1 The group, its reorganisation and principal activities

Background of the group

China Netcom Corporation (Hong Kong) Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("Hong Kong") of the People's Republic of China ("PRC") on October 22, 1999 as a limited liability company under the Hong Kong Companies Ordinance. Prior to a reorganisation conducted for the listing of the shares of the Company (the "Reorganisation"), the Company's ultimate holding company was China Netcom (Holdings) Company Limited ("China Netcom Holdings").

China Netcom Holdings was previously owned by four state-owned enterprises and became the Company's holding company in December 2000. The Company, through its principal operating subsidiary China Netcom (Group) Limited (''CNC China''), is engaged in the provision of fixed line telecommunication services through different regional branch offices in the PRC. In March 2003, the Company along with two co-investors through Asia Netcom Corporation Limited (''Asia Netcom''), being a 51% owned jointly controlled entity of the Company at that time, acquired the Asia-Pacific submarine cable assets and related physical network assets and liabilities, from Asia Global Crossing Ltd. On December 31, 2003, the Company further purchased the remaining 49% interests in Asia Netcom held by the other co-investors and became the sole owner of Asia Netcom.

Reorganisation of the group

In anticipation of the listing of the Company's shares and American Depository Shares ("ADSs") on The Stock Exchange of Hong Kong and the New York Stock Exchange Inc. respectively (the "Global Offering"), China Netcom Holdings and China Network Communications Group Corporation (the "China Netcom Group") both being state owned enterprises under the supervision and regulation of the Ministry of Information Industry (''MII''), underwent the Reorganisation which was effective for accounting purposes on June 30, 2004 (see Note 2). Immediately after the Reorganisation, the ultimate holding company of the Company was China Netcom Group.

China Netcom Group, the Company's current ultimate holding company, was established by the State Council of the PRC in May 2002. Under a comprehensive industry restructuring plan relating to the fixed line telecommunication sector in China approved by the State Council in November 2001, the fixed line telecommunications businesses originally operated by China Telecommunication Corporation (''China Telecom Group'') were split into northern and southern operations. In May 2002, China Netcom Group took over the northern part fixed line telecommunication operations in 10 provinces, municipalities and autonomous regions.

The Reorganisation undertaken in anticipation of the listing of the Company comprised the following:

(a) China Netcom Group acquired the entire interest in China Netcom Holdings from its four state owners and became the ultimate holding company of the Group;

(b) The Company's principal operating subsidiary, namely CNC China, transferred all of its assets and liabilities in the PRC telecommunications operations to China Netcom Group, and assets and liabilities of the PRC fixed line telecommunications operations previously owned by both China Netcom Group and the Company were combined in the respective provinces, municipalities and autonomous regions;

1 The group, its reorganisation and principal activities *(continued)*

Reorganisation of the group *(continued)*

(c) After excluding certain assets and liabilities which were retained by China Netcom Group as set out in (f) (i) below, the net assets of the telecommunications operations of 8 PRC provinces and municipalities, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province, Liaoning Province, Shanghai Municipality and Guangdong Province (collectively referred to as the "Eight Service Regions"), which had been valued at RMB43,012 million, based on an independent valuation, were injected into the Company in consideration of approximately 5,442 million ordinary shares (21,769 million shares before share consolidation, see Note 32(b) for details) of the Company (the "Asset Injection").

(d) Certain Asia-Pacific submarine cable assets and related physical network assets and liabilities were transferred from Asia Netcom to China Netcom Group.

(e) The Company and its subsidiaries (the "Group"), immediately after the Reorganisation, contained the assets and liabilities related to: (i) fixed line telecommunication operations in the Eight Service Regions; and (ii) fixed line telecommunication operations in the Asia-Pacific region operated by Asia Netcom (collectively the "Restructured Businesses").

(f) China Netcom Group, immediately after the Reorganisation, retained or held the following assets and liabilities: (i) certain assets and liabilities of the Eight Service Regions including fixed assets, mainly inter-provincial optic fibers, investments in associated companies, long-term investments, bank balances and borrowings and those attributable to certain minor ancillary telecommunications services; (ii) all assets and liabilities of the fixed line telecommunication operations outside the Eight Service Regions; (iii) all non-core businesses representing businesses other than the principal communications services operations in the Group's our northern and southern service regions and primarily include procurement of materials, equipment maintenance services, engineering, project planning and design and operations of certain social facilities and (iv) the Asia-Pacific submarine cable assets and related physical network transferred from Asia Netcom (collectively the "Retained Businesses").

The above reorganisation procedures primarily resulted in a net effect of (i) the transfer from China Netcom Group to the Company of the assets and liabilities of the telecommunications operations in the Eight Service Regions, which were previously owned by China Netcom Group prior to the Reorganisation; and (ii) the transfer from the Company to China Netcom Group of certain assets and liabilities of the telecommunications operations outside the Eight Service Regions and the Asia-Pacific submarine cable assets and related physical network, which were previously owned by the Group prior to the Reorganisation.

The shares of the Company were listed on The Stock Exchange of Hong Kong Limited on November 17, 2004 and the ADSs of the Company were listed on The New York Stock Exchange Inc. on November 16, 2004.

1 The group, its reorganisation and principal activities *(continued)*

Principal activities

After the Reorganisation, the Group is a dominant provider of fixed line telephone services, broadband, other Internet-related services, and business and data communications services in six northern municipalities and provinces, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province and Liaoning Province in the PRC. The Group also provides telecommunications services to selected business and residential customers in a southern municipality and a southern province, namely Shanghai Municipality and Guangdong Province in the PRC. In addition, the Group operates a network and offers international data services throughout the Asia Pacific countries and regions.

After the Reorganisation, the Group's principal services consist of:

- fixed line telephone services (including the personal handy phone system (PHS) services), comprising:
  - local, domestic long distance and international long distance services;
  - value-added services, including caller identity, telephone information services; and
  - interconnection services provided to other domestic telecommunications service providers including the fellow subsidiary owned by China Netcom Group operating outside the Eight Service Regions ;
- broadband services and other Internet-related services;
- business and data communications services, including integrated regional data and voice communications services; and
- international services consisting of international voice services, including international inbound calls destined for the PRC or transit through the PRC or other Asia-Pacific countries and regions, and leased line, Internet access, managed data and other telecommunications services provided to business and carrier customers located outside the PRC.

The Group's PRC operations are subject to the supervision of and regulation by the PRC Government. The MII, pursuant to the authority delegated by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations (the "Telecommunications Regulations").

1 The group, its reorganisation and principal activities *(continued)*

Principal activities *(continued)*

Under the Telecommunications Regulations, all telecommunications operators in the PRC must obtain a telecommunications service operating license from the MII or from the provincial telecommunications administrations. Providers of value-added services within a single province are required to obtain licenses from provincial telecommunications administrations. Providers of basic telecommunications services and providers of value-added services in two or more provinces, autonomous regions and municipalities are required to obtain licenses from the MII. In accordance with the approval of the MII, CNC China, the Group's principal operating subsidiary in China, as an indirect subsidiary of China Netcom Group, has the right to operate the Group's telecommunications business in Eight Service Regions under the authorisation of China Netcom Group, which holds the license required for operating the Group's telecommunications businesses in the PRC.

Following the Reorganisation, China Netcom Group continues to be the holder of the licenses for operating a telecommunications network in China, but has, with the consent of the MII, granted CNC China the right to operate under its licenses, the assets described above and the related business. The Company is the holder of licenses that are necessary to own and operate the assets that are outside the PRC described above in such key countries and regions such as Hong Kong, Japan, Singapore and Korea.

2 Basis of presentation

The Reorganisation was effective for accounting purposes on June 30, 2004, which was the date on which the Company and China Netcom Group signed the legally binding agreements that identified (i) all specific assets and liabilities under the Asset Injection to be transferred to the Company from China Netcom Group and (ii) the specific assets and liabilities to be transferred from Asia Netcom to China Netcom Group.

China Netcom Group and China Netcom Holdings were both state-owned enterprises before and after the Reorganisation, and the acquisition of China Netcom Holdings by China Netcom Group was carried out under the directive of the State Council. Accordingly, the Reorganisation was regarded as a common control transaction and accounted for using merger accounting, as permitted by the Hong Kong Statement of Standard Accounting Practice 27 "Accounting for group reconstructions", and the assets and liabilities injected into the Company by China Netcom Group under Note 1 (c) above have been stated at historical amounts. The consolidated financial statements present the consolidated results and financial position of the Group as if China Netcom Holdings and China Netcom Group had been merged throughout the periods presented and as if the Restructured Businesses were injected into the Company from China Netcom Group at the beginning of the earliest periods presented or when such businesses were acquired by the Group or China Netcom Group, whichever is later. The consolidated financial statements do not include the results and financial position of businesses previously owned by China Netcom Group outside the Eight Service Regions which have been retained by China Netcom Group upon the Reorganisation.

2 Basis of presentation *(continued)*

Prior to the consummation of the Reorganisation, the assets and liabilities of the PRC telecommunications operations, both within and outside the Eight Service Regions of the Company held through CNC China, the Company's principal operating subsidiary, had been historically under common management and control. Therefore, the Group's consolidated income statements for the years ended December 31, 2003 and 2004 and consolidated balance sheets as at December 31, 2003 include the entire consolidated financial data of the PRC operations of CNC China up to the effective date of the Reorganisation although the assets and liabilities of operations of CNC China outside the Eight Service Regions had been transferred to China Netcom Group under the Reorganisation as set out in Note 1 above. In addition, the consolidated balance sheet as at December 31, 2003 also includes the assets and liabilities of the Eight Service Regions in the PRC which had been retained by China Netcom Group under the Reorganisation (see Note 1 (f) (i) above) and the assets and liabilities that were transferred from Asia Netcom to China Netcom Group under the Reorganisation (see Note 1 (f) (iv) above) as those assets and liabilities were part of the telecommunications operations and were not separately managed throughout the periods presented. The above assets and liabilities retained by, or transferred to, China Netcom Group but included in the financial statements as at year ended December 31, 2003 and the amounts of such assets and liabilities distributed to owners on June 30, 2004 as a result of the Reorganisation were as follows:

	As at	
	June 30, 2004	December 31, 2003
	RMB million	RMB million
Assets and liabilities:		
Current assets	**1,915**	2,637
Fixed assets, net		
- Land and buildings	**10,169**	10,276
- Telecommunications networks and equipment	**6,760**	7,089
- Furniture, fixtures, motor vehicles and other equipment	**251**	216
	17,180	17,581
Construction in progress	**1,401**	2,057
Interest in associated companies and long-term investments	**969**	970
Other non-current assets	**281**	396
Current liabilities	**(5,830)**	(7,618)
Non-current loans and other borrowings	**(5,153)**	(4,979)
Other non-current liabilities	**(4,716)**	(4,833)
Net assets	**6,047**	6,211

2 Basis of presentation *(continued)*

The results of the PRC operations of CNC China that were subsequently retained by China Netcom Group upon the Reorganisation up to June 30, 2004 (the effective date of the Reorganisation) but are included in the consolidated income statements for the year ended 31 December 2003 and 2004 are summarised as follows:

	For the six months ended June 30, and the year ended December 31, 2004	For the year ended December 31, 2003
	RMB Million	RMB million
Revenues	**479**	802
Operating expenses, mainly comprising:		
Depreciation and amortisation	**(276)**	(240)
Networks, operations and support	**(272)**	(409)
Staff costs	**(64)**	(65)
Selling, general and administrative	**(138)**	(257)
Other operating income/(expenses)	**28**	(71)
Finance costs	**(248)**	(496)
Loss for the period/year	**(486)**	(740)

Accounting principles and standards

The financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and accounting principles generally accepted in Hong Kong. They have been prepared under the historical cost convention modified by the revaluation of certain fixed assets and the marking to fair values of certain investments as explained in the principal accounting policies in Note 3 below, and on a going concern basis.

The HKICPA has issued a number of new and revised HKFRSs which are effective for accounting periods beginning on or after January 1, 2005. The Group has not early adopted these new and revised HKFRSs in the financial statements for the year ended December 31, 2004. The Group has commenced an assessment of the impact of these new and revised HKFRSs, but is not yet in a position to state whether these new and revised HKFRSs would have a significant impact on its results of operations and financial position.

2 Basis of presentation *(continued)*

Accounting principles and standards *(continued)*

A significant percentage of the Group's funding requirements is achieved through short term borrowings. Consequently, the balance sheet indicates a significant working capital deficit. In the past, a substantial portion of the Group's short term borrowings have been rolled over upon maturity. Based on the Group's history of obtaining finance, its relationships with its bankers and its operating performance, the directors consider that the Group will continue to be able to roll over such short term financing, or will be able to obtain sufficient alternative sources of financing to enable it to operate and meet its liabilities as and when they fall due.

3 Principal accounting policies

The principal accounting policies adopted in the financial statements are set out below:

(a) Basis of consolidation

As set out in Note 2 above, the Reorganisation involved the injection of businesses from the Group's ultimate holding company into the Group and was accounted for using merger accounting in accordance with SSAP No.27 issued by the HKICPA. The results and financial position of the businesses merged under the Reorganisation were included in the consolidated financial statements as if the businesses were acquired at the beginning of the earliest periods presented or the date that such businesses were acquired by the Group or China Netcom Group whichever was later.

Acquisitions of subsidiaries from third parties are accounted for using purchase accounting. The results and financial positions of such subsidiaries acquired or disposed of during the year are included in the consolidated income statements from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

(b) Subsidiaries

Subsidiaries are those entities in which the Company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power, or holds more than half of the issued share capital.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

3 Principal accounting policies *(continued)*

(c) Jointly controlled entities

A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity. A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns income. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the results of the jointly controlled entity under the equity method of accounting.

The consolidated income statements include the Group's share of the results of jointly controlled entities under the equity method of accounting.

(d) Associated companies

An associated company is a company, not being a subsidiary or a jointly controlled entity, in which an equity interest is held for the long-term and significant influence is exercised in its management.

The consolidated income statements include the Group's share of the results of associated companies for the year, and the consolidated balance sheets include the Group's share of the net assets of the associated companies and any unamortised goodwill (net of accumulated amortisation) on acquisition.

Equity accounting is discontinued when the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

(e) Revenue recognition

(i) The Group's revenues are recognised as follows:

- Revenues derived from local, domestic long distance ("DLD") and international long distance ("ILD") telephone usage, which vary depending on the day, the time of day, the distance and duration of the call and the tariffs, are recognised when the services are provided to customers.

- Monthly telephone service fees are recognised in the period during which the telephone services are provided to customers.

- Upfront connection and installation fees received are deferred and recognised over the expected customer relationship period of 10 years. With effect from July 1, 2001, no further upfront fees for connection were charged to customers.

3 Principal accounting policies *(continued)*

(e) Revenue recognition *(continued)*

(i) The Group's revenues are recognised as follows: *(continued)*

- Revenues from the sale of prepaid calling cards are deferred and recognised as the cards are consumed by customers.

- Revenues from PHS bundled service contracts are recognised as local, DLD, or ILD service fees according to the type of usage and on a systematic basis to match the pattern of usage of the PHS services by customers. PHS bundled service contracts comprise the provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period in order to receive a free handset (see Note 3(t)(ii) for the policy on the cost of the handset).

- Revenues from value-added communication services such as call waiting, call diverting and caller number display are recognised when the services are provided to customers.

- Revenues from the provision of broadband and other Internet-related services and managed data services are recognised when the services are provided to customers.

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

- Lease income from the leasing of lines and customer-end equipment is recognised over the term of the lease. Lease income from other domestic telecommunications operators and business customers for the usage of the Group's fixed line telecommunications networks is measured by the number of lines leased and the agreed upon rate per line leased. The lease arrangements are primarily determined on a year to year basis.

(ii) Interest income

Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established.

3 Principal accounting policies *(continued)*

(f) Interest expenses

Interest expenses that are attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other interest expenses are charged to the consolidated income statement in the year in which they are incurred.

(g) Interconnection charges

Interconnection charges represent amounts incurred for the use of other telecommunications operators' networks for facilitating the completion of calls that originate from the Group's fixed line telecommunications networks. Interconnection charges are recognised on an accrual basis. For interconnection charges with domestic operators and the fellow subsidiaries of the Group, they are accrued based on actual amounts, while those with overseas operators are accrued based on the actual amounts, if known, or the Group's estimates.

(h) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet dates are translated at rates of exchange ruling at the balance sheet dates. Exchange differences arising in these cases are dealt with in the consolidated income statement.

The balance sheets of subsidiaries and associated companies expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet dates and the respective income statement accounts are translated at the average exchange rates for the year. Exchange differences are dealt with as a movement in reserves.

(i) Cash and cash equivalents

Cash and cash equivalents, comprising cash on hand, deposits held at call with banks and cash investments with original maturities of three months or less are carried at cost.

(j) Accounts receivable

Accounts receivable are carried at original amounts less provisions for doubtful debts. The provision for doubtful debts is recorded if there is objective evidence that the Group will not be able to collect all amounts due according to the original term of the accounts receivable.

3 Principal accounting policies *(continued)*

(k) Inventories and consumables

Inventories comprise mainly telephone handsets and are stated at the lower of cost and net realisable value on a first-in, first-out basis, after provisions for obsolescence.

Consumables consist of materials and supplies used in maintaining the Group's telecommunication networks and are charged to the income statement when brought into use. Consumables are valued at cost less any provision for obsolescence.

(l) Fixed assets

(i) Construction-in-progress

Construction-in-progress represents buildings, telecommunications networks plant, transmission and switching equipment under construction and pending installation, and is stated at cost less any provision for impairment losses. Cost comprises direct costs of construction including borrowing costs attributable to the construction during the period of construction. When the asset being constructed becomes available for use, the construction-in-progress is transferred to the appropriate category of fixed assets.

(ii) Other fixed assets

Fixed assets are initially stated at cost less accumulated depreciation and accumulated impairment losses. Major costs incurred in restoring fixed assets to their normal working condition are charged to the income statement as incurred. Improvements are capitalised and depreciated over their expected useful lives.

Land and buildings, subsequent to initial recognition, are stated at cost less accumulated impairment losses and are depreciated over their expected useful lives.

Subsequent to the revaluation carried out as at December 31, 2003, which was based on depreciated replacement costs (Note 18), fixed assets other than land and buildings are carried at their revalued amounts, being the fair values at the date of revaluation, less subsequent accumulated depreciation and impairment losses. When an item of fixed asset is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately together 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.

(iii) Revaluations

Revaluations on fixed assets other than land and buildings will be performed at intervals of not more than three years by independent valuers; in each of the intervening years valuations will be undertaken by executives of the Group. Increases in valuation are credited to the revaluation reserve. Decreases in valuation are first set off against any revaluation surplus arising from earlier valuations in respect of the same item and thereafter are debited to operating profit. Any subsequent increases are credited to operating profit up to the amount previously debited.

3 Principal accounting policies *(continued)*

(l) Fixed assets *(continued)*

(iv) Depreciation

Fixed assets are depreciated at rates sufficient to write off their costs or revalued amounts less accumulated impairment losses and estimated residual values over their estimated useful lives on a straight-line basis. The principal useful lives are as follows:

Land	over the term of the lease, being 10-50 years
Buildings	8-30 years
Telecommunications networks and equipment	5-10 years
Furniture, fixtures, motor vehicles and other equipment	5-10 years

The useful lives are reviewed periodically to ensure that the methods and rates of depreciation are consistent with the expected pattern of economic benefits from fixed assets.

(v) Gain or loss on sale of fixed assets

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement, except where the fixed asset is carried at valuation, the relevant portion of the revaluation reserve realised in respect of previous valuations is transferred to retained earnings and is shown as a movement in reserves.

(m) Impairment of assets

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Estimated recoverable amounts are determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. The recoverable amount is the higher of value in use or net selling price. Such impairment losses are recognised in the income statement, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation surplus.

3 Principal accounting policies *(continued)*

(n) Assets under leases

(i) Finance leases

Leases that substantially transfer to the Group all of the risks and rewards of ownership of assets are accounted for as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased assets or the present value of the minimum lease payments. Each lease payment is allocated between the capital and finance charges so as to achieve a constant rate on the capital balances outstanding. The corresponding rental obligations, net of finance charges, are included in long-term liabilities. The finance charges are charged to the income statement over the lease periods.

Assets held under finance leases are depreciated over the shorter of their estimated useful lives or the lease periods.

(ii) Operating leases

Leases where substantially all of the risks and rewards of ownership of the assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases, net of any incentives received from the leasing company, are charged to the income statement on a straight-line basis over the lease periods.

(o) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary, jointly controlled entity or associated company, at the date of acquisition.

Goodwill on acquisitions is included in intangible assets and is amortised using the straight-line method over its estimated useful life of not more than 20 years.

(ii) Negative goodwill

Negative goodwill represents the excess of the fair value of the Group's share of the net assets acquired over the cost of acquisition. Negative goodwill is presented in the same balance sheet classification as goodwill. Negative goodwill, not exceeding the fair values of the non-monetary assets acquired, is recognised in the income statement over the remaining weighted average useful life of those assets; negative goodwill in excess of the fair values of those non-monetary assets is recognised in the income statement immediately.

(iii) Purchased software

Expenditure on purchased software is capitalised and amortised using the straight-line method over the expected useful lives of the software, which vary from three to five years.

3 Principal accounting policies *(continued)*

(p) Investments

(i) Long-term investments

Long-term investments comprise unlisted investment securities that are held for long term purposes. Such investments are stated at cost less any provision for impairment losses.

(ii) Short-term investments

Short-term investments comprise listed securities held for trading purposes and are carried at fair value. At each balance sheet date, the net unrealised gains or losses arising from the changes in fair value of short-term investments are recognised in the income statement. Profits or losses on disposal of short-term investments, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the income statement as they arise.

(q) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

(r) Employee benefits

(i) Pension obligations

(a) As stipulated by the regulations of the PRC, the subsidiaries in the PRC participate in basic defined contribution pension plans organised by their respective municipal governments under which they are governed.The Group is required to make contrubutions to the retirement plans at rate of 20% of the salaries, bonuses and certain allowances of the employees. Employees in the PRC are entitled to retirement benefits equal to a fixed proportion of their salary at their normal retirement age. The Group has no other material obligation for post-retirement benefits beyond these payments as they fall due. Payments made under these plans are expensed as incurred.

(b) The Group also operates a mandatory provident fund scheme (“the MPF scheme”) under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees employed under the jurisdiction of the Hong Kong Employment Ordinance. The MPF scheme is a defined contribution retirement scheme administered by independent trustees. Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5 per cent. of the employees’ relevant income, subject to a cap of monthly relevant income of HK$20,000.

3 Principal accounting policies *(continued)*

(r) Employee benefits *(continued)*

(ii) Early retirement benefits

Early retirement benefits are recognised as expenses when the Group reaches agreement with the relevant employees for early retirement.

(iii) Employee housing benefits

One-off cash housing subsidies paid to employees are charged to the consolidated income statement in the year in which it is determined that the payment of such subsidies is probable and the amounts can be reasonably estimated (see Note 30(a)).

Full-time employees of the Group participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these housing funds are expensed as incurred.

(iv) Share option scheme

Share options are granted to directors and to certain employees at the directors' discretion. When the options are exercised, no charge is recorded to the income statement and the proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium.

(s) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantially enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(t) Deferred costs

(i) Deferred installation costs

The direct incremental costs associated with the installation of fixed line services are deferred and amortised to the income statement over the expected customer relationship period of 10 years except when the direct incremental costs exceed the corresponding upfront installation fees. In such cases, the excess of the direct incremental costs over the installation fees is recorded immediately as expenses in the income statement.

3 Principal accounting policies *(continued)*

(t) Deferred costs *(continued)*

(ii) Customer acquisition costs

The cost of handsets given to customers under bundled service contracts and related commissions paid to distributors are deferred as customer acquisition costs and amortised to the income statement on a systematic basis to match with the pattern of the customer service income over the contract period.

(iii) Prepaid network capacities

Prepayments for the network capacities purchased on an indefeasible rights to use ("IRU") basis are capitalised and amortised over the corresponding lease period.

(iv) Discount on foreign currency exchange forward contracts

The unamortised portion of the discount on foreign currency exchange forward contracts (see Note(w)) is recognised as a deferred cost.

(u) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that the outflow is probable, the contingent liability will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

(v) Segmental reporting

Business segments provide services that are subject to risks and returns that are different from other business segments. Geographical segments provide services within a particular economic environment that is subject to risks and returns that differ from those of components operating in other economic environments. Currently the Group has one business segment, the provision of fixed line telecommunications services. Less than 10% of the Group's assets and operations are located outside the PRC. Accordingly, no business and geographical segment information is presented.

3 Principal accounting policies *(continued)*

(w) Foreign currency exchange forward contracts

A foreign currency exchange forward contract is an agreement to exchange different currencies at a specified future date and at a specified rate. A non-speculative foreign currency exchange forward contract is one which is designated and effective as a hedge of a net investment in a foreign entity, of a foreign currency asset, or of a net monetary asset or liability. All other foreign currency exchange forward contracts, or parts of foreign currency exchange forward contracts in excess of the amount hedged, are speculative.

Where a foreign currency exchange forward contract is non-speculative and used as a hedge of a net monetary asset or liability, the gain or loss on the contract, being the foreign currency amount of the contract multiplied by the difference between the spot rate at the balance sheet date and the spot rate at the date of inception of the contract or at an intervening balance sheet date, is taken to the income statement. The discount or premium on the contract, being the foreign currency amount of the contract multiplied by the difference between the contracted forward rate and the spot rate at the date of inception of the contract, is amortised over the period of the contract. In the balance sheet, unamortised discounts are recorded within deferred costs and unamortised premiums are recorded within deferred revenues.

Where a foreign currency exchange forward contract is speculative, the gain or loss, being the foreign currency amount of the contract multiplied by the difference between the forward rate for the balance of the contract at the balance sheet date and either the contracted forward rate or the forward rate used at an intervening balance sheet date, is credited or charged to the income statement at each intervening balance sheet date.

(x) Earnings/(loss) per share ("EPS") and per ADS

Basic EPS is computed by dividing net profit/(loss) attributable to ordinary shareholders by the weighted average number of ordinary share outstanding during the year.

Diluted EPS is computed by dividing net profit/(loss) attributable to shareholders by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the year. Ordinary equivalent shares consist of ordinary shares issuable upon the exercise of outstanding stock options using the treasure stock method.

Earnings/(loss) per ADS is computed by multiplying the EPS by 20, which is the number of shares represented by each ADS.

4 Revenues

Revenues represent the turnover of the Group and are derived from the provision of fixed line telecommunications and related services, net of the PRC business taxes and government levies. The Group's revenues by nature can be summarised as follows:

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Revenues		
Local usage fees	**18,661**	18,567
Monthly telephone service	**13,743**	12,580
Upfront installation fees	**1,338**	1,044
DLD usage fees	**8,813**	8,871
ILD usage fees	**1,302**	1,410
Value-added services	**2,146**	1,516
Interconnection fees	**4,915**	3,797
Upfront connection fees	**3,378**	3,965
Broadband and other Internet-related service	**5,418**	3,507
Managed data service	**1,526**	1,279
Leased line income	**2,321**	2,509
Other services	**1,361**	853
Total	**64,922**	59,898

4 Revenues *(continued)*

The Group's revenues by geographical location of the customers can be summarised as follows:

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Domestic telecommunications services		
(Being revenues generated from customers located in the PRC)		
Local usage fees	**18,661**	18,567
Monthly telephone service	**13,743**	12,580
Upfront installation fees	**1,338**	1,044
DLD usage fees	**8,813**	8,871
ILD usage fees	**1,121**	1,410
Value-added services	**2,146**	1,516
Interconnection fees	**3,903**	2,580
Upfront connection fees	**3,378**	3,965
Broadband and Internet-related service	**5,058**	3,493
Managed data service	**1,217**	1,215
Leased line income	**1,825**	2,446
Other services	**1,076**	832
Subtotal	**62,279**	58,519
International telecommunications services		
(Being revenues generated from customers located outside the PRC, including Hong Kong, Macau Special Administrative Regions and Taiwan)		
ILD usage fees	**181**	—
Interconnection fees	**1,012**	1,217
Broadband and other Internet-related service	**360**	14
Managed data service	**309**	64
Leased line income	**496**	63
Other services	**285**	21
Subtotal	**2,643**	1,379
Total	**64,922**	59,898

5 Profit/(loss) from operations

Profit/(loss) from operations is stated after charging or crediting the following:

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Charging		
Deficit on revaluation of certain fixed assets (Note 18(c))	**—**	25,778
Depreciation:		
- Owned fixed assets	**18,451**	20,298
- Leased fixed assets	**174**	86
Loss on disposal of fixed assets (included in networks operations and support expenses)	**145**	1,689
Amortisation of intangible assets (Note 20)	**129**	99
Contributions to pension plans (included in staff costs)	**813**	790
Early retirement benefits (included in staff costs)	**206**	132
Cost of inventories	**374**	327
Operating leases:		
- Land and buildings	**571**	117
- Network and machinery	**1,542**	630
Interconnection charges	**2,411**	1,874
Bad debt expense	**832**	619
Auditors' remuneration	**18**	—
Unrealised loss on short-term investments	**4**	—
Unrealised foreign exchange losses	**70**	142
Crediting		
Realised gain on disposal of short-term investments	**—**	1
Unrealised gain on short-term investments	**—**	7

6 Finance costs

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Interest expenses on		
- Bank and other loans wholly repayable within five years	**3,127**	3,340
- Bank and other loans wholly repayable after more than five years	**88**	125
	3,215	3,465
Less: Interest expenses capitalised in construction-in-progress	**(421)**	(621)
	2,794	2,844
Exchange loss, net	**70**	142
Bank charges	**50**	20
Amortisation of discount on foreign currency exchange forward contracts	**18**	20
	2,932	3,026
Interest expenses were capitalised in construction in progress using the following annual interest rates	**3.69%-5.45%**	3.68%-5.51%

7 Taxation

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
PRC enterprise income tax ("EIT")	**2,786**	940
Deferred taxation (Note 31)	**562**	(7,775)
Share of taxation attributable to jointly controlled entity	**—**	16
Taxation charges/(credit)	**3,348**	(6,819)

7 Taxation *(continued)*

The provision for EIT is calculated based on the statutory income tax rate of 33% on the assessable profit of each of the entities now comprising the Group in the PRC as determined in accordance with the relevant income tax rules and regulations in the PRC.

Taxation on profits derived from certain subsidiaries and the jointly controlled entity outside the PRC, including Hong Kong, has been calculated on the estimated assessable profit at the rates of taxation ranging from 17.5% to 30%, prevailing in the countries in which those entities operates.

The reconciliation between the Group's actual tax charge/(credit) and the amount which is calculated based on the weighted average statutory tax rate is as follows:

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Profit/(loss) before taxation	**12,596**	(17,931)
Weighted average statutory tax rate	**33.00%**	33.00%
Tax calculated at the weighted average statutory tax rate	**4,157**	(5,917)
Non-taxable income (Note below)	**(1,264)**	(1,309)
Expenses not deductible for tax purposes	**252**	207
Tax losses not recognised/(utilised)	**356**	246
Others	**(153)**	(46)
Tax charge/ (credit)	**3,348**	(6,819)

Note:

Non-taxable income comprises primarily upfront connection fees charged to customers and amortised over the customer relationship period.

8 Profit/(loss) attributable to shareholders

(a) For the year ended December 31, 2004, profit attributable to shareholders included a loss of RMB41 million (2003: a profit of RMB19 million) which has been dealt with in the financial statements of the Company.

(b) One of the Company's subsidiaries (refer to Note 22) CNC China was registered as foreign investment enterprises in the PRC. In accordance with the Articles and Association of CNC China, it is required to provide for certain statutory reserves, namely, general reserve and staff bonus and welfare fund, which are appropriated from profits after tax but before dividend distribution.

CNC China is required to allocate at least 10% of their profits after tax determined under PRC GAAP to the general reserve fund until the cumulative amounts reach 50% if the registered capital. The statutory reserve can only be used, upon obtained from the relevant authority, to offset accumulated losses or increase capital.

Accordingly, CNC China appropriated approximately RMB723 million (2003: Nil) to the general reserve fund for the year ended December 31, 2004.

9 Final dividend proposed after balance sheet date

	2004
	HKD million
Final dividend proposed after the balance sheet date of HK$0.037 per share	**245**

The final dividend proposed after the balance sheet date has not been recognised as a dividend payable as of December 31, 2004 but will be reflected as appropriation of retained profits in the financial statements for the year ending December 31, 2005.

10 Earnings/(loss) per share

Basic earnings/(loss) per share is computed using the weighted average number of ordinary shares outstanding during the year. Diluted earnings/(loss) per share is computed using the weighted average number of ordinary shares and potential ordinary shares outstanding during the year.

The following table sets forth the computation of basic and diluted net earnings/(loss) per share:

	Years ended December 31,	
	2004	2003
	(in RMB millions, except share and per share data)	
Numerator:		
Profit/(loss) for the year	**9,248**	(11,111)
Denominator:		
Weighted average number of ordinary shares outstanding and shares used in computing basic earnings/(loss) per share	**5,622,685,175**	5,492,258,218
Weighted average number of potential ordinary shares:		
Diluted equivalent shares arising from convertible Preference Shares	**5,140,036**	—
Diluted equivalent shares arising from share options	**2,209,241**	—
Shares used in computing diluted earnings/(loss) per share	**5,630,034,452**	5,492,258,218
Basic earnings/(loss) per share	**RMB1.64**	RMB(2.02)
Diluted earnings/(loss) per share	**RMB1.63**	RMB(2.02)

The diluted loss per share for the year ended December 31, 2003 is the same as the basic loss per share as all potential ordinary shares are anti-dilutive.

All the numbers of shares stated above have taken into consideration the effect of the share consolidation conducted on September 7, 2004 as set out in note 32(a).

11 Staff costs including directors' remunerations

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Wages, salaries and welfare	**7,022**	6,625
Contributions to pensions	**813**	790
Early retirement benefits	**206**	132
Total	**8,041**	7,547

12 Directors' and senior management's emoluments

(a) Directors' emoluments

The following table sets out the emoluments paid to the Company's directors during the years:

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Fees	**1**	—
Basic salaries, housing allowances, other allowances and benefits in kind	**7**	3
Contributions to retirement schemes	**—**	—
	8	3

Directors' fees disclosed above include HK$312,500 (2003: Nil) paid to independent non-executive directors.

The number of directors whose emoluments fell within the following bands is set out as follows:

	Years ended December 31,	
	2004	2003
Nil – RMB1,060,000 (equivalent of HK$1,000,000)	**12**	14
RMB1,060,001 – RMB3,710,000 (equivalent of HK$3,500,000)	**—**	—
RMB3,710,001– RMB4,240,000 (equivalent of HK$4,000,000)	**1**	—

(b) Five highest paid individuals

The five individuals whose emoluments were the highest for the years ended December 31, 2004 (2003: one) include three directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining individuals are as follows:

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Basic salaries, housing allowances, other allowances and benefits in kind	**3**	3
Contributions to retirement schemes	**—**	—
	3	3

12 Directors' and senior management's emoluments *(continued)*

(b) Five highest paid individuals *(continued)*

The number of remaining individuals whose emoluments fell within the following bands is set out as follows:

	Years ended December 31,	
	2004	2003
Nil – RMB1,060,000 (equivalent of HK$1,000,000)	**1**	4
RMB1,060,001 – RMB2,650,000 (equivalent of HK$2,500,000)	**—**	—
RMB2,650,001– RMB3,180,000 (equivalent of HK$3,000,000)	**1**	—

(c) None of the directors and 5 highest paid individuals received any fees, bonuses, inducements, or compensation for loss of office, or waived any emoluments during 2003 and 2004 .

13 Cash and bank deposits

	Years ended December 31,	
	2004	2003
	RMB million	RMB million
Cash and cash equivalents	**10,033**	6,283
Time deposits with original maturities over three months	**20**	33
Total cash and bank deposits	**10,053**	6,316

Included in the cash and bank deposits as at the end of December 31, 2003 and 2004 are Renminbi denominated balances kept in the PRC amounting to RMB5,631 million and RMB1,868 million, respectively. The conversion of Renminbi denominated balances into foreign currencies and the remittance of bank balances and cash out of the PRC are subject to the rules and regulation of foreign exchange control promulgated by the PRC government.

14 Short-term investments

The Group and the Company's short-term investments comprise primarily investments in listed debt securities and investment funds.

15 Accounts receivable

Amounts due from the provision of fixed line telecommunications services to residential and business customers are due within 30 days from the date of billing. Residential and business customers who have accounts overdue by more than 90 days will have their services disconnected. Accounts receivable from other telecommunications operators and customers are due between 30 to 90 days from the billing date.

The ageing analysis of accounts receivable based on the billing date is as follows:

	As at December 31,	
	2004	2003
	RMB million	RMB million
0-30 days	**4,479**	5,232
31-90 days	**861**	876
Over 90 days	**1,404**	1,286
Total	**6,744**	7,394
Less: Allowance for doubtful debts	**(1,056)**	(1,051)
Net carrying amounts	**5,688**	6,343

The movement of allowance for doubtful debts is as follows:

	As at December 31,	
	2004	2003
	RMB million	RMB million
Balance at beginning of year	**1,051**	629
Additional provisions	**852**	558
Less: Amounts utilised	**(798)**	(136)
Distributed to owners in accordance with Reorganisation	**(49)**	—
Balance at end of year	**1,056**	1,051

16 Inventories and consumables

	As at December 31,	
	2004	2003
	RMB million	RMB million
Consumables, at cost	**607**	993
Telephone handsets and other customer end-products held for resale, at cost	**334**	245
	941	1,238

17 Prepayments and other receivables

	Group		Company	
	As at December 31,		As at December 31,	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Prepaid expenses and deposits	**546**	648	**8**	—
Other receivables	**460**	992	**8**	—
	1,006	1,640	**16**	—

18 Fixed assets

	Land and buildings	Telecommunications networks and equipment	Furniture, fixtures, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB million
Cost/valuation:				
Balance at January 1, 2003	27,121	190,535	7,761	225,417
Additions	393	2,381	307	3,081
Acquired through Asia Netcom (Note 35 (c))	—	3,298	—	3,298
Transferred from construction in progress (Note 19)	1,892	24,062	1,286	27,240
Disposals	(408)	(5,676)	(498)	(6,582)
Increase as a result of revaluation	—	6,456	655	7,111
Decrease as a result of revaluation	—	(40,124)	(2,034)	(42,158)
Balance at December 31, 2003	28,998	180,932	7,477	217,407
Accumulated depreciation:				
Balance at January 1, 2003	(4,852)	(71,392)	(3,009)	(79,253)
Charge for the year	(716)	(18,520)	(1,148)	(20,384)
Acquired through Asia Netcom (Note 35(c))	—	(261)	—	(261)
Disposals	103	3,622	434	4,159
Increase as a result of revaluation	—	(3,693)	(436)	(4,129)
Decrease as a result of revaluation	—	15,696	684	16,380
Balance at December 31, 2003	(5,465)	(74,548)	(3,475)	(83,488)
Net book value at December 31, 2003	23,533	106,384	4,002	133,919
Cost/valuation:				
Balance at January 1, 2004	28,998	180,932	7,477	217,407
Additions	200	115	234	549
Transferred from construction in progress (Note19)	1,479	24,160	1,561	27,200
Disposals	(51)	(812)	(75)	(938)
Distributed to owners in accordance with Reorganisation	(12,827)	(9,265)	(325)	(22,417)
Balance at December 31, 2004	17,799	195,130	8,872	221,801

18 Fixed assets *(continued)*

	Land and buildings	Telecommunications networks and equipment	Furniture, fixtures, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB million
Accumulated depreciation:				
Balance at January 1, 2004	(5,465)	(74,548)	(3,475)	(83,488)
Charge for the year	(756)	(16,791)	(1,078)	(18,625)
Disposals	2	591	64	657
Distributed to owners	2,658	2,505	74	5,237
Balance at December 31, 2004	(3,561)	(88,243)	(4,415)	(96,219)
Net book value at December 31, 2004	14,238	106,887	4,457	125,582

(a) The net book value of assets held under finance lease is as follows:

	Land and buildings	Telecommunications networks and equipment	Furniture, fixtures, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB Million
At December 31, 2003	—	715	2	717
At December 31, 2004	—	1,763	7	1,770

During the year ended December 31, 2004, the Group entered into a finance lease arrangement with a related party with certain existing fixed assets to obtain funding of RMB1,085 million. The net book value of such fixed assets included above amounted to RMB954 million and the corresponding finance lease obligation amounted to RMB1,070 million as at December 31, 2004 (see note 27(b)(ii)).

18 Fixed assets *(continued)*

(b) The analysis of the cost or revaluation of the assets of the Group is as follows:

	Land and buildings	Telecommu-nications networks and equipment	Furniture, fixtures, motor vehicles and other equipment	Total
	RMB million	RMB million	RMB million	RMB Million
At December 31, 2003				
Cost	28,998	—	—	28,998
Valuation	—	180,932	7,477	188,409
	28,998	180,932	7,477	217,407
At December 31, 2004				
Cost	17,799	—	—	17,799
Valuation	—	195,130	8,872	204,002
	17,799	195,130	8,872	221,801

The Group's land and buildings are primarily located in the PRC and held on leases of primarily between 10 to 50 years.

(c) As detailed in Note 3 (I) (ii), except for land and buildings, fixed assets were carried at revalued amounts on December 31, 2003. As required by the PRC rules and regulations relevant to the Reorganisation, each class of fixed assets in the PRC injected into the Group as at December 31, 2003, was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such fixed assets in the PRC injected into the Group was determined at RMB122,456 million. The fixed assets retained by the ultimate holding company, which were transferred based on their carrying values upon the Reorganisation, were valued by the Directors at an amount of RMB17,581 million as at December 31, 2003. The impact of the revaluation was a net deficit on revaluation of the fixed assets, other than land and buildings, totalling RMB22,796 million. Such revalued amounts serve as the tax base for such assets for future years following the revaluation (see Note 31).

The land and buildings were also revalued and the result was a net surplus of RMB6,967 million. Such revaluation on land and buildings serves as the tax base for land and buildings for future years following the revaluation, and has not been incorporated in the consolidated financial statements (see Note 31(ii)).

18 Fixed assets *(continued)*

The land and buildings injected by China Netcom Group were valued separately by Sallmanns, independent qualified valuers in Hong Kong, as at December 31, 2003 on the basis of their open market value. The value arrived at by these valuers was consistent with that arrived at by the PRC valuers. The Group's land and buildings are carried at their cost less accumulated depreciation and impairment losses in the consolidated financial statements.

The respective carrying amount of the telecommunications networks and equipment and furniture, fixtures, motor vehicles and other equipment would have been RMB128,049 million and RMB5,133 million as at December 31, 2003 and RMB101,433 million and RMB4,103 million as at December 31, 2004 had they been stated at cost less accumulated depreciation.

The historical carrying amounts of the Group's fixed assets, as at December 31, 2003, and where applicable the corresponding revalued amounts of these assets are as follows:

	Historical carrying amount	Revaluation surplus	Revaluation deficit	Revalued amount
	RMB million	RMB million	RMB million	RMB million
At December 31, 2003				
Land and buildings	23,533	—	—	23,533
Telecommunications networks and equipment	128,049	2,763	(24,428)	106,384
Furniture, fixture, motor vehicles and other equipment	5,133	219	(1,350)	4,002
	156,715	2,982	(25,778)	133,919

The directors have carried out a review of the Group's fixed assets and concluded that there was no impairment of fixed assets as at December 31, 2004, nor was there any significant change in the value of fixed assets at that date.

At December 31, 2003 and 2004, the net book value of fixed assets pledged as security for the Group's long term bank and other loans amounted to RMB2,668 million and RMB22 million respectively.

19 Construction in progress

	As at December 31,	
	2004	2003
	RMB million	RMB million
Balance at beginning of year	**15,695**	17,783
Additions	**20,979**	25,152
Transferred to fixed assets (Note 18)	**(27,200)**	(27,240)
Distributed to owners in accordance with the Reorganisation on June 30, 2004	**(1,401)**	—
Balance at end of year	**8,073**	15,695

20 Intangible assets

	Goodwill/ (negative goodwill)	Purchased software	Total
	RMB million	RMB million	RMB million
Cost:			
Balance at January 1, 2003	3	660	663
Additions	—	191	191
Negative goodwill on acquisition of certain entities of Asia Global Crossing through Asia Netcom (See note below)	(296)	—	(296)
Acquisition of additional 49% interest in Asia Netcom (Note 35(c))	115	—	115
Balance at December 31, 2003	(178)	851	673
Accumulated amortisation:			
Balance at January 1, 2003	(2)	(388)	(390)
Amortisation for the year	—	(99)	(99)
Balance at December 31, 2003	(2)	(487)	(489)
Net book value at December 31, 2003	(180)	364	184
Cost:			
Balance at January 1, 2004	(178)	851	673
Additions	—	261	261
Balance at December 31, 2004	(178)	1,112	934
Accumulated amortisation:			
Balance at January 1, 2004	(2)	(487)	(489)
Amortisation for the year	14	(143)	(129)
Balance at December 31, 2004	12	(630)	(618)
Net book value at December 31, 2004	(166)	482	316

Note:

On March 10, 2003, Asia Netcom, the Group's 51% jointly controlled entity at that time, acquired certain entities from Asia Global Crossing (details see Note 35(c)). The unamortised negative goodwill of RMB296 million arising from the aforementioned acquisition has been consolidated into the Group through Asia Netcom upon the acquisition of the remaining 49% interest of Asia Netcom, which became a wholly owned subsidiary of the Group on December 31, 2003.

21 Deferred costs

	As at December 31,	
	2004	2003
	RMB million	RMB million
Balance at beginning of year		
- Installation costs	**4,708**	4,408
- Customer acquisition costs	**1,370**	44
- Prepaid networks capacities	**1,248**	383
- Discount on foreign currency exchange forward contracts	**77**	97
- Others	**469**	217
	7,872	5,149
Additions for the year		
- Installation costs	**634**	1,455
- Customer acquisition costs	**1,940**	1,666
- Prepaid network capacity		
- additions	**254**	16
- acquired through Asia Netcom (Note 35(c))	**—**	870
- Discount on foreign currency exchange forward contracts	**—**	—
- Others	**425**	431
	3,253	4,438
Charge for the year		
- Installation costs	**(1,068)**	(1,155)
- Customer acquisition costs	**(2,006)**	(340)
- Prepaid network capacities	**(119)**	(21)
- Discount on foreign currency exchange forward contracts	**(18)**	(20)
- Others	**(291)**	(179)
	(3,502)	(1,715)
Distributed to owners in accordance with Reorganisation on June 30, 2004		
- Prepaid network capacity	**(61)**	—
- Others	**(113)**	—
	(174)	—

21 Deferred costs *(continued)*

	As at December 31,	
	2004	2003
	RMB million	RMB million
Balance at end of year		
- Installation costs	**4,274**	4,708
- Customer acquisition costs	**1,304**	1,370
- Prepaid network capacities	**1,322**	1,248
- Discount on foreign currency exchange forward contracts	**59**	77
- Others	**490**	469
	7,449	7,872

22 Investments in subsidiaries

	Company	
	As at December 31,	
	2004	2003
	RMB million	RMB million
Investment in subsidiaries, at cost	**37,509**	1,387

As at December 31, 2004, the Company direct and indirect interests in the following principal subsidiaries, all of which are private companies:

Company name	Place and date of incorporation/ establishment	Issued and fully paid up/ registered capital	Percentage of equity interest attributable to the Group	Principal activities and place of operation
Directly held:				
China Netcom (Group) Company Limited (formerly know as "China Netcom Corporation Limited") (note(a))	PRC August 6, 1999	Registered capital of RMB150 million	100%	Provision of networks communication services in the PRC

22 Investments in subsidiaries *(continued)*

Company name	Place and date of incorporation/ establishment	Issued and fully paid up/ registered capital	Percentage of equity interest attributable to the Group	Principal activities and place of operation
China Netcom Corporation International Limited (note(b))	Bermuda October 15, 2002	12,000 ordinary shares of US$1.00 each	100%	Investment holding in Bermuda
Indirectly held:				
Asia Netcom Corporation Limited (note(c))	Bermuda October 15, 2002	120,000,000 ordinary shares of US$ 0.01each	100%	Investment holding in Bermuda
China Netcom (Hong Kong) Operations Limited (note(d))	Hong Kong May 2, 2001	1,000 ordinary shares of US$ 1.00 each	100%	Provision of networks communication services

Notes:

(a) This company is a wholly owned foreign enterprise established in the PRC. The accounts of this company for the years ended December 31, 2003 and 2004 were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company.

(b) This company adopted March 31 as its financial year end, which is not coterminous with the year end of the Group. No audited accounts have been prepared for this company because there are no statutory requirements to prepare accounts in its jurisdiction.

(c) This company previously adopted March 31 as its financial year end, which was changed to December 31 during 2003. The accounts for the period from October 15, 2002 to March 31, 2003 and April 1, 2003 to December 31, 2003 were audited by PricewaterhouseCoopers.

(d) This company adopted March 31 as its financial year end, which is not coterminous with the year end of the Group. The accounts of this company for the years ended March 31, 2002 and 2003 were audited by PricewaterhouseCoopers.

23 Long-term Investments and interests in associated companies

Long-term investments and interests in associated companies were unlisted equity investments, which were transferred to China Netcom Group upon Reorganisation on June 30, 2004.

24 Foreign currency exchange forward contracts

The Group has entered into certain foreign currency exchange forward contracts with banks, which are non-speculative and used to manage the risk of certain of the Group's borrowings denominated in foreign currencies. The respective foreign currency exchange forward contract receivable and payable balances which are included in other non-current assets and other non-current liabilities are as follows:

	As at December 31,	
	2004	2003
	RMB million	RMB million
Receivable	**408**	469
Payable	**533**	588

25 Accounts payable

	As at December 31,	
	2004	2003
	RMB million	RMB million
0-30 days	**6,122**	7,480
31-60 days	**1,833**	554
61-90 days	**925**	414
91-180 days	**2,115**	2,494
Over 180 days	**3,658**	3,844
	14,653	14,786

26 Accruals and other payables

	Group		Company	
	As at December 31,		As at December 31,	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Accrued expenses	**1,569**	2,949	**140**	5
Other payables	**1,784**	1,461	**—**	—
	3,353	4,410	**140**	5

27 Bank and other loans

(a) As at December 31, 2004, the short term bank loans were unsecured and comprise:

Currency	Interest rate and final maturity	As at December 31, 2004 RMB million	2003 RMB million
Renminbi denominated	Interest rates ranging from 4.54% to 5.02% per annum with maturity through Dec. 30, 2005	**29,220**	32,098
US Dollar denominated	Interest rates ranging from 2.59% to 3.98% per annum with maturity through Nov. 29, 2005	**119**	119
		29,339	32,217

(b) The Group's long term bank and other loans comprise:

	Note	As at December 31, 2004 RMB million	2003 RMB million
Bank and other loans	(i)	**27,571**	37,281
Finance lease obligations	(ii)	**1,560**	744
		29,131	38,025
Less: Current portion		**(7,270)**	(15,716)
		21,861	22,309

27 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(i) Long term bank and other loans

	As at December 31,	
	2004	2003
	RMB million	RMB million
Loans		
Unsecured	**25,228**	33,713
Secured	**2,343**	3,568
Total	**27,571**	37,281
Less: Current portion	**(7,060)**	(15,426)
Long-term loans	**20,511**	21,855

The Group's long term bank and other loans (excluding finance lease liabilities) were repayable as follows:

	As at December 31,	
	2004	2003
	RMB million	RMB million
Within one year	**7,060**	15,426
In the second year	**6,550**	11,513
In the third to fifth year	**11,196**	8,644
After the fifth year	**2,765**	1,698
	27,571	37,281

27 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(i) Long term bank and other loans (continued)

The Group's long term bank and other loans comprise:

Currency	Interest rate and final maturity	As at December 31, 2004 RMB million	2003 RMB million
Bank loans			
Renminbi denominated	Interest rates ranging from 4.5% to 6.1% per annum with maturity through Oct.20, 2014	**23,776**	32,870
US Dollar denominated	Interest rates ranging from 2.1% to 5.0% per cannum with maturity through Dec. 31, 2040	**2,552**	1,920
Japanese Yen denominated	Interest rates ranging from 2.1% to 2.6% per annum with maturity through Oct. 20, 2022	**860**	877
Euro donominated	Interest rates ranging from 2% to 5.94% per annum with maturity through Jun. 30, 2023	**383**	392
		27,571	36,059
Other loans			
US Dollar denominated	Interest rates at 1% per month with maturity through Sep. 2006	**—**	1,222
		27,571	37,281

27 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(i) Long term bank and other loans (continued)

As at December 31, 2004, secured loans and bank loans totalled RMB2,343 million (2003 : RMB3,568 million) which were secured by the following:

(i) Certain fixed assets amounting to RMB22 million (2003 : RMB2,668 million) in respect of loans amounting to RMB3 million (2003 : RMB16 million);

(ii) Corporate guarantees granted by China Netcom Group to the extent of RMB1,888 million (2003 : RMB1,047 million); and

(iii) Corporate guarantees granted by third parties to the extent of RMB452 million (2003 : RMB483 million).

Besides, other loans amounting to RMB1,222 million at December 31, 2003 representing finance arrangements with certain vendors, which were secured by certain cable systems, property and contracts owned by the Group had been all transferred to China Netcom Group upon the Reorganisation on June 30, 2004.

(ii) Finance lease obligations

	As at December 31,	
	2004	2003
	RMB million	RMB million
Obligation under finance leases	**1,560**	744
Less: current portion	**(210)**	(290)
	1,350	454

During the year ended December 31, 2004, the Group entered into a finance lease arrangement with a related party (see note 18 (a)). The lease obligation payable to the related party as at December 31, 2004 amounted to RMB1,070 million.

27 Bank and other loans *(continued)*

(b) The Group's long term bank and other loans comprise: *(continued)*

(ii) Finance lease obligations (continued)

The Group's liabilities under finance leases are analysed as follows:

	As at December 31,	
	2004	2003
	RMB million	RMB million
Within one year	**390**	305
In the second year	**662**	211
In the third to fifth year, inclusive	**580**	250
After the fifth year	**—**	—
	1,632	766
Less: future finance charges on finance leases	**(72)**	(22)
Present value of finance lease liabilities	**1,560**	744

The present value of finance lease liabilities is as follows:

	2004	2003
Within one year	**210**	290
In the second year	**776**	206
In the third to fifth year, inclusive	**574**	248
After the fifth year	**—**	—
	1,560	744

28 Amounts due from/(to) holding companies and fellow subsidiaries

	Note	As at December 31, 2004 RMB Million	2003 RMB million
Current			
Due from holding companies	(a)	**136**	399
Due from fellow subsidiaries	(a)	**237**	50
		373	449
Profits distribution payable to ultimate holding company	(a)	**(8,244)**	(9,002)
Non-current			
Due to holding companies			
- intermediate holding company	(a),(c)	**—**	(3,000)
- ultimate holding company	(b),(c)	**—**	(1,750)
		—	(4,750)

Note:

(a) These are interest free, unsecured and have no fixed terms of repayment.

(b) The amount due to the ultimate holding company amounting to RMB1,750 million as at the end of December 31, 2003 was unsecured, and carried interest at 4.6% per annum.

(c) These balances were waived and recognised into the Group's equity upon the Reorganisation.

29 Deferred revenues

	As at December 31,	
	2004	2003
	RMB million	RMB million
Balance at beginning of year		
- upfront connection fees	**10,390**	14,355
- upfront installation fees	**6,691**	6,456
- advances from network capacity sales	**2,050**	27
- prepaid telephony services	**2,702**	1,971
	21,833	22,809
Additions for the year		
- upfront connection fees	**—**	—
- upfront installation fees	**1,051**	1,279
- advances from network capacity sales		
- additions	**242**	—
- acquired through Asia Netcom (Note 35 (c))	**—**	2,032
- prepaid telephony services	**11,815**	9,790
	13,108	13,101
Reductions for the year		
- upfront connection fees	**(3,378)**	(3,965)
- upfront installation fees	**(1,338)**	(1,044)
- advances from network capacity sales	**(114)**	(9)
- prepaid telephony services	**(11,592)**	(9,059)
	(16,422)	(14,077)
Distributed to owners in accordance with Reorganisation on June 30, 2004		
- advances from network capacity sales	**(5)**	—
- prepaid telephony services	**(44)**	—
	(49)	—

29 Deferred revenues *(continued)*

	As at December 31,	
	2004	2003
	RMB million	RMB million
Balance at end of year		
- upfront connection fees	**7,012**	10,390
- upfront installation fees	**6,404**	6,691
- advances from network capacity sales	**2,173**	2,050
- prepaid telephony services	**2,881**	2,702
	18,470	21,833
Representing:		
- Current portion	**6,653**	7,229
- Non-current portion	**11,817**	14,604
	18,470	21,833

30 Provisions

	Early retirement benefits	**One-off cash housing subsidies**	**Total**
	RMB million	RMB million	RMB million
	Note 3(r)(ii)	Note (a)	
At January 1, 2004	2,754	2,670	5,424
Additional provisions	206	—	206
Payments during the year	(414)	(477)	(891)
At December 31, 2004	2,546	2,193	4,739
Analysis of total provisions:			
Current portion	403	2,193	2,596
Non-current portion	2,143	—	2,143
	2,546	2,193	4,739

30 Provisions *(continued)*

(a) Certain staff quarters have been sold to employees, subject to a number of eligibility requirements, at preferential prices. In 1998, the State Council of the PRC issued a circular which stipulated that the sale of quarters to employees at preferential prices should be terminated. In 2000, the State Council issued a further circular stating that cash subsidies should be made to certain eligible employees following the withdrawal of allocation of staff quarters. However, the specific timetable and procedures of implementation of these policies were to be determined by individual provincial or municipal government based on the particular situation of the provinces or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who had not been allocated with quarters or who had not been allocated with quarters up to the prescribed standards before the discounted sales of quarters were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. Based on the available information, the Group estimated the required provision for these cash housing subsidies amounting to RMB2,818 million, which was charged to the consolidated income statement in the year ended December 31, 2000 when the State Council circular in respect of cash subsidies was issued. Pursuant to the Reorganisation, if the actual payments required for these one-off housing subsidies differ from the amount provided as of June 30, 2004, China Netcom Group will bear any additional payments required or will be paid the difference if the actual payments are lower than the amount provided.

31 Deferred taxation

Movements of the deferred tax and liability are as follows:

	Balance at December 31, 2003	Recognised in income statement	Recognised in equity	Recognised in equity	**Balance at December 31, 2004**
	RMB million	RMB million	RMB million Note (i)	RMB million Note (ii)	**RMB million**
Deferred tax assets					
Deferred revenue, primarily advances from customers	559	(46)	(513)	—	**—**
Other temporary differences primarily allowance for doubtful debts	465	81	(420)	—	**126**
Unrecognised revaluation surplus and deficit (note(ii))	—	(241)	—	2,355	**2,114**
Provision for early retirement provision benefits	974	25	(945)	—	**54**
Disposal of fixed assets	703	(70)	(633)	—	**—**
Others	83	86	(69)	—	**100**
Balance at end of year	2,784	(165)	(2,580)	2,355	**2,394**
Deferred tax liabilities					
Revenue recognition	(712)	133	579	—	**—**
Fixed assets depreciation	(2,347)	(450)	2,797	—	**—**
Deferred costs	(245)	114	131	—	**—**
Interest capitalization	(832)	(142)	(270)	—	**(1,244)**
Others	(77)	(52)	52	—	**(77)**
Balance at end of year	(4,213)	(397)	3,289	—	**(1,321)**

The amounts shown in the consolidated balance sheet include the following:

Deferred tax assets to be recovered after more than 12 months	1,760				**1,968**
Deferred tax liabilities to be settled after more than 12 months	(3,501)				**(1,114)**

31 Deferred taxation *(continued)*

Notes:

(i) As described in Note 18, in connection with the Reorganisation, certain of the Group's telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment were revalued as at December 31, 2003. Such revalued amounts will be used to determine the tax bases for these assets for future years. In addition, in connection with the Reorganisation, the tax bases of certain assets and liabilities have been adjusted to the revalued amounts incorporated as the carrying values in the balance sheet, except for the item described in Note (ii) below. As a result, the Group's net deferred tax liabilities were subsequently reduced by RMB709 million (comprising deferred tax assets of RMB2,580 million and deferred tax liabilities of RMB3,289 million), and this reduction was recorded as a credit to owner's equity upon the date of the Reorganisation on June 30, 2004. Among the RMB709 million net reduction of deferred tax liabilities, RMB846 million, being deferred tax liabilities originated from the revaluation surplus of fixed assets recorded, was credited to revaluation reserves and the remaining RMB137 million deferred tax assets were debited to retained earnings.

(ii) In addition, the Group's land and buildings were revalued for PRC tax purposes with a net surplus of RMB6,967 million as at December 31, 2003 to determine the tax bases for future years. However, the resulting revaluations of land and buildings were not incorporated into the consolidated financial statements. As a result, a deferred tax asset of RMB2,355 million was subsequently recorded with a corresponding increase in owner's equity upon the Reorganisation on June 30, 2004. In the opinion of the directors, it is more likely than not the Group will realize the benefits of the deferred tax asset after making reference to the historical taxable income of the Group. The revaluation asset is being transferred to retained earnings upon the corresponding realisation of the underlying deferred tax assets. The amount of transfer from revaluation reserve to retained earnings for the year ended December 31, 2004 was RMB241 million.

32 Share capital

	Authorised							
	Ordinary shares of US$0.04			Convertible preference shares of US$0.04 each (note (c))			Total	
	No. of shares	US$	RMB million	No. of shares	US$	RMB million	US$	RMB million
At January 1 December 31, 2003 and December 31, 2004	25,000,000,000	1,000,000,000	8,277	7,741,782	309,671	3	1,000,309,671	8,280

	Issued							
	Ordinary shares of US$0.04			Convertible preference shares of US$0.04 each (note (c))			Total	
	No. of shares	US$	RMB million	No. of shares	US$	RMB million	US$	RMB million
At January 1 and 31 December 2003 (note (b))	5,492,258,218	219,690,329	1,816	7,741,782	309,671	3	220,000,000	1,819
Conversion of convertible preference shares (note (c))	7,741,782	309,671	3	(7,741,782)	(309,671)	(3)	—	—
Issue of shares through Global Offering (note (d))	1,093,529,000	43,741,160	362	—	—	—	43,741,160	362
At December 31, 2004	6,593,529,000	263,741,160	2,181	—	—	—	263,741,160	2,181

32 Share capital *(continued)*

Notes:

(a) Pursuant to an ordinary resolution dated September 1, 2004, the authorised share capital of the Company was increased to US$1,000,000,000 by creating an additional 99,600,000,000 shares of US$0.01 each. Pursuant to an ordinary resolution passed on September 7, 2004, every four issued and unissued shares of US$0.01 each were consolidated into one new share of US$0.04 each. Following the creation of 99,600,000,000 additional shares and the share consolidation, the authorised share capital of the Company is RMB8,277 million divided into 25,000,000,000 shares of US$0.04 each, of which 5,492,258,218 shares were in issue and fully paid. The shares after the share consolidation rank par in all respects with each other. All references to the share capital of the Company in this report have been adjusted retrospectively to take into account the increase in authorised share capital and share consolidation. Besides, the increase in authorised capital is applied respectively in connection with presentation of share capital of the consolidated balance sheets as detailed in notes below.

(b) The share capital presented in the consolidated balance sheet at January 1, 2003 represents (i) the share capital of the Company, including the shares as at January 1, 2003 totalling 50,000,000 ordinary shares and (ii) shares issued for the Asset Injection arising from the Reorganisation totalling 5,442,258,218 ordinary shares described in note 1 above.

The shares described in (ii) are deemed to have been issued on January 1, 2003 under the Reorganisation for mergers accounting provision of Hong Kong SSAP No 27. The difference between the nominal value of the shares described in (ii) and the value of the net assets injected into the Company under the Asset Injection, totaling approximately RMB31 billion, is reflected as share premium as at January 1, 2003.

(c) All preference shares were converted into ordinary shares of the Company on August 30, 2004.

(d) On December 8, 2004, the Company completed its Global Offering as follows:

(i) Issue of an aggregate of 950,895,000 shares of US$0.04 each at HK$8.48 per share on The Stock Exchange of Hong Kong Limited ("HKSE") and at US$21.82 (HK$169.60) per ADS on the New York Stock Exchange Inc., on Nov. 17 and Nov. 16 respectively; and

(ii) Issue of 142,634,000 shares of US$0.04 each at HK$8.48 by way of a placing among professional and institutional investors on December 8, 2004 upon the full exercise of an over-allotment option.

The listing proceeds of the aforementioned Global Offering of shares, net of share issue expenses of HK$650 million (equivalent to RMB689 million) amounted to approximately HK$8,438 million (equivalent to RMB8,944 million). The resulting share premium amounted to approximately HK$8,096 million (equivalent to RMB8,582 million).

33 Share option scheme

A share option scheme was approved pursuant to a directors' resolution on September 30, 2004 ("Share Option Scheme"). Share options are granted to directors of the Company and to certain employees of the Group at the directors' discretion. Share options can be exercised at least 18 months from the later of the date of grant or the date of the listing of the shares of the Company on the Hong Kong Stock Exchange and subject to certain vesting schedules.

On October 22, 2004, 158,640,000 share options with an exercise price of HK$ 8.40 each were granted to certain directors of the Company and certain employees of the Group.

The total number of ordinary shares that are available for issuance upon the exercise of options granted pursuant to this scheme may not exceed 10% of the total number of issued ordinary shares. The Company may, however, seek separate approvals from its shareholders for granting options beyond the 10% limit. The scheme will be valid and effective for a period of six years and no options may be granted pursuant to this scheme following the expiration of the scheme.

Pursuant to the Company's share option plan, the Company granted 158,640,000 options to certain of its directors and employees, immediately prior to the closing of its global offering, to subscribe for its ordinary shares at the initial public offering price under the Hong Kong public offering, excluding brokerage and trading fees, and transaction and investor compensation levies. The options granted under this plan has a vesting period of 42 months from the date of listing of our shares and will expire six years from the date of grant.

Details of the share options granted immediately prior to the closing of the global offering and the movement during the year are summarised as follows:

	No. of share options								
Date of grant	Outstanding as at January 1, 2004	Granted during the period	No. of directors and employees	Exercised during the period	Lapsed during the period	Cancelled during the period	Outstanding as at December 31, 2004	Subscription price per share of the Company HK$	Option period
22/10/2004	—	158,640,000	456	—	920,000[a]	—	157,720,000	8.40	157,720,000

[a] A director resigned during the year and the options granted to him lapsed on the date of his resignation in accordance with the terms of the share option scheme.

34 Reserves – Company

	Share premium	Capital Reserve	Retained earnings	Total
	RMB million	RMB Million	RMB million	RMB million
At January 1, 2003	2,771	—	172	2,943
Profit for the year	—	—	19	19
At December 31, 2003	2,771	—	191	2,962
Issue of shares under Asset Injection in accordance with Reorganisation	31,397	2,982	—	34,379
Distributions to owners in accordance with Reorganisation	—	—	(359)	(359)
Loss for the year	—	—	(41)	(41)
Distribution to an owner upon assignment of loan prior to the Global Offering (Note a)	—	—	(1,021)	(1,021)
Issue of shares through Global Offering (net of issue expenses)	8,582	—	—	8,582
At December 31, 2004	42,750	2,982	(1,230)	44,502

(a) Pursuant to the promissory note (the "Note") signed by Group Wealth Finance Limited ("Group Wealth"), a fellow subsidiary owned by CNC BVI, the Company's immediate holding company, dated July 27, 2004, Group Wealth has borrowed an amount of US$123,301,980 (RMB1,020,644,470) from Asia Netcom, and used these funds to acquire the right to receive the outstanding debt payments owed by East Asia Netcom Limited, a fellow subsidiary, from the vendors to the aggregate amount of approximately US$123 million on July 29, 2004.

Subsequently, on September 30, 2004, CNC BVI instructed Group Wealth to assign the loan to the Company. Accordingly, upon such assignment, the amount receivable from Group Wealth of the said amount is effectively waived and the Company recorded such assignment as an equity distribution to CNC BVI.

35 Consolidated cash flow statements

(a) Reconciliation of profit/(loss) before taxation to net cash flows generated from operations

	Years ended December 31, 2004 RMB million	2003 RMB million
Profit/(loss) before taxation	**12,596**	(17,931)
Depreciation of fixed assets and amortisation of intangible assets	**18,754**	20,483
Amortisation of deferred revenues	**(16,422)**	(14,309)
Deferred costs expensed in the income statements	**3,484**	1,927
Deficit on revaluation of fixed assets	**—**	25,778
Allowance for doubtful debts	**832**	619
Loss on disposal of fixed assets	**145**	1,689
Dividend income	**(17)**	(45)
Share of loss from associated companies and jointly controlled entities	**1**	416
Interest income	**(76)**	(79)
Interest expense	**2,794**	2,844
Discount on foreign currency exchange forward contracts	**18**	20
Realised (gain) on disposal of short-term investments	**—**	(1)
Unrealised loss/(gain) on short-term investments	**4**	(7)
Unrealised foreign exchange losses	**70**	142
Operating profit before working capital changes	**22,183**	21,546
Increase in accounts receivable	**(312)**	(1,779)
Decrease/(increase) in inventories and consumables	**201**	(231)
(Increase)/decrease in prepayments and other receivable	**(62)**	270
Increase in deferred costs and other non-current assets	**(3,158)**	(3,494)
Increase in accounts payable	**1,229**	1,883
(Decrease) in accruals and other payables	**(3,483)**	(457)
Increase in deferred revenues	**13,108**	11,069
Net cash inflow generated from operations	**29,706**	28,807

(b) Major non-cash transactions

During 2004, the Group entered into finance lease arrangements in respect of newly acquired fixed assets with a total capital value at the inception of the lease of RMB409 million (2003: RMB276 million).

During 2004, the immediate holding company assigned a loan to the Company which resulted in a direct charge to the Company's equity, see note 34(a) for details.

35 Consolidated cash flow statements *(continued)*

(c) Acquisition of Asia Global Crossing through Asia Netcom

The Group acquired 100% of certain entities previously controlled by Asia Global Crossing through Asia Netcom by way of two acquisitions. On March 10, 2003, the Group injected RMB507 million into Asia Netcom, a 51% owned jointly controlled entity which acquired the entire interest in certain entities, which own and operate an Asia-Pacific region cable network providing city-to-city connectivity, data communications and IP-based services, previously controlled by Asia Global Crossing. On December 31, 2003, the Group acquired the remaining 49% of the equity of Asia Netcom for a total cost of RMB525 million.

From March 10, 2003 to December 31, 2003, Asia Netcom was accounted for as a jointly controlled entity. On December 31, 2003, Asia Netcom became a wholly owned subsidiary of the Company and was consolidated into the Group's financial statements.

The net assets acquired and the net cash inflow in respect of the purchase of the remaining 49% interest in Asia Netcom, which has a group of subsidiaries, is analysed as follows:

	As at December 31, 2003
	RMB million
Net assets acquired at their respective estimated fair values	
Fixed assets	3,037
Deferred costs	870
Other non-current assets	157
Cash and bank deposits	580
Accounts receivables and other current assets	442
Accounts payable and other current liabilities	(1,207)
Advances from network capacity sales	(2,032)
Bank and other loans	(1,011)
Net assets	836
49% of net assets	410
Goodwill (Note 20)	115
Satisfied by cash	525
Cash consideration	(525)
Cash and bank deposits acquired	580
Net cash inflow in respect of the purchase of subsidiaries	55

36 Contingent liabilities

(a) Guarantees

	Group		Company	
	As at December 31,		As at December 31,	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Guarantees for US dollar denominated bank loans of third parties	**63**	125	**—**	—

On December 8, 2000, a subsidiary of the Company entered into an agreement to provide a guarantee to a subsidiary of China Mobile for a foreign currency borrowing. The guarantee arose from the assumption of responsibilities by both parties as part of the legacy arrangements of their predecessor companies commonly controlled by the state government.

The guarantee obligation is limited to the outstanding loan and accrued interest amount payable by the subsidiary of China Mobile which is due to be settled by September 2005. As at December 31, 2003 and 2004, the outstanding balances of the borrowing, including interest payable, were US$15.1 million (RMB125 million) and US$7.6 million (RMB63 million) respectively.

The directors are of the opinion that the possibility of the guaranteed party defaulting on the outstanding balance of the borrowing is remote, hence no provisions have been made for the guarantee.

(b) National Audit Office (“NAO”) audit

During the year, the NAO has completed its audit on the ultimate holding company, China Netcom Group, including all of its business operations, assets and liabilities prior to the Reorganisation. Substantial assets and liabilities currently comprising the Group were injected by China Netcom Group in accordance with the Reorganisation. China Netcom Group has informed the directors that no significant matters have been raised to China Netcom Group by the NAO as a result of its audit. Accordingly the directors are of the opinion that there is no matter concerning the Group that qualifies for disclosure in its consolidated financial statements in relation to the NAO audit.

37 Banking facilities

As at December 31, 2003 and 2004, the Group's banking facilities are as follows:

	Group		Company	
	As at December 31,		As at December 31,	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Amount utilised	**56,910**	69,498	**—**	—
Amount unutilised	**13,590**	10,952	**—**	—
Aggregate banking facilities	**70,500**	80,450	**—**	—

38 Commitments

(a) Capital commitments

	Group		Company	
	As at December 31,		As at December 31,	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Contracted but not provided for				
- Land and buildings	**47**	220	**—**	—
- Telecommunications networks and equipment	**986**	1,971	**—**	—
	1,033	2,191	**—**	—
Authorised but not contracted for				
- Land and buildings	**2**	213	**—**	—
- Telecommunications networks and equipment	**1,778**	4,626	**—**	—
	1,780	4,839	**—**	—

38 Commitments *(continued)*

(b) Operating lease commitments

The Group has future minimum lease payments under non-cancellable operating leases in respect of premises and equipment as follows:

	Group		Company	
	As at December 31,		As at December 31,	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Not later than one year	**793**	463	**—**	—
Later than one year and not later than five years	**1,129**	770	**—**	—
Later than five years	**1,510**	297	**—**	—
	3,432	1,530	**—**	—

39 Related party transactions

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

39 Related party transactions *(continued)*

(a) Transaction before Reorganisation on June 30,2004

The directors consider that the following related party transactions were carried out in the normal course of business of the Group and at terms mutually agreed between the Group and the respective related parties.

	Note	**Period from January1,2004 to June 30, 2004 prior to Reorganisation**	2003
		RMB million	RMB million
Rental income from properties leased to related companies	(v)(a), (v)(c)	**2**	4
Purchase of materials			
- from fellow subsidiaries	(v)(a), (v)(c)	**(528)**	(2,365)
- from related companies	(v)(a), (v)(c)	**(670)**	(1,738)
		(1,198)	(4,103)
Receipt of engineering, project planning, design, construction and information technology services			
- from fellow subsidiaries	(v)(a), (v)(b)	**(321)**	(1,714)
- from related companies	(v)(a), (v)(b)	**(564)**	(1,517)
		(885)	(3,231)
Ancillary telecommunications support services (iii)			
- from fellow subsidiaries	(v)(a), (v)(c)	**(207)**	(1,021)
- from related companies	(v)(a), (v)(c)	**(232)**	(767)
		(439)	(1,788)
Payment of operating lease rentals of premises			
- from fellow subsidiaries	(v)(a), (v)(c)	**(7)**	(13)
- from related companies	(v)(a), (v)(c)	**(5)**	(35)
		(12)	(48)
Support services (iv)			
- from fellow subsidiaries	(v)(a), (v)(c)	**(187)**	(1,028)
- from related companies	(v)(a), (v)(c)	**(149)**	(510)
		(336)	(1,538)

39 Related party transactions *(continued)*

(b) Transaction after Reorganisation on June 30,2004

	Note	Period after Reorganisation from July 1, 2004 to December 31,2004 RMB million
Interconnection fee received from ultimate holding company	(vi)(a)	**144**
Interconnection fee paid to ultimate holding company	(vi)(a)	**(167)**
Payment of operating lease rentals of premises from fellow subsidiaries	(vi)(b)	**(299)**
Payment of operating sub-lease rentals of premises from fellow subsidiaries	(vi)(c)	**(33)**
Common corporate services income received from ultimate holding company	(vi)(d)	**19**
Common corporate services expense paid to ultimate holding company	(vi)(d)	**(213)**
Receipt of engineering, project planning, design, construction and information technology services	(vi)(e)	
- from fellow subsidiaries		**(1,935)**
- from related companies		**(7)**
		(1,942)
Purchase of materials	(vi)(f)	
- from fellow subsidiaries		**(780)**
- from related companies		**(106)**
		(886)

39 Related party transactions *(continued)*

(b) Transaction after Reorganisation on June 30,2004 *(continued)*

	Note	Period after Reorganisation from July 1, 2004 to December 31,2004 RMB million
Ancillary telecommunications support services	(vi)(g)	
- from fellow subsidiaries		**(281)**
- from related companies		**(3)**
		(284)
Support services	(vi)(h)	
- from fellow subsidiaries		**(520)**
- from related companies		**(211)**
		(731)
Payment of operating lease rentals of telecommunications facilities to fellow subsidiaries	(vi)(i)	**(138)**
Payment for purchase of long-term telecommunications capacity to ultimate holding company	(vi)(j)	**(173)**
Payment for lease of long-term telecommunications capacity to ultimate holding company	(vi)(k)	**(28)**
Management fee received from ultimate holding company	(vi)(l)	**28**

39 Related party transactions *(continued)*

Notes:

(i) As at the respective balance sheet dates, the Group had balances with certain related parties, which have been set out in Notes 27(b)(ii) and 28.

(ii) The related companies represent the investees of the unlisted fellow subsidiaries.

(iii) Represents the provision of ancillary telecommunications support services to the Group by the fellow subsidiaries and the related companies. These services include certain telecommunications pre-sale, on-sale and after-sale services, certain sales agency services, the printing and delivery of invoice services, the maintenance of certain air-conditioning, fire alarm equipment and telephone booths and other customers services.

(iv) Represents the support services provided to the Group by the fellow subsidiaries and the related companies. These support services include equipment leasing services, motor vehicles services, safety and security services, conference services, basic construction agency services, equipment maintenance services, employee training services, advertising services, printing services and other support services.

(v) Transactions with individual related parties before reorganisation on June 30, 2004 were priced based on one of the following three criteria:

(a) market price;

(b) prices based on government guidance; or

(c) cost plus basis.

(vi) In connection with the Reorganisation, the Group and China Netcom Group entered into a number of agreements effective on or after July 1, 2004 with an initial term expiring on December 31, 2006. The terms of the principal agreements are summarised as follows:

(a) The Group entered into an Interconnection Settlement Agreement with China Netcom Group for interconnection of domestic and international long distance telephone calls. Pursuant to the said agreement, the telephony operator terminating a telephone call made to its local networks is entitled to receive a fee prescribed by MII from the operator from which the telephone call is originated.

(b) The Group entered into a Property Leasing Agreement with China Netcom Group pursuant to which the Group leases certain properties to/from China Netcom Group. The rental charges are based on either market rates or depreciation charge and maintenance charge in respect of each property, provided that such depreciation and maintenance charge shall not be higher than the market rates.

(c) The Group entered into a Property Sub-leasing Agreement with China Netcom Group pursuant to which the Group leases certain properties from China Netcom Group which are owned by independent third parties. The rental charges are based on market rates negotiated between China Netcom Group and the relevant third parties.

(d) The Group entered into a Master Service Sharing agreement with China Netcom Group pursuant to which expenses associated with common corporate services are allocated between the Group and China Netcom Group based on revenues as appropriate.

39 Related party transactions *(continued)*

Notes: *(continued)*

(e) The Group entered into an Engineering and Information Technology Services Agreement with China Netcom Group pursuant to which China Netcom Group provides the Group with engineering and information technology-related services. The amounts charged for these services are determined by reference to market rates as reflected in prices obtained through a tender.

(f) The Group entered into a Materials Procurement Agreement with China Netcom Group pursuant to which China Netcom Group provides the Group with the procurement of equipment and materials. The amount charged for this service is based on a percentage not exceeding 3% of the contract value of the equipment and materials purchased from domestic suppliers or 1% of the contract value of the equipment and materials purchased from overseas suppliers.

(g) The Group entered into an Ancillary Telecommunications Services Agreement with China Netcom Group. The ancillary telecommunications services provided by China Netcom Group include certain telecommunications pre-sale, on-sale and after-sale services, sales agency services and certain customer services. Pursuant to the said agreement, China Netcom Group charges the Group for these services in accordance with the following terms:

- Government prescribed price;
- Where there is no government prescribed price but there is a government guided price, the government guided price will apply;
- Where there is neither 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.

(h) The Group entered into a Support Services Agreement for various support services with China Netcom Group. The support services provided by China Netcom Group include equipment leasing and maintenance services, motor vehicles services, safety and security service, basic construction agency services, research and development services, employee training services and advertising services and other support services. Pursuant to the said agreement, China Netcom Group charges the Group for these services in accordance with the following terms:

- Government prescribed price;
- Where there is no government prescribed price but there is a government guided price, the government guided price will apply;
- Where there is neither 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 party transactions *(continued)*

Notes *(continued)*:

(i) The Group entered into a Telecommunications Facilities Leasing Agreement with China Netcom Group pursuant to which the Group leases the international telecommunications facilities and inter-provincial transmission optic fibres from China Netcom Group. The lease payment is based on the depreciation charge of the assets.

(j) The Group entered into a Capacity Purchase Agreement with East Asia Netcom Limited ("EANL"), a wholly owned subsidiary of China Netcom Group, pursuant to which the Group receives certain amounts of long-term telecommunications capacity from China Netcom Group at market prices as set out in the Capacity Purchase Agreement.

(k) The Group entered into a Capacity Lease Agreement with EANL, pursuant to which the Group leases certain amounts of capacity on China Netcom Group's telecommunications network at market rates as set out in the Capacity Lease Agreement.

(l) The Group entered into a Management Services Agreement with EANL, pursuant to which the Group provides certain management services to China Netcom Group either on a cost reimbursement basis or on the basis of cost plus reasonable profits not exceeding the market price as set out in the Management Service Agreement.

(vii) In addition, pursuant to the Reorganisation, China Netcom Group has agreed to hold and maintain, for the Group's benefit, all licenses received from the MII in connection with the Restructured Businesses transferred to the Group. The licences maintained by China Netcom Group were granted by the MII at nil or nominal costs. To the extent that China Netcom Group incurs a cost to maintain or obtain licences in the future, the Company has agreed reimburse China Netcom Group for any such expense.

(viii) China Netcom Group has also agreed to indemnify the Group in connection with any tax and deferred tax liabilities not recognised in the financial statements of the Group and arisen from transactions prior to the date of Reorganisation.

(ix) During the year, the Group entered into a finance lease arrangement with a related party (see note 18(a)).

(x) During the year, a fellow subsidiary borrowed a loan from the Group and the loan payable from the fellow subsidiary was assigned to the Group at the instruction of its immediate holding company, which resulted in a direct charge to the Company's equity, please refer to note 34(a) for details.

40 Significant subsequent events

After the balance sheet date, the directors proposed a final dividend. Further details are disclosed in note 9.

41 Ultimate holding company

The directors regard China Netcom Group, a state-owned company established in the PRC, as being the ultimate holding company.

42 Approval of financial statements

The financial statements were approved by the Board of Directors on April 6, 2005.