF THE DIRECTORS** *(continued)***PUBLIC FLOAT**

As at the date of this Report, based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed public float under the Listing Rules and as agreed with The Stock Exchange of Hong Kong Limited.

**DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS**

For the year ended 31 December 2005, no Director or Supervisor of the Company had any material interest, whether directly or indirectly, in any contract of significance entered into by the Company, any of its holding companies or subsidiaries or subsidiaries of the Company's holding company, apart from service contracts.

**EMOLUMENTS OF THE DIRECTORS AND SUPERVISORS**

Please refer to note 26 of the audited financial statements for details of the emoluments of the Directors and Supervisors of the Company in 2005.

**PURCHASE, SALE AND REDEMPTION OF SHARES**

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any securities of the Company during the reporting period.

**SUMMARY OF FINANCIAL INFORMATION**

Please refer to pages 127 to 128 of this annual report for a summary of the operating results, assets and liabilities of the Group for each of the years in the five-year period ended 31 December 2005.

**BANK LOANS AND OTHER BORROWINGS**

Please refer to note 14 of the audited financial statements for details of bank loans and other borrowings of the Group.

**CAPITALISED INTEREST**

Please refer to note 24 of the audited financial statements for details of the Group's capitalised interest for the year ended 31 December 2005.

**FIXED ASSETS**

Please refer to note 4 of the audited financial statements for movements in the fixed assets of the Group for the year ended 31 December 2005.

**TRUST DEPOSITS AND OVERDUE FIXED DEPOSITS**

As at 31 December 2005, the Company did not have any trust deposit or any overdue fixed deposits with financial institutions or any other units.

## RESERVES

Pursuant to Article 147 of the Company's articles of association (the "Articles of Association"), where the financial statements prepared in accordance with PRC accounting standards and regulations materially differ from those prepared in accordance with either International Financial Reporting Standards or those of the place outside the PRC where the Company's shares are listed, the distributable profit for the relevant accounting period shall be deemed to be the lesser of the amounts shown in those respective financial statements. Distributable reserves of the Company as at 31 December 2005, calculated on the above basis and before deducting the proposed final dividends for 2005, amounted to approximately RMB7,858 million.

In addition to the allocation to the statutory reserve funds, the Directors propose to make an allocation to a discretionary surplus reserve. The allocation proposal shall be submitted for consideration at the Annual General Meeting to be held on 23 May 2006.

Please refer to note 20 of the audited financial statements for details of the movements in the reserves of the Company and the Group for the year ended 31 December 2005.

## DONATIONS

For the year ended 31 December 2005, the Group made charitable and other donations in a total amount of RMB21 million.

## SUBSIDIARIES AND ASSOCIATED COMPANIES

Please refer to note 6 and note 7 of the audited financial statements for details of the Company's subsidiaries and the Group's interests in associated companies as at 31 December 2005.

## CHANGES IN EQUITY

Please refer to the consolidated statement of changes in equity contained in the audited financial statements (page 78 of this annual report).

## RETIREMENT BENEFITS

Please refer to note 34 of the audited financial statements for details of the retirement benefits provided by the Group.

## STOCK APPRECIATION RIGHTS

Please refer to note 35 of the audited financial statements for details of the stock appreciation rights offered by the Company.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights in the Articles of Association requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

## REPORT OF THE DIRECTORS (continued)

## MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2005, sales to the five largest customers of the Group represented an amount not exceeding 30% of the operating revenue of the Group.

For the year ended 31 December 2005, purchases from the five largest suppliers of the Group accounted for approximately 33.7% of the total annual purchases of the Group.

For the year ended 31 December 2005, purchases from the Group's largest supplier accounted for approximately 10.8% of the total annual purchases of the Group. The amount of the Group's annual purchase includes amount of equipment purchase, investments in infrastructure and pipeline, and amount payable for interconnection settlement.

So far as the Directors are aware, no director of the Company, their associates, or any person holding more than 5% of the issued share capital in the Company has any interests in such suppliers.

## CONTINUING CONNECTED TRANSACTIONS

The following table sets out the amounts of continuing connected transactions of the Group during the year ended 31 December 2005:

Transaction	Group	Annual Monetary cap for continuing connected transactions
	(RMB millions)	(RMB millions)
Share of expenses for centralised services	275	800
Net expenses for interconnection settlement	542	N/A <sup>1</sup>
Provision of comprehensive services by China Telecommunications Corporation and its subsidiaries (the "China Telecom Group")	425	1,070
Provision of engineering services by China Telecom Group	6,411	8,327
Mutual leasing of properties	388	440
Provision of third party property sub-leasing by China Telecom Group	43	130
Provision of IT services by China Telecom Group	164	320
Provision of equipment procurement services by China Telecom Group	267	470
Provision of community services by China Telecom Group	2,632	3,410
Provision of ancillary telecommunications services by China Telecom Group	2,456	2,640

<sup>1</sup> According to a waiver letter issued by The Stock Exchange of Hong Kong Limited on 18 May 2004, the Company is not required to set an annual monetary cap for the total amount under interconnection agreements.

### ***Centralised Services Agreement***

The Centralised Services Agreement was renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. The aggregate costs incurred by the Company and China Telecommunications Corporation for the provision of management services relating to the operation of the business support centre and the network management centre, the costs of headquarters and certain network support premises and related facilities (including labour costs, depreciation of equipment and premises, daily expenses, costs relating to maintenance and research) and certain large corporate customers of the headquarters of China Telecommunications Corporation, will be apportioned on a pro rata basis between the Company and China Telecommunications Corporation according to the revenues generated by each party. In relation to the use of the international telecommunications facilities, the Company and China Telecommunications Corporation have agreed to apportion the costs associated with operating such assets on a pro rata basis, according to the aggregate volume of the inbound international calls terminated by, and outbound international calls originated from, the Company and China Telecom Group, respectively.

The Company and China Telecommunications Corporation entered into a supplemental agreement in relation to the Centralised Services Agreement on 15 December, 2005, to amend the scope of the centralised services by including in the Centralised Services Agreement the management and operation services provided by the Company to China Telecommunications Corporation, and amended the Centralised Services Agreement to make it, in addition to being applicable to both parties, also applicable to the subsidiaries and branches of the parties as well as any entities controlled by them. Except for the abovementioned amendments, other material terms and conditions of the original Centralised Services Agreement remain unchanged.

### ***Interconnection Agreement***

Pursuant to the Interconnection Agreement, the telephone operator terminating a telephone call made to its local access network shall be entitled to receive from the operator from which the telephone call originated a fee prescribed by the MII from time to time, which is currently RMB0.06 per minute.

### ***Comprehensive Services Framework Agreement***

The Comprehensive Services Framework Agreement was renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. This Agreement governs the terms and conditions of transactions between them on two levels: (i) between the Group and certain associates held by China Telecommunications Corporation as long-term investments; and (ii) between the Group and certain subsidiaries of China Telecommunications Corporation operating in other provinces (the "Provincial Subsisting Companies"). Such transactions include procurement of telecommunications equipment such as optic fiber, network designs, software upgrade, system integration, manufacture of calling cards and so on. Prices under such agreement should be determined in accordance with the government-prescribed prices. In the absence of the government-prescribed prices, the government-guided prices (if any) shall apply. In the absence of both government-prescribed prices and government-guided prices, the market prices shall apply, i.e., the prices at which the same type of services are provided by independent third party in the ordinary course of business. If none of such prices is applicable, the prices shall be determined through consultation between the parties based on reasonable costs plus reasonable profit. For this purpose, "reasonable costs" shall mean the costs determined by the parties after negotiations.

**REPORT OF THE DIRECTORS** *(continued)*

In December 2005, the following agreements were renewed by each of Shanghai Telecom Company Limited, Guangdong Telecom Company Limited, Jiangsu Telecom Company Limited, Zhejiang Telecom Company Limited, Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited, Sichuan Telecom Company Limited, Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited, Xinjiang Telecom Company Limited under the Company (the "Twenty Provincial Telecom Companies") and the Provincial Subsisting Companies in their respective service region.

***Property Leasing Framework Agreements***

The Property Leasing Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Twenty Provincial Telecom Companies under the Company lease properties from the Provincial Subsisting Companies for use as business premises, offices, equipment storage facilities and sites for network equipment. On the other hand, the Twenty Provincial Telecom Companies also lease certain properties to the Provincial Subsisting Companies. The rent shall be determined based on the market price with reference to the standard set forth by local pricing authorities.

***Property Sub-Leasing Framework Agreements***

The Property Sub-Leasing Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies sub-lease certain properties owned and leased by independent third parties to the Twenty Provincial Telecom Companies under the Group for use as offices, retail outlets, spare parts storage facilities and sites for network equipment. The rent for sub-leasing of third party property shall be determined based on the market price as agreed between the relevant Provincial Subsisting Company and relevant third party through arm's length negotiation.

***IT Services Framework Agreements***

The IT Services Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies may participate in the bidding for the right to provide the Twenty Provincial Telecom Companies with certain information technology services, such as office automation and software upgrade. The charges payable for such IT services shall be determined by reference to market rates or as determined by prices obtained through the tender process.

***Equipment Procurement Services Framework Agreements***

The Equipment Procurement Services Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies have agreed to provide comprehensive procurement services, including management of tenders, verification of technical specifications and installation services. The maximum commission for such procurement services shall be calculated based on the following: (1) not more than 1% of the contract value for procurement of imported telecommunications equipment; or (2) not more than 3% of the contract value for the procurement of domestic telecommunications equipment and other domestic non-telecommunications materials.

### ***Engineering Framework Agreements***

The Engineering Framework Agreements will expire on 31 December 2006, and may be renewed for further periods of three years upon expiration. These agreements set out provisions in respect of the supervision and management of services relating to construction, design, and equipment installation and tests provided to the Twenty Provincial Telecom Companies by the Provincial Subsisting Companies through bidding, and/or services as the general contractors for the construction and supervision of engineering projects of the Twenty Provincial Telecom Companies. The charges payable for such engineering services shall be determined by reference to market rates as reflected by prices obtained through tender process.

### ***Community Services Framework Agreements***

The Community Services Framework Agreements will expire on 31 December 2006, and may be renewed for further periods of three years upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies will provide the Twenty Provincial Telecom Companies with services relating to culture, education, property management, vehicle service, medical care, hotel and conference service, community and sanitary service. The pricing terms for such services are the same as those for comprehensive services.

### ***Ancillary Telecommunications Services Framework Agreements***

The Ancillary Telecommunications Services Framework Agreements will expire on 31 December 2006, and may be renewed for further periods of three years upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies agree to provide the Twenty Provincial Telecom Companies with certain repair and maintenance services, including maintenance of telecommunications equipment, fire equipment and telephone booths, as well as other customer services. The pricing terms for such services are the same as those for comprehensive services.

The independent non-executive directors have confirmed that all continuing connected transactions for the year ended 31 December 2005 to which the Group was a party:

1. had been entered into, and the agreements governing those transactions were entered into, by the Group in the ordinary and usual course of business;
2. had been entered into either:
  - (i) on normal commercial terms; or
  - (ii) where there was no available comparison to judge whether they are on normal commercial terms, on terms no less favourable than those available to or (if applicable) from independent third parties; and
3. had been entered into on terms that are fair and reasonable so far as the overall interests of the independent shareholders of the Company are concerned.

The independent non-executive directors have further confirmed that:

The values of continuing connected transactions entered into between the Group and its connected persons which are subject to annual caps have not exceeded their respective annual caps.

**REPORT OF THE DIRECTORS** *(continued)*

The auditors of the Group have reviewed the continuing connected transactions of the Group and have confirmed to the Directors that the transactions:

1. have received the approval of the Directors;
2. have been entered into in accordance with the pricing policies as stated in the relevant agreements;
3. have been entered into in accordance with the terms of the agreements governing such transactions; and the values of continuing connected transactions entered into between the Group and connected persons of the Group which are subject to annual caps have not exceeded their respective annual cap.

**EMPLOYEES**

As at 31 December 2005, the group has 244,867 employees illustrated as follows:

	<b>Number of employees</b>	<b>Percentage</b>
Management, finance and administration	38,975	15.92%
Sales and marketing	113,329	46.28%
Operations and maintenance	91,443	37.34%
Others	1,120	0.46%
<b>Total</b>	<b>244,867</b>	<b>100%</b>

As at 31 December 2005, the Group also had 97,090 staffs seconded by third parties.

The Company has implemented a short-term and long-term combined incentive scheme: the primary components of an employee's remuneration include basic salary, bonus based on performance, compensation based on seniority and stock appreciation rights (stock appreciation rights are exclusively for senior management and senior technological experts). In addition, the Company also emphasizes the importance of employee training and uses various means of training to improve the quality and capability of key employees.

**COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES**

Please see the "Corporate Governance Report" set out in page 54 of this 2005 annual report of the Company for details of our compliance with the Code on Corporate Governance Practices.

## MATERIAL LEGAL PROCEEDINGS

As at 31 December 2005, as far as the Directors are aware of, the Company was not involved in any material litigation or arbitration and no material litigation claims were pending or threatened or made against the Company.

## AUDITORS

KPMG and KPMG Huazhen were appointed as the international and domestic auditors of the Company for the year ended 31 December 2005. KPMG has audited the accompanying financial statements, which have been prepared in accordance with International Financial Reporting Standards. The Company has retained KPMG and KPMG Huazhen since the date of its listing. A resolution for the reappointment of KPMG and KPMG Huazhen as the international and domestic auditors of the Company for the year ending 31 December 2006 will be proposed at the annual general meeting of the Company to be held on 23 May 2006.

By Order of the Board

**Wang Xiaochu**

*Chairman and Chief Executive Officer*

Beijing, PRC

22 March 2006