

The following are the texts of the reports, prepared for the purpose of incorporation in this prospectus, from the auditors and reporting accountants of Xinao Gas Holdings Limited, Deloitte Touche Tohmatsu.

A. ACCOUNTANTS' REPORT FOR JINGGU XINAO

德勤·關黃陳方會計師行

Certified Public Accountants
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香港中環干諾道中111號
永安中心26樓

**Deloitte
Touche
Tohmatsu**

27 April 2001

The Directors
Xinao Gas Holdings Limited
N M Rothschild & Sons (Hong Kong) Limited

Dear Sirs,

We refer to the conditional agreement entered into on 31 January 2001 between Xinao Pinggu Investment Limited, a wholly owned subsidiary of Xinao Gas Holdings Limited, and 新奧集團股份有限公司 (“Xinao Group Company Limited”), a company which is controlled by Mr. Wang Yusuo. Pursuant to this agreement, Xinao Pinggu Investment Limited will acquire a 70 per cent. equity interest in 北京新奧京谷燃氣有限公司 (“Beijing Xinao Jinggu Gas Company Limited”) (“Jinggu Xinao”) owned by Xinao Group Company Limited, the completion of which is conditional on all necessary approvals being obtained in relation to the transfer of the equity interest and the conversion of Jinggu Xinao into a Sino-foreign equity joint venture.

Jinggu Xinao was established in the People's Republic of China (“PRC”) as a joint venture on 11 August 2000 for the principal business of sales of piped natural gas, gas pipeline investment and provision of gas connection services. At the date of this report, the registered capital of Jinggu Xinao was RMB9,900,000, of which RMB6,930,000 was contributed by Xinao Group Company Limited.

No audited financial statements have been prepared for Jinggu Xinao since its establishment.

For the purpose of this report, we have undertaken our own independent audit of the management accounts of Jinggu Xinao for the period from 11 August 2000 (date of establishment) to 31 December 2000 (the “Relevant Period”), which are prepared under accounting principles generally accepted in Hong Kong, in accordance with the Auditing Standards issued by the Hong Kong Society of Accountants, and we have carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline “Prospectuses and the Reporting Accountant” as recommended by the Hong Kong Society of Accountants.

The summaries of the results of Jinggu Xinao for the Relevant Period and of its net tangible assets as at 31 December 2000 (the “Summaries”) set out in this report have been prepared based on its management accounts. The directors of Jinggu Xinao are responsible for preparation of

these management accounts which give a true and fair view. The directors of Xinao Gas Holdings Limited are responsible for the contents of the prospectus in which this report is included. It is our responsibility to form an independent opinion on the Summaries and to report our opinion to you.

In our opinion, the Summaries together with the notes thereon give, for the purpose of this report, a true and fair view of the results of Jinggu Xinao for the Relevant Period and of its net tangible assets as at 31 December 2000.

1. PRINCIPAL ACCOUNTING POLICIES

The financial information set out in this report has been prepared under the historical cost convention. The principal accounting policies adopted, which are in accordance with accounting principles generally accepted in Hong Kong, are as follows:

Revenue recognition

Interest income is accrued on a time basis by reference to the principal outstanding and at the interest rate applicable.

Property, plant and equipment

Property, plant and equipment other than construction in progress are stated at cost less depreciation and amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of the asset.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Where the recoverable amount of an asset has declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. In determining the recoverable amount of assets, expected future cash flows are not discounted to their present values.

Depreciation and amortisation are provided to write off the cost of each asset other than construction in progress, over its estimated useful life, and after taking into account its estimated residual value, using the straight line method, as follows:

Land use rights	Over the term of the lease
Buildings	Over the shorter of 30 years or the operation period of the joint venture
Machinery and equipment	10 years
Motor vehicles	6 years
Office equipment	6 years

Construction in progress

Construction in progress represents machinery and pipelines under construction and is stated at cost. Cost comprises direct and indirect costs of acquisition or construction. Completed items are transferred from construction in progress to proper categories of property, plant and equipment when they are ready for their intended use.

Inventories

Inventories, including construction materials and spare parts, are stated at the lower of cost and net realisable value. Cost which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition is calculated using the weighted average method. Net realisable value is based on estimated selling prices in the ordinary course of business less estimated costs to completion and the estimated costs necessary to make the sale.

Taxation

The charge for taxation is based on the results for the period after adjusting for items which are non-assessable or disallowed. Certain items of income and expense are recognised for tax purposes in a different accounting period from that in which they are recognised in the financial statements. The tax effect of the resulting timing differences, computed under the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight line basis over the relevant lease terms.

2. RESULTS

The following is a summary of the results of Jinggu Xinao for the Relevant Period:

	<i>Notes</i>	<i>RMB'000</i>
Interest income		6
Administrative expenses		<u>(1,094)</u>
Loss for the period	<i>(a)</i>	<u><u>(1,088)</u></u>
Dividends	<i>(c)</i>	<u><u>–</u></u>

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES
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Notes:

(a) Loss for the period

RMB'000

Loss for the period has been arrived at after charging:

Auditors' remuneration	–
Retirement benefits scheme contribution	35
Other staff costs	212
Depreciation and amortisation of property, plant and equipment	57
Operating lease rentals in respect of land and buildings	5
	5

(b) Taxation

No provision for PRC enterprise income tax has been made as Jinggu Xinao had no profit for the Relevant Period.

There was no significant unprovided deferred taxation during the Relevant Period.

(c) Dividends

No dividends have been paid or declared by Jinggu Xinao since the date of its establishment.

(d) Remuneration of directors and employees

No remuneration was paid or payable to any directors of Jinggu Xinao and of Xinao Gas Holdings Limited during the Relevant Period.

The emoluments of the five highest paid employees of Jinggu Xinao for the Relevant Period were as follows:

RMB'000

Employees	
– basic salaries and allowances	64
– bonus	–
	64

The emoluments of each of the above employees did not exceed RMB1,000,000 during the Relevant Period.

During the Relevant Period, no emoluments were paid by Jinggu Xinao to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining Jinggu Xinao or as compensation for loss of office. None of the directors waived any emoluments during the Relevant Period.

(e) Transfer to or from reserves

RMB'000

Capital reserve

Capital surplus arising on injection of capital during the period and balance carried forward	31
	31

Other than the above, there was no movement in reserves during the Relevant Period.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES

3. NET TANGIBLE ASSETS

The following is a summary of the net tangible assets of Jinggu Xiniao as at 31 December 2000:

	<i>Notes</i>	<i>RMB'000</i>	<i>RMB'000</i>
Non-current assets			
Property, plant and equipment	<i>(a)</i>		6,386
Current assets			
Inventories, at cost		1,067	
Other receivables		1,238	
Amounts due from related companies	<i>(b)</i>	2,770	
Bank balances and cash		1,247	
		6,322	
Current liabilities			
Other payables		2,610	
Amounts due to related companies	<i>(c)</i>	1,186	
Secured bank loan – due within one year	<i>(d)</i>	25	
		3,821	
Net current assets			2,501
Total assets less current liabilities			8,887
Non-current liability			
Secured bank loan – due after one year	<i>(d)</i>		44
Net tangible assets			8,843

Notes:

(a) Property, plant and equipment

	Cost <i>RMB'000</i>	Accumulated depreciation and amortisation <i>RMB'000</i>	Net book value <i>RMB'000</i>
Land and buildings	4,129	44	4,085
Machinery and equipment	58	–	58
Motor vehicles	325	9	316
Office equipment	128	4	124
Construction in progress	1,803	–	1,803
	6,443	57	6,386

The land and buildings were situated in the PRC with medium term land use rights.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES

(b) Amounts due from related companies

Particulars of the amounts due from related companies are as follows:

Name of company	At 31 December 2000 <i>RMB'000</i>	At 11 August 2000 <i>RMB'000</i>	Maximum amount outstanding during the Relevant Period <i>RMB'000</i>
Xinao Group Company Limited	1,458	–	1,500
Beijing Xinao Gas Company Limited	1,312	–	1,389
	<u>2,770</u>	<u>–</u>	

The amounts arose from advances to the related companies. The amounts were unsecured, interest free and had no fixed repayment term. The amount due from Xinao Group Company Limited was fully settled subsequent to 31 December 2000.

Beijing Xinao Gas Company Limited is controlled by Mr. Wang Yusuo and Ms. Zhao Baoju and became a subsidiary of Xinao Gas Holdings Limited since 28 March 2001.

(c) Amounts due to related companies

Particulars of the amounts due to related companies are as follows:

Name of company	<i>RMB'000</i>
Beijing Xinao Jingchang Gas Company Limited	1,128
Langfang Xinao Gas Company Limited	58
	<u>1,186</u>

The amounts arose from advances from the related companies. The amounts were unsecured, interest free and had no fixed repayment terms.

Beijing Xinao Jingchang Gas Company Limited is a subsidiary of Xinao Group Company Limited. Langfang Xinao Gas Company Limited is controlled by Mr. Wang Yusuo and Ms. Zhao Baoju and became a subsidiary of Xinao Gas Holdings Limited since 28 March 2001.

(d) Secured bank loan

	<i>RMB'000</i>
The bank loan is repayable:	
Within one year	25
In one to two years	25
In two to five years	19
	<u>69</u>
Less: Amount due within one year shown under current liabilities	(25)
Amount due after one year	<u>44</u>

(e) Operating lease commitments

At 31 December 2000, Jinggu Xinao had no operating lease commitments.

(f) Pledge of assets

At 31 December 2000, Jinggu Xinao's motor vehicle with an aggregate net book value of approximately RMB138,000 was pledged to a bank for a bank loan granted to Jinggu Xinao.

4. DISTRIBUTABLE RESERVES

At 31 December 2000, Jinggu Xinao had no reserve available for distribution to its shareholders.

5. ULTIMATE HOLDING COMPANY

The directors of Jinggu Xinao consider Xinao Group Company Limited, a company which is incorporated in the PRC, to be its ultimate holding company.

6. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements of Jinggu Xinao have been prepared in respect of any period subsequent to 31 December 2000.

Yours faithfully,
Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong

B. ACCOUNTANTS' REPORT FOR QINGDAO XINAO

德勤·關黃陳方會計師行

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Hong Kong

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永安中心26樓

**Deloitte
Touche
Tohmatsu**

27 April 2001

The Directors
Xinao Gas Holdings Limited
N M Rothschild & Sons (Hong Kong) Limited

Dear Sirs,

We refer to the conditional agreement entered into on 31 January 2001 between Xinao Huangdao Investment Limited, a wholly owned subsidiary of Xinao Gas Holdings Limited, and 新奧集團股份有限公司 (“Xinao Group Company Limited”), a company which is controlled by Mr. Wang Yusuo. Pursuant to this agreement, Xinao Huangdao Investment Limited will acquire a 90 per cent. equity interest in 青島新奧燃氣有限公司 (“Qingdao Xinao Gas Company Limited”) (“Qingdao Xinao”) owned by Xinao Group Company Limited, the completion of which is conditional on all necessary approvals being obtained in relation to the transfer of the equity interest and the conversion of Qingdao Xinao into a Sino-foreign equity joint venture.

Qingdao Xinao was established in the People's Republic of China (“PRC”) as a joint venture on 30 October 2000 for the principal business of sales of piped natural gas, gas pipeline investment and provision of gas connection services. At the date of this report, the registered capital of Qingdao Xinao was RMB20,000,000, of which RMB18,000,000 was contributed by Xinao Group Company Limited.

No audited financial statements have been prepared for Qingdao Xinao since its establishment.

For the purpose of this report, we have undertaken our own independent audit of the management accounts of Qingdao Xinao for the period from 30 October 2000 (date of establishment) to 31 December 2000 (the “Relevant Period”), which are prepared under accounting principles generally accepted in Hong Kong, in accordance with the Auditing Standards issued by the Hong Kong Society of Accountants, and we have carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline “Prospectuses and the Reporting Accountant” as recommended by the Hong Kong Society of Accountants.

The summaries of the results of Qingdao Xinao for the Relevant Period and of its net tangible assets as at 31 December 2000 (the “Summaries”) set out in this report have been prepared based on its management accounts. The directors of Qingdao Xinao are responsible for preparation of these management accounts which give a true and fair view. The directors of Xinao Gas Holdings Limited are responsible for the contents of the prospectus in which this report is included. It is our responsibility to form an independent opinion on the Summaries and to report our opinion to you.

In our opinion, the Summaries together with the notes thereon give, for the purpose of this report, a true and fair view of the results of Qingdao Xinao for the Relevant Period and of its net tangible assets as at 31 December 2000.

1. PRINCIPAL ACCOUNTING POLICIES

The financial information set out in this report has been prepared under the historical cost convention. The principal accounting policies adopted, which are in accordance with accounting principles generally accepted in Hong Kong, are as follows:

Revenue recognition

Sales of liquefied petroleum gas are recognised when goods are delivered and title has been passed.

Property, plant and equipment

Property, plant and equipment other than construction in progress are stated at cost less depreciation and amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of the asset.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Where the recoverable amount of an asset has declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. In determining the recoverable amount of assets, expected future cash flows are not discounted to their present values.

Depreciation and amortisation are provided to write off the cost of each asset other than construction in progress, over its estimated useful life, and after taking into account its estimated residual value, using the straight line method, as follows:

Land use rights	Over the term of the lease
Buildings	Over the shorter of 30 years or the operation period of the joint venture
Machinery and equipment	10 years
Motor vehicles	6 years
Office equipment	6 years

Construction in progress

Construction in progress represents machinery and pipelines under construction and is stated at cost. Cost comprises direct and indirect costs of acquisition or construction. Completed items are transferred from construction in progress to proper categories of property, plant and equipment when they are ready for their intended use.

Inventories

Inventories, including construction materials and spare parts, are stated at the lower of cost and net realisable value. Cost which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition is calculated using the weighted average method. Net realisable value is based on estimated selling prices in the ordinary course of business less estimated costs to completion and the estimated costs necessary to make the sale.

Taxation

The charge for taxation is based on the results for the period after adjusting for items which are non-assessable or disallowed. Certain items of income and expense are recognised for tax purposes in a different accounting period from that in which they are recognised in the financial statements. The tax effect of the resulting timing differences, computed under the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight line basis over the relevant lease terms.

2. RESULTS

The following is a summary of the results of Qingdao Xinao for the Relevant Period:

	<i>Notes</i>	<i>RMB'000</i>
Turnover	<i>(a)</i>	705
Cost of sales		<u>(676)</u>
Gross profit		29
Administrative expenses		(834)
Other operating expenses		<u>(261)</u>
Loss for the period	<i>(b)</i>	<u><u>(1,066)</u></u>
Dividends	<i>(d)</i>	<u><u>–</u></u>

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES

Notes:

(a) Turnover

Turnover represents the amounts received and receivable for sales of liquefied petroleum gas.

(b) Loss for the period

RMB'000

Loss for the period has been arrived at after charging:

Auditors' remuneration	–
Staff costs	57
Depreciation and amortisation of property, plant and equipment	37
Loss on disposal of property, plant and equipment	261
Operating lease rentals in respect of land and buildings	10
	10

(c) Taxation

No provision for PRC enterprise income tax has been made as Qingdao Xinao had no profit for the Relevant Period.

There was no significant unprovided deferred taxation during the Relevant Period.

(d) Dividends

No dividends have been paid or declared by Qingdao Xinao since the date of its establishment.

(e) Remuneration of directors and employees

No remuneration was paid or payable to any directors of Qingdao Xinao and of Xinao Gas Holdings Limited during the Relevant Period.

The emoluments of the five highest paid employees of Qingdao Xinao for the Relevant Period were as follows:

RMB'000

Employees	
– basic salaries and allowances	12
– bonus	–
	12

The emoluments of each of the above employees did not exceed RMB1,000,000 during the Relevant Period.

During the Relevant Period, no emoluments were paid by Qingdao Xinao to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining Qingdao Xinao or as compensation for loss of office.

(f) Transfer to or from reserves

There was no movement in reserves during the Relevant Period.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES
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3. NET TANGIBLE ASSETS

The following is a summary of the net tangible assets of Qingdao Xinao as at 31 December 2000:

	<i>Notes</i>	<i>RMB'000</i>	<i>RMB'000</i>
Non-current assets			
Property, plant and equipment	(a)		3,123
Current assets			
Inventories, at cost		1,139	
Trade and other receivables		1,172	
Amounts due from related companies	(b)	12,613	
Bank balances and cash		2,657	
		17,581	
Current liabilities			
Trade and other payables		792	
Amounts due to related companies	(c)	978	
		1,770	
Net current assets			15,811
Net tangible assets			18,934

Notes:

(a) **Property, plant and equipment**

	Cost	Accumulated depreciation and amortisation	Net book value
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Land and buildings	377	2	375
Machinery and equipment	909	26	883
Motor vehicles	511	9	502
Office equipment	132	–	132
Construction in progress	1,231	–	1,231
	3,160	37	3,123
	3,160	37	3,123

The land and buildings were situated in the PRC with medium term land use rights.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES

(b) Amounts due from related companies

Particulars of the amounts due from related companies are as follows:

Name of company	At 31 December 2000 <i>RMB'000</i>	At 30 October 2000 <i>RMB'000</i>	Maximum amount outstanding during the Relevant Period <i>RMB'000</i>
Langfang Development Zone Urban Construction Engineering Company Limited	12,000	–	12,000
青島經濟技術開發區熱電燃氣總公司 ("Qingdao Economic and Technical Development Zone Heating, Electricity and Gas Corporation")	613	–	613
	12,613	–	613

The amounts arose from advances to the related companies. The amounts were unsecured, interest free and had no fixed repayment terms. The amount due from Langfang Development Zone Urban Construction Engineering Company Limited was fully settled subsequent to 31 December 2000.

Langfang Development Zone Urban Construction Engineering Company Limited is controlled by Mr. Wang Yusuo. Qingdao Economic and Technical Development Zone Heating, Electricity and Gas Corporation is the minority shareholder of Qingdao Xinao.

(c) Amounts due to related companies

Particulars of the amounts due to related companies are as follows:

Name of company	<i>RMB'000</i>
Xinao Group Company Limited	968
Langfang Xinao Gas Company Limited	10
	978

The amounts arose from advances from the related companies. The amounts were unsecured, interest free and had no fixed repayment terms. The amount due to Xinao Group Company Limited was fully settled subsequent to 31 December 2000.

Langfang Xinao Gas Company Limited is controlled by Mr. Wang Yusuo and Ms. Zhao Baoju and became a subsidiary of Xinao Gas Holding Limited since 28 March 2001.

(d) Operating lease commitments

At 31 December 2000, Qingdao Xinao had outstanding annual commitments of RMB263,000 payable in the following year under non-cancellable operating leases in respect of land and buildings which expire in the second to fifth year inclusive.

(e) Capital commitments

At 31 December 2000, Qingdao Xinao had commitments of approximately RMB95,500 relating to the acquisition of property, plant and equipment which was contracted for but not provided in the Summaries.

4. DISTRIBUTABLE RESERVES

At 31 December 2000, Qingdao Xinao had no reserve available for distribution to its shareholders.

5. ULTIMATE HOLDING COMPANY

The directors of Qingdao Xinao consider Xinao Group Company Limited, a company which is incorporated in the PRC, to be its ultimate holding company.

6. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements of Qingdao Xinao have been prepared in respect of any period subsequent to 31 December 2000.

Yours faithfully,
Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong

C. ACCOUNTANTS' REPORT FOR JINGCHANG XINAO

德勤·關黃陳方會計師行

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**Deloitte
Touche
Tohmatsu**

27 April 2001

The Directors
Xinao Gas Holdings Limited
N M Rothschild & Sons (Hong Kong) Limited

Dear Sirs,

We refer to the conditional agreement entered into on 31 January 2001 between Xinao Changping Investment Limited, a wholly owned subsidiary of Xinao Gas Holdings Limited, and 新奧集團股份有限公司 (“Xinao Group Company Limited”), a company which is controlled by Mr. Wang Yusuo. Pursuant to this agreement, Xinao Changping Investment Limited will acquire an 80 per cent. equity interest in 北京新奧京昌燃氣有限公司 (“Beijing Xinao Jingchang Gas Company Limited”) (“Jingchang Xinao”) owned by Xinao Group Company Limited, the completion of which is conditional on all necessary approvals being obtained in relation to the transfer of the equity interest and the conversion of Jingchang Xinao into a Sino-foreign equity joint venture.

Jingchang Xinao was established in the People's Republic of China (“PRC”) as a joint venture on 16 November 2000 for the principal business of sales of piped natural gas, gas pipeline investment, and provision of gas connection services. At the date of this report, the registered capital of Jingchang Xinao was RMB9,900,000, of which RMB7,920,000 was contributed by Xinao Group Company Limited.

No audited financial statements have been prepared for Jingchang Xinao since its establishment.

For the purpose of this report, we have undertaken our own independent audit of the management accounts of Jingchang Xinao for the period from 16 November 2000 (date of establishment) to 31 December 2000 (the “Relevant Period”), which are prepared under accounting principles generally accepted in Hong Kong, in accordance with the Auditing Standards issued by the Hong Kong Society of Accountants, and we have carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline “Prospectuses and the Reporting Accountant” as recommended by the Hong Kong Society of Accountants.

The summaries of the results of Jingchang Xinao for the Relevant Period and of its net tangible assets as at 31 December 2000 (the “Summaries”) set out in this report have been prepared based on its management accounts. The directors of Jingchang Xinao are responsible for preparation of these management accounts which give a true and fair view. The directors of Xinao Gas Holdings Limited are responsible for the contents of the prospectus in which this report is included.

It is our responsibility to form an independent opinion on the Summaries and to report our opinion to you.

In our opinion, the Summaries together with the notes thereon give, for the purpose of this report, a true and fair view of the results of Jingchang Xinao for the Relevant Period and of its net tangible assets as at 31 December 2000.

1. PRINCIPAL ACCOUNTING POLICIES

The financial information set out in this report has been prepared under the historical cost convention. The principal accounting policies adopted, which are in accordance with accounting principles generally accepted in Hong Kong, are as follows:

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation and amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of the asset.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Where the recoverable amount of an asset has declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. In determining the recoverable amount of assets, expected future cash flows are not discounted to their present values.

Depreciation and amortisation are provided to write off the cost of each asset, over its estimated useful life, and after taking into account its estimated residual value, using the straight line method, as follows:

Buildings	Over the shorter of 30 years or the operation period of the joint venture
Pipelines	Over the shorter of 30 years or the operation period of the joint venture
Machinery and equipment	10 years
Motor vehicles	6 years
Office equipment	6 years

Inventories

Inventories, including construction materials and spare parts, are stated at the lower of cost and net realisable value. Cost which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition is calculated using the weighted average method. Net realisable value is based on estimated selling prices in the ordinary course of business less estimated costs to completion and the estimated costs necessary to make the sale.

Taxation

The charge for taxation is based on the results for the period after adjusting for items which are non-assessable or disallowed. Certain items of income and expense are recognised for tax purposes in a different accounting period from that in which they are recognised in the financial statements. The tax effect of the resulting timing differences, computed under the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

2. RESULTS

The following is a summary of the results of Jingchang Xinao for the Relevant Period:

	<i>Notes</i>	<i>RMB'000</i>
Administrative expenses		<u>(260)</u>
Loss for the period	<i>(a)</i>	<u><u>(260)</u></u>
Dividends	<i>(c)</i>	<u><u>–</u></u>

Notes:

(a) Loss for the period

RMB'000

Loss for the period has been arrived at after charging:

Auditors' remuneration		–
Staff costs		<u>6</u>

(b) Taxation

No provision for PRC enterprise income tax has been made as Jingchang Xinao had no profit for the Relevant Period.

There was no significant unprovided deferred taxation during the Relevant Period.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES

(c) Dividends

No dividends have been paid or declared by Jingchang Xinao since the date of its establishment.

(d) Remuneration of directors and employees

No remuneration was paid or payable to any directors of Jingchang Xinao and of Xinao Gas Holdings Limited during the Relevant Period.

The emoluments of the five highest paid employees of Jingchang Xinao for the Relevant Period were as follows:

	<i>RMB'000</i>
Employees	
– basic salaries and allowances	6
– bonus	–
	<hr/>
	<u>6</u>

The emoluments of each of the above employees did not exceed RMB1,000,000 during the Relevant Period.

During the Relevant Period, no emoluments were paid by Jingchang Xinao to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining Jingchang Xinao or as compensation for loss of office.

(e) Transfer to or from reserves

There was no movement in reserves during the Relevant Period.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES
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3. NET TANGIBLE ASSETS

The following is a summary of the net tangible assets of Jingchang Xinao as at 31 December 2000:

	<i>Notes</i>	<i>RMB'000</i>	<i>RMB'000</i>
Non-current assets			
Property, plant and equipment	(a)		22,375
Current assets			
Inventories, at cost		799	
Other receivables		5,258	
Amounts due from related companies	(b)	1,173	
Bank balances and cash		1,176	
		8,406	
Current liabilities			
Other payables		1,716	
Amounts due to related companies	(c)	19,425	
		21,141	
Net current liabilities			(12,735)
Net tangible assets			9,640

Notes:

(a) **Property, plant and equipment**

	Cost and net book value <i>RMB'000</i>
Buildings	3,000
Pipelines	19,000
Machinery and equipment	50
Motor vehicles	245
Office equipment	80
	22,375
	22,375

No provision for depreciation and amortisation has been made during the Relevant Period because the above assets were not yet put into use.

APPENDIX II ACCOUNTANTS' REPORT FOR THE ACQUISITION COMPANIES

(b) Amounts due from related companies

Particulars of the amounts due from related companies are as follows:

Name of company	At 31 December 2000 <i>RMB'000</i>	At 16 November 2000 <i>RMB'000</i>	Maximum amount outstanding during the Relevant Period <i>RMB'000</i>
Beijing Xinao Jinggu Gas Company Limited 新奧集團石家莊化工機械股份有限公司 (“Xinao Group Shijiazhong Chemical and Machinery Company Limited”)	1,128	–	1,128
	45	–	45
	1,173	–	

The amounts arose from advances to the related companies. The amounts were unsecured, interest free and had no fixed repayment terms. The amount due from Xinao Group Shijiazhong Chemical and Machinery Company Limited was fully settled subsequent to 31 December 2000.

Beijing Xinao Jinggu Gas Company Limited is a subsidiary of Xinao Group Company Limited. Xinao Group Shijiazhong Chemical and Machinery Company Limited is controlled by Mr. Wang Yusuo.

(c) Amounts due to related companies

Particulars of the amounts due to related companies are as follows:

Name of company	<i>RMB'000</i>
Xinao Group Company Limited 北京市昌平市政經濟發展總公司 (“Beijing City Changping Urban Economic Development Head Corporation”)	10,103
Beijing Xinao Gas Company Limited	9,120
	202
	19,425

The amounts arose from advances by the related companies. The amounts were unsecured, interest free and had no fixed repayment terms and the amount due to Xinao Group Company Limited was fully settled subsequent to 31 December 2000.

Beijing City Changping Urban Economic Development Head Corporation is the minority shareholder of Jingchang Xinao. Beijing Xinao Gas Company Limited is controlled by Mr. Wang Yusuo and Ms. Zhao Baoju and became a subsidiary of Xinao Gas Holdings Limited since 28 March 2001.

4. DISTRIBUTABLE RESERVES

At 31 December 2000, Jingchang Xinao had no reserve available for distribution to its shareholders.

5. ULTIMATE HOLDING COMPANY

The directors of Jingchang Xinao consider Xinao Group Company Limited, a company which is incorporated in the PRC, to be its ultimate holding company.

6. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements of Jingchang Xinao have been prepared in respect of any period subsequent to 31 December 2000.

Yours faithfully,
Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong