Notes to the Financial Statements

For the year ended 31st December, 2005

1. GENERAL

The Company was incorporated as a joint stock limited company with limited liability in the People's Republic of China (the "PRC") and its H shares are listed on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") with effect from 11th March, 2004. The addresses of the registered office and principal place of business of the Company are disclosed in the corporate information section in the annual report.

The financial statements are presented in Renminbi, which is the functional currency of the Company.

The principal activities of the Company are the manufacture and sale of diesel engines and related parts. The principal activities of its associate and subsidiaries are set out in notes 20 and 37 respectively.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") that are effective for accounting periods beginning on or after 1st January, 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, consolidated balance sheet and consolidated statement of changes in equity. The changes in presentation have been applied retrospectively. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current and prior accounting years are prepared and presented:

Financial Instruments

In the current year, the Group has applied HKAS 32 *Financial Instruments: Disclosure and Presentation* and HKAS 39 *Financial Instruments: Recognition and Measurement.* HKAS 32 requires retrospective application. HKAS 39, which is effective for annual periods beginning on or after 1st January, 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS 32 and HKAS 39 are summarised below:

Classification and measurement of financial assets and financial liabilities

The Group has applied the relevant transitional provisions in HKAS 39 with respect to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

Notes to the Financial Statements

For the year ended 31st December, 2005

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES (Continued)

Financial Instruments (Continued)

Prior to 31st December, 2004, the Group classified and measured its equity securities in accordance with the benchmark treatment of Statement of Standard Accounting Practice 24 ("SSAP 24"). Under SSAP 24, investments in debt or equity securities are classified as "investment securities", "other investments" or "held-to-maturity investments" as appropriate. "Investment securities" are carried at cost less impairment losses (if any) while "other investments" are measured at fair value, with unrealised gains or losses included in profit or loss. Held-to-maturity investments are carried at amortised cost less impairment losses (if any). From 1st January, 2005 onwards, the Group has classified and measured its equity securities in accordance with HKAS 39. Under HKAS 39, financial assets are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables", or "held-to-maturity financial assets". "Financial assets at fair value through profit or loss" and "available-for-sale financial assets" are carried at fair value, with changes in fair values recognised in profit or loss and equity respectively. Available-for-sale equity investments that do not have quoted market prices in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost less impairment after initial recognition. "Loans and receivables" and "held-to-maturity financial assets" are measured at amortised cost using the effective interest method after initial recognition.

On 1st January, 2005, the Group classified and measured its equity securities in accordance with the transitional provisions of HKAS 39. Investment securities of RMB20,000,000 which are unlisted equity securities whose fair value cannot be measured reliably were reclassified as available-for-sale investments and are stated at cost less impairment losses (see Note 2A for the financial impact).

Financial assets and financial liabilities other than debt and equity securities

From 1st January, 2005 onwards, the Group has classified and measured its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. Classification of financial assets are mentioned above. Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "other financial liabilities". Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in profit or loss directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES (Continued)

Financial Instruments (Continued)

Financial assets and financial liabilities other than debt and equity securities (Continued)

Prior to the application of HKAS 39, an interest-free non-trade balance from a related party was stated at the nominal amount. HKAS 39 requires all financial assets and financial liabilities to be measured at fair value on initial recognition. Such interest-free non-trade balance is measured at amortised cost determined using the effective interest method at subsequent balance sheet dates. The Group has applied the relevant transitional provisions in HKAS 39. As a result of this change in the accounting policy, the carrying value of an amount due to a related party as at 1st January, 2005 was reduced by approximately RMB30,607,000 in order to state such amount at amortised cost in accordance with HKAS 39. Correspondingly, the Group's capital reserve as at 1st January, 2005 was increased by the same amount which represents the deemed capital contribution from the related party. Profit for the year was decreased by approximately RMB12,135,000 due to the recognition of imputed interest expense (see Note 2A for the financial impact).

Cost of equity transactions

Under HKAS 32, the Group records transaction costs of an equity transaction as a deduction from equity. The transaction costs of an equity transaction are accounted for as a deduction from equity to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to these transactions using a basis of allocation that is rational and consistent with similar transactions.

On applying HKAS 32, listing expenses of approximately RMB5,626,000 were reversed from share premium and accounted for as an expense item for the year ended 31st December, 2004 (see Note 2A for the financial impact).

Derecognition

HKAS 39 provides more rigorous criteria for the derecognition of financial assets than the criteria applied in previous periods. Under HKAS 39, a financial asset is derecognised, when and only when, either the contractual rights to the asset's cash flows expire, or the asset is transferred and the transfer qualifies for derecognition in accordance with HKAS 39. The decision as to whether a transfer qualifies for derecognition is made by applying a combination of risks and rewards and control tests. The Group has applied the relevant transitional provisions and applied the revised accounting policy prospectively to transfers of financial assets from 1st January, 2005 onwards. As a result, the Group's bill receivables discounted with full recourse which were derecognised prior to 1st January, 2005 have not been restated. As at 31st December, 2005, the Group's bills receivables discounted with full recourse have not been derecognised. Instead, the related borrowings of approximately RMB232,500,000 have been recognised on the balance sheet date. This change in accounting policy has had no material effect on results for the current year.

Notes to the Financial Statements

For the year ended 31st December, 2005

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES (Continued)

Owner-occupied Leasehold Interest in Land

In previous years, owner-occupied leasehold land and buildings were included in property, plant and equipment and measured using the cost model. In the current year, the Group has applied HKAS 17 *Leases*. Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively (see Note 2A for the financial impact).

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior years are as follows:

	2005 **RMB'000**	2004 RMB'000
Increase in administrative expenses in respect of listing expenses	**—**	(5,626)
Increase in finance costs in respect of imputed interest on an amount due to a related party	**(12,135)**	—
Decrease in profit for the year	**(12,135)**	(5,626)

Notes to the Financial Statements

For the year ended 31st December, 2005

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES (Continued)

The cumulative effects of the application of the new HKFRSs on 31st December, 2004 and 1st January, 2005 are summarised below:

	As at 31.12.2004 (originally stated) RMB'000	Adjustments RMB'000	As at 31.12.2004 (restated) RMB'000	Adjustments RMB'000	**As at 1.1.2005 (restated) RMB'000**
Balance sheet items					
Impact of HKAS 17:					
Property, plant and equipment	974,980	(63,047)	911,933	—	**911,933**
Prepaid lease payments — non-current portion	—	61,769	61,769	—	**61,769**
Prepaid lease payments — current portion	—	1,278	1,278	—	**1,278**
Impact of HKAS 32 and HKAS 39:					
Investment securities	20,000	—	20,000	(20,000)	**—**
Available-for-sale investments	—	—	—	20,000	**20,000**
Amount due to a related party — due within one year	(90,525)	—	(90,525)	11,099	**(79,426)**
Amount due to a related party — due after one year	(202,226)	—	(202,226)	19,508	**(182,718)**
Total effects on assets and liabilities	702,229	—	702,229	30,607	**732,836**
Share premium	1,100,416	5,626	1,106,042	—	**1,106,042**
Capital reserve	—	—	—	30,607	**30,607**
Retained profits	604,314	(5,626)	598,688	—	**598,688**
Total effects on equity	1,704,730	—	1,704,730	30,607	**1,735,337**

Notes to the Financial Statements

For the year ended 31st December, 2005

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES (Continued)

The Group has not early applied the following new standards and interpretations that have been issued but are not yet effective. The Directors of the Company anticipate that the application of these Standards or Interpretations will have no material impact on the financial statements of the Group.

HKAS 1 (Amendment)	Capital disclosures[1]
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures[2]
HKAS 21 (Amendment)	Net investment in a foreign operation[2]
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions[2]
HKAS 39 (Amendment)	The fair value option[2]
HKAS 39 & HKFRS 4 (Amendments)	Financial guarantee contracts[2]
HKFRS 6	Exploration for and evaluation of mineral resources[2]
HKFRS 7	Financial instruments: Disclosures[1]
HK(IFRIC) — INT 4	Determining whether an arrangement contains a lease[2]
HK(IFRIC) — INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds[2]
HK(IFRIC) — INT 6	Liabilities arising from participating in a specific market-waste electrical and electronic equipment[3]
HK(IFRIC) — INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[4]

1 Effective for annual periods beginning on or after 1st January, 2007.

2 Effective for annual periods beginning on or after 1st January, 2006.

3 Effective for annual periods beginning on or after 1st December, 2005.

4 Effective for annual periods beginning on or after 1st March, 2006.

3. CHANGES OF ACCOUNTING ESTIMATES

In previous years, intangible assets were amortised over their estimated useful lives of 4.5 years to 8 years. HKAS 38 requires intangible assets to be assessed at the individual asset level as having either finite or indefinite life. A finite-life intangible asset is amortised over its estimated useful life whereas an intangible asset with an indefinite useful life is carried at cost less accumulated impairment losses (if any). Intangible assets with indefinite lives are not subject to amortisation but are tested for impairment annually or more frequently when there are indications of impairment. In accordance with the transitional provisions in HKAS 38, the Group reassessed the useful lives of its intangible assets on 1st January, 2005 and concluded that certain intangible assets with a total carrying amount of RMB108,892,000 recognised under the predecessor accounting standard have indefinite useful lives. The Group has applied the revised useful lives prospectively and discontinued amortising intangible assets with indefinite useful lives from 1st January, 2005 onwards. No amortisation has been charged in relation to intangible assets with indefinite useful lives for the year ended 31st December, 2005. As a result, the profit for the year has been increased by approximately RMB15,556,000. Comparative figures for 2004 have not been restated.

4. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Notes to the Financial Statements

For the year ended 31st December, 2005

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interest in an associate

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amount receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

Income from repairs are recognised when services are provided.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Property, plant and equipment

Property, plant and equipment other than construction in progress are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Construction in progress is carried at cost, less any identified impairment loss.

Depreciation is provided to write off the cost of items of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property, plant and equipment (Continued)

No depreciation is provided for construction in progress until the construction is completed and the properties and assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognised.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the leasee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

Borrowing costs

All borrowing costs are recognised as and included in finance costs in the income statement in the period in which they are incurred.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise.

Retirement benefit costs

Payments to the defined contribution retirement benefit plans are charged as expenses as they fall due.

Notes to the Financial Statements

For the year ended 31st December, 2005

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Retirement benefit costs (Continued)

Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution plans where the Company's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit plan.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on the tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Intangible assets

On initial recognition, intangible assets acquired separately are recognised at cost. After initial recognition, intangible assets with finite useful lives are carried at costs less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on a straight-line basis over their estimated useful lives. Alternatively, intangible assets with indefinite useful lives are carried at cost less any subsequent accumulated impairment losses.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible assets (Continued)

Gain or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually by comparing their carrying amounts with their recoverable amounts, irrespective of whether there is any indication that they may be impaired. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

Intangible assets with finite useful lives are also tested for impairment when there is an indication that an asset may be impaired (see the accounting policies in respect of impairment losses for tangible and intangible assets below).

Research and development expenditures

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its useful life, and carried at cost less subsequent accumulated amortisation and any accumulated impairment losses.

Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Notes to the Financial Statements

For the year ended 31st December, 2005

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

The Group's financial assets are classified into one of the two categories, including loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of financial assets are set out below.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and bills receivables, deposits, other receivables, pledged deposits and bank balances) are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as any of the other categories.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Available-for-sale financial assets (Continued)

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, they are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The Group's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Other financial liabilities

Other financial liabilities including trade and bills payables, other payables, amount due to a related party and unsecured bank borrowings are subsequently measured at amortised cost, using the effective interest rate method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Notes to the Financial Statements

For the year ended 31st December, 2005

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

For financial liabilities, they are removed from the Group's balance sheet (i.e. when the obligation specified in the relevant contract is discharged, cancelled or expires). The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

Impairment loss

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss is subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

5. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment on trade receivables

The Group performs ongoing credit evaluations of its customers and adjusts credit limit based on payment history and customers' current credit-worthiness, as determined by the review of their current credit information. The Group continuously monitors collections and payments from its customers and maintains an impairment for estimated credit losses based upon its historical experience and any specific collection issues that it has identified. While such credit losses have historically been within the Group's expectations and the impairment established, there is no guarantee that it will continue to experience the same credit loss that it has had in the past.

Impairment on intangible assets

During the year, the management reassessed the carrying amount of its intangible assets. This process requires managements estimate of future cash flows generated by its intangible assets. For any instance where the evaluation process indicates impairment, the appropriate asset's carrying value are written down to the recoverable amount and the amount of the write down is charged against the results of operations.

Intangible assets with finite useful lives

The Group's net book value of intangible assets with finite useful lives as at 31st December, 2005 was RMB93,334,000. The Group amortises these intangible assets on a straight-line basis over the estimated useful lives of 4.5 years. The estimated useful lives reflect the Directors' estimate of the periods that the Group intends to derive future economic benefits from the use of the Group's intangible assets.

Warranty expenses

The Group offers a six-month to one-year warranty for its products, during which free warranty service for the repair and maintenance of parts or components under normal usage is provided to the customers. Warranty expenses are acquired with reference to historical cost data for repairs and maintenance, and units of products sold.

Notes to the Financial Statements

For the year ended 31st December, 2005

6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include trade and bills receivables, deposits, other receivables, pledged deposits, bank balances and cash, trade and bills payables, other payables, borrowings, discounted bills with recourse and amount due to a related party. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Currency risk

The Group has foreign currency purchases, which expose the Group to foreign currency risk. Certain trade payables of the Group are denominated in foreign currencies. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arises.

Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31st December, 2005 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the Directors of the Company consider that the Group's credit risk is significantly reduced.

The Group has a number of counterparties and customers, however, credit risk of the Group is concentrated on certain major customers. The management considers the strong financial background and good creditability of these customers, and there is no significant credit risk.

Interest rate risk

The Group is exposed to interest rate risk through the impact of rate changes on interest bearing bank borrowings. The Group currently does not have any interest rate hedging policy. The interest rates and terms of repayment of bank borrowings of the Group are disclosed in note 28.

6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Commodity price risk

The Group is exposed to the commodity price risk such as steel and metal (major components of the Group's raw materials). The Group currently does not have any commodity futures to hedge the price risk exposure of its raw material purchases.

7. BUSINESS AND GEOGRAPHICAL SEGMENTS

The Group was principally engaged in the business of manufacture and sale of diesel engines and related parts and substantially all of the Group's turnover and operating results were derived from the PRC and accordingly, no analysis of business and geographical segment is presented.

8. OTHER INCOME

	2005	2004
	RMB'000	RMB'000
Other income includes:		
Gain on sale of scrap and other materials	**32,402**	29,549
Sales and warranty period repair services fee income	**21,025**	13,454
Bank interest income	**10,246**	18,592
Others	**6,290**	3,342
	69,963	64,937

9. FINANCE COSTS

	2005	2004
	RMB'000	RMB'000
Interest on:		
Bank borrowings wholly repayable within five years	**30,843**	53,159
Imputed interest expense on amount due to a related party	**12,135**	—
	42,978	53,159

Notes to the Financial Statements

For the year ended 31st December, 2005

10. INCOME TAX EXPENSE

	2005	2004
	RMB'000	RMB'000
PRC Enterprise Income Tax:		
Current year	**106,379**	269,371
Overprovision in prior year	**(203)**	(240)
Tax credit	**(10,407)**	(63,647)
	95,769	205,484
Deferred tax (note 31)	**(1,850)**	—
	93,919	205,484

PRC Enterprise Income Tax is calculated at the statutory income tax rate of 33% (2004: 33%) of the assessable profit of the Group, except on assessable profit derived from the production in the high technology development zone, which is taxed at a preferential rate of 15% since current financial year pursuant to the Notice of Ministry of Finance and the State Administration of Taxation concerning certain preferential policies on enterprise income tax (財政部、國家稅務總局《關於企業所得稅若干優惠政策的通知》) and the Notice of the State Administration of Taxation concerning proper implementation of the continuing administrative work after the cancellation delegation of the examination and approval procedure for enterprise income tax (國家稅務總局《關於做好已取消和下放管理的企業所得稅審批項目後續管理工作的通知》).

Pursuant to the notice issued by Jiang Jing Municipal Tax Bureau, the Company's Chongqing branch is also subject to PRC Enterprise Income Tax at a preferential rate of 15% (2004: 15%).

The Company's Hong Kong branch is subject to Hong Kong Profits Tax at 17.5% (2004: 17.5%) on its estimated assessable profit. No provision for Hong Kong Profits Tax has been made as the branch had no assessable profit for the year.

Pursuant to the notices issued by Weifang Municipal Tax Bureau and Chongqing Municipal Tax Bureau, the Group is entitled to a total income tax credit of approximately RMB10,407,000 (2004: RMB63,647,000) in respect of eligible additions of domestic machinery and equipment for production use.

10. INCOME TAX EXPENSE (Continued)

The tax charge for the year can be reconciled to the profit before tax per the income statement as follows:

	2005 RMB'000	2004 RMB'000
Profit before tax	**410,602**	738,738
Tax at PRC Enterprise Income Tax rate of 33% (2004: 33%)	**135,499**	243,784
Tax effect of share of results of an associate	**(311)**	—
Tax effect of expenses not deductible for tax purpose	**11,310**	41,556
Tax effect of concessionary tax rate for the Company's operation in high technology development zone	**(26,803)**	—
Effect of different tax rate for the Company's Chongqing branch	**(15,166)**	(15,969)
Overprovision in prior year	**(203)**	(240)
Tax credit	**(10,407)**	(63,647)
	93,919	205,484

11. PROFIT FOR THE YEAR

	2005 RMB'000	2004 RMB'000
Profit for the year has been arrived at after charging (crediting):		
Depreciation of property, plant and equipment	**109,597**	53,835
Amortisation of prepaid lease payments (included in administrative expenses)	**1,278**	699
Amortisation of technologies (included in administrative expenses)	**62,223**	62,223
Amortisation of trademarks (included in distribution expenses)	**—**	10,372
Auditors' remuneration	**3,000**	3,000
Impairment loss on trade receivables	**15,272**	17,244
Cost of inventories recognised as expense	**4,096,408**	4,651,073
Transportation costs for the products sold (included in distribution expenses)	**29,657**	36,744
Directors' and Supervisors' emoluments (note 12)	**3,874**	5,438
Staff costs excluding Directors' and Supervisors' emoluments	**220,959**	241,373
Retirement benefits scheme contributions excluding amounts included in Directors' and Supervisors' emoluments	**27,328**	25,232
Share of tax of an associate (included in share of results of an associate)	**(311)**	—
Loss on disposal of property, plant and equipment	**489**	1,266

Staff costs disclosed above do not include an amount of approximately RMB16,036,000 (2004: RMB13,832,000) relating to research and development activities, which is included under research and development expenses.

Notes to the Financial Statements

For the year ended 31st December, 2005

12. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS

The remuneration paid or payable to each of the 16 (2004: 16) Directors and 3 (2004: 3) Supervisors were as follows:

2005

	Tan Xuguang RMB'000	Xu Xinyu RMB'000	Sun Shaojun RMB'000	Zhang Quan RMB'000	Yeung Sai Hong RMB'000	Chen Xue Jian RMB'000	Yao Yu RMB'000	Li San Yim RMB'000	Tong Jingen RMB'000	Zhang Fusheng RMB'000	Julius G. Kiss RMB'000	Han Xiaoqun RMB'000	Feng Gang RMB'000	Koo Fook Sun, Louis RMB'000	Zhang Xiaoyu RMB'000	Fang Zhong Chang RMB'000	Sun Chengping RMB'000	Wang Yong RMB'000	Jiang Jianfang RMB'000	Total RMB'000
Fees	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other emoluments																				
Salaries and other benefits	380	250	250	250	50	50	50	50	50	50	50	2	48	146	100	100	50	60	50	2,036
Retirement benefits scheme contribution	76	50	50	50	—	—	—	—	—	—	—	—	—	—	—	—	—	12	—	238
Performance related incentive payments	500	300	300	300	—	—	—	—	—	—	—	—	—	—	—	—	—	200	—	1,600
Total emoluments	956	600	600	600	50	50	50	50	50	50	50	2	48	146	100	100	50	272	50	3,874

2004

	Tan Xuguang RMB'000	Xu Xinyu RMB'000	Sun Shaojun RMB'000	Zhang Quan RMB'000	Yeung Sai Hong RMB'000	Liu Zheng RMB'000	Chen Xue Jian RMB'000	Yao Yu RMB'000	Li San Yim RMB'000	Tong Jingen RMB'000	Zhang Fusheng RMB'000	Julius G. Kiss RMB'000	Feng Gang RMB'000	Koo Fook Sun, Louis RMB'000	Zhang Xiaoyu RMB'000	Fang Zhong Chang RMB'000	Sun Chengping RMB'000	Wang Yong RMB'000	Jiang Jianfang RMB'000	Total RMB'000
Fees	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other emoluments																				
Salaries and other benefits	380	250	250	250	50	25	25	50	50	50	50	50	50	146	100	4	50	60	50	1,940
Retirement benefits scheme contribution	76	50	50	50	—	—	—	—	—	—	—	—	—	—	—	—	—	12	—	238
Performance related incentive payments	1,560	300	300	300	—	—	—	—	—	—	300	—	—	—	—	—	300	200	—	3,260
Total emoluments	2,016	600	600	600	50	25	25	50	50	50	350	50	50	146	100	4	350	272	50	5,438

Note: The performance related incentive payment is determined as a percentage of the Group's profit for the two years ended 31st December, 2005.

13. EMPLOYEES' EMOLUMENTS

Of the five individuals with the highest emoluments in the Group, four (2004: four) were Executive Directors of the Company whose emoluments are included in the disclosures in note 12 above. The emoluments of the remaining one (2004: one) individual was as follows:

	2005 RMB'000	2004 RMB'000
Salaries and allowances	**1,352**	1,525
Retirement benefits scheme contributions	**12**	3
	1,364	1,528

No emoluments were paid by the Group to the Directors, Supervisors or the five highest paid individuals as an inducement to join or upon joining the Group or as a compensation for loss of office. None of the Directors nor any of the Supervisors waived any emoluments for either 2004 or 2005.

14. DIVIDENDS

	2005 RMB'000	2004 RMB'000
Final, paid — 2004: RMB0.15 (2003: RMB0.105) per share	**49,500**	22,575
Interim, paid — 2005: RMB0.165 (2004: RMB0.15) per share	**54,450**	49,500
	103,950	72,075

A final dividend of RMB0.165 for the year ended 31st December, 2005 (2004: RMB0.15 per share which was declared on 27th May, 2005) per share has been proposed by the Directors and is subject to approval by the shareholders in the annual general meeting to be held on 30th June, 2006.

Notes to the Financial Statements

For the year ended 31st December, 2005

15. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit for the year attributable to equity holders of parent of approximately RMB315,203,000 (2004: RMB533,254,000 as restated) and on the number of 330,000,000 (2004: average number of 308,005,000) ordinary shares in issue during the year.

The following table summarises the impact on basic earnings per share as a result of:

	Impact on basic earnings per share	
	2005	2004
	RMB	RMB
Reported figures before adjustments	**1.00**	1.75
Adjustments arising from the changes in accounting policies	**(0.04)**	(0.02)
Restated	**0.96**	1.73

16. PROPERTY, PLANT AND EQUIPMENT

	Construction in progress RMB'000	Buildings RMB'000	Plant and machinery RMB'000	Computer, equipment and fixtures RMB'000	Motor vehicles RMB'000	Total RMB'000
COST						
At 1st January, 2004						
— As originally stated	148,114	54,971	181,929	15,572	15,660	416,246
— Reclassified to prepaid lease payments	—	(14,003)	—	—	—	(14,003)
— As restated	148,114	40,968	181,929	15,572	15,660	402,243
Additions	593,754	—	75	9,563	2,366	605,758
Transfer	(268,073)	34,182	208,548	8,889	16,454	—
Disposals	—	—	(1,661)	(388)	(49)	(2,098)
At 31st December, 2004	473,795	75,150	388,891	33,636	34,431	1,005,903
Additions	801,634	—	148	4,849	612	807,243
Transfer	(967,196)	276,724	622,223	30,155	38,094	—
Disposals	—	—	(1,086)	(109)	(274)	(1,469)
At 31st December, 2005	308,233	351,874	1,010,176	68,531	72,863	1,811,677
DEPRECIATION						
At 1st January, 2004						
— As originally stated	—	4,825	29,163	3,845	2,982	40,815
— Reclassified to prepaid lease payments	—	(160)	—	—	—	(160)
— As restated	—	4,665	29,163	3,845	2,982	40,655
Charged for the year	—	3,739	40,367	4,876	4,853	53,835
Eliminated on disposals	—	—	(387)	(117)	(16)	(520)
At 31st December, 2004	—	8,404	69,143	8,604	7,819	93,970
Charged for the year	—	12,462	77,860	9,247	10,028	109,597
Eliminated on disposals	—	—	(505)	(79)	(146)	(730)
At 31st December, 2005	—	20,866	146,498	17,772	17,701	202,837
CARRYING VALUE						
At 31st December, 2005	308,233	331,008	863,678	50,759	55,162	1,608,840
At 31st December, 2004 (restated)	473,795	66,746	319,748	25,032	26,612	911,933

Notes to the Financial Statements

For the year ended 31st December, 2005

16. PROPERTY, PLANT AND EQUIPMENT (Continued)

Depreciation is provided to write off the cost of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method at the following rates per annum:

Buildings	20 years
Plant and machinery	5 to 10 years
Computer, equipment and fixtures	5 years
Motor vehicles	5 years

All buildings are situated in the PRC on land under operating leases with medium-term.

17. PREPAID LEASE PAYMENTS

The Group's prepaid lease payments represented land use rights in the PRC held under medium-term lease.

	2005	2004
	RMB'000	RMB'000
Analysed for reporting purposes as:		
Current	**1,278**	1,278
Non-current	**60,491**	61,769
	61,769	63,047

18. INTANGIBLE ASSETS

	Trademarks RMB'000 *(Note i)*	Technologies RMB'000 *(Note ii)*	Total RMB'000
COST			
At 1st January, 2004	—	222,965	222,965
Acquired from China Heavy Duty Truck Group *(Note iii)*	119,264	—	119,264
At 31st December, 2004 and 31st December, 2005	119,264	222,965	342,229
AMORTISATION			
At 1st January, 2004	—	5,185	5,185
Charge for the year	10,372	62,223	72,595
At 31st December, 2004	10,372	67,408	77,780
Charge for the year	—	62,223	62,223
At 31st December, 2005	10,372	129,631	140,003
CARRYING VALUE			
At 31st December, 2005	108,892	93,334	202,226
At 31st December, 2004	108,892	155,557	264,449

Notes:

(i) The trademarks have a legal life up to 2012 but are renewable every 10 years at minimal cost. The Directors of the Company are of the opinion that the Group would renew the trademarks continuously and has the ability to do so.

As a result, the trademarks are considered by the management of the Group as having an indefinite useful life because it is expected to contribute to net cash inflows indefinitely. The trademarks will not be amortised until its useful life is determined to be finite. Instead it will be tested for impairment annually and whenever there is an indication that it may be impaired. Particulars of the impairment testing are disclosed in Note 19.

(ii) Technologies are amortised on a straight-line basis over 4.5 years.

(iii) China Heavy Duty Truck Group Co., Ltd. ("CHDTGL") was the holding company of a substantial shareholder in the Company. CHDTGL and its affiliates other than the Group are collectively referred as China Heavy Duty Truck Group.

Notes to the Financial Statements

For the year ended 31st December, 2005

19. IMPAIRMENT TESTING ON TRADEMARKS WITH INDEFINITE USEFUL LIVES

As explained in Note 7, the Group was principally engaged in the business of manufacture and sale of diesel engines and related parts, which is the Group's only cash generating unit (CGU). For the purposes of impairment testing, the carrying amounts of trademarks as at 31st December, 2005 are fully allocated to this unit.

During the year ended 31st December, 2005, management of the Group determines that there is no impairment of its CGU containing trademarks with indefinite useful lives.

The recoverable amount of the CGU is determined based on a value in use calculation. The key assumptions for the value in use calculation is those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGU. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next five years and extrapolates cash flows for the following five years based on an estimated growth rate of 10% to 18%. This rate does not exceed the average long-term growth rate for the relevant markets. The rate used to discount the forecast cash flows is 6.8%. Management believes that any reasonably possible change in any of these assumptions would not cause the aggregate carrying amount of the CGU to exceed the aggregate recoverable amount of the CGU.

20. INTEREST IN AN ASSOCIATE

	2005	2004
	RMB'000	RMB'000
Cost of investment in an unlisted associate	**560,250**	—
Share of post-acquisition profit	**941**	—
	561,191	—

20. INTEREST IN AN ASSOCIATE (Continued)

As at 31st December, 2005, the Group had an interest in the following associate:

Name of entity	Form of business structure	Country of registration/ Principal place of operation	Paid up registered capital *RMB*	Proportion of registered capital held by the Group	Principal activity
濰柴動力(濰坊)投資有限公司	Incorporated	The PRC	1,245,000,000	45%	Investment holding in 28.12% equity interest in Torch Automobile Group Co., Ltd. (湘火炬汽車集團股份有限公司) which is principally engaged in the manufacture and sale of heavy duty trucks and vehicle parts

The summarised financial information in respect of the Group's associate is set out below:

	2005 RMB'000	2004 RMB'000
Total assets	**1,247,714**	—
Total liabilities	**(623)**	—
Net assets	**1,247,091**	—
Group's share of net assets of associate	**561,191**	—
Revenue	**4,052**	—
Profit for the year	**2,091**	—
Group's share of result of associate for the year	**941**	—

Notes to the Financial Statements

For the year ended 31st December, 2005

21. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets as at 31st December, 2005 represented an investment in 5.71% of the registered capital of 山東福田重工股份有限公司 ("山東福田"), a private entity established in the PRC. As the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, the Directors of the Company are of the opinion that the instruments shall be measured at cost less impairment at each balance sheet date.

22. INVESTMENT SECURITIES

Investment securities as at 31st December, 2004 represented an investment in 5.71% of the registered capital of 山東福田. Upon the application of HKAS 39 on 1st January, 2005, investment securities were reclassified to available-for-sale financial assets under HKAS 39 (see Note 2 for details).

23. DEPOSITS PAID FOR ACQUISITION OF PROPERTY, PLANT AND EQUIPMENT

As at 31st December, 2005, the amount represented the deposits paid to certain vendors for the acquisition of property, plant and equipment. Details of the related capital commitments are set out in note 32.

Included in the balance was a refundable deposit of RMB80,000,000 paid to CHDTGL in relation to a framework agreement dated 27th September, 2004 for the Group to acquire certain assets of Hangzhou Motor Engine Factory, a wholly-owned subsidiary of CHDTGL. While the framework agreement expired on 31st December, 2005, in the opinion of the Directors, efforts and negotiation will continue to be made with a view to enforce completion of the agreement. Accordingly, the deposit continues to be presented as non-current at the balance sheet date.

24. INVENTORIES

	2005	2004
	RMB'000	RMB'000
Raw materials and consumables	**340,362**	164,498
Work-in-progress	**81,041**	26,175
Finished goods	**224,175**	238,476
	645,578	429,149

25. OTHER FINANCIAL ASSETS

Trade and bills receivables

	2005 RMB'000	2004 RMB'000
Third party customers	**151,850**	317,550
Related party customers	**251,128**	197,386
Less: accumulated impairment	**(42,584)**	(27,312)
	360,394	487,624
Bills receivable	**801,655**	174,288
	1,162,049	661,912

The credit terms granted by the Group to its customers are normally in the range from 30 days to 180 days. However, customers with established trading records could be granted longer credit period. The following is an aged analysis of trade and bills receivables net of impairment losses as at the balance sheet date:

	2005 RMB'000	2004 RMB'000
Within 90 days	**974,679**	521,199
Between 91 to 180 days	**180,522**	124,953
Between 181 to 365 days	**2,916**	4,146
Over 365 days	**3,932**	11,614
	1,162,049	661,912

The related party customers represented China Heavy Duty Truck Group, Fujian Longgong and Guangxi Liugong. At 31st December, 2005, the related party customers also included 湘火炬汽車集團股份有限公司 and its affiliates.

Details of the relationship with Fujian Longgong and Guangxi Liugong are set out in note 36(a).

The bills are non-interest bearing and have a maturity of six months.

Notes to the Financial Statements

For the year ended 31st December, 2005

25. OTHER FINANCIAL ASSETS (Continued)

The fair value of the Group's trade and bills receivables, deposits and other receivables at 31st December, 2005 approximates carrying amounts.

Bank balances and cash

Bank balances and cash, which carry prevailing market interest rates, comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amounts of these assets approximated their fair value at the balance sheet date.

26. PLEDGE OF ASSETS

At 31st December, 2005, bank deposits of approximately RMB371,670,000 (2004: RMB334,445,000) were pledged to banks to secure bills payable issued and bills receivables discounted by the Group.

At 31st December, 2004, bills receivable of approximately RMB119,876,000 were pledged to banks to secure bills payable issued by the Group.

The pledged bank deposits carry prevailing bank interest rates. The pledge will be released upon the settlement of the relevant bank borrowings. The fair value of the bank deposits at 31st December, 2005 approximates carrying amounts.

27. OTHER FINANCIAL LIABILITIES

Trade and bills payables

	2005 RMB'000	2004 RMB'000
Third party suppliers	**1,184,615**	1,212,276
Related party suppliers	**75,411**	42,466
	1,260,026	1,254,742
Bills payable	**551,480**	700,804
	1,811,506	1,955,546

An analysis of trade and bills payables as at the balance sheet date is as follows:

	2005	2004
Within 90 days	**1,312,896**	1,294,745
Between 91 to 180 days	**439,327**	644,684
Between 181 to 365 days	**13,123**	10,044
Over 365 days	**46,160**	6,073
	1,811,506	1,955,546

Related party suppliers represented China Heavy Duty Truck Group.

The bills are non-interest bearing and have a maturity of six months.

The fair value of the Group's trade and bills payables and other payables at 31st December, 2005 approximates carrying amounts.

Notes to the Financial Statements

For the year ended 31st December, 2005

28. UNSECURED BANK BORROWINGS

	2005 RMB'000	2004 RMB'000
Unsecured bank borrowings	**334,241**	20,000
The maturity profile of the above bank borrowings is as follows:		
On demand or within one year	**44,241**	20,000
More than one year, but not exceeding two years	**240,000**	—
More than two years, but not exceeding five years	**50,000**	—
	334,241	20,000
Less: Amounts due within one year shown under current liabilities	**(44,241)**	(20,000)
	290,000	—

Unsecured bank borrowings include approximately RMB310,000,000 (2004: RMB20,000,000) fixed-rate borrowings which carry interest ranging from 5.6% to 5.8% (2004: at 5.1%). The remaining unsecured bank borrowings of approximately USD3,000,000 (equivalent to approximately RMB24,241,000) (2004: Nil) are denominated in currencies other the functional currencies of the relevant group entities. These borrowings are variable-rate borrowings which carry interest at 1.2% over London Interbank Offered Rate.

During the year, the Group obtained new loans in the amount of RMB634,241,000. The loans bear fixed interest at a range from 5.6% to 5.8% and will be repayable within three years.

The fair value of the Group's bank borrowings approximates to the corresponding carrying amount calculated by discounting the future cash flows at the prevailing market borrowing rate for similar borrowings at the balance sheet date.

As at the balance sheet date, the Group had undrawn borrowing facilities with floating rate expiring within one year amounting to approximately USD7,000,000 (2004: Nil).

29. WARRANTY PROVISION

	RMB'000
At 1st January, 2005	12,996
Additional provision in the year	195,851
Utilisation of provision	(190,288)
At 31st December, 2005	18,559

The warranty provision represents management's best estimate of the Group's liability under six-month to one-year warranty granted on products, based on past experience for defective products.

30. SHARE CAPITAL

	Number of shares		Registered,
	Domestic		issued and
	shares	H shares	fully paid
	'000	'000	RMB'000
At 1st January, 2004	215,000	—	215,000
Conversion of certain state-owned domestic shares to H shares *(Note)*	(11,500)	11,500	—
Issue of H shares upon listing on the Main Board of the Stock Exchange (including those converted from domestic shares)	—	115,000	115,000
At 31st December, 2004 and 31st December, 2005	203,500	126,500	330,000

Note: Pursuant to the approval from the Ministry of Finance of the PRC regarding the sale and conversion of the domestic shares, the total number of H shares issued at HK$10.50 each was 126,500,000 H shares, comprising 115,000,000 new H shares and 11,500,000 H shares converted from 11,500,000 domestic shares.

Notes to the Financial Statements

For the year ended 31st December, 2005

31. DEFERRED TAXATION

The following are the major deferred tax liabilities and assets recognised and movements thereon during the current and prior years:

	Trademarks	Others	Total
	RMB'000	RMB'000	RMB'000
At 1st January, 2004 and 31st December, 2004	—	—	—
Charge (credit) to income for the year	5,133	(6,983)	(1,850)
At 31st December, 2005	5,133	(6,983)	(1,850)

32. CAPITAL COMMITMENTS

	2005	2004
	RMB'000	RMB'000
Capital expenditure in respect of acquisition of property, plant and equipment contracted for but not provided in the financial statements	**234,912**	423,631
Capital expenditure in respect of the acquisition of property, plant and equipment authorised but not contracted for	**—**	340,180

As set out in note 23, the Group paid a refundable deposit of RMB80,000,000 to CHDTGL for the proposed acquisition of certain assets pursuant to a framework agreement dated 27th September, 2004.

While the framework agreement expired on 31st December, 2005, in the opinion of the Directors, efforts and negotiation will continue to be made with a view to enforce completion of the agreement. However, the final amount of the consideration for the acquisition, if the transaction does go ahead, is yet to be determined.

33. OTHER COMMITMENTS

In August 2003, in conjunction with China Heavy Duty Truck Group, the Group entered into research and development contracts with AVL List GmbH, a third party, with a contract sum of approximately Euro 6.6 million (equivalent to approximately RMB68,741,000).

As at 31st December, 2004, the outstanding commitment amounted to approximately Euro 1,445,000 (equivalent to approximately RMB15,242,000). All such commitments were fulfilled as at 31st December, 2005 as the project was completed during the year.

34. OPERATING LEASE COMMITMENTS

The Group as lessee

	2005 RMB'000	2004 RMB'000
Minimum lease payments paid under operating leases during the year:		
Plant and machinery	**30,117**	30,117
Premises	**20,522**	18,712
	50,639	48,829

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	2005 RMB'000	2004 RMB'000
Within one year	**50,355**	48,620
In the second to fifth year inclusive	**73,218**	118,508
	123,573	167,128

Operating lease payments represent rentals payable by the Group for certain of its plant and machinery and premises. Leases are negotiated for a term ranging from 1 year to 5 years and rent is fixed over the lease term.

35. POST BALANCE SHEET EVENT

On 20th March, 2006, 山東省人民政府國有資產監督管理委員會 (State-owned Assets Supervision and Administration Commission of Shandong Province People's Government, "Shandong SASAC") issued a document approving the segregation of ownership between CHDTGL and 濰坊柴油機廠 (Weifang Diesel Engine Works, the "Weichai Factory") such that CHDTGL transferred its entire ownership in Weichai Factory to Shandong SASAC for its direct holding (the "Transfer").

Up to the date of the annual report, Weichai Factory is interested in approximately 23.53% shareholding interest in the Company and is the single largest shareholder of the Company. Upon completion of the Transfer, Shandong SASAC has become the direct supervising authority over Weichai Factory.

Notes to the Financial Statements

For the year ended 31st December, 2005

36. CONNECTED AND RELATED PARTIES DISCLOSURE

(a) During the year, the Group had the following significant transactions with related parties and connected persons:

	2005	2004
	RMB'000	RMB'000
Connected persons and related parties		
China Heavy Duty Truck Group:		
Sales of diesel engines and related parts	**1,806,798**	2,003,837
Purchases of materials	**128,868**	124,768
Purchases of finished diesel engines	**409,791**	—
General services fee paid	**23,571**	21,288
Utility services fee paid	**129,172**	123,494
Processing services fee	**60,042**	89,178
Sales and warranty period repair services fee income	**21,025**	13,454
Purchases of property, plant and equipment	**145**	88
Disposal of property, plant and equipment	**71**	196
Purchase of trademarks	**—**	119,264
Trademarks fee paid	**—**	5,184
Rental paid for certain premises, machinery and equipment	**46,218**	46,218
Connected persons		
Fujian Longgong Group *(note i):*		
Sales of diesel engines and related parts	**349,774**	317,715
Guangxi Liugong Group *(note ii):*		
Sales of diesel engines and related parts	**266,338**	335,463

Notes:

(i) Fujian Longgong is a promoter of the Company and holds 6.52% interest in the Company at 31st December, 2005. Fujian Longgong together with its affiliates are collectively referred as the "Fujian Longgong Group".

(ii) Guangxi Liugong is a promoter of the Company and holds 1.36% interest in the Company at 31st December, 2005. Guangxi Liugong together with its affiliates are collectively referred as the "Guangxi Liugong Group".

36. CONNECTED AND RELATED PARTIES DISCLOSURE (Continued)

(a) During the year, the Group had the following significant transactions with related parties and connected persons: (Continued)

Compensation of key management personnel

The remuneration of Directors and other members of key management during the year was as follows:

	2005 **RMB'000**	2004 RMB'000
Short-term benefits	**3,636**	5,200
Post-employment benefits	**238**	238
	3,874	5,438

(b) Details of the trading balances with related parties are set out in notes 25 and 27. These trading balances arose from the transactions set out in note 36(a).

(c) Details of the non-trade balances with related party are as follows:

(i) *Name of related company*

	2005 **RMB'000**	2004 RMB'000
Amount due to a related party:		
China Heavy Duty Truck Group *(Note)*	**186,865**	292,751

The amount is unsecured and interest-free. An amount of RMB182,719,000 (2004: RMB269,635,000) is repayable in instalments over a period of 5 years and the remaining balance is repayable on demand and approximates fair value.

Notes to the Financial Statements

For the year ended 31st December, 2005

36. CONNECTED AND RELATED PARTIES DISCLOSURE (Continued)

(c) Details of the non-trade balances with related party are as follows: (Continued)

(i) *Name of related company (Continued)*

Note: As at 31st December, 2005, included in the balance due to China Heavy Duty Truck Group was an amount of approximately RMB182,719,000 (2004: approximately RMB269,635,000) which represented the balance of the consideration payable for the acquisition of technologies and trademarks from China Heavy Duty Truck Group. The amount is repayable as follows:

	2005 RMB'000	2004 RMB'000
Within one year	**59,126**	67,409
In the second year	**62,083**	67,409
In the third to fifth year inclusive	**61,510**	134,817
	182,719	269,635
Less: Amount due for settlement within one year (including under current liabilities)	**(59,126)**	(67,409)
	123,593	202,226

The effective interest rate for the amount due to a related party of RMB182,179,000 is approximately 5%.

At 31st December, 2005, the fair value of the amount due to a related part was approximately RMB182,719,000, determined based on the present value of the estimated future cash outflows discounted using the prevailing market rate at the balance sheet.

(ii) Details of a refundable deposit of RMB80,000,000 (2004: RMB80,000,000) paid to CHDTGL are set out in note 23.

(d) Transactions/balances with other state-controlled entities in the PRC

The Group operates in an economic environment currently predominated by entities directly or indirectly owned or controlled by the PRC government ("state-controlled entities"). In addition, the Group itself is part of a larger group of companies under Weichai Factory which is controlled by the PRC government. Apart from the transactions with Weichai Factory and fellow subsidiaries and other related parties disclosed in sections (a) to (c) above, the Group also conducts business with other state-controlled entities. The Directors consider those state-controlled entities are independent third parties so far as the Group's business transactions with them are concerned.

In establishing its pricing strategies and approval process for transactions with other state-controlled entities, the Group does not differentiate whether the counter-party is a state-controlled entity or not.

36. CONNECTED AND RELATED PARTIES DISCLOSURE (Continued)

(d) Transactions/balances with other state-controlled entities in the PRC (Continued)

Material transactions/balances with other state-controlled entities are as follows:

	2005 RMB'000	2004 RMB'000
Trade sales	**1,394,513**	2,078,155
Trade purchases	**598,002**	865,640
Amounts due to other state-controlled entities	**121,652**	184,804
Amounts due from other state-controlled entities	**140,659**	181,856

In addition, the Group has entered into various transactions, including deposits placements, borrowings and other general banking facilities, with certain banks and financial institutions which are state-controlled entities in its ordinary course of business. In view of the nature of those banking transactions, the Directors are of the opinion that separate disclosure would not be meaningful.

Except as disclosed above, the Directors are of the opinion that transactions with other state-controlled entities are not significant to the Group's operations.

37. PARTICULARS OF SUBSIDIARIES

The following table lists the subsidiaries of the Group as at 31st December, 2005:

Name of subsidiary	Form of business structure	Country of registration/ Principal place of operation	Paid up registered capital RMB	Proportion of registered capital held by the Company directly	Principal activities
濰柴動力(濰坊)備品資源有限公司	Incorporated	The PRC	45,795,918	51%	Trading of spare parts of diesel engine
濰柴動力(濰坊)油品有限公司	Incorporated	The PRC	5,200,000	52%	Trading of lubricant oil products
濰柴動力(濰坊)集約配送有限公司	Incorporated	The PRC	10,400,000	52%	Provision of warehouse management services
濰柴動力(上海)投資有限公司	Incorporated	The PRC	47,500,000	95%	Inactive

None of the subsidiaries had any debt securities outstanding at the end of the year or at any time during the year.