

## Notes to the Accounts

(Expressed in Renminbi)

### 1 Restructuring and basis of presentation of accounts

The Company was incorporated in Hong Kong under the Companies Ordinance on 3 September 1997. Through a restructuring in preparation for the listing of the Company's shares on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited on 22 October 1997 and 23 October 1997, respectively, the MPT transferred its 100 per cent interest in Guangdong Mobile Communication Corporation and 99.63 per cent interest in Zhejiang GSM Mobile Communication Company Limited to the Company. 9,010,000,000 ordinary shares of HK\$0.10 each were issued by the Company to China Telecom Hong Kong (BVI) Limited, a wholly-owned subsidiary of the MPT, as consideration for this transfer. Following the transfer, Guangdong Mobile Communication Corporation became a wholly-owned foreign enterprise, Guangdong Mobile Communication Company Limited ("Guangdong Mobile") and Zhejiang GSM Mobile Communication Company Limited became a sino-foreign joint venture company, Zhejiang Mobile Communication Company Limited ("Zhejiang Mobile").

The consolidated profit and loss account for the period ended 31 December 1997 includes the results of the Company for the period from 3 September 1997 to 31 December 1997 and the post-acquisition results of its subsidiaries for the period from 27 September 1997 to 31 December 1997. The consolidated cash flow statement for the period ended 31 December 1997 is prepared based on the consolidated balance sheet at 31 December 1997 and the proforma combined balance sheet at 31 December 1996. A separate note is included in the notes to the consolidated cash flow statement which shows the increase in the amount of cash and cash equivalents for the period from 3 September 1997 to 31 December 1997.

The proforma combined profit and loss accounts (including notes to the accounts) for the years ended 31 December 1996 and 1997 include the results of the subsidiaries with effect from 1 January 1996 or since their respective dates of incorporation, where this is a shorter period, on a combined basis as if the current group structure had been in existence throughout the years ended 31 December 1996 and 1997. The proforma combined balance sheet at 31 December 1996 is a combination of the balance sheets of the subsidiaries of the Company as at 31 December 1996. The proforma combined cash flow statement for the year ended 31 December 1996 includes the results of the subsidiaries with effect from 1 January 1996 or since their respective dates of incorporation, where this is a shorter period, on a combined basis as if the current group structure had been in existence throughout the year ended 31 December 1996. These proforma combined accounts are presented for information only.

In the opinion of the directors, the resulting presentation of the accounts gives a more meaningful view of the results and the state of affairs of the Group as a whole.

### 2 Principal accounting policies

These accounts have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. A summary of the significant accounting policies is set out below.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

#### (a) Basis of consolidation

- (i) The consolidated accounts include the accounts of the Company and both of its subsidiaries made up to 31 December 1997. The results of subsidiaries acquired during the period are included in the consolidated profit and loss account from the date of their acquisition. All material intercompany transactions are eliminated on consolidation.
- (ii) The excess of the Group's share of the fair value of the separable net assets of subsidiaries acquired over the cost of investments in these companies is credited to capital reserve.

#### (b) Interest in subsidiaries

Interest in subsidiaries in the Company's balance sheet is stated at cost less any provisions for permanent diminution in value, if necessary, as determined by the directors.

#### (c) Associated companies

An associated company is a company, not being a subsidiary, in which the Group's interest is for the long term and the Group is in a position to exercise significant influence over the company in which the investment is made.

The Group's share of the post-acquisition results of its associated companies for the period is not considered material and therefore is not included in the consolidated profit and loss account. In the consolidated balance sheet, interest in associated companies is stated at cost less any provisions for permanent diminution in value, if necessary, as determined by the directors.

#### (d) Fixed assets and depreciation

- (i) Fixed assets are stated at cost/revalued amount less accumulated depreciation.
- (ii) The cost of fixed assets comprises the purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed asset has been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to the profit and loss account 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 fixed asset, the expenditure is capitalised as an additional cost of the fixed asset.
- (iii) Gains or losses arising from the retirement or disposal of fixed assets are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the profit and loss account on the date of retirement or disposal.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

#### (d) Fixed assets and depreciation (cont'd)

- (iv) The carrying amount of fixed assets carried at depreciated cost is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised as an expense in the profit and loss account. In determining the recoverable amount, expected future cash flows generated by the fixed assets are discounted to their present values.

A subsequent increase in the recoverable amount of an asset carried at depreciated cost is written back to the profit and loss account when the circumstances and events that led to the write-down or write-off cease to exist. The amount written back is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.

- (v) Depreciation is calculated to write off the cost, or revalued amount where appropriate, of fixed assets on a straight-line basis over their estimated useful lives, to residual values, as follows:

	Depreciable life	Residual value
Land use rights	Over the period of grant	—
Buildings	8 – 35 years	3%
Telecommunications transceivers, switching centres and other network equipment	7 years	3%
Office equipment, furniture and fixtures and others	4 – 18 years	3%

#### (e) Construction in progress

Construction in progress is stated at cost. Cost comprises direct costs of construction as well as interest expense and exchange differences capitalised during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed. No depreciation is provided in respect of construction in progress until it is completed and ready for its intended use.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

(f) Inventories

Inventories, which consist primarily of handsets, SIM cards and accessories, are stated at the lower of cost and net realisable value. Cost represents purchase cost of goods calculated using the weighted average cost method. Net realisable value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or to management's estimates based on prevailing market conditions.

(g) Deferred revenue

Deferred revenue from assignment of rights to income from subscribers with distributors of telecommunications services is stated in the balance sheet at the amount of consideration received according to the relevant assignment contracts less income recognised in the profit and loss account up to the balance sheet date.

Income is deferred and recognised on a straight-line basis over the relevant assignment period. For assignment contracts which the distributors surrender for early cancellation, the balance of the Group's deferred revenue in respect of those contracts is recognised as income when the assignment contracts are cancelled.

(h) Borrowing costs

Borrowing costs are expensed in the profit and loss account in the period in which they are incurred, except to the extent that such costs are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

(i) Revenue recognition

Revenue is recognised when it is probable that the economic benefits will accrue to the Group and when the revenue can be measured reliably on the following bases:

- (i) usage fees are recognised as revenue when the service is rendered;
- (ii) monthly fees are recognised as revenue in the month during which the service is rendered;
- (iii) connection fees are recognised as revenue when received;
- (iv) deferred revenue from assignment of rights to income from subscribers is recognised on a straight-line basis over the duration of the assignment period;
- (v) interest income is recognised on a time proportion basis on the principal outstanding and at the rate applicable; and
- (vi) sales of handsets and SIM cards are recognised on delivery of goods to the buyer. Such revenue, net of cost of goods sold, is included in other income due to its insignificance.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

(j) Allowance for doubtful accounts

An allowance for doubtful accounts is provided based upon evaluation of the recoverability of the receivables at the balance sheet date.

(k) Translation of foreign currencies

Foreign currency transactions during the period are translated into Renminbi at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates ruling at the balance sheet date. Exchange differences attributable to the translation of borrowings denominated in foreign currencies and used for financing the construction of fixed assets, are included in the cost of the related construction in progress. Exchange differences capitalised to construction in progress are immaterial for the periods presented. Other exchange gains and losses are recognised in the profit and loss account.

(l) Deferred taxation

Deferred taxation is provided in respect of the tax effect arising from all significant timing differences which are expected with reasonable probability to crystallise in the foreseeable future and is calculated under the liability method. Future deferred tax benefits are not recognised unless their realisation is assured beyond reasonable doubt.

(m) Retirement benefits

The employees of the subsidiaries participate in a defined benefit retirement plan managed by the MPT whereby the subsidiaries are required to contribute to the scheme at a fixed rate of 19.1 per cent of the employees' salary costs. The subsidiaries have no obligation for the payment of retirement and other post-retirement benefits of staff other than the contributions described above.

(n) Operating leases

Operating lease payments are charged to the profit and loss account on a straight-line basis over the periods of the respective leases.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 3 Turnover

Turnover primarily represents usage fees, monthly fees and connection fees for the use of the Group's cellular telephone networks, net of PRC business tax and government surcharges and, in 1997, central irrigation construction levy. Business tax and government surcharges are charged at approximately 3.3 per cent of the corresponding revenue and central irrigation construction levy was charged at approximately 3 per cent of certain connection and surcharge revenue. Turnover is analysed as follows:

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
Usage fees	2,760,412	8,718,056	5,527,875
Monthly fees	771,414	2,692,166	1,658,188
Connection fees	851,057	3,173,529	2,673,425
Others	313,450	904,028	507,753
	<u>4,696,333</u>	<u>15,487,779</u>	<u>10,367,241</u>

Prior to 20 October 1997, International Direct Dial ("IDD") and certain Domestic Direct Dial ("DDD") call charges receivable from subscribers are not reflected as revenue. Pursuant to the new interconnection agreements, with effect from 20 October 1997, Guangdong Mobile and Zhejiang Mobile reflect IDD and DDD calls charges receivable from subscribers and the amounts payable by relevant Posts and Telecommunications Administrations ("PTA") to the Group for inbound calls to the Group's subscribers which originate from the MPT System's fixed line Public Switched Telephone Network ("PSTN") as revenue.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 4 Profit before tax and minority interests

Profit before tax and minority interests is arrived at

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
<b>after crediting:</b>			
Amortisation of deferred revenue from assignment of rights to income from subscribers	49,710	119,255	2,393
Interest income on bank deposits	599,915	653,645	68,692
Interest income on amounts due from related parties	—	2,962	3,956
Penalty income on overdue accounts	23,738	92,992	40,019
Exchange gain, net	—	—	1,596
Gain on disposal of fixed assets	—	—	72
	<u>          </u>	<u>          </u>	<u>          </u>
<b>and after charging:</b>			
Interest on bank advances and other borrowings repayable within five years	11,834	46,942	78,746
Interest on other loans	81,715	240,367	134,982
Less: Amount capitalised as construction in progress (Note)	<u>(55,176)</u>	<u>(111,974)</u>	<u>(46,584)</u>
Interest expense	38,373	175,335	167,144
Depreciation	854,268	2,680,538	1,424,306
Operating lease charges in respect of			
— properties	60,735	211,015	111,876
— leased lines	791,512	3,134,260	2,213,563
— others	6,061	16,759	11,885
Exchange loss, net	57,877	60,902	—
Loss on disposal of fixed assets	12,476	12,668	—
Contribution to retirement scheme	26,916	100,770	40,660
Provision for doubtful accounts	139,662	449,124	227,430
Provision for obsolete inventories	3,086	6,083	67,954
Auditors' remuneration	<u>10,703</u>	<u>10,703</u>	<u>—</u>

Note: The borrowing costs have been capitalised at a rate of 7.5 per cent to 11.03 per cent for construction in progress during the period ended 31 December 1997.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**5 Directors' remuneration**

Directors' remuneration disclosed pursuant to section 161 of the Companies Ordinance is as follows:

## (a) Executive directors

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000
Fees	385	385
Salaries, allowances and benefits in kind	2,829	3,113
Retirement benefits	33	94
Bonuses	<u>30</u>	<u>66</u>
	<u><u>3,277</u></u>	<u><u>3,658</u></u>

## (b) Non-executive directors

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000
Fees	<u>257</u>	<u>257</u>



## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 5 Directors' remuneration (cont'd)

The number of directors whose remuneration from the Group falls within the following band is set out below:

	<b>Period from 3 September 1997 (date of incorporation) to 31 December 1997</b>	<b>(Note 1) Proforma combined 1997</b>
Nil to RMB1,000,000	<u>10</u>	<u>10</u>

### 6 Five highest paid individuals

Of the five highest paid individuals in this period, four are directors of the Company and their remuneration has been included in Note 5 above. The remuneration of the remaining highest paid individual is as follows:

	<b>Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000</b>	<b>(Note 1) Proforma combined 1997 RMB'000</b>
Salaries, allowances and benefits in kind	<u>231</u>	<u>231</u>

During the period/year, no emoluments were paid by the Group to the five highest paid individuals, including directors, as an inducement to join or upon joining the Group or as compensation for loss of office.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**7 Income tax**

(a) Income tax in the consolidated profit and loss account represents:

	<b>Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000</b>	<b>(Note 1) Proforma combined 1997 RMB'000</b>	<b>(Note 1) Proforma combined 1996 RMB'000</b>
Provision for Hong Kong profits tax for the period/year	8,161	8,161	—
Provision for PRC income tax on the estimated taxable profits for the period/year	421,684	984,867	449,566
Deferred tax asset (Note 16(a))	<u>(2,009)</u>	<u>(2,009)</u>	<u>(22,023)</u>
	<u><b>427,836</b></u>	<u><b>991,019</b></u>	<u><b>427,543</b></u>

- (i) The provision for Hong Kong profits tax is calculated at 16.5 per cent of the estimated assessable profits for the period ended 31 December 1997.
- (ii) Pursuant to the income tax rules and regulations of the PRC, the Group's subsidiaries in the PRC are subject to the statutory income tax rate of 33 per cent for the period ended 31 December 1997. According to a notice from the PRC Ministry of Finance, connection fees and certain surcharges, which were previously not subject to income tax, are subject to income tax rate of 33 per cent with effect from 23 October 1997.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 7 Income tax (cont'd)

(b) Taxation in the balance sheet represents:

	The Group (Note 1) Proforma combined 1997 RMB'000	1996 RMB'000	The Company 1997 RMB'000
Provision for Hong Kong profits tax for the period	8,161	—	8,161
Provision for PRC income tax for the year	984,867	449,566	—
Balance of PRC income tax recoverable relating to prior year	(174,372)	—	—
PRC income tax paid	<u>(546,216)</u>	<u>(623,938)</u>	<u>—</u>
	<u>272,440</u>	<u>(174,372)</u>	<u>8,161</u>

### 8 Net profit for the period

The net profit for the period attributable to shareholders includes a profit of RMB483,086,000 which has been dealt with in the accounts of the Company.

### 9 Dividends

The board of directors of the Company do not recommend the payment of a final dividend for the period ended 31 December 1997.

### 10 Earnings per share

The calculation of earnings per share for the period from 3 September 1997 to 31 December 1997 is based on the consolidated net profit of RMB1,513,723,000 and the weighted average number of 8,802,944,500 shares in issue during the period ended 31 December 1997.

The calculation of proforma earnings per share for the year ended 31 December 1997 is based on the proforma combined net profit for the year of RMB4,955,381,000 and the proforma weighted average number of 9,534,365,315 shares in issue during the year. The calculation of proforma earnings per share for the year ended 31 December 1996 is based on the proforma combined net profit for the year of RMB4,509,158,000 and the proforma 9,010,000,000 shares in issue during the year.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**11 Fixed assets**

(a) The Group

	<b>Land use rights and buildings</b> RMB'000	<b>Telecommunications transceivers, switching centres and other network equipment</b> RMB'000	<b>Office equipment, furniture and fixtures and others</b> RMB'000	<b>Total</b> RMB'000
<b>Cost:</b>				
Acquired on acquisition of subsidiaries	609,904	14,808,572	488,301	15,906,777
Additions	445	66,525	95,559	162,529
Transferred from construction in progress	165,540	4,237,155	—	4,402,695
Disposals	—	(28,903)	—	(28,903)
At 31 December 1997	<u>775,889</u>	<u>19,083,349</u>	<u>583,860</u>	<u>20,443,098</u>
<b>Accumulated depreciation:</b>				
Acquired on acquisition of subsidiaries	7,251	921,044	31,141	959,436
Charge for the period	6,230	822,152	25,886	854,268
Written back on disposals	—	(4,843)	—	(4,843)
At 31 December 1997	<u>13,481</u>	<u>1,738,353</u>	<u>57,027</u>	<u>1,808,861</u>
<b>Net book value:</b>				
At 31 December 1997	<u><u>762,408</u></u>	<u><u>17,344,996</u></u>	<u><u>526,833</u></u>	<u><u>18,634,237</u></u>

(b) The Company

	<b>Office equipment, furniture and fixtures and others</b> RMB'000
<b>Cost:</b>	
Additions during the period and balance at 31 December 1997	2,350
<b>Accumulated depreciation:</b>	
Charge for the period and balance at 31 December 1997	<u>301</u>
<b>Net book value:</b>	
At 31 December 1997	<u><u>2,049</u></u>

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 11 Fixed assets (cont'd)

(c) The analysis of net book value of land use rights is as follows:

	<b>The Group 1997 RMB'000</b>
Long leases	<b>85,691</b>
Medium-term leases	<b><u>77,950</u></b>
	<b><u><u>163,641</u></u></b>

All of the Group's buildings are located elsewhere in the PRC.

As part of the Group restructuring, the cellular telephone business of Guangdong Mobile and Zhejiang Mobile together with the relevant assets and liabilities were transferred to the Company. As required by the relevant PRC rules and regulations, a valuation of the assets and liabilities to be injected into the Group was carried out at 31 May 1997 and approved by the State-owned Assets Administration Bureau on 5 September 1997 and the injected assets and liabilities were reflected in the accounts on this basis. This 1997 valuation was a one-off exercise which established the deemed cost of the fixed assets purchased by the Group.

The effect of this valuation on the fixed assets of Guangdong Mobile and Zhejiang Mobile is to increase the depreciation charges reflected in the proforma combined profit and loss account for the year ended 31 December 1997 by approximately RMB379,813,000.

### 12 Construction in progress

Construction in progress comprises expenditure incurred on the network expansion projects, construction of office buildings and construction of staff quarters not yet completed at 31 December 1997.

### 13 Interest in subsidiaries

	<b>1997 RMB'000</b>
Capital contributions, at cost	<b><u><u>18,333,765</u></u></b>

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**13 Interest in subsidiaries** (cont'd)

Details of the subsidiaries are as follows:

<b>Name of company</b>	<b>Place of incorporation and operation</b>	<b>Particulars of issued and paid up capital</b>	<b>Attributable interest held directly</b>	<b>Principal activities</b>
Guangdong Mobile	PRC	RMB5,594,840,700	100%	Cellular telephone operator
Zhejiang Mobile	PRC	RMB2,117,790,000	99.63%	Cellular telephone operator

**14 Interest in associated companies**

	<b>The Group 1997 RMB'000</b>
Unlisted shares, at cost	<b>21,430</b>
Capital contributions, at cost	<b>9,000</b>
	<b><u>30,430</u></b>

Details of the associated companies are as follows:

<b>Name of company</b>	<b>Place of incorporation</b>	<b>Attributable interest held by the Group</b>	<b>Principal activities</b>
China Motion United Telecom Limited	Hong Kong	30%	Provision of telecommunication services
Shenzhen China Motion Telecom United Limited	PRC	30%	Provision of telecommunication services

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 15 Amounts due from related parties

Amounts due from related parties primarily represent amounts due from Guangdong PTA and Zhejiang PTA. Such amounts are unsecured, non-interest bearing, repayable on demand and arose in the ordinary course of business.

### 16 Deferred taxation

(a) Movements on deferred taxation comprise:

	<b>The Group</b>	
		(Note 1)
		Proforma
		combined
	<b>1997</b>	1996
	<b>RMB'000</b>	RMB'000
Balance at 1 January	—	108
Acquired on acquisition of subsidiaries	<b>22,131</b>	—
Transfer to the profit and loss account (Note 7(a))	<b>2,009</b>	22,023
	<u>          </u>	<u>          </u>
Balance at 31 December	<b>24,140</b>	22,131
	<u>          </u>	<u>          </u>

(b) Deferred tax asset of the Group consists of provision for obsolete inventories.

(c) Deferred tax asset/(liability) of the Group not provided for is as follows:

	<b>The Group</b>	
		(Note 1)
		Proforma
		combined
	<b>1997</b>	1996
	<b>RMB'000</b>	RMB'000
Provision for doubtful accounts	<b>228,082</b>	82,606
Fixed assets basis differences	—	(444,155)
	<u>          </u>	<u>          </u>
	<b>228,082</b>	(361,549)
	<u>          </u>	<u>          </u>

As described in Note 11, in connection with the restructuring, the fixed assets of Guangdong Mobile and Zhejiang Mobile have been revalued at 31 May 1997. As a result of such valuation, the fixed assets basis differences that gave rise to the potential deferred tax liabilities of the subsidiaries were eliminated.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**17 Bank and other loans**

## (a) Short-term

	<b>The Group</b>	(Note 1)
	<b>1997</b>	Proforma
	<b>RMB'000</b>	combined
		1996
		RMB'000
Bank loans	<b>600,000</b>	103,000
Loans from related parties	<b>227,000</b>	932,700
	<b>827,000</b>	1,035,700
Current portion of long-term bank and other loans (Note 17(b))	<b>1,320,558</b>	468,556
	<b>2,147,558</b>	1,504,256

All of the above short-term loans are unsecured. Loans from related parties mainly represent short-term loans from Zhejiang PTA, bearing interest at 7.65 per cent per annum.

## (b) Long-term

	<b>The Group</b>	(Note 1)
	<b>1997</b>	Proforma
	<b>RMB'000</b>	combined
		1996
		RMB'000
Bank loans	<b>413,990</b>	426,910
Loans from related parties	<b>800,000</b>	—
Loan from ultimate holding company	<b>1,382,395</b>	—
Other loans	<b>1,594,499</b>	1,988,090
	<b>4,190,884</b>	2,415,000
Less: Current portion (Note 17(a))	<b>(1,320,558)</b>	(468,556)
	<b>2,870,326</b>	1,946,444



**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**17 Bank and other loans** (cont'd)

## (b) Long-term (cont'd)

All of the above long-term loans are unsecured. Loans from related parties represent long-term loans from Zhejiang PTA, bearing interest at 10.98 per cent per annum with maturities in 1998 to 1999. Loan from ultimate holding company bears interest at 7.5 per cent per annum with maturities in 1998 to 2000. Other loans bear interest at various rates between 6.4 per cent to 10.98 per cent per annum with maturities in 1998 to 2004.

## (c) The Group's long-term bank and other loans were repayable as follows:

At 31 December 1997:

	<b>The Group</b>		
	<b>Bank loans</b> RMB'000	<b>Other loans</b> RMB'000	<b>Total</b> RMB'000
On demand or within one year	103,498	1,217,060	1,320,558
After one year but within two years	103,498	1,248,236	1,351,734
After two years but within five years	206,994	997,005	1,203,999
After five years	—	314,593	314,593
	<u>310,492</u>	<u>2,559,834</u>	<u>2,870,326</u>
	<u>413,990</u>	<u>3,776,894</u>	<u>4,190,884</u>

At 31 December 1996:

**(Note 1) Proforma combined**

	<b>(Note 1) Proforma combined</b>		
	<b>Bank loans</b> RMB'000	<b>Other loans</b> RMB'000	<b>Total</b> RMB'000
On demand or within one year	7,000	461,556	468,556
After one year but within two years	108,726	452,256	560,982
After two years but within five years	311,184	651,644	962,828
After five years	—	422,634	422,634
	<u>419,910</u>	<u>1,526,534</u>	<u>1,946,444</u>
	<u>426,910</u>	<u>1,988,090</u>	<u>2,415,000</u>

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**18 Deferred revenue**

Deferred revenue from assignment of rights to income from subscribers represents the unamortised portion of proceeds received by Guangdong Mobile from certain distributors of telecommunications services pursuant to agreements under which Guangdong Mobile sold certain mobile phone numbers to these distributors at RMB9,167 each, in return for assigning to such distributors the rights to certain revenue such as usage fees, monthly fees, connection fees, telephone number selection fees and 50 per cent value-added services fees from those subscribers over a period of seven years. The distributors have no recourse to the Group under the relevant agreements and the Group maintains no credit risk from such subscribers during the seven-year period. The proceeds received by Guangdong Mobile have been accounted for as deferred revenue and are amortised over a period of seven years. After the expiration of the relevant agreements, the rights to income from these subscribers will revert to the Group.

	<b>The Group</b>	
		(Note 1)
		Proforma
		combined
	<b>1997</b>	1996
	<b>RMB'000</b>	RMB'000
Acquired on acquisition of subsidiaries	<b>1,174,573</b>	—
Additions	<b>228,000</b>	201,000
Recognised in profit and loss account	<b>(49,710)</b>	(2,393)
Balance at 31 December	<b><u>1,352,863</u></b>	<u>198,607</u>

**19 Share capital**

	<b>Number of ordinary shares</b>	<b>Nominal amount of each ordinary share</b>	<b>Amount HK\$'000</b>
<b>Authorised:</b>			
Authorised share capital on incorporation	100,000	HK\$0.1	10
Increase in authorised share capital	<u>15,999,900,000</u>	HK\$0.1	<u>1,599,990</u>
Balance at 31 December 1997	<u>16,000,000,000</u>		<u>1,600,000</u>

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**19 Share capital** (cont'd)

	Number of ordinary shares	Nominal amount of each ordinary share	Amount HK\$'000
<b>Issued and fully paid:</b>			
Issue of shares on incorporation	2	HK\$0.1	—
Issue of new shares in connection with the restructuring	<u>9,009,999,998</u>	HK\$0.1	<u>901,000</u>
	9,010,000,000		901,000
Issue of new shares in the offering to the public and placing of new shares to professional and institutional investors	<u>2,770,788,000</u>	HK\$0.1	<u>277,079</u>
Balance at 31 December 1997	<u><u>11,780,788,000</u></u>		<u><u>1,178,079</u></u>
		RMB'000 equivalent	<u><u>1,261,419</u></u>
Balance at 31 December 1996		RMB'000 equivalent	<u><u>480,322</u></u>

The Company was established in Hong Kong on 3 September 1997 as a limited company, with a registered share capital of HK\$10,000 divided into 100,000 shares of HK\$0.10 each, two of which were issued and credited as fully paid.

At an extraordinary general meeting of the Company held on 27 September 1997,

- (i) the authorised share capital of the Company was increased from HK\$10,000 to HK\$1,600,000,000 by the creation of an additional 15,999,900,000 shares of HK\$0.10 each; and
- (ii) 9,009,999,998 shares were credited as fully paid and issued to China Telecom Hong Kong (BVI) Limited for the transfer of interests in Guangdong Mobile and Zhejiang Mobile to the Company.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 19 Share capital (cont'd)

Pursuant to the resolutions passed on 21 October 1997, the Company issued 2,600,000,000 shares of HK\$0.1 each at HK\$11.68 per share and the shares were listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited on 22 October 1997 and 23 October 1997 respectively. On 7 November 1997, the Company issued 170,788,000 shares of HK\$0.1 each at HK\$11.68 per share by way of a placing among professional and institutional investors.

The 1996 comparative figure represents the combined share capital of the subsidiaries as at 31 December 1996 on the basis set out in Note 1.

### 20 Share option scheme

On 8 October 1997, the Company adopted a share option scheme to which the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares up to a maximum aggregate number of shares equal to 10 per cent of the total issued share capital of the Company. The consideration payable by a participant for the grant of an option under the share option scheme will be HK\$1.00. The price of a share payable by a participant upon the exercise of an option will be determined by the directors of the Company at their discretion, except that such price may not be set below a minimum price which is the higher of:

- (i) the nominal value of a share; and
- (ii) 80 per cent of the average of the closing prices of shares on The Stock Exchange of Hong Kong Limited on the five trading days immediately preceding the date of grant of the option.

The period during which an option may be exercised will be determined by the directors at their discretion, except that no option may be exercised later than 10 years after the adoption date of the scheme.

As at 31 December 1997, no options were granted by the Company under the share option scheme.

On 9 March 1998, share options for a total of 12,000,000 shares at an exercise price of HK\$11.1 per share (which can be exercised during the period from 9 March 1998 to 8 March 2006) were granted under the share option scheme to certain eligible employees, including executive directors of the Company.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 21 Reserves

	Share premium RMB'000	Capital reserve RMB'000	General reserve RMB'000	PRC statutory reserves RMB'000	Retained profits RMB'000	Total RMB'000
<b>The Group</b>						
Premium arising on issue of shares	51,698,908	—	—	—	—	51,698,908
Expenses incurred in connection with the issue of shares	(1,056,331)	—	—	—	—	(1,056,331)
Capital reserve arising on acquisition of subsidiaries	—	1,131,950	—	—	—	1,131,950
Net profit for the period	—	—	—	—	1,513,723	1,513,723
Transfer to general reserve	—	—	72,463	—	(72,463)	—
Transfer to PRC statutory reserves, net of minority interests' share	—	—	—	110,946	(110,946)	—
	<u>50,642,577</u>	<u>1,131,950</u>	<u>72,463</u>	<u>110,946</u>	<u>1,330,314</u>	<u>53,288,250</u>
At 31 December 1997						
<b>The Company</b>						
Premium arising on issue of shares	51,698,908	—	—	—	—	51,698,908
Expenses incurred in connection with the issue of shares	(1,056,331)	—	—	—	—	(1,056,331)
Net profit for the period (Note 8)	—	—	—	—	483,086	483,086
Transfer to general reserve	—	—	72,463	—	(72,463)	—
	<u>50,642,577</u>	<u>—</u>	<u>72,463</u>	<u>—</u>	<u>410,623</u>	<u>51,125,663</u>
At 31 December 1997						

At 31 December 1997, the amount of distributable reserves of the Company amounted to RMB483,086,000.

#### PRC statutory reserves

In accordance with the Articles of Association and Regulations on Posts and Telecommunications Enterprises, Guangdong Mobile and Zhejiang Mobile are required to transfer a certain percentage of profit after taxation to the statutory surplus reserve and statutory public welfare reserve as determined by accounting principles generally accepted in the PRC ("PRC GAAP"). At 31 December 1997, the balances of statutory surplus reserve and statutory public welfare reserve were RMB73,964,000 and RMB36,982,000 respectively.

Statutory surplus reserve can be used to make good previous years' losses, provided that the balance after such offset is not less than 25 per cent of the registered capital. Statutory public welfare reserve can only be utilised on capital items for the collective benefits of the employees such as the construction of staff quarters and other staff welfare facilities. This reserve is non-distributable other than in liquidation.

In connection with the restructuring, Guangdong Mobile became a wholly-owned foreign enterprise while Zhejiang Mobile became a sino-foreign joint venture company. In accordance with the Regulations on Enterprises with Foreign Investment, both Guangdong Mobile and Zhejiang Mobile are required to transfer a certain percentage of profit after taxation, as determined under PRC GAAP, to the general reserve fund and the enterprise expansion fund. In the case of Guangdong Mobile, since it is a wholly-owned foreign enterprise, at least 10 per cent of its profit after taxation determined under the PRC GAAP should be transferred to the general reserve fund until its balance is equal to 50 per cent of the registered capital. The general reserve fund can be used to make good losses and to increase capital while enterprise expansion fund can be used to increase capital.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 22 Connected and related party transactions

The Group's operations are subject to extensive regulation by the PRC government. The MPT, pursuant to the authority delegated to it by the PRC State Council, directly or indirectly regulates licensing, competition, interconnection, technology and equipment standards, and other aspects of the PRC telecommunications industry. The MPT, together with other PRC government entities, also regulates tariff policy, foreign investment and spectrum allocation and spectrum usage fees. Specifically, the Group's tariffs are subject to the regulation by various Government authorities, including the State Planning Commission ("SPC"), the MPT, the PTAs and the relevant Provincial Price Bureaus ("PPBs"). The connection fees charged by the Group are based on a guidance price range set jointly by the MPT and SPC, with each actual fee determined by the relevant PTA in consultation with the relevant PPB. In general, the Group's base usage charges and domestic roaming usage charges are set by the MPT and SPC. International roaming charges are set by the MPT pursuant to agreements between the DGT and other cellular operators. The principal connected and related party transactions, which were entered into with the MPT and other entities under the control of MPT, are as follows:

	Note	Proforma combined 1997 RMB'000
Interconnection charges	(i)	738,520
Leased line charges	(ii)	3,134,260
Roaming revenue	(iii)	470,258
Roaming expenses	(iv)	475,709
Spectrum fees	(v)	20,138
Operating lease charges	(vi)	151,691
Purchase of mobile phones and equipment		1,743,286
Sales commission	(vii)	151,614
Debt collection service fees	(vii)	60,239
Billing service fees	(vii)	506
Interest paid/payable	(viii)	106,020
Interest received		2,962
Capital contributions	(ix)	245,700
Distributions	(x)	221,812

Notes:

- (i) Interconnection charges represent the amounts paid or payable to the Guangdong PTA and the Zhejiang PTA in respect of calls made between the Total Access Communication Systems ("TACS") / Global System for Mobile Communications ("GSM") networks and the PSTN in Guangdong and Zhejiang respectively. Prior to 20 October 1997, no interconnection fees were charged to the Group for the TACS network in Zhejiang and TACS and GSM networks in Guangdong and the interconnection fees charged for the GSM networks in Zhejiang were calculated pursuant to Zhe You Ju Cai (1996) No. 13. Pursuant to the new interconnection agreements, with effect from 20 October 1997, the Group records the amounts payable by the Group for outbound calls from the Group's subscribers which terminate on the MPT System's PSTN as interconnection charges.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 22 Connected and related party transactions (cont'd)

Notes: (cont'd)

- (ii) Leased line charges represent expenses paid or payable to the Guangdong PTA/Posts and Telecommunications Bureaus ("PTBs") and the Zhejiang PTA/PTBs for the use of leased lines between the base transceiver stations, base station controllers, base stations, fixed line network connectors, long distance network connectors and main switches.
- (iii) A cellular telephone user using roaming services is charged at the respective roaming usage rate for roaming in calls, in addition to applicable long distance charges. Roaming revenue represents domestic and international roaming in usage charges from non-subscribers received or receivable from the relevant PTAs and international cellular telephone operators through MPT.
- (iv) A cellular telephone user using roaming services is charged at the respective roaming usage rate for roaming out calls, in addition to applicable long distance charges. Roaming expenses represent the amount of domestic and international roaming out charges received or receivable from subscribers which is to be remitted to the relevant PTAs and international cellular telephone operators for their share of the roaming revenue through MPT.
- (v) Spectrum fees represent the spectrum usage fees paid or payable through DGT to the State Radio Regulatory Commission for the usage of the frequency bands allocated to Guangdong Mobile and Zhejiang Mobile.
- (vi) Operating lease charges represent the rental paid or payable to the Guangdong PTA/PTBs, the Zhejiang PTA/PTBs and Telpo for operating leases in respect of land and buildings and others.
- (vii) With effect from 20 October 1997, the Group entered into certain new services agreements with Guangdong PTA and Zhejiang PTA in respect of commission services with authorised dealers, debt collection services and billing services.  
  
Sales commission represents the amounts paid or payable to the Guangdong PTA/PTBs and the Zhejiang PTA/PTBs for their marketing of the cellular services in Guangdong and Zhejiang, respectively.  
  
Debt collection service fees represent the amounts paid or payable to the Guangdong PTA/PTBs for their provision of debt collection services to Guangdong Mobile.  
  
Billing service fees represent the amounts paid or payable to the Zhejiang PTA/PTBs for their provision of the billing services to Zhejiang Mobile.
- (viii) Interest paid/payable represents the interest incurred on loans borrowed from Zhejiang PTA and Telpo.
- (ix) Capital contributions represent cash received from the Guangdong PTA.
- (x) Distributions represent cash payments by Guangdong Mobile to acquire assets transferred to the Guangdong PTA for businesses unrelated to Guangdong Mobile, and the cash effects of the effective settlement of an intercompany account balance arising in the ordinary course of business related to Zhejiang Mobile's TACS operations.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**23 Commitments**

## (a) Capital commitments

Capital commitments outstanding at 31 December 1997 not provided for in the accounts were as follows:

	<b>The Group 1997 RMB'000</b>	<b>The Company 1997 RMB'000</b>
Commitments in respect of land and buildings		
— authorised and contracted for	<b>298,226</b>	—
— authorised but not contracted for	<b>865,987</b>	—
	<b><u>1,164,213</u></b>	<b><u>—</u></b>
Commitments in respect of telecommunications equipment		
— authorised and contracted for	<b>6,788,040</b>	<b>2,893,128</b>
— authorised but not contracted for	<b>9,919,129</b>	—
	<b><u>16,707,169</u></b>	<b><u>2,893,128</u></b>
Total commitments		
— authorised and contracted for	<b>7,086,266</b>	<b>2,893,128</b>
— authorised but not contracted for	<b>10,785,116</b>	—
	<b><u>17,871,382</u></b>	<b><u>2,893,128</u></b>



**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**23 Commitments** (cont'd)

## (b) Operating lease commitments

At 31 December 1997, the Group and the Company had commitments under operating leases to make payments in the next year as follows:

	<b>Land and buildings</b> RMB'000	<b>The Group 1997</b> <b>Leased lines</b> RMB'000	<b>Others</b> RMB'000	<b>Total</b> RMB'000	<b>The Company 1997</b> <b>Land and buildings</b> RMB'000
Leases expiring:					
Within one year	5,392	—	—	5,392	—
After one year but within five years	30,172	830,318	—	860,490	4,730
After five years	<u>107,282</u>	<u>1,592,195</u>	<u>17,116</u>	<u>1,716,593</u>	<u>—</u>
	<u>142,846</u>	<u>2,422,513</u>	<u>17,116</u>	<u>2,582,475</u>	<u>4,730</u>

**24 Post balance sheet events**

Subsequent to the balance sheet date, the Company commenced discussions with the MPT in relation to the acquisition of the cellular telephone operations in Jiangsu province of the PRC and to date no contractual terms have been agreed.

**25 Ultimate holding company**

The directors consider the ultimate holding company at 31 December 1997 to be Telpo Communications (Group) Limited, incorporated in Hong Kong.

## Supplementary Information for ADS Holders

The Group's accounts are prepared in accordance with the generally accepted accounting principles applicable in Hong Kong ("HK GAAP"), which differ in certain significant respects from those applicable in the United States ("US GAAP"). The significant differences relate principally to the following items and the adjustments considered necessary to restate net profit and shareholders' equity in accordance with the US GAAP are shown in the tables set out below.

### (a) Capitalisation of interest

Under HK GAAP, the Group capitalises interest costs to the extent that the related borrowings are directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

Under US GAAP, interest costs capitalised are determined based on specific borrowings related to the acquisition or construction of an asset, if an entity's financing plans associate a specific new borrowing with a qualifying asset. If average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with an asset, additional interest costs capitalised are based on the weighted average interest rate applicable to other borrowings of the entity.

### (b) Revaluation of fixed assets

For certain periods prior to 31 May 1997, the fixed assets of the subsidiaries were revalued in compliance with PRC rules and regulations, resulting in an increase in shareholders' equity.

Additionally, in connection with the Group restructuring, the fixed assets of the subsidiaries were revalued as of 31 May 1997. Such fixed assets revaluation results in an increase in shareholders' equity with respect to the increase in carrying amount of certain fixed assets above their historical cost bases.

Under US GAAP, fixed assets are stated at their historical cost, less accumulated depreciation. However, as a result of the tax deductibility of the revaluation reserve, a deferred tax asset related to the reversal of the revaluation reserve is created under US GAAP with a corresponding increase in shareholders' equity.

### (c) Employee housing scheme

The subsidiaries of the Group provides staff quarters under its employee housing schemes at below market prices. Under HK GAAP, employee housing scheme costs borne by the corresponding PTA and not charged to the subsidiaries are not recognised by the subsidiaries.

Under US GAAP, employee housing scheme costs borne by the corresponding PTA and not charged to the subsidiaries are reflected as an expense in the profit and loss account and a corresponding capital contribution. Additionally, under US GAAP, the costs to be borne by the subsidiaries are accrued over the term of the programme.

**Supplementary Information for ADS Holders (cont'd)**

**(d) Deferred taxation**

Under HK GAAP, the Group provides for deferred tax liabilities only to the extent that there is a reasonable probability that such deferred tax liabilities will become payable in the foreseeable future. Deferred tax assets are not recognised unless their realisation is assured beyond reasonable doubt.

Under US GAAP, provisions are made for all deferred taxes as they arise, except a valuation allowance is provided against deferred tax assets when realisation of such amounts does not meet the criterion of "more likely than not".

Effect on proforma combined net profit of significant differences between HK GAAP and US GAAP is as follows:

	<b>1997</b>	<b>1997</b>	1996	1995
	<b>US\$'000</b>	<b>RMB'000</b>	RMB'000	RMB'000
<b>Net profit under HK GAAP</b>	<b>598,490</b>	<b>4,955,381</b>	4,509,158	4,668,646
Adjustments:				
Capitalised interest	<b>7,088</b>	<b>58,688</b>	133,938	43,411
Revaluation of fixed assets	<b>49,710</b>	<b>411,587</b>	31,711	31,647
Employee housing scheme	<b>(2,347)</b>	<b>(19,433)</b>	(36,374)	(36,510)
Deferred taxation	<b>5,189</b>	<b>42,963</b>	(163,839)	(105,106)
Deferred tax effects of US GAAP adjustments	<u><b>(18,743)</b></u>	<u><b>(155,191)</b></u>	<u>(54,664)</u>	<u>(20,022)</u>
<b>Approximate net profit under US GAAP</b>	<u><b>639,387</b></u>	<u><b>5,293,995</b></u>	<u>4,419,930</u>	<u>4,582,066</u>
Approximate net profit per proforma share in accordance with US GAAP	<u><b>0.07</b></u>	<u><b>0.56</b></u>	<u>0.49</u>	
Approximate net profit per proforma ADS in accordance with US GAAP*	<u><b>1.34</b></u>	<u><b>11.11</b></u>	<u>9.81</u>	

\* Based on a ratio of 20 ordinary shares to one ADS.

**Supplementary Information for ADS Holders (cont'd)**

Effect on shareholders' equity of significant differences between HK GAAP and US GAAP is as follows:

	1997 US\$'000	1997 RMB'000	Proforma combined 1996 RMB'000
<b>Shareholders' equity under HK GAAP</b>	<b>6,588,283</b>	<b>54,549,669</b>	12,471,099
Adjustments:			
Capitalised interest	28,508	236,037	177,349
Revaluation of fixed assets			
— Cost	(453,092)	(3,751,508)	(222,438)
— Accumulated depreciation	57,362	474,945	63,358
Deferred tax adjustments on revaluations	130,590	1,081,260	52,491
Employee housing scheme	(14,694)	(121,665)	(102,232)
Deemed capital contribution for employee housing scheme	11,675	96,665	83,604
Recognition of deferred taxes	27,547	228,082	(361,549)
Deferred tax effects of US GAAP adjustments	<u>(9,408)</u>	<u>(77,893)</u>	<u>(58,526)</u>
<b>Approximate shareholders' equity under US GAAP</b>	<b><u>6,366,771</u></b>	<b><u>52,715,592</u></b>	<b><u>12,103,156</u></b>

Solely for the convenience of the reader, the 31 December 1997 accounts have been translated into United States dollars at the rate of US\$ 1.00 = RMB8.2798 quoted by the People's Bank of China on 31 December 1997. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate or at any other certain rate on 31 December 1997, or any other certain date.