Notes to the Financial Statements

for the year ended 31 December 2006

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 and international long distance 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 Group 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 Group and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibers.

As part of the reorganisation (the "Restructuring") 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 13).

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 13).

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 consideration 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 2(g)) and available-for-sale equity securities (Note 2(k)). The accounting policies described below have been consistently applied by the Group.

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.

Notes to the Financial Statements

for the year ended 31 December 2006

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.

The IASB has issued certain new and revised IFRS which are effective for accounting periods on or after 1 January 2006. The adoption of these new and revised IFRS did not result in significant changes to the Group's accounting policies applied in these financial statements for the years presented.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see Note 38).

With effect from 1 January 2006, the Group has presented the amount of personnel expenses on the face of the consolidated income statement as a separate caption and has disclosed the respective amounts attributable to the network operations and support, and selling, general and administrative functions in the notes to the financial statements. The related comparative figures have been reclassified to conform with the current year's presentation.

(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.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of consolidation (continued)

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.

(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 (Note 2(i)), 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 3, 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 2006, the carrying amount of assets held under finance leases was RMB197 million (2005: RMB272 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.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Property, plant and equipment (continued)

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

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) Investments

Investments in available-for-sale equity securities are carried at fair value with any change in fair value being recognised directly in equity. When these investments are derecognised or impaired, the cumulative gain or loss previously recognised directly in equity is recognised in the consolidated income statement. Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost less impairment losses (Note 2(l)).

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) Impairment

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

Investments in 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 2005 and 2006, no impairment loss was made for investments in equity securities. For the year ended 31 December 2006, impairment losses for trade and other receivables of RMB1,232 million (2005: RMB1,274 million) were recognised.

(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. When an asset does not generate cash flows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit). 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 2006, a provision for impairment loss of nil (2005: RMB163 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.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(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 telecommunications 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.

(v) Revenues derived from value-added telecommunications 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 RMB10,514 million for the year ended 31 December 2006 (2005: RMB9,417 million).

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(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 2006, research and development expense was RMB292 million (2005: RMB261 million).

(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 expense 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 charged or credited to the consolidated 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 the amount initially recognised and redemption value being recognised in the consolidated income statement over the period of the borrowings, together with any interest, 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.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(t) Provisions and contingent liabilities (continued)

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 consolidated 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.

(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. PROPERTY, PLANT AND EQUIPMENT, NET

The Group:

	Buildings and improvements RMB millions	Telecom-munications network plant and equipment RMB millions	Furniture, fixture, motor vehicles and other equipment RMB millions	Total RMB millions
Cost/valuation:				
Balance at 1 January 2005	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
Additions	**103**	**735**	**577**	**1,415**
Transferred from construction in progress	**3,259**	**47,414**	**1,113**	**51,786**
Disposals	**(362)**	**(13,773)**	**(1,153)**	**(15,288)**
Reclassification	**(83)**	**3,467**	**(3,384)**	**–**
Balance at 31 December 2006	**73,746**	**523,095**	**19,199**	**616,040**
Accumulated depreciation and impairment:				
Balance at 1 January 2005	(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)
Depreciation charge for the year	**(2,943)**	**(45,275)**	**(2,490)**	**(50,708)**
Written back on disposals	**135**	**11,618**	**1,065**	**12,818**
Reclassification	**(117)**	**(1,384)**	**1,501**	**–**
Balance at 31 December 2006	**(16,767)**	**(260,079)**	**(10,890)**	**(287,736)**
Net book value at 31 December 2006	**56,979**	**263,016**	**8,309**	**328,304**
Net book value at 31 December 2005	56,987	260,214	11,080	328,281

3. PROPERTY, PLANT AND EQUIPMENT, NET (continued)

The Company:

	Telecom-munications network plant and equipment RMB millions	Furniture, fixture, motor vehicles and other equipment RMB millions	Total RMB millions
Cost:			
Balance at 1 January 2005	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
Additions	**3**	**2**	**5**
Transferred from construction in progress	**84**	**9**	**93**
Disposals	**(21)**	**(12)**	**(33)**
Reclassification	**14**	**(14)**	**–**
Balance at 31 December 2006	**406**	**122**	**528**
Accumulated depreciation:			
Balance at 1 January 2005	(6)	(48)	(54)
Depreciation charge for the year	(40)	(21)	(61)
Balance at 31 December 2005	(46)	(69)	(115)
Depreciation charge for the year	**(49)**	**(20)**	**(69)**
Disposals	**15**	**12**	**27**
Reclassification	**(5)**	**5**	**–**
Balance at 31 December 2006	**(85)**	**(72)**	**(157)**
Net book value at 31 December 2006	**321**	**50**	**371**
Net book value at 31 December 2005	280	68	348

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.

3. 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 years ended 31 December 2006 and 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.

4. CONSTRUCTION IN PROGRESS

	The Group RMB millions	**The Company** RMB millions
Balance at 1 January 2005	29,450	73
Additions	51,926	139
Transferred to property, plant and equipment	(57,809)	(56)
Balance at 31 December 2005	23,567	156
Additions	**46,635**	**186**
Transferred to property, plant and equipment	**(51,786)**	**(93)**
Balance at 31 December 2006	**18,416**	**249**

5. INVESTMENTS IN SUBSIDIARIES

	The Company	
	2006 **RMB millions**	2005 RMB millions
Unquoted investments, at cost	**177,132**	165,926

5. INVESTMENTS IN SUBSIDIARIES (continued)

Details of the Company's subsidiaries at 31 December 2006, 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	4,523
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	6,208
Hunan Telecom Company Limited	Limited Company	12 March 2004	3,574
Hainan Telecom Company Limited	Limited Company	9 March 2004	1,233
Guizhou Telecom Company Limited	Limited Company	12 March 2004	2,801
Yunnan Telecom Company Limited	Limited Company	9 March 2004	3,747
Shaanxi Telecom Company Limited	Limited Company	8 March 2004	3,254
Gansu Telecom Company Limited	Limited Company	10 March 2004	4,515
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.

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6. INTERESTS IN ASSOCIATES

	The Group	
	2006 **RMB** **millions**	2005 RMB millions
Share of net assets	**581**	548

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.

7. INVESTMENTS

	The Group	
	2006 **RMB** **millions**	2005 RMB millions
Available-for-sale equity securities	**104**	38
Other unlisted equity investments	**121**	144
	225	182

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.

8. 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	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Current						
Provisions and impairment losses, primarily for receivables	**413**	294	**–**	–	**413**	294
Non-Current						
Property, plant and equipment	**611**	610	**(1,566)**	(1,508)	**(955)**	(898)
Deferred revenues and installation costs	**2,152**	2,114	**(1,123)**	(1,112)	**1,029**	1,002
Land use rights	**7,690**	7,867	**–**	–	**7,690**	7,867
Available-for-sale equity securities	**–**	–	**(22)**	–	**(22)**	–
Deferred tax assets/(liabilities)	**10,866**	10,885	**(2,711)**	(2,620)	**8,155**	8,265

The Group recognises a deferred tax asset only to the extent that it is probable that future taxable income will be available against which the asset can be utilised. The Group has reviewed its deferred tax assets as at 31 December 2006 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.

Movements in temporary differences are as follows:

	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					
Provisions and impairment losses, primarily for 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	(i) and (ii)	8,061	(189)	(5)	7,867
Net deferred tax assets		8,503	(233)	(5)	8,265
			(Note 25)		

8. DEFERRED TAX ASSETS AND LIABILITIES (continued)

	Note	Balance at 1 January 2006 RMB millions	Recognised in income statement RMB millions	Recognised in equity RMB millions	Balance at 31 December 2006 RMB millions
Current					
Provisions and impairment losses, primarily for receivables		294	119	–	413
Non-current					
Property, plant and equipment		(898)	(57)	–	(955)
Deferred revenues and installation costs		1,002	27	–	1,029
Land use rights	(i) and (ii)	7,867	(182)	5	7,690
Available-for-sale equity securities		–	–	(22)	(22)
Net deferred tax assets		8,265	(93)	(17)	8,155
			(Note 25)		

Note:

(i) In connection with the Restructuring and the Acquisitions, the land use rights of the Predecessor Operations, the First Acquired Group and the Second Acquired Group were revalued as required by the relevant PRC rules and regulations. The tax bases of the land use rights were adjusted to conform to such revalued amounts. The land use rights were not revalued for financial reporting purposes and accordingly, the deferred tax assets were created with corresponding increases in shareholders' equity under the caption of other reserves.

(ii) The amounts recognised in equity represent the effect of change in tax rate for a subsidiary on the carrying amount of the deferred tax asset which was previously charged or credited to equity.

9. INVENTORIES

Inventories represent:

	The Group	
	2006 RMB millions	2005 RMB millions
Materials and supplies	**1,770**	1,854
Goods for resale	**1,248**	848
	3,018	2,702

10. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, are analysed as follows:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Accounts receivable				
Third parties	**15,375**	15,636	**153**	–
Amounts due from subsidiaries	**–**	–	**69**	18
China Telecom Group	**136**	224	**–**	–
Other state-controlled telecommunications operators in the PRC	**1,791**	1,786	**44**	–
	17,302	17,646	**266**	18
Less: Impairment losses for bad and doubtful debts	**(1,496)**	(1,504)	**–**	–
	15,806	16,142	**266**	18

Amounts due from the provision of wireline telecommunications services to residential and business customers are due within 30 days from the date of billing.

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

	The Group	
	2006 RMB millions	2005 RMB millions
At beginning of year	**1,504**	1,682
Impairment losses for bad and doubtful debts	**1,221**	1,274
Accounts receivable written off	**(1,229)**	(1,452)
At end of year	**1,496**	1,504

10. ACCOUNTS RECEIVABLE, NET (continued)

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

	The Group	
	2006	2005
	RMB millions	RMB millions
Current, within 1 month	**11,634**	12,104
1 to 3 months	**1,055**	1,563
4 to 12 months	**1,060**	1,037
More than 12 months	**314**	340
	14,063	15,044
Less: Impairment losses for bad and doubtful debts	**(1,374)**	(1,377)
	12,689	13,667

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	
	2006	2005	**2006**	2005
	RMB millions	RMB millions	**RMB millions**	RMB millions
Current, within 1 month	**1,626**	1,244	**76**	–
1 to 3 months	**765**	686	**104**	10
4 to 12 months	**529**	371	**80**	8
More than 12 months	**319**	301	**6**	–
	3,239	2,602	**266**	18
Less: Impairment losses for bad and doubtful debts	**(122)**	(127)	**–**	–
	3,117	2,475	**266**	18

11. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets represent:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Amounts due from China Telecom Group	**548**	606	**3**	4
Amounts due from subsidiaries	**–**	–	**64,919**	51,725
Other state-controlled telecommunications operators in the PRC	**242**	397	**–**	–
Prepayments in connection with construction work and equipment purchases	**742**	679	**–**	–
Prepaid expenses and deposits	**517**	389	**1**	–
Other receivables	**380**	335	**12**	9
	2,429	2,406	**64,935**	51,738

12. CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Cash at bank and in hand	**10,486**	11,583	**881**	727
Time deposits with original maturity within three months	**7,705**	3,538	**7,500**	3,412
	18,191	15,121	**8,381**	4,139

13. SHORT-TERM AND LONG-TERM DEBT

Short-term debt comprises:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Loans from state-controlled banks — unsecured	**35,750**	45,704	**–**	–
Commercial paper – unsecured	**20,000**	9,917	**20,000**	9,917
Loans from China Telecom Group – unsecured	**23,766**	20,384	**–**	–
Total short-term debt	**79,516**	76,005	**20,000**	9,917

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13. SHORT-TERM AND LONG-TERM DEBT (continued)

Weighted average interest rate of the Group's total short-term debt as at 31 December 2006 was 3.7% (2005: 4.2%). As at 31 December 2006, the loans from state-controlled banks bear interest at rates ranging from 4.7% to 5.7% per annum and are repayable within one year; the commercial paper bears interest at a fixed rate of 3.05% per annum and is repayable in April 2007; the loans from China Telecom Group bear interest at fixed rates ranging from 2.30% to 2.55% per annum and are repayable within one year.

Long-term debt comprises:

	Interest rates and final maturity	The Group 2006 RMB millions	The Group 2005 RMB millions	The Company 2006 RMB millions	The Company 2005 RMB millions
Bank loans — unsecured					
Renminbi denominated	Interest rates ranging from 3.6% to 6.4% per annum with maturities through 2020	**11,039**	19,112	**–**	–
US Dollars denominated	Interest rates ranging from 0.5% to 8.3% per annum with maturities through 2038	**1,320**	2,087	**–**	–
Japanese Yen denominated	Interest rates ranging from 0.6% to 3.5% per annum with maturities through 2040	**2,053**	2,449	**–**	–
Euro denominated	Interest rates ranging from 0.5% to 6.0% per annum with maturities through 2032	**851**	843	**–**	–
Other currencies denominated		**84**	93	**–**	–
		15,347	24,584	**–**	–
Other loans — unsecured					
Renminbi denominated		**2**	6	**–**	–
Amount due to China Telecom — unsecured					
In connection with the First Acquisition — Renminbi denominated (Note (i))		**15,000**	25,000	**15,000**	25,000
In connection with the Second Acquisition — Renminbi denominated (Note (ii))		**15,150**	15,150	**15,150**	15,150
Total long-term debt		**45,499**	64,740	**30,150**	40,150
Less: current portion		**(8,242)**	(8,963)	**–**	–
Non-current portion		**37,257**	55,777	**30,150**	40,150

13. 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 bears interest on the outstanding balance at 5.184% per annum until 31 December 2008. 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 April 2006, 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 bears interest on the outstanding balance at 5.184% per annum until 30 June 2009. 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.

The aggregate maturities of the Group's and the Company's long-term debts subsequent to 31 December 2006 are as follows:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Within 1 year	**8,242**	8,963	**–**	–
Between 1 to 2 years	**3,815**	8,773	**–**	–
Between 2 to 3 years	**656**	3,824	**–**	–
Between 3 to 4 years	**246**	382	**–**	–
Between 4 to 5 years	**208**	252	**–**	–
Thereafter	**32,332**	42,546	**30,150**	40,150
	45,499	64,740	**30,150**	40,150

The Group's short-term and long-term debts do not contain any financial covenants. As at 31 December 2006, the Group had available credit facilities of RMB40,268 million (2005: RMB31,266 million) which it can draw upon.

14. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Third parties	**25,441**	26,996	**61**	74
China Telecom Group	**6,482**	6,886	**8**	–
Other state-controlled telecommunications operators in the PRC	**63**	67	**–**	–
	31,986	33,949	**69**	74

14. ACCOUNTS PAYABLE (continued)

Amounts due to China Telecom Group are repayable in accordance with contractual terms which are similar to those terms offered by third parties.

Ageing analysis of accounts payable is as follows:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Due within 1 month or on demand	**5,923**	5,379	**–**	–
Due after 1 month but within 3 months	**8,687**	8,797	**45**	46
Due after 3 months but within 6 months	**7,181**	9,283	**9**	4
Due after 6 months	**10,195**	10,490	**15**	24
	31,986	33,949	**69**	74

15. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables represent:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Amounts due to China Telecom Group	**1,982**	4,534	**175**	104
Amounts due to subsidiaries	**–**	–	**14,340**	–
Other state-controlled telecommunications operators in the PRC	**181**	243	**–**	–
Accrued expenses	**12,756**	12,087	**1,204**	571
Customer deposits and receipts in advance	**11,651**	10,021	**90**	44
	26,570	26,885	**15,809**	719

16. FINANCE LEASE OBLIGATIONS

Obligations under finance leases are analysed as follows:

	The Group	
	2006	2005
	RMB	RMB
	millions	millions
Within 1 year	**48**	114
Between 1 to 2 years	**–**	55
Total minimum lease payments	**48**	169
Less: finance charges related to future periods	**–**	(9)
Present value of minimum lease payments	**48**	160
Less: current portion	**(48)**	(108)
Non-current portion	**–**	52

17. 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	
	2006	2005
	RMB	RMB
	millions	millions
Balance at beginning of year	**27,708**	36,771
Additions for the year		
– installation fees	**912**	1,431
– calling cards	**4,204**	3,895
	5,116	5,326
Reduction for the year		
– amortisation of connection fees	**(4,971)**	(6,781)
– amortisation of installation fees	**(2,913)**	(2,970)
– usage of calling cards	**(4,217)**	(4,638)
Balance at end of year	**20,723**	27,708
Representing:		
– Current portion	**7,098**	8,958
– Non-current portion	**13,625**	18,750
	20,723	27,708

17. DEFERRED REVENUES (continued)

Included in other non-current assets are capitalised direct incremental costs associated with the installation of wireline services. As at 31 December 2006, the unamortised portion of these costs was RMB8,473 million (2005: RMB10,025 million).

18. SHARE CAPITAL

	The Group and the Company	
	2006	2005
	RMB	RMB
	millions	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

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

19. RESERVES

The Group	Capital reserve RMB millions (Note (i))	Share premium RMB millions	Re-valuation reserve RMB millions	Surplus reserves RMB millions	Statutory common welfare fund RMB millions	Other reserves RMB millions (Note (ii))	Retained earnings RMB millions	Total RMB millions
Balance as at 1 January 2005	(2,804)	10,746	7,585	25,629	5,793	7,683	23,642	78,274
Effect of change in tax rate (Note 8)	–	–	–	–	–	(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 (iii) and (iv))	–	–	–	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
Effect of change in tax rate (Note 8)	**–**	**–**	**–**	**–**	**–**	**5**	**–**	**5**
Revaluation surplus realised	**–**	**–**	**(94)**	**–**	**–**	**–**	**94**	**–**
Deferred tax on revaluation surplus of property, plant and equipment realised	**–**	**–**	**–**	**–**	**–**	**33**	**(33)**	**–**
Deferred tax on land use rights realised	**–**	**–**	**–**	**–**	**–**	**(182)**	**182**	**–**
Change in fair value of available-for-sale equity securities (net of deferred tax)	**–**	**–**	**–**	**–**	**–**	**44**	**–**	**44**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**27,142**	**27,142**
Transfer from statutory common welfare fund to surplus reserves (Note (iv))	**–**	**–**	**–**	**7,078**	**(7,078)**	**–**	**–**	**–**
Appropriations (Notes (iii) and (iv))	**–**	**–**	**–**	**7,602**	**–**	**–**	**(7,602)**	**–**
Dividends (Note 29)	**–**	**–**	**–**	**–**	**–**	**–**	**(6,283)**	**(6,283)**
Balance as at 31 December 2006	**(2,804)**	**10,746**	**7,357**	**49,818**	**–**	**7,401**	**48,975**	**121,493**

19. RESERVES (continued)

The Company	Capital reserve RMB millions (Note (i))	Share premium RMB millions	Surplus reserves RMB millions	Statutory common welfare fund RMB millions	Retained earnings/ (deficit) RMB millions	Total RMB millions
Balance as at 1 January 2005	29,168	10,746	25,629	5,793	(29,375)	41,961
Profit for the year	–	–	–	–	53,623	53,623
Appropriations (Notes (iii) and (iv))	–	–	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
Profit for the year	**–**	**–**	**–**	**–**	**19,276**	**19,276**
Transfer from statutory common welfare fund to surplus reserves (Note (iv))	**–**	**–**	**7,078**	**(7,078)**	**–**	**–**
Appropriations (Notes (iii) and (iv))	**–**	**–**	**7,602**	**–**	**(7,602)**	**–**
Dividends (Note 29)	**–**	**–**	**–**	**–**	**(6,283)**	**(6,283)**
Balance as at 31 December 2006	**29,168**	**10,746**	**49,818**	**–**	**13,249**	**102,981**

Note:

(i) Capital reserve of the Group represents the sum of (a) the difference between the carrying amount of the Company's net assets and the par value of the Company's shares issued upon its formation; and (b) the difference between the consideration paid by the Company for the acquired entities under the First Acquisition and the Second Acquisition, which were accounted for as equity transactions as disclosed in Note 1 to the financial statements, and the historical carrying amount of net assets of these acquired entities.

Capital reserve of the Company represents the difference between the carrying amount of the Company's net assets and the par value of the Company's shares issued upon its formation.

(ii) Other reserves represent primarily the balance of the deferred tax assets resulted from the revaluation of land use rights for tax purposes (and not for financial reporting purposes) as disclosed in Note 8 to the financial statements.

(iii) 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 2006, the Company transferred RMB2,534 million (2005: RMB2,570 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, the transfer of RMB5,068 million for the year ended 31 December 2006 (2005: RMB6,939 million), being 20% (2005: 27%) 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.

19. RESERVES (continued)

Note:

(iv) According to the Company's Articles of Association, the Company was 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 the transfer of RMB1,285 million, being 5% of the year's net profit determined in accordance with the PRC accounting rules and regulations, to this fund.

Pursuant to the revision of the PRC Company Law, companies with limited liabilities and companies limited by shares are no longer required to make annual profit appropriation to the statutory common welfare fund commencing on 1 January 2006. The opening balance of the Group's statutory common welfare fund as at 1 January 2006 was transferred to the surplus reserves in accordance with "Notice on accounting issue relating to the implementation of the Company Law of the PRC" issued by the Ministry of Finance.

(v) 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 2006, the amount of retained earnings available for distribution was RMB13,249 million (2005: RMB7,858 million), being the amount determined in accordance with IFRS. Final dividend of approximately RMB6,820 million in respect of the financial year 2006 proposed after the balance sheet date has not been recognised as a liability at the balance sheet date (Note 29).

20. 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	
	Note	**2006 RMB millions**	2005 RMB millions
Upfront connection fees	(i)	**4,971**	6,781
Upfront installation fees	(ii)	**2,913**	2,970
Monthly fees	(iii)	**28,973**	30,351
Local usage fees	(iv)	**46,188**	47,624
DLD	(iv)	**25,517**	25,993
ILD	(iv)	**3,140**	3,407
Internet	(v)	**23,630**	17,862
Managed data	(vi)	**3,031**	2,958
Interconnections	(vii)	**14,095**	12,838
Leased line	(viii)	**4,503**	4,464
Value-added services	(ix)	**14,133**	9,976
Others	(x)	**3,999**	4,086
		175,093	169,310

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.

20. OPERATING REVENUES (continued)

Note:

(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.

(viii) Represent primarily 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 wireline value-added services, which comprise primarily caller ID services, short messaging services, ring tone services, integrated information services and telephone information services.

(x) Represent primarily revenues from sale and repairs and maintenance of customer-end equipment, and constructions of telecommunications network and infrastructure for customers.

21. PERSONNEL EXPENSES

Personnel expenses are attributable to the following functions:

	The Group	
	2006 RMB millions	2005 RMB millions
Network operations and support	**17,529**	17,459
Selling, general and administrative	**8,490**	7,501
	26,019	24,960

22. OTHER OPERATING EXPENSES

Other operating expenses consist of:

		The Group	
	Note	**2006 RMB millions**	2005 RMB millions
Interconnection charges	(i)	**6,212**	5,473
Donations		**23**	21
Others		**20**	24
		6,255	5,518

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 2006 include auditors' remuneration of RMB61 million (2005: RMB46 million).

24. NET FINANCE COSTS

Net finance costs comprise:

	The Group	
	2006 RMB millions	2005 RMB millions
Interest expense incurred	**5,795**	6,763
Less: Interest expense capitalised*	**(716)**	(1,062)
Net interest expense	**5,079**	5,701
Interest income	**(326)**	(243)
Foreign exchange losses	**60**	42
Foreign exchange gains	**(146)**	(605)
	4,667	4,895
* Interest expense was capitalised in construction in progress at the following rates per annum	**1.9%–5.0%**	2.1%–5.1%

25. INCOME TAX

Income tax in the consolidated income statement comprises:

	The Group	
	2006 RMB millions	2005 RMB millions
Provision for PRC income tax	**6,661**	5,927
Deferred taxation — PRC (Note 8)	**93**	233
	6,754	6,160

25. INCOME TAX (continued)

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

		The Group	
	Note	**2006 RMB millions**	2005 RMB millions
Profit before taxation		**33,979**	34,114
Expected PRC income tax expense at statutory tax rate of 33%	(i)	**11,213**	11,258
Differential tax rate on subsidiaries' income	(i)	**(1,714)**	(1,689)
Non-deductible expenses	(ii)	**657**	720
Non-taxable income	(iii)	**(1,989)**	(2,651)
Tax credit for domestic equipment purchases		**(1,413)**	(1,478)
Income tax		**6,754**	6,160

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 7.5% 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.

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	Retirement scheme contributions RMB thousands	Share-based payments RMB thousands	Total RMB thousands
2006						
Executive directors						
Wang Xiaochu	—	324	745	64	—	1,133
Leng Rongquan	—	291	671	58	—	1,020
Wu Andi	—	276	633	54	314	1,277
Zhang Jiping	—	276	633	54	314	1,277
Huang Wenlin	—	276	633	54	314	1,277
Li Ping	—	276	633	54	314	1,277
Wei Leping	—	108	107	22	162	399
Yang Jie	—	276	633	52	—	961
Sun Kangmin	—	276	633	53	—	962
Independent non-executive directors						
Zhang Youcai	150	—	—	—	—	150
Vincent Lo Hong Sui	200	—	—	—	—	200
Shi Wanpeng	150	—	—	—	—	150
Xu Erming	150	—	—	—	—	150
Tse Hau Yin	500	—	—	—	—	500
Supervisors						
Zhang Xiuqin	—	142	218	50	236	646
Li Jian	—	131	174	40	170	515
Xu Cailiao	—	109	188	36	144	477
Ma Yuzhu	—	173	263	50	236	722
Independent supervisor						
Zhu Lihao	75	—	—	—	—	75
	1,225	2,934	6,164	641	2,204	13,168

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for the year ended 31 December 2006

26. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

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

	Directors'/ supervisors' fees RMB thousands	Salaries, allowances and benefits in kind RMB thousands	Discretionary bonuses RMB thousands	Retirement scheme contributions RMB thousands	Share-based payments RMB thousands	Total RMB thousands
2005						
Executive directors						
Wang Xiaochu	–	304	33	61	–	398
Leng Rongquan	–	274	30	55	–	359
Wu Andi	–	259	251	51	278	839
Zhang Jiping	–	259	251	51	278	839
Huang Wenlin	–	259	251	51	278	839
Li Ping	–	259	251	51	278	839
Wei Leping	–	259	251	51	278	839
Yang Jie	–	259	191	49	–	499
Sun Kangmin	–	258	191	50	–	499
Cheng Xiyuan	–	159	475	13	232	879
Feng Xiong	–	182	487	57	232	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	44	209	645
Li Jian	–	32	78	12	151	273
Xu Cailiao	–	23	63	10	128	224
Ma Yuzhu	–	43	87	15	209	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	650	2,551	10,420

27. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five highest paid individuals of the Group for the year ended 31 December 2006, all of them were directors of the Company and their remuneration has been disclosed in Note 26. Of the five highest paid individuals of the Group for the year ended 31 December 2005, four of them were directors of the Company and whose remuneration was disclosed in Note 26. For the year ended 31 December 2005, the Group's remaining highest paid individual was not a director or a supervisor of the Company and whose remuneration included salaries, allowances and benefits in kind of RMB850 thousands and retirement benefits of RMB82 thousands.

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 RMB19,276 million (2005: RMB18,451 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 26 March 2007, a final dividend of equivalent to HK$0.085 per share totalling approximately RMB6,820 million for the year ended 31 December 2006 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 2006.

Pursuant to the shareholders' approval at the Annual General Meeting held on 23 May 2006, a final dividend of RMB0.077637 (equivalent to HK$0.075) per share totalling RMB6,283 million in respect of the year ended 31 December 2005 was declared, which was paid on 15 June 2006.

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, which was paid on 23 June 2005.

30. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the years ended 31 December 2006 and 2005 is based on the profit attributable to equity holders of the Company of RMB27,142 million and RMB27,912 million, respectively, divided by 80,932,368,321 shares.

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 2006 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:

	2006 RMB millions	2005 RMB millions
Within 1 year	**468**	326
Between 1 to 2 years	**315**	195
Between 2 to 3 years	**266**	134
Between 3 to 4 years	**223**	119
Between 4 to 5 years	**172**	108
Thereafter	**329**	180
Total minimum lease payments	**1,773**	1,062

Total rental expense in respect of operating leases charged to the consolidated income statement for the year ended 31 December 2006 was RMB1,262 million (2005: RMB1,208 million).

Capital commitments

As at 31 December 2006 and 2005, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2006 RMB millions	2005 RMB millions	**2006 RMB millions**	2005 RMB millions
Authorised and contracted for				
Properties	**570**	513	**113**	148
Telecommunications network plant and equipment	**2,832**	2,278	**3**	16
	3,402	2,791	**116**	164
Authorised but not contracted for				
Properties	**1,622**	1,896	**165**	110
Telecommunications network plant and equipment	**5,590**	3,047	**6**	15
	7,212	4,943	**171**	125

31. COMMITMENTS AND CONTINGENCIES (continued)

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 2006 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, or other forms of contingent liabilities.

As at 31 December 2006, the Company's undiscounted maximum amount of potential future payments under guarantees given to banks in respect of banking facilities granted to subsidiaries was RMB1,649 million (2005: RMB1,497 million).

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 outcome 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.

32. CONCENTRATION OF RISKS (continued)

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:

	2006 RMB millions	2005 RMB millions
Interconnection revenues	**12,035**	10,947
Interconnection charges	**3,405**	2,643
Leased line revenues	**1,088**	2,020

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 13.

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 a part of a large group of companies under China Telecom, a company 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	**2006 RMB millions**	2005 RMB millions
Purchases of telecommunications equipment and materials	(i)	**155**	267
Construction, engineering and information technology services	(ii)	**8,216**	6,575
Provision of community services	(iii)	**2,378**	2,632
Provision of ancillary services	(iv)	**3,238**	2,456
Provision of comprehensive services	(v)	**1,143**	425
Operating lease expenses	(vi)	**364**	386
Centralised service expenses	(vii)	**306**	275
Interconnection revenues	(viii)	**179**	183
Interconnection charges	(viii)	**750**	725
Interest on amounts due to and loans from China Telecom Group	(ix)	**2,361**	2,849

Note:

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

(ii) Represent network construction, engineering and information technology services provided by China Telecom Group.

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

(iv) Represent amounts paid and payable 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 to entities of China Telecom Group which were not within the scope of other related party service agreements in respect of services for 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 leases of business premises and inter-provincial transmission optic fibres.

33. RELATED PARTY TRANSACTIONS (continued)

(a) Transactions with China Telecom Group (continued)

Note:

(vii) Represent net amount charged by China Telecom 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 Group with respect to the amounts due to China Telecom and loans from China Telecom Group (Note 13).

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

	2006 RMB millions	2005 RMB millions
Accounts receivable	**136**	224
Prepayments and other current assets	**548**	606
Total amounts due from China Telecom Group	**684**	830
Accounts payable	**6,482**	6,886
Accrued expenses and other payables	**1,982**	4,534
Short-term debt	**23,766**	20,384
Long-term debt	**30,150**	40,150
Total amounts due to China Telecom Group	**62,380**	71,954

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 contractual terms which are similar to those terms offered by third parties. The term and conditions associated with short-term debt and long-term debt payable to China Telecom Group are set out in Note 13.

As at 31 December 2006 and 2005, no material impairment losses for bad and doubtful debts was recorded in respect of amounts due from China Telecom Group.

On 30 August 2006, the Company entered into a strategic agreement ("the Agreement") with China Communication Services Corporation Limited ("CCS"), a company under the control of China Telecommunication Corporation. The Agreement was approved by the Company's independent shareholders at an Extraordinary General Meeting held on 25 October 2006. The Agreement will be effective from 1 January 2007 to 31 December 2009, pursuant to which the Company's subsidiaries in the Shanghai, Guangdong, Zhejiang, Fujian, Hubei and Hainan regions will, on an annual basis, procure design, construction and engineering services provided by CCS for at least 12.5% of these subsidiaries' capital expenditure. In return, CCS agreed to provide an additional price discount of at least 5% for the above services. In addition, the above subsidiaries will also procure facilities management services provided by CCS of not less than RMB1,330 million during the effective period of the Agreement.

33. RELATED PARTY TRANSACTIONS (continued)

(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:

	2006 RMB thousands	2005 RMB thousands
Short-term employee benefits	**10,323**	7,219
Post-employment benefits	**641**	650
Equity-based compensation benefits	**2,204**	2,551
	13,168	10,420

The above remuneration is included in personnel expenses.

(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-controlled public utilities enterprise and operates in an economic regime currently dominated by entities directly or indirectly controlled by the State through government authorities, agencies, affiliations and other organisations (collectively referred to as "state-controlled entities").

Apart from transactions with parent company and its affiliates, the Group have transactions with other state-controlled entities which include but not limited to the following:

— sales and purchases of goods, properties and other assets

— rendering and receiving services

— lease of assets

— depositing and borrowing money

— use of public utilities

These transactions are conducted in the ordinary course of the Group's business on terms comparable to the terms of transactions with other entities that are not state-controlled. The Group prices its telecommunications services and products based on government-regulated tariff rates, where applicable, or based on commercial negotiations. The Group has also established its procurement policies and approval processes for purchases of products and services, which do not depend on whether the counterparties are state-controlled entities or not.

33. RELATED PARTY TRANSACTIONS (continued)

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

Having considered the transactions potentially affected by related party relationships, the entity's pricing strategy, procurement policies and approval processes, and the information that would be necessary for an understanding of the potential effect of the related party relationship on the financial statements, the directors are of the opinion that the following related party transactions require disclosure of numeric details:

(i) *Transactions with other state-controlled telecommunications operators in the PRC*

The Group's wireline telecommunications networks interconnect with the networks of other state-controlled 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-controlled telecommunications operators in the PRC is disclosed in Note 32.

Amounts due from/to other state-controlled telecommunications operators in the PRC included in the following balances are summarised as follows:

	2006 RMB millions	2005 RMB millions
Accounts receivable	**1,791**	1,786
Prepayments and other current assets	**242**	397
Total amounts due from other state-controlled telecommunications operators in the PRC	**2,033**	2,183
Accounts payable	**63**	67
Accrued expenses and other payables	**181**	243
Total amounts due to other state-controlled telecommunications operators in the PRC	**244**	310

Amounts due from/to other state-controlled telecommunications operators in the PRC bear no interest, are unsecured and are repayable in accordance with normal commercial terms.

As at 31 December 2006 and 2005, there were no material impairment losses for bad and doubtful debts in respect of amounts due from other state-controlled telecommunications operators in the PRC.

33. RELATED PARTY TRANSACTIONS (continued)

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

(ii) *Transactions with state-controlled banks*

The Group deposits its cash balances with several state-controlled banks in the PRC and obtains short-term and long-term loans from these banks in the ordinary course of business. The interest rates of the bank deposits and loans are regulated by the People's Bank of China. The Group's interest income earned from deposits with and interest expenses incurred on loans from state-controlled banks in the PRC are as follows:

	2006 RMB millions	2005 RMB millions
Interest income	**326**	243
Interest expense	**2,993**	3,861

The amounts of cash deposited with and loans from state-controlled banks in the PRC are summarised as follows:

	2006 RMB millions	2005 RMB millions
Cash at bank	**10,475**	11,572
Time deposits with maturity within three months	**7,705**	3,538
Time deposits with maturity over three months	**119**	292
Total deposits with state-controlled banks in the PRC	**18,299**	15,402
Short-term loans	**35,750**	45,704
Long-term loans	**15,347**	24,584
Total loans with state-controlled banks in the PRC	**51,097**	70,288

Further details of the interest rates and repayment terms of loans from state-controlled banks are set out in Note 13.

The directors believe the above information provides 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 2006 were RMB2,374 million (2005: RMB2,258 million).

The amount payable for contributions to defined contribution retirement plans as at 31 December 2006 was RMB522 million (2005: RMB591 million).

35. STOCK APPRECIATION RIGHTS

The Group implemented a stock appreciation rights plan for members of its management to provide 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. The Company recognises compensation expense of the stock appreciation rights over the applicable vesting period.

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 had 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 had 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.

In January 2006, the Company's compensation committee approved the granting of 837.3 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights had a contractual life of six years from date of grant and an exercise price of HK$2.85 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.

35. STOCK APPRECIATION RIGHTS (continued)

During the year ended 31 December 2006, 67 million (2005: 70 million) stock appreciation right units were exercised. For the year ended 31 December 2006, compensation expense recognised by the Group in respect of stock appreciation rights was RMB514 million (2005: RMB81 million).

As at 31 December 2006, the carrying amount of liability arising from stock appreciation rights was RMB574 million (2005: RMB129 million). As at 31 December 2006, the intrinsic value of the vested stock appreciation rights outstanding was nil (2005: RMB0.4 million).

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 2006 and 2005, the carrying amounts and fair values of the Group's long-term debt were as follows:

	2006		2005	
	Carrying amount RMB millions	**Fair value RMB millions**	Carrying amount RMB millions	Fair value RMB millions
Long-term debt	**45,499**	**43,733**	64,740	63,561

Except for available-for-sale equity securities which had fair value of RMB104 million as at 31 December 2006 (2005: RMB38 million) based on quoted price on a PRC stock exchange, the Group's long-term investments are unlisted equity interests for which no quoted market prices exist 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 other factors 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 amortises 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 with consideration of 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 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 its 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.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

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 would 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. When an asset does not generate cash flows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit). 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.

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 2006

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 2006 and which have not been adopted in these financial statements:

	Effective for accounting period beginning on or after
IFRS 7, Financial instruments: disclosures	1 January 2007
IFRS 8, Operating segments	1 January 2009
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
IFRIC 10, Interim financial reporting and impairment	1 November 2006
IFRIC 11, IFRS 2 — Group and treasury share transactions	1 March 2007
IFRIC 12, Service concession arrangements	1 January 2008
Amendment to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007
Revised guidance on Implementing IFRS 4	1 January 2007

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 the adoption of the above amendments, revised guidance, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

39. NON-ADJUSTING POST BALANCE SHEET EVENT

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China ("new tax law"), which will take effect on 1 January 2008. According to the new tax law, the corporate income tax rate for entities other than certain high-tech enterprises and small-scale enterprises earning a "small profit", as defined in the new tax law, will be revised to 25%. In addition, entities that are currently taxed at preferential rates will be subject to a five-year transition period during which the tax rates will gradually be increased to the unified rate of 25% from 1 January 2008. As a result of the new tax law, it is expected that the income tax rate applicable to the Company and certain of its subsidiaries will be reduced from 33% to 25% from 1 January 2008. However, since the detailed implementation rules as to how the existing preferential rates will gradually be increased to the unified rate of 25% over the five-year transition period have not been formulated and promulgated, management is not yet in a position to estimate the impact of the new tax law on the deferred tax assets and liabilities of certain subsidiaries which are being taxed at preferential rates. The financial effect of the new tax law, if any, will be reflected in the Group's 2007 financial statements. The enactment of the new tax law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.

40. PARENT AND ULTIMATE HOLDING COMPANY

The parent and ultimate holding company of the Group as at 31 December 2006 is China Telecommunications Corporation, a state-owned enterprise established in the PRC. This entity does not produce financial statements available for public use.