NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION

Principal activities

China Telecom Corporation Limited (the "Company") and its subsidiaries (hereinafter, collectively referred to as the "Group") are engaged in the provision of wireline telecommunications and related services in Shanghai Municipality, Guangdong Province, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality, Sichuan Province, Hubei Province, Hunan Province, Hainan Province, Guizhou Province, Yunnan Province, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region of the People's Republic of China (the "PRC"). The Group offers a comprehensive range of wireline telecommunications services to residential and business customers, including local, domestic long distance ("DLD") and international long distance ("ILD") telephone services, Internet and managed data, leased line, and other related services.

The operations of the Group are subject to the supervision and regulation by the PRC government. The Ministry of Information Industry, pursuant to the authority delegated to it by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations, including the regulation and setting of tariff levels for basic telecommunications services, such as local and long distance telephone services, managed data services, leased line and interconnection arrangements.

Organisation

China Telecommunications Corporation ("China Telecom" and together with its subsidiaries other than the Company referred to as "China Telecom Group") is a state-owned enterprise which is under the supervision and regulation of the Ministry of Information Industry. In November 2001, pursuant to an industry restructuring plan approved by the State Council, China Telecom's wireline telecommunications networks and related operations in 10 northern provinces, municipalities and autonomous regions of the PRC were transferred to China Netcom Group. China Telecom retained the wireline telecommunications networks and related operations of 21 provinces, municipalities and autonomous regions of the PRC, including those of the Company's subsidiaries. In accordance with this industry restructuring plan, China Telecom and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibers.

As part of an reorganisation (the "Restructing") of China Telecom, the Company was incorporated in the PRC on 10 September, 2002. In connection with the Restructuring, China Telecom transferred to the Company the wireline telecommunications business and related operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province together with the related assets and liabilities (the "Predecessor Operations") in consideration for 68,317 million ordinary domestic shares of the Company. The shares issued to China Telecom have a par value of RMB1.00 each and represented the entire registered and issued share capital of the Company of that date.

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 15 December 2003, the Company acquired the entire equity interests in Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited (collectively the "First Acquired Group") and certain network management and research and development facilities from China Telecom for a total purchase price of RMB46,000 million on 31 December 2003 (hereinafter, referred to as the "First Acquisition"). The purchase price consisted of a cash payment of RMB11,000 million and a long-term payable of RMB35,000 million (see Note 14).

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION *(continued)*

Organisation *(continued)*

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 9 June 2004, the Company acquired the entire equity interests in 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 and Xinjiang Telecom Company Limited (collectively the "Second Acquired Group") from China Telecom for a total purchase price of RMB27,800 million on 30 June 2004 (hereinafter, referred to as the "Second Acquisition"). The purchase price consisted of a cash payment of RMB8,340 million and a long-term payable of RMB19,460 million. On 30 June 2004, the Company repaid RMB4,310 million of this payable amount using the net proceeds from issue of new H shares in May 2004 (see Note 14).

Basis of presentation

Since the Company, the First Acquired Group and the Second Acquired Group (the "Acquired Groups") were under the common control of China Telecom, the First Acquisition and the Second Acquisition (the "Acquisitions") have been reflected in the accompanying consolidated financial statements as a combination of entities under common control in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the Acquired Groups have been accounted for at historical amounts and the consolidated financial statements of the Company prior to the Acquisitions have been restated to include the results of operations and assets and liabilities of the Acquired Groups on a combined basis. The considerations paid by the Company for the acquisition of the Acquired Groups have been accounted for as equity transactions in the consolidated statement of changes in equity.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board ("IASB"). IFRS includes International Accounting Standards ("IAS") and 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.

These financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment (Note 4). The accounting policies described below have been consistently applied by the Group, except those disclosed in Note 3.

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

for the year ended 31 December 2005

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

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.

Judgement made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in future financial periods are described in Note 37.

(b) Basis of consolidation

The consolidated financial statements comprise the Company and its subsidiaries and the Group's interests in associates. A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The financial results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases, and the profit attributable to minority interests is separately presented on the face of the consolidated income statement as an allocation of the profit or loss for the year between the minority interests and the equity holders of the Company. Minority interests at the balance sheet date, being 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, are presented in the consolidated balance sheet and consolidated statement of changes in equity within equity, separately from equity attributable to the equity holders of the Company.

An associate is an entity, not being a subsidiary, in which the Group exercises significant influence, but not control, over its management. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

An investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the Group's equity share of the post-acquisition results of the associate.

All significant intercompany balances and transactions and any unrealised gains arising from intercompany transactions are eliminated on consolidation. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(c) Translation of foreign currencies

The functional and presentation currency of the Group is Renminbi ("RMB"). Foreign currency transactions during the year are translated into RMB at the applicable rates of exchange quoted by the People's Bank of China ("PBOC rates") prevailing on the transaction dates. Foreign currency monetary assets and liabilities are translated into RMB at the applicable PBOC rates at the balance sheet date.

Exchange differences, other than those capitalised as construction in progress, are recognised as income or expense in the consolidated income statement. For the periods presented, no exchange differences were capitalised.

(d) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and time deposits with original maturities of three months or less when purchased. Cash equivalents are stated at cost, which approximates fair value. None of the Group's cash and cash equivalents is restricted as to withdrawal.

(e) 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 (Note 2(l)).

(f) Inventories

Inventories consist of materials and supplies used in maintaining the wireline telecommunications network and goods for resale. Materials and supplies are valued at cost using the first in, first out method, less a provision for obsolescence.

Inventories that are held for resale are stated at the lower of cost and net realisable value. 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.

(g) Property, plant and equipment

Property, plant and equipment are initially recorded at cost, less subsequent accumulated depreciation and impairment losses (Note 2(l)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to working condition and location for its intended use and the cost of borrowed funds used during the periods of construction. Expenditure incurred after the asset has been put into operation, including cost of replacing part of such an item, is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment and the cost can be measured reliably. All other expenditure, including the cost of repairs and maintenance, is expensed as it is incurred.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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

Subsequent to the revaluation as described in (Note 4), property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation, less subsequent accumulated depreciation and impairment losses. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. The separate classes into which the Company groups assets for the revaluation are buildings and improvements; telecommunications network plant and transmission and switching equipment; and furniture, fixture, motor vehicles and other equipment. When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is revalued simultaneously. When an asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to equity under the component of revaluation reserve. However, a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense in the consolidated income statement. However, a revaluation decrease is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Revaluations are performed annually on items which experience significant and volatile movements in fair value while items which experience insignificant movements in fair value are revalued every three years.

Assets acquired under leasing agreements which effectively transfer substantially all the risks and benefits incidental to ownership from the lessor to the lessee are classified as assets under finance leases. Assets held under finance leases are initially recorded at amounts equivalent to the present value of the minimum lease payments (computed using the rate of interest implicit in the lease) which approximate the fair value at the inception of the lease. The net present value of the future minimum lease payments is recorded correspondingly as a finance lease obligation. Assets held under finance leases are amortised over their estimated useful lives on a straight-line basis. As at 31 December 2005, the carrying amount of assets held under finance leases was RMB272 million (2004: RMB314 million).

Gains or losses arising from retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the consolidated income statement on the date of disposal. On disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings.

Depreciation is provided to write off the cost/revalued amount of each asset over its estimated useful life on a straight-line basis, after taking into account its estimated residual value, as follows:

	Depreciable lives primarily range from
Buildings and improvements	8 to 30 years
Telecommunications network plant, transmission and switching equipment	6 to 10 years
Furniture, fixture, motor vehicles and other equipment	4 to 10 years

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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

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.

(h) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's land bureau. Land use rights are carried at cost less accumulated amortisation and impairment losses (Note 2(l)). Amortisation is provided to write off the cost of lease prepayments on a straight-line basis over the respective periods of the rights which range from 20 years to 70 years.

(i) Construction in progress

Construction in progress represents buildings, telecommunications network plant, transmission and switching equipment and other equipment under construction and pending installation, and is stated at cost less impairment losses (Note 2(l)). The cost of an item comprises direct costs of construction, 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 periods of construction. Capitalisation of these costs ceases and the 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) Investments in subsidiaries

In the Company's stand-alone balance sheet, investments in subsidiaries are stated at cost less impairment losses (Note 2(l)).

(k) Other investments

Investments in non-marketable equity securities are stated at cost less impairment losses (Note 2(l)).

(l) Impairment

(i) Impairment of investments in non-marketable equity securities and impairment losses for trade and other receivables

Investments in non-marketable equity securities and trade and other receivables are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If such evidence exists, 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 financial asset where the effect of discounting is material, and is recognised as an expense in the consolidated income statement. Impairment losses for trade and other receivables are reversed through profit and loss if in a subsequent period the amount of the impairment losses decreases. Impairment losses for equity securities are not reversed.

For the years ended 31 December 2004 and 2005, no impairment loss was made for investments in non-marketable securities. For the year ended 31 December 2005, impairment losses for trade and other receivables of RMB1,274 million (2004: RMB1,121 million) were recognised.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(l) Impairment *(continued)*

(ii) Impairment of other assets

The carrying amounts of the Group's long-lived assets, including property, plant and equipment and lease prepayments 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. The amount of the reduction is recognised as an expense in the consolidated income statement. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the assets are discounted to their present value. For the year ended 31 December 2005, a provision for impairment loss of RMB163 million (2004: RMB88 million) was made against the carrying value of certain outdated telecommunications service equipment.

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognised for an asset 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 an income in the consolidated income statement. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred. For the years presented, no reversal of impairment loss was recognised in the consolidated income statement.

(m) Revenue recognition

The Group's revenues are principally derived from the provision of local, domestic long distance ("DLD") and international long distance ("ILD") telephone services which consist of (i) usage charges for telephone services, which vary depending on the day, the time of day, distance and duration of the telephone call, (ii) a monthly telephone service fee, (iii) service activation and installation fees, and (iv) charges for value-added services, such as caller ID services, short messaging services, telephone information services and ring tone services. The Group records wireline service revenues over the periods they are earned as follows:

(i) Revenues derived from local, DLD and ILD telephone usage are recognised as the services are provided.

(ii) Upfront fees received for activation of wireline services and wireline installation charges are deferred and recognised over the expected customer relationship period. The related direct incremental customer acquisition costs are deferred to the extent of the upfront fees and are amortised over the same expected customer relationship period.

(iii) Monthly telephone service fees are recognised in the month during which the telephone services are provided to customers.

(iv) Revenues from sale of prepaid calling cards are recognised as the cards are used by customers.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(m) Revenue recognition *(continued)*

(v) Revenues derived from value-added services are recognised when the services are provided to customers.

Other related wireline telecommunications service revenues are recognised as follows:

(i) Revenues from the provision of Internet and managed data services are recognised when the services are provided to customers.

(ii) Interconnection fees from domestic and foreign telecommunications operators are recognised when the services are rendered as measured by the minutes of traffic processed.

(iii) Lease income from operating leases is recognised over the term of the lease.

(iv) Sale of customer-end equipment is recognised on delivery of the equipment to customers and when the significant risks and rewards of ownership and title have been transferred to the customers.

(n) Advertising and promotion expense

The costs for advertising and promoting the Group's wireline telecommunications services are expensed as incurred. Advertising and promotion expense, which is included in selling, general and administrative expenses, was RMB9,417 million for the year ended 31 December 2005 (2004: RMB8,701 million).

(o) Net finance costs

Net finance costs comprise interest income on bank deposits, interest expense on borrowings, and foreign exchange gains and losses. Interest income from bank deposits is recognised as it accrues using the effective interest method.

Interest costs incurred in connection with borrowings, calculated using the effective interest method, are expensed as incurred, except to the extent that they are capitalised as being directly attributable to the construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

(p) Research and development expense

Research and development expenditure is expensed as incurred. For the year ended 31 December 2005, research and development expense was RMB261 million (2004: RMB172 million).

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(q) Employee benefits

The Group's contributions to defined contribution retirement plans administered by the PRC government are recognised as an expense in the consolidated income statement as incurred. Further information is set out in Note 34.

Compensation under the Group's stock appreciation rights scheme is measured as the amount by which the quoted market price of the Company's H shares exceeds the exercise price. Compensation expense in respect of the stock appreciation rights granted is accrued as a charge to the income statement over the applicable vesting period based on the fair value of the stock appreciation rights. The liability of the accrued compensation expense is re-measured to fair value at each balance sheet date with the effect of changes in the fair value of the liability is charged or credited to the income statement. Further details of the Group's stock appreciation rights scheme are set out in Note 35.

(r) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in income statement over the period of the borrowings using the effective interest method.

(s) 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.

(t) Provisions and contingent liabilities

A provision is recognised in the consolidated balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

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.

(u) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is calculated on the taxable income for the year by applying the applicable tax rates. Deferred tax is provided using the balance sheet liability method, providing for all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax is calculated on the basis of the enacted tax rates that are expected to apply in the period when the asset is realised or the liability is settled. The effect on deferred tax of any changes in tax rates is charged or credited to the consolidated income statement, except for the effect of a change in tax rate on the carrying amount of deferred tax assets and liabilities which were previously charged or credited directly to equity upon initial recognition, in such case the effect of a change in tax rate is also charged or credited to equity. A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the asset 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.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(v) Dividends

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

(w) Segmental reporting

A business 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. For the periods presented, the Group has one operating segment which is the provision of wireline telecommunications services. All of the Group's operating activities are carried out in the PRC.

3. CHANGES IN ACCOUNTING POLICIES, FINANCIAL STATEMENT PRESENTATION AND DISCLOSURES

The IASB has issued a number of new and revised IFRS and Interpretations that are effective for accounting periods beginning on or after 1 January 2005. The Group has adopted these new and revised IFRS in the preparation of the Group's financial statements for the year ended 31 December 2005. The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (Note 38).

The accounting policies of the Group after the adoption of these new and revised IFRS have been summarised in Note 2. The following sets out further information on the changes in accounting policies, financial statement presentation and disclosures for the annual accounting period beginning on 1 January 2005 which have been reflected in these financial statements.

(i) Minority interests (IAS 1 "Presentation of financial statements" and IAS 27 "Consolidated and separate financial statements")

In prior years, minority interests at the balance sheet date were presented in the Group's consolidated balance sheet separately from liabilities and equity. Minority interests in the results of the Group for the year were also separately presented in the Group's consolidated income statement as deduction before arriving at the profit attributable to shareholders.

With effect from 1 January 2005, in order to comply with IAS 1 and IAS 27, minority interests at the balance sheet date are presented in the Group's consolidated balance sheet within equity, separately from the equity attributable to the equity holders of the Company, and minority interests in the results of the Group for the period are presented on the face of the Group's consolidated income statement as an allocation of the total profit or loss for the period between the minority interests and the equity holders of the Company.

The presentation of minority interests in the Group's consolidated balance sheet, the Group's consolidated income statement and the Group's consolidated statement of changes in equity for the comparative period has been restated accordingly.

for the year ended 31 December 2005

3. CHANGES IN ACCOUNTING POLICIES, FINANCIAL STATEMENT PRESENTATION AND DISCLOSURES *(continued)*

(ii) Related party disclosures (IAS 24 "Related party disclosures")

The Group is a state-owned enterprise and operates in an economic regime currently predominated by state-owned enterprises. Apart from transactions with parent company and its affiliates, the Group conducts certain business activities with enterprises directly or indirectly owned or controlled by the PRC government and government authorities and affiliates (collectively "state-owned entities") in the ordinary course of business. In prior years, transactions with state-owned entities other than China Telecom and its affiliates were not required to be disclosed as related party transactions.

With effect from 1 January 2005, in order to comply with IAS 24, the Group has made further disclosure of key management personnel compensation, contributions to post-retirement benefit plans and transactions with state-owned entities in the PRC. Numeric disclosure of certain related party transactions described in Note 33 for the comparative period has been made accordingly.

(iii) Accounting for investments in subsidiaries (IAS 27 "Consolidated and separate financial statements")

In prior years, investments in subsidiaries are accounted for using the equity method in the Company's stand-alone balance sheet.

With effect from 1 January 2005, in order to comply with IAS 27, investments in subsidiaries are accounted for using the cost method. Investments in subsidiaries and reserve balances in the Company's stand-alone balance sheet for the comparative period have been restated accordingly.

The following table discloses the adjustments that have been made in accordance with IAS 27 to each of the line items in the Company's balance sheet as previously reported as at 31 December 2004. The effect of such change on reserve balances as at 1 January 2004 and 2005 are disclosed in Note 20.

	2004 (as previously reported) RMB millions	**Effect on new policy (decrease in net assets)** RMB millions	**2004 (as restated)** RMB millions
Investments in subsidiaries	205,027	(36,313)	168,714
Reserves	78,274	(36,313)	41,961

Management considers that it is impractical to provide an estimate of the extent to which investments in subsidiaries and reserve balances in the Company's balance sheet as at 31 December 2005 is higher or lower than it would have been had the previous accounting policy still been applied in the year because management has sole discretion to determine the dividends to be declared from subsidiaries to the Company which would affect the carrying value of investments in subsidiaries under the equity method.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

4. PROPERTY, PLANT AND EQUIPMENT, NET

The Group:

	Buildings and improvements RMB millions	**Telecommunications network plant and equipment** RMB millions	**Furniture, fixture, motor vehicles and other equipment** RMB millions	**Total** RMB millions
Cost/valuation:				
Balance at 1 January 2004	60,939	421,014	19,264	501,217
Additions	178	1,469	696	2,343
Transferred from construction in progress	4,380	49,775	1,976	56,131
Disposals	(119)	(14,195)	(1,259)	(15,573)
Reclassification	22	17	(39)	–
Revaluations	944	(8,776)	–	(7,832)
Balance at 31 December 2004	66,344	449,304	20,638	536,286
Additions	63	1,352	523	1,938
Transferred from construction in progress	4,684	50,580	2,545	57,809
Disposals	(262)	(15,984)	(1,660)	(17,906)
Balance at 31 December 2005	**70,829**	**485,252**	**22,046**	**578,127**
Accumulated depreciation:				
Balance at 1 January 2004	(8,331)	(174,961)	(8,029)	(191,321)
Depreciation charge for the year	(2,646)	(41,246)	(2,930)	(46,822)
Provision for impairment	–	(88)	–	(88)
Written back on disposals	37	13,214	1,070	14,321
Reclassification	(11)	(5)	16	–
Revaluations	(67)	7,870	–	7,803
Balance at 31 December 2004	(11,018)	(195,216)	(9,873)	(216,107)
Depreciation charge for the year	(2,943)	(43,630)	(2,616)	(49,189)
Provision for impairment	–	(163)	–	(163)
Written back on disposals	119	13,971	1,523	15,613
Balance at 31 December 2005	**(13,842)**	**(225,038)**	**(10,966)**	**(249,846)**
Net book value at 31 December 2005	**56,987**	**260,214**	**11,080**	**328,281**
Net book value at 31 December 2004	55,326	254,088	10,765	320,179

for the year ended 31 December 2005

4. PROPERTY, PLANT AND EQUIPMENT, NET *(continued)*

The Company:

	Telecomm-unications network plant and equipment RMB millions	**Furniture, fixture, motor vehicles and other equipment** RMB millions	**Total** RMB millions
Cost:			
Balance at 1 January 2004	360	16	376
Additions	–	5	5
Transferred from construction in progress	19	5	24
Reclassification	(73)	73	–
Balance at 31 December 2004	306	99	405
Additions	2	2	4
Transferred from construction in progress	18	38	56
Disposals	–	(2)	(2)
Balance at 31 December 2005	**326**	**137**	**463**
Accumulated depreciation:			
Balance at 1 January 2004	(1)	–	(1)
Depreciation charge for the year	(47)	(6)	(53)
Reclassification	42	(42)	–
Balance at 31 December 2004	(6)	(48)	(54)
Depreciation charge for the year	(40)	(21)	(61)
Balance at 31 December 2005	**(46)**	**(69)**	**(115)**
Net book value at 31 December 2005	**280**	**68**	**348**
Net book value at 31 December 2004	300	51	351

In accordance with the Group's accounting policy (Note 2(g)), the property, plant and equipment of the Group as at 31 December 2004 were revalued for each asset class by the directors of the Company on a depreciated replacement cost basis. The value of the property, plant and equipment as at 31 December 2004 was determined at RMB320,179 million. The surplus on revaluation of certain property, plant and equipment totalling RMB1,233 million was credited to the revaluation reserve while the deficit arising from the revaluation of certain property, plant and equipment totalling RMB1,262 million was recognised as an expense for the year ended 31 December 2004.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

4. PROPERTY, PLANT AND EQUIPMENT, NET *(continued)*

The following is a summary of the carrying value of the Group's property, plant and equipment prior to the revaluation and the revalued amounts of these assets as at 31 December 2004:

	Carrying value prior to revaluation RMB millions	**Revaluation surplus** RMB millions	**Revaluation deficit** RMB millions	**Revalued amounts** RMB millions
Buildings and improvements	54,449	877	–	55,326
Telecommunications network plant and equipment	254,994	356	(1,262)	254,088
Furniture, fixture, motor vehicles and other equipment	10,765	–	–	10,765
	320,208	1,233	(1,262)	320,179

For the year ended 31 December 2005, no revaluation was performed as the Group did not have any items of property, plant and equipment which experienced significant and volatile movements in fair value.

5. CONSTRUCTION IN PROGRESS

	The Group RMB millions	**The Company** RMB millions
Balance at 1 January 2004	31,617	77
Additions	53,964	20
Transferred to property, plant and equipment	(56,131)	(24)
Balance at 31 December 2004	29,450	73
Additions	51,926	139
Transferred to property, plant and equipment	(57,809)	(56)
Balance at 31 December 2005	**23,567**	**156**

6. INVESTMENTS IN SUBSIDIARIES

	The Company	
	2005 **RMB millions**	2004 RMB millions
Unquoted investments, at cost	**165,926**	168,714

6. INVESTMENTS IN SUBSIDIARIES *(continued)*

Details of the Company's subsidiaries at 31 December 2005, which principally affected the results of operations and the financial position of the Group, are as follows:

Name of Company	Type of legal entity	Date of incorporation	Registered capital (RMB millions)
Shanghai Telecom Company Limited	Limited Company	11 October 2002	15,984
Guangdong Telecom Company Limited	Limited Company	10 October 2002	47,513
Jiangsu Telecom Company Limited	Limited Company	19 October 2002	19,208
Zhejiang Telecom Company Limited	Limited Company	10 October 2002	22,400
Anhui Telecom Company Limited	Limited Company	26 August 2003	3,871
Fujian Telecom Company Limited	Limited Company	28 August 2003	10,364
Jiangxi Telecom Company Limited	Limited Company	18 September 2003	1,153
Guangxi Telecom Company Limited	Limited Company	28 August 2003	4,992
Chongqing Telecom Company Limited	Limited Company	22 August 2003	4,276
Sichuan Telecom Company Limited	Limited Company	28 August 2003	8,123
Hubei Telecom Company Limited	Limited Company	9 March 2004	5,412
Hunan Telecom Company Limited	Limited Company	12 March 2004	661
Hainan Telecom Company Limited	Limited Company	9 March 2004	580
Guizhou Telecom Company Limited	Limited Company	12 March 2004	2,401
Yunnan Telecom Company Limited	Limited Company	9 March 2004	3,747
Shaanxi Telecom Company Limited	Limited Company	8 March 2004	2,482
Gansu Telecom Company Limited	Limited Company	10 March 2004	3,413
Qinghai Telecom Company Limited	Limited Company	10 March 2004	965
Ningxia Telecom Company Limited	Limited Company	10 March 2004	795
Xinjiang Telecom Company Limited	Limited Company	11 March 2004	4,660

All of the above subsidiaries are incorporated in the PRC, are wholly-owned by the Company and are engaged in provision of telecommunications services.

7. INTERESTS IN ASSOCIATES

	The Group	
	2005 RMB millions	2004 RMB millions
Share of net assets	**548**	511

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

7. INTERESTS IN ASSOCIATES *(continued)*

The Group's interests in associates are accounted for under the equity method and are individually and in aggregate not material to the Group's financial conditions or results of operations for all periods presented. Details of the Group's principal associates are as follows:

Name of company	Attributable equity interest	Principal activities
Shenzhen Shekou Telecommunications Company Limited	50%	Provision of telecommunications services
Shanghai Information Investment Incorporation	24%	Provision of information technology consultancy services

The above associates are established in the PRC and are not traded on any stock exchange.

8. OTHER INVESTMENTS

	The Group	
	2005 RMB millions	2004 RMB millions
Unlisted equity investments	**182**	200

Unlisted equity investments mainly represent the Group's various interests in PRC private enterprises which are mainly engaged in the provision of information technology services and Internet contents. These investments are accounted for at cost, less provision for impairment loss. The Group has no investment in marketable securities.

9. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and deferred tax liabilities are attributable to the items set out below:

The Group:

	Assets		Liabilities		Net balance	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Current						
Impairment losses, primarily for receivables	**294**	286	**–**	–	**294**	286
Non-Current						
Property, plant and equipment	**610**	516	**(1,508)**	(1,295)	**(898)**	(779)
Deferred revenues and installation costs	**2,114**	1,942	**(1,112)**	(1,007)	**1,002**	935
Land use rights	**7,867**	8,061	**–**	–	**7,867**	8,061
Deferred tax assets/(liabilities)	**10,885**	10,805	**(2,620)**	(2,302)	**8,265**	8,503

for the year ended 31 December 2005

9. DEFERRED TAX ASSETS AND LIABILITIES *(continued)*

A valuation allowance on deferred tax assets is recorded if it is probable that some portion or all of the deferred tax assets will not be realised through recovery of taxes previously paid and/or future taxable income. The allowance is subject to ongoing adjustments based on changes in circumstances that affect the Group's assessment of the realisability of the deferred tax assets. The Group has reviewed its deferred tax assets as at 31 December 2004 and 2005. Based on the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes that it is probable the Group will realise the benefits of these temporary differences. Therefore, no valuation allowances were provided for the years ended 31 December 2004 and 2005 in respect of deferred tax assets arising from temporary differences.

Movements in temporary differences are as follows:

	Note	Balance at 1 January 2004 RMB millions	Recognised in income statement RMB millions	Recognised in equity RMB millions	Balance at 31 December 2004 RMB millions
Current					
Impairment losses, primarily of receivables		198	88	–	286
Non-current					
Property, plant and equipment	(i)	(512)	111	(378)	(779)
Deferred revenues and installation costs		1,042	(107)	–	935
Land use rights	(ii)	8,470	(165)	(244)	8,061
Net deferred tax assets		9,198	(73)	(622)	8,503
			(Note 25)		

	Note	**Balance at 1 January 2005 RMB millions**	**Recognised in income statement RMB millions**	**Recognised in equity RMB millions**	**Balance at 31 December 2005 RMB millions**
Current					
Impairment losses, primarily of receivables		**286**	**8**	**–**	**294**
Non-current					
Property, plant and equipment		**(779)**	**(119)**	**–**	**(898)**
Deferred revenues and installation costs		**935**	**67**	**–**	**1,002**
Land use rights	(iii)	**8,061**	**(189)**	**(5)**	**7,867**
Net deferred tax assets		**8,503**	**(233)**	**(5)**	**8,265**
			(Note 25)		

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

9. DEFERRED TAX ASSETS AND LIABILITIES *(continued)*

Note:

(i) As described in Note 4, in accordance with the Group's accounting policy, the property, plant and equipment of the Group were revalued as at 31 December 2004. The tax base of these assets was not adjusted to conform to such revalued amounts and accordingly, a deferred tax asset and a deferred tax liability in the respective amount of RMB356 million and RMB378 million in respect of the revaluation deficit and surplus were recognised. The deferred tax asset was credited to the income statement while the deferred tax liability was charged to equity as the related revaluation deficit was charged to income statement and the revaluation surplus was credited to equity.

(ii) In 2004, certain subsidiaries of the Group with operations in the western region of the PRC obtained approval from tax authority to reduce the income tax rate from 33% to 15% for the period from 1 January 2004 to 31 December 2010. In addition, certain subsidiaries of the Group obtained approval from tax authority to reduce income tax rate from 33% to 15% with effect from 1 January 2004. Since the deferred tax asset was previously credited to equity upon initial recognition, the effect of the change in tax on carrying amount of the deferred tax asset expected to be realised during the relevant period amounting to RMB244 million was charged to equity.

(iii) In 2005, a subsidiary of the Group obtained approval from tax authority for income tax exemption for the period from 1 January 2005 to 31 December 2009 and a 50% reduction in tax rate for the period from 1 January 2010 to 31 December 2014. Since the deferred tax asset was previously credited to equity upon initial recognition, the effect of the change in tax rate on the carrying amount of the deferred tax asset expected to be realised by that subsidiary during the relevant period amounting to RMB5 million was charged to equity. The effect of income tax exemption is not material to the consolidated financial statements.

10. INVENTORIES

Inventories represent:

	The Group	
	2005	2004
	RMB millions	RMB millions
Materials and supplies	**1,854**	1,907
Goods for resale	**848**	860
	2,702	2,767

11. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, are analysed as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB millions	RMB millions	**RMB millions**	RMB millions
Accounts receivable				
Third parties	**17,422**	15,368	**–**	–
Amount due from subsidiaries	**–**	–	**18**	5
China Telecom Group	**224**	235	**–**	–
	17,646	15,603	**18**	5
Less: Impairment losses for bad and doubtful debts	**(1,504)**	(1,682)	**–**	–
	16,142	13,921	**18**	5

11. ACCOUNTS RECEIVABLE, NET *(continued)*

Amounts due from the provision of wireline telecommunications services to residential and business customers are due within 30 days from the date of billing. Customers who have accounts overdue by more than 90 days will have their services disconnected.

The following table summarises the changes in impairment losses for bad and doubtful debts:

	The Group	
	2005 RMB millions	2004 RMB millions
At beginning of year	**1,682**	1,818
Impairment losses for bad and doubtful debts	**1,274**	1,121
Accounts receivable written off	**(1,452)**	(1,257)
At end of year	**1,504**	1,682

Ageing analysis of accounts receivable from telephone and Internet subscribers is as follows:

	The Group	
	2005 RMB millions	2004 RMB millions
Current, within 1 month	**12,104**	10,258
1 to 3 months	**1,563**	1,270
4 to 12 months	**1,037**	1,083
More than 12 months	**340**	526
	15,044	13,137
Less: Impairment losses for bad and doubtful debts	**(1,377)**	(1,609)
	13,667	11,528

The Company did not have accounts receivable balance from telephone and Internet subscribers.

Ageing analysis of accounts receivable from other telecommunications operators and customers is as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Current, within 1 month	**1,244**	1,358	**–**	5
1 to 3 months	**686**	550	**10**	–
4 to 12 months	**371**	275	**8**	–
More than 12 months	**301**	283	**–**	–
	2,602	2,466	**18**	5
Less: Impairment losses for bad and doubtful debts	**(127)**	(73)	**–**	–
	2,475	2,393	**18**	5

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

12. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets represent:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Amounts due from China Telecom Group	**606**	640	**4**	4
Amounts due from subsidiaries	**–**	–	**51,725**	2,502
Prepayments in connection with construction work and equipment purchases	**679**	854	**–**	–
Prepaid expenses and deposits	**389**	607	**–**	–
Other receivables	**732**	963	**9**	13
	2,406	3,064	**51,738**	2,519

13. CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Cash at bank and in hand	**11,583**	10,512	**727**	882
Time deposits with maturity within three months	**3,538**	2,953	**3,412**	2,800
	15,121	13,465	**4,139**	3,682

14. SHORT-TERM AND LONG-TERM DEBT

Short-term debt comprises:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Bank loans – unsecured	**45,704**	55,887	**–**	–
Commercial paper	**9,917**	–	**9,917**	–
Loans from China Telecom Group	**20,384**	10,089	**–**	–
Total short-term debt	**76,005**	65,976	**9,917**	–

Weighted average interest rate of the Group's total short-term debt as at 31 December 2005 was 4.2% (2004: 4.4%). The unsecured bank loans bear interest at rates ranging from 4.7% to 6.0% per annum and are repayable within one year. The commercial paper bears interest at a fixed rate of 2.54% per annum, is unsecured and is repayable within six months. The loans from China Telecom Group bear interest at fixed rates ranging from 2.3% to 5.0% per annum, are unsecured and are repayable within one year.

14. SHORT-TERM AND LONG-TERM DEBT *(continued)*

Long-term debt comprises:

	Interest rates and final maturity	The Group 2005 RMB millions	The Group 2004 RMB millions	The Company 2005 RMB millions	The Company 2004 RMB millions
Bank loans					
Renminbi denominated	Interest rates ranging from 2.9% to 6.4% per annum with maturities through 2020	**19,112**	26,859	**–**	–
US Dollars denominated	Interest rates ranging from 0.5% to 8.3% per annum with maturities through 2038	**2,087**	2,883	**–**	–
Japanese Yen denominated	Interest rates ranging from 0.6% to 3.5% per annum with maturities through 2040	**2,449**	3,182	**–**	–
Euro denominated	Interest rates ranging from 0.5% to 7.4% per annum with maturities through 2032	**843**	1,053	**–**	–
Other currencies		**93**	70	**–**	–
		24,584	34,047	**–**	–
Other loans					
Renminbi denominated		**6**	11	**–**	–
Amount due to China Telecom					
In connection with the First Acquisition – Renminbi denominated (Note (i))		**25,000**	35,000	**25,000**	35,000
In connection with the Second Acquisition – Renminbi denominated (Note (ii))		**15,150**	15,150	**15,150**	15,150
Total long-term debt		**64,740**	84,208	**40,150**	50,150
Less: current portion		**(8,963)**	(11,842)	**–**	–
Non-current portion		**55,777**	72,366	**40,150**	50,150

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

14. SHORT-TERM AND LONG-TERM DEBT *(continued)*

Note:

(i) Represents the deferred consideration payable to China Telecom in respect of the First Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the First Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 31 December 2013 and the Company may, from time to time, repay all or part of the amount at any time until 31 December 2013 without penalty. In October 2005, the Company repaid RMB10,000 million to China Telecom.

(ii) Represents the remaining balance of the deferred consideration payable to China Telecom in respect of the Second Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the Second Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 30 June 2014 and the Company may, from time to time, repay all or part of the amount at any time until 30 June 2014 without penalty.

As at 31 December 2004 and 2005, no bank loans were secured.

The aggregate maturities of the Group's and the Company's long-term debts subsequent to 31 December 2005 are as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Within 1 year	**8,963**	11,842	**–**	–
Between 1 to 2 years	**8,773**	10,022	**–**	–
Between 2 to 3 years	**3,824**	8,343	**–**	–
Between 3 to 4 years	**382**	552	**–**	–
Between 4 to 5 years	**252**	268	**–**	–
Thereafter	**42,546**	53,181	**40,150**	50,150
	64,740	84,208	**40,150**	50,150

The Group's short-term and long-term debts do not contain any financial covenants. As at 31 December 2005, the Group had available credit facilities of RMB31,266 million (2004: RMB27,855 million) which it can draw upon.

15. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Third parties	**27,063**	26,591	**74**	17
China Telecom Group	**6,886**	7,067	**–**	–
	33,949	33,658	**74**	17

for the year ended 31 December 2005

15. ACCOUNTS PAYABLE *(continued)*

Ageing analysis of accounts payable is as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Due within 1 month or on demand	**5,379**	5,599	**–**	6
Due after 1 month but within 3 months	**8,797**	6,451	**46**	4
Due after 3 months but within 6 months	**9,283**	7,856	**4**	–
Due after 6 months	**10,490**	13,752	**24**	7
	33,949	33,658	**74**	17

16. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables represent:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Amounts due to China Telecom Group	**4,534**	4,889	**104**	230
Accrued expenses	**12,330**	15,923	**571**	2,094
Customer deposits and receipts in advance	**10,021**	6,719	**44**	–
	26,885	27,531	**719**	2,324

17. FINANCE LEASE OBLIGATIONS

Obligations under finance leases are analysed as follows:

	The Group	
	2005 RMB millions	2004 RMB millions
Within 1 year	**114**	163
Between 1 to 2 years	**55**	110
Between 2 to 3 years	**–**	51
Total minimum lease payments	**169**	324
Less: finance charges related to future periods	**(9)**	(11)
Present value of minimum lease payments	**160**	313
Less: current portion	**(108)**	(156)
Non-current portion	**52**	157

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

18. DEFERRED REVENUES

Deferred revenues represent the unearned portion of upfront connection fees and installation fees received from customers and the unused portion of calling cards. Connection fees and installation fees are amortised over the expected customer relationship period of 10 years. Beginning 1 July 2001, connection fees were no longer collected from new customers.

	The Group	
	2005	2004
	RMB millions	RMB millions
Balance at beginning of year	**36,771**	46,601
Additions for the year		
– installation fees	**1,431**	2,135
– calling cards	**3,895**	4,392
	5,326	6,527
Reduction for the year		
– amortisation of connection fees	**(6,781)**	(8,458)
– amortisation of installation fees	**(2,970)**	(2,865)
– usage of calling cards	**(4,638)**	(5,034)
Balance at end of year	**27,708**	36,771
Representing:		
– Current portion	**8,958**	11,589
– Non-current portion	**18,750**	25,182
	27,708	36,771

Included in other non-current assets are capitalised direct incremental costs associated with the installation of wireline services. As at 31 December 2005, the unamortised portion of these costs was RMB10,025 million (2004: RMB11,428 million).

19. SHARE CAPITAL

	The Group and the Company	
	2005	2004
	RMB millions	RMB millions
Registered, issued and fully paid		
67,054,958,321 ordinary domestic shares of RMB1.00 each	**67,055**	67,055
13,877,410,000 overseas listed H shares of RMB1.00 each	**13,877**	13,877
	80,932	80,932

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19. SHARE CAPITAL *(continued)*

In May 2004, the Company issued and allotted 5,318,181,818 new H shares with a par value of RMB1.00 each, representing 4,466,693,018 H shares and 8,514,888 American Depositary Shares ("ADS", each representing 100 H shares), at prices of HK$2.30 per H share and US$29.49 per ADS, respectively, by way of a global offering to Hong Kong and overseas investors. As part of the global offering, 531,818,182 existing domestic shares of RMB1.00 each owned by China Telecom and the other domestic shareholders were converted into H shares and sold to Hong Kong and overseas investors. The Company raised net proceeds of RMB12,702 million from issue of new H shares.

All ordinary domestic shares and H shares rank pari passu in all material respects.

20. RESERVES

The Group	Capital reserve RMB millions	Share premium RMB millions	Re-valuation reserve RMB millions	Surplus reserves RMB millions	Statutory common welfare fund RMB millions	Other reserves RMB millions	Retained earnings RMB millions	Total RMB millions
Balance as at 1 January 2004	6,567	3,362	6,424	15,461	3,372	24,246	15,748	75,180
Revaluation surplus (Note 4)	–	–	1,233	–	–	–	–	1,233
Deferred tax on revaluation surplus of property, plant and equipment (Note 9)	–	–	–	–	–	(378)	–	(378)
Effect of change in tax rate (Note 9)	–	–	–	–	–	(244)	–	(244)
Revaluation surplus realised	–	–	(72)	–	–	–	72	–
Deferred tax on land use rights realised	–	–	–	–	–	(165)	165	–
Profit for the year	–	–	–	–	–	–	28,023	28,023
Issue of shares, net of issuing expenses of RMB294 million	–	7,384	–	–	–	–	–	7,384
Contributions from China Telecom	–	–	–	–	–	–	100	100
Transfer from retained earnings to other reserves	–	–	–	–	–	2,653	(2,653)	–
Consideration for the acquisition of the Second Acquired Group (Note 1)	–	–	–	–	–	(27,800)	–	(27,800)
Transfer from other reserves to capital reserve	(9,371)	–	–	–	–	9,371	–	–
Appropriations (Notes (i) and (ii))	–	–	–	10,168	2,421	–	(12,589)	–
Dividends	–	–	–	–	–	–	(5,224)	(5,224)
Balance as at 31 December 2004	(2,804)	10,746	7,585	25,629	5,793	7,683	23,642	78,274
Effect of change in tax rate (Note 9)	–	–	–	–	–	(5)	–	(5)
Revaluation surplus realised	–	–	(134)	–	–	–	134	–
Deferred tax on revaluation surplus of property, plant and equipment realised	–	–	–	–	–	12	(12)	–
Deferred tax on land use rights realised	–	–	–	–	–	(189)	189	–
Profit for the year	–	–	–	–	–	–	27,912	27,912
Appropriations (Notes (i) and (ii))	–	–	–	9,509	1,285	–	(10,794)	–
Dividends (Note 29)	–	–	–	–	–	–	(5,596)	(5,596)
Balance as at 31 December 2005	(2,804)	10,746	7,451	35,138	7,078	7,501	35,475	100,585

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

20. RESERVES *(continued)*

The Company	Capital reserve RMB millions	Share premium RMB millions	Re-valuation reserve RMB millions	Surplus reserves RMB millions	Statutory common welfare fund RMB millions	Other reserves RMB millions	Retained earnings/ (deficits) RMB millions	Total RMB millions
Balance as at 1 January 2004, as previously reported	6,567	3,362	6,424	15,461	3,372	24,246	15,748	75,180
Prior period adjustment in respect of investments in subsidiaries (Note 3(iii))	22,601	–	(6,424)	–	–	(24,246)	(33,298)	(41,367)
Balance as at 1 January 2004, as restated	29,168	3,362	–	15,461	3,372	–	(17,550)	33,813
Profit for the year	–	–	–	–	–	–	5,988	5,988
Issue of shares, net of issuing expenses of RMB294 million	–	7,384	–	–	–	–	–	7,384
Appropriations (Notes (i) and (ii))	–	–	–	10,168	2,421	–	(12,589)	–
Dividends	–	–	–	–	–	–	(5,224)	(5,224)
Balance as at 31 December 2004 (Note 3(iii))	29,168	10,746	–	25,629	5,793	–	(29,375)	41,961
Profit for the year	–	–	–	–	–	–	53,623	53,623
Appropriations (Notes (i) and (ii))	–	–	–	9,509	1,285	–	(10,794)	–
Dividends (Note 29)	–	–	–	–	–	–	(5,596)	(5,596)
Balance as at 31 December 2005	29,168	10,746	–	35,138	7,078	–	7,858	89,988

Note:

(i) According to the Company's Articles of Association, the Company is required to transfer 10% of its net profit, as determined in accordance with the PRC accounting rules and regulations, to a statutory surplus reserve until such reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of any dividend to shareholders. For the year ended 31 December 2005, the Company transferred RMB2,570 million (2004: RMB2,421 million), being 10% of the year's net profit determined in accordance with the PRC accounting rules and regulations, to this reserve.

According to the Company's Articles of Association, the Directors authorised, subject to shareholders' approval, for the year ended 31 December 2005, the transfer of RMB6,939 million (2004: RMB7,747 million), being 27% (2004: 32%) of the year's net profit determined in accordance with the PRC accounting rules and regulations, to a discretionary surplus reserve.

The statutory and discretionary surplus reserves are non-distributable other than liquidation and can be used to make good of previous years' losses, if any, and may be utilised for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholdings or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

(ii) According to the Company's Articles of Association, the Company is required to transfer 5% to 10% of its net profit, as determined in accordance with the PRC accounting rules and regulations, to a statutory common welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's employees such as construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than on liquidation. The transfer to this fund must be made before distribution of any dividend to shareholders. For the year ended 31 December 2005, the Directors authorised, subject to shareholders' approval, the transfer of RMB1,285 million (2004: RMB2,421 million), being 5% (2004: 10%) of the year's net profit determined in accordance with the PRC accounting rules and regulations, to this fund.

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20. RESERVES *(continued)*

Note:

(iii) According to the Company's Articles of Association, the amount of retained earnings available for distribution to shareholders of the Company is the lower of the amount determined in accordance with the PRC accounting rules and regulations and the amount determined in accordance with IFRS. At 31 December 2005, the amount of retained earnings available for distribution was RMB7,858 million, being the amount determined in accordance with IFRS. As described in Note 3(iii), the accounting policy for investment in subsidiaries under IFRS was changed with effect from 1 January 2005 and hence affects the calculation of retained earnings available for distribution to shareholders of the Company under IFRS. The amount of retained earnings available for distribution as at 31 December 2004 prior to this change in accounting policy was RMB20,609 million, being the amount determined in accordance with the PRC accounting rules and regulations. Final dividend of approximately RMB6,315 million in respect of the financial year 2005 proposed after the balance sheet date has not been recognised as a liability at the balance sheet date (Note 29).

21. OPERATING REVENUES

Operating revenues represent revenues from the provision of wireline telecommunications services. The components of the Group's operating revenues are as follows:

		The Group	
		2005	2004
	Note	**RMB millions**	RMB millions
Upfront connection fees	(i)	**6,781**	8,458
Upfront installation fees	(ii)	**2,970**	2,865
Monthly fees	(iii)	**30,351**	29,827
Local usage fees	(iv)	**47,624**	47,646
DLD	(iv)	**25,993**	26,231
ILD	(iv)	**3,407**	3,788
Internet	(v)	**17,862**	14,109
Managed data	(vi)	**2,958**	3,015
Interconnections	(vii)	**12,838**	10,719
Leased line	(viii)	**4,464**	4,154
Value-added services	(ix)	**9,976**	6,120
Others	(x)	**4,086**	4,280
		169,310	161,212

Note:

(i) Represent the amortised amount of the upfront fees received for initial activation of wireline services.

(ii) Represent the amortised amount of the upfront fees received for installation of wireline services.

(iii) Represent amounts charged to customers each month for their use of the Group's telephone services.

(iv) Represent usage fees charged to customers for the provision of telephone services.

(v) Represent amounts charged to customers for the provision of Internet access services.

(vi) Represent amounts charged to customers for the provision of managed data transmission services.

(vii) Represent amounts charged to domestic and foreign telecommunications operators for delivery of voice and data traffic connecting to the Group's wireline telecommunications networks.

21. OPERATING REVENUES *(continued)*

Note:

(viii) Represent lease income from other domestic telecommunications operators and business customers for the usage of the Group's wireline telecommunications networks and is measured by the number of lines leased and the agreed upon rate per line leased.

(ix) Represent amounts charged to customers for provision of value-added services, which comprise primarily caller ID services, short messaging services, telephone information services and ring tone services.

(x) Represent primarily revenue from sale and repairs and maintenance of customer-end equipment and provision of consulting services.

22. OTHER OPERATING EXPENSES

Other operating expenses consist of:

	Note	The Group 2005 RMB millions	2004 RMB millions
Interconnection charges	(i)	**5,473**	4,095
Donations		**21**	17
Others		**24**	27
		5,518	4,139

Note:

(i) Interconnection charges represent amounts incurred for the use of other domestic and foreign telecommunications operators' networks for delivery of voice and data traffic that originate from the Group's wireline telecommunications networks.

23. TOTAL OPERATING EXPENSES

Total operating expenses for the year ended 31 December 2005 include personnel expenses of RMB24,960 million (2004: RMB23,233 million) and auditors' remuneration of RMB46 million (2004: RMB48 million).

24. NET FINANCE COSTS

Net finance costs comprise:

	The Group 2005 RMB millions	2004 RMB millions
Interest expense incurred	**6,763**	6,834
Less: Interest expense capitalised*	**(1,062)**	(1,467)
Net interest expense	**5,701**	5,367
Interest income	**(243)**	(231)
Foreign exchange losses	**42**	207
Foreign exchange gains	**(605)**	(3)
	4,895	5,340
* Interest expense was capitalised in construction in progress at the following rates per annum	**2.1%-5.1%**	4.1%-5.2%

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25. INCOME TAX

Income tax in the consolidated income statement comprises:

	The Group 2005 RMB millions	2004 RMB millions
Provision for PRC income tax	**5,927**	5,114
Deferred taxation (Note 9)	**233**	73
	6,160	5,187

A reconciliation of the expected tax with the actual tax expense is as follows:

	Note	The Group 2005 RMB millions	2004 RMB millions
Profit before taxation		**34,114**	33,263
Expected PRC income tax expense at statutory tax rate of 33%	(i)	**11,258**	10,977
Differential tax rate on subsidiaries' income	(i)	**(1,689)**	(1,608)
Non-deductible expenses	(ii)	**720**	294
Non-taxable income	(iii)	**(2,651)**	(3,266)
Tax credit for domestic equipment purchases		**(1,478)**	(1,210)
Income tax		**6,160**	5,187

Note:

(i) The provision for PRC current income tax is based on a statutory rate of 33% of the assessable income of the Group as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain subsidiaries of the Company which are taxed at preferential rates ranging from 0% to 15%.

(ii) Amounts represent personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose.

(iii) Amounts primarily represent connection fees received from customers which are not subject to income tax.

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26. DIRECTORS' AND SUPERVISORS' REMUNERATION

The following table sets out the remuneration received or receivable by the Company's directors and supervisors:

	Directors'/ supervisors' fees RMB thousands	Salaries, allowances and benefits in kind RMB thousands	Discretionary bonuses RMB thousands	Share-based payments RMB thousands	Retirement scheme contributions RMB thousands	Total RMB thousands
2005						
Executive directors						
Wang Xiaochu	–	304	33	–	61	398
Leng Rongquan	–	274	30	–	55	359
Wu Andi	–	259	251	278	51	839
Zhang Jiping	–	259	251	278	51	839
Huang Wenlin	–	259	251	278	51	839
Li Ping	–	259	251	278	51	839
Wei Leping	–	259	251	278	51	839
Yang Jie	–	259	191	–	49	499
Sun Kangmin	–	258	191	–	50	499
Cheng Xiyuan	–	159	475	232	13	879
Feng Xiong	–	182	487	232	57	958
Independent non-executive directors						
Zhang Youcai	130	–	–	–	–	130
Vincent Lo Hong Sui	208	–	–	–	–	208
Shi Wanpeng	130	–	–	–	–	130
Xu Erming	50	–	–	–	–	50
Tse Hau Yin	173	–	–	–	–	173
Supervisors						
Zhang Xiuqin	–	130	262	209	44	645
Li Jian	–	32	78	151	12	273
Xu Cailiao	–	23	63	128	10	224
Ma Yuzhu	–	43	87	209	15	354
Li Jing	–	53	104	–	13	170
Xie Songguang	–	70	120	–	16	206
Wang Huanhui	10	–	–	–	–	10
Independent supervisor						
Zhu Lihao	60	–	–	–	–	60
	761	3,082	3,376	2,551	650	10,420
2004	524	2,271	3,277	2,446	515	9,033

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27. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five highest paid individuals of the Group for the year ended 31 December 2005, four are directors of the Company and their remuneration has been included in Note 26. Of the five highest paid individuals of the Group for the year ended 31 December 2004, one was a director of the Company and whose remuneration was included in Note 26. The following table sets out the emoluments of the Group's remaining highest paid employees who were not director or supervisor of the Company during the periods presented:

	2005 RMB thousands	2004 RMB thousands
Salaries, allowances and benefits in kind	**850**	2,777
Retirement benefits	**82**	223
	932	3,000

The number of these employees whose emoluments fall within the following band is set out below:

	2005 Number	2004 Number
HK$ equivalent		
Nil – 1,000,000	**1**	4

None of these employees received any inducements or compensation for loss of office, or waived any emoluments during the periods presented.

28. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated profit attributable to equity holders of the Company includes a profit of RMB18,451 million (2004 (restated): RMB5,988 million) which has been dealt with in the stand-alone financial statements of the Company.

29. DIVIDENDS

Pursuant to a resolution passed at the Directors' meeting on 22 March 2006, a final dividend of equivalent to HK$0.075 per share totalling approximately RMB6,315 million for the year ended 31 December 2005 was proposed for shareholders' approval at the Annual General Meeting. The dividend has not been provided for in the consolidated financial statements for the year ended 31 December 2005.

Pursuant to the shareholders' approval at the Annual General Meeting held on 25 May 2005, a final dividend of RMB0.069139 (equivalent to HK$0.065) per share totalling RMB5,596 million in respect of the year ended 31 December 2004 was declared and was paid on 23 June 2005.

30. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the year ended 31 December 2005 is based on the profit attributable to equity holders of the Company of RMB27,912 million divided by 80,932,368,321 shares. The calculation of basic earnings per share for the year ended 31 December 2004 is based on the profit attributable to equity holders of the Company of RMB28,023 million and the weighted average number of shares in issue during the year of 78,839,968,917 shares. The weighted average number of shares in issue for the year ended 31 December 2004 reflects the issuance of 5,318,181,818 new H shares in May 2004 (Note 19).

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for all periods presented.

31. COMMITMENTS AND CONTINGENCIES

Operating lease commitments

The Group leases business premises through non-cancelable operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the rental agreements contain escalation provisions that may require higher future rental payments nor impose restrictions on dividends, additional debt and/or further leasing. The Company does not have significant operating lease commitments.

As at 31 December 2004 and 2005, the Group's future minimum lease payments under non-cancelable operating leases having initial or remaining lease terms of more than one year were as follows:

	2005 RMB millions	2004 RMB millions
Within 1 year	**326**	369
Between 1 to 2 years	**195**	187
Between 2 to 3 years	**134**	137
Between 3 to 4 years	**119**	124
Between 4 to 5 years	**108**	127
Thereafter	**180**	341
Total minimum lease payments	**1,062**	1,285

Total rental expense in respect of operating leases charged to the consolidated income statement for the year ended 31 December 2005 was RMB1,208 million (2004: RMB1,271 million).

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31. COMMITMENTS AND CONTINGENCIES *(continued)*

Capital commitments

As at 31 December 2004 and 2005, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2005 **RMB millions**	2004 RMB millions	**2005** **RMB millions**	2004 RMB millions
Authorised and contracted for				
– Properties	**513**	918	**148**	17
– Telecommunications network plant and equipment	**2,278**	3,947	**16**	36
	2,791	4,865	**164**	53
Authorised but not contracted for				
– Properties	**1,896**	1,699	**110**	287
– Telecommunications network plant and equipment	**3,047**	9,168	**15**	15
	4,943	10,867	**125**	302

Contingent liabilities

(a) The Company and the Group were advised by their PRC lawyers that, except for liabilities arising out of or relating to the businesses of the Predecessor Operations and the Acquired Groups transferred to the Company in connection with the Restructuring and the Acquisitions, no other liabilities were assumed by the Company or the Group, and the Company or the Group are not jointly and severally liable for other debts and obligations incurred by China Telecom Group prior to the Restructuring and the Acquisitions.

(b) As at 31 December 2004 and 2005, the Group did not have contingent liabilities in respect of guarantees given to banks in respect of banking facilities granted to other parties, nor other forms of contingent liabilities.

As at 31 December 2005, the Company's undiscounted maximum amount of potential future payments under guarantees given to banks in respect of banking facilities granted to subsidiaries was RMB1,497 million (2004: RMB1,884 million). The Company monitors the conditions that are subject to the guarantees to identify whether it is probable that a loss has occurred, and recognised any such losses under guarantees when those losses can be estimated. As at 31 December 2004 and 2005, it was not probable that the Company would be required to make payments under these guarantees. Thus no liability was accrued for losses related to the Company's obligations under these guarantee arrangements.

Legal contingencies

The Group is a defendant in certain lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Group.

32. CONCENTRATION OF RISKS

Credit and concentration risks

The carrying amounts of cash and cash equivalents, time deposits, accounts receivable and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets. The majority of the Group's accounts receivable relate to provision of telecommunications services to residential and corporate customers operating in various industries. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on accounts receivable.

The Group has a diversified base of customers. No single customer contributed more than 10% of revenues for the periods presented.

The Group does not have concentrations of available sources of labour, services, franchises, licenses or other rights that could, if suddenly eliminated, severely impact its operations. The Group places its cash with several large state-owned financial institutions in the PRC.

Business and economic risks

The Group conducts its principal operations in the PRC and accordingly is subject to special considerations and significant risks not typically associated with companies operating in United States and Western Europe. These include risks associated with, among others, the political, economic, legal environment and social uncertainties in the PRC, influence of the Ministry of Information Industry over certain aspects of the Group's operations and competition in the telecommunications industry. In addition, the ability to negotiate and implement specific business development projects in a timely and favourable manner may be impacted by political considerations unrelated to or beyond the control of the Group. Although the PRC government has been pursuing economic reform policies for the past two decades, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective and as a result, changes in the rate or method of taxation, reduction in tariff protection and other import restrictions, and changes in State policies and regulations affecting the telecommunications industry may have a negative impact on the Group's operating results and financial condition.

The Group's wireline telecommunications networks interconnect with the networks of other state-owned telecommunications operators. The Group also leases wireline telecommunications networks to these operators in the normal course of business. The interconnection and leased line charges are regulated by the Ministry of Information Industry. The extent of the Group's interconnection and leased line transactions with other state-owned telecommunications operators in the PRC is as follows:

	2005 **RMB millions**	2004 RMB millions
Interconnection revenues	**10,947**	8,964
Interconnection charges	**2,643**	2,190
Leased line revenues	**2,020**	2,701

32. CONCENTRATION OF RISKS *(continued)*

Currency risk

Substantially all of the revenue-generating operations of the Group are transacted in RMB, which is not fully convertible into foreign currencies. On 1 January 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted by the People's Bank of China. However, the unification of the exchange rate does not imply convertibility of RMB into United States dollars or other foreign currencies. All foreign exchange transactions must take place either through the People's Bank of China or other institutions authorised to buy and sell foreign exchange or at a swap center. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

On 21 July 2005, the People's Bank of China announced that the PRC government reformed the exchange rate regime by adopting a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies.

Interest rate risk

The interest rates and terms of repayment of the Group's debts are disclosed in Note 14.

33. RELATED PARTY TRANSACTIONS

Companies are considered to be related if one company has the ability, directly or indirectly, to control or jointly control the other company or exercise significant influence over the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control.

(a) Transactions with China Telecom Group

The Group is part of a large group of companies under China Telecom, which is owned by the PRC government, and has significant transactions and relationships with members of China Telecom. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among unrelated parties.

The principal transactions with China Telecom Group which were carried out in the ordinary course of business are as follows:

	Note	**2005 RMB millions**	2004 RMB millions
Purchases of telecommunications equipment and materials	(i)	**267**	304
Construction, engineering and information technology services	(ii)	**6,575**	6,568
Provision of community services	(iii)	**2,632**	2,417
Provision of ancillary services	(iv)	**2,456**	2,490
Provision of comprehensive services	(v)	**425**	361
Operating lease expenses	(vi)	**386**	393
Centralised service expenses	(vii)	**275**	163
Interconnection revenues	(viii)	**183**	98
Interconnection charges	(viii)	**725**	201
Interest on amounts due to and loans from China Telecom Group	(ix)	**2,849**	2,426

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

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33. RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with China Telecom Group *(continued)*

Note:

(i) Represent commission paid and payable by the Group for equipment and materials procurement services provided by China Telecom Group.

(ii) Represent provision of network construction, engineering and information technology services to the Group by China Telecom Group.

(iii) Represent amounts paid and payable by the Group to China Telecom Group in respect of cultural, educational, hygiene and other community services.

(iv) Represent amounts paid and payable by the Group to China Telecom Group in respect of ancillary services such as repairs and maintenance of telecommunications equipment and facilities and certain customer services.

(v) Represent amounts paid and payable by the Group to entities of China Telecom Group which were not within the scope of other related party service agreements in respect of services like procurement of telecommunications equipment, network design, software upgrade, system integration and manufacturing of calling cards.

(vi) Represent amounts paid and payable to China Telecom Group for operating leases in respect of business premises and inter-provincial transmission optic fibres.

(vii) Represent net amount charged by China Telecom to the Group for costs associated with common corporate services and international telecommunications facilities.

(viii) Represent amounts charged from/to China Telecom for interconnection of domestic long distance telephone calls.

(ix) Represent interest paid and payable to China Telecom with respect to the deferred consideration payable to China Telecom in connection with the Acquisitions and interest with respect to loans from China Telecom Group (Note 14).

Amounts due from/to China Telecom Group included in respective balances are summarised as follows:

	2005 **RMB millions**	2004 RMB millions
Accounts receivable	**224**	235
Prepayments and other current assets	**606**	640
Total amounts due from China Telecom Group	**830**	875
Accounts payable	**6,886**	7,067
Accrued expenses and other payables	**4,534**	4,889
Short-term debt	**20,384**	10,089
Long-term debt	**40,150**	50,150
Total amounts due to China Telecom Group	**71,954**	72,195

33. RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with China Telecom Group *(continued)*

Amounts due from/to China Telecom Group, other than short-term debt and long-term debt, bear no interest, are unsecured and are repayable in accordance with normal commercial terms. The term and conditions associated with short-term debt and long-term debt payable to China Telecom Group are set out in Note 14.

As at 31 December 2004 and 2005, no impairment losses for bad and doubtful debts were recorded in respect of amounts due from China Telecom Group.

(b) Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and supervisors of the Group.

Key management personnel compensation of the Group is summarised as follows:

	2005 RMB thousands	2004 RMB thousands
Short-term employee benefits	**7,219**	6,072
Post-employment benefits	**650**	515
Equity-based compensation benefits	**2,551**	2,446
	10,420	9,033

The above remuneration is included in personnel expenses (Note 23).

(c) Contributions to post-employment benefit plans

The Group participates in various defined contribution post-employment benefit plans organised by municipal and provincial governments for its employees. Further details of the Group's post-employment benefit plans are disclosed in Note 34.

(d) Transactions with other state-owned entities in the PRC

The Group is a state-owned enterprise and operates in an economic regime currently predominated by state-owned entities. Apart from transactions with parent company and its affiliates, the Group conducts certain business activities with enterprises directly or indirectly owned or controlled by the PRC government and government authorities and agencies (collectively referred to as "state-owned entities") in the ordinary course of business. These transactions, which include sales and purchase of goods, rendering and receiving services, lease of assets and obtaining finance, are carried out at terms similar to those that would be entered into with non-state-owned entities and have been reflected in the financial statements.

Further information of the Group's principal transactions with other state-owned telecommunications operators in the PRC in the normal course of providing telecommunications services are set out in Note 32.

Management believes the above information has provided meaningful disclosure of related party transactions.

34. POST-EMPLOYMENT BENEFITS PLANS

As stipulated by the regulations of the PRC, the Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the retirement plans at rates ranging from 18% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above.

The Group's contributions for the year ended 31 December 2005 were RMB2,258 million (2004: RMB2,031 million).

The outstanding amount of contributions to defined contribution retirement plans as at 31 December 2005 was RMB591 million (2004: RMB599 million).

35. STOCK APPRECIATION RIGHTS

The Group implemented a stock appreciation rights plan for members of its management in order to provide further incentives to these employees. Under this plan, stock appreciation rights are granted in units with each unit representing one H share. No shares will be issued under the stock appreciation rights plan. Upon exercise of the stock appreciation rights, a recipient will receive, subject to any applicable withholding tax, a cash payment in RMB, translated from the Hong Kong dollar amount equal to the product of the number of stock appreciation rights exercised and the difference between the exercise price and market price of the Company's H shares at the date of exercise based on the applicable exchange rate between RMB and Hong Kong dollar at the date of the exercise.

In March 2003, the Company's compensation committee approved the granting of 276.5 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights will have a contractual life of six years from date of grant and an exercise price of HK$1.48 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 18 months after the date of grant. As at each of the third, fourth, fifth and sixth anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

In April 2005, the Company's compensation committee approved the granting of 560.0 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights will have a contractual life of six years from date of grant and an exercise price of HK$2.78 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 24 months after the date of grant. As at each of the third, fourth, fifth and six anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

During the year ended 31 December 2005, 70 million (2004: 70 million) stock appreciation right units were exercised.

The Company recognised compensation expense of the stock appreciation rights over the applicable vesting period. For the year ended 31 December 2005, compensation expense recognised by the Group in respect of stock appreciation rights was RMB81 million (2004: RMB70 million).

35. STOCK APPRECIATION RIGHTS *(continued)*

As at 31 December 2005, the carrying amount of liability arising from stock appreciation rights was RMB129 million (2004: RMB113 million). As at 31 December 2005, the intrinsic value of the vested stock appreciation rights outstanding was RMB0.4 million (2004: Nil).

36. FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial assets of the Group include cash and cash equivalents, time deposits, investments, accounts receivable, amounts due from China Telecom Group, advances and other receivables. Financial liabilities of the Group include debts, accounts payable, amounts due to China Telecom Group, accrued expenses and other payables. The Group does not hold nor issue financial instruments for trading purposes.

The disclosures of the fair value estimates, methods and assumptions set forth below for the Group's financial instruments are made to comply with the requirements of IAS 32 and IAS 39, and should be read in conjunction with the Group's consolidated financial statements and related notes. The estimated fair value amounts have been determined by the Group using market information and valuation methodologies considered appropriate. However, considerable judgment is required to interpret market data to develop the estimates of fair values. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following summarises the major methods and assumptions used in estimating the fair values of the Group's financial instruments.

Long-term debt: The fair values of long-term indebtedness are estimated by discounting future cash flows using current market interest rates offered to the Group for debt with substantially the same characteristics and maturities. As at 31 December 2004 and 2005, the carrying amounts and fair values of the Group's long-term debt were as follows:

	2005		2004	
	Carrying amount RMB millions	**Fair value RMB millions**	Carrying amount RMB millions	Fair value RMB millions
Long-term debt	**64,740**	**63,561**	84,208	82,850

The Group's long-term investments are unlisted equity interests and there are no quoted market prices for such interests in the PRC. Accordingly, a reasonable estimate of their fair values could not be made without incurring excessive costs.

The fair values of all other financial instruments approximate their carrying amounts due to the short-term maturity of these instruments.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group's financial position and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the consolidated financial statements. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of significant accounting policies, the judgements and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the consolidated financial statements. The significant accounting policies are set forth in Note 2. The Group believes the following significant accounting policies involve the most significant judgements and estimates used in the preparation of the consolidated financial statements.

Revenue recognition for upfront connection and installation fees

The Group defers the recognition of upfront fees for activation of wireline services and wireline installation fees and amortise such fees over the expected customer relationship period of ten years. The related direct incremental customer acquisition costs (including direct costs of installation) are also deferred and amortised over the same expected customer relationship period. The Group estimates the expected customer relationship period based on the historical customer retention experience and factoring in the expected level of future competition, the risk of technological or functional obsolescence of its services, technological innovation, and the expected changes in the regulatory and social environment. If the Group's estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of deferred revenue and deferred customer acquisition costs would change for future periods. There have been no significant changes to the estimated customer relationship period for the years presented.

Impairment losses for bad and doubtful debts

The Group estimates impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. The Group bases the estimates on the aging of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs might be higher than expected and could significantly affect the results of future periods.

Impairment on long-lived assets

If circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the asset may be considered "impaired", and an impairment loss may be recognised in accordance with accounting policy for impairment of long-lived assets as described in Note 2(l). The carrying amounts of long-lived assets 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 recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for the Group's long-lived assets may not be readily available. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to level of revenue and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of revenue and amount of operating costs. Changes in these estimates could have a significant impact on the carrying value of the assets and could result in additional impairment charge or reversal of impairment in future periods.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual value. The Group reviews the estimated useful lives and residual values of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives and residual values are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

38. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2005

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended 31 December 2005 and which have not been adopted in these financial statements:

	Effective for accounting period beginning on or after
IFRS 6, Exploration for and evaluation of mineral resources	1 January 2006
IFRS 7, Financial instruments: disclosures	1 January 2007
IFRIC 4, Determining whether an arrangement contains a lease	1 January 2006
IFRIC 5, Rights to interests arising from decommissioning, restoration environmental rehabilitation funds	1 January 2006
IFRIC 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005
IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies	1 March 2006
IFRIC 8, Scope of IFRS 2	1 May 2006
IFRIC 9, Reassessment of embedded derivatives	1 June 2006
Amendment to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007
Amendment to IAS 19, Employee benefits – Actuarial gains and losses, group plans and disclosures	1 January 2006
Amendment to IAS 21, Net investment in a foreign operation	1 January 2006
Amendments to IAS 39, Financial instruments: Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments to IFRS 1, First-time Adoption of International Financial Reporting Standards	1 January 2006

38. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2005 *(continued)*

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far the Group believes that IFRS 6, IFRIC 5, IFRIC 6, IFRIC 7, IFRIC 8, IFRIC 9 and the amendments to IAS 19, IAS 21 and IFRS 1 are not applicable to any of the Group's operations and that the adoption of the rest of the above amendments, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

39. COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified as a result of the changes in accounting policies disclosed in Note 3.

40. PARENT AND ULTIMATE HOLDING COMPANY

The parent and ultimate holding company of the Group at 31 December 2005 is China Telecommunications Corporation, a state-owned enterprise established in the PRC. This entity does not produce financial statements available for public use.