中国电信
CHINA TELECOM

Transforming to
Enhance Value
積極轉型 提升價值

CHINA TELECOM CORPORATION LIMITED
ANNUAL REPORT **2005**
Stock code: 728

CONTENTS

FINANCIAL HIGHLIGHTS

Financials excluding amortisation of upfront connection fees

	2004	**2005**	Growth rate
Operating revenue (RMB millions)	152,754	**162,529**	6.4%
EBITDA (RMB millions)	78,542	**81,825**	4.2%
EBITDA margin	51.4%	**50.3%**	-1.1p.p.
Net profit* (RMB millions)	19,565	**21,131**	8.0%
Free cash flow (RMB millions)	17,048	**21,801**	27.9%

Financials including amortisation of upfront connection fees

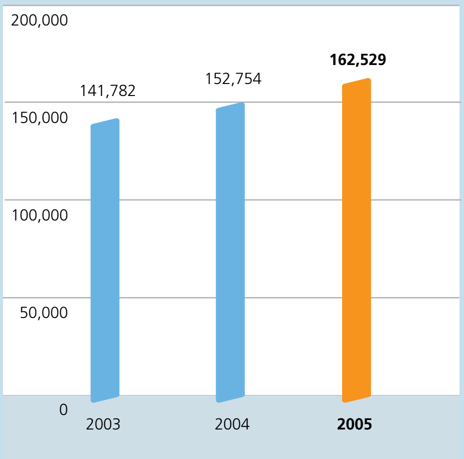
	2004	**2005**
Operating revenue (RMB millions)	161,212	**169,310**
EBITDA (RMB millions)	87,000	**88,606**
EBITDA margin	54.0%	**52.3%**
Net profit* (RMB millions)	28,023	**27,912**

* Net profit represents profit attributable to equity holders of the Company.

The charts below are based on financials excluding amortisation of upfront connection fees

Operating Revenue

(RMB millions)

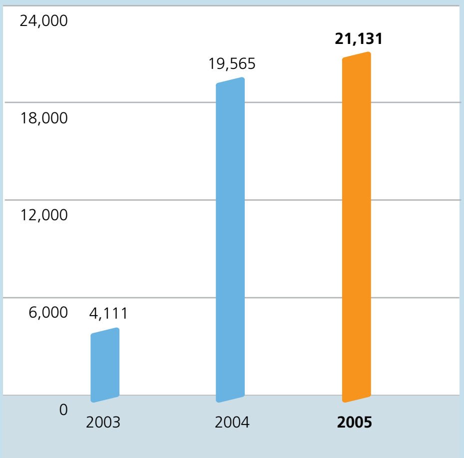


EBITDA

(RMB millions)

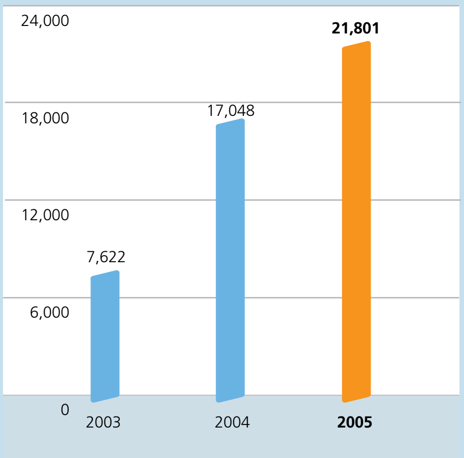
Net Profit

(RMB millions)



Free Cash Flow

(RMB millions)



COMPANY PROFILE AND CORPORATE INFORMATION

China Telecom Corporation Limited (the "Company") is the leading provider of wireline telecommunications services in Shanghai municipality, Guangdong province, Jiangsu province, Zhejiang province, Anhui province, Fujian province, Jiangxi province, Guangxi Zhuang autonomous region, Chongqing municipality, Sichuan province, Hubei province, Hunan province, Hainan province, Guizhou province, Yunnan province, Shaanxi province, Gansu province, Qinghai province, Ningxia Hui autonomous region and Xinjiang Uygur autonomous region in China. Our scope of business includes:

(1) operating a variety of domestic wireline telecommunications networks and facilities (including wireless local loops);

(2) providing voice, data, image, multimedia telecommunications and information services based on the wireline networks;

(3) providing international services and conducting accounts settlement with overseas operators in accordance with state regulations; and

(4) providing telecommunications and information-related system integration, technological development, technical services, information consulting, and conducting design, manufacture, sales and installation of telecommunications equipment.

Our H shares and American Depositary Shares ("ADS") were listed on the Stock Exchange of Hong Kong and the New York Stock Exchange on 15 November 2002 and 14 November 2002 respectively. As of 31 December 2005, our share capital comprises 80,932,368,321 shares, in which 13,877,410,000 are H shares.

Chinese registered name:	中国电信股份有限公司
English name:	China Telecom Corporation Limited
Authorised representative:	Wang Xiaochu
International auditors:	KPMG
Legal advisers:	Jingtian & Gongcheng Freshfields Bruckhaus Deringer Sullivan & Cromwell LLP
Registered address:	31 Jinrong Avenue, Xicheng District, Beijing, PRC, 100032
Telephone:	(8610) 6642 8166
Facsimile:	(8610) 6601 0728
Website:	www.chinatelecom-h.com

H share registrar:	Computershare Hong Kong Investor Services Limited 1712-1716, 17th Floor Hopewell Centre 183 Queen's Road East, Wanchai Hong Kong
ADS depositary:	Bank of New York 101 Barclay Street New York, NY 10286 The United States of America
Listings:	
H shares:	The Stock Exchange of Hong Kong Limited stock code: 728
ADSs:	New York Stock Exchange, Inc. stock code: CHA

Dear Shareholders,

Whilst 2005 was not an easy year for us, it was a year when hope was on the horizon. In spite of intensifying competition, we managed to achieve sustained business growth through strategic transformation. Our revenue increased by 6.4%, of which revenue from growth businesses (Internet access and value-added services) rose by 37.6%, accounting for 17.1% of our operating revenue. More importantly, I am very encouraged to see our people at all levels are now very committed to finding new ways of delighting our customers and creating value for them. This is crucial to the successful execution of our strategic transformation. I am fully confident in our sustainable future growth and enhancing value to you, as shareholders.

CHAIRMAN'S STATEMENT

The Company's financial performance in 2005 was favourable, with operating revenue reaching RMB169,310 million, of which amortisation of upfront connection fees was RMB6,781 million. Excluding the upfront connection fees, our operating revenue was RMB162,529 million, an increase of 6.4% from 2004; EBITDA[1] was RMB81,825 million, an increase of 4.2%; EBITDA margin[1] was 50.3%; profit attributable to equity holders of the Company[1] was RMB21,131 million, an increase of 8.0% from 2004; earnings per share[1] was RMB0.26. Capital expenditure was effectively controlled, and decreased by 4.3% from 2004. Free cash flow[2] reached RMB21,801 million.

Having considered the need to maintain the capital flexibility for ensuring the sustainable development of the Company and availability of capital for future development of our business, the Board of Directors will recommend in the upcoming shareholders general meeting that dividend be increased and a final dividend equivalent to HK$0.075 per share be declared, representing an increase of 15.4% from 2004.

In 2005, our business developed steadily and our customer base progressively expanded. The number of local telephone subscribers reached 210 million, a net increase of 23.45 million from 2004. The number of broadband subscribers reached 21.02 million, a net increase of 7.19 million from 2004, representing our third consecutive year-on-year increase. Our revenue structure has been further optimised, and value-added services achieved a record high in revenue reaching nearly RMB10.0 billion, contributing to a growth in operating revenue (excluding amortisation of upfront connection fees) by 2.5 percentage points from 2004.

Our Company was confronted with severe challenges in 2005, when the value of telecommunications services began to shift from telephony to information services and enterprise customers' business capabilities enabled by telecommunications. Faced with this new situation, the Company adhered to its business tenet of continuously increasing its corporate value. By the end of 2004, we proposed the idea of strategic transformation, and by mid-2005, we had finalised the corresponding plan. While we reinforced the horizontal integration of multi-networks, multi-terminals and multi-services, we also emphasized the vertical extension of the value chain, and closely followed the shift in value. By leveraging the effective development of our traditional wireline telecommunications business, we were able to intensively explore business models for our emerging services and concentrate our efforts on the development of integrated information services, so as to cultivate the new core competitive strength of the Company.

In 2005, the varieties of our products were continuously enhanced, and new areas of value creation were discovered. We launched many new services based on the intelligent upgrading of wireline network and endeavored to prolong the life cycle of voice products. We also enriched both the function and content of value-added services, such as "SMS over PHS" and "Color Ring Tone", thereby accelerating the development of these value-added services. We formulated comprehensive and customised Information Communication and Technology (ICT) solutions for enterprise customers in key industries, and actively developed new global businesses to enable

1 Including the amortisation of upfront connection fees, EBITDA was RMB88,606 million, EBITDA margin was 52.3%, profit attributable to equity holders of the Company was RMB27,912 million and earnings per share was RMB0.34.

2 Free cash flow is calculated from EBITDA (excluding amortisation of upfront connection fees) minus capital expenditure and income tax.

CHAIRMAN'S STATEMENT *(continued)*

us to create value for customers while consolidating our market for enterprise customers. As part of this strategic transformation, services such as "BizNavigator", an ICT service for enterprise customers and "Best Tone", an integrated information enquiry service, were successfully launched such that we were able to consolidate our traditional business while exploring new sources of revenue and, more importantly, laid a solid foundation for providing integrated communication and information services in future.

The Company optimised its resources allocation in 2005. We controlled our investment in traditional wireline networks and implemented the upgrading to intelligent networks across the board. The expansionary capital expenditure on PHS was compressed. We ensured proper investment in marketing and business transformation and controlled effectively on labour costs and administrative expenses, thereby enhancing the efficiency in utilising such costs. By issuing short-term commercial paper at a low interest rate in the Chinese capital markets, finance costs were effectively reduced. We further improved our remuneration system and enhanced our efforts in staff training, thereby facilitating the career development of our employees.

In 2005, precision management was implemented across the board. Front line departments were optimised by shifting from functional management to a more holistic focus on process management. Precision sales and marketing were strengthened, and sales channels were improved. Effective and scientific method of resources allocation was established to maximise the effectiveness of the performance appraisal-oriented system. The quality of capital planning and cash flow budgeting was upgraded, and our debt structure was continuously improved. IT system was further developed to unify our front-end database and the establishment of our customer relation management system was accelerated. Our operation supporting systems were consolidated and our back-end resources database was gradually improved.

We continuously improved our corporate governance and internal controls during the year. The Company held its annual general meeting in Hong Kong for the first time in 2005, with a view to building a more direct and effective communication channel with our shareholders. In 2005, we began to disclose our key operating data and certain financial data on a quarterly basis, thereby improving the transparency of the Company. In September 2005, a new session of the Board of Directors was elected and a Nomination Committee was newly formed. Additional independent directors were appointed so that independent directors account for one third of the members of the Board of Directors. An internationally renowned finance professional joined the Audit Committee. The role of independent directors was strengthened. In 2005, the Company continued to comply with requirements of the regulatory authorities and adhere to the best international practices so as to strengthen our internal control progressively, minimise corporate risk and enhance our standards of operation and management.

As a major telecommunications and information service provider in China, we have made proactive efforts to discharge our social responsibilities by contributing to the informationalisation of our community and the development of the national economy. We enthusiastically engaged in environmental protection projects. In 2005, we provided monetary support to the green landscaping project around the Three Gorges Reservoir peripheral area, handicapped children and those who were unable to attend school due to poverty. We also participated in setting up "School of Hope". We sponsored the "International Scheme for the Youth of China to Start up Businesses" in order to assist youngsters to start their way to be a successful entrepreneur.

Looking ahead, we are fully confident in our future. With the steady and rapid growth of the economy of China and burgeoning new technologies, customers demand will be increasingly generated and therefore provide an ample market for the Company's strategic transformation. Our highly innovative management team and well performed employees constitute abundant human resources for the transformation. Our growing customer base and solid financial strength provide us with an important safeguard in terms of our capacity to ensure our successful strategic transformation.

We shall adhere to the philosophy of co-opetition and proactively manage the changing demand and shifts in industry value, thereby creating a favourable business environment for the Company's development. We shall fully utilise new technologies to energise our traditional business. While enhancing the investment return on wireline network, we will also explore new growth areas to assure the sustainable growth of the Company. Through dynamic allocation of resources, we shall achieve a balanced development in both our traditional business and business for transformation. We shall reinforce the planning for our operations, marketing and network, get prepared to be a "Triple-player", offering voice, data and video services in future. Through the convergence of information service resources in our community, we shall make the upmost effort to expand room for new growth. By leveraging our advantage on network resources and distribution channel, we shall strenghten our leading position in the value chain of integrated information services and endeavor to be the forerunner in the field of integrated communication and information services.

Finally, on behalf of the Board of Directors of the Company, I would like to thank Mr. Cheng Xiyuan and Mr. Feng Xiong for their dedication and hard work during their offices as directors of the Company, and at the same time I welcome Mr. Tse Hau Yin, Aloysius and Mr. Xu Erming to join the Board of Directors of the Company. I also take this opportunity to express my sincere appreciation to all of our shareholders, directors and the members of the Supervisory Committee as well as our employees and customers.

Wang Xiaochu
Chairman and Chief Executive Officer

Beijing, PRC
22 March 2006

A Well Developed Foundation

BUSINESS REVIEW

The following table sets out our key operating data in 2003, 2004 and 2005:

	Unit	2003	2004	2005	Change 2005 over 2004
Local wireline access lines in service	Thousand	160,988	186,648	**210,094**	12.6%
Local voice usage	Million pulses	384,496	429,150	**449,404**	4.7%
Domestic long distance usage	Million minutes	67,312	81,960	**93,817**	14.5%
International (including Hong Kong, Macau and Taiwan) long distance usage	Million minutes	1,670	1,654	**1,711**	3.4%
Broadband subscribers	Thousand	7,231	13,839	**21,024**	51.9%
2M digital circuits leased	Thousand	163.14	169.45	**197.42**	16.5%
Volume of inbound local calls	Million minutes	76,210	94,747	**102,670**	8.4%
Caller ID service subscribers	Thousand	82,461	109,031	**131,461**	20.6%
Telephone information service usage	Million minutes	1,743	2,419	**3,540**	46.3%
SMS Usage Volume	Million messages	–	–	**17,254**	–
Color Ring Tone subscribers	Thousand	–	–	**18,162**	–

In 2005, we steadily implemented our strategic transformation, moving forward from a traditional basic network operator to a modern integrated information services provider. While maintaining steady development of our traditional wireline voice services, we made great efforts in the strategic development of broadband service and "SMS over PHS", Color Ring Tone and other mature value-added services ("VAS") to extend our value chain. In our effort to develop business models for emerging services, we launched integrated services such as the "Best Tone", "BizNavigator" and fixed line and PHS convergence ("FPC"). We also conducted overall planning for the Company, taking into account both the front end and back end in concert, which reinforced our competitive advantages in service quality and brand name image in the industry.

Our operating revenue in 2005 was RMB169,310 million, an increase of 5.0% from 2004. Excluding the amortisation of upfront connection fees, our operating revenue was RMB162,529 million, representing a 6.4% annual growth. In 2005, revenue from our local telephone services was slightly higher than that of previous year. Revenue from Internet access service and VAS grew rapidly, driving the overall operating revenue up by 5.0%.

BUSINESS ANALYSIS

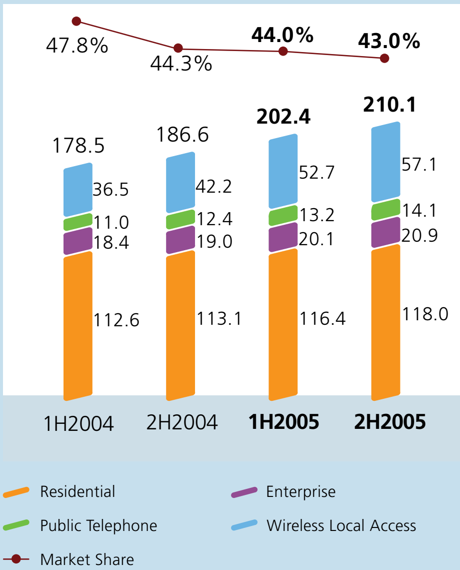
Local telephone services

In 2005, as the gap between mobile phone tariffs and tariffs for wireless local access services narrowed, mobile substitution for wireline telephone subscribers and local usage exacerbated. To ensure steady development of our local telephone services, an important foundation of the Company, we effectively segmented our subscribers, launched diversified service packages, optimised our distribution channels and strengthened our agent channels and on-line channels, while focusing our effort on optimising the coverage of our wireless local access network at hot spots so as to improve our service quality. Revenue from local telephone services for 2005 amounted to RMB80,945 million, an increase of 0.8% from 2004, representing 49.8% of operating revenue (excluding the amortisation of upfront connection fees). Revenue from local usage fees was similar to that of 2004. Local voice usage amounted to 449,404 million pulses, indicating an annual growth of 4.7%.

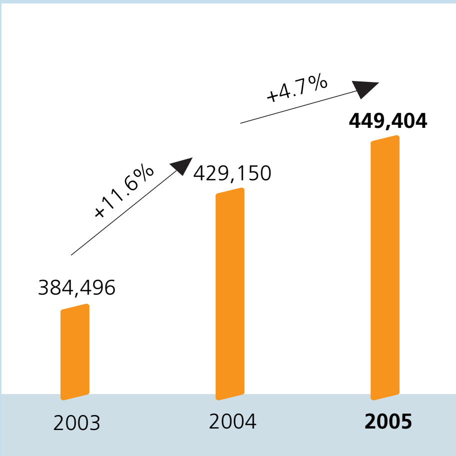
In 2005, our local telephone subscribers reached 210.09 million, and our market share for subscribers[1] was 43.0%, a decrease of 1.3 percentage points from 2004. Based on regional differences, we focused on newly constructed commercial buildings and residential communities in urban areas, towns and prosperous rural regions, reasonably allocated our resources and adopted a number of flexible ways for connection, sales and marketing, thereby rapidly penetrating the targeted market. As a result, net increase of rural residential subscribers in 2005 was 4.90 million, representing a growth rate of 8.8%.

At the same time, we continued to optimise our local wireless telephone network by adhering to our principle of effective coverage, so as to improve the network utilisation and service quality and lower sales costs. In 2005, wireless local access services grew steadily with a net increase of 14.91 million subscribers, an annual growth rate of 35.4%.

Local Telephone Subscriber
(million)



Local Voice Usage
(million pulses)



[1] Market share for subscribers is calculated by dividing local telephone subscribers of the Company by all of the wireline telephone subscribers and mobile telephone subscribers in the Company's service area, and based on statistical data from the Ministry of Information Industries ("MII") and the Company.

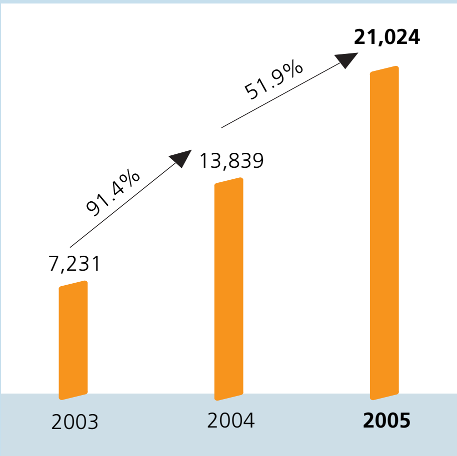
BUSINESS REVIEW *(continued)*

Internet and VAS services

In 2005, our Internet and VAS services grew rapidly. Revenue from Internet and VAS services reached RMB27,838 million, an increase of 37.6% from 2004, accounting for 17.1% of our operating revenue (excluding amortisation of upfront connection fees), which was 3.9 percentage points higher than in 2004.

Broadband service is our most valuable strategic operation and one of the major media for various information services and applications. In 2005, the Company continued to expand its broadband subscriber base to 21.02 million with a net increase of 7.19 million or a growth rate of 51.9%. At the same time, we speeded up our exploration on the bandwidth-based segmentation of broadband subscribers and provided differentiated services in terms of quality, application contents and prices. We also began to consolidate the authentication and the billing systems for broadband subscribers and proceed with simplifying the verification procedures for broadband access and multiple applications in order to improve our customers' experience and upgrade the product value of broadband access.

Broadband Subscribers
(Thousand)



In 2005, revenue from caller ID, telephone information services and Internet VAS continued to experience fast growth. In addition, we made great efforts to promote the VAS on PHS, including "SMS over PHS" and "Color Ring Tone" services. We emphasized the economy of scale of these services and their packaging with traditional services. We strengthened our

"Short messaging services over PHS"

promotion of brand names via television advertisement and printed media. We also established our service provider management platform and cooperated extensively with content providers for SMS and "Color Ring Tone". As a result, the annual SMS usage volume amounted to 17,254 million messages and there were 18.16 million subscribers for the "Color Ring Tone" service.

Long distance services

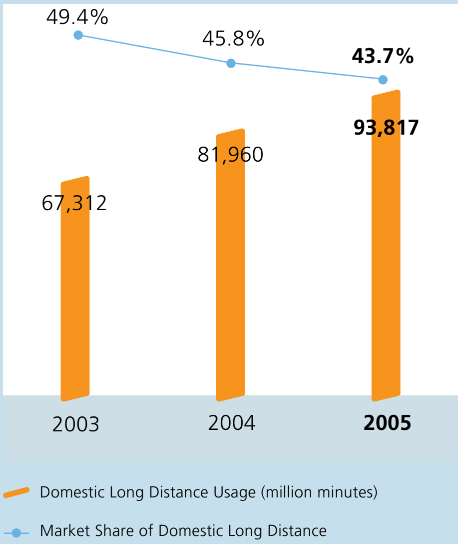
In 2005, revenue from domestic long distance services was RMB25,993 million, a slight decrease of 0.9% from 2004. On the principle of stablising our market share, we responded quickly to market changes and launched various packages to meet the needs of subscribers from different segments in the market. We also increased our effort of promotion to lower the "perceived price" by subscribers and alleviate the increasing diversion of our long distance traffic. Our market share[2] for domestic long distance usage was stablised with a decrease of 2.1 percentage points from 2004 to 43.7% in 2005. Our domestic long distance usage grew 14.5% to 93,817 million in 2005.

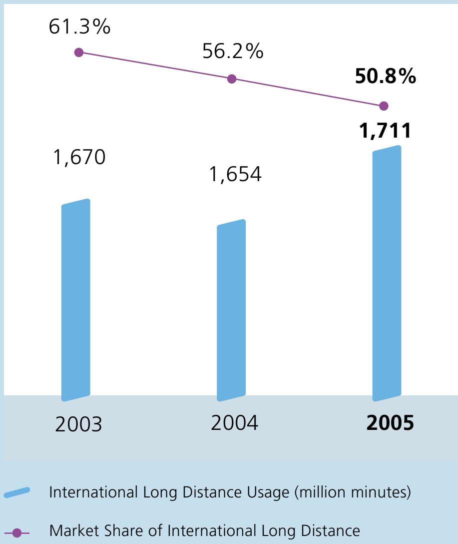
In 2005, competition in international and Hong Kong, Macau and Taiwan long distance telephone services was further intensified. Diversion to technologies such as Instant Message and IP telephony was more apparent. Revenue from international long distance services was RMB3,407 million, a decrease of 10.1% from 2004. Usage volume was 1,711 million minutes, an increase of 3.4% over 2004. Market share[2] dropped by 5.4 percentage points from 2004 to 50.8%. In order to alleviate the declining trend, we launched a variety of marketing initiatives to address different customer segments, such as "familiarity numbers" package and

[2] Based on statistical data from the MII and the Company.

BUSINESS REVIEW *(continued)*

combination of broadband and IP services. We also took advantage of the government policy of "Supporting Overseas Expansion of the Enterprises in China" to enhance our marketing efforts to target PRC enterprises seeking overseas development, so as to stabilise our revenue from international, Hong Kong, Macau and Taiwan long distance telephone services.





Managed data and leased line services

In the wake of rapid informationalisation, we provided our corporate clients with integrated one-stop shopping solutions through system integration and network maintenance outsourcing service. We explored more thoroughly our customers' needs for IT service and expanded our market effectively. Revenue from managed data and leased line services was RMB7,422 million in 2005.

Interconnection services

In 2005, revenue from interconnection was RMB12,838 million, an increase of 19.8% from 2004, and net interconnection revenue was RMB7,365 million, an increase of 11.2% from 2004. As the number of mobile subscribers continued to grow rapidly, the volume of inbound local calls reached 102,670 million minutes, indicating an increase of 8.4% from 2004.

PRODUCT DEVELOPMENT, SERVICES INNOVATION AND BRAND PROMOTION

In 2005, we achieved favorable results in the development of new products such as the integrated terminal and integrated services. In order to enhance the value for our traditional voice services, we developed FPC product, based on the principle of "terminal first and network next". In order to effectively expand the market for integrated information services, we launched "Best Tone", an integrated information enquiries service, and "BizNavigator", an ICT service for enterprise clients. We consolidated the public customer information services and the enterprise application services, and cooperated with both downstream and upstream enterprises, thereby achieving extension and expansion of the value chain of business lines and service lines.

We reinforced our image of quality service through customer service hotline "10000". We unified the customer-oriented interfaces and service standards, and gradually build up our competitive advantages in terms of customer friendliness and business handling capacity. We also further optimised our own sales channels and improved coordination among such channels, and enhanced the service standards of the business outlets. In addition, we strengthened our agency distribution channels and the role of online customer service centres.

"BizNavigator" - ICT for small & medium enterprises

In 2005, we established our unified brand name framework and development planning. Service brand names such as "Color Ring Tone" and "ChinaVnet" have already been well recognized. At the same time, we designed customer segment-oriented service portfolio brand names such as the "BizNavigator", and our framework for brand names has been evolving from constituting mainly service brand names to a blend of major service brand names and customer brand names.

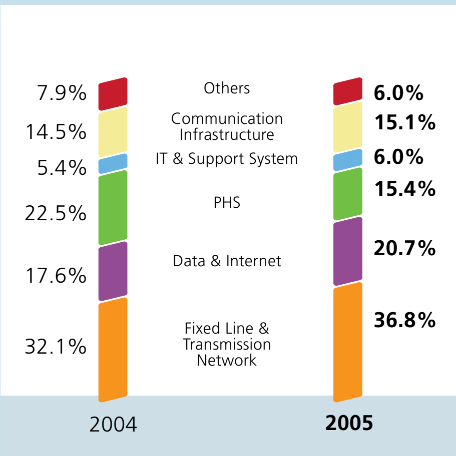
BUSINESS REVIEW *(continued)*

IMPLEMENTATION OF NETWORK UPGRADING TO SUPPORT OUR BUSINESS TRANSFORMATION

According to our established strategic deployment for our transformation, we took proactive efforts in materialising our network transformation in 2005. Driven by the needs of customers and technological advances, we speeded up the transformation of our existing network system to the next generation network. We endeavour to materialise the speedy deployment of network and services and the effective support to the integration of broadband and narrowband services, with a view to minimise the costs of services provision and network operations, and to provide our customers with differentiated network qualities and maintenance services. In 2005, we adhered to the principle of "high quality, high value-adding applications, high utilisation of resources, low churn rate and low subsidies", and have seen great improvement in the operation of our wireless local access network. Network quality of the wireless local access network improved significantly by means of network optimisation. In 2005, we fully implemented the upgrade of wireline network to intelligent network, and thereby speeded up the introduction of the "softswitch" technology. As at the end of 2005, we had basically completed the network intelligence upgrade in 40% of our subsidiaries, 35% of our subsidiaries completed part of local network upgrade, and the remaining 25% of our subsidiaries were preparing for such upgrade. At present, in service areas where the upgrading of intelligent network has been completed, new businesses such as our wireline "Color Ring Tone", prepaid services, "Unicode service", wireline telephone number portability within local network, have gradually found popularity among our customers. We expect to complete all of our network upgrade by the end of 2006, thereby forming a centralised management platform for subscribers and enabling centralised management of wireline telephone subscribers, PHS subscribers and related services. These will lay a sound foundation for customer identification, tailored services and provision of inter-network integration services. In addition, we have also boosted IP-based Metropolitan Area Network (MAN) optimisation and broadband speeding up in order to improve our bandwidth supporting capability and support key businesses such as video services.

It is essential for our successful strategic transformation to optimise our capex structure and improve investment efficiency. In 2005, we continuously adjusted and optimised our investment structure and balanced the proportion between expansionary investment and maintenance investment, and between strategic investment and recurring investment, thereby achieving

CAPEX Composition



effective interaction between investment, network capacity and market demand and service provisioning capabilities. We continuously increased our investment in broadband and VAS, IT support system, the intelligent upgrading of wireline network and network coverage in rural areas, of which the proportion of investment in the data network and Internet increased by approximately 3.1 percentage points from last year. Investment in wireless local access service has been under control, the investment proportion of which dropped by 7.1 percentage points from 2004. Such investments have enabled continued, profitable growth of traditional fixed line service, and provided more privileges to investment in key networks, services and geographical areas, which have ensured fast growth of core services and products and satisfied the strategic demand for network capabilities.

2006 BUSINESS OUTLOOK

In 2006, we will continue with our subscriber base development and retention of existing subscribers and usage. We will allocate our resources in a more rational way and adopt various cooperation models to penetrate newly constructed residential communities in urban areas and more profitable rural markets. We will ensure that our wireless local access network be optimised in areas where the usage volume is high, increase the in-door coverage, and promote FPC service and other widely accepted service packages. With these measures, we will ensure a steady growth of our traditional voice service. We will also promote broadband services in a more differentiated way and enrich terminal functions and applications to accelerate its growth. Based on the intelligent upgrading of network, we will enrich personalised applications such as “SMS over PHS” and “Color Ring Tone”. At the same time, we will push forward the healthy development of VAS, speed up the promotion of transformation services featuring “BizNavigator” and “Best Tone”, and establish a flexible joint marketing mechanism. By so doing, we will firmly establish our leading position in the field of comprehensive information services.


“Best Tone” – Voice search engine

Stimulating Growth

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

SUMMARY

Our operating revenue in 2005 was RMB169,310 million, an increase of 5.0% from 2004. Operating expenses was RMB130,356 million, an increase of 7.4% from 2004; net profit[1] (profit attributable to equity holders of the Company) was RMB27,912 million, and earnings per share were RMB0.34. EBITDA[2] was RMB88,606 million, and EBITDA margin was 52.3%.

Excluding the amortisation of upfront connection fees of RMB6,781 million, our operating revenue in 2005 was RMB162,529 million, an increase of 6.4% from 2004; net profit[1] (profit attributable to equity holders of the Company) was RMB21,131 million, earnings per share were RMB0.26. EBITDA[2] was RMB81,825 million and EBITDA margin was 50.3%.

OPERATING REVENUE

Our operating revenue in 2005 was RMB169,310 million, an increase of 5.0% from 2004. Excluding the amortisation of upfront connection fees, our operating revenue in 2005 was RMB162,529 million, an increase of RMB9,775 million or 6.4% from 2004. Revenue from Internet access services and value-added services, and interconnection revenue increased by RMB7,609 million and RMB2,119 million respectively from 2004, which represented the main sources of revenue growth. The growth in local telephone services revenue was stablising, which increased by 0.8% from 2004. Revenue from leased line services and other businesses increased by 1.4% from 2004. On the other hand, revenue from long distance telephone services and managed data services decreased.

1 Our net profit for 2004 included a deficit on revaluation of property, plant and equipment of RMB1,262 million.

2 Our EBITDA refers to profit before net finance costs, investment income, share of profit from associates, income tax, depreciation and amortisation, deficit on revaluation of property, plant and equipment and minority interests. As the telecommunications business is a capital intensive industry, capital expenditure, the level of gearing and finance costs may have a significant impact on the net profit of companies with similar operating results. Therefore, we believe EBITDA may be helpful in analysing the operating results of a telecommunications service provider like us. Although EBITDA has been widely applied in the global telecommunications industry as a benchmark to reflect the operating performance, financial capability and liquidity, it is not regarded as a measure of operating performance and liquidity under generally accepted accounting principles. It also does not represent net cash from operating activities. In addition, our EBITDA may not be comparable to similar indicators provided by other companies.

The following table sets forth a breakdown of our operating revenue for 2004 and 2005, together with their respective rates of change:

	For the year ended 31 December		
	2005	2004	Rate of Change
	(RMB in millions, except percentage data)		
Wireline telephone services[3]			
Local			
Installation fees	**2,970**	2,865	3.7%
Monthly fees	**30,351**	29,827	1.8%
Local usage fees	**47,624**	47,646	(0.0)%
Subtotal	**80,945**	80,338	0.8%
Domestic long distance[4]	**25,993**	26,231	(0.9)%
International, Hong Kong, Macau and Taiwan long distance[4]	**3,407**	3,788	(10.1)%
Interconnections	**12,838**	10,719	19.8%
Upfront connection fees	**6,781**	8,458	(19.8)%
Subtotal	**49,019**	49,196	(0.4)%
Internet access and value-added services	**27,838**	20,229	37.6%
Managed data	**2,958**	3,015	(1.9)%
Leased line services and others[5]	**8,550**	8,434	1.4%
Operating revenue (excluding amortisation of upfront connection fees)	**162,529**	152,754	6.4%
Total operating revenue	**169,310**	161,212	5.0%

3 Including revenue from our registered subscribers, public telephones and pre-paid calling cards services.

4 Including revenue from VoIP long distance services.

5 Including primarily revenue from the lease of telecommunications network facilities and provision of sales and repairs and maintenance of customer-end equipment.

LOCAL TELEPHONE SERVICES

Revenue from our local telephone services grew by 0.8% from RMB80,338 million in 2004 to RMB80,945 million in 2005, which accounted for 47.8% of our operating revenue or 49.8% of our operating revenue excluding amortisation of upfront connection fees. This revenue growth was mainly attributable to the continued growth of our subscriber base. However, as the gap between mobile service tariffs and wireline service tariffs narrowed, mobile operations exacerbated the diversion from wireline services, causing a decrease in local voice ARPU.

Installation fees. Upfront installation fees will be amortised over the expected customer relationship period of 10 years. Revenue from amortisation of upfront installation fees increased by 3.7% from RMB2,865 million in 2004 to RMB2,970 million in 2005.

Monthly fees. Revenue from monthly fees increased by RMB524 million, or 1.8%, from RMB29,827 million in 2004 to RMB30,351 million in 2005.

Local usage fees. Revenue from local usage fees was RMB47,624 million in 2005, which was similar to that of 2004. Local voice usage volume increased by 4.7% from 2004, to 449,404 million pulses in 2005. Due to the intensifying mobile substitution, popularisation of network based communication and the diversification of the means of communication, revenue contribution by traditional voice usage weakened.

LONG DISTANCE TELEPHONE SERVICES

Revenue from our long distance telephone services decreased by 2.1% from RMB30,019 million in 2004 to RMB29,400 million in 2005, representing 17.4% of our operating revenue or 18.1% of our operating revenue excluding amortisation of upfront connection fees.

Domestic long distance services. In 2005, revenue from our domestic long distance services decreased by 0.9% from RMB26,231 million in 2004 to RMB25,993 million in 2005, while domestic long distance telephone usage volume increased by 14.5% from 81,960 million minutes in 2004 to 93,817 million minutes in 2005. The decrease in revenue was attributable to a decrease in average unit price, which decreased from RMB0.32 per minute in 2004 to RMB0.28 per minute in 2005.

International, Hong Kong, Macau and Taiwan long distance services. International, Hong Kong, Macau and Taiwan long distance services revenue decreased by 10.1%, from RMB3,788 million in 2004 to RMB3,407 million in 2005, while the usage volume of our international, Hong Kong, Macau and Taiwan long distance usage volume increased by 3.4% from 2004. The decrease in revenue was attributable to a decrease in average unit price, which decreased from RMB2.29 per minute in 2004 to RMB1.99 per minute in 2005.

INTERNET ACCESS AND VALUE-ADDED SERVICES

Revenue from our Internet access and value-added services increased by 37.6%, from RMB20,229 million in 2004 to RMB27,838 million in 2005, representing 16.4% of our operating revenue or 17.1% of our operating revenue excluding amortisation of upfront connection fees. Driven by the continuous expansion of our broadband subscriber base in recent years, our Internet access services revenue recorded a sustained and rapid growth. The number of our broadband subscribers increased by 7.19 million from the end of 2004 to 21.02 million as of the end of 2005. The increase in the revenue from value-added services was mainly attributable to the rapid development of SMS, caller ID service, Color Ring Tone and telephone information services, of which SMS and Color Ring Tone were the new drivers for revenue growth.

INTERCONNECTION SERVICES

Revenue from our interconnection services increased by 19.8%, from RMB10,719 million in 2004 to RMB12,838 million in 2005, representing 7.6% of our operating revenue or 7.9% of our operating revenue excluding amortisation of upfront connection fees. Increase in such revenue was mainly attributable to an increase in interconnection volume resulting from the expansion of the domestic telecommunications services subscriber base. The increase was also attributable to the revenue from SMS interconnections newly introduced in 2005.

MANAGED DATA SERVICES

Revenue from our managed data services decreased by 1.9%, from RMB3,015 million in 2004 to RMB2,958 million in 2005. The decrease in revenue was mainly attributable to the substitution by new connection methods and therefore reduced the usage volume of conventional services.

LEASED LINE SERVICES AND OTHER BUSINESS

Revenue from our leased line services and other business increased by 1.4%, from RMB8,434 million in 2004 to RMB8,550 million in 2005, representing 5.0% of our operating revenue or 5.3% of our operating revenue excluding amortisation of upfront connection fees.

UPFRONT CONNECTION FEES

Upfront connection fees represent the amortised amount of the upfront fees received for the initial activation of wireline services, amortised over the expected customer relationship period of 10 years. Effective from July 2001, we ceased to charge new subscribers upfront connection fees. The amortised amount decreased by 19.8%, from RMB8,458 million in 2004 to RMB6,781 million in 2005.

The table below sets forth the amortisation of upfront connection fees for each year from 2006 to 2011 based on the calculation of amortisation over the 10-year estimated amortisation period (with 2011 as the end of the amortisation period):

	For the year ending 31 December					
	2006	**2007**	**2008**	**2009**	**2010**	**2011**
	(RMB in millions)					
Amortisation of upfront connection fees	4,965	3,295	2,022	1,151	497	98

OPERATING EXPENSES

In 2005, our operating expenses were RMB130,356 million, representing an increase of 7.4% from 2004. The ratio of our operating expenses to operating revenue increased from 75.3% in 2004 to 77.0%, or increased by 0.7 percentage points to 80.2% of our operating revenue excluding amortisation of upfront connection fees. The following table sets out a breakdown of our operating expenses in 2004 and 2005 and their respective rates of change:

	For the year ended 31 December		
	2005	2004	Rate of Change
	(RMB in millions, except percentage data)		
Depreciation and amortisation	**49,652**	47,170	5.3%
Network operations and support expenses	**30,334**	27,611	9.9%
Selling, general and administrative expenses	**19,892**	19,229	3.4%
Personnel expenses	**24,960**	23,233	7.4%
Interconnection and other operating expenses	**5,518**	4,139	33.3%
Total operating expenses	**130,356**	121,382	7.4%

Depreciation and amortisation

Our depreciation and amortisation expenses were RMB49,652 million in 2005, an increase of 5.3% from 2004, representing 29.3% of our operating revenue. The depreciation and amortisation expenses as a percentage of our operating revenue excluding amortisation of upfront connection fees decreased from 30.9% in 2004 to 30.5% in 2005.

Network operations and support expenses

Our network and support expenses excluding personnel expenses increased by 9.9%, from RMB27,611 million in 2004 to RMB30,334 million in 2005, representing 17.9% of our operating revenue. The network operations and support expenses as a percentage to our operating revenue excluding amortisation of upfront connection fees increased from 18.1% in 2004 to 18.7% in 2005. In order to improve the maintenance quality of our network operations, we appropriately increased our resources input to repairs and maintenance.

Selling, general and administrative expenses

In 2005, selling, general and administration expenses excluding personnel expenses amounted to RMB19,892 million , an increase of 3.4% from RMB19,229 million in 2004, representing 11.7% of our operating revenue. Selling, general and administrative expenses as percentage of our operating revenue excluding amortisation of upfront connection fees decreased from 12.6% in 2004 to 12.2% in 2005. To cope with the market competition, we increased our advertisement and promotion expenses to promote our corporate image, our core and new businesses to bring these in line with our strategic transformation. We also launched advertising and promotion campaigns in tandem with various marketing initiatives (such as service packaging). Therefore, our advertisement expenses increased quickly.

Personnel expenses

In 2005, our personnel expenses increased by 7.4%, from RMB23,233 million in 2004 to RMB24,960 million in 2005, representing 14.7% of our operating revenue, and 15.4% of our operating revenue excluding amortisation of upfront connection fees, an increase of 0.2 percentage points from 2004. This increase was mainly attributable to an increase in reward to employees with good performance in order to maintain and attract professionals and management personnel for our strategic transformation.

Interconnection and other operating expenses

Our interconnection and other expenses increased by RMB1,379 million, from RMB4,139 million in 2004 to RMB5,518 million in 2005, an increase of 33.3%. The significant growth in voice interconnections and the newly added SMS interconnections led to the increase in interconnection fees. The net revenue from interconnections (interconnection revenue less interconnection expenses) amounted to RMB7,365 million, an increase of 11.2% from 2004.

NET FINANCE COSTS

In 2005, our net finance costs were RMB4,895 million, a decrease of RMB445 million or 8.3% from RMB5,340 million in 2004.

Among the components of net finance costs, net exchange gain increased by RMB767 million and interest expenses increased by RMB334 million.

The revaluation of Renminbi in 2005 was the main reason for the net exchange gain. According to the exchange rates published by the People's Bank of China on 30 December 2005, the exchange rates of Renminbi to US dollars, Japanese Yen and Euro increased by 2.5%, 14.7% and 14.9% respectively from 31 December 2004.

We acquired the telecommunications operations in 10 provinces including Hubei on 30 June 2004. The consideration for the acquisition included a deferred payment of RMB15,150 million, and the full year interest expenses thereon in 2005 was the main reason for the increase in interest expenses.

INCOME TAX

Our statutory income tax rate is 33%. In 2005, our income tax expenses were RMB6,160 million, and our effective income tax rate was 18.1%, whereas our effective income tax rate excluding upfront connection fee was 22.5%. The difference between our effective income tax rate and the statutory income tax rate was mainly due to the exclusion of upfront connection fees from taxable revenue, and the preferential income tax rate of 15% enjoyed by our subsidiaries located in special economic zones and in the western part of China. Another reason for our effective tax rate being lower than the statutory tax rate was that some of our operating subsidiaries received tax credits of RMB1,478 million on the purchases of domestic equipment in 2005. As the tax credits on purchases of domestic equipment are subject to various restrictions, we cannot reasonably foresee their impact on the effective tax rate in future years.

NET PROFIT (PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY)

In 2005, our operating efficiency and profit level continued to grow steadily and our net profit reached RMB27,912 million. Excluding amortisation of upfront connection fees, our net profit was RMB21,131 million. Our net profit in 2004 was RMB28,023 million, and excluding amortisation of upfront connection fees, it was RMB19,565 million. Excluding amortisation of upfront connection fees, our net profit increased by 8.0% from 2004.

CAPITAL EXPENDITURE

In 2005, we continued our prudent policy on capital expenditure. Our capital expenditure decreased by 4.3%, from RMB56,307 million in 2004 to RMB53,864 million in 2005. In accordance with our strategic transformation, we further optimised our capital expenditure structure and significantly reduced the capital expenditure on wireless local access service and increased our investment in Internet access and data network. Proportion of the capital expenditure on wireless local access service to the total capital expenditure decreased by 7.1 percentage points, and proportion of the capital expenditure on Internet access and data network to the total capital expenditure increased by 3.1 percentage points from 2004.

In 2006, our estimated capital expenditure is RMB51 billion. The main sources of our capital are cash generated from operating activities, bank borrowings and other indebtedness. We expect that we will have sufficient funding sources to meet our capital expenditure requirements in future.

CASH FLOWS AND CAPITAL RESOURCES

Cash Flows

In 2005, our net cash inflow was RMB1,656 million, as compared with the net cash inflow of RMB744 million in 2004.

The following table sets out our cash flow position in 2004 and 2005:

	For the year ended 31 December	
	2005	2004
	(RMB in millions)	
Net cash flows from operating activities	**68,359**	66,078
Net cash used in investing activities	**(51,894)**	(56,353)
Net cash used in financing activities	**(14,809)**	(8,981)
Net increase in cash and cash equivalents	**1,656**	744

In 2005, our net cash flow from operating activities was RMB68,359 million, an increase of RMB2,281 million from RMB66,078 million in 2004. Increase in net cash from operating activities indicated the steady growth in our business and an improvement in our operating efficiency.

In 2005, we achieved saving in capital expenditure. Cash used in investing activities was RMB51,894 million, a decrease of RMB4,459 million from 2004.

In 2005, our net cash flows used in financing activities were RMB14,809 million, compared to the net cash used of RMB8,981 million in 2004.

In October 2005, we raised RMB9.88 billion in cash to meet the working capital requirement of our operations through the issue of short-term commercial paper due in six months with a nominal value of RMB10 billion. In addition, we continued to repay certain long-term borrowings in 2005, and net cash used in repaying such borrowings (the difference between the cash from borrowings and the cash used for repaying borrowings) increased from RMB3,950 million in 2004 to RMB9,046 million in 2005.

Working capital

By the end of 2005, our working capital (total current assets minus total current liabilities) deficit was RMB120,313 million, an increase of RMB1,901 million from deficit of RMB118,412 million of 2004. This increase was mainly attributable to an increase in short-term debts, which enjoyed lower interest rates. By the end of 2005, our cash and cash equivalents amounted to RMB15,121 million, of which 99.1% was denominated in Renminbi.

Indebtedness

The indebtedness as of the end of 2004 and 2005 was as follows:

	As of 31 December	
	2005	2004
	(RMB in millions)	
Short-term debt	**76,005**	65,976
Long-term debt maturing within one year	**8,963**	11,842
Finance lease obligations maturing within one year	**108**	156
Long-term debt (excluding current portion)	**55,777**	72,366
Finance lease obligations (excluding current portion)	**52**	157
Total debt	**140,905**	150,497

By the end of 2005, our total indebtedness was RMB140,905 million, a decrease of RMB9,592 million from 2004. The main reason for the decrease was that we repaid certain long-term borrowings with the net cash generated from our operating activities.

Therefore, the ratio of our total indebtedness to total assets decreased from 36.5% in 2004 to 33.8% in 2005. We believe that the Company has maintained a solid capital structure.

Most of our revenue-generating operations and payments made are denominated in Renminbi, and Renminbi is not a freely convertible currency. By the end of 2005, loans in Renminbi, Janpanese Yen, US Dollars and Euro represented 95.6%, 2.0% and 1.7% and 0.6% of our total indebtedness, respectively. 66.4% of our indebtedness was loans with fixed interest rates terms.

CONTRACTUAL OBLIGATIONS

The following table sets out our contractual obligations as of 31 December 2005:

	Payable in					
	Total	**2006**	**2007**	**2008**	**2009**	**After 2009**
			(RMB in millions)			
Short-term debt	76,005	76,005	–	–	–	–
Long-term debt	64,740	8,963	8,773	3,824	382	42,798
Finance lease obligations	160	108	52	–	–	–
Operating lease commitments	1,062	326	195	134	119	288
Capital commitments	2,791	2,791	–	–	–	–
Total contractual obligations	144,758	88,193	9,020	3,958	501	43,086

Going to the Fruitful Future

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Mr. Wang Xiaochu

Age 48, is Chairman of the Board of Directors and Chief Executive Officer of our Company. Mr. Wang has held positions such as director general and deputy director general of the Hangzhou Telecommunications Bureau in Zhejiang province, director general of the Tianjin Posts and Telecommunications Administration, chairman and chief executive officer of China Mobile (Hong Kong) Limited, and vice president of China Mobile Communications Corporation. Mr. Wang is also President of China Telecommunications Corporation. He was responsible for the development of China Telecom's telephone network management systems and various other information technology projects and as a result, received the Class Three National Science and Technology Advancement Award and the former Ministry of Posts and Telecommunications's Class One Science and Technology Advancement Award. Mr. Wang graduated from Beijing Institute of Posts and Telecommunications in 1980 and received a Doctorate degree in Business Administration from The Hong Kong Polytechnic University in 2005. He has over 25 years of management experience in the telecommunications industry.

Mr. Leng Rongquan

Age 57, is Executive Director, President and Chief Operating Office of our Company. Mr. Leng is a director level senior engineer. He graduated from the Beijing Institute of Posts and Telecommunications with a Master of Science in engineering. Mr. Leng has held positions such as chief engineer of the Beijing Long Distance Telephone Bureau, deputy chief engineer of the Directorate General of Telecommunications ("DGT") of the Ministry of Posts and Telecommunications ("MPT"), deputy director general of the DGT of the MPT, deputy general manager of China Telecommunications Corporation, deputy general manager of China Network Communications Group Corporation and vice chairman of China Netcom Group Corporation (Hong Kong) Limited. Mr. Leng is also Vice President of China Telecommunications Corporation. Mr. Leng has had 30 years of operational management experience in the telecommunications industry in the PRC.

Ms. Wu Andi

Age 51, is Executive Director, Executive Vice President and the Chief Financial Officer in charge of financial management of our Company. Ms. Wu is a Senior Accountant. She graduated in 1983 from the Beijing Institute of Economics with a B.A. degree in finance and trading. From 1996 to 1998, Ms. Wu studied in a postgraduate program in business economics management at the Chinese Institute of Social Sciences. Prior to joining China Telecommunications Corporation in May 2000, Ms. Wu served as Director General of the Department of Economic Adjustment and Communication Settlement of the Ministry of Information Industry ("MII"), and Director General, deputy Director General and director of the Department of Finance of the MPT. Ms. Wu is also Vice President of China Telecommunications Corporation. Ms. Wu has 24 years of financial management experience in the telecommunications industry in China.

Mr. Zhang Jiping

Age 50, is Executive Director and Executive Vice President of our Company. Mr. Zhang is a professor level Senior Engineer. He graduated in 1982 from the Beijing University of Posts and Telecommunications with a B.Sc. degree in radio telecommunications engineering. From 1986 to 1988, Mr. Zhang studied in a postgraduate program in applied computer engineering at Northeastern Industrial University. Prior to joining China Telecommunications Corporation in May 2000, Mr. Zhang was Deputy Director General of DGT of MPT, and a Deputy Director General and Director of the Network Management Center of the Posts and Telecommunications Administration of Liaoning Province. Mr. Zhang is also Vice President of China Telecommunications Corporation and Chairman and General Manager of Northern Telecom Co., Ltd. under China Telecommunications Corporation. Mr. Zhang has 24 years of operational and managerial experience in the telecommunications industry in China.

Ms. Huang Wenlin

Age 52, is Executive Director and Executive Vice President of our Company. Ms. Huang is a Senior Economist. She graduated in 1984 from the Beijing University of Posts and Telecommunications with a major in engineering management. Prior to joining China Telecommunications Corporation in May 2000, Ms. Huang served as Director of the Domestic Communications Division and Director of the Communications Organization Division of the DGT of the MPT. Ms. Huang is also Vice President of China Telecommunications Corporation. Ms. Huang has 31 years of operational and managerial experience in the telecommunications industry in China.

Mr. Li Ping

Age 52, is Executive Director, Executive Vice President and Joint Company Secretary of our Company. Mr. Li is a Senior Engineer. He graduated in 1976 from the Beijing University of Posts and Telecommunications with a major in radio telecommunications and received an MBA degree from the state University of New York at Buffalo in 1989. Prior to joining China Telecommunications Corporation in August 2000, Mr. Li served as Chairman and President of China Telecom (Hong Kong) International Limited, Vice Chairman and Executive Vice President of China Mobile (Hong Kong) Limited and Deputy Director General of the DGT of the MPT. Mr. Li is also Vice President of China Telecommunications Corporation. Mr. Li has extensive experience in managing public companies and 30 years of operational and managerial experience in the telecommunications industry in China.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT *(continued)*

Mr. Wei Leping

Age 60, is Executive Director of our Company. Mr. Wei is a professor level Senior Engineer. He graduated in 1970 from Tsinghua University with a major in radio engineering and received a Master degree in communication and information systems engineering from the Research Institute of Post and Telecommunications. Prior to joining China Telecommunications Corporation in April 2001, Mr. Wei served as Deputy Director of the Telecommunications Research Institute of the MII, Deputy Director of the Telecommunications Science Planning and Research Institute of the MPT and Deputy Director and Chief Engineer of the Telecommunications Transmissions Research Center of the MPT. Mr. Wei is also Chief Engineer of China Telecommunications Corporation. Mr. Wei has 28 years of experience in research and development for network technologies in the telecommunications industry in China.

Mr. Yang Jie

Age 44, is Executive Director and Executive Vice President of our Company. Mr. Yang is a senior engineer at professor level. In 1984, Mr. Yang graduated from Beijing University of Posts and Telecommunications with a Bachelor degree in radio engineering. He then obtained a master degree of telecommunications and information management at the Norwegian School of Management. Mr. Yang previously served as Deputy Director General of Shanxi Posts and Telecommunications Administration, General Manager of Shanxi Telecommunications Corporation, Vice President of China Telecom Beijing Research Institute and General Manager of the Northern Telecom Department of China Telecommunications Corporation. He is also Vice President of China Telecommunications Corporation. Mr. Yang has 22 years of operational and managerial experience in the telecommunications industry in China.

Mr. Sun Kangmin

Age 49, is Executive Director and Executive Vice President of our Company. Mr. Sun is a senior engineer. Mr. Sun previously served as Department Head of the Information Industry Department of Sichuan Province, Director General of Communications Bureau of Sichuan Province as well as Chairman and General Manager of Sichuan Telecom Company Limited. Mr. Sun has 22 years of operational and managerial experience in the telecommunications industry in China.

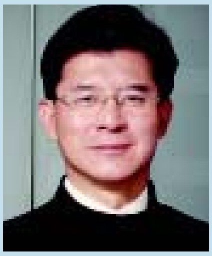
Mr. Li Jinming

Age 54, is Non-executive Director of our Company. Mr. Li is Chairman of Guangdong Rising Assets Management Co., Ltd., one of the domestic shareholders of the Company, and Chairman of Shenzhen Zhongjin Lingnan Nonfemet Company Limited. Mr. Li graduated from Guangdong Provincial Broadcast and Television University, and studied in the postgraduate class in the faculty of international economics of Lingnan College, Zhongshan University, majoring in international industry and commerce management. He is currently studying in the EMBA class at Lingnan College, Zhongshan University. Mr. Li has held positions such as section chief and deputy director general of the Guangdong Provincial Discipline Inspection Commission, and director and deputy general manager of Guangdong Rising Assets Management Co., Ltd. Mr. Li has extensive experience in enterprise management.

Mr. Zhang Youcai

Age 65, is Independent Non-executive Director of our Company. He is currently a member of the Standing Committee of the National People's Congress, vice-chairman of the Financial and Economic Affairs Committee and the chairman of the China Chief Financial Officer Association. Mr. Zhang graduated from Nanjing Industrial Chemistry College in 1965 with a major in inorganic chemistry. He was a former Vice Minister of the Ministry of Finance of China and was responsible for the formulation and implementation of government finance policies. Mr. Zhang has contributed to the improvement and reform of the finance system of China for more than a decade. Prior to serving at the Ministry of Finance, Mr. Zhang served as a Deputy Director of the Planning Commission of Nantong City in Jiangsu Province and a Deputy Mayor and Mayor of Nantong. Mr. Zhang is also an Independent Director of China Petroleum & Chemical Corporation. Mr. Zhang has more than 40 years of experience in the regulation of Chinese state-owned enterprises and finance administration.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT *(continued)*



Mr. Lo Hong Sui Vincent

Age 58, is Independent Non-executive Director of our Company. Mr. Lo is the Chairman and Chief Executive of the Shui On Group which was founded by him in 1971. He is also the Chairman and Chief Executive Officer of Shui On Land Limited.

Mr. Lo is a Member of The Tenth National Committee of Chinese People's Political Consultative Conference, Honorary Life President of Business and Professionals Federation of Hong Kong, President of Shanghai-Hong Kong Council for the Promotion and Development of Yangtze, Vice Chairman of All-China Federation of Industry & Commerce, Economic Adviser to the Chongqing Municipal Government, Vice Chairman of Chamber of International Commerce Shanghai, Director of Great Eagle Holdings Ltd, Non-Executive Director of Hang Seng Bank Ltd, Court Member of The Hong Kong University of Science and Technology, Adviser to HK Thailand Business Council, Director of The Real Estate Developers Association of Hong Kong, Adviser to Chinese Society of Macroeconomics and Peking University China Center for Economic Research, and Council Member of China Overseas Friendship Association.

He was awarded the Gold Bauhinia Star in 1998 and appointed Justice of the Peace in 1999 by the Government of the Hong Kong Special Administrative Region. He was made an Honorary Citizen of Shanghai in 1999 and was named Businessman of the Year by the Hong Kong Business Awards in 2001. He also won the Director of the Year Award in the category of Listed Company Executive Directors from The Hong Kong Institute of Directors in 2002. In 2005, he was awarded the Chevalier des Arts et des Lettres by the French government.

Mr. Shi Wanpeng

Age 69, is Independent Non-executive Director of our Company. He is currently a member of the Standing Committee of the Tenth Chinese People's Political Consultative Conference. Mr. Shi graduated in 1960 from Northern Jiaotong University with a major in Railway Transportation Management. He is a Professor level Senior Engineer and served as Deputy Director General and Director General of Department of Transportation and Department of Economy & Technology Cooperation of State Economy & Trade Commission, Director General of Department of Production Planning of State Development Planning Commission, Deputy Director of Economic and Trade Office of the State Council, Chairman of China Textile Industry Association and Vice Chairman of the State Economic and Trade Commission (minister level). He has more than 40 years of operational and managerial experience in state-owned enterprise and state industry development of PRC.

Mr. Xu Erming

Age 56, is Independent Non-executive Director of our Company. He is currently the Dean of the School of Business and the supervisor of the PhD candidates of Remin University of China. Mr. Xu is also a member of the Fifth Session of the Academic Appraisal Group of the Academic Degree Committee of the State Council, the Chairman of the Steering Committee (Section of Higher Education in Business Administration) of the Ministry of Education as well as the Professor of the University of Scranton and the Polytechnic University of Hong Kong etc. Mr. Xu graduated from Remin University of China and obtained the PhD in Economics in 1994. Over the years, he has been working as the Instructor and Associate Professor of the Faculty of Industrial Economics as well as the Professor and the Assistant Dean, and subsequently, the Dean of the School of Business Administration of Remin University of China. Mr. Xu has attained a relatively high level of academic research standards on the strategic management and operational aspects of enterprises.

Mr. Tse Hau Yin, Aloysius

Age 58, is Independent Non-executive Director of our Company. He joined the Board of Directors of the Company in September 2005. Mr. Tse is currently an Independent Non-executive Director of CNOOC Limited, China Construction Bank Corporation, Wing Hang Bank, Limited and Linmark Group Limited and is currently the Chairman of the International Advisory Council of The People's Municipal Government of Wuhan. Mr. Tse is a fellow of The Institute of Chartered Accountants in England and Wales, and the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Mr. Tse is a past president of the HKICPA. He joined KPMG in 1976 and became a partner in 1984 and retired in March 2003. Mr. Tse was a non-executive Chairman of KPMG's operations in the PRC and a member of the KPMG China advisory board from 1997 to 2000. Mr. Tse is a graduate of the University of Hong Kong.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT *(continued)*

Mr. Wang Qi

Age 51, is the controller of our Company. Mr. Wang is a senior accountant. He studied at Beijing Institute of Posts and Telecommunications and the Australian National University. Mr. Wang has a B.A. degree in international economics and a Master degree in international management. Prior to joining the Company, Mr. Wang served as a Deputy Director General of Anhui PTA. Mr. Wang also served as a Deputy General Manager of China Telecom Group Anhui Corporation prior to his relocation to the headquarters of China Telecom Group in 2000. Mr. Wang is also Managing Director of the Finance Department of China Telecommunications Corporation. Mr. Wang has 31 years of managerial and accounting experience in the telecommunications industry in China.

Mr. Yung Shun Loy, Jacky

Age 43, is the Assistant Chief Financial Officer, qualified accountant and Joint Company Secretary of our Company. Mr. Yung is a fellow member of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants of United Kingdom. Mr. Yung is also a Certified Practising Accountant of Australia. Mr. Yung has nearly 20 years of experience in auditing, company secretary and senior financial management of listed companies.

Ms. Zhang Xiuqin

Age 59, is the Chairperson of our Supervisory Committee. Ms. Zhang is a Senior Accountant. Prior to joining China Telecom Group, Ms. Zhang served as a Director of the Systems Division of the Financial Department of the MPT, Director of the Department of Economic Adjustment and Communication Settlement of the MII, Director of the Communication Settlement Centre of the MII and General Manager of the Huaxin Posts and Telecommunications Economic Development Center. Ms. Zhang has served as Director of the Audit Department of our Company. Ms. Zhang has 37 years of operational and managerial experience in the telecommunications industry in China.

Ms. Zhu Lihao

Age 65, is an independent Supervisor on our Supervisory Committee. Ms. Zhu is a Senior Auditor and is a PRC registered accountant. She graduated from Engineering Economics Department of Beijing Mining College in 1963. Ms. Zhu served as a Deputy Director General and Director General of the Department of Industry and Communications of the National Audit Bureau of China, and the Director General of the Department of Foreign Affairs and Foreign-related Auditing of the Audit Bureau. Ms. Zhu has 43 years of experience in management and auditing.

Mr. Li Jian

Age 44, is a Supervisor on our Supervisory Committee. He is currently the Vice President of the Department of Diversified Business Management in China Telecommunications Corporation. He graduated from Beijing Radio and Television University in 1982 with a major in Accounting and obtained a Master degree in International Business Administration from Australian National University. Previously, he was the Director of Treasury Division of the Department of Finance of the Ministry of Posts and Telecommunications and served at China Telecommunications Corporation to take up the post of the Director of the Treasury Division and Assets Division, the Director of the General Affairs and Assets Division under the Department of Finance, the Chairman and President of China Telecom (Hong Kong) International Limited and the Managing Director of the Investor Relations Department of our Company. Mr. Li is an accountant and has 24 years of operational and management experience in the telecommunications industry.

Mr. Xu Cailiao

Age 42, is a Supervisor on our Supervisory Committee. He is currently a Director of the Corporate Strategic Department of our Company. He graduated from the School of Law of Peking University in 1987 and obtained a Master degree in Law. Previously, he was a Director of the State Commission for Economic Restructuring and the Managing Director of the Hong Kong branch of Irico Group etc. He was qualified to practise law in China in 1988. Mr. Xu is highly experienced in respect of corporate governance, organizational development and process management.

Mr. Ma Yuzhu

Age 52, is an Employee Representative Supervisor on our Supervisory Committee. He is currently a Director of the Corporate Culture Department of our Company and the Vice Chairman of the Trade Union of China Telecommunications Corporation. Mr. Ma graduated in 1982 from the Beijing Institute of Posts and Telecommunications with a majoring in telecommunications. Mr. Ma studied part- time in Australian National University in 2000 and obtained a Master degree in International Business Administration in 2001. Mr. Ma previously worked as Director General in China Communications Construction No. 1 engineering bureau, Director of the department of General Engineering of DGT. Mr. Ma is a senior Engineer and has over 30 years of telecommunications construction and operational management experience in the telecommunications industry.

REPORT OF THE DIRECTORS

The Board of Directors (the "Board") of China Telecom Corporation Limited (the "Company") is pleased to present its report together with the audited financial statements of the Company and its subsidiaries (the "Group") prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2005.

PRINCIPAL BUSINESSES

The principal businesses of the Group are: provision of comprehensive wireline telecommunications and other relevant services, including local telephone, domestic long distance telephone, international long distance telephone, Internet and managed data, leased line and other related services to its subscribers within the service area of the Group. The principal business of the Company is investment holding.

RESULTS

Results of the Group for the year ended 31 December 2005 and the financial position of the Company and the Group as at that date are set out in the audited financial statements on pages 74 to 122 in this annual report.

DIVIDEND

The Directors propose to declare a final dividend in the amount equivalent to HK$0.075 per share, totaling approximately RMB6,315 million for the year ended 31 December 2005. The dividend proposal will be submitted for consideration at the Annual General Meeting to be held on 23 May 2006. Dividends will be denominated and declared in Renminbi. Dividends on domestic shares will be paid in Renminbi and dividends on H shares will be paid in Hong Kong dollars. The relevant exchange rate will be the mean of the average rate of Renminbi to Hong Kong dollars as announced by the People's Bank of China for the week prior to the date of declaration of dividends by the Annual General Meeting. The final dividends are expected to be paid around 15 June 2006 after its approval by the Annual General Meeting.

ISSUE OF SHORT TERM COMMERCIAL PAPER BY THE COMPANY

Pursuant to the resolution passed at the Extraordinary General Meeting held on 18 October 2005, the Company may, before the date on which the annual general meeting of the Company for the year ended 31 December 2005 is held, issue short term commercial paper, in one or more tranches, with a maximum outstanding repayment amount of RMB30 billion.

On 25 October 2005, the Company successfully issued short term commercial paper in the nominal amount of RMB10 billion, due in 6 months with an annual interest rate of 2.54%. The short term commercial paper was issued through a book-building and centralised placing process in the PRC inter-bank debenture market on a discounted basis. All the proceeds from this issue of short term commercial paper will be used to satisfy the Company's funding needs of production and operation. The Company considers that the issue of short term commercial paper will enable it to lower its finance costs, to diversify its capital-raising channels and to improve its market image.

DIRECTORS AND SENIOR MANAGEMENT OF THE COMPANY

The following table sets out certain information concerning the directors and senior management of the Company as at the date of this Report:

Name	Age	Position in the Company	Date of Appointment
Wang Xiaochu	48	Chairman and Chief Executive Officer	20 December 2004
Leng Rongquan	57	Executive Director, President and Chief Operational Officer	20 December 2004
Wu Andi	51	Executive Director, Executive Vice President and Chief Financial Officer	10 September 2002
Zhang Jiping	50	Executive Director and Executive Vice President	10 September 2002
Huang Wenlin	52	Executive Director and Executive Vice President	10 September 2002
Li Ping	52	Executive Director, Executive Vice President and Joint Company Secretary	10 September 2002
Wei Leping	60	Executive Director	10 September 2002
Yang Jie	44	Executive Director and Executive Vice President	20 October 2004
Sun Kangmin	49	Executive Director and Executive Vice President	20 October 2004
Li Jinming	54	Non-executive Director	20 December 2004
Zhang Youcai	65	Independent Non-executive Director	10 September 2002
Lo Hong Sui, Vincent	58	Independent Non-executive Director	10 September 2002
Shi Wanpeng	69	Independent Non-executive Director	20 June 2003
Xu Erming	56	Independent Non-executive Director	9 September 2005
Tse Hau Yin, Aloysius	58	Independent Non-executive Director	9 September 2005
Wang Qi	51	Controller	10 September 2002
Yung Shun Loy, Jacky	43	Assistant Chief Financial Officer, Qualified Accountant and Joint Company Secretary	1 February 2005

On 9 September 2005, the office term of the First Session of the Board of Directors of the Company expired, and Mr. Cheng Xiyuan and Mr. Feng Xiong ceased to be the executive directors of the Company. On 9 September 2005, all members of the First Session of the Board of Directors, except Mr. Cheng Xiyuan and Mr. Feng Xiong, were reappointed as members of the Second Session of the Board of Directors pursuant to a resolution passed at the Extraordinary General Meeting. The meeting also elected Mr. Xu Erming and Mr. Tse Hau Yin, Aloysius as independent non-executive directors of the Company.

On 22 March 2006, Mr. Wei Leping has resigned from the position of executive vice president of the Company, and proposed to resign from the position of executive director, which will be effective after approval in 2005 Annual General Meeting.

REPORT OF THE DIRECTORS *(continued)*

The following table sets out certain information concerning the senior management of the Company's subsidiaries at the provincial level as at the date of this Report:

Name	Age	Position in the Company's subsidiaries at the provincial level	Date of Appointment
Zhang Weihua	45	Chairman of Shanghai Telecom Company Limited	9 December 2005
Wang Wei	41	General Manager of Shanghai Telecom Company Limited	20 October 2004
Feng Xiong	60	Chairman and General Manager of Guangdong Telecom Company Limited	28 September 2002
Sun Jiuming	59	Chairman and General Manager of Jiangsu Telecom Company Limited	19 October 2002
Zhang Xinjian	50	Chairman and General Manager of Zhejiang Telecom Company Limited	2 March 2005
Tao Ping	48	Chairman and General Manager of Anhui Telecom Company Limited	14 February 2006
Liu Yaoming	54	Chairman and General Manager of Fujian Telecom Company Limited	19 August 2003
Ke Ruiwen	42	Chairman and General Manager of Jiangxi Telecom Company Limited	12 September 2003
Zhao Qiang	46	Chairman and General Manager of Guangxi Telecom Company Limited	7 September 2005
Zou Bingxuan	56	Chairman and General Manager of Chongqing Telecom Company Limited	19 August 2003
Liu Hongjian	45	Chairman and General Manager of Sichuan Telecom Company Limited	4 June 2004
Liao Renbin	46	Chairman and General Manager of Hubei Telecom Company Limited	5 March 2004
Wen Huiguo	52	Chairman and General Manager of Hunan Telecom Company Limited	5 March 2004
Jin Dongbin	51	Chairman and General Manager of Hainan Telecom Company Limited	7 September 2005
Liao Kang	43	Chairman and General Manager of Guizhou Telecom Company Limited	5 March 2004
Li Hua	42	Chairman of Yunnan Telecom Company Limited	5 November 2005
		General Manager of Yunnan Telecom Company Limited	9 March 2005
Yin Yiping	46	Chairman of Shaanxi Telecom Company Limited	20 October 2005
		General Manager of Shaanxi Telecom Company Limited	3 March 2005
En Guangli	58	Chairman and General Manager of Gansu Telecom Company Limited	5 March 2004
Yang Jianqing	45	Chairman and General Manager of Qinghai Telecom Company Limited	5 March 2004
Ma Linfeng	50	Chairman and General Manager of Ningxia Telecom Company Limited	5 March 2004
Gao Tongqing	42	Chairman and General Manager of Xinjiang Telecom Company Limited	5 March 2004

In September 2005, Zhao Qiang was appointed as the Chairman and the General Manager of Guangxi Telecom Company Limited while Sun Junyan resigned from the position of the Chairman and the General Manager of Guangxi Telecom Company Limited.

In September 2005, Jin Dongbin was appointed as the Chairman and the General Manager of Hainan Telecom Company Limited while Wang Dan resigned from the position of the Chairman and the General Manager of Hainan Telecom Company Limited.

In October 2005, Yin Yiping was appointed as the Chairman of Shaanxi Telecom Company Limited while Zhou Shifu resigned from the position of the Chairman of Shaanxi Telecom Company Limited.

In November 2005, Li Hua was appointed as the Chairman of Yunnan Telecom Company Limited while Wu Yongquan resigned from the position of the Chairman of Yunnan Telecom Company Limited.

In December 2005, Zhang Weihua was appointed as the Chairman of Shanghai Telecom Company Limited while Cheng Xiyuan resigned from the position of the Chairman of Shanghai Telecom Company Limited.

In February 2006, Tao Ping was appointed as the Chairman and the General Manager of Anhui Telecom Company Limited while Zhang Jun'an resigned from the position of the Chairman and the General Manager of Anhui Telecom Company Limited.

SUPERVISORS OF THE COMPANY

The following table sets out certain information concerning the supervisors of the Company as at the date of this Report:

Name	Age	Position in the Company	Date of Appointment
Zhang Xiuqin	59	Chairperson of the Supervisory Committee	10 September 2002
Zhu Lihao	65	Independent Supervisor	10 September 2002
Li Jian	44	Supervisor	9 September 2005
Xu Cailiao	42	Supervisor	9 September 2005
Ma Yuzhu	52	Supervisor (Employee Representative)	9 September 2005

On 9 September 2005, the office term of the First Session of the Supervisory Committee of the Company expired, and Mr. Wang Huanhui, Mr. Li Jing and Mr. Xie Songguang ceased to be the supervisors of the Company. At the same time, Mr. Li Jian and Mr. Xu Cailiao were elected as supervisors pursuant to the resolution of the Company's extraordinary general meeting held on the same day, and Mr. Ma Yuzhu was elected as a supervisor (employee representative) in the employee representatives meeting.

SHARE CAPITAL

The share capital of the Company as at 31 December 2005 was RMB80,932,368,321, divided into 80,932,368,321 shares of RMB1.00 each. As at 31 December 2005, the share capital of the Company comprised:

Shares	**Number of shares as at 31 December 2005**	**Percentage of the total number of shares in issue as at 31 December 2005**
		(%)
Domestic shares (total):	67,054,958,321	82.85
Domestic shares held by:		
China Telecommunications Corporation	57,377,053,317	70.89
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653	6.94
Jiangsu Guoxin Investment Group Co., Ltd.	957,031,543	1.18
Zhejiang Financial Development Company	2,137,473,626	2.64
Fujian State-owned Assets Investment Holdings Co., Ltd.	969,317,182	1.20
Total number of H shares (including ADSs):	13,877,410,000	17.15
Total	80,932,368,321	100.00

MATERIAL INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2005, the interests or short position of persons who are entitled to exercise or control the exercise of 5% or more of the voting power at any of the Company's general meetings (excluding the Directors and Supervisors) in the shares and underlying shares of equity derivatives of the Company as recorded in the register required to be maintained under Section 336 of the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong) (the "SFO") are as follows:

Name of shareholder	Number of shares held	Type of shares	Percentage of the respective type of shares	Percentage of the total number of shares in issue	Capacity
			(%)	(%)	
China Telecommunications Corporation	57,377,053,317	Domestic shares	85.57	70.89	Beneficial owner
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653	Domestic shares	8.37	6.94	Beneficial owner
JPMorgan Chase & Co.	1,080,661,621	H shares	7.79	1.34	Beneficial owner; investment manager; custodian

Save as stated above, as at 31 December 2005, in the register required to be maintained under Section 336 of the SFO, no other persons were recorded to hold any interests or short positions in the shares or underlying shares of the equity derivatives of the Company.

DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, none of the directors and supervisors of the Company had any interests or short positions in the share, underlying shares of equity derivatives or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be maintained under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at 31 December 2005, the Company had not granted its Directors or Supervisors, or their respective spouses or children below the age of 18 any rights to subscribe for the shares or debentures of the Company or any of its associated corporations and none of them has ever exercised any such right to subscribe for shares or debentures.

PUBLIC FLOAT

As at the date of this Report, based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed public float under the Listing Rules and as agreed with The Stock Exchange of Hong Kong Limited.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

For the year ended 31 December 2005, no Director or Supervisor of the Company had any material interest, whether directly or indirectly, in any contract of significance entered into by the Company, any of its holding companies or subsidiaries or subsidiaries of the Company's holding company, apart from service contracts.

EMOLUMENTS OF THE DIRECTORS AND SUPERVISORS

Please refer to note 26 of the audited financial statements for details of the emoluments of the Directors and Supervisors of the Company in 2005.

PURCHASE, SALE AND REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any securities of the Company during the reporting period.

SUMMARY OF FINANCIAL INFORMATION

Please refer to pages 127 to 128 of this annual report for a summary of the operating results, assets and liabilities of the Group for each of the years in the five-year period ended 31 December 2005.

BANK LOANS AND OTHER BORROWINGS

Please refer to note 14 of the audited financial statements for details of bank loans and other borrowings of the Group.

CAPITALISED INTEREST

Please refer to note 24 of the audited financial statements for details of the Group's capitalised interest for the year ended 31 December 2005.

FIXED ASSETS

Please refer to note 4 of the audited financial statements for movements in the fixed assets of the Group for the year ended 31 December 2005.

TRUST DEPOSITS AND OVERDUE FIXED DEPOSITS

As at 31 December 2005, the Company did not have any trust deposit or any overdue fixed deposits with financial institutions or any other units.

RESERVES

Pursuant to Article 147 of the Company's articles of association (the "Articles of Association"), where the financial statements prepared in accordance with PRC accounting standards and regulations materially differ from those prepared in accordance with either International Financial Reporting Standards or those of the place outside the PRC where the Company's shares are listed, the distributable profit for the relevant accounting period shall be deemed to be the lesser of the amounts shown in those respective financial statements. Distributable reserves of the Company as at 31 December 2005, calculated on the above basis and before deducting the proposed final dividends for 2005, amounted to approximately RMB7,858 million.

In addition to the allocation to the statutory reserve funds, the Directors propose to make an allocation to a discretionary surplus reserve. The allocation proposal shall be submitted for consideration at the Annual General Meeting to be held on 23 May 2006.

Please refer to note 20 of the audited financial statements for details of the movements in the reserves of the Company and the Group for the year ended 31 December 2005.

DONATIONS

For the year ended 31 December 2005, the Group made charitable and other donations in a total amount of RMB21 million.

SUBSIDIARIES AND ASSOCIATED COMPANIES

Please refer to note 6 and note 7 of the audited financial statements for details of the Company's subsidiaries and the Group's interests in associated companies as at 31 December 2005.

CHANGES IN EQUITY

Please refer to the consolidated statement of changes in equity contained in the audited financial statements (page 78 of this annual report).

RETIREMENT BENEFITS

Please refer to note 34 of the audited financial statements for details of the retirement benefits provided by the Group.

STOCK APPRECIATION RIGHTS

Please refer to note 35 of the audited financial statements for details of the stock appreciation rights offered by the Company.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights in the Articles of Association requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2005, sales to the five largest customers of the Group represented an amount not exceeding 30% of the operating revenue of the Group.

For the year ended 31 December 2005, purchases from the five largest suppliers of the Group accounted for approximately 33.7% of the total annual purchases of the Group.

For the year ended 31 December 2005, purchases from the Group's largest supplier accounted for approximately 10.8% of the total annual purchases of the Group. The amount of the Group's annual purchase includes amount of equipment purchase, investments in infrastructure and pipeline, and amount payable for interconnection settlement.

So far as the Directors are aware, no director of the Company, their associates, or any person holding more than 5% of the issued share capital in the Company has any interests in such suppliers.

CONTINUING CONNECTED TRANSACTIONS

The following table sets out the amounts of continuing connected transactions of the Group during the year ended 31 December 2005:

Transaction	**Group**	**Annual Monetary cap for continuing connected transactions**
	(RMB millions)	(RMB millions)
Share of expenses for centralised services	275	800
Net expenses for interconnection settlement	542	N/A[1]
Provision of comprehensive services by China Telecommunications Corporation and its subsidiaries (the "China Telecom Group")	425	1,070
Provision of engineering services by China Telecom Group	6,411	8,327
Mutual leasing of properties	388	440
Provision of third party property sub-leasing by China Telecom Group	43	130
Provision of IT services by China Telecom Group	164	320
Provision of equipment procurement services by China Telecom Group	267	470
Provision of community services by China Telecom Group	2,632	3,410
Provision of ancillary telecommunications services by China Telecom Group	2,456	2,640

1 According to a waiver letter issued by The Stock Exchange of Hong Kong Limited on 18 May 2004, the Company is not required to set an annual monetary cap for the total amount under interconnection agreements.

Centralised Services Agreement

The Centralised Services Agreement was renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. The aggregate costs incurred by the Company and China Telecommunications Corporation for the provision of management services relating to the operation of the business support centre and the network management centre, the costs of headquarters and certain network support premises and related facilities (including labour costs, depreciation of equipment and premises, daily expenses, costs relating to maintenance and research) and certain large corporate customers of the headquarters of China Telecommunications Corporation, will be apportioned on a pro rata basis between the Company and China Telecommunications Corporation according to the revenues generated by each party. In relation to the use of the international telecommunications facilities, the Company and China Telecommunications Corporation have agreed to apportion the costs associated with operating such assets on a pro rata basis, according to the aggregate volume of the inbound international calls terminated by, and outbound international calls originated from, the Company and China Telecom Group, respectively.

The Company and China Telecommunications Corporation entered into a supplemental agreement in relation to the Centralised Services Agreement on 15 December, 2005, to amend the scope of the centralised services by including in the Centralised Services Agreement the management and operation services provided by the Company to China Telecommunications Corporation, and amended the Centralised Services Agreement to make it, in addition to being applicable to both parties, also applicable to the subsidiaries and branches of the parties as well as any entities controlled by them. Except for the abovementioned amendments, other material terms and conditions of the original Centralised Services Agreement remain unchanged.

Interconnection Agreement

Pursuant to the Interconnection Agreement, the telephone operator terminating a telephone call made to its local assess network shall be entitled to receive from the operator from which the telephone call originated a fee prescribed by the MII from time to time, which is currently RMB0.06 per minute.

Comprehensive Services Framework Agreement

The Comprehensive Services Framework Agreement was renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. This Agreement governs the terms and conditions of transactions between them on two levels: (i) between the Group and certain associates held by China Telecommunications Corporation as long-term investments; and (ii) between the Group and certain subsidiaries of China Telecommunications Corporation operating in other provinces (the "Provincial Subsisting Companies"). Such transactions include procurement of telecommunications equipment such as optic fiber, network designs, software upgrade, system integration, manufacture of calling cards and so on. Prices under such agreement should be determined in accordance with the government-prescribed prices. In the absence of the government-prescribed prices, the government-guided prices (if any) shall apply. In the absence of both government-prescribed prices and government-guided prices, the market prices shall apply, i.e., the prices at which the same type of services are provided by independent third party in the ordinary course of business. If none of such prices is applicable, the prices shall be determined through consultation between the parties based on reasonable costs plus reasonable profit. For this purpose, "reasonable costs" shall mean the costs determined by the parties after negotiations.

REPORT OF THE DIRECTORS *(continued)*

In December 2005, the following agreements were renewed by each of Shanghai Telecom Company Limited, Guangdong Telecom Company Limited, Jiangsu Telecom Company Limited, Zhejiang Telecom Company Limited, Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited, Sichuan Telecom Company Limited, Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited, Xinjiang Telecom Company Limited under the Company (the "Twenty Provincial Telecom Companies") and the Provincial Subsisting Companies in their respective service region.

Property Leasing Framework Agreements

The Property Leasing Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Twenty Provincial Telecom Companies under the Company lease properties from the Provincial Subsisting Companies for use as business premises, offices, equipment storage facilities and sites for network equipment. On the other hand, the Twenty Provincial Telecom Companies also lease certain properties to the Provincial Subsisting Companies. The rent shall be determined based on the market price with reference to the standard set forth by local pricing authorities.

Property Sub-Leasing Framework Agreements

The Property Sub-Leasing Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies sub-lease certain properties owned and leased by independent third parties to the Twenty Provincial Telecom Companies under the Group for use as offices, retail outlets, spare parts storage facilities and sites for network equipment. The rent for sub-leasing of third party property shall be determined based on the market price as agreed between the relevant Provincial Subsisting Company and relevant third party through arm's length negotiation.

IT Services Framework Agreements

The IT Services Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies may participate in the bidding for the right to provide the Twenty Provincial Telecom Companies with certain information technology services, such as office automation and software upgrade. The charges payable for such IT services shall be determined by reference to market rates or as determined by prices obtained through the tender process.

Equipment Procurement Services Framework Agreements

The Equipment Procurement Services Framework Agreements were renewed on 15 December 2005, and may be renewed for further periods of one year upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies have agreed to provide comprehensive procurement services, including management of tenders, verification of technical specifications and installation services. The maximum commission for such procurement services shall be calculated based on the following: (1) not more than 1% of the contract value for procurement of imported telecommunications equipment; or (2) not more than 3% of the contract value for the procurement of domestic telecommunications equipment and other domestic non-telecommunications materials.

Engineering Framework Agreements

The Engineering Framework Agreements will expire on 31 December 2006, and may be renewed for further periods of three years upon expiration. These agreements set out provisions in respect of the supervision and management of services relating to construction, design, and equipment installation and tests provided to the Twenty Provincial Telecom Companies by the Provincial Subsisting Companies through bidding, and/or services as the general contractors for the construction and supervision of engineering projects of the Twenty Provincial Telecom Companies. The charges payable for such engineering services shall be determined by reference to market rates as reflected by prices obtained through tender process.

Community Services Framework Agreements

The Community Services Framework Agreements will expire on 31 December 2006, and may be renewed for further periods of three years upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies will provide the Twenty Provincial Telecom Companies with services relating to culture, education, property management, vehicle service, medical care, hotel and conference service, community and sanitary service. The pricing terms for such services are the same as those for comprehensive services.

Ancillary Telecommunications Services Framework Agreements

The Ancillary Telecommunications Services Framework Agreements will expire on 31 December 2006, and may be renewed for further periods of three years upon expiration. Pursuant to such agreements, the Provincial Subsisting Companies agree to provide the Twenty Provincial Telecom Companies with certain repair and maintenance services, including maintenance of telecommunications equipment, fire equipment and telephone booths, as well as other customer services. The pricing terms for such services are the same as those for comprehensive services.

The independent non-executive directors have confirmed that all continuing connected transactions for the year ended 31 December 2005 to which the Group was a party:

1. had been entered into, and the agreements governing those transactions were entered into, by the Group in the ordinary and usual course of business;

2. had been entered into either:

   (i) on normal commercial terms; or

   (ii) where there was no available comparison to judge whether they are on normal commercial terms, on terms no less favourable than those available to or (if applicable) from independent third parties; and

3. had been entered into on terms that are fair and reasonable so far as the overall interests of the independent shareholders of the Company are concerned.

The independent non-executive directors have further confirmed that:

The values of continuing connected transactions entered into between the Group and its connected persons which are subject to annual caps have not exceeded their respective annual caps.

The auditors of the Group have reviewed the continuing connected transactions of the Group and have confirmed to the Directors that the transactions:

1. have received the approval of the Directors;

2. have been entered into in accordance with the pricing policies as stated in the relevant agreements;

3. have been entered into in accordance with the terms of the agreements governing such transactions; and the values of continuing connected transactions entered into between the Group and connected persons of the Group which are subject to annual caps have not exceeded their respective annual cap.

EMPLOYEES

As at 31 December 2005, the group has 244,867 employees illustrated as follows:

	Number of employees	**Percentage**
Management, finance and administration	38,975	15.92%
Sales and marketing	113,329	46.28%
Operations and maintenance	91,443	37.34%
Others	1,120	0.46%
Total	244,867	100%

As at 31 December 2005, the Group also had 97,090 staffs seconded by third parties.

The Company has implemented a short-term and long-term combined incentive scheme: the primary components of an employee's remuneration include basic salary, bonus based on performance, compensation based on seniority and stock appreciation rights (stock appreciation rights are exclusively for senior management and senior technological experts). In addition, the Company also emphasizes the importance of employee training and uses various means of training to improve the quality and capability of key employees.

COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES

Please see the "Corporate Governance Report" set out in page 54 of this 2005 annual report of the Company for details of our compliance with the Code on Corporate Governance Practices.

MATERIAL LEGAL PROCEEDINGS

As at 31 December 2005, as far as the Directors are aware of, the Company was not involved in any material litigation or arbitration and no material litigation claims were pending or threatened or made against the Company.

AUDITORS

KPMG and KPMG Huazhen were appointed as the international and domestic auditors of the Company for the year ended 31 December 2005. KPMG has audited the accompanying financial statements, which have been prepared in accordance with International Financial Reporting Standards. The Company has retained KPMG and KPMG Huazhen since the date of its listing. A resolution for the reappointment of KPMG and KPMG Huazhen as the international and domestic auditors of the Company for the year ending 31 December 2006 will be proposed at the annual general meeting of the Company to be held on 23 May 2006.

By Order of the Board
Wang Xiaochu
Chairman and Chief Executive Officer

Beijing, PRC
22 March 2006

REPORT OF THE SUPERVISORY COMMITTEE

Dear Shareholders,

In 2005, the Supervisory Committee of China Telecom Corporation Limited had spared no effort in performing its duties and earnestly safeguarding the interests of the shareholders and the benefits of the Company in accordance with the relevant laws and regulations of the PRC and the Articles of Association of the Company.

During the reporting period, the Supervisory Committee held three meetings. At the fifth meeting of the First Session of the Supervisory Committee held in March 2005, operating results and the Company's financial statements for 2004 had been reviewed. In addition, the First Session of the Supervisory Committee reviewed and approved five agenda items, including the financial statements, profit appropriation proposal and the independent auditors' report for the year ended 31 December 2004. At the sixth meeting of the First Session of the Supervisory Committee held in August of the same year, the interim financial statements and the independent auditors' review report of 2005 were reviewed, and a summary of the work of the First Session of the Supervisory Committee was made. The term for the First Session of the Supervisory Committee expired on 9 September 2005, and the work targets during the three-year period of office had been successfully achieved. Re-election for the Supervisory Committee was completed pursuant to the requirements of the *Company Law of PRC* and the Company's Articles of Association. At the first meeting of the Second Session of the Supervisory Committee held in September 2005, the resolution for the election of Ms. Zhang Xiuqin as the Chairman of the Second Session of the Supervisory Committee of China Telecom Corporation Limited was approved. During the reporting period, through attending the Annual General Meeting of the Company for 2004, the Extraordinary General Meetings and the meetings of the Board of Directors in 2005, members of the Supervisory Committee supervised the major decision-making processes of the Company and the performance of duties by the members of the Board of Directors and the senior management.

The Supervisory Committee is of the view that in 2005, the Company focused on corporate transformation and precision management, maintained growth at a fast pace and paid great attention to implementing corporate governance and preserving integrity of the businesses of the Company. It continued to intensify reform and strengthen its management capabilities, so that our services had grown steadily with greater cost-effectiveness and improvement in the value of the Company.

The Supervisory Committee believes that during 2005, all members of the Board of Directors and members of the senior management were dedicated, hard-working and prudent in their decision-making. They had strictly complied with the Listing Rules during work to protect the interests of the shareholders and to achieve admirable financial performance of the company.

Upon the review of the unqualified financial statements of the Company for the year ended 2005 and other relevant information which were prepared in accordance with PRC accounting rules and regulations and International Financial Reporting Standards, audited by external auditors of the Company and proposed to be submitted to the shareholders general meeting by the Board of Directors, the Supervisory Committee is of the opinion that the financial statements were prepared by adhering to the principle of consistency and that they truly and fairly reflect the Company's financial position and results of operations.

In 2006, guided by the Articles of Association of the Company and relevant regulatory requirements, the Supervisory Committee will further enhance its work procedures and do the utmost to perform its supervisory role with a view to preserving the interests of the Company and its shareholders.

By order of the Supervisory Committee
Zhang Xiuqin
Chairperson of the Supervisory Committee

Beijing, PRC
22 March 2006

CORPORATE GOVERNANCE REPORT

The Company has been attaching great importance to corporate governance. In 2005, we continued to make efforts in establishing and perfecting the Company's corporate governance guidelines in accordance with the relevant regulatory requirements and international best practice on corporate governance. By so doing, the Company's operation became more systematic, its management became more efficient and its operation became more rational, and the shareholders' interests as a whole were protected to the maximum degree. The Charters for Audit Committee and Remuneration Committee of the Company have been amended in March 2005 to reflect certain code provisions under Appendix 14 Code on Corporate Governance Practices of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the Listing Rules) which became effective from 1 January 2005. The roles of Chairman and Chief Executive Officer of the Company are performed by the same individual. Save as stated above, the Company is in compliance with all the code provisions as set out in Appendix 14 Code on Corporate Governance Practices of the Listing Rules throughout the year ended 31 December 2005.

1. OVERVIEW OF CORPORATE GOVERNANCE

Summary of corporate governance

As a company incorporated in China, the Company adopts the recently amended PRC Company Law and other related laws and regulations as the basic guidelines for the Company's corporate governance. As a company listed both in Hong Kong and the United States, we have always given special attention to the relevant regulatory requirements of where we are listed. The current Articles of Association have fully taken into consideration of the Listing Rules and its alignment and integration with the regulatory requirements for listed companies in the United States, and serve as a guidance for the Company to improve its foundation of corporate governance. The Company has made a further step to regularly release responsibilities statement in respect of internal control in accordance with the Sarbanes-Oxley Act of 2002 of the U.S., the regulatory requirements of the U.S. Securities and Exchange Commission and the New York Stock Exchange to confirm that the Company has complied with requirements of regulations in relation to financial reporting, information disclosure and corporate internal controls.

In 2005, the Company's efforts and achievement in corporate governance received recognition from authouritative institutions. In the list of winners in the selection for "Asia's Best Managed Companies 2005" by Euromoney, a well-known international financial magazine, the Company won the "The Best Managed Telecommunications Company in China" award; and in the list of winners for "2005 Asia Investor Relations Ranking" in Institutional Investors, a renowned international financial magazine, Mr. Wang Xiaochu, our Chairman and Chief Executive Officer, won "The Best CEO in China" award for 2005.

Chairman Wang Xiaochu awarded "The Best CEO in China" for 2005

China Telecom awarded "The Best Managed Telecommunications Company in China" for 2005

Overall structure for corporate governance

A double-tier structure has been adopted as our overall structure of corporate governance: the Board of Directors and the Supervisory Committee under the Shareholders' Meeting, and various committees under the Board of Directors. The Board of Directors is authorised by the Articles of Association to make major decisions for the Company's operations, and it also oversees the routine management by the senior management personnel. The Supervisory Committee is mainly responsible for the supervision of the performance of duties by the Board of Directors and the senior management personnel. Each of the Board of Directors and the Supervisory Committee is independently accountable to the Shareholders' Meeting.

2. OPERATION OF THE CORPORATE GOVERNANCE STRUCTURE

Shareholders' Meeting

In 2005, the Company convened three shareholders general meetings, including the Annual General Meeeting ("AGM") for 2004 and two Extraordinary General Meetings ("EGMs").

Annual General Meeting was held in Hong Kong on 25 May 2005

The AGM for 2004 held on 25 May 2005 mainly reviewed and approved the consolidated financial statements, Report of the Directors, Report of the Supervisory Committee, Report of the International Auditors, the annual profit distribution proposal for the year ended 31 December 2004 and the declaration of final dividends. It also approved the renewal of appointment of KPMG and KPMG Huazhen as our international auditors and domestic auditors respectively for the year ended 31 December 2005, and authorised the Board of Directors to determine the remuneration of the auditors. The AGM also approved the Charter for Supervisory Committee of China Telecom Corporation Limited.

At the EGM held on 9 September 2005, new sessions of the Board of Directors and Supervisory Committee were elected, and the Articles of Association of the Company were amended accordingly.

At the EGM held on 18 October 2005, it was approved that one or more tranches of short-term commercial paper can be issued by the Company prior to the AGM for the year ended 31 December 2005, with a maximum outstanding repayment amount of RMB30 billion.

At each of the shareholders general meetings, separate shareholders resolution is proposed in respect of each independent item, and details of the voting procedures and the right of voting by poll at the demand of shareholders are recorded in the circulars to shareholders in accordance with the Articles of Association and listing rules of the places of listing. The circulars to shareholders also provide details of the resolutions. Results of the voting are published in the newspapers and on the website of The Stock Exchange of Hong Kong Limited.

Board of Directors

The Company strictly complies with the Code on Corporate Governance Practices of the Listing Rules of The Stock Exchange of Hong Kong Limited and seriously regulates the operating procedures of the Board of Directors and the committees under it, and ensure that proceeding of the Board meetings are standardised in terms of organisation, regulations and personnel. The Board of Directors is responsible for supervision of the preparation of accounts for each financial period, so that such accounts truly and fairly reflect the financial position, the operating results and cash flows of the Company for each period. In preparing the accounts for the year ended 31 December 2005, the directors selected appropriate accounting policies and made judgments and estimates which were prudent, fair and reasonable, and prepared the accounts on going concern basis. A statement by the international auditors about their reporting responsibilities is included in the Report of the International Auditors on page 73.

Based on confirmation from the directors, all of the Company's directors have strictly complied with Appendix 10 Model Code for Securities Transaction by Directors of Listed Issuers of the Listing Rules regarding the standard requirements for directors in conducting securities transactions.

On 9 September 2005, re-election of the Board of Directors of the Company was conducted and gave birth to the second session of the Board of Directors consisting of 15 directors with 9 executive directors, 1 non-executive director, and 5 independent non-executive directors, each having a period of office of 3 years. Pursuant to the recommended best practices of the Code on Corporate Governance Practices of the Listing Rules, 2 additional independent non-executive directors were elected to the Board of Directors, making the number of independent non-executive directors equal to one third of the directors in the Board of Directors, which further reinforced the independence of the Board of Directors and ensured that the Board of Directors will be able to make independent judgments effectively. The Company has received annual independence confirmation from each of the independent non-executive directors, and considers them to be independent.

Members of the new sessions of the Audit Committee and the Remuneration Committee were also elected, and a Nomination Committee was newly established in order to assist the Board of Directors to work out a formal, prudent and transparent procedure for the appointment of directors, and plans for succession of directors. Mr. Tse Hau Yin, Aloysius, an independent non-executive director who was elected in the additional election as the chairman of the Audit Committee, is an internationally renowned financial expert and is very experienced in accounting and financial management.

In 2005, the Board of Directors was playing a more and more important role in matters such as operations of the Company, budgeting, decision-making, supervision, internal controls and corporate governance. In 2005, the Board of Directors convened ten meetings (including the committees under it). All the directors had an attendance rate of 100%. At the meetings, the Board of Directors reviewed matters such as the final accounts, assets valuation assessment report, issue of short-term commercial paper, proposal of financial budget for 2006, resolutions on extension of ongoing connected transactions, implementation plan for remuneration of directors, progress report on the establishment of the internal control system and evaluation arrangement etc. The Board of Directors also reviewed and approved certain fundamental systems in respect of corporate governance such as the *Code on Conducts and Ethics for Employees of China Telecom Corporation Limited* and the *Provisional Rules on Disclosure of China Telecom Corporation Limited*.

Attendance rate of individual directors (including attendance with written proxies) at Board meetings in 2005:

Number of Directors: 15

Executive Directors	Meetings for The First Session of the Board	Attendance Rate	Meetings for The Second Session of of the Board	Attendance Rate
Wang Xiaochu (Chairman)	3/3	100%	2/2	100%
Leng Rongquan	3/3	100%	2/2	100%
Wu Andi	3/3	100%	2/2	100%
Zhang Jiping	3/3	100%	2/2	100%
Huang Wenlin	3/3	100%	2/2	100%
Li Ping	3/3	100%	2/2	100%
Wei Leping	3/3	100%	2/2	100%
Yang Jie	3/3	100%	2/2	100%
Sun Kangmin	3/3	100%	2/2	100%
Cheng Xiyuan (First Session)	3/3	100%	N/A	N/A
Feng Xiong (First Session)	3/3	100%	N/A	N/A

Independent Non-Executive Directors	Meetings for The First Session of the Board	Attendance Rate	Meetings for The Second Session of the Board	Attendance Rate
Zhang Youcai	3/3	100%	2/2	100%
Lo Hong Sui, Vincent	3/3	100%	2/2	100%
Shi Wanpeng	3/3	100%	2/2	100%
Xu Erming (Second Session)	N/A	N/A	2/2	100%
Tse Hau Yin, Aloysius (Second Session)	N/A	N/A	2/2	100%

Non-Executive Directors	Meetings for The First Session of the Board	Attendance Rate	Meetings for The Second Session of the Board	Attendance Rate
Li Jinming	3/3	100%	2/2	100%

Besides, the Company was also committed to continuously expanding the communication channel for the independent directors. Internal audit department of the Company can report directly to the Audit Committee on matters of importance and be subject to their supervision. At the same time, there was a smooth communication channel between the Audit Committee and the external auditors. These enabled the independent directors to fully utilise their experience and capabilities in the aspects of the Company's operations, financial management and corporate governance etc.

The Company has always placed emphasis on the continuous training of directors and improving their understanding of regulatory rules. In 2005, the Company organised a series of training for directors on securities regulations such as the new PRC Company Law, updates of the Listing Rules and the Sarbanes-Oxley Act of 2002.

Committees under the Board

▲ **Audit Committee**

The Company set up an Audit Committee in 2002 with one chairman. In 2005, a new session of the Audit Committee was successfully elected. Pursuant to the recommended best practices of the Code on Corporate Governance Practices, the new Audit Committee comprises 4 members which was one more than the previous Audit Committee, and is formed entirely by independent non-executive directors, each having a period of office of 3 years. The Audit Committee will regularly report on its work to the Board of Directors. Usually, at least 3 regular meetings are held each year.

The Board of Directors approved the Charter for the Audit Committee in March 2005, which clearly defines the status, qualifications, work procedures, duties and responsibilities, funding and remuneration, etc. of the Audit Committee.

The Audit Committee's principal duties include the supervision on the truthfulness and completeness of the Company's financial statements, the effectiveness and completeness of the Company's internal controls and risk management system as well as the work of the Company's internal audit department. It is also responsible for the monitoring and review of the qualifications, selection and appointment, independence and services of external independent auditors. The Audit Committee has set up a reporting system to receive and handle cases of complaints or anonymous reports regarding the Company's accounting, internal control on accounting and auditing matters.

In 2005, the Audit Committee convened 3 meetings, where it mainly reviewed the 2004 audited financial statements, the 2005 interim financial statements, the extension of ongoing connected transactions and other related arrangements, and was debriefed about the establishment of the internal control system and assessment arrangements, and reviewed the reports by external auditors in relation to the annual audit plans and arrangements for 2005, reports on the internal audit, assessment of internal controls and the Company's risk management etc., and proposed practical and professional amelioration recommendations according to the actual situation of the Company.

Attendance rate of individual members of the 2005 Audit Committee (including attendance with written proxies):

Number of the Committee members
First Session: 3
Second Session: 4

Percentage of Independent Non-executive directors of the Committee: 100%

Member of the Committee	Meetings for the First Session of the Committee	Attendance Rate	Meetings for the Second Session of the Committee	Attendance Rate
Lo Hong Sui, Vincent (First Session)	2/2	100%	n/a	n/a
Shi Wanpeng	2/2	100%	1/1	100%
Zhang Youcai	2/2	100%	1/1	100%
Tse Hau Yin, Aloysius (Second Session)	n/a	n/a	1/1	100%
Xu Erming (Second Session)	n/a	n/a	1/1	100%

▲ **Remuneration Committee**

The Company established the Remuneration Committee in 2003 which was formed entirely by independent non-executive directors with one chairman. In 2005, the second session of the Remuneration Committee was successfully elected and the newly elected Remuneration Committee comprises 4 members, which was one more than the previous Remuneration Committee. Pursuant to the recommended best practices of the Code on Corporate Governance Practices, the new Remuneration Committee was formed entirely by independent non-executive directors, each having a period of office of 3 years. The Remuneration Committee regularly reports on its work to the Board of Directors and meets when necessary.

The Board of Directors approved the Charter for the Remuneration Committee in March 2005, which clearly defines the status, qualifications, work procedures, duties and responsibilities, funding and remuneration etc. of the Remuneration Committee.

The Remuneration Committee's principal duties include the supervision on the compliance of the Company's remuneration system with the legal requirements. It reports to the Board of Directors and submits to the Board of Directors remuneration evaluation report of the Company. It makes recommendations to the Board of Directors in respect of the overall remuneration policy and structure for the directors and senior management personnel and fully complies with the requirements of the Code on Corporate Governance Practices.

In 2005, the Remuneration Committee convened two meetings, where it mainly approved the Charter for the Remuneration Committee, reviewed and approved the Remuneration Implementation Proposal of the Second Session of the Board of Directors and also recommended the Board of Directors to approve such proposal. In considering the remuneration proposals of the member of the Remuneration Committee, each member declared his personal interest and abstained from his right of voting accordingly.

Attendance rate of individual members of the Remuneration Committee (including with written proxies) in 2005:

Number of the Committee members
First Session: 3
Second Session: 4

Percentage of Independent Non-executive directors of the Committee: 100%

Member of the Committee	Meetings for the First Session of the Committee	Attendance Rate	Meetings for the Second Session of the Committee	Attendance Rate
Lo Hong Sui, Vincent	1/1	100%	1/1	100%
Shi Wanpeng	1/1	100%	1/1	100%
Zhang Youcai (First Session)	1/1	100%	n/a	n/a
Tse Hau Yin, Aloysius (Second Session)	n/a	n/a	1/1	100%
Xu Erming (Second Session)	n/a	n/a	1/1	100%

▲ **Nomination Committee**

Pursuant to the recommended best practices of the Code on Corporate Governance Practices, the Company established a Nomination Committee in September 2005 which comprised 4 members (Mr. Shi Wanpeng (Chairperson), Mr. Zhang Youcai, Mr. Xu Erming and Mr. Tse Hau Yin, Aloysius) in total with one chairman. It was formed entirely by independent non-executive directors, each having a period of office of 3 years. The Nomination Committee is accountable to and regularly reports on its work to the Board of Directors, and meets when necessary. No meeting was held in 2005.

The Board of Directors approved the Charter for the Nomination Committee in September 2005, which clearly defines the status, qualifications, work procedures, duties and responsibilities, funding and remuneration etc. of the Nomination Committee.

The principal duties of the Nomination Committee include: regularly reviews the structure, number of members and composition of the Board of Directors; identifies candidates for directors with the appropriate qualifications and advises the Board of Directors about this; evaluates the independence of independent non-executive directors; advises the Board of Directors on matters regarding the appointment or re-appointment of directors and the succession plan for directors (in particular the Chairman and Chief Executive Officer).

Supervisory Committee

The Company established its First Session of the Supervisory Committee in 2002 in accordance with the PRC Company Law. In September 2005, the Second Session of the Supervisory Committee was formed through election at the shareholders' general meeting. At present, the Supervisory Committee comprises 5 supervisors, of which there is an external supervisor and an employee representative supervisor. The Supervisory Committee is a standing supervisory organisation of the Company, which is accountable and reports to all shareholders. The Supervisory Committee holds meetings at least twice a year.

The principal duties of the Supervisory Committee consist of supervising, in accordance with the law, the Company's financial affairs and performance of directors, managers and other senior officers of the Company and prevent them from abusing their powers.

In order to further standardise the operation of the Supervisory Committee, at the 2004 Annual General Meeting held in May 2005, the Charter of the Supervisory Committee of China Telecom Corporation Limited was approved as a special resolution.

Attendance rate of individual members of the Supervisory Committee in 2005

Number of supervisors: 5

Supervisors	Meetings for the first Session of the Committee	Attendance Rate	Meetings for the second Session of the Committee	Attendance Rate
Zhang Xiuqin (Chairperson)	2/2	100%	1/1	100%
Wang Huanhui (Employee Representative, First Session)	2/2	100%	n/a	n/a
Zhu Lihao (Independent Supervisor)	2/2	100%	1/1	100%
Xie Songguan (First Session)	2/2	100%	n/a	n/a
Li Jing (First Session)	2/2	100%	n/a	n/a
Ma Yuzhu (Employee Representative, Second Session)	n/a	n/a	1/1	100%
Li Jian (Second Session)	n/a	n/a	1/1	100%
Xu Cailiao (Second Session)	n/a	n/a	1/1	100%

External Auditors

The international and domestic auditors of the Company are KPMG and KPMG Huazhen respectively. In order to maintain its independence, the non-audit services provided by the auditors have not been in contravention to the requirements of the Sarbanes-Oxley Act of 2002 and have obtained pre-approval from the Audit Committee.

Breakdown of the remuneration received by the external auditors for audit and non-audit services for the Company during 2005 is as follows:

Subject of the service	**Fee for 2005** (RMB millions)
Audit services	45.76
Non-audit services (Internal Control Advisory Service)	3.73

The Audit Committee approved the re-appointment of KPMG and KPMG Huazhen as the international and domestic auditors of the Company for the year ending 31 December 2006, and the resolution has been agreed by the Board of Directors, and will be submitted to the shareholders general meeting for approval.

3. ESTABLISHMENT AND IMPLEMENTATION OF ANCILLARY MECHANISMS

Strengthening of the monitoring function of the Board

The Board of Directors leads and supervises the Company with a strong sense of responsibility. All the Directors are aware of the need to be objective, prudent in decision-making, highly efficient in operation for the overall interests of the Company and shareholders.

In order to strengthen the leadership and monitoring functions of the Board of Directors in respect of corporate governance, the Company adopts a number of measures to strengthen the monitoring function of the Board of Directors, thereby making it more standardised, institutionalised and systematic.

▲ *Clearly defining the duties between the Board of Directors and the Management*
The roles of Chairman and Chief Executive Officer of the Company are performed by the same person. The Board of Directors considers that this could enhance the Company's decision-making and operational efficiency, and enable the Company to grasp business opportunities effectively. Further, such arrangement is being adopted by many international leading enterprises. At the same time, the Company increased the number of independent non-executive directors to five, accounting for one-third of the total number of directors during the year. Such arrangement further strengthened the independence and objectivity of the decisions made by the Board of Directors and provide full and impartial supervision over the Company's management, with a view to ensuring shareholders' best interests.

The Articles of Association clearly define the respective terms of reference of the Board of Directors and the Management. Major decision-making for operation, financial proposals and policies, formulation of the basic management system of the Company and the establishment of the Company's internal administrative institutions and sub-institutions shall be determined by the Board of Directors, whereas the Management is responsible for the operation and management of the Company, and organises and implements resolutions of the Board of Directors and the annual operation plans and investment proposals of the Company, and performs such other duties authorised by the Articles of Association and the Board of Directors.

In order to keep the highly efficient operation and the flexibility and swiftness of operational decision-making, the Board of Directors, when necessary, may delegate its managing and administrative powers to the Management, and provide clear guidance regarding such delegation so as to avoid seriously impeding or undermining the overall capacities of the Board of Directors in exercising of its powers.

Establishment of the internal control system

In order to meet the regulatory requirements of the listing places such as the U.S. and Hong Kong and strengthen the internal controls of the Company and guard against operational risks of the Company, the Company launched the establishment of the "Internal Control System over Financial Reporting" in August 2003. Over more than two years, the Company has formulated the *Manual on Internal Control over Financial Reporting and its Implementing Rules* in accordance with the requirements of the U.S. securities regulatory authorities and the COSO internal control framework. They are implemented after a certain period of trial to ensure that the financial statements are true and reliable and will meet the need of internal governance and the requirements of the capital market.

In 2005, the Company, in accordance with authorisation by the Board of Directors, speeded up the establishment of the internal control mechanism and improved a series of internal control measures, including the *Internal Control Manual of China Telecom Corporation Limited (2005) the Limits of Authority Lists,* the *Provisional Administrative Measures of Internal Control of China Telecom Corporation Limited* and the *Provisional Measures for Evaluation of Internal Control over Financial Reporting of China Telecom Corporation Limited.*

In respect of the control environment, in order to strengthen the corporate governance of the Company and standardise the operations of the Board of Directors and to increase the Company's transparency, we have also formulated the *Provisional Rules on Information Disclosure of China Telecom Corporation Limited*, the *Administrative Measures on Contracts of China Telecom corporation Limited*, the *Code of Ethics for Senior officers of China Telecom corporation Limited* and the *Code of Conduct and Ethics for Employees of China Telecom Corporation Limited*.

In order to meet the requirements of Public Company Accounting Oversight Board Auditing Standards No. 2 of the U.S. in respect of the requirements for internal control mechanisms of listed companies on the information system relating to financial reporting, the Company fully launched the internal control improvement for its information system in the end of 2005, and based on the earlier efforts, to standardise its information system according to the internal control requirements to ensure that the internal control system relating to financial reporting can be more complete.

In accordance with requirements of the Listing Rules, in February 2005, the Company engaged Mr. Yung Shun Loy, Jacky, who is a professional highly experienced in auditing of listed companies, company secretary and financial management, and an international qualified accountant to act as the assistant chief financial officer and joint company secretary of the Company. As a qualified accountant of the Company, he also helps improving the financial reporting procedures and its internal control mechanism.

In strict compliance with the *Sarbanes-Oxley Act of 2002* and related regulatory requirements, the Company has established and improved its internal complaining mechanism. The website of the Company publishes the correspondence addresses and telephone numbers for making complaints and encourages anonymous reporting on the contravention by employees of the Company, in particular, its directors and senior management.

In 2005, the internal control system of the Company is further standardised and scientised. The Board of Directors and the Management placed much emphasis on the improvement of internal control system, and results of the improvement of the internal control system were recognised by the Board of Directors, which has laid a sound foundation for the further improvement of the Company's internal control system in 2006.

Summary of the Significant Ways in which the Corporate Governance Practices of the Company differ from those followed by Domestic Companies under NYSE Listing Standards

The Company was established in the PRC and is listed on The Stock Exchange of Hong Kong Limited ("Stock Exchange") and the New York Stock Exchange ("NYSE"). As a foreign private issuer, the Company is not required to comply with all the corporate governance rules of Section 303A of the NYSE Listed Company Manual. However, the Company is required to disclose the significant ways in which the corporate governance practices of the Company differ from those followed by domestic companies under NYSE listing standards.

Under currently applicable PRC and Hong Kong laws and regulations, the Board of Directors of the Company is not required to be formed by independent directors in majority. Since we are listed on the Stock Exchange, the Company will need to comply with the Listing Rules. These rules require that at least 3 independent directors shall be on the board of directors of a listed company. The Board of Directors of the Company comprises 15 directors, of which 5 are independent directors. These independent directors satisfy the requirements on "independence" under both the Listing Rules and Section 303A.02 of the Listed Company Manual of NYSE.

Pursuant to the currently applicable PRC and Hong Kong laws and regulations, the Company is not required to formulate any rules for corporate governance; therefore the Company has not formulated any separate corporate governance rules. However, the Company complies with the Code on Corporate Governance Practices of the Stock Exchange.

Risk management mechanism

In order to further improve our internal control and reduce corporate risks, the Company has recently commenced a comprehensive research on risk management in accordance with the COSO framework and the requirements on risk management and corporate internal control set out by the Stock Exchange, and has introduced the idea of comprehensive risk management, so as to improve the risk management system step by step.

Pursuant to the framework of *Guidance for Comprehensive Risk Management of Corporations under Central Government*, regulations of the places of listing and requirements for corporate internal controls, the Company will, based on the actual situation, further strengthen, standardise and improve the corporate risk management mechanism.

The Company has had good foundation of internal control. However, the Company will continue to improve and upgrade its risk management system, and gradually apply such to the ordinary and daily course of business and view the upgrading of risk management as a continuous work.

Information disclosure mechanism

The Board of Directors approved the *Provisional Rules on Information Disclosure of China Telecom Corporation Limited* and the *Internal Responsibility Statement System (Provisional) of China Telecom Corporation Limited* and other related mechanisms to form our information disclosure management system.

The Company attaches great importance to high transparency for information, and the Board of Directors insists on the active communication with its investors, and in particular communicates with shareholders at the AGM and other shareholders general meetings and encourages their participation. To encourage and facilitate shareholders, in particular

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public shareholders to actively attend shareholders general meeting and meanwhile improve the direct exchange and communication between the Board of Directors and shareholders, since the AGM in 2004, the AGM began to be held in Hong Kong, which changed the tradition of holding AGM in Beijing. In 2005, we began to disclose our key operating data and certain financial data on a quarterly basis and in 2006, we began to disclose the number of subscribers on monthly basis. The Company also establishes and maintains a smooth channel for exchange of information by way of our annual reports, interim reports and other information disclosure methods. It also endeavours to continue to improve the channel and methods of communication with shareholders and increase the transparency for corporate information. In addition, the Company creates many channels such as meeting with investment analysts, feedback road shows, news release and telephone conference with investors to provide them with important information and to respond to significant issues which are the concerns of investors recently. These moves help them to better understand the operations of the Company and the overall development of the telecommunication industry. The Company has established an investor service centre both in Beijing and in Hong Kong serving investors specially in the aspects of reception and information disclosure, so as to maintain its normal communication with shareholders, investors and the media.

The overall remuneration package and long-term incentive mechanism
By making references to the remuneration level in the market, the Company's remuneration system gradually converges with the market. The Company strengthens the performance management and reasonably determines the remuneration level, and further reinforces its incentives and constraint mechanism.

Remuneration of the executive directors balances both short-term and long-term incentives. It takes into account effects such as the scale of the corporation, the remuneration standard at large and also fully demonstrates the principle that remuneration should be linked to performance and the system of awards and penalty. It also strengthens the executive directors' sense for long-term development to avoid activities for short-term behavior.

Remuneration of independent directors makes reference to the standards of independent directors' remuneration in both the domestic and international companies, and be adjusted according to changes in remuneration of the market.

In order to better encourage our staff to create more value for the Company, the shareholders meeting held in September 2002 approved the stock appreciation scheme for the senior management that links the remuneration of the senior management with the Company's future results and the performance of the H shares.

HUMAN RESOURCES DEVELOPMENT

In 2005, efforts the Company made in respect of its human resources revolved around corporate transformation, guided by the philosophy that talents make a company prosperous and the people – oriented philosophy. Taking the route of transforming our teams and system, we explored new human resources management mechanisms in emerging business areas. We speeded up the reform of our labour force, personnel matters and remuneration system. We made obvious achievement in the control of the scale of workforce, structure optimisation, capability enhancement and energy buildup.

In order to establish a system of human resources management which focuses on qualities of human resources, in 2005, the Company commenced its study on the quality model. We worked with international well-known consulting groups to create staff quality dictionary consisting of groups from 9 position groups and 28 quality items. The establishment of the quality model has laid a sound foundation for the standardisation, personalised development and optimisation of human resources allocation.

The company has attached great importance to identifying, honoring and training people who have excellent performance and good potentials of development. In 2005, 206 outstanding employees were selected by the Company as outstanding workers of the Group, and were showered with ceremonious honor through many ways. Also, we have come up with proposals for assembling our working teams with the best people. We continued to make great effort in promoting their career development, and improving "Double Channels" system where the positions of management and positions of special technology can develop side-by-side. Based on position groups and quality model, we started career development design for each position group in detail.

In 2005, the Company also refined our remuneration system so that it will better match the track of our employee's career development. Also, the remuneration package of our employees is more closely linked to the Company's overall performance as well as their own performance. We controlled more strictly our personnel cost, and established a resources allocation model for labor costs so that on the one hand it will ensure that the overall costs be under control, and on the other hand, the allocation of labor costs have now become more scientific and rationalised.

Employees were participating in the training for "China Telecom E-University"

In 2005, the Company continued its investment in the training of employees, thereby achieving a win-win situation where the competitive strengths of both the Company and the employees were enhanced. Through the year, 200,000 employees in companies of all levels had participated in various training programs for more than 40 hours, representing 81.6% of all the employees, of which there were 25,000 management employees and 175,000 professional employees joining various training programs. The total person-time for training was 890,000 person-times, and the total length of training time was 1,630,000 person-days. Average time employees spent in training are 8.1 working days. In order to enhance the level of corporate management, the Company cooperated with well-know universities both in China and overseas in training our middle and high level management. We have also fully leveraged our corporate strengths and established China Telecom E-University so that our employees all over the country may register for the learning and training at any time. In 2005, 230,000 of our employees have participated in online learning, and average number of hours spent in the online learning was 37.8. China Telecom E-University has now become an effective platform for our staff to acquire more knowledge and improve their skills for their positions. This has become more and more important in the training of our staff and has effectively reduced our training costs.

CORPORATE SOCIAL RESPONSIBILITY

As a telecommunication corporation with an established history of development, China Telecom Corporation Limited has been making consistent efforts in providing the general public with convenient and efficient telecommunication and information services. In 2005, the Company proposed the idea of transforming from a traditional wireline network provider to a "integrated information service provider". In doing so, we strived to expand the channels where the public may obtain and exchange information, speeded up the informatisation of the society and improved the living standards of the people by integration of services with the information terminals as well as their respective innovation, with an aim that in turn benefits the Company in achieving a sustainable and healthy development.

As a corporate citizen, the Company always bears in mind of fulfilling its social responsibility by participating in public welfare businesses while pursuing its business development. In 2005, the Company continued to take part in helping the poor and subsidising the local construction in the Yanyuan and Muli of Sichuan Province. By making investment to improve the local infrastructure and providing training for the expertise, we succeeded in improving the living conditions, from both the material or spiritual perspectives, of the local citizens. After the South Asia Tsunami, both the Company and the entities under its control, based on the spirit of humanitarianism, actively made donations to the affected nations through many channels so as to help those disaster victims to rebuild their homes as well as their communities. In order to support education in China and help offer equal education opportunity to the under-privileged, the Company provided funding to the unschooled and the disabled children and participated in the construction of "School of Hope" in order to help improving the conditions of the schools. In 2005, the Company lent a helping hand to sponsor the "International Scheme for the Youth of China to Start up Businesses", which will help them on their way to successful business ventures.

The Company makes an active effort in promoting scientific research. In 2005, we sponsored the convening of the ITC, a remarkable and highly authoritative international event in the field of the IT research and application in connection with the global telecommunication and internet, as a way to show our support to the researchers in their hard work to explore and keep track with the development of the state-of-the-art technology in the telecommunication industry.

Emergency repair team was providing emergency telecommunications services to customers

The Company places high importance in maintaining a healthy living environment for the people and always applies the environmental protection ideas and measures during the course of construction of the telecommunications projects. In selecting telecommunication equipment, we meticulously select those optic fibre cables and transmission systems that are noiseless and would not produce electromagnetic radiations or pollutants. When carrying out the field works on tracking of the communication routes, we deliberately avoid from carrying out those works at the mines, forests, grasslands, wide animals, natural heritages, human relic, natural reserves and famous scenic landscapes, etc. When laying down the optic fibre cables, we normally adopt the drilling techniques so that cables can directly pass through any obstacles without having to change the surrounding environment. The Company is enthusiastic in promoting environmental protection. In 2005, we invested and took part in the project of constructing the landscaping belt around the peripheral Three Gorges Dam areas as a way to make contribution towards the protection of the land and water along the Yangtze River.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the annual general meeting of China Telecom Corporation Limited (the "Company") for the year ended 2005 will be held at 11:00 am on 23 May 2006 in the Ballroom, Level 3, JW Marriott Hotel Hong Kong, Pacific Place, 88 Queensway, Hong Kong to consider and, if thought fit, pass the following businesses:

ORDINARY RESOLUTIONS

1. **THAT** the consolidated financial statements of the Company, the report of the Board of Directors, the report of the Supervisory Committee and the report of the international auditors for the year ended 31 December 2005 be considered and approved, and the Board of Directors be authorised to prepare the budget of the Company for year 2006;

2. **THAT** the profit distribution proposal and the declaration and payment of a final dividend for the year ended 31 December 2005 be considered and approved;

3. **THAT** the reappointment of KPMG and KPMG Huazhen as the international auditors and domestic auditors of the Company respectively for the year ending 31 December 2006 be considered and approved, and the Board of Directors of the Company be authorised to fix the remuneration of the auditors;

4. **THAT** Mr. Wei Leping's resignation from the position as an executive director of the Company be considered and approved; and

to consider and approve other businesses (if any).

And as special business, to consider and, if thought fit, pass the following as special resolutions:

SPECIAL RESOLUTIONS

5. **THAT** the issue of short-term commercial paper by the Board of Directors be considered, approved, confirmed and ratified.

   (1) **THAT** the Company's issue of short-term commercial paper before end of October 2006 pursuant to *The Notice of the People's Bank of China on the Issue of Short-term Commercial Paper by China Telecom Corporation Limited* (Yin Fa [2005] No. 286) and based on the need of the Company and the market conditions, and with a maximum outstanding repayment amount of RMB30 billion be approved; **THAT** the Company's issue of short-term commercial paper, in one or more tranches, from end of October 2006 to the day before the date on which the annual general meeting of the Company for the year ending 31 December 2006 is held, and with a maximum outstanding repayment amount of RMB40 billion be approved (the "Issue").

   (2) **THAT** the board of directors of the Company (the "Board") or any two or more directors of the Company (the "Directors") duly authorised by the Board, taking into consideration the specific needs of the Company and other market conditions, be and are hereby generally and unconditionally authorised to:

      (a) determine the specific terms, conditions and other matters of the Issue (including, but not limited to, the determination of the actual aggregate amount, interest rate, rating, guarantee arrangements and use of proceeds of the Issue);

      (b) do all such acts which are necessary and incidental to the Issue (including, but not limited to, the securing of approvals, the determination of underwriting arrangements and the preparation of relevant application documents); and

      (c) take all such steps which are necessary for the purposes of executing the Issue (including, but not limited to, the execution of all requisite documentation and the disclosure of relevant information in accordance with applicable laws),

   and to the extent that any of the aforementioned acts and steps have already been undertaken by the Board or the Directors in connection with the Issue, such acts and steps be hereby approved, confirmed and ratified.

6. "**THAT**:

(a) subject to paragraph (c) below, the exercise by the board of directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to allot, issue and deal with additional shares of the company ("Shares") and to make or grant offers, agreements and options which might require the exercise of such powers be hereby generally and unconditionally approved;

(b) the approval in paragraph (a) shall authorise the board of directors of the Company during the Relevant Period to make or grant offers, agreements and options which might require the exercise of such powers after the end of the Relevant Period;

(c) the amount of additional domestic Shares or overseas-listed foreign invested shares ("H Shares") (as the case may be) allotted, issued and dealt with or agreed conditionally or unconditionally to be allotted, issued and dealt with either separately or concurrently once every twelve months by the board of directors of the Company pursuant to the approval in paragraph (a), otherwise than pursuant to (i) a Rights Issue (as hereinafter defined) or (ii) any scrip dividend or similar arrangement providing for the allotment of Shares in lieu of the whole or part of a dividend on Shares in accordance with the articles of association of the Company shall not exceed 20% of each of the Company's existing domestic Shares and H Shares (as the case may be) in issue at the date of passing this special resolution; and

(d) for the purpose of this special resolution 6:

"Relevant Period" means the period from the passing of special resolution 6 until the earliest of:

(i) the conclusion of the next annual general meeting of the Company;

(ii) the expiration of the 12 months period following the passing of these special resolutions; and

(iii) the revocation or variation of the authority given to the board of directors of the Company under these special resolutions by a special resolution of the Company's shareholders in general meeting.

"Rights Issue" means an offer of shares open for a period fixed by the board of directors of the Company to holders of Shares on the register of members on a fixed record date in proportion of their then holdings of such Shares (subject to such exclusion or other arrangements as the board of directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any legal or practical restrictions or obligations under the laws of, or the requirement of, any recognised regulatory body or any stock exchange in any territory applicable to the Company) and an offer, allotment or issue of shares by way of rights shall be construed accordingly."

7. "**THAT** the board of directors of the Company be authorised to increase the registered capital of the Company to reflect the issue of shares in the Company authorised under special resolution 6, and to make such appropriate and necessary amendments to the articles of association of the Company as they think fit to reflect such increases in the registered capital of the Company and to take any other action and complete any formality required to effect such increase of the registered capital of the Company."

By Order of the Board
Li Ping **Yung Shun Loy, Jacky**
Joint Company Secretaries

Beijing, PRC
3 April 2006

NOTICE OF ANNUAL GENERAL MEETING *(continued)*

Notes:

(1) Mr. Wei Leping proposed to retire from his position as executive director of the Company, which will be effective after approval in the annual general meeting.

(2) Buyers who submit the share transfer application forms to the Company's share registrar before 4:00 pm on 21 April 2006 and then register as shareholders on the register of members of the Company are entitled to attend the annual general meeting.

(3) Each shareholder entitled to attend and vote at the annual general meeting may appoint one or more proxies to attend and vote on his behalf at the annual general meeting. A proxy need not be a shareholder. Each shareholder who wishes to appoint one or more proxies should first review the annual report of the Company for the year 2005, which is expected to be despatched to shareholders around 4 April 2006.

(4) To be valid, the form of proxy together with the power of attorney or other authorisation document (if any) signed by the authorised person or notarially certified power of attorney must be delivered to the Office of the Board of the Company for holders of domestic shares and to the Computershare Hong Kong Investor Services Limited for holders of H shares not less than 24 hours before the designated time for the holding of the annual general meeting. Completion and return of a form of proxy will not preclude a shareholder from attending in person and voting at the annual general meeting if he so wishes.

The address of the share registrar for the Company's H shares is as follows:

Computershare Hong Kong Investor Services Limited
46th Floor, Hopewell Centre,
183 Queen's Road East,
Wanchai, Hong Kong

(5) A proxy of a shareholder may vote by hand or vote on a poll, but a proxy of a shareholder who has appointed more than one proxy may only vote on a poll.

(6) The registration procedure for attending the annual general meeting:

(a) shareholders attending the annual general meeting in person or by proxy shall present their identity certification. If the attending shareholder is a corporation, its legal representative or person authorised by the board or other decision making authority shall present a copy of the relevant resolution of the board or other decision making authority in order to attend the annual general meeting.

(b) shareholders intending to attend the annual general meeting shall return the attendance slip via hand delivery, mail or fax to the Office of the Board of the Company on or before 2 May 2006.

(7) Closure of the register of members:

The register of members of the Company will be closed from 24 April 2006 to 23 May 2006 (both days inclusive).

(8) The annual general meeting is expected to last for half a day and shareholders (in person or by proxy) attending the annual general meeting shall be responsible for their own transport and accommodation expenses.

(9) The address of the Office of the Board is as follows:

31 Jinrong Street
Xicheng District, Beijing 100032
PRC

Contact person:	Li Ping	Yung Shun Loy, Jacky
Telephone:	(8610) 6642 8166	
Facsimile:	(8610) 6601 0728	

REPORT OF THE INTERNATIONAL AUDITORS

To the Shareholders of
China Telecom Corporation Limited
(Incorporated in The People's Republic of China with limited liability)

We have audited the financial statements on pages 74 to 122 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants

Hong Kong, China
22 March 2006

CONSOLIDATED BALANCE SHEET

at 31 December 2005
(Amounts in millions)

	Note	2005 RMB	2004 RMB
ASSETS			
Non-current assets			
Property, plant and equipment, net	4	**328,281**	320,179
Construction in progress	5	**23,567**	29,450
Lease prepayments		**5,117**	4,830
Interests in associates	7	**548**	511
Other investments	8	**182**	200
Deferred tax assets	9	**10,885**	10,805
Other assets	18	**11,893**	13,063
Total non-current assets		**380,473**	379,038
Current assets			
Inventories	10	**2,702**	2,767
Accounts receivable, net	11	**16,142**	13,921
Prepayments and other current assets	12	**2,406**	3,064
Time deposits with maturity over three months		**292**	315
Cash and cash equivalents	13	**15,121**	13,465
Total current assets		**36,663**	33,532
Total assets		**417,136**	412,570
LIABILITIES AND EQUITY			
Current liabilities			
Short-term debt	14	**76,005**	65,976
Current portion of long-term debt	14	**8,963**	11,842
Accounts payable	15	**33,949**	33,658
Accrued expenses and other payables	16	**26,885**	27,531
Income tax payable		**2,108**	1,192
Current portion of finance lease obligations	17	**108**	156
Current portion of deferred revenues	18	**8,958**	11,589
Total current liabilities		**156,976**	151,944
Net current liabilities		**(120,313)**	(118,412)
Total assets less current liabilities		**260,160**	260,626
Non-current liabilities			
Long-term debt	14	**55,777**	72,366
Finance lease obligations	17	**52**	157
Deferred revenues	18	**18,750**	25,182
Deferred tax liabilities	9	**2,620**	2,302
Total non-current liabilities		**77,199**	100,007
Total liabilities		**234,175**	251,951

The notes on pages 81 to 122 form part of these financial statements.

at 31 December 2005
(Amounts in millions)

	Note	**2005 RMB**	2004 RMB
Equity			
Share capital	19	**80,932**	80,932
Reserves	20	**100,585**	78,274
Total equity attributable to equity holders of the Company		**181,517**	159,206
Minority interests	3(i)	**1,444**	1,413
Total equity		**182,961**	160,619
Total liabilities and equity		**417,136**	412,570

Approved and authorised for issue by the Board of Directors on 22 March 2006.

Wang Xiaochu	**Leng Rongquan**	**Wu Andi**
Chairman and Chief Executive Officer	*Executive Director, President and Chief Operating Officer*	*Executive Director, Executive Vice President and Chief Financial Officer*

The notes on pages 81 to 122 form part of these financial statements.

BALANCE SHEET

at 31 December 2005
(Amounts in millions)

	Note	2005 RMB	2004 RMB (Note 3(iii))
ASSETS			
Non-current assets			
Property, plant and equipment, net	4	**348**	351
Construction in progress	5	**156**	73
Investments in subsidiaries	6	**165,926**	168,714
Other assets		**31**	37
Total non-current assets		**166,461**	169,175
Current assets			
Accounts receivable, net	11	**18**	5
Prepayments and other current assets	12	**51,738**	2,519
Cash and cash equivalents	13	**4,139**	3,682
Income tax recoverable		**–**	3
Total current assets		**55,895**	6,209
Total assets		**222,356**	175,384
LIABILITIES AND EQUITY			
Current liabilities			
Short-term debt	14	**9,917**	–
Accounts payable	15	**74**	17
Accrued expenses and other payables	16	**719**	2,324
Income tax payable		**576**	–
Total current liabilities		**11,286**	2,341
Net current assets		**44,609**	3,868
Total assets less current liabilities		**211,070**	173,043
Non-current liabilities			
Long-term debt	14	**40,150**	50,150
Total liabilities		**51,436**	52,491
Equity			
Share capital	19	**80,932**	80,932
Reserves	20	**89,988**	41,961
Total equity		**170,920**	122,893
Total liabilities and equity		**222,356**	175,384

Approved and authorised for issue by the Board of Directors on 22 March 2006.

Wang Xiaochu	**Leng Rongquan**	**Wu Andi**
Chairman and Chief Executive Officer	*Executive Director, President and Chief Operating Officer*	*Executive Director, Executive Vice President and Chief Financial Officer*

The notes on pages 81 to 122 form part of these financial statements.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2005
(Amounts in millions, except per share data)

	Note	2005 RMB	2004 RMB
Operating revenues	21	**169,310**	161,212
Operating expenses			
Depreciation and amortisation		**(49,652)**	(47,170)
Network operations and support		**(47,793)**	(43,070)
Selling, general and administrative		**(27,393)**	(27,003)
Other operating expenses	22	**(5,518)**	(4,139)
Total operating expenses	23	**(130,356)**	(121,382)
Operating profit		**38,954**	39,830
Deficit on revaluation of property, plant and equipment	4	**–**	(1,262)
Net finance costs	24	**(4,895)**	(5,340)
Investment (loss)/income		**(7)**	6
Share of profit from associates		**62**	29
Profit before taxation		**34,114**	33,263
Income tax	25	**(6,160)**	(5,187)
Profit for the year		**27,954**	28,076
Attributable to:			
Equity holders of the Company		**27,912**	28,023
Minority interests	3(i)	**42**	53
Profit for the year		**27,954**	28,076
Basic earnings per share	30	**0.34**	0.36
Weighted average number of shares	30	**80,932**	78,840

The notes on pages 81 to 122 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2005
(Amounts in millions)

		Attributable to equity holders of the Company										
	Note	Share capital RMB	Capital reserve RMB	Share premium RMB	Re-valuation reserve RMB	Surplus reserves RMB	Statutory common welfare fund RMB	Other reserves RMB	Retained earnings RMB	Total RMB	(Note 3(i)) Minority interests RMB	Total equity RMB
Balance as at 1 January 2004		75,614	6,567	3,362	6,424	15,461	3,372	24,246	15,748	150,794	1,269	152,063
Net income recognised directly in equity:												
Revaluation surplus of property, plant and equipment	4	–	–	–	1,233	–	–	–	–	1,233	–	1,233
Deferred tax on revaluation surplus of property, plant and equipment	9	–	–	–	–	–	–	(378)	–	(378)	–	(378)
Effect of change in tax rate	9	–	–	–	–	–	–	(244)	–	(244)	–	(244)
Revaluation surplus realised		–	–	–	(72)	–	–	–	72	–	–	–
Deferred tax on land use rights realised		–	–	–	–	–	–	(165)	165	–	–	–
		–	–	–	1,161	–	–	(787)	237	611	–	611
Profit for the year		–	–	–	–	–	–	–	28,023	28,023	53	28,076
Total recognised income and expenses		–	–	–	1,161	–	–	(787)	28,260	28,634	53	28,687
Issue of shares, net of issuing expenses of RMB294 million		5,318	–	7,384	–	–	–	–	–	12,702	–	12,702
Contributions from minority interests		–	–	–	–	–	–	–	–	–	91	91
Contributions from China Telecom		–	–	–	–	–	–	–	100	100	–	100
Transfer from retained earnings to other reserves		–	–	–	–	–	–	2,653	(2,653)	–	–	–
Consideration for the acquisition of the Second Acquired Group	1	–	–	–	–	–	–	(27,800)	–	(27,800)	–	(27,800)
Transfer from other reserves to capital reserve		–	(9,371)	–	–	–	–	9,371	–	–	–	–
Appropriations	20	–	–	–	–	10,168	2,421	–	(12,589)	–	–	–
Dividends		–	–	–	–	–	–	–	(5,224)	(5,224)	–	(5,224)
Balance as at 31 December 2004		80,932	(2,804)	10,746	7,585	25,629	5,793	7,683	23,642	159,206	1,413	160,619
Net income recognised directly in equity:												
Effect of change in tax rate	9	–	–	–	–	–	–	(5)	–	(5)	–	(5)
Revaluation surplus realised		–	–	–	(134)	–	–	–	134	–	–	–
Deferred tax on revaluation surplus of property, plant and equipment realised		–	–	–	–	–	–	12	(12)	–	–	–
Deferred tax on land use rights realised		–	–	–	–	–	–	(189)	189	–	–	–
		–	–	–	(134)	–	–	(182)	311	(5)	–	(5)
Profit for the year		–	–	–	–	–	–	–	27,912	27,912	42	27,954
Total recognised income and expenses		–	–	–	(134)	–	–	(182)	28,223	27,907	42	27,949
Contributions from minority interests		–	–	–	–	–	–	–	–	–	12	12
Distributions to minority interests		–	–	–	–	–	–	–	–	–	(23)	(23)
Appropriations	20	–	–	–	–	9,509	1,285	–	(10,794)	–	–	–
Dividends	29	–	–	–	–	–	–	–	(5,596)	(5,596)	–	(5,596)
Balance as at 31 December 2005		80,932	(2,804)	10,746	7,451	35,138	7,078	7,501	35,475	181,517	1,444	182,961

The notes on pages 81 to 122 form part of these financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW

for the year ended 31 December 2005
(Amounts in millions)

	Note	2005 RMB	2004 RMB
Net cash from operating activities	(a)	**68,359**	66,078
Cash flows from investing activities			
Capital expenditure		**(52,083)**	(56,446)
Purchase of investments		**–**	(42)
Lease prepayments		**(386)**	(444)
Proceeds from disposal of investments		**–**	42
Proceeds from disposal of property, plant and equipment		**552**	379
Purchase of time deposits with maturity over three months		**(292)**	(325)
Maturity of time deposits with maturity over three months		**315**	483
Net cash used in investing activities		**(51,894)**	(56,353)
Cash flows from financing activities			
Proceeds from issue of shares, net of issuing expenses		**–**	12,702
Capital element of finance lease payments		**(156)**	(50)
Proceeds from bank and other loans		**95,538**	77,120
Repayments of bank and other loans		**(94,584)**	(81,070)
Repayment of amount due to China Telecom in connection with the First Acquisition		**(10,000)**	–
Payment of dividends		**(5,596)**	(5,224)
Net cash (distributions to)/contributions from minority interests		**(11)**	91
Cash payment for the acquisition of the Second Acquired Group		**–**	(12,650)
Cash contributions from China Telecom		**–**	100
Net cash used in financing activities		**(14,809)**	(8,981)
Net increase in cash and cash equivalents		**1,656**	744
Cash and cash equivalents at 1 January		**13,456**	12,721
Cash and cash equivalents at 31 December		**15,121**	13,465

The notes on pages 81 to 122 form part of these financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW *(continued)*

for the year ended 31 December 2005
(Amounts in millions)

(a) Reconciliation of profit before taxation to net cash from operating activities

	2005 RMB	2004 RMB
Profit before taxation	**34,114**	33,263
Adjustments for:		
Depreciation and amortisation	**49,652**	47,170
Deficit on revaluation of property, plant and equipment	**–**	1,262
Impairment losses for bad and doubtful debts	**1,274**	1,121
Investment loss/(income)	**7**	(6)
Share of profit from associates	**(62)**	(29)
Interest income	**(243)**	(231)
Interest expense	**5,701**	5,367
Unrealised foreign exchange (gains)/losses	**(390)**	152
Loss on retirement and disposal of property, plant and equipment	**1,741**	873
Impairment losses on property, plant and equipment	**163**	88
Operating profit before changes in working capital	**91,957**	89,030
Increase in accounts receivable	**(3,495)**	(2,091)
Decrease in inventories	**65**	486
Decrease in prepayments and other current assets	**483**	481
Decrease in other non-current assets	**806**	297
(Decrease)/increase in accounts payable	**(253)**	55
(Decrease)/increase in accrued expenses and other payables	**(637)**	1,517
Decrease in deferred revenues	**(9,063)**	(9,830)
Cash generated from operations	**79,863**	79,945
Interest received	**243**	231
Interest paid	**(6,772)**	(6,824)
Investment income received	**36**	43
Income tax paid	**(5,011)**	(7,317)
Net cash from operating activities	**68,359**	66,078

The notes on pages 81 to 122 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION

Principal activities

China Telecom Corporation Limited (the "Company") and its subsidiaries (hereinafter, collectively referred to as the "Group") are engaged in the provision of wireline telecommunications and related services in Shanghai Municipality, Guangdong Province, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality, Sichuan Province, Hubei Province, Hunan Province, Hainan Province, Guizhou Province, Yunnan Province, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region of the People's Republic of China (the "PRC"). The Group offers a comprehensive range of wireline telecommunications services to residential and business customers, including local, domestic long distance ("DLD") and international long distance ("ILD") telephone services, Internet and managed data, leased line, and other related services.

The operations of the Group are subject to the supervision and regulation by the PRC government. The Ministry of Information Industry, pursuant to the authority delegated to it by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations, including the regulation and setting of tariff levels for basic telecommunications services, such as local and long distance telephone services, managed data services, leased line and interconnection arrangements.

Organisation

China Telecommunications Corporation ("China Telecom" and together with its subsidiaries other than the Company referred to as "China Telecom Group") is a state-owned enterprise which is under the supervision and regulation of the Ministry of Information Industry. In November 2001, pursuant to an industry restructuring plan approved by the State Council, China Telecom's wireline telecommunications networks and related operations in 10 northern provinces, municipalities and autonomous regions of the PRC were transferred to China Netcom Group. China Telecom retained the wireline telecommunications networks and related operations of 21 provinces, municipalities and autonomous regions of the PRC, including those of the Company's subsidiaries. In accordance with this industry restructuring plan, China Telecom and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibers.

As part of an reorganisation (the "Restructing") of China Telecom, the Company was incorporated in the PRC on 10 September, 2002. In connection with the Restructuring, China Telecom transferred to the Company the wireline telecommunications business and related operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province together with the related assets and liabilities (the "Predecessor Operations") in consideration for 68,317 million ordinary domestic shares of the Company. The shares issued to China Telecom have a par value of RMB1.00 each and represented the entire registered and issued share capital of the Company of that date.

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 15 December 2003, the Company acquired the entire equity interests in Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited (collectively the "First Acquired Group") and certain network management and research and development facilities from China Telecom for a total purchase price of RMB46,000 million on 31 December 2003 (hereinafter, referred to as the "First Acquisition"). The purchase price consisted of a cash payment of RMB11,000 million and a long-term payable of RMB35,000 million (see Note 14).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION *(continued)*

Organisation *(continued)*

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 9 June 2004, the Company acquired the entire equity interests in Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited (collectively the "Second Acquired Group") from China Telecom for a total purchase price of RMB27,800 million on 30 June 2004 (hereinafter, referred to as the "Second Acquisition"). The purchase price consisted of a cash payment of RMB8,340 million and a long-term payable of RMB19,460 million. On 30 June 2004, the Company repaid RMB4,310 million of this payable amount using the net proceeds from issue of new H shares in May 2004 (see Note 14).

Basis of presentation

Since the Company, the First Acquired Group and the Second Acquired Group (the "Acquired Groups") were under the common control of China Telecom, the First Acquisition and the Second Acquisition (the "Acquisitions") have been reflected in the accompanying consolidated financial statements as a combination of entities under common control in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the Acquired Groups have been accounted for at historical amounts and the consolidated financial statements of the Company prior to the Acquisitions have been restated to include the results of operations and assets and liabilities of the Acquired Groups on a combined basis. The considerations paid by the Company for the acquisition of the Acquired Groups have been accounted for as equity transactions in the consolidated statement of changes in equity.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board ("IASB"). IFRS includes International Accounting Standards ("IAS") and interpretations. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

These financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment (Note 4). The accounting policies described below have been consistently applied by the Group, except those disclosed in Note 3.

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgement made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in future financial periods are described in Note 37.

(b) Basis of consolidation

The consolidated financial statements comprise the Company and its subsidiaries and the Group's interests in associates. A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The financial results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases, and the profit attributable to minority interests is separately presented on the face of the consolidated income statement as an allocation of the profit or loss for the year between the minority interests and the equity holders of the Company. Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and consolidated statement of changes in equity within equity, separately from equity attributable to the equity holders of the Company.

An associate is an entity, not being a subsidiary, in which the Group exercises significant influence, but not control, over its management. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

An investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the Group's equity share of the post-acquisition results of the associate.

All significant intercompany balances and transactions and any unrealised gains arising from intercompany transactions are eliminated on consolidation. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(c) Translation of foreign currencies

The functional and presentation currency of the Group is Renminbi ("RMB"). Foreign currency transactions during the year are translated into RMB at the applicable rates of exchange quoted by the People's Bank of China ("PBOC rates") prevailing on the transaction dates. Foreign currency monetary assets and liabilities are translated into RMB at the applicable PBOC rates at the balance sheet date.

Exchange differences, other than those capitalised as construction in progress, are recognised as income or expense in the consolidated income statement. For the periods presented, no exchange differences were capitalised.

(d) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and time deposits with original maturities of three months or less when purchased. Cash equivalents are stated at cost, which approximates fair value. None of the Group's cash and cash equivalents is restricted as to withdrawal.

(e) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (Note 2(l)).

(f) Inventories

Inventories consist of materials and supplies used in maintaining the wireline telecommunications network and goods for resale. Materials and supplies are valued at cost using the first in, first out method, less a provision for obsolescence.

Inventories that are held for resale are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

(g) Property, plant and equipment

Property, plant and equipment are initially recorded at cost, less subsequent accumulated depreciation and impairment losses (Note 2(l)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to working condition and location for its intended use and the cost of borrowed funds used during the periods of construction. Expenditure incurred after the asset has been put into operation, including cost of replacing part of such an item, is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment and the cost can be measured reliably. All other expenditure, including the cost of repairs and maintenance, is expensed as it is incurred.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Property, plant and equipment *(continued)*

Subsequent to the revaluation as described in (Note 4), property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation, less subsequent accumulated depreciation and impairment losses. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. The separate classes into which the Company groups assets for the revaluation are buildings and improvements; telecommunications network plant and transmission and switching equipment; and furniture, fixture, motor vehicles and other equipment. When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is revalued simultaneously. When an asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to equity under the component of revaluation reserve. However, a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense in the consolidated income statement. However, a revaluation decrease is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Revaluations are performed annually on items which experience significant and volatile movements in fair value while items which experience insignificant movements in fair value are revalued every three years.

Assets acquired under leasing agreements which effectively transfer substantially all the risks and benefits incidental to ownership from the lessor to the lessee are classified as assets under finance leases. Assets held under finance leases are initially recorded at amounts equivalent to the present value of the minimum lease payments (computed using the rate of interest implicit in the lease) which approximate the fair value at the inception of the lease. The net present value of the future minimum lease payments is recorded correspondingly as a finance lease obligation. Assets held under finance leases are amortised over their estimated useful lives on a straight-line basis. As at 31 December 2005, the carrying amount of assets held under finance leases was RMB272 million (2004: RMB314 million).

Gains or losses arising from retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the consolidated income statement on the date of disposal. On disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings.

Depreciation is provided to write off the cost/revalued amount of each asset over its estimated useful life on a straight-line basis, after taking into account its estimated residual value, as follows:

	Depreciable lives primarily range from
Buildings and improvements	8 to 30 years
Telecommunications network plant, transmission and switching equipment	6 to 10 years
Furniture, fixture, motor vehicles and other equipment	4 to 10 years

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Property, plant and equipment *(continued)*

Where parts of an item of property, plant and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value are reviewed annually.

(h) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's land bureau. Land use rights are carried at cost less accumulated amortisation and impairment losses (Note 2(l)). Amortisation is provided to write off the cost of lease prepayments on a straight-line basis over the respective periods of the rights which range from 20 years to 70 years.

(i) Construction in progress

Construction in progress represents buildings, telecommunications network plant, transmission and switching equipment and other equipment under construction and pending installation, and is stated at cost less impairment losses (Note 2(l)). The cost of an item comprises direct costs of construction, interest charges, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the periods of construction. Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

(j) Investments in subsidiaries

In the Company's stand-alone balance sheet, investments in subsidiaries are stated at cost less impairment losses (Note 2(l)).

(k) Other investments

Investments in non-marketable equity securities are stated at cost less impairment losses (Note 2(l)).

(l) Impairment

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

Investments in non-marketable equity securities and trade and other receivables are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If such evidence exists, the impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material, and is recognised as an expense in the consolidated income statement. Impairment losses for trade and other receivables are reversed through profit and loss if in a subsequent period the amount of the impairment losses decreases. Impairment losses for equity securities are not reversed.

For the years ended 31 December 2004 and 2005, no impairment loss was made for investments in non-marketable securities. For the year ended 31 December 2005, impairment losses for trade and other receivables of RMB1,274 million (2004: RMB1,121 million) were recognised.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(l) Impairment *(continued)*

(ii) Impairment of other assets

The carrying amounts of the Group's long-lived assets, including property, plant and equipment and lease prepayments are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised as an expense in the consolidated income statement. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the assets are discounted to their present value. For the year ended 31 December 2005, a provision for impairment loss of RMB163 million (2004: RMB88 million) was made against the carrying value of certain outdated telecommunications service equipment.

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist. An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognised as an income in the consolidated income statement. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred. For the years presented, no reversal of impairment loss was recognised in the consolidated income statement.

(m) Revenue recognition

The Group's revenues are principally derived from the provision of local, domestic long distance ("DLD") and international long distance ("ILD") telephone services which consist of (i) usage charges for telephone services, which vary depending on the day, the time of day, distance and duration of the telephone call, (ii) a monthly telephone service fee, (iii) service activation and installation fees, and (iv) charges for value-added services, such as caller ID services, short messaging services, telephone information services and ring tone services. The Group records wireline service revenues over the periods they are earned as follows:

(i) Revenues derived from local, DLD and ILD telephone usage are recognised as the services are provided.

(ii) Upfront fees received for activation of wireline services and wireline installation charges are deferred and recognised over the expected customer relationship period. The related direct incremental customer acquisition costs are deferred to the extent of the upfront fees and are amortised over the same expected customer relationship period.

(iii) Monthly telephone service fees are recognised in the month during which the telephone services are provided to customers.

(iv) Revenues from sale of prepaid calling cards are recognised as the cards are used by customers.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(m) Revenue recognition *(continued)*

(v) Revenues derived from value-added services are recognised when the services are provided to customers.

Other related wireline telecommunications service revenues are recognised as follows:

(i) Revenues from the provision of Internet and managed data services are recognised when the services are provided to customers.

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

(iii) Lease income from operating leases is recognised over the term of the lease.

(iv) Sale of customer-end equipment is recognised on delivery of the equipment to customers and when the significant risks and rewards of ownership and title have been transferred to the customers.

(n) Advertising and promotion expense

The costs for advertising and promoting the Group's wireline telecommunications services are expensed as incurred. Advertising and promotion expense, which is included in selling, general and administrative expenses, was RMB9,417 million for the year ended 31 December 2005 (2004: RMB8,701 million).

(o) Net finance costs

Net finance costs comprise interest income on bank deposits, interest expense on borrowings, and foreign exchange gains and losses. Interest income from bank deposits is recognised as it accrues using the effective interest method.

Interest costs incurred in connection with borrowings, calculated using the effective interest method, are expensed as incurred, except to the extent that they are capitalised as being directly attributable to the construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

(p) Research and development expense

Research and development expenditure is expensed as incurred. For the year ended 31 December 2005, research and development expense was RMB261 million (2004: RMB172 million).

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(q) Employee benefits

The Group's contributions to defined contribution retirement plans administered by the PRC government are recognised as an expense in the consolidated income statement as incurred. Further information is set out in Note 34.

Compensation under the Group's stock appreciation rights scheme is measured as the amount by which the quoted market price of the Company's H shares exceeds the exercise price. Compensation expense in respect of the stock appreciation rights granted is accrued as a charge to the income statement over the applicable vesting period based on the fair value of the stock appreciation rights. The liability of the accrued compensation expense is re-measured to fair value at each balance sheet date with the effect of changes in the fair value of the liability is charged or credited to the income statement. Further details of the Group's stock appreciation rights scheme are set out in Note 35.

(r) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in income statement over the period of the borrowings using the effective interest method.

(s) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(t) Provisions and contingent liabilities

A provision is recognised in the consolidated balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

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

(u) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is calculated on the taxable income for the year by applying the applicable tax rates. Deferred tax is provided using the balance sheet liability method, providing for all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax is calculated on the basis of the enacted tax rates that are expected to apply in the period when the asset is realised or the liability is settled. The effect on deferred tax of any changes in tax rates is charged or credited to the consolidated income statement, except for the effect of a change in tax rate on the carrying amount of deferred tax assets and liabilities which were previously charged or credited directly to equity upon initial recognition, in such case the effect of a change in tax rate is also charged or credited to equity. A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(v) Dividends

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

(w) Segmental reporting

A business segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments. For the periods presented, the Group has one operating segment which is the provision of wireline telecommunications services. All of the Group's operating activities are carried out in the PRC.

3. CHANGES IN ACCOUNTING POLICIES, FINANCIAL STATEMENT PRESENTATION AND DISCLOSURES

The IASB has issued a number of new and revised IFRS and Interpretations that are effective for accounting periods beginning on or after 1 January 2005. The Group has adopted these new and revised IFRS in the preparation of the Group's financial statements for the year ended 31 December 2005. The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (Note 38).

The accounting policies of the Group after the adoption of these new and revised IFRS have been summarised in Note 2. The following sets out further information on the changes in accounting policies, financial statement presentation and disclosures for the annual accounting period beginning on 1 January 2005 which have been reflected in these financial statements.

(i) Minority interests (IAS 1 "Presentation of financial statements" and IAS 27 "Consolidated and separate financial statements")

In prior years, minority interests at the balance sheet date were presented in the Group's consolidated balance sheet separately from liabilities and equity. Minority interests in the results of the Group for the year were also separately presented in the Group's consolidated income statement as deduction before arriving at the profit attributable to shareholders.

With effect from 1 January 2005, in order to comply with IAS 1 and IAS 27, minority interests at the balance sheet date are presented in the Group's consolidated balance sheet within equity, separately from the equity attributable to the equity holders of the Company, and minority interests in the results of the Group for the period are presented on the face of the Group's consolidated income statement as an allocation of the total profit or loss for the period between the minority interests and the equity holders of the Company.

The presentation of minority interests in the Group's consolidated balance sheet, the Group's consolidated income statement and the Group's consolidated statement of changes in equity for the comparative period has been restated accordingly.

3. CHANGES IN ACCOUNTING POLICIES, FINANCIAL STATEMENT PRESENTATION AND DISCLOSURES *(continued)*

(ii) Related party disclosures (IAS 24 "Related party disclosures")

The Group is a state-owned enterprise and operates in an economic regime currently predominated by state-owned enterprises. Apart from transactions with parent company and its affiliates, the Group conducts certain business activities with enterprises directly or indirectly owned or controlled by the PRC government and government authorities and affiliates (collectively "state-owned entities") in the ordinary course of business. In prior years, transactions with state-owned entities other than China Telecom and its affiliates were not required to be disclosed as related party transactions.

With effect from 1 January 2005, in order to comply with IAS 24, the Group has made further disclosure of key management personnel compensation, contributions to post-retirement benefit plans and transactions with state-owned entities in the PRC. Numeric disclosure of certain related party transactions described in Note 33 for the comparative period has been made accordingly.

(iii) Accounting for investments in subsidiaries (IAS 27 "Consolidated and separate financial statements")

In prior years, investments in subsidiaries are accounted for using the equity method in the Company's stand-alone balance sheet.

With effect from 1 January 2005, in order to comply with IAS 27, investments in subsidiaries are accounted for using the cost method. Investments in subsidiaries and reserve balances in the Company's stand-alone balance sheet for the comparative period have been restated accordingly.

The following table discloses the adjustments that have been made in accordance with IAS 27 to each of the line items in the Company's balance sheet as previously reported as at 31 December 2004. The effect of such change on reserve balances as at 1 January 2004 and 2005 are disclosed in Note 20.

	2004 (as previously reported) RMB millions	**Effect on new policy (decrease in net assets)** RMB millions	**2004 (as restated)** RMB millions
Investments in subsidiaries	205,027	(36,313)	168,714
Reserves	78,274	(36,313)	41,961

Management considers that it is impractical to provide an estimate of the extent to which investments in subsidiaries and reserve balances in the Company's balance sheet as at 31 December 2005 is higher or lower than it would have been had the previous accounting policy still been applied in the year because management has sole discretion to determine the dividends to be declared from subsidiaries to the Company which would affect the carrying value of investments in subsidiaries under the equity method.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

4. PROPERTY, PLANT AND EQUIPMENT, NET

The Group:

	Buildings and improvements RMB millions	Telecommunications network plant and equipment RMB millions	Furniture, fixture, motor vehicles and other equipment RMB millions	Total RMB millions
Cost/valuation:				
Balance at 1 January 2004	60,939	421,014	19,264	501,217
Additions	178	1,469	696	2,343
Transferred from construction in progress	4,380	49,775	1,976	56,131
Disposals	(119)	(14,195)	(1,259)	(15,573)
Reclassification	22	17	(39)	–
Revaluations	944	(8,776)	–	(7,832)
Balance at 31 December 2004	66,344	449,304	20,638	536,286
Additions	63	1,352	523	1,938
Transferred from construction in progress	4,684	50,580	2,545	57,809
Disposals	(262)	(15,984)	(1,660)	(17,906)
Balance at 31 December 2005	**70,829**	**485,252**	**22,046**	**578,127**
Accumulated depreciation:				
Balance at 1 January 2004	(8,331)	(174,961)	(8,029)	(191,321)
Depreciation charge for the year	(2,646)	(41,246)	(2,930)	(46,822)
Provision for impairment	–	(88)	–	(88)
Written back on disposals	37	13,214	1,070	14,321
Reclassification	(11)	(5)	16	–
Revaluations	(67)	7,870	–	7,803
Balance at 31 December 2004	(11,018)	(195,216)	(9,873)	(216,107)
Depreciation charge for the year	(2,943)	(43,630)	(2,616)	(49,189)
Provision for impairment	–	(163)	–	(163)
Written back on disposals	119	13,971	1,523	15,613
Balance at 31 December 2005	**(13,842)**	**(225,038)**	**(10,966)**	**(249,846)**
Net book value at 31 December 2005	**56,987**	**260,214**	**11,080**	**328,281**
Net book value at 31 December 2004	55,326	254,088	10,765	320,179

for the year ended 31 December 2005

4. PROPERTY, PLANT AND EQUIPMENT, NET *(continued)*

The Company:

	Telecomm-unications network plant and equipment RMB millions	**Furniture, fixture, motor vehicles and other equipment** RMB millions	**Total** RMB millions
Cost:			
Balance at 1 January 2004	360	16	376
Additions	–	5	5
Transferred from construction in progress	19	5	24
Reclassification	(73)	73	–
Balance at 31 December 2004	306	99	405
Additions	2	2	4
Transferred from construction in progress	18	38	56
Disposals	–	(2)	(2)
Balance at 31 December 2005	**326**	**137**	**463**
Accumulated depreciation:			
Balance at 1 January 2004	(1)	–	(1)
Depreciation charge for the year	(47)	(6)	(53)
Reclassification	42	(42)	–
Balance at 31 December 2004	(6)	(48)	(54)
Depreciation charge for the year	(40)	(21)	(61)
Balance at 31 December 2005	**(46)**	**(69)**	**(115)**
Net book value at 31 December 2005	**280**	**68**	**348**
Net book value at 31 December 2004	300	51	351

In accordance with the Group's accounting policy (Note 2(g)), the property, plant and equipment of the Group as at 31 December 2004 were revalued for each asset class by the directors of the Company on a depreciated replacement cost basis. The value of the property, plant and equipment as at 31 December 2004 was determined at RMB320,179 million. The surplus on revaluation of certain property, plant and equipment totalling RMB1,233 million was credited to the revaluation reserve while the deficit arising from the revaluation of certain property, plant and equipment totalling RMB1,262 million was recognised as an expense for the year ended 31 December 2004.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

4. PROPERTY, PLANT AND EQUIPMENT, NET *(continued)*

The following is a summary of the carrying value of the Group's property, plant and equipment prior to the revaluation and the revalued amounts of these assets as at 31 December 2004:

	Carrying value prior to revaluation RMB millions	**Revaluation surplus** RMB millions	**Revaluation deficit** RMB millions	**Revalued amounts** RMB millions
Buildings and improvements	54,449	877	–	55,326
Telecommunications network plant and equipment	254,994	356	(1,262)	254,088
Furniture, fixture, motor vehicles and other equipment	10,765	–	–	10,765
	320,208	1,233	(1,262)	320,179

For the year ended 31 December 2005, no revaluation was performed as the Group did not have any items of property, plant and equipment which experienced significant and volatile movements in fair value.

5. CONSTRUCTION IN PROGRESS

	The Group RMB millions	**The Company** RMB millions
Balance at 1 January 2004	31,617	77
Additions	53,964	20
Transferred to property, plant and equipment	(56,131)	(24)
Balance at 31 December 2004	29,450	73
Additions	51,926	139
Transferred to property, plant and equipment	(57,809)	(56)
Balance at 31 December 2005	**23,567**	**156**

6. INVESTMENTS IN SUBSIDIARIES

	The Company	
	2005 **RMB millions**	2004 RMB millions
Unquoted investments, at cost	**165,926**	168,714

6. INVESTMENTS IN SUBSIDIARIES *(continued)*

Details of the Company's subsidiaries at 31 December 2005, which principally affected the results of operations and the financial position of the Group, are as follows:

Name of Company	Type of legal entity	Date of incorporation	Registered capital (RMB millions)
Shanghai Telecom Company Limited	Limited Company	11 October 2002	15,984
Guangdong Telecom Company Limited	Limited Company	10 October 2002	47,513
Jiangsu Telecom Company Limited	Limited Company	19 October 2002	19,208
Zhejiang Telecom Company Limited	Limited Company	10 October 2002	22,400
Anhui Telecom Company Limited	Limited Company	26 August 2003	3,871
Fujian Telecom Company Limited	Limited Company	28 August 2003	10,364
Jiangxi Telecom Company Limited	Limited Company	18 September 2003	1,153
Guangxi Telecom Company Limited	Limited Company	28 August 2003	4,992
Chongqing Telecom Company Limited	Limited Company	22 August 2003	4,276
Sichuan Telecom Company Limited	Limited Company	28 August 2003	8,123
Hubei Telecom Company Limited	Limited Company	9 March 2004	5,412
Hunan Telecom Company Limited	Limited Company	12 March 2004	661
Hainan Telecom Company Limited	Limited Company	9 March 2004	580
Guizhou Telecom Company Limited	Limited Company	12 March 2004	2,401
Yunnan Telecom Company Limited	Limited Company	9 March 2004	3,747
Shaanxi Telecom Company Limited	Limited Company	8 March 2004	2,482
Gansu Telecom Company Limited	Limited Company	10 March 2004	3,413
Qinghai Telecom Company Limited	Limited Company	10 March 2004	965
Ningxia Telecom Company Limited	Limited Company	10 March 2004	795
Xinjiang Telecom Company Limited	Limited Company	11 March 2004	4,660

All of the above subsidiaries are incorporated in the PRC, are wholly-owned by the Company and are engaged in provision of telecommunications services.

7. INTERESTS IN ASSOCIATES

	The Group	
	2005 RMB millions	2004 RMB millions
Share of net assets	**548**	511

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

7. INTERESTS IN ASSOCIATES *(continued)*

The Group's interests in associates are accounted for under the equity method and are individually and in aggregate not material to the Group's financial conditions or results of operations for all periods presented. Details of the Group's principal associates are as follows:

Name of company	Attributable equity interest	Principal activities
Shenzhen Shekou Telecommunications Company Limited	50%	Provision of telecommunications services
Shanghai Information Investment Incorporation	24%	Provision of information technology consultancy services

The above associates are established in the PRC and are not traded on any stock exchange.

8. OTHER INVESTMENTS

	The Group	
	2005 RMB millions	2004 RMB millions
Unlisted equity investments	**182**	200

Unlisted equity investments mainly represent the Group's various interests in PRC private enterprises which are mainly engaged in the provision of information technology services and Internet contents. These investments are accounted for at cost, less provision for impairment loss. The Group has no investment in marketable securities.

9. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and deferred tax liabilities are attributable to the items set out below:

The Group:

	Assets		Liabilities		Net balance	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Current						
Impairment losses, primarily for receivables	**294**	286	**–**	–	**294**	286
Non-Current						
Property, plant and equipment	**610**	516	**(1,508)**	(1,295)	**(898)**	(779)
Deferred revenues and installation costs	**2,114**	1,942	**(1,112)**	(1,007)	**1,002**	935
Land use rights	**7,867**	8,061	**–**	–	**7,867**	8,061
Deferred tax assets/(liabilities)	**10,885**	10,805	**(2,620)**	(2,302)	**8,265**	8,503

for the year ended 31 December 2005

9. DEFERRED TAX ASSETS AND LIABILITIES *(continued)*

A valuation allowance on deferred tax assets is recorded if it is probable that some portion or all of the deferred tax assets will not be realised through recovery of taxes previously paid and/or future taxable income. The allowance is subject to ongoing adjustments based on changes in circumstances that affect the Group's assessment of the realisability of the deferred tax assets. The Group has reviewed its deferred tax assets as at 31 December 2004 and 2005. Based on the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes that it is probable the Group will realise the benefits of these temporary differences. Therefore, no valuation allowances were provided for the years ended 31 December 2004 and 2005 in respect of deferred tax assets arising from temporary differences.

Movements in temporary differences are as follows:

	Note	Balance at 1 January 2004 RMB millions	Recognised in income statement RMB millions	Recognised in equity RMB millions	Balance at 31 December 2004 RMB millions
Current					
Impairment losses, primarily of receivables		198	88	–	286
Non-current					
Property, plant and equipment	(i)	(512)	111	(378)	(779)
Deferred revenues and installation costs		1,042	(107)	–	935
Land use rights	(ii)	8,470	(165)	(244)	8,061
Net deferred tax assets		9,198	(73)	(622)	8,503
			(Note 25)		

	Note	**Balance at 1 January 2005 RMB millions**	**Recognised in income statement RMB millions**	**Recognised in equity RMB millions**	**Balance at 31 December 2005 RMB millions**
Current					
Impairment losses, primarily of receivables		**286**	**8**	**–**	**294**
Non-current					
Property, plant and equipment		**(779)**	**(119)**	**–**	**(898)**
Deferred revenues and installation costs		**935**	**67**	**–**	**1,002**
Land use rights	(iii)	**8,061**	**(189)**	**(5)**	**7,867**
Net deferred tax assets		**8,503**	**(233)**	**(5)**	**8,265**
			(Note 25)		

9. DEFERRED TAX ASSETS AND LIABILITIES *(continued)*

Note:

(i) As described in Note 4, in accordance with the Group's accounting policy, the property, plant and equipment of the Group were revalued as at 31 December 2004. The tax base of these assets was not adjusted to conform to such revalued amounts and accordingly, a deferred tax asset and a deferred tax liability in the respective amount of RMB356 million and RMB378 million in respect of the revaluation deficit and surplus were recognised. The deferred tax asset was credited to the income statement while the deferred tax liability was charged to equity as the related revaluation deficit was charged to income statement and the revaluation surplus was credited to equity.

(ii) In 2004, certain subsidiaries of the Group with operations in the western region of the PRC obtained approval from tax authority to reduce the income tax rate from 33% to 15% for the period from 1 January 2004 to 31 December 2010. In addition, certain subsidiaries of the Group obtained approval from tax authority to reduce income tax rate from 33% to 15% with effect from 1 January 2004. Since the deferred tax asset was previously credited to equity upon initial recognition, the effect of the change in tax on carrying amount of the deferred tax asset expected to be realised during the relevant period amounting to RMB244 million was charged to equity.

(iii) In 2005, a subsidiary of the Group obtained approval from tax authority for income tax exemption for the period from 1 January 2005 to 31 December 2009 and a 50% reduction in tax rate for the period from 1 January 2010 to 31 December 2014. Since the deferred tax asset was previously credited to equity upon initial recognition, the effect of the change in tax rate on the carrying amount of the deferred tax asset expected to be realised by that subsidiary during the relevant period amounting to RMB5 million was charged to equity. The effect of income tax exemption is not material to the consolidated financial statements.

10. INVENTORIES

Inventories represent:

	The Group	
	2005 RMB millions	2004 RMB millions
Materials and supplies	**1,854**	1,907
Goods for resale	**848**	860
	2,702	2,767

11. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, are analysed as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Accounts receivable				
Third parties	**17,422**	15,368	**–**	–
Amount due from subsidiaries	**–**	–	**18**	5
China Telecom Group	**224**	235	**–**	–
	17,646	15,603	**18**	5
Less: Impairment losses for bad and doubtful debts	**(1,504)**	(1,682)	**–**	–
	16,142	13,921	**18**	5

11. ACCOUNTS RECEIVABLE, NET *(continued)*

Amounts due from the provision of wireline telecommunications services to residential and business customers are due within 30 days from the date of billing. Customers who have accounts overdue by more than 90 days will have their services disconnected.

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

	The Group	
	2005 RMB millions	2004 RMB millions
At beginning of year	**1,682**	1,818
Impairment losses for bad and doubtful debts	**1,274**	1,121
Accounts receivable written off	**(1,452)**	(1,257)
At end of year	**1,504**	1,682

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

	The Group	
	2005 RMB millions	2004 RMB millions
Current, within 1 month	**12,104**	10,258
1 to 3 months	**1,563**	1,270
4 to 12 months	**1,037**	1,083
More than 12 months	**340**	526
	15,044	13,137
Less: Impairment losses for bad and doubtful debts	**(1,377)**	(1,609)
	13,667	11,528

The Company did not have accounts receivable balance from telephone and Internet subscribers.

Ageing analysis of accounts receivable from other telecommunications operators and customers is as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Current, within 1 month	**1,244**	1,358	**–**	5
1 to 3 months	**686**	550	**10**	–
4 to 12 months	**371**	275	**8**	–
More than 12 months	**301**	283	**–**	–
	2,602	2,466	**18**	5
Less: Impairment losses for bad and doubtful debts	**(127)**	(73)	**–**	–
	2,475	2,393	**18**	5

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

12. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets represent:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Amounts due from China Telecom Group	**606**	640	**4**	4
Amounts due from subsidiaries	**–**	–	**51,725**	2,502
Prepayments in connection with construction work and equipment purchases	**679**	854	**–**	–
Prepaid expenses and deposits	**389**	607	**–**	–
Other receivables	**732**	963	**9**	13
	2,406	3,064	**51,738**	2,519

13. CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Cash at bank and in hand	**11,583**	10,512	**727**	882
Time deposits with maturity within three months	**3,538**	2,953	**3,412**	2,800
	15,121	13,465	**4,139**	3,682

14. SHORT-TERM AND LONG-TERM DEBT

Short-term debt comprises:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Bank loans – unsecured	**45,704**	55,887	**–**	–
Commercial paper	**9,917**	–	**9,917**	–
Loans from China Telecom Group	**20,384**	10,089	**–**	–
Total short-term debt	**76,005**	65,976	**9,917**	–

Weighted average interest rate of the Group's total short-term debt as at 31 December 2005 was 4.2% (2004: 4.4%). The unsecured bank loans bear interest at rates ranging from 4.7% to 6.0% per annum and are repayable within one year. The commercial paper bears interest at a fixed rate of 2.54% per annum, is unsecured and is repayable within six months. The loans from China Telecom Group bear interest at fixed rates ranging from 2.3% to 5.0% per annum, are unsecured and are repayable within one year.

14. SHORT-TERM AND LONG-TERM DEBT *(continued)*

Long-term debt comprises:

	Interest rates and final maturity	The Group 2005 RMB millions	The Group 2004 RMB millions	The Company 2005 RMB millions	The Company 2004 RMB millions
Bank loans					
Renminbi denominated	Interest rates ranging from 2.9% to 6.4% per annum with maturities through 2020	**19,112**	26,859	**–**	–
US Dollars denominated	Interest rates ranging from 0.5% to 8.3% per annum with maturities through 2038	**2,087**	2,883	**–**	–
Japanese Yen denominated	Interest rates ranging from 0.6% to 3.5% per annum with maturities through 2040	**2,449**	3,182	**–**	–
Euro denominated	Interest rates ranging from 0.5% to 7.4% per annum with maturities through 2032	**843**	1,053	**–**	–
Other currencies		**93**	70	**–**	–
		24,584	34,047	**–**	–
Other loans					
Renminbi denominated		**6**	11	**–**	–
Amount due to China Telecom					
In connection with the First Acquisition – Renminbi denominated (Note (i))		**25,000**	35,000	**25,000**	35,000
In connection with the Second Acquisition – Renminbi denominated (Note (ii))		**15,150**	15,150	**15,150**	15,150
Total long-term debt		**64,740**	84,208	**40,150**	50,150
Less: current portion		**(8,963)**	(11,842)	**–**	–
Non-current portion		**55,777**	72,366	**40,150**	50,150

14. SHORT-TERM AND LONG-TERM DEBT *(continued)*

Note:

(i) Represents the deferred consideration payable to China Telecom in respect of the First Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the First Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 31 December 2013 and the Company may, from time to time, repay all or part of the amount at any time until 31 December 2013 without penalty. In October 2005, the Company repaid RMB10,000 million to China Telecom.

(ii) Represents the remaining balance of the deferred consideration payable to China Telecom in respect of the Second Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the Second Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 30 June 2014 and the Company may, from time to time, repay all or part of the amount at any time until 30 June 2014 without penalty.

As at 31 December 2004 and 2005, no bank loans were secured.

The aggregate maturities of the Group's and the Company's long-term debts subsequent to 31 December 2005 are as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Within 1 year	**8,963**	11,842	**–**	–
Between 1 to 2 years	**8,773**	10,022	**–**	–
Between 2 to 3 years	**3,824**	8,343	**–**	–
Between 3 to 4 years	**382**	552	**–**	–
Between 4 to 5 years	**252**	268	**–**	–
Thereafter	**42,546**	53,181	**40,150**	50,150
	64,740	84,208	**40,150**	50,150

The Group's short-term and long-term debts do not contain any financial covenants. As at 31 December 2005, the Group had available credit facilities of RMB31,266 million (2004: RMB27,855 million) which it can draw upon.

15. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

	The Group		The Company	
	2005 RMB millions	2004 RMB millions	**2005 RMB millions**	2004 RMB millions
Third parties	**27,063**	26,591	**74**	17
China Telecom Group	**6,886**	7,067	**–**	–
	33,949	33,658	**74**	17

15. ACCOUNTS PAYABLE *(continued)*

Ageing analysis of accounts payable is as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB millions	RMB millions	**RMB millions**	RMB millions
Due within 1 month or on demand	**5,379**	5,599	**–**	6
Due after 1 month but within 3 months	**8,797**	6,451	**46**	4
Due after 3 months but within 6 months	**9,283**	7,856	**4**	–
Due after 6 months	**10,490**	13,752	**24**	7
	33,949	33,658	**74**	17

16. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables represent:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB millions	RMB millions	**RMB millions**	RMB millions
Amounts due to China Telecom Group	**4,534**	4,889	**104**	230
Accrued expenses	**12,330**	15,923	**571**	2,094
Customer deposits and receipts in advance	**10,021**	6,719	**44**	–
	26,885	27,531	**719**	2,324

17. FINANCE LEASE OBLIGATIONS

Obligations under finance leases are analysed as follows:

	The Group	
	2005	2004
	RMB millions	RMB millions
Within 1 year	**114**	163
Between 1 to 2 years	**55**	110
Between 2 to 3 years	**–**	51
Total minimum lease payments	**169**	324
Less: finance charges related to future periods	**(9)**	(11)
Present value of minimum lease payments	**160**	313
Less: current portion	**(108)**	(156)
Non-current portion	**52**	157

18. DEFERRED REVENUES

Deferred revenues represent the unearned portion of upfront connection fees and installation fees received from customers and the unused portion of calling cards. Connection fees and installation fees are amortised over the expected customer relationship period of 10 years. Beginning 1 July 2001, connection fees were no longer collected from new customers.

	The Group	
	2005 RMB millions	2004 RMB millions
Balance at beginning of year	**36,771**	46,601
Additions for the year		
– installation fees	**1,431**	2,135
– calling cards	**3,895**	4,392
	5,326	6,527
Reduction for the year		
– amortisation of connection fees	**(6,781)**	(8,458)
– amortisation of installation fees	**(2,970)**	(2,865)
– usage of calling cards	**(4,638)**	(5,034)
Balance at end of year	**27,708**	36,771
Representing:		
– Current portion	**8,958**	11,589
– Non-current portion	**18,750**	25,182
	27,708	36,771

Included in other non-current assets are capitalised direct incremental costs associated with the installation of wireline services. As at 31 December 2005, the unamortised portion of these costs was RMB10,025 million (2004: RMB11,428 million).

19. SHARE CAPITAL

	The Group and the Company	
	2005 RMB millions	2004 RMB millions
Registered, issued and fully paid		
67,054,958,321 ordinary domestic shares of RMB1.00 each	**67,055**	67,055
13,877,410,000 overseas listed H shares of RMB1.00 each	**13,877**	13,877
	80,932	80,932

19. SHARE CAPITAL *(continued)*

In May 2004, the Company issued and allotted 5,318,181,818 new H shares with a par value of RMB1.00 each, representing 4,466,693,018 H shares and 8,514,888 American Depositary Shares ("ADS", each representing 100 H shares), at prices of HK$2.30 per H share and US$29.49 per ADS, respectively, by way of a global offering to Hong Kong and overseas investors. As part of the global offering, 531,818,182 existing domestic shares of RMB1.00 each owned by China Telecom and the other domestic shareholders were converted into H shares and sold to Hong Kong and overseas investors. The Company raised net proceeds of RMB12,702 million from issue of new H shares.

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

20. RESERVES

The Group	Capital reserve RMB millions	Share premium RMB millions	Re-valuation reserve RMB millions	Surplus reserves RMB millions	Statutory common welfare fund RMB millions	Other reserves RMB millions	Retained earnings RMB millions	Total RMB millions
Balance as at 1 January 2004	6,567	3,362	6,424	15,461	3,372	24,246	15,748	75,180
Revaluation surplus (Note 4)	–	–	1,233	–	–	–	–	1,233
Deferred tax on revaluation surplus of property, plant and equipment (Note 9)	–	–	–	–	–	(378)	–	(378)
Effect of change in tax rate (Note 9)	–	–	–	–	–	(244)	–	(244)
Revaluation surplus realised	–	–	(72)	–	–	–	72	–
Deferred tax on land use rights realised	–	–	–	–	–	(165)	165	–
Profit for the year	–	–	–	–	–	–	28,023	28,023
Issue of shares, net of issuing expenses of RMB294 million	–	7,384	–	–	–	–	–	7,384
Contributions from China Telecom	–	–	–	–	–	–	100	100
Transfer from retained earnings to other reserves	–	–	–	–	–	2,653	(2,653)	–
Consideration for the acquisition of the Second Acquired Group (Note 1)	–	–	–	–	–	(27,800)	–	(27,800)
Transfer from other reserves to capital reserve	(9,371)	–	–	–	–	9,371	–	–
Appropriations (Notes (i) and (ii))	–	–	–	10,168	2,421	–	(12,589)	–
Dividends	–	–	–	–	–	–	(5,224)	(5,224)
Balance as at 31 December 2004	(2,804)	10,746	7,585	25,629	5,793	7,683	23,642	78,274
Effect of change in tax rate (Note 9)	–	–	–	–	–	(5)	–	(5)
Revaluation surplus realised	–	–	(134)	–	–	–	134	–
Deferred tax on revaluation surplus of property, plant and equipment realised	–	–	–	–	–	12	(12)	–
Deferred tax on land use rights realised	–	–	–	–	–	(189)	189	–
Profit for the year	–	–	–	–	–	–	27,912	27,912
Appropriations (Notes (i) and (ii))	–	–	–	9,509	1,285	–	(10,794)	–
Dividends (Note 29)	–	–	–	–	–	–	(5,596)	(5,596)
Balance as at 31 December 2005	(2,804)	10,746	7,451	35,138	7,078	7,501	35,475	100,585

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

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20. RESERVES *(continued)*

The Company	Capital reserve RMB millions	Share premium RMB millions	Re-valuation reserve RMB millions	Surplus reserves RMB millions	Statutory common welfare fund RMB millions	Other reserves RMB millions	Retained earnings/ (deficits) RMB millions	Total RMB millions
Balance as at 1 January 2004, as previously reported	6,567	3,362	6,424	15,461	3,372	24,246	15,748	75,180
Prior period adjustment in respect of investments in subsidiaries (Note 3(iii))	22,601	–	(6,424)	–	–	(24,246)	(33,298)	(41,367)
Balance as at 1 January 2004, as restated	29,168	3,362	–	15,461	3,372	–	(17,550)	33,813
Profit for the year	–	–	–	–	–	–	5,988	5,988
Issue of shares, net of issuing expenses of RMB294 million	–	7,384	–	–	–	–	–	7,384
Appropriations (Notes (i) and (ii))	–	–	–	10,168	2,421	–	(12,589)	–
Dividends	–	–	–	–	–	–	(5,224)	(5,224)
Balance as at 31 December 2004 (Note 3(iii))	29,168	10,746	–	25,629	5,793	–	(29,375)	41,961
Profit for the year	–	–	–	–	–	–	53,623	53,623
Appropriations (Notes (i) and (ii))	–	–	–	9,509	1,285	–	(10,794)	–
Dividends (Note 29)	–	–	–	–	–	–	(5,596)	(5,596)
Balance as at 31 December 2005	29,168	10,746	–	35,138	7,078	–	7,858	89,988

Note:

(i) According to the Company's Articles of Association, the Company is required to transfer 10% of its net profit, as determined in accordance with the PRC accounting rules and regulations, to a statutory surplus reserve until such reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of any dividend to shareholders. For the year ended 31 December 2005, the Company transferred RMB2,570 million (2004: RMB2,421 million), being 10% of the year's net profit determined in accordance with the PRC accounting rules and regulations, to this reserve.

According to the Company's Articles of Association, the Directors authorised, subject to shareholders' approval, for the year ended 31 December 2005, the transfer of RMB6,939 million (2004: RMB7,747 million), being 27% (2004: 32%) of the year's net profit determined in accordance with the PRC accounting rules and regulations, to a discretionary surplus reserve.

The statutory and discretionary surplus reserves are non-distributable other than liquidation and can be used to make good of previous years' losses, if any, and may be utilised for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholdings or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

(ii) According to the Company's Articles of Association, the Company is required to transfer 5% to 10% of its net profit, as determined in accordance with the PRC accounting rules and regulations, to a statutory common welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's employees such as construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than on liquidation. The transfer to this fund must be made before distribution of any dividend to shareholders. For the year ended 31 December 2005, the Directors authorised, subject to shareholders' approval, the transfer of RMB1,285 million (2004: RMB2,421 million), being 5% (2004: 10%) of the year's net profit determined in accordance with the PRC accounting rules and regulations, to this fund.

20. RESERVES *(continued)*

Note:

(iii) According to the Company's Articles of Association, the amount of retained earnings available for distribution to shareholders of the Company is the lower of the amount determined in accordance with the PRC accounting rules and regulations and the amount determined in accordance with IFRS. At 31 December 2005, the amount of retained earnings available for distribution was RMB7,858 million, being the amount determined in accordance with IFRS. As described in Note 3(iii), the accounting policy for investment in subsidiaries under IFRS was changed with effect from 1 January 2005 and hence affects the calculation of retained earnings available for distribution to shareholders of the Company under IFRS. The amount of retained earnings available for distribution as at 31 December 2004 prior to this change in accounting policy was RMB20,609 million, being the amount determined in accordance with the PRC accounting rules and regulations. Final dividend of approximately RMB6,315 million in respect of the financial year 2005 proposed after the balance sheet date has not been recognised as a liability at the balance sheet date (Note 29).

21. OPERATING REVENUES

Operating revenues represent revenues from the provision of wireline telecommunications services. The components of the Group's operating revenues are as follows:

		The Group	
	Note	**2005 RMB millions**	2004 RMB millions
Upfront connection fees	(i)	**6,781**	8,458
Upfront installation fees	(ii)	**2,970**	2,865
Monthly fees	(iii)	**30,351**	29,827
Local usage fees	(iv)	**47,624**	47,646
DLD	(iv)	**25,993**	26,231
ILD	(iv)	**3,407**	3,788
Internet	(v)	**17,862**	14,109
Managed data	(vi)	**2,958**	3,015
Interconnections	(vii)	**12,838**	10,719
Leased line	(viii)	**4,464**	4,154
Value-added services	(ix)	**9,976**	6,120
Others	(x)	**4,086**	4,280
		169,310	161,212

Note:

(i) Represent the amortised amount of the upfront fees received for initial activation of wireline services.

(ii) Represent the amortised amount of the upfront fees received for installation of wireline services.

(iii) Represent amounts charged to customers each month for their use of the Group's telephone services.

(iv) Represent usage fees charged to customers for the provision of telephone services.

(v) Represent amounts charged to customers for the provision of Internet access services.

(vi) Represent amounts charged to customers for the provision of managed data transmission services.

(vii) Represent amounts charged to domestic and foreign telecommunications operators for delivery of voice and data traffic connecting to the Group's wireline telecommunications networks.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

for the year ended 31 December 2005

21. OPERATING REVENUES *(continued)*

Note:

(viii) Represent lease income from other domestic telecommunications operators and business customers for the usage of the Group's wireline telecommunications networks and is measured by the number of lines leased and the agreed upon rate per line leased.

(ix) Represent amounts charged to customers for provision of value-added services, which comprise primarily caller ID services, short messaging services, telephone information services and ring tone services.

(x) Represent primarily revenue from sale and repairs and maintenance of customer-end equipment and provision of consulting services.

22. OTHER OPERATING EXPENSES

Other operating expenses consist of:

		The Group	
		2005	2004
	Note	**RMB millions**	RMB millions
Interconnection charges	(i)	**5,473**	4,095
Donations		**21**	17
Others		**24**	27
		5,518	4,139

Note:

(i) Interconnection charges represent amounts incurred for the use of other domestic and foreign telecommunications operators' networks for delivery of voice and data traffic that originate from the Group's wireline telecommunications networks.

23. TOTAL OPERATING EXPENSES

Total operating expenses for the year ended 31 December 2005 include personnel expenses of RMB24,960 million (2004: RMB23,233 million) and auditors' remuneration of RMB46 million (2004: RMB48 million).

24. NET FINANCE COSTS

Net finance costs comprise:

	The Group	
	2005	2004
	RMB millions	RMB millions
Interest expense incurred	**6,763**	6,834
Less: Interest expense capitalised*	**(1,062)**	(1,467)
Net interest expense	**5,701**	5,367
Interest income	**(243)**	(231)
Foreign exchange losses	**42**	207
Foreign exchange gains	**(605)**	(3)
	4,895	5,340
* Interest expense was capitalised in construction in progress at the following rates per annum	**2.1%-5.1%**	4.1%-5.2%

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25. INCOME TAX

Income tax in the consolidated income statement comprises:

	The Group	
	2005	2004
	RMB millions	RMB millions
Provision for PRC income tax	**5,927**	5,114
Deferred taxation (Note 9)	**233**	73
	6,160	5,187

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

		The Group	
		2005	2004
	Note	**RMB millions**	RMB millions
Profit before taxation		**34,114**	33,263
Expected PRC income tax expense at statutory tax rate of 33%	(i)	**11,258**	10,977
Differential tax rate on subsidiaries' income	(i)	**(1,689)**	(1,608)
Non-deductible expenses	(ii)	**720**	294
Non-taxable income	(iii)	**(2,651)**	(3,266)
Tax credit for domestic equipment purchases		**(1,478)**	(1,210)
Income tax		**6,160**	5,187

Note:

(i) The provision for PRC current income tax is based on a statutory rate of 33% of the assessable income of the Group as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain subsidiaries of the Company which are taxed at preferential rates ranging from 0% to 15%.

(ii) Amounts represent personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose.

(iii) Amounts primarily represent connection fees received from customers which are not subject to income tax.

26. DIRECTORS' AND SUPERVISORS' REMUNERATION

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

	Directors'/ supervisors' fees RMB thousands	Salaries, allowances and benefits in kind RMB thousands	Discretionary bonuses RMB thousands	Share-based payments RMB thousands	Retirement scheme contributions RMB thousands	Total RMB thousands
2005						
Executive directors						
Wang Xiaochu	–	304	33	–	61	398
Leng Rongquan	–	274	30	–	55	359
Wu Andi	–	259	251	278	51	839
Zhang Jiping	–	259	251	278	51	839
Huang Wenlin	–	259	251	278	51	839
Li Ping	–	259	251	278	51	839
Wei Leping	–	259	251	278	51	839
Yang Jie	–	259	191	–	49	499
Sun Kangmin	–	258	191	–	50	499
Cheng Xiyuan	–	159	475	232	13	879
Feng Xiong	–	182	487	232	57	958
Independent non-executive directors						
Zhang Youcai	130	–	–	–	–	130
Vincent Lo Hong Sui	208	–	–	–	–	208
Shi Wanpeng	130	–	–	–	–	130
Xu Erming	50	–	–	–	–	50
Tse Hau Yin	173	–	–	–	–	173
Supervisors						
Zhang Xiuqin	–	130	262	209	44	645
Li Jian	–	32	78	151	12	273
Xu Cailiao	–	23	63	128	10	224
Ma Yuzhu	–	43	87	209	15	354
Li Jing	–	53	104	–	13	170
Xie Songguang	–	70	120	–	16	206
Wang Huanhui	10	–	–	–	–	10
Independent supervisor						
Zhu Lihao	60	–	–	–	–	60
	761	3,082	3,376	2,551	650	10,420
2004	524	2,271	3,277	2,446	515	9,033

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27. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five highest paid individuals of the Group for the year ended 31 December 2005, four are directors of the Company and their remuneration has been included in Note 26. Of the five highest paid individuals of the Group for the year ended 31 December 2004, one was a director of the Company and whose remuneration was included in Note 26. The following table sets out the emoluments of the Group's remaining highest paid employees who were not director or supervisor of the Company during the periods presented:

	2005 RMB thousands	2004 RMB thousands
Salaries, allowances and benefits in kind	**850**	2,777
Retirement benefits	**82**	223
	932	3,000

The number of these employees whose emoluments fall within the following band is set out below:

	2005 Number	2004 Number
HK$ equivalent		
Nil – 1,000,000	**1**	4

None of these employees received any inducements or compensation for loss of office, or waived any emoluments during the periods presented.

28. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated profit attributable to equity holders of the Company includes a profit of RMB18,451 million (2004 (restated): RMB5,988 million) which has been dealt with in the stand-alone financial statements of the Company.

29. DIVIDENDS

Pursuant to a resolution passed at the Directors' meeting on 22 March 2006, a final dividend of equivalent to HK$0.075 per share totalling approximately RMB6,315 million for the year ended 31 December 2005 was proposed for shareholders' approval at the Annual General Meeting. The dividend has not been provided for in the consolidated financial statements for the year ended 31 December 2005.

Pursuant to the shareholders' approval at the Annual General Meeting held on 25 May 2005, a final dividend of RMB0.069139 (equivalent to HK$0.065) per share totalling RMB5,596 million in respect of the year ended 31 December 2004 was declared and was paid on 23 June 2005.

30. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the year ended 31 December 2005 is based on the profit attributable to equity holders of the Company of RMB27,912 million divided by 80,932,368,321 shares. The calculation of basic earnings per share for the year ended 31 December 2004 is based on the profit attributable to equity holders of the Company of RMB28,023 million and the weighted average number of shares in issue during the year of 78,839,968,917 shares. The weighted average number of shares in issue for the year ended 31 December 2004 reflects the issuance of 5,318,181,818 new H shares in May 2004 (Note 19).

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for all periods presented.

31. COMMITMENTS AND CONTINGENCIES

Operating lease commitments

The Group leases business premises through non-cancelable operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the rental agreements contain escalation provisions that may require higher future rental payments nor impose restrictions on dividends, additional debt and/or further leasing. The Company does not have significant operating lease commitments.

As at 31 December 2004 and 2005, the Group's future minimum lease payments under non-cancelable operating leases having initial or remaining lease terms of more than one year were as follows:

	2005 RMB millions	2004 RMB millions
Within 1 year	**326**	369
Between 1 to 2 years	**195**	187
Between 2 to 3 years	**134**	137
Between 3 to 4 years	**119**	124
Between 4 to 5 years	**108**	127
Thereafter	**180**	341
Total minimum lease payments	**1,062**	1,285

Total rental expense in respect of operating leases charged to the consolidated income statement for the year ended 31 December 2005 was RMB1,208 million (2004: RMB1,271 million).

31. COMMITMENTS AND CONTINGENCIES *(continued)*

Capital commitments

As at 31 December 2004 and 2005, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB millions	RMB millions	**RMB millions**	RMB millions
Authorised and contracted for				
– Properties	**513**	918	**148**	17
– Telecommunications network plant and equipment	**2,278**	3,947	**16**	36
	2,791	4,865	**164**	53
Authorised but not contracted for				
– Properties	**1,896**	1,699	**110**	287
– Telecommunications network plant and equipment	**3,047**	9,168	**15**	15
	4,943	10,867	**125**	302

Contingent liabilities

(a) The Company and the Group were advised by their PRC lawyers that, except for liabilities arising out of or relating to the businesses of the Predecessor Operations and the Acquired Groups transferred to the Company in connection with the Restructuring and the Acquisitions, no other liabilities were assumed by the Company or the Group, and the Company or the Group are not jointly and severally liable for other debts and obligations incurred by China Telecom Group prior to the Restructuring and the Acquisitions.

(b) As at 31 December 2004 and 2005, the Group did not have contingent liabilities in respect of guarantees given to banks in respect of banking facilities granted to other parties, nor other forms of contingent liabilities.

As at 31 December 2005, the Company's undiscounted maximum amount of potential future payments under guarantees given to banks in respect of banking facilities granted to subsidiaries was RMB1,497 million (2004: RMB1,884 million). The Company monitors the conditions that are subject to the guarantees to identify whether it is probable that a loss has occurred, and recognised any such losses under guarantees when those losses can be estimated. As at 31 December 2004 and 2005, it was not probable that the Company would be required to make payments under these guarantees. Thus no liability was accrued for losses related to the Company's obligations under these guarantee arrangements.

Legal contingencies

The Group is a defendant in certain lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Group.

32. CONCENTRATION OF RISKS

Credit and concentration risks

The carrying amounts of cash and cash equivalents, time deposits, accounts receivable and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets. The majority of the Group's accounts receivable relate to provision of telecommunications services to residential and corporate customers operating in various industries. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on accounts receivable.

The Group has a diversified base of customers. No single customer contributed more than 10% of revenues for the periods presented.

The Group does not have concentrations of available sources of labour, services, franchises, licenses or other rights that could, if suddenly eliminated, severely impact its operations. The Group places its cash with several large state-owned financial institutions in the PRC.

Business and economic risks

The Group conducts its principal operations in the PRC and accordingly is subject to special considerations and significant risks not typically associated with companies operating in United States and Western Europe. These include risks associated with, among others, the political, economic, legal environment and social uncertainties in the PRC, influence of the Ministry of Information Industry over certain aspects of the Group's operations and competition in the telecommunications industry. In addition, the ability to negotiate and implement specific business development projects in a timely and favourable manner may be impacted by political considerations unrelated to or beyond the control of the Group. Although the PRC government has been pursuing economic reform policies for the past two decades, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective and as a result, changes in the rate or method of taxation, reduction in tariff protection and other import restrictions, and changes in State policies and regulations affecting the telecommunications industry may have a negative impact on the Group's operating results and financial condition.

The Group's wireline telecommunications networks interconnect with the networks of other state-owned telecommunications operators. The Group also leases wireline telecommunications networks to these operators in the normal course of business. The interconnection and leased line charges are regulated by the Ministry of Information Industry. The extent of the Group's interconnection and leased line transactions with other state-owned telecommunications operators in the PRC is as follows:

	2005 **RMB millions**	2004 RMB millions
Interconnection revenues	**10,947**	8,964
Interconnection charges	**2,643**	2,190
Leased line revenues	**2,020**	2,701

32. CONCENTRATION OF RISKS *(continued)*

Currency risk

Substantially all of the revenue-generating operations of the Group are transacted in RMB, which is not fully convertible into foreign currencies. On 1 January 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted by the People's Bank of China. However, the unification of the exchange rate does not imply convertibility of RMB into United States dollars or other foreign currencies. All foreign exchange transactions must take place either through the People's Bank of China or other institutions authorised to buy and sell foreign exchange or at a swap center. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

On 21 July 2005, the People's Bank of China announced that the PRC government reformed the exchange rate regime by adopting a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies.

Interest rate risk

The interest rates and terms of repayment of the Group's debts are disclosed in Note 14.

33. RELATED PARTY TRANSACTIONS

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

(a) Transactions with China Telecom Group

The Group is part of a large group of companies under China Telecom, which is owned by the PRC government, and has significant transactions and relationships with members of China Telecom. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among unrelated parties.

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

	Note	**2005 RMB millions**	2004 RMB millions
Purchases of telecommunications equipment and materials	(i)	**267**	304
Construction, engineering and information technology services	(ii)	**6,575**	6,568
Provision of community services	(iii)	**2,632**	2,417
Provision of ancillary services	(iv)	**2,456**	2,490
Provision of comprehensive services	(v)	**425**	361
Operating lease expenses	(vi)	**386**	393
Centralised service expenses	(vii)	**275**	163
Interconnection revenues	(viii)	**183**	98
Interconnection charges	(viii)	**725**	201
Interest on amounts due to and loans from China Telecom Group	(ix)	**2,849**	2,426

NOTES TO THE FINANCIAL STATEMENTS *(continued)*
for the year ended 31 December 2005

33. RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with China Telecom Group *(continued)*

Note:

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

(ii) Represent provision of network construction, engineering and information technology services to the Group by China Telecom Group.

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

(iv) Represent amounts paid and payable by the Group to China Telecom Group in respect of ancillary services such as repairs and maintenance of telecommunications equipment and facilities and certain customer services.

(v) Represent amounts paid and payable by the Group to entities of China Telecom Group which were not within the scope of other related party service agreements in respect of services like procurement of telecommunications equipment, network design, software upgrade, system integration and manufacturing of calling cards.

(vi) Represent amounts paid and payable to China Telecom Group for operating leases in respect of business premises and inter-provincial transmission optic fibres.

(vii) Represent net amount charged by China Telecom to the Group for costs associated with common corporate services and international telecommunications facilities.

(viii) Represent amounts charged from/to China Telecom for interconnection of domestic long distance telephone calls.

(ix) Represent interest paid and payable to China Telecom with respect to the deferred consideration payable to China Telecom in connection with the Acquisitions and interest with respect to loans from China Telecom Group (Note 14).

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

	2005 RMB millions	2004 RMB millions
Accounts receivable	**224**	235
Prepayments and other current assets	**606**	640
Total amounts due from China Telecom Group	**830**	875
Accounts payable	**6,886**	7,067
Accrued expenses and other payables	**4,534**	4,889
Short-term debt	**20,384**	10,089
Long-term debt	**40,150**	50,150
Total amounts due to China Telecom Group	**71,954**	72,195

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33. RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with China Telecom Group *(continued)*

Amounts due from/to China Telecom Group, other than short-term debt and long-term debt, bear no interest, are unsecured and are repayable in accordance with normal commercial terms. The term and conditions associated with short-term debt and long-term debt payable to China Telecom Group are set out in Note 14.

As at 31 December 2004 and 2005, no impairment losses for bad and doubtful debts were recorded in respect of amounts due from China Telecom Group.

(b) Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and supervisors of the Group.

Key management personnel compensation of the Group is summarised as follows:

	2005 RMB thousands	2004 RMB thousands
Short-term employee benefits	**7,219**	6,072
Post-employment benefits	**650**	515
Equity-based compensation benefits	**2,551**	2,446
	10,420	9,033

The above remuneration is included in personnel expenses (Note 23).

(c) Contributions to post-employment benefit plans

The Group participates in various defined contribution post-employment benefit plans organised by municipal and provincial governments for its employees. Further details of the Group's post-employment benefit plans are disclosed in Note 34.

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

The Group is a state-owned enterprise and operates in an economic regime currently predominated by state-owned entities. Apart from transactions with parent company and its affiliates, the Group conducts certain business activities with enterprises directly or indirectly owned or controlled by the PRC government and government authorities and agencies (collectively referred to as "state-owned entities") in the ordinary course of business. These transactions, which include sales and purchase of goods, rendering and receiving services, lease of assets and obtaining finance, are carried out at terms similar to those that would be entered into with non-state-owned entities and have been reflected in the financial statements.

Further information of the Group's principal transactions with other state-owned telecommunications operators in the PRC in the normal course of providing telecommunications services are set out in Note 32.

Management believes the above information has provided meaningful disclosure of related party transactions.

34. POST-EMPLOYMENT BENEFITS PLANS

As stipulated by the regulations of the PRC, the Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the retirement plans at rates ranging from 18% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above.

The Group's contributions for the year ended 31 December 2005 were RMB2,258 million (2004: RMB2,031 million).

The outstanding amount of contributions to defined contribution retirement plans as at 31 December 2005 was RMB591 million (2004: RMB599 million).

35. STOCK APPRECIATION RIGHTS

The Group implemented a stock appreciation rights plan for members of its management in order to provide further incentives to these employees. Under this plan, stock appreciation rights are granted in units with each unit representing one H share. No shares will be issued under the stock appreciation rights plan. Upon exercise of the stock appreciation rights, a recipient will receive, subject to any applicable withholding tax, a cash payment in RMB, translated from the Hong Kong dollar amount equal to the product of the number of stock appreciation rights exercised and the difference between the exercise price and market price of the Company's H shares at the date of exercise based on the applicable exchange rate between RMB and Hong Kong dollar at the date of the exercise.

In March 2003, the Company's compensation committee approved the granting of 276.5 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights will have a contractual life of six years from date of grant and an exercise price of HK$1.48 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 18 months after the date of grant. As at each of the third, fourth, fifth and sixth anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

In April 2005, the Company's compensation committee approved the granting of 560.0 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights will have a contractual life of six years from date of grant and an exercise price of HK$2.78 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 24 months after the date of grant. As at each of the third, fourth, fifth and six anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

During the year ended 31 December 2005, 70 million (2004: 70 million) stock appreciation right units were exercised.

The Company recognised compensation expense of the stock appreciation rights over the applicable vesting period. For the year ended 31 December 2005, compensation expense recognised by the Group in respect of stock appreciation rights was RMB81 million (2004: RMB70 million).

35. STOCK APPRECIATION RIGHTS *(continued)*

As at 31 December 2005, the carrying amount of liability arising from stock appreciation rights was RMB129 million (2004: RMB113 million). As at 31 December 2005, the intrinsic value of the vested stock appreciation rights outstanding was RMB0.4 million (2004: Nil).

36. FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial assets of the Group include cash and cash equivalents, time deposits, investments, accounts receivable, amounts due from China Telecom Group, advances and other receivables. Financial liabilities of the Group include debts, accounts payable, amounts due to China Telecom Group, accrued expenses and other payables. The Group does not hold nor issue financial instruments for trading purposes.

The disclosures of the fair value estimates, methods and assumptions set forth below for the Group's financial instruments are made to comply with the requirements of IAS 32 and IAS 39, and should be read in conjunction with the Group's consolidated financial statements and related notes. The estimated fair value amounts have been determined by the Group using market information and valuation methodologies considered appropriate. However, considerable judgment is required to interpret market data to develop the estimates of fair values. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following summarises the major methods and assumptions used in estimating the fair values of the Group's financial instruments.

Long-term debt: The fair values of long-term indebtedness are estimated by discounting future cash flows using current market interest rates offered to the Group for debt with substantially the same characteristics and maturities. As at 31 December 2004 and 2005, the carrying amounts and fair values of the Group's long-term debt were as follows:

	2005		2004	
	Carrying amount RMB millions	**Fair value RMB millions**	Carrying amount RMB millions	Fair value RMB millions
Long-term debt	**64,740**	**63,561**	84,208	82,850

The Group's long-term investments are unlisted equity interests and there are no quoted market prices for such interests in the PRC. Accordingly, a reasonable estimate of their fair values could not be made without incurring excessive costs.

The fair values of all other financial instruments approximate their carrying amounts due to the short-term maturity of these instruments.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group's financial position and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the consolidated financial statements. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of significant accounting policies, the judgements and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the consolidated financial statements. The significant accounting policies are set forth in Note 2. The Group believes the following significant accounting policies involve the most significant judgements and estimates used in the preparation of the consolidated financial statements.

Revenue recognition for upfront connection and installation fees

The Group defers the recognition of upfront fees for activation of wireline services and wireline installation fees and amortise such fees over the expected customer relationship period of ten years. The related direct incremental customer acquisition costs (including direct costs of installation) are also deferred and amortised over the same expected customer relationship period. The Group estimates the expected customer relationship period based on the historical customer retention experience and factoring in the expected level of future competition, the risk of technological or functional obsolescence of its services, technological innovation, and the expected changes in the regulatory and social environment. If the Group's estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of deferred revenue and deferred customer acquisition costs would change for future periods. There have been no significant changes to the estimated customer relationship period for the years presented.

Impairment losses for bad and doubtful debts

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

Impairment on long-lived assets

If circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the asset may be considered "impaired", and an impairment loss may be recognised in accordance with accounting policy for impairment of long-lived assets as described in Note 2(l). The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for the Group's long-lived assets may not be readily available. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to level of revenue and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of revenue and amount of operating costs. Changes in these estimates could have a significant impact on the carrying value of the assets and could result in additional impairment charge or reversal of impairment in future periods.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual value. The Group reviews the estimated useful lives and residual values of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives and residual values are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

38. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2005

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended 31 December 2005 and which have not been adopted in these financial statements:

	Effective for accounting period beginning on or after
IFRS 6, Exploration for and evaluation of mineral resources	1 January 2006
IFRS 7, Financial instruments: disclosures	1 January 2007
IFRIC 4, Determining whether an arrangement contains a lease	1 January 2006
IFRIC 5, Rights to interests arising from decommissioning, restoration environmental rehabilitation funds	1 January 2006
IFRIC 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005
IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies	1 March 2006
IFRIC 8, Scope of IFRS 2	1 May 2006
IFRIC 9, Reassessment of embedded derivatives	1 June 2006
Amendment to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007
Amendment to IAS 19, Employee benefits – Actuarial gains and losses, group plans and disclosures	1 January 2006
Amendment to IAS 21, Net investment in a foreign operation	1 January 2006
Amendments to IAS 39, Financial instruments: Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments to IFRS 1, First-time Adoption of International Financial Reporting Standards	1 January 2006

38. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2005 *(continued)*

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far the Group believes that IFRS 6, IFRIC 5, IFRIC 6, IFRIC 7, IFRIC 8, IFRIC 9 and the amendments to IAS 19, IAS 21 and IFRS 1 are not applicable to any of the Group's operations and that the adoption of the rest of the above amendments, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

39. COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified as a result of the changes in accounting policies disclosed in Note 3.

40. PARENT AND ULTIMATE HOLDING COMPANY

The parent and ultimate holding company of the Group at 31 December 2005 is China Telecommunications Corporation, a state-owned enterprise established in the PRC. This entity does not produce financial statements available for public use.

SUPPLEMENTARY INFORMATION FOR AMERICAN DEPOSITARY SHAREHOLDERS

The Group's accounting policies conform with IFRS which differ in certain significant respects from accounting principles generally accepted in the United States of America ("US GAAP"). The significant differences are set out below.

(a) Revaluation of property, plant and equipment

In connection with the Restructuring, the property, plant and equipment of the Company's predecessor operations were revalued as at 31 December 2001. The net revaluation deficit was reflected in the consolidated financial statements as at 31 December 2001. Such revaluation resulted in an increase directly to equity of RMB4,154 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB11,930 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

In connection with the First Acquisition, the property, plant and equipment of the First Acquired Group were revalued as at 31 December 2002. The net revaluation deficit was reflected in the consolidated financial statements as at 31 December 2002. Such revaluation resulted in an increase directly to equity of RMB760 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB14,690 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

In connection with the Second Acquisition, the property, plant and equipment of the Second Acquired Group were revalued as at 31 December 2003. The net revaluation deficit was reflected in the consolidated financial statements as at 31 December 2003. Such revaluation resulted in an increase directly to equity of RMB1,537 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB14,832 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

In accordance with Group's accounting policy, the property, plant and equipment of the Group were revalued as at 31 December 2004. The net revaluation deficit was reflected in the consolidated financial statements as at 31 December 2004. Such revaluation resulted in an increase directly to equity of RMB1,233 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB1,262 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

Under US GAAP, property, plant and equipment are stated at their historical cost less accumulated depreciation unless an impairment loss has been recorded. An impairment loss on property, plant and equipment is recorded under US GAAP if the carrying amount of such asset exceeds its future undiscounted cash flows resulting from the use of the asset and its eventual disposition. The future undiscounted cash flows of the Group's property, plant and equipment, whose carrying amount was reduced as a result of the above revaluations, exceed the historical cost carrying amount of such property, plant and equipment and, therefore, impairment of such assets is not appropriate under US GAAP. Accordingly, the revaluation reserve recorded directly to equity and the charges to income recorded under IFRS as a result of the above revaluations, are reversed for US GAAP purposes.

However, as a result of the tax deductibility of the net revaluation deficit, a deferred tax liability related to the net revaluation deficit is created under US GAAP with a corresponding decrease in equity.

SUPPLEMENTARY INFORMATION FOR AMERICAN DEPOSITARY SHAREHOLDERS *(continued)*

(b) Disposal of revalued property, plant and equipment

Under IFRS, on disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings. Under US GAAP, the gain and loss on disposal of an asset is determined with reference to the asset's historical cost carrying amount and included in current earnings.

(c) Effect of change in tax rate

Under IFRS, the effect of a change in tax rate that results in a change in the carrying amounts of deferred tax assets and liabilities is charged or credited directly to equity, to the extent that such deferred tax assets and liabilities were previously charged or credited to equity upon initial recognition. Under US GAAP, the effect of a change in tax rate for all items of deferred tax assets and liabilities is recorded in the income statement.

(d) Minority interests

Under IFRS, minority interests at the balance sheet date are presented in the consolidated balance sheet within equity, separately from the equity attributable to the equity shareholders of the Company, and minority interests in the results of the Group for the period are presented on the face of the consolidated income statement as an allocation of the total net profit for the period between the minority interests and the equity shareholders of the Company. Under US GAAP, minority interests at the balance sheet date are presented in the consolidated balance sheet either as liabilities or separately from liability and equity. Minority interests in the results of the Group for the period are also separately presented in the consolidated income statement as deduction before arriving at the net profit.

(e) Recently issued accounting standards

SFAS No. 123R

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-based payment" (SFAS No. 123R). SFAS No. 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires an entity to recognise the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. SFAS No. 123R generally requires that an entity account for those transactions using the fair-value-based method, and eliminates an entity's ability to account for share-based compensation transactions using the intrinsic value method of accounting, which was permitted under Statement 123, as originally issued. For the Group, SFAS No. 123R is effective at the beginning of the reporting period that begins after 15 June 2005. Currently, the Group does not expect the application of SFAS No. 123R will have a material impact on its consolidated financial statements.

SFAS No. 153

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets". SFAS No. 153 addresses the accounting for non-monetary exchanges of productive assets. SFAS No. 153 requires non-monetary exchanges to be accounted for at fair value, recognising any gains or losses, if the fair value is determinable within reasonable limits and the transaction has commercial substance. For the Group, SFAS No. 153 is effective for fiscal years beginning after 15 June 2005. Currently, the Group does not expect the application of SFAS No. 153 will have a material impact on its consolidated financial statements.

(e) Recently issued accounting standards *(continued)*

EITF 04-13

In September 2005, the Emerging Issues Task Force of the FASB issued EITF Issue No. 04-13 "Accounting for Purchases and Sales of Inventory with the Same Counterparty" ("EITF 04-13"). EITF 04-13 provides guidance as to when purchases and sales of inventory with the same counterparty should be accounted for as a single exchange transaction. EITF 04-13 also provides guidance as to when a non-monetary exchange of inventory should be accounted for at fair value. EITF 04-13 will be applied to new arrangements entered into, and modifications or renewals of existing arrangements occurring after 1 January 2007. Currently, the Group does not expect the application of EITF 04-13 will have a material impact on its consolidated financial statements.

SFAS No. 155

In February 2006, the FASB issued SFAS No.155, "Accounting for Certain Hybrid Financial Instruments". SFAS No.155 amends SFAS No.133 and SFAS No. 140 and allows financial instruments that have embedded derivatives that otherwise would require bifurcation from the host to be accounted for as a whole, if the holder irrevocably elects to account for the whole instrument on a fair value basis. Subsequent changes in the fair value of the instrument would be recognised in the income statement. For the Group, SFAS No.155 is effective for fiscal years beginning after 15 September 2006. Currently, the Group does not expect the application of SFAS No. 155 will have a material impact on its consolidated financial statements.

(f) Reconciliation of net profit and equity attributable to equity holders of the Company under IFRS to US GAAP

The effect on net profit of significant differences between IFRS and US GAAP for the years ended 31 December 2004 and 2005 is as follows:

	2005 US$ millions (Note)	**2005 RMB millions**	2004 RMB millions
Net profit attributable to equity holders of the Company under IFRS	**3,459**	**27,912**	28,023
US GAAP adjustments:			
Reversal of deficit on revaluation of property, plant and equipment	**–**	**–**	1,262
Depreciation on revalued property, plant and equipment, net of minority interest of RMB16 million for 2004 and RMB15 million for 2005	**(848)**	**(6,844)**	(6,766)
Disposal of revalued property, plant and equipment	**(39)**	**(316)**	(128)
Effect of change in tax rate on deferred tax assets arising from revaluation of land use rights	**(1)**	**(5)**	(244)
Effect of change in tax rate on deferred tax liabilities arising from revaluation of property, plant and equipment	**3**	**22**	2,189
Deferred tax effect of US GAAP adjustments	**224**	**1,806**	1,379
Net profit attributable to equity holders of the Company under US GAAP	**2,798**	**22,575**	25,715
Basic earnings per share under US GAAP	**0.03**	**0.28**	0.33
Basic earnings per ADS* under US GAAP	**3.46**	**27.89**	32.62

** Basic earnings per ADS is calculated on the basis that one ADS is equivalent to 100 H shares.*

SUPPLEMENTARY INFORMATION FOR AMERICAN DEPOSITARY SHAREHOLDERS *(continued)*

(f) Reconciliation of net profit and equity attributable to equity holders of the Company under IFRS to US GAAP *(continued)*

The effect on equity of significant differences between IFRS and US GAAP as at 31 December 2004 and 2005 is as follows:

	2005 US$ millions (Note)	**2005 RMB millions**	2004 RMB millions
Equity attributable to equity holders of the Company under IFRS	**22,492**	**181,517**	159,206
US GAAP adjustments:			
Revaluation of property, plant and equipment, net of minority interests of RMB39 million as at 31 December 2004 and RMB24 million as at 31 December 2005	**1,894**	**15,287**	22,447
Deferred tax effect of US GAAP adjustment	**(457)**	**(3,691)**	(5,519)
Equity attributable to equity holders of the Company under US GAAP	**23,929**	**193,113**	176,134

Note: Solely for the convenience of the reader, the amounts as at and for the year ended 31 December 2005 have been translated into United States dollars at the noon buying rate in New York City on 31 December 2005 for cable transfers in RMB as certified for custom purposes by the Federal Reserve Bank of New York of US$1.00 = RMB8.0702. No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at that rate or at any other certain rate on 31 December 2005, or at any other date.

FINANCIAL SUMMERY

(Amounts in millions, except per share data)

	Year ended 31 December				
	2005 RMB	2004 RMB	2003 RMB	2002 RMB	2001 RMB
Results					
Upfront connection fees	**6,781**	8,458	9,771	10,564	10,942
Upfront installation fees	**2,970**	2,865	2,643	2,305	1,887
Monthly fees	**30,351**	29,827	27,499	25,338	20,491
Local usage fees	**47,624**	47,646	45,815	44,440	42,516
DLD	**25,993**	26,231	25,460	25,726	26,679
ILD	**3,407**	3,788	3,943	3,878	3,991
Internet	**17,862**	14,109	10,007	5,998	3,395
Managed data	**2,958**	3,015	3,210	3,147	2,660
Interconnections	**12,838**	10,719	8,365	7,524	6,712
Leased line	**4,464**	4,154	5,103	5,520	5,176
Value-added services and others	**14,062**	10,400	9,737	6,466	5,632
Operating revenues	**169,310**	161,212	151,553	140,906	130,081
Depreciation and amortisation	**49,652**	47,170	46,597	45,810	41,777
Network operations and support	**47,793**	43,070	44,118	46,215	46,359
Selling, general and administrative	**27,393**	27,003	24,810	20,585	18,879
Other operating expenses	**5,518**	4,139	3,176	3,188	2,352
Operating expenses	**130,356**	121,382	118,701	115,798	109,367
Operating profit	**38,954**	39,830	32,852	25,108	20,714
Deficit on revaluation of property, plant and equipment	**–**	(1,262)	(14,832)	(14,690)	(11,930)
Net finance costs	**(4,895)**	(5,340)	(3,606)	(4,071)	(2,228)
Investment (loss)/income	**(7)**	6	(42)	50	261
Share of profit from associates	**62**	29	35	38	22
Profit before taxation	**34,114**	33,263	14,407	6,435	6,839
Income tax	**(6,160)**	(5,187)	(469)	1,856	1,499
Profit for the year	**27,954**	28,076	13,938	8,291	8,338
Attributable to:					
Equity holders of the Company	**27,912**	28,023	13,882	8,219	8,352
Minority interests	**42**	53	56	72	(14)
Profit for the year	**27,954**	28,076	13,938	8,291	8,338
Basic earnings per share	**0.34**	0.36	0.18	0.12	0.12

FINANCIAL SUMMARY *(continued)*

(Amounts in millions, except per share data)

	As at 31 December				
	2005	2004	2003	2002	2001
	RMB	RMB	RMB	RMB	RMB
Financial condition					
Property, plant and equipment, net	**328,281**	320,179	309,896	311,241	312,326
Construction in progress	**23,567**	29,450	31,617	37,192	42,180
Other non-current assets	**28,625**	29,409	29,336	32,290	31,388
Cash and bank deposits	**15,413**	13,780	13,194	24,254	15,993
Other current assets	**21,250**	19,752	19,899	18,724	21,547
Total assets	**417,136**	412,570	403,942	423,701	423,434
Current liabilities	**156,976**	151,944	149,135	147,478	144,060
Non-current liabilities	**77,199**	100,007	102,744	88,012	108,914
Total liabilities	**234,175**	251,951	251,879	235,490	252,974
Total equity attributable to equity holders of the Company	**181,517**	159,206	150,794	187,025	169,472
Minority interests	**1,444**	1,413	1,269	1,186	988
Total equity	**182,961**	160,619	152,063	188,211	170,460
Total liabilities and equity	**417,136**	412,570	403,942	423,701	423,434

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31 Jinrong Avenue, Xicheng District,
Beijing, PRC, 100032