Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

1. PRINCIPAL ACTIVITIES AND ORGANISATION

(a) Principal activities

China Communications Services Corporation Limited (the ''Company'') and its subsidiaries (hereinafter collectively referred to as the ''Group'') is a leading integrated service provider to the telecommunications industry in the People's Republic of China (the ''PRC''). Its principal activities comprise provision of a full range of telecommunications support services to the telecommunications operators in the PRC, including (i) telecommunications infrastructure design, construction and supervision and management; (ii) business process outsourcing (including network maintenance, facilities management, distribution of telecommunications service and products); and (iii) a variety of other services including applications, content and others.

(b) Organisation

The Company was established in the PRC on 30 August 2006 as a joint stock limited company under the Company Law of the PRC as part of the Restructuring (as defined below) of China Telecommunications Corporation (''CTC''), a state-owned enterprise under the direct supervision of the State Council of the PRC. Pursuant to the Restructuring (as defined below), the Group assumed the telecommunications support services previously carried on by various subsidiaries wholly-owned or controlled by CTC in six provinces and municipality in the PRC, namely, Guangdong Province, Zhejiang Province, Shanghai Municipality, Fujian Province, Hubei Province and Hainan Province (collectively, the ''Predecessor Operations'') from CTC. The Company was founded by CTC, Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation by ways of the injection of those subsidiaries carrying on the Predecessor Operations and cash contributions.

In connection with the Restructuring (as defined below), the Predecessor Operations together with the related assets and liabilities that were to be transferred to the Group were segregated from CTC effective on 31 March 2006 (the ''Restructuring''). The Restructuring comprised the following:

(i) CTC has undergone a restructuring programme in connection with its full range of telecommunications related services, namely (1) telecommunications infrastructure design, construction and supervision and management; (2) business process outsourcing (including network maintenance, facilities management and distribution of telecommunications services and products); and (3) a variety of other services including applications, content and others.

(ii) The net assets have been injected into the Company by ways of asset injection of those subsidiaries carrying on the Predecessor Operations in consideration of approximately 3,623.4 million ordinary shares with a par value of RMB1 each (the ''Asset Injection'').

(iii) The Group, immediately after the Restructuring, contains substantially all of the operating assets and liabilities relating to the Predecessor Operations, comprising (1) telecommunications infrastructure design, construction and supervision and management; (2) business process outsourcing (including network maintenance, facilities management, distribution of telecommunications services and products); and (3) a variety of other services including applications, content and others.

(iv) In connection with the Restructuring, certain assets and liabilities historically associated with the Predecessor Operations were not transferred to the Company and were retained by CTC.

1. PRINCIPAL ACTIVITIES AND ORGANISATION (Continued)

(b) Organisation (Continued)

The above Restructuring procedures primarily resulted in an effect of the transfer from CTC to the Company of the operating assets and liabilities relating to the telecommunications related services carried on by the Predecessor Operations, which were previously owned or controlled by CTC prior to the Restructuring.

In December 2006, the Company issued 1,291,293,000 H shares with a par value of RMB1.00 each, at a price of HK$2.20 per H share by way of an initial public offering (the ''IPO'') to Hong Kong and overseas investors. In connection with the IPO, 129,129,300 domestic state-owned shares of RMB1.00 each owned by CTC and its subsidiaries were converted into H shares and transferred to the National Council for Social Security Fund of the PRC (''SSF''). In December 2006, the Company also issued 193,693,000 H shares with a par value of RMB1.00 each, at a price of HK$2.20 per H share upon the exercise of the over-allotment option. In connection with the exercise of the over-allotment option, 19,369,300 domestic state-owned shares of RMB1.00 each owned by CTC and its subsidiaries were converted into H shares and transferred to SSF. A total of 1,633,484,600 H shares were listed on the Stock Exchange of Hong Kong Limited (the ''Stock Exchange'').

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

The financial statements of the Company and the Group have been prepared in accordance with International Financial Reporting Standards (''IFRSs'') promulgated by the International Accounting Standards Board (''IASB''). IFRSs includes all applicable individual International Financial Reporting Standards, International Accounting Standards (''IASs'') and related interpretations. The 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.

A summary of the significant accounting policies adopted by the Group is set out below.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2006 comprise the Group and its interests in associates.

The financial statements are prepared on the historical cost basis, except that property, plant and equipment (see note 16) is stated at its revalued amount, (see note 2(g)). The accounting policies have been consistently applied by the Group and are consistent with those used in the previous year.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. 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 judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Basis of preparation of the financial statements (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.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 38.

The IASB has issued certain new and revised IFRSs which are effective for accounting periods on or after 1 January 2006. The adoption of these new and revised IFRSs 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 standards or interpretations that is not yet effective for the current accounting period (see note 43).

(c) Basis of consolidation

(i) Subsidiaries and minority interests

Subsidiaries are those companies controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transaction and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Group, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders/ owner of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders/ owner of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Basis of consolidation (Continued)

(i) Subsidiaries and minority interests (Continued)

Loans from holders of minority interests and other contractual obligations towards these holders are presented as financial liabilities in the consolidated balance sheet in accordance with notes 2 (p) or (q) depending on the nature of the liability.

In the Company's balance sheet, investments in subsidiaries are stated at cost less impairment losses (see note 2(l)).

(ii) Associates

Associates are those entities in which the Group has significant influence, but not control, over its management, including participation in the finance and operating decisions.

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 post-acquisition change in the Group's share of the associate's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment associates recognised for the year (see notes 2(d) and 2(l)).

When the Group's share of losses exceeds its interest in the associate, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For this purpose, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the consolidated income statement.

(d) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(l)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in the associate.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in the consolidated income statement.

On disposal of a cash generating unit or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Other investments in debt and equity securities

The Group's policies for investments in debt and equity securities, other than investments in subsidiaries and associates, are as follows:

Investments in debt and equity securities are initially stated at cost, which is their transaction price unless fair value can be more reliably estimated using valuation techniques whose variables include only data from observable markets. Cost includes attributable transaction costs, except where indicated otherwise below. These investments are subsequently accounted for as follows, depending on their classification:

Dated debt securities that the Group have the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are stated in the consolidated balance sheet at amortised cost less impairment losses (see note 2(l)).

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 recognised in the consolidated balance sheet at cost less impairment losses (see note 2(l)).

Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.

(f) Investment properties

Investment properties are land or/and buildings which are owned to earn rental income and/or for capital appreciation.

Investment properties are stated in the consolidated balance sheet at cost less accumulated depreciation and impairment losses (see note 2(l)). Depreciation is calculated to write off the cost less estimated residual value if applicable and is charged to the consolidated income statement on a straight-line basis over the estimated useful lives ranging from 20 years to 30 years.

Rental income from investment properties is accounted for as described in note 2(v)(iv).

When an item of property, plant and equipment is transferred to investment property following a change in its use or when an investment property becomes owner-occupied and reclassified as property, plant and equipment, its carrying amount at the date of reclassification becomes its initial cost for accounting purposes.

(g) Other property, plant and equipment

The following items of property, plant and equipment are initially recognised in the consolidated balance sheet at cost less accumulated depreciation and impairment losses (see note 2(l)):

— buildings held for own use which are situated on leasehold land, where the fair value of the building could be measured separately from the fair value of the leasehold land at the inception of the lease (see note 2(k)); and

— other items of plant and equipment.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Other property, plant and equipment (Continued)

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs (see note 2(y)).

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in the consolidated income statement on the date of retirement or disposal.

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight-line method over their estimated useful lives as follows:

Buildings	20–30 years
Buildings improvements	5 years
Motor vehicles	5–10 years
Furniture, fixtures and other equipment	5–10 years

Both the useful life of an asset and its residual value, if any, are reviewed annually.

Subsequent to the revaluation which was required by PRC rules and regulations in connection with the Restructuring and which was based on depreciated replacement costs (see note 16), 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 and 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. 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 as a 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 to ensure that the carrying amount of these assets does not differ materially from that which would be determined using fair values at the balance sheet date.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Construction in progress

Construction in progress is stated at cost less impairment losses (see note 2(l)). Cost comprises direct costs of construction and borrowing costs on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the period of construction.

Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment and investment properties when substantially all the activities necessary to prepare the asset for its intended use are completed. No depreciation is provided in respect of construction in progress until it is completed and ready for its intended use.

(i) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's governmental authorities. Land use rights are carried at cost and are charged to the consolidated income statement on a straight-line basis over the respective periods of the rights.

(j) Intangible assets (other than goodwill)

Intangible assets that are acquired by the Group are stated in the consolidated balance sheet at cost less accumulated amortisation and impairment losses (see note 2(l)) (where the estimated useful life is finite).

Amortisation of intangible assets with finite useful lives is charged to the consolidated income statement on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets with an indefinite useful life are systematically tested for impairment at each balance sheet date. Intangible assets are amortised over 5 years to 10 years from the date they are available for use.

(k) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

Assets that are held by Group under leases which do not transfer to the Group substantially all the risks and rewards of ownership are classified as being held under operating leases.

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to the consolidated income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the consolidated income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the consolidated income statement in the accounting period in which they are incurred.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Impairment of assets

(i) Impairment of investments in debt and equity securities and other receivables

Investments in debt and equity securities and other current and non-current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

— For unquoted equity securities and current receivables that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset 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. Impairment losses for equity securities are not reversed.

— For trade and other current receivables and other financial assets carried at cost or amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the consolidated income statement. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

— For available-for-sale securities, the cumulative loss that has been recognised directly in equity is removed from equity and is recognised in the consolidated income statement. The amount of the cumulative loss that is recognised in the consolidated income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the consolidated income statement.

Impairment losses recognised in the consolidated income statement in respect of available-for-sale equity securities are not reversed through the consolidated income statement. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the consolidated income statement.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Impairment of assets (Continued)

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

— property, plant and equipment;

— investment properties;

— construction in progress;

— lease prepayments;

— intangible assets;

— investments in subsidiaries and associates; and

— goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

— Calculation of recoverable amount
The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows 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).

— Recognition of impairment losses
An impairment loss is recognised in the consolidated income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Impairment of assets (Continued)

(ii) Impairment of other assets (Continued)

— Reversals of impairment losses
In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the consolidated income statement in the relevant period in which the reversals are recognised.

(m) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversals occurs.

(n) Construction contracts

The accounting policy for contract revenue is set out in note 2(v)(i). When the outcome of a construction contract can be estimated reliably, contract costs are recognised as an expense by reference to the stage of completion of the contract at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. When the outcome of a construction contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred.

Construction contracts in progress at the balance sheet date are recorded in the balance sheet at the net amount of costs incurred plus recognised profit less recognised losses and progress billings, and are presented in the consolidated balance sheet as the ''Unbilled revenue for contract work'' (as an asset) or the ''Receipts in advance for contract work'' (as a liability), as applicable. Progress billings not yet paid by the customer are included in the consolidated balance sheet under ''Accounts and bills receivable''. Amounts received before the related work is performed are included in the consolidated balance sheet, as a liability, as ''Receipts in advance for contract work''.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) 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 (see note 2(l)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 2(l)).

(p) 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 and fees payable, using the effective interest method.

(q) 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.

(r) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(s) Employee benefits

(i) *Short-term employee benefits and contributions to defined contribution retirement plans*

Salaries, annual bonuses, paid annual leave, contributions to defined contribution plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) *Termination benefits*

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(t) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the consolidated income statement except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) Income tax (Continued)

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination).

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

— in the case of current tax assets and liabilities, the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

— in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  — the same taxable entity; or

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) Income tax (Continued)

— different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(u) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(v) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the consolidated income statement as follows:

(i) *Contract revenue*

When the outcome of a construction contract can be estimated reliably, revenue from a fixed price contract is recognised using the percentage of completion method, measured by reference to the percentage of contract costs incurred to date to estimated total contract costs for the contract.

When the outcome of a construction contract cannot be estimated reliably, revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable.

(ii) *Services rendered*

Revenue from design services rendered is recognised in the consolidated income statement in proportion to the stage of completion of the transaction at the balance sheet date.

Revenue from other services rendered is recognised upon the delivery or performance of the services.

(iii) *Sales of goods*

Revenue is recognised when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(v) Revenue recognition (Continued)

(iv) Rental income from operating leases

Rental income receivable under operating leases is recognised in the consolidated income statement in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognised in the consolidated income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

(v) Dividends

— Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

— Dividend income from listed investments is recognised when the share price of the investment goes ex-dividend.

(vi) Interest income

Interest income is recognised as it accrues using the effective interest method.

(w) Government grants

Government grants are recognised in the consolidated balance sheet initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in the consolidated income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are deducted in arriving at the carrying amount of the asset and consequently are recognised in the consolidated income statement over the useful life of the asset.

(x) 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'') prevailing on the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into RMB at the applicable rates ruling at the balance sheet date. Foreign currency differences, other than those capitalised as construction in progress (see note 2(h)), are recognised as income or expense in the consolidated income statement.

(y) Borrowing costs

Borrowing costs are expensed in the consolidated income statement in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(z) Research and development costs

Research and development costs are recognised as expenses in the period in which they are incurred.

(aa) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

(bb) Dividends or profit distributions

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

(cc) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

(i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;

(ii) the Group and the party are subject to common control;

(iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;

(iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;

(v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or

(vi) the party is a post-employment benefit plan which is for the benefit or employees of the Group or of any entity that is a related party of the Group.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including any director (whether executive or otherwise) of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

3 REVENUES

Revenues are derived from the provision of integrated telecommunications support services, net of sales taxes, and after allowance for trade discounts. The Group's revenues by business nature can be summarised as follows:

	2006 RMB'000	2005 RMB'000
Revenue from telecommunications infrastructure services	**7,472,427**	7,199,590
Revenue from business process outsourcing services	**5,153,540**	4,363,152
Revenue from applications, content and others	**1,556,833**	1,669,549
	14,182,800	13,232,291

4 COST OF REVENUES

	2006 RMB'000	2005 RMB'000
Depreciation and amortisation	**249,691**	239,300
Direct personnel costs	**2,604,229**	2,521,904
Operating lease charges	**199,236**	138,022
Purchase of materials and telecommunications products	**4,333,050**	4,337,923
Subcontracting charges	**2,760,555**	2,029,152
Others	**1,276,835**	1,278,079
	11,423,596	10,544,380

5 OTHER OPERATING INCOME

	2006 RMB'000	2005 RMB'000
Dividend income from unlisted securities	**22,473**	30,198
Government grants	**37,119**	27,444
Net gain on disposal of investments	**28,948**	4,327
Net gain on disposal of property, plant and equipment	**6,163**	3,576
Penalty income	**1,801**	1,458
Management fee income	**45,104**	—
Write-off of non-payable liabilities	**268**	18,783
Others	**17,538**	29,886
	159,414	115,672

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

6 OTHER OPERATING EXPENSES

	2006 RMB'000	2005 RMB'000
Impairment losses on other investments	—	2,177
Impairment losses on property, plant and equipment	—	2,079
Donation	1,800	2,998
Penalty charge	3,297	5,917
Others	7,201	7,895
	12,298	21,066

7 NET FINANCING INCOME

	2006 RMB'000	2005 RMB'000
Interest income	111,451	59,982
Net foreign exchange (loss)/gain	(7,909)	502
Interest on bank advances and other borrowings wholly repayable within five years	(17,898)	(22,081)
	85,644	38,403

For the years ended 31 December 2005 and 2006, no borrowing costs were capitalised in relation to construction in progress.

8 NEGATIVE GOODWILL

	2006 RMB'000	2005 RMB'000
Negative goodwill arising from acquisition of subsidiaries (note 35(a))	—	158,813
Negative goodwill arising from acquisition from minority interests	4,039	686
	4,039	159,499

Negative goodwill has arisen on the acquisition as a result of gains from bargain purchases.

9 PROFIT BEFORE TAX

		2006 RMB'000	2005 RMB'000
(a)	Staff costs:		
	Salaries, wages and other benefits	**3,394,249**	3,270,807
	Contributions to defined contribution retirement schemes	**355,425**	302,863
		3,749,674	3,573,670
(b)	Other items:		
	Depreciation and amortisation	**400,221**	401,579
	Auditors' remuneration	**10,800**	7,912
	Cost of inventories	**4,333,050**	4,337,923
	Impairment losses on trade and other receivables	**3,742**	38,400
	Operating lease charges	**257,425**	190,478
	Research and development costs	**15,872**	53,353
	Share of associates' taxation	**—**	4,428

10 INCOME TAX

(a) Income tax in the consolidated income statement represents:

	2006 RMB'000	2005 RMB'000
Current tax		
PRC enterprise income tax	**293,623**	264,541
Deferred tax		
Origination and reversal of temporary differences (note 24)	**(12,911)**	(4,059)
Total income tax	**280,712**	260,482

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

10 INCOME TAX (Continued)

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2006 RMB'000	2005 RMB'000
Profit before tax	**999,972**	1,040,984
Expected PRC income tax expense at a statutory tax rate of 33% (note (i))	**329,991**	343,525
Differential tax rates on subsidiaries' income (note (i))	**(98,732)**	(147,088)
Non-deductible expenses (note (ii))	**84,858**	84,606
Non-taxable income (note (iii))	**(46,435)**	(46,666)
Tax losses not recognised (note (iv))	**11,030**	26,105
Income tax	**280,712**	260,482

Notes:

(i) The provision of PRC income tax of the Group is calculated based on a statutory rate of 33% of the assessable profit of the Group as determined in accordance with the relevant PRC income tax rules and regulations for the years ended 31 December 2005 and 2006, except for certain subsidiaries of the Group, which are taxed at preferential rate of 15%.

(ii) The amounts include personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose. The amounts for the year ended 31 December 2006 also include the deficit on revaluation of property, plant and equipment.

(iii) Non-taxable income mainly represents dividend income and negative goodwill.

(iv) The amount includes deferred tax assets not recognised amounting to RMB4.8 million (2005: RMB26.1 million) in respect of the tax losses of the entities distributed to the then owner pursuant to the Restructuring.

11 DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The names of the directors and the supervisors of the Company and their remuneration for the year ended 31 December 2006 are as follows:

	Fees RMB'000	Salaries, allowances and other benefits in kind RMB'000	Discretionary bonus RMB'000	Pension scheme contributions RMB'000	2006 Total RMB'000
Name of directors and supervisors					
Wang Xiaochu	—	—	—	—	**—**
Li Ping	—	—	—	—	**—**
Liu Aili	—	—	—	—	**—**
Zhang Junan	—	—	—	—	**—**
Wang Jun	53	—	—	—	**53**
Chan Mo Po, Paul	63	—	—	—	**63**
Zhao Chunjun	40	—	—	—	**40**
Wu Shangzhi	40	—	—	—	**40**
Hao Weimin	27	—	—	—	**27**
Xia Jianghua	—	—	—	—	**—**
Yan Dong	—	98	192	34	**324**
Hai Liancheng	31	—	—	—	**31**
	254	98	192	34	**578**

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

11 DIRECTORS' AND SUPERVISORS' EMOLUMENTS (Continued)

The names of the directors and the supervisors of the Company and their remuneration for the year ended 31 December 2005 are as follows:

	Fees RMB'000	Salaries, allowances and other benefits in kind RMB'000	Discretionary bonus RMB'000	Pension scheme contributions RMB'000	2005 Total RMB'000
Name of directors and supervisors					
Wang Xiaochu	—	—	—	—	—
Li Ping	—	—	—	—	—
Liu Aili	—	—	—	—	—
Zhang Junan	—	—	—	—	—
Wang Jun	—	—	—	—	—
Chan Mo Po, Paul	—	—	—	—	—
Zhao Chunjun	—	—	—	—	—
Wu Shangzhi	—	—	—	—	—
Hao Weimin	—	—	—	—	—
Xia Jianghua	—	—	—	—	—
Yan Dong	—	—	—	—	—
Hai Liancheng	—	—	—	—	—
	—	—	—	—	—

The number of directors and supervisors whose remuneration fell within the following band is as follows:

	2006	2005
HK$ equivalent Nil to 1,000,000	**12**	12

12 INDIVIDUALS WITH HIGHEST EMOLUMENTS

The five highest paid employees of the Group are as follows:

	2006	2005
Directors and supervisors	**—**	—
Non-director and non-supervisor employees	**5**	5
	5	5

12 INDIVIDUALS WITH HIGHEST EMOLUMENTS (Continued)

The remuneration paid to the above non-director, non-supervisor, highest paid employees are as follows:

	2006 RMB'000	2005 RMB'000
Salaries, allowances and benefits in kind	**782**	705
Bonuses	**1,921**	1,886
Pension scheme contributions	**418**	484
	3,121	3,075

The number of these non-director, non-supervisor, highest paid employees whose remuneration fell within the following band is as follows:

	2006	2005
HK$ equivalent		
Nil to 1,000,000	**5**	5

13 PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a profit of RMB55,375,000 which has been dealt with in the financial statements of the Company.

14 DIVIDENDS

(a) Special dividend

As disclosed in the Prospectus of the Company dated 27 November 2006, in accordance with the ''Provisional Regulation relating to Corporate Restructuring of Enterprises and Related Management of State-owned Capital and Financial Treatment'' which was issued by the PRC Ministry of Finance and a resolution passed on 1 November 2006, the directors proposed and the shareholders approved the distribution of profit of the Group for the period from 1 April 2006 to 29 August 2006, being the calendar day immediately preceding to the date of incorporation of the Company. In the same resolution, the directors proposed and the shareholders approved the distribution of profit of the Group for the period from 30 August 2006 to the calendar day immediately preceding the date of its listing on the Stock Exchange (i.e. 7 December 2006) (together, the ''2006 Special Dividend'').

Pursuant to a resolution passed at directors' meeting on 17 April 2007, the directors resolved to pay the 2006 Special Dividend to CTC and its subsidiaries amounting to RMB535 million in total (being the distributable profit of the Group for the period from 1 April 2006 to 7 December 2006). The Company will pay the 2006 Special Dividend to CTC and its subsidiaries in a series of payments commencing in July 2007.

(b) Final dividend

The directors do not recommend the payment of final dividend for 2006.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

15 EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company for the year ended 31 December 2006 of RMB696,078,000 (2005: RMB597,556,000) and the weighted average number of shares in issue during the year ended 31 December 2006 of 4,057,643,000 (2005: 3,960,000,000). The weighted average number of shares in issue during the year ended 31 December 2005 represents the number of shares issued and outstanding upon the legal formation of the Company on 30 August 2006 as if such shares have been outstanding for the above entire year. The weighted average number of shares for the year ended 31 December 2006 also reflects the issuance of 1,484,986,000 shares in 2006 in connection with the Company's initial public offering (see note 33). The weighted average number of shares in issue is set out below:

	2006 Thousands shares	2005 Thousands shares
Shares issued to CTC upon formation of the Company in 2006 as if such shares have been outstanding for the entire year in 2006 and 2005 (see note 33)	**3,960,000**	3,960,000
Effect of shares issued in December 2006	**97,643**	—
	4,057,643	3,960,000

There was no difference between basic and diluted earnings per share as there were no dilutive potential shares outstanding for the periods presented.

16 PROPERTY, PLANT AND EQUIPMENT, NET

The Group

	Buildings RMB'000	Buildings improvements RMB'000	Motor vehicles RMB'000	Furniture, fixtures and other equipment RMB'000	Total RMB'000
Cost:					
As at 1 January 2005	2,020,000	158,598	643,025	998,421	3,820,044
Through acquisition of subsidiaries	16,572	—	15,582	27,338	59,492
Transferred from construction in progress	123,778	21,519	5,515	57,426	208,238
Additions	63,263	17,274	61,099	126,551	268,187
Disposals	(35,823)	(14,228)	(33,178)	(118,395)	(201,624)
Distributions	(143,127)	(2,479)	(886)	(74)	(146,566)
As at 31 December 2005	2,044,663	180,684	691,157	1,091,267	4,007,771
Accumulated depreciation and impairment losses:					
As at 1 January 2005	348,096	82,620	351,354	420,658	1,202,728
Through acquisition of subsidiaries	3,291	—	6,935	15,021	25,247
Depreciation charge	76,947	26,792	81,975	166,417	352,131
Written back on disposal	(9,309)	(9,907)	(20,124)	(54,896)	(94,236)
Impairment losses	2,024	—	—	55	2,079
Distributions	(44,859)	(1,890)	(694)	(71)	(47,514)
As at 31 December2005	376,190	97,615	419,446	547,184	1,440,435
Net carrying value:					
As at 31 December 2005	1,668,473	83,069	271,711	544,083	2,567,336

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

16 PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

The Group (Continued)

	Buildings RMB'000	Buildings improvements RMB'000	Motor vehicles RMB'000	Furniture, fixtures and other equipment RMB'000	Total RMB'000
Cost or valuation:					
As at 1 January 2006	2,044,663	180,684	691,157	1,091,267	4,007,771
Through acquisition of subsidiaries	35,536	2,160	8,111	22,214	68,021
Transferred from construction in progress	158,093	32,102	3,425	51,154	244,774
Additions	275,522	4,598	115,697	228,219	624,036
Disposals	(221,797)	(27,287)	(114,385)	(136,925)	(500,394)
Distributions	(839,671)	(11,423)	(178,800)	(178,731)	(1,208,625)
Revaluation	(42,490)	(11,341)	(108,655)	(259,486)	(421,972)
As at 31 December 2006	1,409,856	169,493	416,550	817,712	2,813,611
Representing:					
Cost	282,636	31,766	99,668	215,675	629,745
Valuation (on a depreciated replacement cost basis as at 31 March 2006)	1,127,220	137,727	316,882	602,037	2,183,866
	1,409,856	169,493	416,550	817,712	2,813,611
Accumulated depreciation and impairment losses:					
As at 1 January 2006	376,190	97,615	419,446	547,184	1,440,435
Through acquisition of subsidiaries	6,522	1,284	4,563	13,704	26,073
Depreciation charge	61,071	25,922	108,937	174,830	370,760
Written back on disposal	(74,171)	(18,071)	(86,553)	(106,156)	(284,951)
Distributions	(162,069)	(8,808)	(108,500)	(79,931)	(359,308)
Revaluation	(149,757)	(17,003)	(191,501)	(253,985)	(612,246)
As at 31 December 2006	57,786	80,939	146,392	295,646	580,763
Net carrying value:					
As at 31 December 2006	1,352,070	88,554	270,158	522,066	2,232,848

16 PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

The Company

	Furniture, fixtures and other equipment RMB'000
Cost :	
Additions	9
As at 31 December 2006	9
Accumulated depreciation:	
As at 31 December 2006	—
Net carrying value:	
As at 31 December 2006	9

(a) All the Group's buildings are located in the PRC.

(b) Valuation pursuant to the Restructuring

As required by the relevant PRC rules and regulations with respect to the Restructuring, all the property, plant and equipment of the Group were valued by China United Assets Appraisal Co., Ltd (the "PRC valuers"), independent valuers registered in the PRC, on a depreciated replacement cost basis.

The surplus arising from the valuation of these assets has been credited to owner's equity and minority interests as at 31 March 2006 amounting to RMB294 million and RMB1 million respectively. The deficit arising from the valuation of these assets amounting to RMB105 million, has been recognised as an expense in 2006.

The above buildings were also valued separately by Savills Valuation and Professional Services Limited, independent qualified valuers in Hong Kong, as at 30 September 2006. The value arrived at by them was approximately the same as that arrived at by the PRC valuers as adjusted for the depreciation for the period from 1 April 2006 to 30 September 2006.

(c) Certain of the Group's bank loans were secured by certain of the Group's property, plant and equipment as described in note 30.

(d) Up to the date of issue of these financial statements, the Group was in the process of applying for or changing registration of the title certificates of certain of its properties with an aggregate carrying value of approximately RMB161 million as at 31 December 2006. The directors of the Company are of the opinion that the Group is entitled to lawfully and validly occupy or use the above mentioned properties.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

16 PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

(e) Had property, plant and equipment been carried at cost less accumulated depreciation, the historical carrying amounts as at 31 December 2006 would have been as follows:

	RMB'000
Buildings	1,246,187
Buildings improvements	83,244
Motor vehicles	191,798
Furniture, fixtures and other equipment	527,136
	2,048,365

17 INVESTMENT PROPERTIES

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	**835,588**	766,517
Through acquisition of subsidiaries	**10,323**	18,770
Transferred from construction in progress	**2,109**	4,266
Additions	**188,031**	46,035
Disposals	**(100,700)**	—
Distributions	**(616,363)**	—
As at 31 December	**318,988**	835,588
Accumulated depreciation:		
As at 1 January	**159,725**	118,342
Through acquisition of subsidiaries	**—**	2,933
Depreciation charge	**16,927**	38,450
Written back on disposal	**(32,435)**	—
Distributions	**(112,121)**	—
As at 31 December	**32,096**	159,725
Net carrying value:		
As at 31 December	**286,892**	675,863
Fair value	**292,172**	798,853

All the Group's investment properties are located in the PRC and are with medium-term leases.

17 INVESTMENT PROPERTIES (Continued)

The Group leases out its properties under operating leases. The leases typically run for period of one year to ten years, with an option to renew the lease after that date at which time all terms are renegotiated. None of the leases includes contingent rentals. At the balance sheet date, the Group's total future minimum lease payments under non-cancellable operating leases were receivables as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Within 1 year	**7,014**	31,371
After 1 year but within 5 years	**20,286**	28,769
After 5 years	**11,731**	4,876
	39,031	65,016

During the year ended 31 December 2006, RMB41 million (2005: RMB59 million) was recognised as rental income in the consolidated income statement and RMB5 million (2005: RMB9 million) in respect of direct operating expenses relating to investment properties was recognised as expenses in the consolidated income statement.

Up to the date of these financial statements, the Group was in the process of applying for or changing registration of the title certificates of certain of its properties with an aggregate carrying value of approximately RMB3.4 million as at 31 December 2006. The directors of the Company are of the opinion that the Group is entitled to lawfully and validly occupy or use the above mentioned properties.

18 CONSTRUCTION IN PROGRESS

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	**396,124**	185,546
Through acquisition of subsidiaries	**—**	26,004
Additions	**223,382**	417,190
Transferred to property, plant and equipment	**(244,774)**	(208,238)
Transferred to investment properties	**(2,109)**	(4,266)
Distributions	**(106,819)**	(20,112)
As at 31 December	**265,804**	396,124

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

19 LEASE PREPAYMENTS

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	**155,522**	151,781
Through acquisition of subsidiaries	**10,192**	6,681
Additions	**49,819**	5,619
Disposals	**(23,532)**	(8,559)
Distributions	**(81,865)**	—
As at 31 December	**110,136**	155,522
Accumulated depreciation:		
As at 1 January	**10,472**	8,807
Through acquisition of subsidiaries	**1,501**	—
Amortisation charge	**3,612**	2,363
Written back on disposal	**(1,919)**	(698)
Distributions	**(6,720)**	—
As at 31 December	**6,946**	10,472
Net carrying value:		
As at 31 December	**103,190**	145,050

Lease prepayments represent payments for land use rights paid to the PRC authorities. The Group's lease prepayments are located in the PRC and are with medium-term leases.

20 INTANGIBLE ASSETS

	The Group	
	2006 **RMB'000**	2005 RMB'000
Cost:		
As at 1 January	**45,171**	33,893
Through acquisition of subsidiaries	**2,609**	216
Additions	**20,337**	13,921
Disposals	**(2,527)**	(2,859)
Distributions	**(9,926)**	—
As at 31 December	**55,664**	45,171
Accumulated amortisation:		
As at 1 January	**19,575**	11,103
Through acquisition of subsidiaries	**1,382**	139
Amortisation charge	**8,922**	8,635
Written back on disposal	**(829)**	(302)
Distributions	**(6,354)**	—
As at 31 December	**22,696**	19,575
Net carrying value:		
As at 31 December	**32,968**	25,596

Intangible assets mainly represent computer software used in telecommunications infrastructure projects.

21 INVESTMENT IN SUBSIDIARIES

	The Company
	2006 **RMB'000**
Unlisted investments, at cost	**5,373,776**

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

21 INVESTMENT IN SUBSIDIARIES (Continued)

The following list contains only the particulars of subsidiaries at 31 December 2006 which principally affected the results, assets or liabilities of the Group.

Name of Company	Type of legal entity	Place of incorporation/ establishment	Held by the Company Directly	Held by the Company Indirectly	Issued and fully paid up/registered capital	Principal Activities
Guangdong Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB857 million	Provision of integrated telecommunications support services through its subsidiaries in Guangdong Province
Zhejiang Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB1,098 million	Provision of Integrated telecommunications support services through its subsidiaries in Zhejiang Province
Shanghai Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB976 million	Provision of integrated telecommunications support services through its subsidiaries in Shanghai Municipality
Fujian Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB311 million	Provision of integrated telecommunications support services through its subsidiaries in Fujian Province
Hubei Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB317 million	Provision of integrated telecommunications support services through its subsidiaries in Hubei Province
Hainan Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB79 million	Provision of integrated telecommunications support services through its subsidiaries in Hainan Province

22 INTERESTS IN ASSOCIATES

	The Group	
	2006	2005
	RMB'000	RMB'000
Share of net assets	**7,927**	180,749

As at 31 December 2006, the Group's associates are unlisted, established and operated in the PRC. The Group's interests in associates are individually and in aggregate not material to the Group's financial condition or results of operations for the year.

23 OTHER INVESTMENTS

	The Group	
	2006	2005
	RMB'000	RMB'000
At cost:		
Unlisted equity securities	**101,697**	208,069
Held-to-maturity unlisted debt securities	**36,778**	536
	138,475	208,605

The above investments are individually and in the aggregate not material to the Group's financial condition or results of operations.

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(Expressed in Renminbi)

24 DEFERRED TAX ASSETS

Deferred tax assets attributable to the following:

	The Group	
	2006 **RMB'000**	2005 RMB'000
Impairment losses, primarily for receivables and inventories	**5,216**	8,016
Pre-operating expenses	**1,562**	2,231
Revaluation of lease prepayments	**41,334**	—
Unused tax losses (note (i))	**26,109**	8,556
Deferred tax assets	**74,221**	18,803

Movements in temporary differences for the year ended 31 December 2005 and 2006 are as follows:

The Group

	As at 1 January 2006 RMB'000	**Recognised in consolidated income statement** RMB'000	**Recognised in owner's equity** RMB'000	**As at 31 December 2006** RMB'000
Impairment losses, primarily for receivables and inventories	8,016	(2,800)	—	5,216
Pre-operating expenses	2,231	(669)	—	1,562
Revaluation of lease prepayments	—	(1,173)	42,507	41,334
Unused tax losses	8,556	17,553	—	26,109
Deferred tax assets	18,803	12,911	42,507	74,221
		(note 10 (a))		

24 DEFERRED TAX ASSETS (Continued)

	As at 1 January 2005 RMB'000	Recognised in consolidated income statement RMB'000	As at 31 December 2005 RMB'000
Impairment losses, primarily for receivables and inventories	4,972	3,044	8,016
Pre-operating expenses	2,900	(669)	2,231
Unused tax losses	6,872	1,684	8,556
Deferred tax assets	14,744	4,059	18,803
		(note 10 (a))	

Notes:

(i) Expiry of recognised tax losses

	2006 RMB'000
Year of expiry	
2008	**130**
2009	**8,968**
2010	**16,978**
2011	**53,042**
	79,118

(ii) In connection with the Restructuring, the Group's land use rights were revalued as required by the relevant PRC rules and regulations as at 31 March 2006. The revalued amount will serve as the tax base for future years. The land use rights were not revalued for financial reporting purposes and accordingly, deferred tax assets of RMB42.5 million is created with a corresponding increase in equity. Based upon the level of historical taxable income and projections for future taxable income, management believes it is probable that the Group will realise the benefits of the deferred tax assets.

(iii) As at 31 December 2006, the Group has not recognised deferred tax assets in respect of tax losses of RMB20.6 million (2005: RMB156.9 million) as it is not probable that future taxable profits against which the losses can be utilised will be available. The tax losses will be expired in 2011.

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(Expressed in Renminbi)

25 INVENTORIES

	The Group	
	2006 **RMB'000**	2005 RMB'000
Construction materials	**337,247**	127,539
Finished goods	**435,373**	346,566
Spare parts and consumables	**55,504**	49,991
	828,124	524,096

The analysis of the amount of inventories recognised as an expense is as follows:

	The Group	
	2006 **RMB'000**	2005 RMB'000
Carrying amount of inventories consumed and sold	**4,333,050**	4,337,923
Write down of inventories	**1,011**	2,304
	4,334,061	4,340,227

26 ACCOUNTS AND BILLS RECEIVABLE, NET

	The Group	
	2006 **RMB'000**	2005 RMB'000
Bills receivable	**58,675**	10,071
Unbilled revenue for contract work (note 27)	**376,409**	242,930
Trade receivables	**2,916,178**	2,742,506
	3,351,262	2,995,507

26 ACCOUNTS AND BILLS RECEIVABLE, NET (Continued)

(a) Included in accounts and bills receivable are amounts due from fellow subsidiaries of RMB1,740 million (2005: RMB1,728 million) as at 31 December 2006. The amounts due from fellow subsidiaries are unsecured, interest free and are expected to be recovered within one year.

(b) In general, debts are due for payment upon billing. Subject to negotiation, credit terms within a range of one to three months are available for certain customers with well-established trading and payment records.

(c) The ageing analysis of accounts and bills receivable (net of impairment losses) is as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Within 1 year	**3,171,309**	2,782,245
After 1 year but less than 2 years	**157,771**	155,258
After 2 years but less than 3 years	**16,583**	47,570
After 3 years	**5,599**	10,434
	3,351,262	2,995,507

27 CONSTRUCTION CONTRACTS

The aggregate amounts of costs incurred plus recognised profit less recognised losses to date, included in the gross amount due from/to customers for contract work at 31 December 2006 are RMB1,236 million (2005: RMB1,276 million).

In respect of construction contacts in progress at the balance sheet date, the amounts of retentions receivable from customers, recorded within ''Accounts and bills receivable'' at 31 December 2006 are RMB10 million (2005: RMB19 million).

28 PREPAYMENTS AND OTHER CURRENT ASSETS

	The Group		The Company
	2006 RMB'000	2005 RMB'000	**2006 RMB'000**
Advances to staff	**88,462**	64,848	**—**
Amounts due from fellow subsidiaries	**252,729**	1,320,403	**—**
Prepayments in connection with construction work and equipment purchases	**275,054**	285,081	**—**
Prepaid expenses and deposits	**199,638**	152,608	**—**
Others	**122,757**	263,513	**2,360**
	938,640	2,086,453	**2,360**

The amounts due from fellow subsidiaries are unsecured, interest free and are expected to be recovered within one year.

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(Expressed in Renminbi)

29 CASH AND CASH EQUIVALENTS

	The Group		The Company
	2006 RMB'000	2005 RMB'000	**2006 RMB'000**
Cash at bank and in hand	**6,934,427**	3,024,172	**3,150,555**
Deposits with banks and other financial institutions	**136,602**	661,744	**—**
Cash and cash equivalents	**7,071,029**	3,685,916	**3,150,555**

Renminbi is not a freely convertible currency and the remittance of funds out of the PRC is subject to the exchange restrictions imposed by the PRC government.

Included in cash and cash equivalents are the following amounts denominated in a currency other than the functional currency of the Group:

	The Group		The Company
	2006 HKD'000	2005 HKD'000	**2006 HKD'000**
Hong Kong dollars	**3,139,190**	183	**3,134,926**

The cash and cash equivalents denominated in Renminbi and Hong Kong dollars bear interest at 0.72% to 2.25% (2005: 0.72% to 2.25%) and 2.75% to 4.30% (2005: 3.00%) per annum for the year ended 31 December 2006 respectively.

30 INTEREST-BEARING BORROWINGS

The Group's short-term borrowings are denominated in Renminbi and comprise:

	The Group	
	2006 RMB'000	2005 RMB'000
Borrowings from banks		
— secured	**50,000**	—
— unsecured	**45,500**	151,500
Loans from fellow subsidiaries		
— unsecured	**—**	58,045
	95,500	209,545

30 INTEREST-BEARING BORROWINGS (Continued)

The Group's interest rate per annum on short-term borrowings is:

	The Group	
	2006	2005
Borrowings from banks	**4.65%–5.86%**	4.96%–6.42%
Loans from fellow subsidiaries	**—**	4.25%–5.58%

As at 31 December 2006, bank loans amounting to RMB50 million (2005: Nil) were secured by certain of the Group's property, plant and equipment with net book value of RMB21 million.

31 ACCOUNTS AND BILLS PAYABLE

Accounts and bills payable comprise:

	The Group	
	2006 **RMB'000**	2005 RMB'000
Trade payable	**2,697,409**	1,908,436
Bills payable	**162,656**	39,030
	2,860,065	1,947,466

The ageing analysis of accounts and bills payable is as follows:

	The Group	
	2006 **RMB'000**	2005 RMB'000
Within 1 year	**2,784,827**	1,929,576
After 1 year but less than 2 years	**69,504**	13,790
After 2 years but less than 3 years	**3,368**	3,139
After 3 years	**2,366**	961
	2,860,065	1,947,466

Included in accounts and bills payable are amounts due to fellow subsidiaries of RMB110 million (2005: RMB121 million) as at 31 December 2006. The amounts due to fellow subsidiaries are unsecured, interest free and are expected to be settled within one year.

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(Expressed in Renminbi)

32 ACCRUED EXPENSES AND OTHER PAYABLES

	The Group		The Company
	2006 RMB'000	2005 RMB'000	**2006 RMB'000**
Wages and welfare payables	**472,499**	783,407	**—**
Amounts due to fellow subsidiaries	**302,844**	715,328	**1,150**
Advances received	**95,785**	98,623	**—**
Other taxes payable	**123,425**	188,814	**3,335**
Dividends payable	**202,851**	82,142	**—**
Payables for construction and purchase of fixed assets	**179,784**	236,463	**—**
Others	**692,517**	703,350	**50,295**
	2,069,705	2,808,127	**54,780**

The amounts due to fellow subsidiaries are unsecured, interest free and are expected to be settled within one year.

Dividends payable represent dividends declared by certain of the subsidiaries now comprising the Group and payable to the then owners.

33 SHARE CAPITAL

	The Group and the Company	
	2006 RMB'000	2005 RMB'000
Registered, issued and fully paid:		
3,811,501,400 (2005: Nil) domestic state-owned ordinary shares of RMB1.00 each	**3,811,501**	—
1,633,484,600 (2005: Nil) H shares of RMB1.00 each	**1,633,485**	—
	5,444,986	—

	The Group and the Company	
	2006 Thousands shares	2005 Thousands shares
At 1 January	**—**	—
Issuance of domestic state-owned ordinary shares	**3,960,000**	—
Conversion of domestic state-owned ordinary shares into H shares	**(148,499)**	—
Issuance of H shares	**1,633,485**	—
At 31 December	**5,444,986**	—

33 SHARE CAPITAL (Continued)

The Company was incorporated on 30 August 2006 with a registered share capital of 3,960,000,000 domestic state-owned ordinary shares with a par value of RMB1.00 each. Such shares were issued to CTC, Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation, as a consideration for the transferring of the Predecessor Operations and injection of cash to the Company (see note 1). In December 2006, the Company issued 1,484,986,000 H shares with a par value of RMB1.00, at a price of HK$2.20 per H share and 148,498,600 domestic state-owned shares of RMB1.00 each owned by CTC were converted into H shares in connection with the initial public offering. For more details, please refer to note 1(b).

All shareholders are entitled to receive dividends as declared from time to time except for the special dividends described in note 14 and are entitled to one vote per share at meetings of the Company. All shares rank equally with regard to the Company's residual assets.

34 RETIREMENT BENEFIT OBLIGATIONS

In accordance with the labour regulations of the PRC, the Group participates in various defined contribution retirement schemes organised by the municipal and provincial governments for its employees. The Group is required to make contributions to the retirement schemes at rates ranging from 16.5% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the scheme is entitled to a pension equal to a fixed proportion of the salary prevailing at his or her retirement date.

The Group has no other material obligation for the payment of pension benefits associated with these schemes beyond the annual contributions described above.

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35 NOTES TO CONSOLIDATED CASH FLOW STATEMENT

(a) Acquisition of subsidiaries

During the year ended 31 December 2006, the Group acquired several subsidiaries as follows:

	2006 RMB'000	2005 RMB'000
Property, plant and equipment, net	**41,948**	34,245
Investment properties	**10,323**	15,837
Construction in progress	**—**	26,004
Lease prepayments	**8,691**	6,681
Intangible assets	**1,227**	77
Inventories	**14,068**	393
Accounts and bills receivable, net	**46,623**	202,941
Prepayments and other current assets	**31,133**	116,220
Cash and cash equivalents	**16,139**	64,913
Accounts and bills payable	**(39,104)**	(4,970)
Accrued expenses and other payables	**(25,598)**	(94,015)
Income tax payable	**(26)**	(68,921)
Net identifiable assets and liabilities	**105,424**	299,405
Contributed by owner (note)	**(105,424)**	(89,528)
Negative goodwill arising on consolidation	**—**	(158,813)
Total purchase price paid, satisfied in cash	**—**	51,064
Less: cash of the subsidiaries acquired	**(16,139)**	(64,913)
Net cash inflow in respect of the purchase of subsidiaries	**(16,139)**	(13,849)

Note: These represent the acquisition of subsidiaries made by owner, being transferred to the Group by way of capital contribution.

(b) Major non-cash transactions

	2006 RMB'000	2005 RMB'000
Contributions in forms of property, plant and equipment, lease prepayments and other assets	**203,128**	467,862
Distributions in forms of property, plant and equipment, lease prepayments and other assets	**222,806**	367,095
Distribution of net assets to owner pursuant to the Restructuring	**1,430,962**	—

36 COMMITMENTS AND CONTINGENT LIABILITIES

(a) Capital commitments

As at 31 December 2006, the Group has capital commitment for acquisition and construction of property, plant and equipment as follows:

	The Group	
	2006 **RMB'000**	2005 RMB'000
Authorised and contracted for	**75,184**	129,649
Authorised but not contracted for	**36,969**	62,020

(b) Operating lease commitments

As at 31 December 2006, the Group's total future minimum lease payments under non-cancellable operating leases were payable as follows:

	The Group	
	2006 **RMB'000**	2005 RMB'000
Within 1 year	**58,832**	46,783
After 1 year but within 5 years	**104,802**	129,844
After 5 years	**7,615**	11
	171,249	176,638

The Group leases a number of properties under operating leases. The leases typically run for period of one year to six years, with an option to renew the lease when all terms are renegotiated. None of the leases includes contingent rentals.

(c) Contingent liabilities

The Group had no material contingent liabilities and no financial guarantees issued.

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37 FINANCIAL INSTRUMENTS

Exposure to credit, interest and liquidity risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

(a) Credit risk

Management has a credit policy in place and the exposure to credit risks is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. Normally, the Group does not obtain collateral from customers.

The Group's major customers are CTC and its subsidiaries (collectively referred to as "CTC Group"), and China Mobile Limited. The Group has a certain concentration of credit risk as the Group's largest customer accounted for 52% of the total accounts and bills receivable as at 31 December 2006 (2005: 58%). The Group has no significant credit risk with any of these customers since the Group maintains long-term and stable business relationships with these large customers in the telecommunications industry.

(b) Interest rate risk

The interest rates and terms of repayment of outstanding loans and deposits of the Group at balance sheet date are disclosed in notes 30 and 29 respectively.

(c) Liquidity risk

Individual operating entities within the Group are responsible for their own cash management, including the short-term investment of cash surpluses and the raising of loans to cover expected cash demands, subject to approval by the board of the entities when the borrowings exceed certain predetermined levels of authority. The Group's policy is to regularly monitor current and expected liquidity requirements, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

(d) Fair value

The fair values of cash and cash equivalents, accounts and bills receivable, prepayments and other current assets, accounts and bills payable and accrued expenses and other payables are not materially different from their carrying amounts.

The fair values of the Group's interest-bearing borrowings are estimated to approximate to their fair value based on the nature or short-term maturity.

The fair values of Group's other investments could not be reasonably estimated without incurring excessive costs, since there are no listed market prices for such interest in the PRC.

37 FINANCIAL INSTRUMENTS (Continued)

(e) Foreign currency risk

Substantially all the revenue-generating operations of the Group are transacted in Renminbi, which is not freely convertible into foreign currencies. On 1 January 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange quoted by the PBOC. However, the unification of the exchange rate does not imply convertibility of Renminbi into other foreign currencies. All foreign exchange transactions continue to take place either through the PBOC or other institutions authorised to buy and sell foreign currencies. Approval of foreign currency payments, including remittances of dividends, by the PBOC or other institutions requires submitting a payment application form together with relevant supporting documents.

38 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

In determining the carrying amounts of certain assets and liabilities, the Group makes assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. The Group's estimates and assumptions are based on historical experience and expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying the Group's accounting policies.

(a) Construction contracts

As explained in notes 2(n) and 2(v)(i) revenue and profit recognition on an uncompleted project is dependent on estimating the total outcome of the construction contract, as well as the work done to date. Based on the Group's recent experience and the nature of the construction activity undertaken by the Group, the Group makes estimates of the point at which it considers the work is sufficiently advanced such that the costs to complete and revenue can be reliably estimated. As a result, until this point is reached the amounts due from customers for contract work as disclosed in note 27 will not include profit which the Group may eventually realise from the work done to date. In addition, actual outcomes in terms of total cost or revenue may be higher or lower than estimated at the balance sheet date, which would affect the revenue and profit recognised in future years as an adjustment to the amounts recorded to date.

(b) Impairment for bad and doubtful debts

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

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38 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

(c) Impairment of long-lived assets

If circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the asset may be considered ''impaired'', and an impairment loss may be recognised in accordance with accounting policy for impairment of long-lived assets as described in note 2(l). The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. 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.

39 RELATED PARTIES

The Group is part of a large group of companies under CTC and has significant transactions and relationships with members of CTC. Apart from the transactions and balances disclosed in the financial statements set out above, there are the following related party transactions:

(a) Transactions with CTC Group

Because of the relationships between the Group, CTC and members of the CTC, it is possible that the terms of those transactions are not the same as those that would result from transactions among unrelated parties.

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

	2006 RMB'000	2005 RMB'000
Income from related parties:		
Engineering related services (note (i))	**4,126,272**	3,326,337
IT application services (note (ii))	**147,058**	106,422
Provision of ancillary telecommunications services (note (iii))	**2,197,976**	1,496,072
Provision of operation support services (note (iv))	**1,017,242**	1,015,466
Property leasing (note (v))	**45,375**	38,783
Management fee income (note(vi))	**45,104**	—
Expenses paid to related parties:		
Property leasing charges (note (vii))	**45,325**	35,962
IT application service charges (note (viii))	**170,925**	176,796
Operation support service charges (note (ix))	**104,247**	101,722
Interest paid (note (x))	**2,160**	2,954

39 RELATED PARTIES (Continued)

(a) Transactions with CTC Group (Continued)

Notes:

(i) The amount represents the engineering related services, such as design, construction and project management for telecommunications infrastructure project provided to CTC Group.

(ii) The amount represents the telecommunications network support services, software and hardware development and other IT related services provided to CTC Group.

(iii) The amount represents ancillary telecommunications services such as maintenance of network facilities including optical ducts and cables, exchange buildings and base stations; operation of distribution channels, fixed line and wireless value-added service, internet contents and information services provided to CTC Group.

(iv) The amount represents the facilities management, advertising, conferencing services and certain repair and leasing of equipments services provided to CTC Group.

(v) The amount represents rental income in respect of premises leased to CTC Group.

(vi) The amounts represent management fee income in respect of centralised services provided to CTC Group.

(vii) The amount represents operating leases in respect of business premises paid and payable to CTC Group.

(viii) The amount represents basic telecommunications service, value-added service and information application service charged by CTC Group.

(ix) The amount represents the charge paid and payable to CTC Group for logistics, labour resources, cultural, educational, hygiene and other supporting services.

(x) Interest paid/payable represents the interest paid or payable to CTC Group in respect of the loans from fellow subsidiaries.

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

	2006 RMB'000	2005 RMB'000
Accounts and bills receivable, net	**1,740,358**	1,728,006
Prepayments and other current assets	**252,729**	1,320,403
Total amounts due form CTC Group	**1,993,087**	3,048,409
Interest-bearing borrowings	**—**	58,045
Accounts and bills payable	**110,036**	121,293
Receipts in advance for contact work	**82,105**	429,144
Accrued expenses and other payables	**465,788**	773,610
Total amounts due to CTC Group	**657,929**	1,382,092

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39 RELATED PARTIES (Continued)

(a) Transactions with CTC Group (Continued)

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

The directors are of the opinion that the above transactions with related parties were conducted on normal commercial terms in the ordinary course of business and the terms are fair and reasonable so far as the shareholders of the Company are concerned.

In connection with the Restructuring, the Company and CTC entered into a number of agreements effective as at 16 November 2006 to take up the existing agreements signed between the Predecessor Operations and CTC as set out in items (1), (2) and (3) below, together with a new agreement governing the provision of headquarter management function by the Company as set out in item (4). The terms of the principal agreements impacting the results of operations of the Group are summarised as follows:

(1) The Group has entered into agreements with CTC pursuant to which the Group provides CTC Group with construction, design and project supervision and management for telecommunications infrastructure projects. In addition, the Group has entered into information technology service agreements with CTC pursuant to which the Group provides CTC Group with telecommunications network support service, software and hardware development and other IT related services. The amounts charged for these services are determined by reference to market rates as reflected in prices obtained through a tender.

(2) The Group has entered into facilities leasing agreements with CTC pursuant to which the Group leases certain premises and other facilities to CTC Group, and vice versa. The rental charges are based on market rate, with reference to amounts stipulated by local price bureau.

(3) The Group has entered into operation support services agreements for facilities management, advertising, conferencing, logistics, cultural, educational, hygiene and other community services with CTC. In addition, the Group has entered into ancillary services agreements with CTC. The ancillary services provided to CTC Group include repairs and maintenance of telecommunications equipment and facilities and certain customer services. Pursuant to these agreements, the Group charges CTC Group, and vice versa, for these services in accordance with the following terms:

— government prescribed price;

— where there is no government prescribed prices but where there is a government guided price, the government guided price will apply;

— where there is neither a government prescribed price nor a government guided price, the market price will apply;

— where none of the above is available, the price is to be agreed between the relevant parties, which shall be based on the cost incurred in providing the services plus a reasonable profit margin.

39 RELATED PARTIES (Continued)

(a) Transactions with CTC Group (Continued)

(4) The Group has entered into agreement with CTC pursuant to which the Group takes up the role as headquarter management function to manage assets of the telecommunications support business of provinces, municipalities and autonomous regions including Jiangsu, Anhui, Jiangxi, Sichuan, Chongqing, Hunan, Guizhou, Yunan, Guangxi, Shaanxi, Ningxia, Gansu, Qinghai, Xingjiang, Tibet and any assets retained by CTC after the Restructuring. The aggregate administrative costs incurred by the Group for the provision of the centralised services are apportioned pro rata between the Group and CTC Group according to the net asset ratio of each of the relevant party.

(5) The Group acquired certain property, plant and equipment from CTC Group for a total consideration of RMB295 million in 2006 subsequent to the incorporation of the Company.

(b) Transactions with other state-controlled entities in the PRC

The Group is a state-controlled entity and operates in an economic regime currently predominated by entities directly or indirectly owned or controlled by the PRC government and numerous government authorities and agencies (collectively referred to as ''state-controlled entities''). Apart from transactions mentioned in the above, the Group conducts a majority of its business activities with state-controlled entities in the ordinary course of business. These transactions are carried out at terms similar to those that would be entered into with non-state-controlled entities. Transactions with other state-controlled entities in the PRC include but not limited to the following:

— sales and purchase of goods, properties and other assets;

— rendering and receiving services;

— depositing and borrowing money; and

— use of public utilities.

The Group prices its services and products based on guideline ceiling rates prescribed by relevant government agencies, where applicable, or based on the commercial negotiations. The Group has also established its procurement policies and approval processes for purchase of products and services, which do not depend on whether the counter parties are state-controlled entities or not.

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39 RELATED PARTIES (Continued)

(b) Transactions with other state-controlled 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 or the potential effect of the related party relationships on the consolidated financial statements, the directors are of the opinion that the following amounts due from/to state controlled entities in the PRC require disclosure.

Cash deposited with the state-controlled banks in the PRC and the interest income are as follows:

	2006 RMB'000	2005 RMB'000
Cash and cash equivalents	**3,913,664**	3,682,502

	2006 RMB'000	2005 RMB'000
Interest income	**42,572**	59,982

(c) Transactions with key management personnel

Remuneration for key management personnel, including amounts paid to the Company's directors and supervisors as disclosed in note 11 and certain of the highest paid employees as disclosed in note 12, is as follows:

	2006 RMB'000	2005 RMB'000
Salaries and other emoluments	**872**	820
Retirement benefits	**490**	556
Bonuses	**2,224**	2,183
	3,586	3,559

Total remuneration is included in ''Staff costs'' in note 9.

39 RELATED PARTIES (Continued)

(d) Contributions to defined contribution retirement plans

The Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its staff. The details of the Group's employee benefits plan are disclosed in note 34. As at 31 December 2005 and 2006, there was no material outstanding contribution to post-employment benefit plans.

(e) Transactions with ten largest state-controlled customers and suppliers

The directors consider that the transactions with state-controlled entities which require disclosure in the financial statements have been set out above. The following are the additional disclosure in respect of transactions entered into by the Group with its ten largest state-controlled customers and suppliers:

Transactions with the Group's ten largest customers, which are state-controlled entities, amounting to approximately RMB10,023 million for the year ended 31 December 2006 (2005: RMB8,756 million).

Transactions with the Group's ten largest suppliers, which are state-controlled entities, amounting to RMB539 million for the year ended 31 December 2006 (2005: RMB289 million).

40 SEGMENTAL REPORTING

For the years ended 31 December 2005 and 2006, the Group principally has one business segment, the provision of integrated telecommunications service to the telecommunications industry in the PRC. The Group mainly operates in the PRC. Accordingly, no business and geographical segment information are presented.

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41 DISTRIBUTABLE RESERVES

The movement of shareholders' equity of the Company for 2006 is as follows:

	Share capital	Share premium	Capital reserves	Statutory surplus reserves	Retained earnings/ (loss)	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
	(Note 33)					
Capitalisation upon legal establishment of the Company (Note 1)	3,960,000	—	1,413,776	—	—	5,373,776
Issuance of shares upon public listing	1,484,986	1,807,727	—	—	—	3,292,713
Shares issue expenses	—	(249,944)	—	—	—	(249,944)
Profit for the period	—	—	—	—	55,375	55,375
Appropriation	—	—	—	69,969	(69,969)	—
At 31 December 2006	5,444,986	1,557,783	1,413,776	69,969	(14,594)	8,471,920

According to the Company's Articles of Association, the amount of retained profits available for distribution to equity 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 IFRSs after the appropriation to statutory surplus reserve as detailed in Note (e) to the consolidated statement of changes in equity.

At 31 December 2006, there were no distributable reserves attributable to the equity shareholders of the Company.

42 COMPARATIVE FIGURES

Subcontracting charges of RMB499 million in 2005 have been reclassified to direct personnel costs to conform with the current year's presentation.

43 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING YEAR ENDED 31 DECEMBER 2006

Up to the date of issue of these financial statements, the IASB has issued amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2006 and which have not been adopted in these financial statements. Of these developments, the following relate to matters they may be relevant to the Group's operations and financial statements:

		Effective for accounting periods beginning on or after
IFRS 7	Financial instruments: Disclosures	1 January 2007
IFRS 8	Operating segments	1 January 2007
Amendment to IAS 1 (August 2005)	Presentation of financial statements: capital disclosures	1 January 2009
IFRIC 10	Interim financial reporting and impairment	1 November 2006

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 it has concluded that while the adoption of them may result in new or amended disclosures, it is unlikely to have a significant impact on the Group's results of operations and financial position.

44 IMMEDIATE AND ULTIMATE CONTROLLING PARTY

At 31 December 2006, the directors consider the immediate and ultimate controlling party of the Group to be CTC, a stated-owned enterprise established in the PRC. CTC does not produce financial statements available for public use.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

45 NON-ADJUSTING POST BALANCE SHEET EVENT

The Corporate Income Tax Law of the People's Republic of China (''new tax law'') has been passed by the Fifth Plenary Session of the Tenth National People's Congress on 16 March 2007 and will take effect on 1 January 2008. According to the new tax law, except for certain subsidiaries of the Company which are taxed at preferential rates, the income tax rate applicable to the Group will be reduced from 33% to 25% from 1 January 2008. From 1 January 2008, certain subsidiaries 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% and certain high-tech enterprises will continue to be entitled to a reduced tax rate of 15%. However, the new tax law has not set out the details as to how the existing preferential tax rate will gradually increase to the standard rate of 25% and the detailed implementation rules regarding the preferential tax policies (e.g. the details of how a taxpayer can be qualified as a high-tech enterprise to enjoy the preferential rate of 15%) have yet to be made public. Consequently, management is not 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.