# CHINASOFT INTERNATIONAL LIMITED

# 中軟國際有限公司*

*(Incorporated in the Cayman Islands with limited liability)*

## 2005 Annual Report

(Stock Code: 8216)

* for identification purpose only

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*This report, for which the directors ("the Directors") of Chinasoft International Limited (the "Company" and, together with its subsidiaries, the "Group") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the "GEM Listing Rules") for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:– (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

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# Corporate Information

## REGISTERED OFFICE
Century Yard, Cricket Square, Hutchins Drive
P. O. Box 2681 GT
George Town
Grand Cayman
Cayman Islands
British West Indies

## HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN THE PRC
3rd Floor, No.3 Building, Chinasoft Building
No. 55 Xue Yuan Nan Road
Haidian District, Beijing
PRC

## PRINCIPAL PLACE OF BUSINESS IN HONG KONG
Units 4607-8, 46th Floor,
COSCO Tower
No.183 Queen's Road Central
Hong Kong

## WEBSITE
www.icss.com.cn

## COMPANY SECRETARY
Mr. Fok Ming Fuk, William, *MBA, FCCA, CPA CHARTERED ACCOUNTANT, FTIHK, MHKSI*

## COMPLIANCE OFFICER
Dr. Chen Yuhong

## QUALIFIED ACCOUNTANT
Mr. Fok Ming Fuk, William, *MBA, FCCA, CPA CHARTERED ACCOUNTANT, FTIHK, MHKSI*

## AUDIT COMMITTEE
Mr. He Ning
Mr. Zeng Zhijie
Dr. Leung Wing Yin, Patrick

## AUTHORISED REPRESENTATIVES
Dr. Chen Yuhong
Mr. Fok Ming Fuk, William, *MBA, FCCA, CPA CHARTERED ACCOUNTANT, FTIHK, MHKSI*

## INTERNATIONAL AUDITORS
Deloitte Touche Tohmatsu

## SPONSOR
Oriental Patron Asia Limited

## PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE
Bank of Butterfield International (Cayman) Ltd.
Butterfield House, 68 Fort Street
P. O. Box 705
George Town
Cayman Islands

## HONG KONG SHARE REGISTRAR AND TRANSFER OFFICE
Computershare Hong Kong Investor Services Limited
46th Floor
Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

## PRINCIPAL BANKERS
Bank of China
Haidian sub-branch
No. 58 Beisihuan West Road
Haidian District

The Bank of East Asia Limited
22nd Floor
Bank of East Asia Harbour View Centre
56 Gloucester Road
Hong Kong

## STOCK CODE
8216

# Five Years Financial Summary

## RESULTS

| | For the year ended 31 December | | | | |
|---|---|---|---|---|---|
| | 2001 RMB'000 | 2002 RMB'000 | 2003 RMB'000 (restated) | 2004 RMB'000 (restated) | **2005 RMB'000** |
| Turnover | 53,264 | 114,485 | 166,055 | 293,896 | **382,275** |
| Profit before taxation | 20,474 | 22,857 | 30,798 | 39,052 | **48,714** |
| Taxation | – | – | (2,735) | (3,841) | **(5,718)** |
| Profit for the year | 10,474 | 22,857 | 28,063 | 35,211 | **42,996** |
| Attributable to: | | | | | |
| Equity holders of the parent | 8,899 | 19,409 | 23,953 | 32,205 | **39,656** |
| Minority interests | 1,575 | 3,448 | 4,110 | 3,006 | **3,340** |
| | 10,474 | 22,857 | 28,063 | 35,211 | **42,996** |
| Dividend | – | 5,406 | – | 6,784 | **7,394** |



## ASSETS AND LIABILITIES

| | At 31 December | | | | |
|---|---|---|---|---|---|
| | 2001 RMB'000 | 2002 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | **2005 RMB'000** |
| Total assets | 73,232 | 96,898 | 183,117 | 331,325 | **438,765** |
| Total liabilities | (12,210) | (19,386) | (42,824) | (131,930) | **(129,730)** |
| Minority interests | (9,085) | (11,572) | (14,182) | – | **(14,032)** |
| | 51,937 | 65,940 | 126,111 | 199,395 | **295,003** |

Notes:

1. The results for each of the two years ended 31 December 2001 and 31 December 2002 were extracted from the prospectus of the Company dated 10 June 2003.

2. Assets and liabilities of the Group as at 31 December 2001 and 2002 were extracted from the prospectus of the Company dated 10 June 2003.

3. Prior periods have been adjusted to reflect the changes in accounting policies as described in note 3 to the financial statements.

# Milestones 2005

**JANUARY**

- Entered into contract of the second phase of 'The Tobacco Production and Operation Decision Management System of the State Tobacco Control Bureau'
- The feasibility study report for the first phase of the 'e-Quality Project' was approved by experts

**MARCH**

- The Group entered into various development contracts for the 'e-Audit Project' with the State Audit Office

**APRIL**

- Entered into agreement to acquire 51% of the equity interest in Chinasoft Resources Information Technology Services Limited
- Entered into a promotion contract with Zhejiang Audit Office

**MAY**

- Completed the second phase of deployment of 'The Tobacco Production and Operation Decision Management System'
- Won the bidding for the first phase project of the Anhui Tobacco Business Information Management System
- Won the bidding for a project of Yunnan Tobacco Resources and Ancillary Items Company
- Established Chinasoft International (Kunming) Information Technology Limited ("Chinasoft Kunming")

**JUNE**

- Won the bidding for the software project of the Guangdong Tobacco Business Operation Digital Management and Control System Project
- Entered into a promotion contract with the Audit Office of Shaanxi province
- Entered into a promotion contract with the Audit Office of Jiangsu
- Entered into a promotion contract with the Audit Bureau of New Pudong District, Shanghai

# Milestones 2005



## JUNE

- Entered into a promotion contract with the Audit Bureau of Songjiang District, Shanghai
- Entered into a promotion contract with the Audit Office of Zhongshan, Guangdong
- Secured the Audit Management and Information System of China National Petroleum Corporation
- Won the tender for numerous software and hardware projects for the 'e-Quality Project'

## JULY

- Completed the promotion of the 'Tobacco Production and Operation Decision Making Management System' and basically passed the acceptance inspection
- Provided training in 'e-Audit' to several audit offices
- Won the bidding for phase one of the data center system project of Guizhou Huangguoshu (Tobacco) Group Co., Ltd.(貴州黃果樹烟草集團公司)
- Won the bidding for the marketing information system database of Yuxi Hongta(玉溪紅塔)

## AUGUST

- Engaged by the State Audit Office to draft a feasibility report for the second phase of 'e-Audit'

## SEPTEMBER

- Successfully secured financing of US$35 million from Microsoft and IFC
- Entered into a promotion contract with the Audit Bureau of Shijiazhuang, Hebei
- Entered into a promotion contract with the Audit Bureau of Jinshan District, Shanghai
- Successfully acquired 20% of the equity interest in China National Tobacco Material E-Commerce Co., Ltd.(北京中烟物資電子商務有限公司)
- Successfully formed Wuhan Chinasoft International Information Technology Limited(武漢中軟國際信息技術有限公司)

# Milestones 2005

**SEPTEMBER**

- Named as a top ten e-Government IT manufacturer
- Rated the number one brand name of the e-Government application platforms in China by CCID Consulting for the third time

**OCTOBER**

- Entered into a promotion contract with the Audit Bureau of Qingdao, Shandong Province
- Entered into a promotion contract with the Audit Bureau of Xiamen, Fujian Province
- Secured the network-based audit project for Capital Airport
- Prepared the preliminary design for the "e-Quality Project" of the State General Administration of Quality Supervision, Inspection and Quarantine

**NOVEMBER**

- Continued the data integration of the cooperative operation project of General Tobacco Group Co., Ltd. as well as the decisional support of the system construction project
- Won the bidding for the project of the website portal of Guizhou Huangguoshu Tobacco Group Company（貴州黃果樹煙草集團公司）
- Entered into a promotion contract with the Audit Bureau of Dongguan
- Undertook the social medical care, work injury and birth information management system of Xin Xiang City
- Entered into agreement to acquire the remaining 49% of the equity interest in Chinasoft Resources Information Technology Services Limited

**DECEMBER**

- Entered into a promotion contract with the Audit Bureau of Shanxi Province
- Entered into a promotion contract with the Audit Bureau of Shijiazhuang, Hebei Province
- Entered into a promotion contract with the Audit Bureau of Tianjin
- Entered into a promotion contract with the Audit Bureaux of Bengbu, Huainan of Anhui Province

# Milestones 2005

## DECEMBER

- Entered into a promotion contract with the Audit Bureau of Suzhou, Jiangsu Province
- Entered into a promotion contract with the Audit Bureau of Baoshan District, Shanghai
- Entered into a promotion contract with the Audit Bureau of Luwan District, Shanghai
- Entered into a promotion contract with the Audit Bureau of Jiaxing, Zhejiang Province
- Entered into a promotion contract with the Audit Bureau of Jinshan District, Shanghai
- Entered into a promotion contract with the Audit Office of Hubei Province
- Entered into a promotion contract with the Audit Bureau of Zhuhai, Guangdong Province
- Entered into a promotion contract with the Audit Bureau of Shunde District, Guangdong Province
- Entered into a promotion contract with the Audit Bureau of Xinhui, Guangdong Province
- Entered into a promotion contract with the Audit Office of Guangxi Province
- Entered into a promotion contract with the Audit Office of Yunnan Province
- Entered into a promotion contract with the Audit Bureau of Hainan Province
- Secured the Automated Office System of the Tibet Municipality Tobacco Control Bureau (Company)
- The No. 1 data back-transmission project of Zhejiang Zhongyan Industrial Company（浙江中煙工業公司）
- Won the bidding for the Labour and Social Protection Information System Application Development service contract of Shantou City
- Awarded by Deloitte as one of the "500 Fastest Growing Hi-tech Enterprises in the Asia Pacific" for the second time

# Managing Director's Report

I am pleased to report that, given the keen competition in the software industry in the PRC, the Group has utilised its core technology competitive edge, and committed itself in industries which it has a leading position. The Group increased its market share in those industries, whilst at the same time explored new industries to act as new bases for the Group's continuing development. I would like to take this opportunity to share with the Shareholders the Group's certain financial and business highlights in 2005:

## OPERATING RESULTS

For the year ended 31 December 2005, the Company recorded a turnover and net profit of approximately RMB382,275,000 and RMB39,656,000 (2004: approximately RMB293,896,000 and RMB32,205,000) respectively, an increase of 30% and 23% respectively over that of last year. Earnings per share was approximately RMB0.0556 (2004: RMB0.0487).

The Directors recommend the payment of a final dividend of HKD0.025 per share for the year ended 31 December 2005.

## BUSINESS REVIEW

The Group captured the growing business opportunities in the e-Government market and attained the following achievements during the reporting period via its competitive advantage in technology:

The satisfactory result is attributable to the business expansion strategy of "Champion Industry" formulated at the beginning of the year. Our business strategy as at the beginning of the review period were to take a dominant role in the e-Government and information development projects of State-owned major enterprises in the PRC, and we have made breakthrough achievements to date.

The result of the implementation of the so-called "3+1", that is the strategy of "Be Champion in 3 Industries" and "1 data center solution for all industries": tobacco, auditing and the developing quality control and inspection, and the business development of data center solutions, the results of which are encouraging:

(1) Completed all the contract-signing of the second phase project for the "Tobacco Production and Operational Decision Management System for the State Tobacco Control Bureau"; (2) The deployment of phase two of the "Tobacco Production and Operation Decision System of the Tobacco Industry" was completed and passed the acceptance inspection; (3) The Group won the tender of Hunan Province Tobacco Control Bureau; (4) Undertook the comprehensive analysis of the statistics and commercial operation systems of Yuxi Hongta Tobacco (Group) Limited; (5) Won the bidding for the marketing information system database of Yuxi Hongta (玉溪紅塔); (6) Successfully won the tender of the Central Data Bank System of Yunnan Zhongyan Company Limited (雲南中煙工業公司) by the Group; (7) The Group successfully bidded a project of Yunnan Tobacco Resources and Ancillary Items Company (雲南煙草物資配套公司); (8) The Group successfully bidded the phase one project of Anhui Tobacco Business Information Management System; (9) The Group successfully won the tender for the software project of the Guangdong Tobacco Business Operation Digital Management and Control System Project; (10) Won the bidding for phase one of the data center system project of Guizhou Huangguoshu (Tobacco) Group Co. Ltd. (貴州黃果樹煙草集團公司); (11) Undertook the data integration and decision support system construction project of the cooperation project sub-contracted by Jiangjun Tobacco Group Co. Ltd. (將軍煙草集團有限公司); (12) Undertook the project sub-contracted by Automated Office System of Tibet Municipality Tobacco Control Bureau (Company); (13) Successfully bidded the No. 1 data back-transmission project of Zhejiang Zhongyan Industrial Company (浙江中煙工

# Managing Director's Report

業公司); (14) Entered into several contracts with the State Audit Office; new progress for the "e-Audit" Project; (15) The Group started the promotion of "e-Audit Project"; (16) Provided training in "e-Audit" to various audit departments; (17) Engaged by the State Audit Office to draft a feasibility report for the second phase of "e-Audit"; (18) The Group contracted the Audit Management and Information System Project of the China National Petroleum Corporation; (19) Contracted in the network-based audit project for Capital Airport; (20) Feasibility study report of the First Phase of "e-Quality" Project passed the expert debate; (21) Successfully bidded the Unified Application Software Development and Implementation Project of Hubei Province Labour Protection System; (22) Undertook the social medical care, work injury and birth information management system of Xin Xiang City; (23) Successfully bidded the Labour and Social Protection Information System Application Development service contract of Shantou City;

Having successfully obtained finance and carried out the merger and acquisition activities, the Company is transforming to be a solely software and services provider. While striving to become an international company, the Company also focuses on exploiting the international market:

(1) Successfully raised funds of US$35 million from Microsoft and IFC; (2) Successfully acquired 100% of the equity interest of Chinasoft Resources Information Technology Services Limited (北京中軟資源信息科技服務有限公司); (3) Successfully acquired 20% of the equity interest in China National Tobacco Material E-Commerce Co. Ltd. (北京中煙物資電子商務有限公司); (4) Established Chinasoft International (Kunming) Information Technology Limited (中軟國際(昆明)信息技術有限公司); (5) Successfully formed Wuhan Chinasoft International Information Technology Company Limited (武漢中軟國際信息技術有限公司); (6) Became a top ten e-Government IT manufacturer; (7) Rated the number one brand name in e-Government application platforms in China by CCID Consulting for the third time; (8) Named again by Deloitte as one of the "500 Fastest Growing Hi-tech Enterprise in the Asia Pacific".



## BUSINESS PROSPECTS

The software and servicing industries in PRC achieved greater progress in 2005. While the domestic demand increase continually, there is a rapid boost in the international outsourcing business. Looking forward, the Company as a PRC-based supplier providing global services shall be positioned at the following 3 objectives:

1. The leader of the industry in PRC

2. The leading outsourcing enterprise

3. The top workflow (quality) control company

## APPRECIATION

On behalf of the Group, I take this opportunity to extend my sincere gratitude to all partners, clients and suppliers of the Group as well as all members of the staff for their support and contribution during the past year and to express my desire to continue to strive for progress together with them in the future.

**Dr. Chen Yuhong**
*Managing Director*

Beijing, The PRC
30 March 2006

# Business Objectives and Business Progress Comparison

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

The following is a comparison of the business objectives as stated in the prospectus of the Company dated 10 June 2003 (the "Prospectus") and the actual business progress up to 31 December 2005:

| Major area | Major business objective stated in the Prospectus | Actual business progress |
|---|---|---|
| Strengthen the Group's Solutions | • To establish new business partners/strategic alliances with technology companies for joint development of Solutions. | • Sustained cooperation relations with current partners, and trying to seek for new partners. |
| Development of new standalone software products and enhancement of existing standalone software products | • Continue to enhance the features on existing middleware and application software. | • Completed. |
| Development of the business of IT consulting and training and IT outsourcing | • Continue to monitor existing customers' system and provide consulting and training services to them. | • Completed.<br>• Purchase 100% shareholding of Chinasoft Resources so as to strengthen the Group's capacity. |
| Sales and marketing | • Send staff to relevant exhibitions and conferences to promote the Group's e-government solutions. | • The Group continuously participated in various contests in order to enhance its reputation. |

# Business Objectives and Business Progress Comparison

## USE OF PROCEEDS FROM THE LISTING

The net proceeds raised from the listing of the Company on GEM on 20 June 2003 was approximately HK$34,013,000.

As at 31 December 2005, the Company had incurred the following sums to achieve its business objectives as set out in the Prospectus:

| Major area stated in the Prospectus | Intended use of proceeds stated in the Prospectus up to 31 December 2005 HK$' million | Actual amount used up to 31 December 2005 HK$' million | Unused balance HK$' million |
|---|---|---|---|
| 1. Development of new and enhancement of the Group's existing solutions | 11.00 | 11.00 | — |
| 2. Development of new standalone software products and enhancement of the Group's existing solutions | 11.00 | 11.00 | — |
| 3. Development of business of IT consulting and training | 2.50 | 3.50 | — |
| 4. Development of business of IT outsourcing | 3.00 | 3.00 | — |
| 5. Sales and Marketing | 5.50 | 5.50 | — |
| | 33.00 | 34.00 | — |

# Management Discussion and Analysis

## FINANCIAL REVIEW

For the fiscal year ended 31 December 2005, the Company reported a total turnover of approximately RMB382,275,000 and net profit attributable to shareholders of approximately RMB39,656,000 as compared to a turnover of approximately RMB293,896,000 and net profit of approximately RMB32,205,000 (restated under the new HKFRS) in 2004, representing an increase of about 30% and 23% respectively. Earnings per share is approximately RMB0.0556 and net assets per share of the Company is approximately RMB0.42.

## ANALYSIS OF TURNOVER

The turnover of the Group for the year ended 31 December 2005 can be classified by categories of services and products:

| **Products Segment** | **2005** | | 2004 | | |
|---|---|---|---|---|---|
| | **Turnover RMB'000** | **Portion** | Turnover RMB'000 | Portion | Increase (decrease) in Turnover % |
| Solutions | **301,075** | **79%** | 240,820 | 82% | 25% |
| IT Outsourcing | **53,034** | **14%** | 34,286 | 12% | 55% |
| IT Consulting and Training Services | **7,552** | **2%** | 6,298 | 2% | 20% |
| Sale of Standalone Software and Hardware Products | **20,614** | **5%** | 12,492 | 4% | 65% |
| Total | **382,275** | **100%** | 293,896 | 100% | 30% |

No geographical segments information of the Group is shown as the operating business of Group is solely carried out in the PRC and its assets are substantially located in the PRC.

# Management Discussion and Analysis

## RESULTS

For the year ended 31 December 2005, the Group continued to achieve an impressive result of having a turnover of approximately RMB382,275,000, representing an increase of approximately 30% as compared to the corresponding period in 2004. The Group also achieved a net profit attributable to shareholders of approximately RMB39,656,000, representing an approximately 23% increase as compared to the corresponding period in 2004. Both remarkable increase in turnover and net profit attributable to shareholders were attributable to the Group's continuous efforts in marketing by expanding its sales and marketing team to enhance market penetration and to open up new markets, thereby maintaining the Group's good reputation, branding , as well as customers' confidence in the Group, and its consistent policy of achieving external growth through the acquisition of high growth companies.

The turnover of the Group is derived from the provision of Solutions, IT outsourcing, IT consulting and training and sales of standalone software product, all of which grew tremendously as compared to the year ended 31 December, 2004. The substantial growth in IT outsourcing is due to the successful acquisition of Chinasoft Resources Information Technology Services Limited, principally engaged in IT outsourcing, in August, 2005.

Compared with the year ended 31 December, 2004, gross profit margin increased from 27.4% to 30.87%, which resulted from the determination of the Group to be a leading software and solutions provider. The distribution costs for the year were approximately RMB18,918,000 representing an increase of approximately 78% from the previous year. The increase in distribution cost was mainly due to an increase in the Group's sales of 30% and the expansion of its sales and distribution team. The administrative expenses for the reporting period were approximately RMB44,564,000, an increase of approximately 63% from the last period. The increase in administrative costs was mainly due to an increase in headcount, depreciation and amortization of intangible assets and expansion of the research and marketing team which is essential for the further expansion of the Group's business and development.



## FINANCIAL RESOURCES AND WORKING CAPITAL

As at 31 December 2005, shareholders' funds of the Group amounted to approximately RMB309,035,000. Current assets amounted to approximately RMB309,787,000, of which approximately RMB100,086,000 were cash and bank deposits. The Group had no other non-current liabilities except Deferred tax liabilities of RMB1,824,000 and its current liabilities amounted to approximately RMB127,906,000, mainly consisting of trade and other payables, bills payable and taxation payable. The net asset value per share was approximately RMB0.42 and the Group had no bank borrowing as at year ended.

During the year ended 31 December 2005, as all major Group's sales and purchases were substantially denominated in Renminbi, the Directors consider that the potential foreign exchange exposure of the Group is limited.

As at 31 December 2005, except for a bank deposit of approximately RMB1,653,000 pledged with a bank for trade facilities granted to the Group by its suppliers, the Group did not have any material investment in assets and assets pledged.

# Management Discussion and Analysis

The Group entered into the subscription agreement with Microsoft and IFC in Beijing on 26th September 2005 for the issue of redeemable convertible preferred shares worth USD20million by the Company to Microsoft and IFC. Through such strategic investments, the Group will further strengthen its capital base and cash flows and enhance its technical expertise and corporate governance.

## BUSINESS REVIEW

The Group achieved remarkable operating results for 2005, of which the details are as follows:

**I. Financing:**

- Successfully raised funds of US$35 million from Microsoft and IFC

**II. In the aspect of business:**

- Completed all contract-signing of the second phase project for the "Tobacco Production and Operational Decision Management System for the State Tobacco Control Bureau"
- The deployment of phase two of "Tobacco Production and Operation Decision System of the Tobacco Industry" was completed and passed the acceptance inspection
- The Group won the tender of Hunan Province Tobacco Control Bureau
- Undertook the comprehensive analysis of the statistics and commercial operation systems of Yuxi Hongta Tobacco (Group) Limited
- Won the bidding for the marketing information system database of Yuxi Hongta（玉溪紅塔）
- Successfully won the tender of the Central Data Bank System of Yunnan Zhongyan Company Limited (雲南中煙工業公司) by the Group
- The Group successfully bidded a project of Yunnan Tobacco Resources and Ancillary Items Company（雲南煙草物資配套公司）
- The Group successfully bidded the project of phase one of Anhui Tobacco Business Information Management System
- The Group successfully won the tender for the software project of the Guangdong Tobacco Business Operation Digital Management and Control System Project
- Won the bidding for phase one of the data center system project of Guizhou Huangguoshu (Tobacco) Group Co. Ltd.（貴州黃果樹煙草集團公司）

# Management Discussion and Analysis

- Undertook the data integration and decision support system construction project of the cooperation project sub-contracted by Jiangjun Tobacco Group Co. Ltd.（將軍煙草集團有限公司）

- Undertook the Automated Office System of Tibet Municipality Tobacco Control Bureau (Company)

- Successfully bidded the No. 1 data back-transmission project of Zhejiang Zhongyan Industrial Company （浙江中煙工業公司）

- Entered into several contracts with the State Audit Office; new progress for the "e-Audit Project"

- The Group started the promotion of "e-Audit Project"

- Provided training in "e-Audit" to various audit departments

- Engaged by the State Audit Office to draft a feasibility study report for the second phase of "e-Audit"

- The Group contracted in the Audit Management and Information System Project of China National Petroleum Corporation



- Contracted in the network-based audit project for Capital Airport

- Feasibility study report of the first phase of "e-Quality Project" passed the expert debate

- Successfully bidded the Unified Application Software Development and Implementation Project of Hubei Province Labour Protection System

- Successfully bidded the Labour and Social Protection Information System Application Development service contract of Shantou City

**III. Acquisition and Investment:**

- Successfully acquired 100% of the equity interest of Chinasoft Resources Information Technology Services Limited（北京中軟資源信息科技服務有限公司）

- Successfully acquired 20% of the equity interest in China National Tobacco Material E-Commerce Co. Ltd. (北京中煙物資電子商務有限公司)

- Established Chinasoft International (Kunming) Information Technology Limited（中軟國際（昆明）信息技術有限公司）

- Successfully formed Wuhan Chinasoft International Information Technology Company Limited（武漢中軟國際信息技術有限公司）

## IV. Awards received:

- Became a top ten e-Government IT manufacturer
- Rated the number one brand name in e-Government application platforms in China by CCID Consulting for the third time
- Named again by Deloitte as one of the "500 Fastest Growing Hi-tech Enterprise in the Asia Pacific"

## I. Financing:

### *1. Successfully raised funds of US$35 million from Microsoft and IFC*

During the reporting period, Microsoft and IFC has strategically invested a total amount of up to US$35 million in the Group in Beijing. In addition, the Chinasoft-Microsoft online laboratory officially commenced operation simultaneously.

The signing ceremony of the strategic investment agreement was held in Beijing Hotel, a famous hotel in Beijing, and various officials of Beijing's municipal government, the State Reform and Development Commission and the Ministry of Information Industry were invited to attend the ceremony. According to the agreement, Mircosoft and IFC will invest up to US$20 million and US$15 million respectively to the Group through preferred shares. Mircosoft and IFC will make an initial cash investment of US$10 million, amounting to US$20 million in total. These two investors are also entitled to further invest US$15 million in the Company in the future.

Based on this cooperation, the Group will be able to capitalize on the advantages of Microsoft's technology and its global market and, together with the Group's localization edge in the China market, extensive user-base and excellence in industry application software and solution, to make the Group become one of China's largest software service providers and information technology outsourcing service providers and world class outsourcing business provider, and to accelerate the Group's internationalization process.

IFC is a member of the World Bank. IFC, as a strategic partner of the Group, will provide the Group with the funds necessary for the Group's development. Furthermore, the joining of IFC, being a company well-known around the world for its management, will enhance the level of the Group's management standards.

# Management Discussion and Analysis

## II. In the aspect of business:

### *1. Completed signing the contracts of the second phase project of the "Tobacco Production and Operational Decision Management System for the State Tobacco Control Bureau"*

During the reporting period, the Group has entered into business contracts with seven commercial enterprises in the tobacco industry and the Group has completed signing all of the contracts of the second phase project of the "Tobacco Production and Operational Decision Management System for the State Tobacco Control Bureau".

During the reporting period, the State Tobacco Control Bureau convened a meeting and highly praised the implementation of the second phase project of the "Tobacco Production and Operational Decision Management System for the State Tobacco Control Bureau" by the Group. At the same time, the State Tobacco Control Bureau has started to adopt the solutions provided by the Group in its operation which has proven to be effective.

### *2. The deployment of phase two of "Tobacco Production and Operation Decision System of the Tobacco Industry" was completed and passed the acceptance inspection*



After the phase two construction, the promotion and implementation of the Tobacco Production and Operation Decision Management System in the tobacco industry was completed. The State Tobacco Control Bureau had started to officially activate the system in the third quarter of 2005.

As such, the first and second phases of the Tobacco Production and Operation Decision System of the Tobacco Industry are now fully completed. This project lasted for one and a half years, involving 49 legal person industrial enterprises in the tobacco industry and their 103 production bases; 33 provincial bureaus (companies), 373 business branch companies and their 960 affiliated warehouses. The project completed the development and deployment of the data center and application demonstration of the State Tobacco Control Bureau and established a unified lawful channel for collecting the industry's statistical data in order to form an information platform integrating numerous functions including data collection, examination, inquiry, analysis, policy management and information release etc. It laid a solid foundation for "systematic integration, resources integration, and information sharing" and realized the original imagination of the project.

To ensure quality of its projects, the Group conducted examinations of and visits to the key enterprises which the system has been operating. Through such examinations and visits, the Group aimed to fully understand the status of implementation and operation of the projects, collect corporate advice and suggestions, resolve problems which occurred in the operation of the systems, facilitate participation of the Group and enhance the standard of service provided and secure safe and steady operation of the entire system.

Currently, the system can realize:

(1) analyzing, communicating and encoding of the quarterly tobacco production plan by the state bureaus, provincial-level bureaus (companies), industrial companies and industrial enterprises through the use of the system;

(2) coding and decoding of tobacco products of industrial enterprises;

(3) scanning and decoding of tobacco products of industrial enterprises which moves out of the warehouse;

(4) confirming, scanning and decoding upon arrival of tobacco products of business enterprises;

(5) gathering business data through the industrial and business data gathering system and report to the relevant authority by industrial and commercial enterprises;

(6) showing the data center and applications of the state bureau.

### 3. *The Group won the tender of Hunan Province Tobacco Control Bureau*

By providing consultation service for Hunan Province Tobacco Control Bureau, the Group won its integrated application service and software platform procurement project.

The contract sets out that the Group should establish, provide consultation and develop and provide training for users of the software and hardware basic environment construction for Hunan Province Tobacco Franchise Bureau.

Main consultation and development details are:

(1) Integrated Overall Solution for Hunan Province Tobacco Industry System

(2) Integrated Standards and Norms for Hunan Province Tobacco Industry System

(3) Construction of the environment for the Integrated Application Software

### 4. *The Group undertook the comprehensive analysis of the statistics and commercial operation systems of Yunnan Yuxi Hongta Tobacco (Group) Limited*

Yunan Yuxi Hongta is a leading company in domestic tobacco industry and in particular, it is known for the construction of informatization in the industry. During the reporting period, the Group won the tender of the comprehensive analysis of the statistics and commercial operation systems of Yunnan Yuxi Hongta Tobacco (Group) Limited.

The Group will provide clients with the following major developments:

(1) The construction of a comprehensive statistics management sub-system

Upon confirmation of the demand, to erase the indicator codes, to establish a statistics reporting system, to process and collect historical data, to set up criteria for statistics data collection, and to establish a collection method of active data.

(2) The construction of a commercial operation sub-system

Including: the production of the current business report and comprehensive analysis report; the 100th market control, tobacco production cost control, key market control, exhibition and analysis of data which requires attention and the development of a business conditions map.

***5. Won the bidding for the marketing information system of the database of Yuxi Hongta（玉溪紅塔）***

The database marketing system that is constructed by the Group for Yunan Yuxi Hongta will reach following goals: to use the up-to-date information technology and computer application technology with the excellent combination of other internal business systems and functional systems of Hongta Group to construct a platform of information treatment and analysis for attracting and retaining clients and turning potential clients into actual clients. Based on collecting client market investigation information, client information and client operation strategic resources, the system can further gather basic information about the market and clients, etc. to build a fast, comprehensive and accurate channel of client service and market analysis and to establish a perfect client satisfaction assessment system. The completed system will be one of the basis for client management and analyzing client consumption trend and market development trend, enhancing client loyalty and satisfaction, consolidating market share in each local area and identifying the clients that generate the maximum profits.

***6. Successfully won the tender of the Central Data Bank System of Yunnan Zhongyan Company Limited (雲南中煙工業公司) by the Group***

The Group won the tender of the Central Data Bank System of Yunnan Zhongyan Company Limited (雲南中煙工業公司) This system is to achieve data integration, and to establish the information web-based Central Data Bank of Yunnan Zhongyan Company Limited (雲南中煙工業公司) and the application system of the Central Data Bank.

***7. The Group successfully bidded a project of Yunnan Tobacco Resources and Ancillary Items Company（雲南煙草物資配套公司）***

As the original local area network and external network systems of Yunnan Tobacco Resources and Ancillary Items Company（雲南煙草物資配套公司）became obsolete and could no longer satisfy current work requirement, the Group was entrusted to modify the software and hardware condition so as to form a solid foundation for future software needs.

## 8. *The Group successfully bidded phase one project of Anhui Tobacco Business Information Management System*

The Group successfully bidded the Anhui Tobacco Business Information Management System Project.

The Project includes planning, implementing, operating and establishing an effective, flexible, open, integrated and safe information management platform so as to lay a foundation for information integration and comprehensive usage of the entire Anhui Tobacco industry as well as to satisfy Anhui Tobacco's internal demand for information application following rapid improvements on the management and operation level, so as to face intensifying market competition.

The objective of phase one of the Project is to adopt an effective information platform to establish an integrated business enterprise management information system and realize the two-level separate management in province and municipality: establish an accurate and consistent data standard through the industry's data management center (coding center) and realize dynamic update; establish a complete information database in business operation through the marketing management system; handle and satisfy client's demand effectively and rapidly; standardize and manage the offline and online of clients through the sales management system to strengthen the effort on management and control of the tobacco market; establish the working platform of different levels of staff in the enterprise through the client management system, and satisfy the enterprise's management and examination requirements towards every level of staff within the enterprise; form a consistent and complete client profile through setting up a business data center; integrate internal and external business data by using the database technique and conduct analysis on clients, market and products etc., to provide all levels of staff and all departments with effective information and realize support for decision making.



## 9. *The Group successfully won the tender for the software project of the Guangdong Tobacco Business Operation Digital Management and Control System Project*

The Guangdong Tobacco Operation and Management Analysis and Monitoring System is built to achieve the goal of building an integrated business data centre within the Guangdong Tobacco Business System for the purpose of integrating the data of various business systems, and on this basis, developing and building data inquiry, simple statement statistics, data analysis and decision making support platforms catering for provincial offices (companies) by means of business intelligence technology, and thereby building the Guangdong Tobacco Operation Management, Analysis and Monitoring System, through which the decision making and management personnel of provincial offices (companies) may conduct search and analysis, and obtain comprehensive, timely and accurate information about the operation and management in the industry or a business unit as well as monitor and appraise the operation and management of various business units in a comprehensive, timely and accurate manner, and the system may also provide accurate and scientific bases for implementing economic and operation adjustments within and determining strategies of the industry.

# Management Discussion and Analysis

**10. *Won the bidding for phase one of the data center system project of Guizhou Huangguoshu (Tobacco) Group Co. Ltd.（貴州黃果樹煙草集團公司）***

The objective of establishing the data center system for Guizhou Huangguoshu (Tobacco) Group Co. Ltd. ("Huangguoshu") is to facilitate the integration of Huangguoshu's data and to build a central database and data applications on the foundation of the industry's existing information network. These facilities should enable Huangguoshu to fully, timely and accurately acquire the industry's information on cigarettes, specification, production volume, sales volume, inventory, price, costs, profit, flow, personnel, education, security and community union, as well as basic data such as the performance of contracts.

Through this project, Huangguoshu can completely centralize its data and provide data sharing amongst departments and applications and can also apply basic data.

After the construction of the system is completed, the central database will become the regional data centre and data hub of Guizhou's cigarette industry. The basic information codes, basic business standards and basic business benchmarks within the industry can be maintained, thereby laying the foundation for comprehensive integrations of the information system and supply chain and management of Guizhou's cigarette industry.



**11. *Undertook the data integration and decision support system construction project for the Co-ordination Office of Jiangjun Tobacco Group Co. Ltd.（將軍煙草集團有限公司）***

The project mainly includes:

(1) Data Integration Construction

To establish an orderly information filing system by sorting, marking, ranking, consolidating and computing on the database information supporting the application system, and conduct data handling, capturing, transmission and data exchange, in order to build a group data center.

(2) Decision Support System Construction.

1) to establish and develop a decision support system with functions such as data enquiry, business statements, data analysis, economic operation analysis etc. based on the Data Center Platform of the Jiangjun Group.

2) Establishment of a knowledge center. To establish a non-structured data center that realizes the management and enquiry and search functions on non-structured data.

***12. Undertook the Automatic Office System of Tibet Municipality Tobacco Control Bureau (Company)***

The project won by the Group mainly includes following tasks:

(1) The document circulation system, to realize the document drafting and approval process among various business department within the company in the region.

(2) The document reporting system, to realize the function of document reporting, receiving and sending between the company and the four subsidized branches in the region.

(3) The archive management system, to realize the management of the archived documents of the company in the region.

(4) The personal office system, to realize the functions such as personal calendar arrangement, pending dealing matter management, address book and notebook etc.

(5) The integrated affair system, to realize the functions of meeting management and resource management.

(6) The email system, to establish a centralized email system.

***13. Successfully bidded the No.1 date back-transmissions project of the Zhejiang Zhongyan Industrial Company（浙江中煙工業公司）***

The objective of this project is to realize the subscription and issuance of the State Bureau data, and the subscription and issuance of the provincial terminal data by the Zhejiang Zhongyan Industrial Company（浙江中煙工業公司）, and to provide two major category of data application of basic analysis and extended analysis through tool products such as data exchange engine, data exchange management system etc.

(1) Fundamental Analysis: report of data analysis by the province

(2) Extension Analysis: analysis of provincial data of effectiveness and commercial brand name.

As the Group becomes more and more influential in the tobacco industry and can accurately estimate the demand of the market, the Group has completely obtained its leading role in the industing, and there are more opportunities available in the tobacco industry.

***14. Entered into several contracts with the State Audit Office; new progress for the "e-Audit" Project***

(1) Entered into contract with the State Audit Office on the software development contract for the Government Budgeting Division Auditing Via Network.

During the reporting period, the Group and the State Audit Office entered into a contract for the software development of the Government Budgeting Division Auditing Via Network. This is an essential step for the transition of the "e-Audit Project" from "standalone" version to "network" version.

The development target of this Project is to carry out the modifications of "Budget Tracing and Network Verification" audit mode, the changes of current audit methods and the collection of data bank from audited units at designated times. This Project can actively serve as an alarm system for suspicious data, generate alarm reports, and at the same time be automatically converted into intermediate audit report. This report will be given to the auditing staff who use the On-site Audit Implementation System (shortened as the AO system) to carry out audit.

Such development project can be divided into 4 parts: Data Collection and Conversion, Audit Alarm System, Basic Management and Initialization of Front Server and On-site Audit.



(2) Entered into contract with the State Audit Office on "1 platform for N users mode" Audit Management System

In order to provide a common audit management system for the utilization of "City-level" and "County-level" local audit offices and cut-down the establishment cost of audit management system for "City-level" and "County-level" local audit offices, modifications of the original audit management system are made so as to make it applicable to the System-sharing of "City-level" and "County-level" auditing divisions (shortened as the "1 platform for N users mode". The modifications of the First Phase of the "e-Audit" Project audit management system based on the "1 platform for N users mode" will adopt the principles of "Centralized Management and Dispersed Application". This is based on the State's e-Government Network Platform and realizes single hardware platform ("City-level") for multi-applications ("County-level"), meanwhile, secure the logical independent usage on "City-level" and "County-level" application and the unity of physical arrangements.

# Management Discussion and Analysis

(3) Entered into contract with the State Audit Office on software development of the OA Exchange Area

Based on the State's e-Government Network Platform, the construction of LAN links up "State Office to County level" audit offices, realizes systematic data exchange network, establishes a fast communicating and data exchanging National Audit Office and Work System and achieves the target of a resources sharing Audit Information-based Network System.

The Group will utilize its established audit management system platform from the "e-Audit Project", base on the middleware of Data Transmission Channel and realize the data transmission and exchange of covering official documents, plans, personnel files, audited units and unit data bank, the audit expert system, auditing method library, statistical indicator module and report.

(4) Entered into contract with the State Audit Office on the AO Exchange Area

The development of the AO Exchange Area Software will attain the following targets:

1) To allow the City Statistics Department personnel to obtain information about the government affairs (notices and announcements) from the AO Exchange Area of the audit division during On-site Audit Visits, as well as to make their feedback about the project.

2) The information in the AO Exchange Area is gathered from the OA audit management system of the Audit Intranet. Due to the physical partition between the Audit Intranet and AO Exchange Area, the software will process under the physical partition environment and achieve data exchange between the audit management system of Audit Intranet and the software of the AO Exchange Area.

3) To assist auditors of On-site Audit to report all kinds of on-site information which is investigated during audit project process to the Audit Offices.

4) To feedback information from On-site Audit through the temporary storage area and exchange data with the Audit Intranet of the Audit Management System (OA).

(5) Entered into contract with the State Audit Office on developing the On-site Audit Implementation System 2005 Version

To maximize the usage of the On-site Audit Implementation System in actual audit implementation process, based on the feedbacks collected from the original "On-site Audit Implementation System". The "On-site Audit Implementation System 2005 Version" has improved its user-friendly feature, enhances its software system and increases its data processing function which reaching the level of 300,000 data entries in a single report.

# Management Discussion and Analysis

***15. The Group started the promotion of "e-Audit Project"***

(1) The Group and the Audit Office of Shaanxi Province, Shanxi Province, Hubei Province, Tianjin, Qindao, Shandong Province, Bengbu, Anhui Province, Huainan Anhui Province, Jiangsu Province, Suzhou, Jiangsu Province, Songjiang District, Shanghai, Baoshan District, Shanghai, Luwan District, Shanghai, Zhongshan, Guangdong Province, Hechi, Guangxi Province, Xinhui, Guangdong Province, Zhuhai, Guangdong Province, Shunde District, Foshan, Guangdong Province, Guangxi Province, Yunnan Province and Hainan Province entered into contracts for the deployment of On-site Audit Implementation Management System.

Reviewing the phase one of "e-audit Project", the audit system developed by the Company is ready to applied in the State Audit Office, 25 Dispatched Audit Offices, 18 Resident Audit Office and several provincial and regional audit office. 35,000 sets of On-site Audit Implementation System has been promoted in the audit offices of various levels in PRC. The phase one of "e-audit Project" has generated significant effects and effectiveness. At the same time, since the system needs a large number of services, the Group, as a general service provider of the e-Audit Project, could also obtain substantial income.

(2) Engaged by the State Audit Office to draft a feasibility study report for the second phase of "e-Audit"

Following as the general integration provider and service provider of phase one of "e-Audit Project", the Group accepted the engagement by the State Audit Office to draft a feasibility study report for the second phase of "e-Audit". The report set out that:

The construction objective of phase two of "e-Audit Project" was to conduct full-scale promotion of, expand and improve the application system constructed for phase one, implement the audit-based computer network in a network environment and complete the construction of a preliminary network-based audit system for important bodies in the sectors of finance, customs, banking, etc. and complete the construction of preliminary information network security system to enable the sharing of resources between audit bodies at the provincial level or above across the country. This phase is to preliminarily realize the construction objective of a "budget-tracking + network-checking" audit model and "Three Shifts", to substantially enhance the efficiency, quality and level of audit, and to form preliminarily a style of modern audit with Chinese characteristics to lay a foundation for China's GAIS (Government Audit Information System). The construction cycle is from 2006 to 2008.

With an advantageous position in the audit sector, the Group is confident in becoming the general integration provider and service provider of phase two of "e-Audit Project" again following as the general integration provider of phase one of "e-Audit Project"

(3) The Group entered into a consultation contract in relation to "e-Audit Project" with the Audit Department of Ningbo, Zhejiang Province

With the Group's distinguished status in the industry, the Audit Department of Ningbo invited the Group to become its strategic partner and compiled 'the Five-Year Plan of "e-Audit Project" of Ningbo' and 'the Implementation Plan of "e-Audit Project" of Ningbo', pursuant to which the Group shall provide a variety of plans from hardware, software to their application.

(4) Provided training in "e-Audit" to various audit departments

As the "e-Audit Project" was carried out in depth, the Group continued to promote the Live-Audit Implementation System and Live-Audit Management System in different ways. This time, the Group entered into training contracts with the departments of audit of Nanyang of Henan Province, Shaanxi Province, Yunnan Province and Heilongjiang Province to provide them with training in the Live-Audit Implementation System. By capitalizing on this opportunity, the Group is able to enhance clients' understanding of the Group's products, provide adequate market support for future promotion. Furthermore, it can be seen that the training is an affiliated project originally, where no extra fee would charge the clients, but it is now an independent project and will bring in extra profits to the Group.



### *16. The Group contracted the Audit Management and Information System Project of China National Petroleum Corporation and commenced the internal audit project*

China National Petroleum Corporation (hereinafter referred to as "CNPC") is a large-scale petrochemical enterprise conglomerate and a state-owned and authorised investment enterprise. It is a leader in the production and processing market of Chinese petroleum and natural gas. CNPC ranked 10th out of the world's 50 largest petroleum companies by "Petroleum Intelligence Weekly" in the U.S., and 52nd out of the world's 500 strongest enterprises by "Fortune" magazine in 2004.

The Group will establish an Audit Management Information System for CNPC and shall ultimately realize audit management through the main network of CNPC. Its main functions will include:

(1) An Audit Information Processing Centre at the head office of CNPC, to enable the processing of audit information by three levels of auditing authorities of CNPC.

(2) Each level of audit authority operates according to the flow of audit business, and to realize the processing flow as follows: audit draft, audit information card, audit information account, audit statistics statement and audit information analysis etc.

(3) Provide ancillary decision management function as the basis for management to make macro decisions.

(4) Users of the Audit Management Information System include the three levels of auditing authorities, leaders of relevant departments and other participants. The audit functions of each level of audit authority are basically the same. Users use their relevant functions according to the authorities allocated.

***17. Contracted in the network-based audit project for Capital Airport***

Beijing Capital International Airport Company Limited, an affiliate of Capital Airports Holding Company (hereinafter referred to as CCAH), is a company listed on the Stock Exchange of Hong Kong Limited.

This project will build up reliable network connection between the State Audit Office's special offices in Beijing, Tianjin and Hebei and CCAH so that the State Audit Office's special offices in Beijing, Tianjin and Hebei may collect timely data to analyse the operation and management, external investment and financial status of CCAH and perform timely supervision of the truthfulness, lawfulness and effectiveness of the accounting process of CCAH, thereby combining dynamic audit with static audit and audit in the course of event and the audit in the aftermath.



The commencement of the CNPC and Capital Airport projects marked the commencement of the network-based audit of the Group.

***18. Feasibility study of the first phase of the "e-Quality Project" passed the expert debate***

The Group was entrusted by the State General Administration for Quality Supervision, Inspection and Quarantine to prepare the feasibility study of the phase I of the "e-Quality Project".

Studying the project contents of the "e-Quality Project", it has covered the Administration's project contents for digitalization related to business development for the coming 5 years. The overall project framework of "e-Quality Project" is as follows:

(1) Construction of Network System

The construction of the Inspection & Quarantine Network of the Quality Supervision and Inspection is divided into 4 classes: Central Class (the State General Administration for Quality Supervision, Inspection and Quarantine), First Class (35 Subordinate Inspection and Quarantine Bureaus), Province Class and City (specifically designated in the State plan) Class (36 Subordinate Quality Supervision and Inspection Centers).

For a province which has both the Subordinate Inspection and Quarantine Bureau and Province (City specifically designated in the State plan) Class Subordinate Quality Supervision and Inspection Center located in the same city, through City e-Government network, the Province (City specifically designated in the State plan) Class Subordinate Quality Supervision and Inspection Center will be linked up to the Subordinate Inspection and Quarantine Bureau and the Subordinate Inspection and Quarantine Bureau will be linked up to the State General Administration for Quality Supervision, Inspection and Quarantine.

(2) Construction of Application System

The construction of the Application System of the "e-Quality Project" is based on Data Centre of the State General Administration for Quality Supervision, Inspection and Quarantine and the Public Access Platform. Upon the completion of the "Three Systems" mentioned above and on such basis, the collection and accumulation of business data will lead to the establishment of "Data Bank Group". At the same time, through data mining and other technologies, the intensive development and utilization of data resources becomes a great support for decision-making.

The Application System of the "e-Quality Project" covers various business scopes including inspection, quarantine, quality control, quality management, certification, accreditation, standardization and estimation. The "e-Quality Project" covers around 16 application scopes.

"e-Quality" users include nearly 4000 internal offices from the Quality and Investigation bodies, the general public and private sectors.

The construction period of Phase I of the "e-Quality Project" is two years and its main missions are:

1) Full utilization of the State's e-Government Extranet and consolidation of the building of quality and inspection specialized network platform will form a WAN linking up the State General Administration for Quality Supervision, Inspection and Quarantine (including the Certification and Accreditation Supervisory and Administration Commission and the People's Republic of China and Standardization Administration Commission), the Subordinate Inspection and Quarantine Bureaus, Province (City specifically designated in the State plan) Class Subordinate Quality Supervision and Inspection Centers, Branch office of Inspection and Quarantine Bureau of each check-point and Bureau of Quality and Technical Supervision of each check-point area so as to perfect nodal LAN.

2) The construction of State Standardization Information Data Bank coverage of the State Administration and Province level and Prefecture (City) level Departments' Company Qualitative Credit Information Data Banks and other basic quality inspection data banks.

# Management Discussion and Analysis

3) The construction of quality inspection control systems covers the information of National speedy actions in cracking down on counterfeit goods, Safety Supervision on Special Facilities, Estimated Business Inspection Supervision, Product Quality Inspection Supervision, Import Cargo Inspection and Quarantine Electronic Supervision and State Compulsory Product Certification Supervision. The construction of Quality Inspection Declaration, Examination and Approval System covers import cargo filing records for examination and approval and other information. The construction of Quality Inspection Information Service System covers state announcement, appraisal, consultation, risk alarm, quick reaction and other information related to the Agreement on the Application of Sanitary and Phytosanitary Measures (WTO/TBT-SPS).

4) The construction of protection, evaluation and appraisal, supervision and audit, management and other security systems lead to the establishment of related standards, factory sites reformation and labor training etc.

Such report has passed the expert debate. Meanwhile, the Group has won the tender for several software and hardware environmental construction projects for the "e-Quality Project", including the tender for the construction of Da Tong Guan backbone network（大通關骨幹網）of Beijing, Jiangsu Province and Shanghai. With the progressive development of the "e-Quality Project", the Group hopes that the project will bring extra revenue to the Group. The Group will also focus on the development of the industry of State Quality Supervision and Inspection, so as to become the industrial champion.



### *19. Winning the Tender of Hubei Province Labour Security System Unified Application Software Development and Implementation Project*

The phase I of the "e-Insurance Project" of Hubei Province was from 2004 to 2006. The aim of this project was to establish an initial unified labour security information of local and provincial level, to establish a 3-level labour security data center which covered provincial, city and county level, and to establish a provincial trunk network connecting nodes at the provincial and city level (provincial and county level) that connecting to central network center, forming a safe and reliable 3-level central-province-city (county) network system. Based on a national unified application system, this project helps to standardize and optimize current operational processes, consolidate five insurance business data, realizing "same person, same city, same database", so as to achieve unified management for social security and labour market data, cross-region or city and cross-province social security transfer, medical and retirement business for expatriate, information exchange and share of employment, re-employment and relating administration services, "network search" for labour security business and statistic information, "non-local" supervising of social security fund, services required by social public on labour security issues, and cross-direction information exchange with relevant authorities. The project won by the Group is the main part of "e-Insurance Project" of Hubei Province.

### *20. Won the tender Labour and Social Security Information System Application and Development service contract of Shantou City*

The construction of Shantou City labour and social security information system is a business application system mainly focused on various areas of social security and employment services. It is designed based on the characteristics of different business application. Contents of the project of the current phrase are as follows:

(1) To establish a new "5-in-1" social security managing information system in compliance with the 2nd revised version of the standards of Ministry of Labor and Social Security's social security managing information system core platform, with 3-level software structure which meets the requirement of localization of the system. This system possesses level-to-level management function, and achieve current pension, industrial injury, unemployment and birth insurance managing information system of central urban region's information exchange with the local systems of Chaoyang, Chaonan, Chenghai and Nanao. The system should be able to manage the data of 600,000 existing participating staff and workers and to handle normal increase of data for the coming six to eight years.

(2) Establishing platform for exchange of data with designated hospitals, through which HIS system of the designated hospitals can exchange data with medical insurance information system on a real time basis. This system also performs the function of medical fee settlement for participating staff and workers, as well as establish and maintain medicine, treatment item and disease list that is compatible with the exchange platform.

(3) Developing software for exchanging data with local tax authorities, through which the Social Security Center can obtain information of social security premium collection status of local tax authorities on a timely manner. Moreover, this system enables local tax authorities to make enquiries on information about participating insurance policies and information on participating units and staff and workers on a real time basis.

(4) Establishing labour security information website based on the Internet, offering public information services regarding government announcements, government services enquiry, working processes and guidelines, policies, law and regulations, and handling of complaints. This system provides convenient, quick and transparent services through the Internet, achieving on-line office and government affairs open to public.

### *21. Made endeavours to develop software outsourcing business*

Chinasoft Resources Information Technology Services Limited and CS&S Cyber Resources Software Technology (Tianjin) Co., Ltd. are the members of the Group primarily engaged in outsourcing business, which continually develop new business with their experience over years in the industry, and also consolidate and explore the demand of existing customers.

# Management Discussion and Analysis



During the reporting period, the Chinasoft-Microsoft online laboratory established by the Group and Microsoft officially commenced operation simultaneously. The laboratory mainly undertook the research and development of software and testing in China outsourced by Microsoft. The laboratory was one of the first batch of outsourcing working environments certified in China by Microsoft. The network of the allied online laboratory will be able to directly access the network of the headquarters of Microsoft in the USA, which will enhance the Group's software development service quality, efficiency and the ability to undertake software outsourcing business from external parties.

The Group also provides complete services such as product testing, development, delivery and maintenance for the other two major customers, IBM and Motorola.

## III. Acquisition and Investment

### *1. Successfully acquired 100% of the equity interest of Chinasoft Resources Information Technology Services Limited（北京中軟資源信息科技服務有限公司）*

Chinasoft Resources Information Technology Services Limited（北京中軟資源信息科技服務有限公司）(hereinafter referred to as "Chinasoft Resources") is a company incorporated in April 2004 in Beijing and involved in the business of contracting outsourcing business. As at 31 December 2004, the audited net profit of Chinasoft Resources after tax and the interest of minority shareholders amounted to RMB9,060,000. Chinasoft Resources is the first strategic partner of Microsoft in China and is one of the 15 core service providers of IBM in China, having a long-term and stable client base including Microsoft, IBM, Oracle, Huawei Technologies（華為技術）, HP, Nokia, Lucent and CA.

During the reporting period, the Group entered into agreements with China National Computer Software & Technology Service Corporation (Hong Kong) Limited (hereinafter referred to as CS&S (HK)) for acquisition of 51% and 49% of the equity interest of Chinasoft Resources on two separate occasions, of which, the consideration for acquisition of 51% of the equity interest of Chinasoft Resources was by issuing new shares on two separate occasions. At first, 34,872,453 shares will be issued to CS&S (HK) after the conditions of the acquisition agreement are met. If the audited consolidated net profit of Chinasoft Resources after tax and the interest of the minority shareholders as at 31 December 2005 amounts to no less than RMB12,000,000, the Company will then issue 23,248,302 new shares to CS&S (HK). Meanwhile, CS&S (HK) has the right to demand the Company to make payment of HK$17,901,193 in place of the shares to be issued on the second time. And the consideration for acquisition of 49% of the equity interest of Chinasoft Resources was a maximum of HK$41,881,132 payable on three separate occasions. At first, HK$20,940,566 will be payable within 14 days after the date of completion. On the second time, if the audited consolidated net profit of Chinasoft Resources after taxation and minority interests for the year ending 31 December 2005 is not less than RMB12 million, an additional amount of HK$10,470,283 will be payable. If the number of IT outsourcing staff of Chinasoft Resources as at 31 March, 2006 is not less than that in 28 April, 2005, a further amount of HK$10,470,283 would be paid.

The acquisition made by the Group this time is mainly aimed at long-term development of the outsourcing sector within the country as IDC's information indicated that market demand for outsourcing in 2004 amounted to US$449,400,000 and will reach US$1,985,400,000 in 2008. The Group believes that Chinasoft Resources will bring in decent profits for the Company.

***2. Successfully acquired 20% of the equity interest in China National Tobacco Material E-Commerce Co. Ltd.（北京中煙物資電子商務有限公司）***

China National Tobacco Material E-Commerce Co. Ltd.（北京中煙物資電子商務有限公司）has three investors at present in addition to the Group, all of which are enterprises under the State Tobacco Control Bureau.

After the acquisition by the Group, the company has been renamed as China National Tobacco Information Co. Ltd.（中煙信息技術有限公司）at present and will be responsible for the future maintenances of all large size informationized projects. At present, it has started to conduct maintenance on the "policy making system for the production, operation and management of the tobacco industry".

The acquisition of the company by the Group marked its continuous aim to strengthen the strategic partnership between the Group and the State Tobacco Control Bureau as well as the tobacco industry. At the same time, the Group has entered into the market of internal business process of the tobacco industry.

***3. Established Chinasoft International (Kunming) Information Technology Limited（中軟國際（昆明）信息技術有限公司）***

In order to further enhance local implementation and its ability to operate in the market, the Group established Chinasoft International (Kunming) Information Technology Limited（中軟國際（昆明）信息技術有限公司）with the professional tobacco informationalization team of Kunming Fangyuanli Technology Co Ltd（昆明方元利科技有限責任公司）as its core team. The company will be principally responsible for the Group's business in Yunnan while expanding into the southwest region simultaneously.

Yunnan Province has an important position in the tobacco industry of China. Being a major supplier of tobacco in China, a number of nationwide well-known brandnames such as "Hong Tan Shan", "Yun Yan" and "Yuxi" are manufactured in Yunnan. The Group is confident that it can gain a leading position in the province.

***4. The Group, Wuhan Chuyan Information Technology Co., Ltd.（武漢楚煙信息技術有限公司）and China Tobacco Corporation, Hubei Branch jointly formed Wuhan Chinasoft International Information Technology Company Limited（武漢中軟國際信息技術有限公司）***

Wuhan Chuyan Information Technology Co., Ltd.（武漢楚煙信息技術有限公司）is also a wholly-owned subsidiary of China Tobacco Corporation, Hubei Branch (hereinafter referred to as "Hubei Zhongyan"). After the formation of Wuhan Chinasoft International Information Technology Company

# Management Discussion and Analysis

Limited (hereinafter referred to as "Wuhan Chinasoft International"), it is the only partner and provider of information technology in the tobacco industry of Hubei Province. Additionally, Wuhan Chinasoft International will expand the services of the Group to neighboring areas.

To date, the Group has expanded its localized services to Eastern China, Central China, Southern China and the Southwest. The Group plans to continue expanding its localized services in the future.

## IV. Awards received:

### *1. Became a top ten e-Government IT manufacturer*

During the reporting period, the fourth session of the e-Government Technology and Application meeting was convened grandly in Beijing, in which the list of the 2005 China e-Government IT Top 100 was disclosed, and the Group was on the list. The Group was placed in eighth place, emerging and entering the top ten with its excellent strength and outstanding performance in the e-Government domain. It was the fourth time for Chinasoft International to enter the top 100 ranking.

This appraisal was organized by Internet Weekly, a well-known IT journal within the country and before this appraisal, a China e-Government IT Top 100 Survey has been held for three consecutive years and it attracted wide attention from and was highly regarded by the business community, gained a lot of experience and accumulated true and effective data. This year, Internet Weekly selected over 3,000 typical e-Government IT enterprises as the samples of this survey on the basis of the last there surveys.

### *2. Rated the number one brand name in e-Government application platforms in China by CCID Consulting for the third time*

Armed with the Group's core competitive advantage – Chinasoft e-Government middleware, Resource One, the Group was rated number one in various items for the products of the e-Government application support platform in 2004 by CCID Consulting（賽迪顧問）for the third time:

(1) continued to rank first in market share;

(2) ranked first in the platform products used by existing clients;

(3) ranked first in market share of the audit sector;

(4) ranked first in market share of the tobacco industry.

***3. Named again by Deloitte as one of the "500 Fastest Growing Hi-tech Enterprises in the Asia Pacific"***

The Group is pleased to be invited by Deloitte to attend this appraisal, and be selected into the list for the second time.

## HUMAN RESOURCES

As at 31 December 2005, the Company had a total of 1,055 employees, 901 of whom have bachelor degree. For the year ended 31 December 2005, the total staff costs paid by the Company to its staff was approximately RMB61,894,000 (2004: approximately RMB34,139,000).

A breakdown of the number of employees of the Company by their functions as at 31 December 2005 and 2004 were as follows:

| **Departments** | **2005** | 2004 |
|---|---|---|
| Management | **42** | 11 |
| Finance and administration | **55** | 48 |
| Research and development | **795** | 307 |
| Sales, technical support and marketing | **163** | 111 |
| Total | **1,055** | 477 |

The pay scale of the Company's employees is maintained at a competitive level and employees are rewarded based on their performance according to the general framework of the Company's salaries and bonus systems, which is reviewed annually. The Group will implement a provident fund scheme for its staff in Hong Kong in compliance with the requirements of the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong). The Group will also provide a medical insurance scheme for its staff in Hong Kong. According to the relevant PRC regulations, the Group is required to participate in the employee retirement scheme administered by the relevant local government bureau in the PRC and to make contributions for its employees who are eligible to participate in the scheme. The contributions to be borne by the Group are calculated at 19% of the basic salaries for those eligible employees.

# Management Discussion and Analysis

## PROSPECTS OF PERFORMANCE

The software and servicing industries in PRC achieved greater progress in 2005. While the domestic demand increase continually, there is a rapid boost in the international outsourcing business. Looking forward, the Company as a PRC-based supplier providing global services shall be positioned at the following 3 objectives:

1. ***The leader of the industry in PRC***

    (1) Fully utilizing the leverage of the Group in the tobacco and audit industries to consolidate and extend industry's advantage

    (2) Achieving sustainable development and income

    (3) Developing the business of parallel industries and achieving industry's advantage finally

    (4) Obtaining opportunities in other vertical industries through merger and acquisition

    (5) Storing up human resources through merger and acquisition and internal training

    (6) Extending regional advantage

2. ***The leading outsourcing enterprise***

    (1) Raising the scale of enterprise rapidly through merger and acquisition

    (2) Striving for developing the outsourcing markets in Europe, the U.S. and Japan

3. ***The top workflow (quality) control company***

    (1) Applying for passing the CMM5 certification

    (2) Establishing knowledge bank and comprehensive human resources training scheme

    In the meantime, the Company intends to keep on financing in order to obtain fund for acquisition, merger and development, so that the Group can develop rapidly.

# Biographical Details of Directors and Senior Management

The following sets out the profile of the Directors and senior management of the Company:

## DIRECTORS

### Executive Directors

*Dr. Chen Yuhong（陳宇紅）*, aged 43, is the managing director and the chief executive officer of the Company and is responsible for the overall business development of the Group. He has over 10 years' experience in software development and corporate management. Dr. Chen holds a doctorate degree in optics from 北京理工大學(Beijing Polytechnic University) in 1991. Prior to joining the Group on 25 April 2000, Dr. Chen was the vice president of CS&S in 2000 and was appointed senior vice-president of CNTC（中軟網絡信息技術有限公司）in December 2003. He has also been appointed a director of Chinasoft Resources. He was a manager of the research department from October 1996 to April 2000. He was also a director of 中軟賽博資源軟件技術（天津）有限公司(CS&S Cyber Resources Software Technology (Tianjin) Co., Ltd.), an associate company of CS&S from 1999 to March 2002. From June 1991 to October 1996, he was the deputy general manager of China Great Wall Computer Software Co., Ltd.

*Dr. Tang Zhenming（唐振明）*, aged 43, is the senior vice president. He is responsible for the human resources of the Group and our newly acquired Training Centre. Prior to joining the Group on 25 April 2000, Dr. Tang was employed by Beijing Institute of Technology Industrial Company (北京理工大學產業總公司) as deputy general manager from May 1995 to March 2000 and by American W&P Company, Beijing Office (美國W&P公司北京辦事處) as officer from December 1993 to March 1995. Dr. Tang is also a director of Chinasoft Resources and Wuhan Chinasoft International. He holds a bachelor's degree in vehicle engineering from Tsinghua University (清華大學) in 1985 and a doctorate degree in motor electronic control from Beijing Polytechnic University (北京理工大學) in 1994.

*Mr. Wang Hui（王暉）*, aged 33, is the senior vice president and chief technical officer. He is responsible for the designing of technical solutions and consulting. Mr. Wang graduated from 天津大學 (Tianjin University) in 1995. He has 6 years experience in systems analysis and in the design of system infrastructure. Prior to joining the Group on 25 April 2000, Mr. Wang was a manager of China Greatwall Computer Software Co., Ltd from 1995 to 2000.

### Non-executive Directors

*Ms. Tang Min（唐敏）*, aged 61, is the chairman of the Company and is the chairman of the PRC Software Alliance and a vice-chairman of the Chinasoft Software Association. Ms. Tang obtained a bachelor's degree in physics from Peking University, the PRC and has the professional qualification of senior engineer in computer science. She has more than 30 years' experience at the management level in the IT industry in the PRC. Madam Tang is the President of China National Software and Service Company Limited ("CNSS"), a joint stock limited company established under the laws of the PRC, the A-shares of which are listed on the Shanghai Stock Exchange. She also holds directorships in a number of the subsidiaries and associate companies of CNSS including CS&S (HK), a corporate shareholder holding approximately 24% of the total issued ordinary shares of the Company and approximately 18.96% of the total voting rights at all general meetings of shareholders of the Company.

# Biographical Details of Directors and Senior Management

*Dr. Cui Hui（崔輝）*, aged 44, is responsible for the financial management of the Group. Dr. Cui has about 20 years' experience in corporate management. Dr. Cui graduated from Jilin University（吉林大學）in the PRC in 1983 with a doctorate degree in economics. Prior to joining the Group on 25 April 2000, Dr. Cui worked for CS&S as deputy department head from August 1983 to April 1992, deputy general manager from July 1999 to January 2000 and was the vice president of China National Software & Technology Service Corporation ("CS&S") in 2000. From May 1992 to December 1997, Dr. Cui was the deputy general manager and general manager of Oriental Technology (Beijing) Company Ltd (東方科技（北京）有限公司). He was the general manager of Chinasoft Tonghe Systems Integration Company Ltd (中軟同和系統集成有限公司) from January 1998 to June 1999. In December 2003, he was appointed senior vice-president of CNTC（中軟網絡信息技術有限公司）(which changed its name to that of CNSS). Dr. Cui currently holds a directorship position in CNSS.

*Mr. Duncan Chiu（邱達根）*, aged 31, has been involved in the management of the Group since joining in January 2000. Mr. Chiu graduated with a bachelor's degree in business administration from Pepperdine University of California in 1996. Mr. Chiu currently serves as vice chairman and treasurer of The Chamber of Hong Kong Listed Companies, vice president of Innovation & Technology Association and is a committee member of All-China Youth Federation. Mr. Chiu is as a director among the Far East Group of Companies. He serves as the managing director and chief executive officer of Far East Technology International Limited ("Far East Technology") and also a non-executive director of Far East Hotel & Entertainment Limited.



Mr. Liu Zheng（劉征）, aged 33, was appointed on 14 June 2002. He has been a general manager of ITG since April 2000. From 1997 to 2000, he was the general manager of DingRong Investment Management Co., Ltd (鼎榮投資管理公司). Mr. Liu worked for China Everbright Bank from 1992 to 1997. Mr. Liu has 10 years' experience in the financial industry and graduated from the Finance and Banking Institute of China（中國金融學院）in 1992 with a bachelor's degree in economics.

Mr. Timothy Y-C Chen *(陳永正)*, aged 49, is the corporate vice president of Microsoft Corporation and its chief executive officer of the greater China region. Prior to joining Microsoft Corporation in September 2003, Mr. Chen was the chairman and president of Motorola Corp.'s China subsidiary. He was appointed as corp. vice president of Motorola Inc, chairman and president of Motorola (China) Electronics Ltd in September 2001. From June 2000 to September 2001, Tim was the chief executive officer of 21CN Cybernet (a listed company in Hong Kong on the Main Board of the Stock Exchange). Before joining 21CN Cybernet, since 1992, Tim held various positions in Motorola including the general manager of Motorola's Greater China Cellular Infrastructure Division. He worked in Lucent (then AT&T Bell Labs) in U.S.A. as research and development manager and marketing manager prior to 1992. Tim holds a master's degree in business administration from University of Chicago and two master's degrees in computer science and mathematics.

**Independent non-executive Directors**

*Mr. He Ning（何寧）*, aged 47, was appointed on 2 July 2002. Mr. He has been the chief executive officer of Beijing CCG Technology Co. Ltd. since September 2000. From January 1997 to August 2000, he was the vice president of the Beijing representative office of Merrill Lynch. Mr. He was the assistant officer of the China Stock Exchange Executive Council from July 1993 to December 1996. He also worked for Morgan Stanley as manager from May 1990 to June 1993. Mr. He obtained a master's degree in business administration from the University of Texas in 1984. Mr. He has over 10 years' experience in investment banking, direct investment and venture business management in the PRC and the USA.

# Biographical Details of Directors and Senior Management

*Mr. Zeng Zhijie*（曾之杰）, aged 38, was appointed on 21 April 2003. Mr. Zeng obtained a master's degree in business administration from Stanford University in June 2001, and is a vice president of Walden International since October 2001, a global venture capital firm with an investment focus on the communications, electronics, software & IT services, semiconductors and life sciences/healthcare industries.

*Dr. Leung Wing Yin*（梁永賢）, aged 49, was appointed on 22 March 2006. Dr. Leung holds a doctor's degree in accounting from the University of New South Wales, Australia, and a member of Certified Public Accountants of Australia, a member of the Hong Kong Institute of Certified Public Accountants and a member of the Hong Kong Securities Institute. He is an Assistant Professor and a Doctor Student Supervisor at the School of Accounting and Finance of the Hong Kong Polytechnic University. Dr. Leung previously worked as a consultant in a firm of Certified Public Accountants and as a Senior Lecturer at Charles Sturt University, Australia and the City University of Hong Kong. He has over three years' working experience in internal auditing and corporate finance in banks.

## SENIOR MANAGEMENT

*Mr. Fok Ming Fuk, William*（霍銘福）aged 44, is the qualified accountant and company secretary of the Company. He has over twenty years' experience in auditing and financial management. Prior to joining the Group on May 17, 2004, Mr. Fok worked as the chief financial officer of Portolan Commerce Solutions, a software developer engaged in enterprise resources planning in Germany. Mr. Fok got a master's degree in business administration from England and is a fellow member of the Hong Kong Institute of Certified Public Accountants, a fellow member of the Association of Chartered Certified Accountants, an associate member of the Institute of Chartered Accountants in England and Wales, a fellow member of the Taxation Institute of Hong Kong and a member of Hong Kong Securities Institute.

*Mr. Simon Chung*（鍾鎮銘）aged 45, is the chief operating officer of the Company and is responsible for the overall daily operation of the Group. He has over 18 years' experience in IT professional services covering account management, service delivery management, technical sales, quality assurance and control, project management and customer support operation in the area of public government, telecom and finance sectors. Prior to joining the Group, he was a project director of Atos Origin responsible for the management of large scale projects and service delivery for major clients in Asia Pacific from 1996 to 2005. He was an information technology officer and manager from 1991 to 1995 for the department of defense in Australia (Navy division). He was an IT database leader in the financial department of a government sector from 1989 to 1991. He holds a bachelor's degree in computing science from the University of Wollongong in Australia.

# Biographical Details of Directors and Senior Management

*Ms. Yan Juanjue（嚴雋珏女士）*, aged 62, is the newly acquired outsourcing general manager. Ms. Yan joined the Group on 28 April 2005, before that she acted as the general manager of Chinasoft Resources. She acted as the vice general manager of 北大計算機系統工程公司 between 1994 and 2001, the officer of the Training Centre of the Peking University between 1992 and 1994 and a lecturer in the Peking University between 1977 and 1992. Ms. Yan graduated from the Peking University in 1967.

## QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

*Mr. Fok Ming Fuk, William（霍銘福）*, is the qualified accountant and company secretary of the Company. Please refer to the paragraph headed "Senior Management" in this section above for further details regarding his background.

## COMPLIANCE OFFICER

*Dr. Chen Yuhong（陳宇紅）*, is the compliance officer of the Company. Please refer to the paragraph headed "Directors" in this section above for further details regarding his background.

# Report of the Directors

The Directors present their annual report and the audited financial statements of the Group for the year ended 31 December 2005.

## PRINCIPAL ACTIVITIES

The Company acts as an investment holding company. The principal activities of its subsidiaries are set out in note 1 to the financial statements. During the year under review, there were no significant changes in the Group's principal activities.

## RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2005 are set out in the consolidated income statement on page 62.

The Directors recommend the payment of a final dividend of HK$0.025 (equivalent to RMB0.026) per share to the shareholders on the register of members on 18 May 2006, amounting to HK$18,309,000 (equivalent to RMB19,042,000.

## FINANCIAL SUMMARY

A summary of the published results and assets and liabilities of the Group for the past five years, as extracted from the audited financial statements, is set out on page 4. This summary does not form part of the audited financial statements.

## DISTRIBUTABLE RESERVES

The reserves available for distribution to shareholders as at 31 December 2005 are RMB109,000,000.

## SHARE CAPITAL

Details of movements during the year in the share capital of the Company are set out in note 27 to the financial statements.

## PROPERTY, PLANT AND EQUIPMENT

Details of movements during the year in the Group's property, plant and equipment are set out in note 14 to the financial statements.

# Report of the Directors

## DIRECTORS

The Directors during the year and up to the date of this report were:

**Executive Directors:**

| | |
|---|---|
| Dr. Chen Yuhong (Managing Director) | |
| Mr. Wang Hui | (appointed on 17 November 2005) |
| Dr. Tang Zhenming | (appointed on 17 November 2005) |
| Mr. Peng Jiang | (resigned on 22 March 2006) |

**Non-executive Directors:**

| | |
|---|---|
| Ms. Tang Min (Chairman) | (formerly an executive director and re-designated as non-executive director on 22 March 2006) |
| Dr. Cui Hui | (formerly an executive director and re-designated as non-executive director on 22 March 2006) |
| Mr. Duncan Chiu | (formerly an executive director and re-designated as non-executive director on 22 March 2006) |
| Mr. Timothy Chen Yung Cheng | (appointed on 22 March 2006) |
| Mr. Liu Zheng | |
| Mr. David Chiu | (resigned on 22 March 2006) |
| Dr. Chen Qiwei | (resigned on 17 November 2005) |

**Independent non-executive Directors:**

| | |
|---|---|
| Mr. He Ning | |
| Mr. Zeng Zhijie | |
| Mr. Au Yeung Shiu Kau Peter | (resigned on 22 March 2006) |
| Dr. Leung Wing Yin Patrick | (appointed on 22 March 2006) |

The Company has received, from each of the independent non-executive Directors, an annual confirmation of his independence pursuant to Rule 5.09 the GEM Listing Rules. The Company considers all of the independent non-executive Directors as independent.

In accordance with article 86 of the Company's Articles of Association, Mr. Wang Hui, Dr. Tang Zhenming, Mr. Timothy Chen Yung Cheng and Dr. Leung Wing Yin Patrick shall hold office until the annual general meeting of the Company and, being eligible, offer themselves for re-election.

In accordance with article 87 of the Company's Articles of Association, Dr. Chen Yuhong and Mr He Ning (who have been longest in office since their last election) will retire from office by rotation and, being eligible, offer themselves for re-election.

## DIRECTORS' SERVICE CONTRACTS

Dr. Chen Yuhong, Dr. Cui Hui, Mr. Duncan Chiu, Mr. Peng Jiang and Madam Tang Min have each entered into a service agreement with the Company. Particulars of these contracts, except as indicated, are in all material respects identical and are set out below:

(i) each service contract is of two years duration commencing on 20 June 2003 except for that of Madam Tang Min, which commenced on 30 September 2004. The service contract shall continue thereafter until terminated by either party giving to the other not less than three months' prior written notice, such notice not to be given before the expiry of the initial term of two years;

(ii) the monthly salary for Dr. Chen Yuhong, Dr. Cui Hui, Mr. Duncan Chiu and Mr. Peng Jiang for the first year of appointment commencing on 20 June 2003 is RMB40,000, RMB10,000, RMB10,000 and RMB35,000 respectively and the monthly salary of Madam Tang Min commencing from 30 September 2004 is RMB10,000. Such salary is to be reviewed annually by the board of directors. For the period from the expiry of the first year of appointment, the salary of these five executive directors shall be determined by the board of directors but shall not be more than 120 percent of the annual salary of such director for the preceding year;

(iii) Dr. Chen Yuhong, Dr. Cui Hui, Mr. Duncan Chiu, Mr. Peng Jiang and Madam Tang Min are each entitled to management bonus by reference to the consolidated net profits of the Group after taxation and minority interests but before extraordinary items as shown in the Group's audited consolidated accounts for the relevant financial year (the "Net Profits") as the Board may approve, provided that the aggregate amount of management bonuses payable to all executive Directors in respect of any financial year of the Group shall not exceed 5 percent of the Net Profits; and

(iv) each such Director shall abstain from voting and shall not be counted in the quorum in respect of the resolution regarding the amount of management bonus payable to himself/herself.

Dr. Tang Zhenming, Mr. Wang Hui and Mr. Au Yeung Shiu Kau, Peter have not entered into service agreements with the Group. The annual director's fee for both Mr. He Ning and Mr. Zeng Zhijie is HK$60,000, while the monthly remuneration for Dr. Tang Zhenming, Mr. Wang Hui and Mr. Au Yeung Shiu Kau Peter is RMB23,500, RMB37,500 and HK$5,000 respectively. Mr. David Chiu, Mr. Liu Zheng and Dr. Chen Qiwei receive no remuneration for holding their office as non-executive director.

Mr. He Ning and Mr. Zeng Zijie were appointed as independent non-executive Directors pursuant to letters of appointment for a term 2 years from 20 June, 2003, and their appointments have continued since expiry of such term. Each of them receives an annual remuneration of HK$60,000 for his office.

Dr. Leung Wing Yin Patrick was appointed as an independent non-executive Director on 22 March 2006 and his annual remuneration is HK$60,000 for his office.

# Report of the Directors

None of the Directors has entered into any service agreements with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

Details of the Directors' remuneration are set out in note 11 to the financial statements. Save as disclosed in note 11 to the financial statements, there are no other emoluments, pension and any compensation arrangements for the Directors and past Directors as is specified in Section 161 and 161A of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong).

## DIRECTORS' INTERESTS IN SHARES

As at 31 December 2005, the following Directors had interests in the shares and underlying shares of the Company and shares in an associated corporation (as defined in Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO")) of the Company as set out below and recorded in the register required to be kept under section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the required standard of dealings by directors of listed issuers as referred to in Rule 5.46 of the GEM Listing Rules:

**Long positions in shares of HK$0.05 each in the capital of the Company ("Shares")**



| Name of Director | No. of Shares | Approximate percentage of total issued share capital of the Company |
|---|---|---|
| Chen Yuhong | 22,967,472 | 3.14% |
| Cui Hui | 20,000,000 | 2.73% |
| Peng Jiang | 7,017,838 | 0.96% |
| Wang Hui | 7,017,838 | 0.96% |
| Tang Zhen Ming | 10,207,765 | 1.39% |

# Report of the Directors

## Options to subscribe for Shares

| Name of Director | Exercise Price (HK$) | No. of share options outstanding as at 31 December 2005 | Percentage of total issued share capital of the Company | No. of underlying Shares interested in | Note |
|---|---|---|---|---|---|
| Chen Yuhong | 0.58 | 1,200,000 | 0.16% | 6,200,000 | (1) |
| | 0.65 | 5,000,000 | 0.68% | | (2) |
| Cui Hui | 0.65 | 500,000 | 0.07% | 500,000 | (2) |
| Duncan Chiu | 0.65 | 1,000,000 | 0.14% | 1,000,000 | (2) |
| Peng Jiang | 0.58 | 800,000 | 0.11% | 3,800,000 | (1) |
| | 0.65 | 3,000,000 | 0.41% | | (2) |
| Wang Hui | 0.58 | 1,000,000 | 0.14% | 4,500,000 | (1) |
| | 0.65 | 3,500,000 | 0.48% | | (2) |
| Tang Zhen Ming | 0.58 | 320,000 | 0.04% | 2,920,000 | (1) |
| | 0.65 | 2,600,000 | 0.36% | | (2) |

Notes:

(1) The above share options were offered on 13th August 2003 under the share option scheme of the Company adopted on 2nd June 2003 (the "Share Option Scheme") and were accepted on 27th August 2003. The share options are exercisable for a period of ten years from the date of offer, subject to the following conditions:

| Exercisable Period | | |
|---|---|---|
| **Commencing** | **Ending** | **Number of share options exercisable** |
| 13/08/2004 | 12/08/2013 | 25% of the total number of share options granted |
| 13/08/2005 | 12/08/2013 | 25% of the total number of share options granted |
| 13/08/2006 | 12/08/2013 | 25% of the total number of share options granted |
| 13/08/2007 | 12/08/2013 | 25% of the total number of share options granted |

(2) The above share options were offered on 13th May 2004 under the Share Option Scheme and were accepted on 10th June 2004. The share options are exercisable for a period of ten years from the date of offer, subject to the following conditions:

| Exercisable Period | | |
|---|---|---|
| **Commencing** | **Ending** | **Number of share options exercisable** |
| 13/05/2004 | 12/05/2014 | 25% of the total number of share options granted |
| 13/05/2005 | 12/05/2014 | 25% of the total number of share options granted |
| 13/05/2006 | 12/05/2014 | 25% of the total number of share options granted |
| 13/05/2007 | 12/05/2014 | 25% of the total number of share options granted |

Save as disclosed above and so far as was known to the Directors, as at 31 December 2005 none of the Directors or chief executive of the Company had any interests or short positions in the shares, debentures or underlying shares of the Company or its associated corporations (as defined in Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he is taken or deemed to have under such provisions of the SFO) or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein or which were required, pursuant to the required standard of dealings by directors of listed issuers as referred to in Rules 5.46 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

As at 31 December 2005, none of the Directors had any direct or indirect interest in any assets which had been, since 31 December 2005 (being the date to which the latest published audited accounts of the Company were made up), acquired or disposed of by, or leased to the Company or any member of the Group, or were proposed to be acquired or disposed of by, or leased to, any member of the Group.

As at 31 December 2005, none of the Directors were materially interested in any subsisting contract or arrangement which was significant in relation to the business of the Group.

## DIRECTORS' RIGHTS TO ACQUIRE SHARES



During the year ended 31 December 2005, none of the Directors was granted any options to subscribe for shares of the Company. As at 31 December 2005, none of the Directors had any rights to acquire shares in the Company save as disclosed above.

## REQUIRED STANDARD OF SECURITIES DEALINGS BY DIRECTORS

During the year ended 31 December 2005, the Company had adopted a code of conduct for directors' securities transactions on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry with all the Directors, the Directors had complied with the required standard of dealings and the code of conduct for directors' securities transactions during the year ended 31 December 2005.

## SHARE OPTION SCHEME

As at 31 December 2005, share options allowing for the subscription of an aggregate of 62,810,000 Shares granted to certain directors and employees of the Group pursuant to the Share Option Scheme were outstanding, with terms on the exercise of such share options granted as set out in Notes (1) and (2) in the section headed "Directors' Interests in Shares" above. During the year ended 31 December 2005, share options for the subscription of in aggregate 530,000 shares had lapsed.

Save as disclosed above, no share options have been granted, exercised or have lapsed pursuant to the Share Option Scheme as at 31 December 2005.

## ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Other than as disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate. None of the Directors, or their spouses or children under 18 years of age, had any rights to subscribe for the shares of the Company, or had exercised any such rights during the period.

## DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Save as disclosed in note 35 to the financial statements, no contracts of significance in relation to the Group's business to which the Company, any of its subsidiary, its holding company or any subsidiary of its holding company was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## CONNECTED TRANSACTIONS

During the year, the Group had entered into connected transactions and continuing connected transactions as set out below.

1. Leases of office premises by Beijing Chinasoft International Information Technology Limited ("Beijing Chinasoft") from CNSS

   (i) Lease of 9th Floor of Block A, 3rd Floor of Block C and 3rd Floor, West Tower of Block B of 55 Xue Yuan Nan Road, Haidian District, Beijing, PRC

| | | |
|---|---|---|
| Date of lease | : | 1 January, 2005 |
| Floor area of leased premises | : | 1724.4031 square meters in aggregate |
| Term | : | 1 January, 2005 to 31 December, 2005 |
| Monthly rent | : | RMB40,255.58 for 9th Floor of Block A<br>RMB55,735.02 for 3rd Floor of Block C<br>RMB16,200 for 3rd Floor, West Tower of Block B |
| User | : | as office premises |

# Report of the Directors

(ii) Memorandum between Beijing Chinasoft and CNSS to add 5th Floor, Block B of 55 Xue Yuan Nan Road, Haidian District, Beijing, PRC to the lease under item (i) above

| | | |
|---|---|---|
| Date | : | 1 September, 2005 |
| Floor area of leased premises | : | 359.5663 square meters in aggregate |
| Term | : | 20 September, 2005 to 31 December, 2005 |
| Monthly rent | : | Rent free period up to 9 October, 2005<br>RMB17,403 for October, 2005<br>RMB23,731.38 for each of November and December, 2005 |

(iii) Lease of 9th Floor of Block A of 55 Xue Yuan Nan Road, Haidian District, Beijing, PRC

| | | |
|---|---|---|
| Date of lease | : | 1 February, 2005 |
| Floor area of leased premises | : | 609.9331 square meters in aggregate |
| Term | : | 1 March, 2005 to 31 December, 2005 |
| Monthly rent | : | RMB40,255.60 |
| User | : | as office premises |

CNSS is a substantial shareholder of the Company and is the landlord of the office premises leased to Beijing Chinasoft, a subsidiary of the Company, referred to above.

2. Agreements by the Group to engage Beijing Chinasoft Shiyuan Property Management Co. Ltd., a company held by CNSS as to about 41% of its equity interest (and thus an associate of CNSS and a connected person of the Company), to provide property management services with aggregate management fees amounting to RMB 1,141,812.48.

3. Acquisition of 51% equity interest in Chinasoft Resources

| | | |
|---|---|---|
| Date of agreement | : | 28 April, 2005 |
| Parties | : | CS&S(HK)<br>Chinasoft International (Hong Kong) Limited ("Chinasoft (HK)") |

Chinasoft (HK), a subsidiary of the Company, agreed to acquire a 51% equity interest in Chinasoft Resources from CS&S(HK), a substantial shareholder of the Company. The consideration for the acquisition was the issue of 34,872,453 Shares to CS&S(HK) and, subject to fulfillment of a condition and the exercise of a cash option, issue of an additional 23,248,302 Shares to CS&S(HK).

# Report of the Directors

4. Commercial Agreement with Microsoft

| | | |
|---|---|---|
| Date of agreement | : | 26 September, 2005 |
| Parties | : | the Company<br>Microsoft, which had entered into an agreement to subscribe for convertible preferred shares of the Company and was expected to hold more than 10% of the voting rights at general meetings of the Company and thus a connected person of the Company. |

The Company and Microsoft entered into the agreement for a term of three years and agreed to drive revenue associated with delivering software solutions using certain software products of Microsoft to assist the Company in growing its IT service business in the PRC. Under such agreement, the Company will achieve a target revenue of US$3.0 million, US$4.5 million and US$6.75 million respectively for the three years commencing from the closing date for subscription for convertible preferred shares of the Company by Microsoft.

The Commercial Agreement constituted a continuing connected transaction of the Company. The annual cap amounts for the transactions contemplated under the Commercial Agreement are US$4.18 million, US$5.83 million and US$8.35 million for the three years ending 31 December, 2008.

5. Acquisition of 49% equity interest in Chinasoft Resources

| | | |
|---|---|---|
| Date of agreement | : | 15 November, 2005 |
| Parties | : | CS&S(HK)<br>Chinasoft (HK) |

Chinasoft (HK), a subsidiary of the Company, agreed to acquire the remaining 49% equity interest in Chinasoft Resources from CS&S(HK), a substantial shareholder of the Company. The consideration for the acquisition was:

(a) HK$20,940,000 payable with 14 days after the date of completion;

(b) an additional HK$10,470,283 if the audited consolidated net profit of Chinasoft Resources after taxation and minority interests but before extraordinary items for the year ended 31 December, 2005 is not less than RMB12 million; and

(c) a further amount of HK$10,470,283 if the number of IT outsourcing staff of Chinasoft Resources and its subsidiaries at 31 March, 2006 is not less than the number of such staff as at 28 April, 2005 (the date of the acquisition agreement for 51% of Chinasoft Resources).

6. Provision of software and services to a customer of CNSS

| | | |
|---|---|---|
| Date of agreement | : | 21 November, 2005 |
| Parties | : | (1) CNSS<br>(2) Beijing Chinasoft |

CNSS engaged Beijing Chinasoft to provide software and installation services for a management system software development and technology project of a customer of CNSS at a consideration of RMB1,374,107.

Beijing Chinasoft shall be responsible for the provision of software developed by itself, and the installation, after-sales and upgrading services to the customer of CNSS

7. A loan agreement dated 1 December, 2005 under which Beijing Chinasoft Cyber-Chinese International Information Technology Limited (held by CNSS as to 30% of its registered capital and thus an associate of CNSS and a connected person of the Company) borrowed an amount of RMB1,450,000 from Beijing Chinasoft for six months, which is unsecured and non-interest bearing.

The Company has complied with the disclosure requirements in accordance with Chapter 20 of the GEM Listing Rules in respect of the transactions under items 3, 4 and 5, but not in respect of the transactions under items 1, 2, 6 and 7.

Save as disclosed therein, there were no other transactions required to be disclosed as connected transactions and/or continuing connected transactions in accordance with the requirements of the GEM Listing Rules.

## MAJOR CUSTOMERS AND SUPPLIERS



During the year, the aggregate turnover attributable to the Group's five largest customers accounted for less than 30% of the Group's total turnover and the Group's largest customer accounted for approximately 7% of the Group's total turnover.

The aggregate purchases during the year attributable to the Group's five largest suppliers was approximately 21% of the Group's total purchases and the Group's largest supplier accounted for approximately 5% of the Group's total purchases.

None of the directors, their associates, or any shareholders of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) has any interest in any of the five largest suppliers or customers of the Group.

## SUBSTANTIAL SHAREHOLDERS

As at 31 December 2005, so far as is known to the Directors, the following persons (other than a Director or chief executive of the Company) had an interest in the shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO:

**Long positions in Shares**

| **Name** | **Nature of interest** | **Approximate number of Shares** (million) | **Approximate percentage of total issued share capital of the Company** |
|---|---|---|---|
| CS&S (HK) (Note 1) | Beneficial interest | 199.01 | 27.17% |
| CNSS (Note 1) | Interest of controlled corporation | 199.01 | 27.17% |
| Chinasoft (HK) (Note 2) | Interest of persons acting in concert | 199.01 | 27.17% |
| Far East Technology (Note 3) | Beneficial interest | 169.89 | 23.2% |
| IFC (Note 4) | Beneficial interest | 97.25 | 13.28% |
| Microsoft (Note 4) | Beneficial interest | 97.25 | 13.28% |
| Authorative Industries Limited ("Authorative") (Note 5) | Beneficial interest | 57.49 | 7.85% |
| Yang Haimo (Note 5) | Interest of controlled corporation | 57.49 | 7.85% |
| Prosperity International Investment Corporation ("Prosperity") (Note 6) | Beneficial interest | 39.79 | 5.43% |

# Report of the Directors

| Name | Nature of interest | Approximate number of Shares (million) | Approximate percentage of total issued share capital of the Company |
|---|---|---|---|
| Joseph Tian Li (Note 6) | Interest of controlled corporation | 39.79 | 5.43% |
| ITG Venture Capital Limited ("ITG") (Note 7) | Beneficial interest | 36.94 | 5.04% |
| Zhou Qi (Note 7) | Interest of controlled corporation | 36.94 | 5.04% |

Notes:

1 CNSS is taken to be interested in the Shares in which CS&S (HK) is interested. CNSS holds approximately 99.3% of the total voting rights of CS&S (HK). The number of Shares in which CS&S (HK) is interested includes 23,248,302 Shares which may be issued by the Company to CS&S (HK) pursuant to an acquisition agreement between Chinasoft (HK) and CS&S (HK) dated 28th April 2005 subject to fulfillment of a condition and the exercise of a cash option.

2. Chinasoft (HK) and CS&S (HK) are parties to agreements to acquire interests in the Company which include provisions imposing restrictions with respect to the disposal of interests acquired, and Chinasoft (HK) is taken to be interested in the Shares in which CS&S (HK) is interested pursuant to section 318 of the SFO.

3. Mr. Duncan Chiu and Mr. David Chiu, who were an executive Director and a non-executive Director of the Company respectively as at 31 December 2005, are nominated by Far East Technology. Both Mr. Duncan Chiu and Mr. David Chiu are directors of Far East Technology.

4. IFC and Microsoft were each interested in 97,250,000 Shares which could be issued to each of them upon the conversion of the 97,250,000 Series A Preferred Shares agreed to be subscribed for by each of them pursuant to a subscription agreement with the Company dated 26th September 2005 subject to the satisfaction of condition precedents set forth in the subscription agreement.

5. Mr. Yang Haimo controls the exercise of more than one-third of the voting power at general meetings of Authorative, and is thus taken to be interested in the Shares held by Authorative.

6. The entire issued share capital of Prosperity is beneficially owned by Mr. Joseph Tian Li. Mr. Joseph Tian Li is taken to be interested in the Shares held by Prosperity.

7. The entire issued share capital of ITG is beneficially owned by Mr. Zhou Qi. Mr. Zhou Qi is taken to be interested in the Shares held by ITG.

Save as disclosed above, as at 31 December 2005, no other interest or short position in the Shares or underlying shares of the Company were recorded in the register required to be kept under section 336 of the SFO.

## PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any listed securities of the Company' during the year under review.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association, or the laws of Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

## SPONSOR'S INTERESTS

As updated and notified by the Company's sponsor, Oriental Patron Asia Limited (''Oriental Patron"), neither Oriental Patron nor its directors, employees or associates had any interests in the share capital of the Company as at 31 December 2005 pursuant to Rules 6.36 and 18.75 of the GEM Listing Rules.

Pursuant to an agreement dated 9 June 2003 entered into between the Company and Oriental Patron, Oriental Patron received a fee for acting as the Company's retained sponsor for the period from 20 June 2003 to 31 December 2005.



## COMPETING INTERESTS

As at 31 December 2005, Dr. Cui Hui, an executive Director, was interested in approximately 1.34% of the issued share capital of CNSS. Dr. Cui Hui also served as a director of CNSS. In addition, Madam Tang Min (an executive Director who was re-designated as a non-executive Director on 22 March 2006 and Dr. Chen Yuhong (an executive Director) had been appointed as directors of CNSS since August 2000 and April 2004 respectively. Although the Directors are of the view that the principal activities of CNSS do not directly compete with those of the Group currently, the Group and CNSS however are both engaged in the provision of information technology outsourcing.

Save as disclosed above, as at 31 December 2005, none of the Directors or the management shareholders of the Company and their respective associates (as defined under the GEM Listing Rules) had any interest in a business which competed or might compete with the business of the Group.

## POST BALANCE SHEET EVENTS

A list of events which happened after the date of the consolidated balance sheet of the Group of 31 December 2005 are set out in note 36 to the financial statements.

# Report of the Directors

## AUDITORS

A resolution will be submitted to the annual general meeting of the Company to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

**Dr. Chen Yuhong**
*Managing Director*

Beijing, 30 March 2006

# Corporate Governance Report

## CORPORATE GOVERNANCE PRACTICES

The board of directors of the Company believes that corporate governance is essential to the success of the Company and has adopted various measures to ensure that a high standard of corporate governance is maintained. The code provisions in the Code on Corporate Governance Practices contained in Appendix 15 of the GEM Listing Rules (the "Code on Corporate Governance Practices") have served as guideposts for the Company to follow in its implementation of corporate governance measures. The Company complied with all the code provisions in the Corporate Governance Practices during the year under review, particularly with respect to the management of the board of directors, financial reporting, communication with shareholders and the procedures for conduct of shareholders' meetings.

## DIRECTORS' SECURITIES TRANSACTION

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry of all the Directors, the Directors complied with such code of conduct and the required standard of dealings and its code of conduct regarding securities transactions by the Directors throughout the year ended 31 December 2005.

## BOARD OF DIRECTORS

During the year in review and up to the date of this report, the board of directors of the Company comprises:

**Executive directors:**

| | |
|---|---|
| Dr. Chen Yuhong | |
| Mr. Wang Hui | (appointed on 17 November 2005) |
| Dr. Tang Zhenming | (appointed on 17 November 2005) |
| Mr. Peng Jiang | (resigned on 22 March 2006) |

**Non-executive directors:**

| | |
|---|---|
| Ms. Tang Min (Chairman) | (formerly an executive Director and re-designated as non-executive Director on 22 March 2006) |
| Dr. Cui Hui | (formerly an executive Director and re-designated as non-executive Director on 22 March 2006) |
| Mr. Duncan Chiu | (formerly an executive Director and re-designated as non-executive Director on 22 March 2006) |
| Mr. Liu Zheng | |
| Mr. Timothy Chen Yung Cheng | (appointed on 22 March 2006) |
| Mr. David Chiu | (resigned on 22 March 2006) |
| Dr. Chen Qiwei | (resigned on 17 November 2005) |

**Independent non-executive directors:**

| | |
|---|---|
| Mr. He Ning | |
| Mr. Zeng Zhijie | |
| Dr. Leung Wing Yin Patrick | (appointed on 22 March 2006) |
| Mr. Au Yeung Shiu Kau Peter | (resigned on 22 March 2006) |

# Corporate Governance Report

During the year ended 31 December 2005, four full board meetings were held and the attendance of each director is set out as follows:

| Name of Director | Number of board meetings attended in 2005 | Attendance rate |
|---|---|---|
| **Executive Directors:** | | |
| Dr. Chen Yuhong | 4 | 100% |
| Mr. Wang Hui | – | N/A |
| Dr. Tang Zhenming | – | N/A |
| Mr. Peng Jiang | 4 | 100% |
| **Non-executive Directors:** | | |
| Ms. Tang Min | 4 | 100% |
| Dr. Cui Hui | 4 | 100% |
| Mr. Duncan Chiu | 4 | 100% |
| Mr. Timothy Chen Yung Cheng | – | N/A |
| Mr. Liu Zheng | 4 | 100% |
| Mr. David Chiu | 4 | 100% |
| Dr. Chen Qiwei | 4 | 100% |
| **Independent non-executive Directors:** | | |
| Mr. He Ning | 4 | 100% |
| Mr. Zeng Zhijie | 4 | 100% |
| Mr. Au Yeung Shiu Kau Peter | 4 | 100% |
| Dr. Leung Wing Yin Patrick | – | N/A |

The Board is currently responsible for corporate strategy and development, overseeing the business operations of the Group, financial reporting, legal and regulatory compliance, directors' appointments, risk management, major acquisitions, disposals and capital transactions. Major corporate matters delegated by the Board to management include preparation of annual and interim accounts for board approval, execution of business strategies and initiatives adopted by the Board and implementation of internal control system.

Details of backgrounds and qualifications of the chairman of the Company and the other Directors are set out in the section headed "Report of the Directors" in this Annual Report. All Directors have given sufficient time and attention to the affairs of the Group. Each executive Director are suitably qualified for his or her position, and has sufficient experience to hold the position so as to carry out his duties effectively and efficiently.

Madam Tang Min and Dr. Cui Hui are both directors of CNSS, a substantial shareholder of the Company. Dr Chen Yuhong and Dr. Cui Hui have been appointed as senior vice presidents of CNSS since December, 2003. Mr. Duncan Chiu is the brother of Dato' David Chiu, a non-executive Director who resigned on 22 March 2006. Both Mr. Duncan Chiu and Dato' David Chiu are directors of Far East, a substantial shareholder of the Company. Save as aforesaid, there are no other relationships among the members of the board of Directors.

The three independent non-executive Directors appointed by the Company have appropriate and sufficient experience and qualification to carry out their duties so as to protect the interests of shareholders. Each independent non-executive Director gives an annual confirmation of his independence to the Company, and the Company considers these Directors to be independent under Rule 3.13 of the Listing Rules.

## CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The post of the chairman of the board (held by Madam Tang Min) and the post of the chief executive officer (held by Dr. Chen Yuhong, the Managing Director) are segregated. Madam Tang is responsible for leadership and organization of the board of directors, whereas Dr. Chen Yuhong is in charge of management of the overall business operations of the Group.

## APPOINTMENT OF NON-EXECUTIVE DIRECTORS

Madam Tang Min, Dr. Cui Hui and Mr. Duncan Chiu were re-designated as non-executive Directors for a term of two years from 22 March 2006 and are subject to termination by one month's notice by the Company or himself or herself. Mr. Timothy Chen Yung Cheng was appointed as a non-executive Director for two years from 22 March 2006, subject to termination by one month's notice by the Company or himself. The term of appointment of Mr. Liu Zheng as a non-executive Director expired on 20 June 2005 and has continued subject to termination by one month's notice by the Company or himself. Dr. Chen Qiwei and Mr. David Chiu resigned as non-executive Director with effect from 17 November 2005 and 22 March 2006 respectively.

## REMUNERATION COMMITTEE

The remuneration committee was established on 28 June 2005. During the year under review, the chairman of the committee was Madam Tang Min, and other members included Mr. He Ning, Dr. Chen Yuhong Mr. Zeng Zhijie and Mr. Au Yeung Shiu Kau Peter. Madam Tang Min and Dr. Chen Yuhong are executive Directors and the remaining three members are independent non-executive Directors. Mr. Au Yeung Shiu Kau Peter has been replaced by Dr. Leung Wing Yin Patrick with effect from 22 March 2006.

The role and function of the remuneration committee included the determination of the specific remuneration packages of all executive Directors, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and making recommendations to the board of Directors for the remuneration of non-executive Directors. The remuneration committee will consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the Directors, employment conditions elsewhere in the Group and desirability of performance-based remuneration.

# Corporate Governance Report

Details of attendance of the meeting of the Remuneration Committee are set out as follows:

| Name of Director | Number of Meetings attended in 2005 | Attendance rate |
|---|---|---|
| Madam Tang Min | 1 | 100% |
| Dr. Chen Yuhong | 1 | 100% |
| Mr. He Ning | 1 | 100% |
| Mr. Zeng Zhijie | 1 | 100% |
| Mr. Au Yeung Shiu Kau, Peter | 1 | 100% |
| Dr. Leung Wing Yin, Patrick | – | N/A |

The board of Directors considered that the existing terms of appointment and levels of remuneration of the Directors are fair and reasonable, and resolved that a review be carried out again in the year ending 31 December, 2006.

The Company adopted a share option scheme on 2 June 2003, which serves as an incentive to attract, retain and motivate talented eligible staff, including the Directors. Details of the share option scheme are set out in note 30* to the financial statements. The emolument payable to directors will depend on their respective contractual terms under employment contracts, if any, and as recommended by the remuneration committee. Details of the directors' remuneration are set out in note 11 to the financial statements.



## NOMINATION OF DIRECTORS

During the year under review, one meeting was held by the board of Directors to consider the appointment and removal of directors. Details of attendance of the nomination of Directors meeting are set out as follows:

| Name of member | Number of meetings attended in 2005 | Attendance rate |
|---|---|---|
| Madam Tang Min | 1 | 100% |
| Dr. Chen Yuhong | 1 | 100% |
| Mr. Duncan Chiu | 1 | 100% |
| Mr. Au Yeung Shiu Kau, Peter | 1 | 100% |

Prior to the convening of the annual general meeting of the Company in April 2005, the board of Directors resolved that Dr. Cui Hui and Mr. Liu Zheng should retire and stand for re-election at the annual general meeting in accordance with the requirements under the Articles of Association of the Company.

On 17 November, 2005, the board of Directors resolved that Dr. Tang Zhengming and Mr. Wang Hui, being senior management of the Group in charge of human resources and personnel training of the Group and product and solution development respectively, be appointed as executive Directors in recognition of their experience, expertise and contributions to the Group.

# Corporate Governance Report

## ACCOUNTABILITY AND AUDIT

The Directors are responsible for overseeing the preparation of accounts for each financial period, which give a true and fair view of the state of affairs of the Group and of tie results and cash flow for that period. In preparing the accounts for the year ended 31 December 2005, the Directors have selected suitable accounting policies and have applied them consistently, adopted appropriate Hong Kong Financial Reporting Standards ("HKFRSs") and Hong Kong Accounting Standards ("HKASs") which are pertinent to its operations and relevant to the financial statements, made judgements and estimates that are prudent and reasonable, and have prepared the accounts on the going concern basis.

## THE AUDIT COMMITTEE

The Company established an audit committee on 2 June 2003 and amended its written terms of reference to comply with the requirements in the Code on Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules. The primary duties of the audit committee are to review and to supervise the financial reporting process and internal control system of the Group. During the year ended 31 December 2005, the audit committee comprised of two independent non-executive Directors, Mr. He Ning and Mr. Zeng Zhijie, and a non-executive Director, Dr. Chen Qiwei until his replacement by Mr. Au Yeung Shiu Kau, Peter, an independent non-executive Director on 17 November 2005. The audit committee met on a quarterly basis during the year ended 31 December 2005. Mr Au Yeung Shiu Kau, Peter has been replaced by Dr. Leung Wing Yin, Patrick as a member of the audit committee with effect from 22 March 2006.

The Group's unaudited quarterly and interim results and annual audited results during the year ended 31 December 2005 have been reviewed by the audit committee, which was of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosure has been made.

During the year under review, four meetings were held by the audit committee. Details of attendance of audit committee meetings are set out as follows:

| Name of member | Number of meetings attended in 2005 | Attendance rate |
|---|---|---|
| Mr. He Ning | 4 | 100% |
| Mr. Zeng Zhijie | 4 | 100% |
| Dr. Chen Qiwei | 4 | 100% |
| Mr. Au Yeung Shiu Kau, Peter | – | N/A |
| Dr. Leung Wing Yin, Patrick | – | N/A |

# Corporate Governance Report

## AUDITORS' REMUNERATION

The audit committee of the Company is responsible for considering the appointment of the external auditor and reviewing any non-audit functions performed by the external auditor, including whether such non-audit functions could lead to any potential material adverse effect on the Company. During the year under review, the Group was required to pay an aggregate of approximately HK$1.6 million* to the external auditors for their services including audit, due diligence and other advisory services.

## INTERNAL CONTROL

During the year under review, the Company periodically conducted reviews of its system of internal control to ensure its effectiveness and adequacy. The Company periodically convened meetings to discuss financial, operational and risk management control.

## INVESTORS RELATIONS

The Company has disclosed all necessary information to the shareholders in compliance with GEM Listing Rules. Meetings are held with media and investors periodically. The Company also replied to the enquires from shareholders in a timely manner. The Directors host a annual general meeting each year to meet the shareholders and answer their enquiries.

# Report of the Auditors

Deloitte.
德勤

**TO THE SHAREHOLDERS OF CHINASOFT INTERNATIONAL LIMITED**
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Chinasoft International Limited (the "Company") and its subsidiaries (the "Group") from pages 62 to 110 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

## RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for the preparation of consolidated financial statements which give a true and fair view. In preparing consolidated financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

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, 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 consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the circumstances of the Group, 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 consolidated financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

## OPINION

In our opinion the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2005 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**Deloitte Touche Tohmatsu**
Certified Public Accountants
Hong Kong
30 March 2006

# Consolidated Income Statement

for the year ended 31 December 2005

| | NOTES | 2005 RMB'000 | 2004 RMB'000 (restated) |
|---|---|---|---|
| Turnover | 7 | **382,275** | 293,896 |
| Cost of sales | | **(264,279)** | (213,243) |
| Gross profit | | **117,996** | 80,653 |
| Other operating income | | **4,649** | 802 |
| Selling and distribution costs | | **(18,918)** | (10,613) |
| Administrative expenses | | **(44,564)** | (27,401) |
| Allowance for doubtful debts | | **(9,264)** | (3,768) |
| Amortisation of intangible assets | | **(2,950)** | (702) |
| Amortisation of goodwill | | **–** | (977) |
| Finance costs | 8 | **(25)** | (104) |
| Share of results of associates | | **1,790** | 1,143 |
| Release of negative goodwill of an associate | | **–** | 19 |
| Profit before taxation | | **48,714** | 39,052 |
| Taxation | 9 | **(5,718)** | (3,841) |
| Profit for the year | 10 | **42,996** | 35,211 |
| Attributable to: | | | |
| Equity holders of the parent | | **39,656** | 32,205 |
| Minority interests | | **3,340** | 3,006 |
| | | **42,996** | 35,211 |
| Dividend | 12 | **7,394** | 6,784 |
| Earnings per share | 13 | | |
| Basic | | **RMB0.0556** | RMB0.0487 |
| Diluted | | **RMB0.0543** | RMB0.0485 |

# Consolidated Balance Sheet

at 31 December 2005

| | NOTES | 2005 RMB'000 | 2004 RMB'000 (restated) |
|---|---|---|---|
| Non-current assets | | | |
| Property, plant and equipment | 14 | **23,288** | 11,682 |
| Intangible assets | 15 | **18,003** | 14,909 |
| Goodwill | 16 | **79,168** | 27,226 |
| Interests in associates | 17 | **8,303** | 1,658 |
| Prepaid lease payments | 35 | **216** | – |
| | | **128,978** | 55,475 |
| Current assets | | | |
| Inventories | 18 | **22,670** | 34,485 |
| Trade and other receivables | 19 | **182,113** | 163,955 |
| Amount due from a related company | 20 | **1,815** | 1,978 |
| Loan to a related company | 35 | **1,450** | – |
| Loans to employees | 21 | **–** | 310 |
| Pledged deposits | 22 | **1,653** | 1,093 |
| Bank balances and cash | 23 | **100,086** | 74,029 |
| | | **309,787** | 275,850 |
| Current liabilities | | | |
| Trade and other payables | 24 | **98,270** | 100,321 |
| Bills payable | 23 | **26,781** | 28,414 |
| Amount due to a shareholder | 25 | **9** | 50 |
| Dividend payable to a shareholder | | **–** | 498 |
| Taxation payable | | **2,846** | 1,426 |
| | | **127,906** | 130,709 |
| Net current assets | | **181,881** | 145,141 |
| Total assets less current liabilities | | **310,859** | 200,616 |
| Non-current liabilities | | | |
| Deferred tax liabilities | 26 | **1,824** | 1,221 |
| | | **309,035** | 199,395 |

# Consolidated Balance Sheet

at 31 December 2005

| | NOTES | 2005<br>RMB'000 | 2004<br>RMB'000<br>(restated) |
|---|---|---|---|
| Capital and reserves | | | |
| Share capital | 27 | **38,816** | 36,968 |
| Reserves | 29 | **256,187** | 162,427 |
| Equity attributable to equity holders of the parent | | **295,003** | 199,395 |
| Minority interests | | **14,032** | – |
| Total equity | | **309,035** | 199,395 |

The financial statements on pages 62 to 110 were approved and authorised for issue by the board of directors on 30 March 2006 and are signed on its behalf by:

**Dr. Chen Yuhong**
DIRECTOR

**Duncan Chiu**
DIRECTOR

# Consolidated Statement of Changes in Equity

for the year ended 31 December 2005

| | Attributable to the equity holders of the parent | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital RMB'000 | Share premium RMB'000 | Issuable shares RMB'000 (note 30) | Translation reserve RMB'000 | Share options reserve RMB'000 | General reserve fund RMB'000 (note 29) | Statutory Enterprise expansion fund RMB'000 (note 29) | Statutory surplus reserve fund RMB'000 (note 29) | Statutory public welfare fund RMB'000 (note 29) | Acc-umulated profits RMB'000 | Total RMB'000 | Minority interests RMB'000 | Total RMB'000 |
| At 1 January 2004 as originally stated | 33,920 | 45,080 | – | 49 | – | 1,074 | 589 | – | – | 45,399 | 126,111 | – | 126,111 |
| Effects of changes in accounting policies (see note 3) | – | – | – | – | 164 | – | – | – | – | (164) | – | 14,182 | 14,182 |
| At 1 January 2004 as restated | 33,920 | 45,080 | – | 49 | 164 | 1,074 | 589 | – | – | 45,235 | 126,111 | 14,182 | 140,293 |
| Exchange differences arising from translation of overseas operations and net gain not recognised in the consolidated income statement | – | – | – | 41 | – | – | – | – | – | – | 41 | – | 41 |
| Share of changes in equity of an associate | – | – | – | – | – | 176 | – | – | – | (176) | – | – | – |
| Profit for the year | – | – | – | – | – | – | – | – | – | 32,205 | 32,205 | 3,006 | 35,211 |
| Total recognised income for the year | – | – | – | 41 | – | 176 | – | – | – | 32,029 | 32,246 | 3,006 | 35,252 |
| Recognition of equity-settled share based payments | – | – | – | – | 3,328 | – | – | – | – | – | 3,328 | – | 3,328 |
| New issue of shares (see note 27(a)) | 3,048 | 41,446 | – | – | – | – | – | – | – | – | 44,494 | – | 44,494 |
| Acquisition of additional interest of a subsidiary | – | – | – | – | – | – | – | – | – | – | – | (17,188) | (17,188) |
| Dividend for 2004 paid | – | (1,341) | – | – | – | – | – | – | – | (5,443) | (6,784) | – | (6,784) |
| At 31 December 2004 | 36,968 | 85,185 | – | 90 | 3,492 | 1,250 | 589 | – | – | 71,821 | 199,395 | – | 199,395 |
| Effects of changes in accounting policies (see note 3) | – | – | – | – | – | – | – | – | – | 111 | 111 | – | 111 |
| At 1 January 2005 as restated | 36,968 | 85,185 | – | 90 | 3,492 | 1,250 | 589 | – | – | 71,932 | 199,506 | – | 199,506 |
| Exchange differences arising from translation of overseas operations and net gain not recognised in the consolidated income statement | – | – | – | (2,137) | – | – | – | – | – | – | (2,137) | – | (2,137) |
| Share of changes in equity of an associate | – | – | – | – | – | 184 | – | – | – | (184) | – | – | – |
| Profit for the year | – | – | – | – | – | – | – | – | – | 39,656 | 39,656 | 3,340 | 42,996 |
| Total recognised (expense) income for the year | – | – | – | (2,137) | – | 184 | – | – | – | 39,472 | 37,519 | 3,340 | 40,859 |
| New issue of shares (see note 27(b)) | 1,848 | 35,487 | – | – | – | – | – | – | – | – | 37,335 | – | 37,335 |
| Shares issuable on acquisition of subsidiaries | – | – | 24,420 | – | – | – | – | – | – | – | 24,420 | – | 24,420 |
| Acquisition of subsidiaries | – | – | – | – | – | – | – | – | – | – | – | 10,692 | 10,692 |
| Recognition of equity-settled share based payments | – | – | – | – | 3,617 | – | – | – | – | – | 3,617 | – | 3,617 |
| Transfer of share options reserve to accumulated profits upon lapse of share options | – | – | – | – | (11) | – | – | – | – | 11 | – | – | – |
| Appropriations | – | – | – | – | – | 139 | 139 | 63 | 32 | (373) | – | – | – |
| Dividend for 2005 paid | – | – | – | – | – | – | – | – | – | (7,394) | (7,394) | – | (7,394) |
| At 31 December 2005 | 38,816 | 120,672 | 24,420 | (2,047) | 7,098 | 1,573 | 728 | 63 | 32 | 103,648 | 295,003 | 14,032 | 309,035 |

# Consolidated Cash Flow Statement

for the year ended 31 December 2005

| | NOTE | 2005 RMB'000 | 2004 RMB'000 (restated) |
|---|---|---|---|
| Operating activities | | | |
| Profit before taxation | | **48,714** | 39,052 |
| Adjustments for: | | | |
| Share of results of associates | | **(1,790)** | (1,143) |
| Finance costs | | **25** | 104 |
| Interest income | | **(548)** | (442) |
| Amortisation of intangible assets | | **2,950** | 702 |
| Amortisation of goodwill | | **–** | 977 |
| Release of negative goodwill of an associate | | **–** | (19) |
| Depreciation of property, plant and equipment | | **3,646** | 2,370 |
| Allowance for doubtful debts | | **9,264** | 3,768 |
| Allowance for inventories | | **1,181** | 653 |
| Share option expense | | **3,578** | 3,298 |
| Operating cash flows before movements in working capital | | **67,020** | 49,320 |
| Decrease (increase) in inventories | | **12,113** | (27,819) |
| Increase in trade and other receivables | | **(17,882)** | (91,744) |
| (Decrease) increase in trade and other payables | | **(11,613)** | 72,112 |
| (Decrease) increase in bills payable | | **(1,633)** | 25,466 |
| Cash generated from operations | | **48,005** | 27,335 |
| Interest paid | | **(25)** | (104) |
| PRC Enterprise Income Tax paid | | **(3,696)** | (2,767) |
| Net cash from operating activities | | **44,284** | 24,464 |
| Investing activities | | | |
| Dividend received from an associate | | **1,768** | 1,000 |
| Repayment from employees | | **310** | 721 |
| Interest received | | **548** | 442 |
| Acquisition of a subsidiary | 30 | **15,214** | 365 |
| Additions of development costs | | **(5,424)** | (5,890) |
| Purchase of technical knowhow | | **(500)** | (6,222) |
| Purchase of software | | **(120)** | – |
| Purchase of property, plant and equipment | | **(11,421)** | (5,386) |
| Establishment of an associate | | **(2,300)** | – |
| Acquisition of an associate | | **(4,200)** | (1,444) |
| Increase in pledged deposits | | **(560)** | (350) |
| Net cash used in investing activities | | **(6,685)** | (16,764) |

# Consolidated Cash Flow Statement

for the year ended 31 December 2005

| | 2005<br>RMB'000 | 2004<br>RMB'000<br>(restated) |
|---|---|---|
| Financing activities | | |
| Dividend paid | **(7,892)** | (6,286) |
| Loan to a related company | **(1,450)** | – |
| Bank loans repaid | **–** | (10,000) |
| Dividend paid to minority shareholder of a subsidiary | **–** | (1,500) |
| Repayment to a shareholder | **(41)** | – |
| Net cash used in financing activities | **(9,383)** | (17,786) |
| Net increase (decrease) in cash and cash equivalents | **28,216** | (10,086) |
| Cash and cash equivalents at beginning of the year | **74,029** | 84,074 |
| Effect of foreign exchange rate changes | **(2,159)** | 41 |
| Cash and cash equivalents at end of the year representing bank balances and cash | **100,086** | 74,029 |

# Notes to the Financial Statements

for the year ended 31 December 2005



## 1. GENERAL INFORMATION OF THE COMPANY

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 16 February 2000 under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

The shares of the Company are listed on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") with effect from 20 June 2003.

The addresses of the registered office and principal places of business of the Company are disclosed in the "Corporate Information" section to the annual report.

The financial statements are presented in Renminbi dollars, which is the same as the functional currency of the Group.

The Company is an investment holding company. The principal activities of the Group are development and provision of solutions, provision of information technology ("IT") consulting, training, outsourcing services and sale of standalone software and hardware products.

Particulars of the Company's subsidiaries at 31 December 2005 are set out as follows:

| Name of company | Place of incorporation or establishment/ operation | Issued and fully paid share capital/ registered capital | Percentage of nominal value of issued share capital/registered capital held by the Company | | Principal activities |
|---|---|---|---|---|---|
| | | | Directly | Indirectly | |
| Chinasoft International Holdings Limited* | Samoa/ Hong Kong | US$1 | 100% | – | Investment holding |
| Chinasoft International (Hong Kong) Limited ("Chinasoft (HK)")** | Hong Kong | HK$100 | – | 100% | Investment holding and trading of standalone software and hardware products |
| 北京中軟國際信息技術有限公司 Chinasoft International Information Technology Limited ("Chinasoft Beijing")*** | PRC | RMB50,000,000 | – | 100% | Provision of solutions, information technology outsourcing, information technology consulting services, software development and trading of standalone software and hardware products |
| 中軟國際(廣州)信息技術有限公司 Chinasoft International (Guang Zhou) Information Technology Limited ("Chinasoft Guangzhou")*** | PRC | HK$5,000,000 | – | 100% | Provision of solutions, information technology outsourcing, information technology consulting services and trading of standalone software and hardware products |

## 1. GENERAL INFORMATION OF THE COMPANY – Continued

| Name of company | Place of incorporation or establishment/ operation | Issued and fully paid share capital/ registered capital | Percentage of nominal value of issued share capital/registered capital held by the Company | | Principal activities |
|---|---|---|---|---|---|
| | | | Directly | Indirectly | |
| 中軟國際(杭州)信息技術有限公司 Chinasoft International (Hang Zhou) Information Technology Limited ("Chinasoft Hangzhou")*** | PRC | HK$5,000,000 | – | 100% | Provision of solutions, information technology outsourcing, information technology consulting services and trading of standalone software and hardware products |
| 中軟總公司計算機培訓中心**** | PRC | RMB500,000 | – | 100% | Provision of information, technology consultancy and training services |
| 中軟國際(昆明)信息技術有限公司 Chinasoft International (Kunming) Information Technology Limited*** ("Chinasoft Kunming") | PRC | Nil (note 1) | – | 100% | Not yet commenced business |
| 北京中軟資源信息科技服務有限公司 Chinasoft Resources Information Technology Services Limited*** ("Chinasoft Resources Beijing") | PRC | US$800,000 | – | 51% | Provision of information technology outsourcing services |

# Notes to the Financial Statements

for the year ended 31 December 2005

## 1. GENERAL INFORMATION OF THE COMPANY – Continued

| Name of company | Place of incorporation or establishment/ operation | Issued and fully paid share capital/ registered capital | Percentage of nominal value of issued share capital/registered capital held by the Company | | Principal activities |
|---|---|---|---|---|---|
| | | | Directly | Indirectly | |
| 深圳市中軟資源技術服務有限公司 Shenzhen Chinasoft Resources Information Technology Services Limited***** ("Chinasoft Resources Shenzhen") | PRC | RMB5,000,000 | – | 50.9% (note 2) | Provision of information technology outsourcing services |
| 上海中軟資源技術服務有限公司 Shanghai Chinasoft Resources Information Technology Services Limited***** ("Chinasoft Resources Shanghai") | PRC | RMB3,000,000 | – | 30.6% (note 2) | Provision of information technology outsourcing services |

* International company
** Limited liability company
*** Wholly foreign-owned enterprise
**** 中華人民共和國事業單位
***** Sino foreign-owned enterprise

None of the subsidiaries had any debt securities subsisting at 31 December 2005 or at any time during the year.

Notes:

1. No capital was contributed to this subsidiary up to 31 December 2005.

2. These subsidiaries were directly held by Chinasoft Resources Beijing which in turn was directly held as to 51% by Chinasoft (HK).

## 2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/ CHANGES IN ACCOUNTING POLICIES

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") that are effective for accounting periods beginning on or after 1 January 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, consolidated balance sheet and consolidated statement of changes in equity. In particular, the presentation of minority interests and share of taxation of associates have been changed. The changes in presentation have been applied retrospectively. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current and prior accounting years are prepared and presented:

**Business Combinations**

In the current year, the Group has applied HKFRS 3 "Business Combinations" which is effective for business combinations for which the agreement date is on or after 1 January 2005. In previous years, goodwill arising on acquisitions was capitalised and amortised over its estimated useful life. The Group has applied the transitional provisions in HKFRS 3. With respect to goodwill previously capitalised on the balance sheet, on 1 January 2005, the Group eliminated the carrying amount of the related accumulated amortisation of RMB977,000 with a corresponding decrease in the cost of goodwill (see note 16). The Group has discontinued amortising such goodwill from 1 January 2005 onwards and such goodwill will be tested for impairment at least annually. Goodwill arising on acquisitions after 1 January 2005 is measured at cost less accumulated impairment losses (if any) after initial recognition. As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current year. Comparative figures for 2004 have not been restated (see note 3 for the financial impact).

**Excess of the Group's interest in the net fair value of acquiree's identifiable assets and liabilities over cost (previously known as "negative goodwill")**

In accordance with HKFRS 3, "Business Combinations" any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of acquisition ("discount on acquisition") is recognised immediately in profit or loss in the period in which the acquisition takes place. In the prior year, negative goodwill of RMB111,000 arising on acquisition of an associate was presented as a deduction from share of net assets in interest in an associate and released to income on a straight-line basis over five years, representing the remaining weighted average useful life of the depreciable assets acquired. In accordance with the relevant transitional provisions in HKFRS 3, the Group derecognised the negative goodwill on 1 January 2005. A corresponding adjustment to the Group's retained earnings of RMB111,000 has been made.

## 2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/ CHANGES IN ACCOUNTING POLICIES – Continued

**Share-based payments**

In the current year, the Group has applied HKFRS 2 "Share-based Payment" which requires an expense to be recognised where the Group buys goods or obtains services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions"). The principal impact of HKFRS 2 on the Group is in relation to the expensing of the fair value of share options granted to directors, employees and customers of the Group and employees of a Group's associate, determined at the date of grant of the share options, over the vesting period. Prior to the application of HKFRS 2, the Group did not recognise the financial effect of these share options until they were exercised. The Group has applied HKFRS 2 to share options granted on or after 1 January 2005. In relation to share options granted before 1 January 2005, the Group chooses not to apply HKFRS 2 with respect to share options granted on or before 7 November 2002 and vested before 1 January 2005. However, the Group is still required to apply HKFRS 2 retrospectively to share options that were granted after 7 November 2002 and had not yet vested on 1 January 2005. Comparative figures have been restated (see note 3 for the financial impact).



The Group and the Company have not early applied the following new HKFRSs and HKFRS interpretations ("HK(IFRIC) – INT") that have been issued but are not yet effective. The directors of the Company have commenced considering the potential impact of these new HKFRSs and HKFRS interpretations. Except for HKAS 39 & HKFRS 4 (Amendments) on financial guarantee contracts (which requires financial guarantees to be initially measured at fair value), which may have potential impact to the financial statements, the directors anticipate that the adoption of these new HKFRSs and HKFRS interpretations should not result in any significant changes in the future as to how the results and financial position are prepared and presented. The Group and the Company are still not in the position to reasonably estimate the impact that may arise from HKAS 39 and HKFRS 4 (Amendments).

| | |
|---|---|
| HKAS 1 (Amendment) | Capital disclosures [1] |
| HKAS 19 (Amendment) | Actuarial gains and losses, group plans and disclosures [2] |
| HKAS 21 (Amendment) | Net investment in a foreign operation [2] |
| HKAS 39 (Amendment) | Cash flow hedge accounting of forecast intragroup transactions [2] |
| HKAS 39 (Amendment) | The fair value option [2] |
| HKAS 39 & HKFRS 4 (Amendments) | Financial guarantee contracts [2] |
| HKFRS 6 | Exploration for and evaluation of mineral resources [2] |
| HKFRS 7 | Financial instruments: Disclosures [1] |
| HK(IFRIC) – INT 4 | Determining whether an arrangement contains a lease [2] |
| HK(IFRIC) – INT 5 | Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds [2] |

## 2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/ CHANGES IN ACCOUNTING POLICIES – Continued

**Share-based payments** – Continued

| | |
|---|---|
| HK(IFRIC) – INT 6 | Liabilities arising from participating in a specific market- waste electrical and electronic equipment [3] |
| HK(IFRIC) – INT 7 | Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies [4] |

1 Effective for annual periods beginning on or after 1 January 2007.

2 Effective for annual periods beginning on or after 1 January 2006.

3 Effective for annual periods beginning on or after 1 December 2005.

4 Effective for annual periods beginning on or after 1 March 2006.

## 3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior years are as follows:

| | **2005 RMB'000** | 2004 RMB'000 |
|---|---|---|
| Non-amortisation of goodwill | **(2,820)** | – |
| Decrease in share of results of associates | **283** | 76 |
| Decrease in taxation | **(283)** | (76) |
| Release of negative goodwill of an associate | **19** | – |
| Recognition of share-based payments as expenses | **3,617** | 3,328 |
| Decrease in profit for the year | **816** | 3,328 |

The effects by income statement items of the application of the new HKFRSs for the years ended 31 December 2005 and 2004 are summarised below:

| | **2005 RMB'000** |
|---|---|
| Increase in cost of sales | **(1,016)** |
| Increase in selling and distribution costs | **(789)** |
| Increase in administrative expenses | **(1,773)** |
| Decrease in amortisation of goodwill | **2,820** |
| Decrease in share of results of associates | **(39)** |
| Decrease in release of negative goodwill of an associate | **(19)** |
| Decrease in profit for the year | **(816)** |

# Notes to the Financial Statements



## 3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES – Continued

| | 2004 (originally stated) RMB'000 | Adjustments RMB'000 | 2004 (restated) RMB'000 |
|---|---|---|---|
| Cost of sales | (212,294) | (949) | (213,243) |
| Selling and distribution costs | (9,883) | (730) | (10,613) |
| Administrative expenses | (25,782) | (1,619) | (27,401) |
| Share of result of an associate | 1,249 | (106) | 1,143 |
| Taxation | (3,917) | 76 | (3,841) |
| Decrease in profit for the year | | (3,328) | |

The cumulative effects of the application of the new HKFRSs as at 31 December 2004 and 1 January 2005 are summarised below:

| | **As at 31 December 2004 (originally stated)** RMB'000 | **Retrospective adjustments** RMB'000 | **As at 31 December 2004 (restated)** RMB'000 | **Prospective adjustments** RMB'000 | **As at 1 January 2005 (restated)** RMB'000 |
|---|---|---|---|---|---|
| Balance sheet items | | | | | |
| Interest in an associate | 1,658 | – | 1,658 | 111 | 1,769 |
| Increase in asset | | | | 111 | |
| Share options reserve | – | 3,492 | 3,492 | – | 3,492 |
| Accumulated profits | 75,313 | (3,492) | 71,821 | 111 | 71,932 |
| Total effect on equity | | – | | 111 | |

The financial effects of the application of the new HKFRSs to the Group's equity on 1 January 2004 are summarised below:

| | **As originally stated** RMB'000 | **Retrospective adjustment** RMB'000 | **As restated** RMB'000 |
|---|---|---|---|
| Share options reserve | – | 164 | 164 |
| Accumulated profits | 45,399 | (164) | 45,235 |
| Minority interests | – | 14,182 | 14,182 |
| Total effect on equity | | 14,182 | |
| Minority interests | 14,182 | (14,182) | – |

## 4. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for financial instruments which are measured initially at fair value.

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the GEM of the Stock Exchange and by the Hong Kong Companies Ordinance.

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

**Goodwill**

Goodwill arising on an acquisition of a subsidiary or an associate for which the agreement date is before 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of the relevant subsidiary or associate at the date of acquisition.

For previously capitalised goodwill, the Group has discontinued amortisation from 1 January 2005 onwards, and such goodwill is tested for impairment annually, and whenever there is an indication that the cash-generating unit to which the goodwill relates may be impaired (see the accounting policy below).

Goodwill arising on an acquisition of a subsidiary or an associate for which the agreement date is on or after 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary or associate at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

## 4. SIGNIFICANT ACCOUNTING POLICIES – Continued

**Goodwill** – Continued

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the balance sheet. Capitalised goodwill arising on an acquisition of an associate (which is accounted for using the equity method) is included in the cost of the investment of the relevant associate.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the income statement. An impairment loss for goodwill is not reversed in subsequent periods.



On subsequent disposal of the subsidiary or an associate, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

**Interests in associates**

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

**Revenue recognition**

Sales of goods are recognised when goods are delivered and title has passed.

Service income from solutions and IT outsourcing on project-based IT development contracts is recognised on the percentage of completion method by reference to the value of work carried out during the year.

## 4. SIGNIFICANT ACCOUNTING POLICIES – Continued

**Revenue recognition** – Continued

Income from provision of IT outsourcing, IT consulting and training services is recognised when the services are performed.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

VAT tax refund is recognised when becomes receivable.

**Impairment losses (other than goodwill (see the accounting policy in respect of goodwill))**

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

**Property, plant and equipment**

Property, plant and equipment are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method, at the following rates per annum:

| | |
|---|---|
| Leasehold improvements | 18% – 20% |
| Furniture, fixtures and equipment | 18% – 30% |
| Motor vehicles | 9% – $11\frac{1}{4}$% |

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognised.

## 4. SIGNIFICANT ACCOUNTING POLICIES – Continued

### Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

### Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.



Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Group's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financials statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Company (i.e. Renminbi dollars) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation on or after 1 January 2005 are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the translation reserve.

## 4. SIGNIFICANT ACCOUNTING POLICIES – Continued

### Retirement benefit costs

Payments to the state-managed retirement benefit schemes or the Mandatory Provident Fund Scheme are charged as an expense as they fall due.

### Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

### Intangible assets

On initial recognition, intangible assets acquired separately are recognised at cost. After initial recognition, intangible assets with finite useful lives are carried at costs less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on a straight-line basis over their estimated useful lives.

## 4. SIGNIFICANT ACCOUNTING POLICIES – Continued

**Intangible assets** – Continued

Gains or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

**Research and development expenditures**

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over the estimated useful life.

Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.



**Technical knowhow**

Technical knowhow is measured initially at cost and amortised on a straight-line basis over its estimated useful life.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the first-in, first-out method.

**Project-based IT development contracts**

When the outcome of a contract for project-based IT development can be estimated reliably, contract costs are charged to the income statement by reference to the stage of completion of the contract activity at the balance sheet date, as measured by the proportion that costs incurred to date bear to estimated costs for each contract.

When the outcome of a contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred.

Where it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

## 4. SIGNIFICANT ACCOUNTING POLICIES – Continued

**Equity-settled share – based payment transactions**

*Share options granted to employees of the Group, employees of an associate of the Group and customers of the Group*

The fair value of services received determined by reference to the fair value of share options granted at the grant date is expensed on a straight-line basis over the vesting period, with a corresponding increase in share options reserve.

At the time when the share options are exercised, the amount previously recognised in share options reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share options reserve will be transferred to accumulated profits.

## 5. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

**Allowance for doubtful debts**

The policy for allowance for doubtful debts of the Group is based on the evaluation of collectability and aging analysis of accounts and on management's judgment. A considerable amount of judgment is required in assessing the ultimate realisation of these receivables, including the current creditworthiness and the past collection history of each customer. If the financial conditions of customers of the Group were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

**Estimated impairment of goodwill**

Determining whether goodwill is impaired requires an estimation of the recoverable amount of the CGUs to which goodwill has been allocated. The Group has obtained business valuation of the relevant CGUs prepared by independent professional valuers for the purpose of goodwill impairment testing. As at 31 December 2005, the carrying amount of goodwill was RMB79,168,000. Details of the recoverable amount calculation are disclosed in note 16.

**Estimated impairment of intangible assets**

Determining whether intangible assets are impaired requires an estimation of the recoverable amount of the intangible assets. The Group has obtained valuations of the relevant intangible assets prepared by independent professional valuers for the purpose of intangible assets impairment testing. As at 31 December 2005, the carrying amount of intangible assets was RMB18,003,000.

## 6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include trade and other receivables, bank balances, trade and other payables and bills payables. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

### Currency risk

It is the Group's policy for each operating entity to operate in local currency as far as possible to minimise currency risk. The Group's principal businesses are conducted and recorded in Renminbi dollars. Since the impact of foreign exchange exposure is minimal, no hedging against foreign currency exposure has been carried out by the management.

### Interest rate risk

The Group is exposed to cash flow interest rate risk through the impact of rate changes on interest bearing financial assets which are mainly short-term bank deposits. Since the bank deposits are all short-term in nature, any future variation in interest rates will not have a significant impact on the results of the Group.



### Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31 December 2005 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. The Group reviews the recoverable amount of each individual trade receivable to ensure that adequate impairment losses, if necessary, are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

The Group's concentration of credit risk by geographical locations is mainly in the People's Republic of China (the "PRC"). The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

## 7. TURNOVER AND SEGMENT INFORMATION

Turnover represents the net amounts received and receivable for goods sold and services rendered during the year.

**Business segments**

For management purposes, the Group is currently organised into four operating divisions – solutions, IT outsourcing, IT consulting and training services, and sale of standalone software and hardware products. These divisions are the basis on which the Group reports its primary segment information.

Segment information about these businesses is presented as follows:

**INCOME STATEMENT**
For the year ended 31 December 2005

| | Solutions RMB'000 | IT outsourcing RMB'000 | IT consulting and training services RMB'000 | Sale of standalone software and hardware products RMB'000 | Consolidated RMB'000 |
|---|---|---|---|---|---|
| Turnover | 301,075 | 53,034 | 7,552 | 20,614 | 382,275 |
| Segment result | 96,597 | 8,743 | 133 | 5,252 | 110,725 |
| Unallocated other operating income | | | | | 4,649 |
| Unallocated corporate expenses | | | | | (56,211) |
| Amortisation of intangible assets | | | | | (2,950) |
| Allowance for doubtful debts | | | | | (9,264) |
| Finance costs | | | | | (25) |
| Share of results of associates | | | | | 1,790 |
| Profit before taxation | | | | | 48,714 |
| Taxation | | | | | (5,718) |
| Net profit for the year | | | | | 42,996 |

# Notes to the Financial Statements



## 7. TURNOVER AND SEGMENT INFORMATION – Continued

**INCOME STATEMENT** – Continued

For the year ended 31 December 2004

| | Solutions RMB'000 | IT outsourcing RMB'000 | IT consulting and training services RMB'000 | Sale of standalone software and hardware products RMB'000 | Consolidated RMB'000 (restated) |
|---|---|---|---|---|---|
| Turnover | 240,820 | 34,286 | 6,298 | 12,492 | 293,896 |
| Segment result | 66,479 | 4,496 | 105 | 6,106 | 77,186 |
| Unallocated other operating income | | | | | 802 |
| Unallocated corporate expenses | | | | | (34,547) |
| Amortisation of intangible assets | | | | | (702) |
| Allowance for doubtful debts | | | | | (3,768) |
| Amortisation of goodwill | | | | | (977) |
| Finance costs | | | | | (104) |
| Share of result of an associate | | | | | 1,143 |
| Release of negative goodwill of an associate | | | | | 19 |
| Profit before taxation | | | | | 39,052 |
| Taxation | | | | | (3,841) |
| Net profit for the year | | | | | 35,211 |

No business segment information for the assets, liabilities, capital additions, depreciation and amortisation and other non-cash expenses of the Group is shown as all the assets and liabilities are shared by the business segments and cannot be separately allocated.

### Geographical segments

No geographical segment information of the Group is shown as the operating businesses of the Group are substantially carried out in the PRC and the Group's assets and liabilities are substantially located in the PRC.

## 8. FINANCE COSTS

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| Interest on borrowings wholly repayable within five years: | | |
| Bank loans | **3** | 25 |
| Other borrowings | **22** | 79 |
| | **25** | 104 |

## 9. TAXATION

| | THE GROUP | |
|---|---|---|
| | 2005<br>RMB'000 | 2004<br>RMB'000<br>(restated) |
| The charge comprises: | | |
| PRC Enterprise Income Tax | **5,115** | 3,030 |
| Deferred tax (note 26) | **603** | 811 |
| Tax charge attributable to the Company and its subsidiaries | **5,718** | 3,841 |

No provision for Hong Kong Profits Tax has been made for the year ended 31 December 2005 as the Group had no assessable profit in Hong Kong for the year.

No provision for Hong Kong Profits Tax had been made for the year ended 31 December 2004 as the assessable profit in Hong Kong of the Group was wholly absorbed by tax losses brought forward.

The statutory rate of PRC Enterprise Income Tax is 33%.

Certain group companies are subject to certain tax exemption arrangements as set out below.

Pursuant to an approval document issued by the State Bureau of Beijing Haidian District dated 21 November 2000, 北京中軟國際信息技術有限公司 ("Chinasoft Beijing"), a subsidiary of the Company, had been designated as an advanced technology enterprise and its income tax rate was reduced from 33% to 15%. Moreover, Chinasoft Beijing was entitled to the three year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2000. As a result, Chinasoft Beijing is subject to the income tax computed at the rate of 7.5% for the three years ended 31 December 2005 and at the rate of 15% on its taxable profit thereafter.

## 9. **TAXATION** – Continued

Pursuant to an approval document issued by the Guangzhou Science and Technology Bureau dated 31 March 2004, 中軟國際(廣州)信息技術有限公司 ("Chinasoft Guangzhou"), a subsidiary of the Company, had been designated as an advanced technology enterprise and its income tax rate was reduced from 33% to 15%. Moreover, pursuant to another approval document issued by the Guangzhou National Tax Bureau dated 2 June 2004, Chinasoft Guangzhou was entitled to the two year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2003.

Pursuant to an approval document issued by the Beijing Science and Technology Commission dated 25 June 2004, 北京中軟資源信息科技服務有限公司 ("Chinasoft Resources Beijing"), a subsidiary of the Company, had been designated as an advanced technology enterprise and its income tax rate was reduced from 33% to 15%. Moreover, Chinasoft Resources Beijing was entitled to the three year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2004.

Pursuant to an approval document issued by the State Bureau of Shenzhen Nanshan District dated 1 March 2005, 深圳市中軟資源技術服務有限公司 ("Chinasoft Resources Shenzhen"), a subsidiary of the Company, had been designated as a newly established software enterprise. As a result, Chinasoft Resources Shenzhen was entitled to the two year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2004.

The tax charge for the year can be reconciled to profit before taxation as follows:

| | **2005**<br>**RMB'000** | 2004<br>RMB'000<br>(restated) |
|---|---|---|
| Profit before taxation | **48,714** | 39,052 |
| Tax at PRC Enterprise Income Tax rate of 33% | **16,076** | 12,887 |
| Tax effect of share of results of associates | **(592)** | (412) |
| Tax effect attributable to tax exemptions granted to PRC subsidiaries | **(15,718)** | (11,976) |
| Tax effect of expenses not deductible for tax purpose | **3,974** | 2,736 |
| Tax effect of income not taxable for tax purpose | **(7)** | (7) |
| Tax effect of utilisation of tax losses previously not recognised | **–** | (37) |
| Tax effect of tax losses not recognised | **261** | – |
| Effect of different tax rate of subsidiaries | **1,405** | 864 |
| Others | **319** | (214) |
| Tax charge for the year | **5,718** | 3,841 |

## 10. PROFIT FOR THE YEAR

| | **2005** **RMB'000** | 2004 RMB'000 (restated) |
|---|---|---|
| Profit for the year has been arrived at after charging: | | |
| Directors' remuneration (note 11) | **2,489** | 1,903 |
| Other staff costs | **53,901** | 29,048 |
| Retirement benefit costs | **3,182** | 969 |
| Share option expense | **2,322** | 2,219 |
| Total staff costs | **61,894** | 34,139 |
| Share option expense | | |
| – granted to employees of an associate | **150** | 116 |
| – granted to customers | **465** | 414 |
| | **615** | 530 |
| Allowance for doubtful debts | **9,264** | 3,768 |
| Allowance for inventories | **1,181** | 653 |
| Auditors' remuneration | | |
| – current year | **1,518** | 795 |
| – underprovision in prior year | **–** | 138 |
| | **1,518** | 933 |
| Cost of inventories recognised as an expense | **195,608** | 190,624 |
| Depreciation of property, plant and equipment | **3,646** | 2,370 |
| Minimum lease payments in respect of land and buildings | **4,605** | 2,640 |
| Share of taxation of associates (included in share of results of associates) | **283** | 76 |
| and after crediting: | | |
| Interest income | **548** | 442 |
| VAT tax refund | **3,441** | 142 |

# Notes to the Financial Statements

for the year ended 31 December 2005

## 11. DIRECTORS' AND EMPLOYEES' EMOLUMENTS

### Directors' emoluments

Details of emoluments to the directors of the Company for the year ended 31 December 2005 are as follows:

| | Executive director | | | | | | | Non-executive director | | | Independent non-executive director | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Chen Yuhong | Peng Jiang | Duncan Chiu | Cui Hui | Tang Min | Wang Hui | Tang Zhenming | David Chiu | Chen Qiwei | Liu Zheng | He Ning | Zeng Zhijie | Au Yeung Shiu Kau Peter | Total |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Fees for: | | | | | | | | | | | | | | |
| Executive directors | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Non-executive directors | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Independent non-executive directors | – | – | – | – | – | – | – | – | – | – | 64 | 64 | 64 | 192 |
| Other emoluments for executive directors: | | | | | | | | | | | | | | |
| Salaries and other benefits | 495 | 405 | 120 | 120 | 120 | 47 | 35 | – | – | – | – | – | – | 1,342 |
| Share option expense | 352 | 214 | 62 | – | – | 31 | 21 | – | – | – | – | – | – | 680 |
| Retirement benefit costs | 14 | 14 | – | – | – | 2 | 1 | – | – | – | – | – | – | 31 |
| Discretionary bonus (note) | – | – | – | – | – | – | – | – | – | – | – | 244 | – | 244 |
| | 861 | 633 | 182 | 120 | 120 | 80 | 57 | – | – | – | 64 | 308 | 64 | 2,489 |
| Other emoluments for non-executive directors | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Other emoluments for independent non-executive directors | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Total directors' remuneration | 861 | 633 | 182 | 120 | 120 | 80 | 57 | – | – | – | 64 | 308 | 64 | 2,489 |

Note: After a review by the board of directors ("BOD") on 7 October 2005, the BOD resolved to pay a special bonus of RMB244,000 to Mr. Zeng Zhijie in recognition of his duties, responsibilities and satisfactory performance.

## 11. DIRECTORS' AND EMPLOYEES' EMOLUMENTS – Continued

### Directors' emoluments – continued

Details of emoluments to the directors of the Company for the year ended 31 December 2004 are as follows:

| | Executive director | | | | | Non-executive director | | | Independent non-executive director | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Chen Yuhong | Peng Jiang | Duncan Chiu | Cui Hui | Tang Min | David Chiu | Chen Qiwei | Liu Zheng | He Ning | Zeng Zhijie | Au Yeung Shiu Kau Peter | Total |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Fees for: | | | | | | | | | | | | |
| Executive directors | – | – | – | – | – | – | – | – | – | – | – | – |
| Non-executive directors | – | – | – | – | – | – | – | – | – | – | – | – |
| Independent non-executive directors | – | – | – | – | – | – | – | – | 64 | 64 | 16 | 144 |
| Other emoluments for executive directors: | | | | | | | | | | | | |
| Salaries and other benefits | 488 | 412 | 120 | 120 | 30 | – | – | – | – | – | – | 1,170 |
| Share option expense | 325 | 199 | 55 | – | – | – | – | – | – | – | – | 579 |
| Retirement benefit costs | 5 | 5 | – | – | – | – | – | – | – | – | – | 10 |
| | 818 | 616 | 175 | 120 | 30 | – | – | – | 64 | 64 | 16 | 1,903 |
| Other emoluments for non-executive directors | – | – | – | – | – | – | – | – | – | – | – | – |
| Other emoluments for independent non-executive directors | – | – | – | – | – | – | – | – | – | – | – | – |
| | – | – | – | – | – | – | – | – | – | – | – | – |
| Total directors' remuneration | 818 | 616 | 175 | 120 | 30 | – | – | – | 64 | 64 | 16 | 1,903 |

## 11. DIRECTORS' AND EMPLOYEES' EMOLUMENTS – Continued

**Employees' emoluments**

Of the five individuals with the highest emoluments in the Group, three (2004: two) were directors of the Company whose emoluments were included above. One of the three highest paid directors was promoted from an employee to a director during the year. The emoluments of the remaining two (2004: three) highest paid individuals, including the employee's emoluments of the director before his promotion were as follows:

| | 2005<br>RMB'000 | 2004<br>RMB'000<br>(restated) |
|---|---|---|
| Salaries and other benefits | **1,420** | 1,133 |
| Share option expense | **364** | 357 |
| Retirement benefit costs | **40** | 24 |
| Discretionary bonus | **143** | – |
| | **1,967** | 1,514 |

Their emoluments were within the following bands:

| | No. of employees | |
|---|---|---|
| | **2005** | 2004 |
| HK$ nil to HK$1,000,000 (equivalent to RMB1,060,000) | **4** | 5 |
| HK$1,000,001 to HK$1,500,000 | **1** | – |
| | **5** | 5 |

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

None of the directors waived any emoluments during both years.

## 12. DIVIDEND

On 28 April 2005, the Company declared a final dividend of HK$0.01 (equivalent to RMB0.0106) per share amounted to HK$6,975,000 (equivalent to RMB7,394,000) for the year ended 31 December 2004 to its shareholders. The amount was paid to its shareholders in May 2005.

A final dividend of HK$0.025 (equivalent to RMB0.026) per share amounted to RMB19,041,684 has been proposed by the directors and is subject to approval by the shareholders in general meeting.

## 13. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the ordinary equity holders of the parent is based on the following data:

| | **2005**<br>**RMB'000** | 2004<br>RMB'000<br>(restated) |
|---|---|---|
| Earnings for the purposes of calculating basic and diluted earnings per share | **39,656** | 32,204 |

| | **Number of shares** | |
|---|---|---|
| | **2005** | 2004<br>(restated) |
| Weighted average number of ordinary shares for the purpose of calculating basic earnings per share | **713,455,342** | 661,267,123 |
| Effect of dilutive potential ordinary shares issuable under the Company's share option scheme | **17,278,640** | 2,338,860 |
| Weighted average number of ordinary shares for the purpose of calculating diluted earnings per share | **730,733,982** | 663,605,983 |

# Notes to the Financial Statements

for the year ended 31 December 2005

## 14. PROPERTY, PLANT AND EQUIPMENT

| | Leasehold improvements RMB'000 | Furniture, fixtures and equipment RMB'000 | Motor vehicles RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| COST | | | | |
| At 1 January 2004 | 2,754 | 6,189 | 2,565 | 11,508 |
| Additions | 869 | 4,035 | 482 | 5,386 |
| Acquired on acquisition of a subsidiary | – | 146 | – | 146 |
| Written off | – | (90) | – | (90) |
| At 31 December 2004 | 3,623 | 10,280 | 3,047 | 16,950 |
| Exchange adjustments | (3) | (2) | – | (5) |
| Additions | 963 | 6,929 | 3,529 | 11,421 |
| Acquired on acquisition of subsidiaries | 635 | 3,198 | – | 3,833 |
| Written off | – | (21) | – | (21) |
| At 31 December 2005 | 5,218 | 20,384 | 6,576 | 32,178 |
| DEPRECIATION | | | | |
| At 1 January 2004 | 947 | 1,824 | 217 | 2,988 |
| Provided for the year | 590 | 1,535 | 245 | 2,370 |
| Eliminated on written off | – | (90) | – | (90) |
| At 31 December 2004 | 1,537 | 3,269 | 462 | 5,268 |
| Exchange adjustments | (2) | (1) | – | (3) |
| Provided for the year | 843 | 2,454 | 349 | 3,646 |
| Eliminated on written off | – | (21) | – | (21) |
| At 31 December 2005 | 2,378 | 5,701 | 811 | 8,890 |
| NET BOOK VALUES | | | | |
| At 31 December 2005 | 2,840 | 14,683 | 5,765 | 23,288 |
| At 31 December 2004 | 2,086 | 7,011 | 2,585 | 11,682 |

## 15. INTANGIBLE ASSETS

| | Development costs RMB'000 | Technical knowhow RMB'000 | Software RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| COST | | | | |
| At 1 January 2004 | 3,738 | – | – | 3,738 |
| Additions | 5,890 | 6,222 | – | 12,112 |
| At 31 December 2004 | 9,628 | 6,222 | – | 15,850 |
| Additions | 5,424 | 500 | 120 | 6,044 |
| At 31 December 2005 | 15,052 | 6,722 | 120 | 21,894 |
| AMORTISATION | | | | |
| At 1 January 2004 | 239 | – | – | 239 |
| Provided for the year | 378 | 324 | – | 702 |
| At 31 December 2004 | 617 | 324 | – | 941 |
| Provided for the year | 2,272 | 678 | – | 2,950 |
| At 31 December 2005 | 2,889 | 1,002 | – | 3,891 |
| NET BOOK VALUES | | | | |
| At 31 December 2005 | 12,163 | 5,720 | 120 | 18,003 |
| At 31 December 2004 | 9,011 | 5,898 | – | 14,909 |

Development costs are internally generated. All of the Group's technical knowhow and software were acquired from third parties.

The above intangible assets have definite useful lives and are amortised on a straight-line basis over the following periods:

| | |
|---|---|
| Development costs and software | 5 years |
| Technical knowhow | 10 years |

# Notes to the Financial Statements



## 16. GOODWILL

| | RMB'000 |
|---|---|
| **THE GROUP** | |
| COST | |
| At 1 January 2004 | – |
| Arising on acquisition of a subsidiary | 897 |
| Arising on acquisition of additional interest of a subsidiary | 27,306 |
| At 31 December 2004 | 28,203 |
| Elimination of accumulated amortisation upon the application of HKFRS 3 (see note 2) | (977) |
| At 1 January 2005 | 27,226 |
| Arising on acquisition of subsidiaries (note 30) | 51,942 |
| At 31 December 2005 | 79,168 |
| AMORTISATION | |
| Charge for the year ended 31 December 2004 and balance at 1 January 2005 | 977 |
| Elimination of accumulated amortisation upon the application of HKFRS 3 (see note 2) | (977) |
| At 31 December 2005 | – |
| CARRYING VALUE | |
| At 31 December 2005 | 79,168 |
| At 31 December 2004 | 27,226 |

Until 31 December 2004, goodwill had been amortised on a straight-line basis over 10 years.

**Impairment testing on goodwill**

As explained in note 7, the Group uses business segments as its primary segment for reporting segment information. For the purposes of impairment testing, the carrying amount of goodwill (net of accumulated amortisation) as at 31 December 2005 has been allocated as follows:

| | RMB'000 |
|---|---|
| IT outsourcing | 51,942 |
| IT consulting and training services | 830 |
| Chinasoft Beijing (note) | 26,396 |
| | 79,168 |

Note: The carrying amount of goodwill of RMB26,396,000 at 31 December 2005 was resulted from the acquisition of additional interest of Chinasoft Beijing in 2004. The goodwill contributes to the cash flows of multiple business segments which cannot be allocated on a non-arbitrary basis to individual business segments.

During the year ended 31 December 2005, management of the Group determines that there are no impairments of any of its CGUs containing goodwill.

## 16. GOODWILL – Continued

**Impairment testing on goodwill** – Continued

The basis of the recoverable amounts of the above CGUs and the methodology used to determine them are the same and are summarised below:

**IT outsourcing**

The recoverable amount of this CGU has been determined based on the valuation at 31 December 2005 prepared by independent professional valuers. The valuation is based on the management's 2006 financial budget and a price to earning ratio of 9 based on comparable companies in the relevant industry. The 2006 budgeted gross margin is determined based on the past performance and management's expectations for the market development after considering other relevant price information. Management believes that any reasonably possible change in any of these assumptions will not cause the aggregate carrying amount of the CGU to exceed its aggregate recoverable amount.

**IT consulting and training services**

The recoverable amount of this CGU has been determined based on the valuation at 31 December 2005 prepared by independent professional valuers. The valuation is based on the management's 2006 financial budget and a price to earning ratio of 15 based on comparable companies in the relevant industry. The 2006 budgeted gross margin is determined based on the past performance and management's expectations for the market development after considering other relevant price information. Management believes that any reasonably possible change in any of these assumptions will not cause the aggregate carrying amount of the CGU to exceed its aggregate recoverable amount.

**Chinasoft Beijing**

The recoverable amount of this CGU has been determined based on the valuation at 31 December 2005 prepared by independent professional valuers. The valuation is based on the management's 2006 financial budget and a price to earning ratio of 21 based on comparable companies in the relevant industry. The 2006 budgeted gross margin is determined based on the past performance and management's expectations for the market development after considering other relevant price information. Management believes that any reasonably possible change in any of these assumptions will not cause the aggregate carrying amount of the CGU to exceed its aggregate recoverable amount.

# Notes to the Financial Statements

for the year ended 31 December 2005

## 17. INTERESTS IN ASSOCIATES

| | 2005<br>RMB'000 | 2004<br>RMB'000<br>(restated) |
|---|---|---|
| Unlisted cost of investments in associates | **8,069** | 1,466 |
| Share of post-acquisition profits, net of dividend received | **234** | 173 |
| Release of negative goodwill of an associate | **–** | 19 |
| | **8,303** | 1,658 |

Particulars of the Group's associates at 31 December 2005 are as follows:

| Name of associate | Form of business structure | Place of establishment | Principal place of operation | Proportion of registered capital held by the Group | Nature of business |
|---|---|---|---|---|---|
| 中軟賽博資源軟件技術(天津)有限公司<br>CS&S Cyber Resources Software Technology (Tianjin) Co., Ltd. ("Cyber Resources") | Sino-foreign equity joint venture enterprise | PRC | PRC | 26% | Provision of protected software developments, testing and related technological services |
| 武漢中軟國際信息技術有限公司<br>Wuhan Chinasoft International Information Technology Limited ("Chinasoft Wuhan") | Equity joint venture enterprise | PRC | PRC | 46% | Provision of solutions and information technology consulting services |
| 北京中烟信息技術有限公司<br>China National Tobacco Information Company Limited ("China Tobacco") | Equity joint venture enterprise | PRC | PRC | 20% | Maintenance of a policy making system for the production, operation and management of the tobacco industry |

Included in the unlisted cost of investments in associates is goodwill of RMB3,052,000 arising on acquisition of China Tobacco during the year.

## 17. INTERESTS IN ASSOCIATES – Continued

Negative goodwill with carrying amount of RMB111,000 as at 31 December 2004 was presented as a deduction from the interests in associates. In the prior year, negative goodwill was released to income on a straight-line basis over 5 years, representing the remaining weighted average useful life of the depreciable assets acquired. The amount of negative goodwill released to the consolidated income statement for the year ended 31 December 2004 was RMB19,000. The negative goodwill was derecognised on 1 January 2005 upon the application of HKFRS 3 (see note 2).

## 18. INVENTORIES

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| Computer hardware, equipment and software products | **22,670** | 34,485 |

## 19. TRADE AND OTHER RECEIVABLES

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| Trade receivables | **142,593** | 120,204 |
| Advances to suppliers | **2,362** | 5,659 |
| Deposits, prepayments and other receivables | **37,158** | 38,092 |
| | **182,113** | 163,955 |

The credit terms of the Group ranged from 30 to 90 days. An aged analysis of trade receivables is as follows:

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| Within 90 days | **83,047** | 65,317 |
| Between 91 – 180 days | **12,740** | 17,073 |
| Between 181 – 365 days | **24,503** | 20,480 |
| Between 1 – 2 years | **11,333** | 16,108 |
| Over 2 years | **10,970** | 1,226 |
| | **142,593** | 120,204 |

The fair value of the Group's trade and other receivables at 31 December 2005 approximates to the corresponding carrying amount.

## 20. AMOUNT DUE FROM A RELATED COMPANY

| | 2005<br>RMB'000 | 2004<br>RMB'000 |
|---|---|---|
| 中國軟件與技術服務股份有限公司 (Chinasoft National Software and Service Company Limited) ("CNSS") (see note 35(i)(a)) | **1,815** | – |
| 中國計算機軟件與技術服務總公司China National Computer Software & Technology Service Corporation ("CS&S") (see note 35(i)(c)) | **–** | 1,978 |
| | **1,815** | 1,978 |

The amount is unsecured, non-interest bearing and repayable on demand. The fair value of the amount due from a related company at 31 December 2005 approximates to the corresponding carrying amount.

## 21. LOANS TO EMPLOYEES

The loans represented housing loans made to employees of the Group. The amounts were unsecured, non-interest bearing and were fully repaid during the year.

## 22. PLEDGED DEPOSITS

The amount represents deposits pledged to various banks and a financial institution registered in the PRC as guarantees for short-term trade facilities granted to the Group and are therefore classified as current assets.

The deposits carry interest at prevailing market interest rates. The pledged deposits will be released upon the settlement of relevant trade facilities. The fair value of deposits at 31 December 2005 approximates to the corresponding carrying amount.

## 23. OTHER FINANCIAL ASSETS AND LIABILITIES

**Bank balances and cash**

The amounts comprise cash held by the Group and short-term bank deposits at prevailing market interest rates with an original maturity of three months or less. The fair values of these assets at 31 December 2005 approximate to their corresponding carrying amounts.

**Bills payable**

The amount is unsecured, non-interest bearing and repayable on demand. The fair value of the amount at 31 December 2005 approximates to its corresponding carrying amount.

## 24. TRADE AND OTHER PAYABLES

| | **2005**<br>**RMB'000** | 2004<br>RMB'000 |
|---|---|---|
| Trade payables | **80,438** | 78,136 |
| Deposits received from customers | **906** | 16,684 |
| Other payables and accrued charges | **16,926** | 5,501 |
| | **98,270** | 100,321 |

An aged analysis of trade payables is as follows:

| | **2005**<br>**RMB'000** | 2004<br>RMB'000 |
|---|---|---|
| Within 90 days | **28,978** | 59,486 |
| Between 91 – 180 days | **11,167** | 9,876 |
| Between 181 – 365 days | **15,931** | 5,783 |
| Between 1 – 2 years | **24,280** | 2,991 |
| Over 2 years | **82** | – |
| | **80,438** | 78,136 |

The fair value of the Group's trade and other payables at 31 December 2005 approximates to the corresponding carrying amount.

## 25. AMOUNT DUE TO A SHAREHOLDER

The amount is unsecured, non-interest bearing and repayable on demand.

The fair value of the Group's amount due to a shareholder at 31 December 2005 approximates to the corresponding carrying amount.

## 26. DEFERRED TAX LIABILITIES

The following are the major deferred tax liabilities recognised by the Group and movement thereon during the current and prior year:

| | **Development costs** |
|---|---|
| | RMB'000 |
| At 1 January 2004 | 410 |
| Charge to the income statement | 811 |
| At 1 January 2005 | 1,221 |
| Charge to the income statement | 603 |
| At 31 December 2005 | 1,824 |

At the balance sheet date, the Group had unused tax losses available for offset against future profits of approximately RMB1,766,000 (2004: RMB274,000) which may be carried forward indefinitely. No deferred tax asset has been recognised in respect of such deductible temporary difference due to the unpredictability of future profit streams.

## 27. SHARE CAPITAL

| | Note | **Nominal value per share** | **Number of shares** | **Amount** |
|---|---|---|---|---|
| | | HK$ | | HK$'000 |
| Authorised ordinary shares | | | | |
| At 1 January 2004, 31 December 2004 and 2005 | | 0.05 | 1,500,000,000 | 75,000 |

## 27. SHARE CAPITAL – Continued

| | Notes | Nominal value per share HK$ | Number of shares | Amount HK$ | Amount shown in the financial statements RMB'000 |
|---|---|---|---|---|---|
| Issued and fully paid: | | | | | |
| Ordinary shares | | | | | |
| At 1 January 2004 | | 0.05 | 640,000,000 | 32,000,000 | 33,920 |
| Issue of new shares | (a) | | 57,500,000 | 2,875,000 | 3,048 |
| At 31 December 2004 | | 0.05 | 697,500,000 | 34,875,000 | 36,968 |
| Issue of new shares | (b) | | 34,872,453 | 1,743,623 | 1,848 |
| At 31 December 2005 | | 0.05 | 732,372,453 | 36,618,623 | 38,816 |

Notes:

(a) Pursuant to an ordinary resolution passed by the shareholders of the Company on 3 August 2004, 57,500,000 new shares of the Company of HK$0.05 each were allotted and issued as fully paid to China National Computer Software & Technology Service Corporation (Hong Kong) Limited ("CS&S (HK)") as the consideration shares of HK$0.73 each for the acquisition of an additional interest of 15% of the registered capital of Chinasoft Beijing.

(b) Pursuant to an ordinary resolution passed by the shareholders of the Company on 22 June 2005, 34,872,453 new shares of the Company of HK$0.05 each were allotted and issued as fully paid to CS&S (HK) as the first part of the consideration shares of HK$1.01 each for the acquisition of 51% equity interest in the registered capital of Chinasoft Resources Beijing.

All the shares which were issued by the Company during the year rank pari passu with each other in all respects.

## 28. REDEEMABLE CONVERTIBLE PREFERRED SHARES

| | Nominal value per share HK$ | Number of shares | Amount HK$'000 |
|---|---|---|---|
| Authorised preferred shares | | | |
| Increase in authorised share capital and balance at 31 December 2005 | 0.05 | 625,000,000 | 31,250 |

## 28. REDEEMABLE CONVERTIBLE PREFERRED SHARES – Continued

At the extraordinary general meeting of the Company held on 28 December 2005, ordinary and special resolutions approving the following were passed and the following took effect:

(i) the Re-stated Memorandum and Articles of the Company (the "M&A") was adopted and replaced the then M&A of the Company;

(ii) the authorised share capital of the Company was increased from HK$75,000,000 divided into 1,500,000,000 ordinary shares of HK$0.05 each to HK$106,250,000 divided into 1,500,000,000 ordinary shares of HK$0.05 each and 625,000,000 redeemable convertible preferred shares (the "Series A Preferred Shares") of HK$0.05 each, with the respective rights and privileges, and subject to the restrictions, set forth in the Re-stated M&A; and

(iii) the issue by the Company of the Series A Preferred Shares pursuant to the terms of the Subscription Agreement, the Investors' Rights Agreement and the relevant provision in the Re-stated M&A and the grant of anti-dilution rights to the holders of the Series A Preferred Shares stated in the Re-stated M&A. The Series A Preferred Shares were issued by the Company subsequent to the balance sheet date and is disclosed as a post balance sheet event in note 36.



Details of the above were set out in a circular dated 2 December 2005 issued by the Company.

## 29. RESERVES

### General reserve fund and enterprise expansion fund

As stipulated by the relevant laws and regulations in the PRC, Chinasoft Beijing, Chinasoft Guangzhou, Chinasoft Hangzhou, Chinasoft Kunming, Chinasoft Resources Beijing and Chinasoft Resources Shanghai (the "Chinasoft subsidiaries") are required to provide for the general reserve fund and the enterprise expansion fund. Appropriations to such reserve funds are made out of net profit after taxation as reported in the statutory financial statements of the Chinasoft subsidiaries prepared in accordance with accounting principles generally accepted in the PRC and the amount and allocation basis are decided by its board of directors annually. The general reserve fund can be used to make up prior year losses of the Chinasoft subsidiaries, if any, and can be applied in conversion into capital by means of capitalisation issue. The enterprise expansion fund is used for expanding the capital base of the Chinasoft subsidiaries by means of capitalisation issue.

### Statutory surplus reserve fund and statutory public welfare fund

As stipulated by the relevant laws and regulations in the PRC, Chinasoft Resources Shenzhen is required to provide for the statutory surplus reserve fund and the statutory public welfare fund. Appropriations to such funds are made out of 5% to 10% of the net profit after taxation as reported in the statutory financial statements of Chinasoft Resources Shenzhen prepared in accordance with accounting principles generally accepted in the PRC. The statutory surplus reserve fund can be used to make up prior year losses, to expand production operations or to increase registered capital of Chinasoft Resources Shenzhen. The statutory public welfare fund can be used for employees' collective welfare benefits.

## 30. ACQUISITION OF SUBSIDIARIES

In July 2005, the Group acquired 51% equity interest in the register capital of Chinasoft Resources Beijing for a consideration of the issuance of a total of 58,120,755 ordinary shares of the Company from CS&S (HK), a shareholder of the Company (see note 35(iii)). Chinasoft Resources Beijing has two subsidiaries, namely Chinasoft Resources Shenzhen and Chinasoft Resources Shanghai. Acquisition of the subsidiaries was accounted for by the purchase method.

The fair values of the identifiable assets and liabilities of the subsidiaries acquired during the year have no significant differences from their respective carrying amounts. The net assets acquired in the transaction, representing the acquiree's carrying amount and fair value, and the goodwill arising, are as follows:

| | **2005** **RMB'000** |
|---|---|
| Net assets acquired: | |
| Property, plant and equipment | **3,833** |
| Inventories | **1,479** |
| Trade and other receivables | **9,540** |
| Bank balances and cash | **15,214** |
| Trade and other payables | **(9,562)** |
| | **20,504** |
| Minority interests | **(10,692)** |
| Goodwill on acquisition | **51,942** |
| Total consideration | **61,754** |
| Satisfied by: | |
| Shares issued and to be issued (note) | **61,754** |
| Amount due from a related company | **–** |
| | **61,754** |
| Inflow of cash and cash equivalents in respect of the acquisition of subsidiaries | **15,214** |

# Notes to the Financial Statements



## 30. ACQUISITION OF SUBSIDIARIES – Continued

Note:

The consideration for the acquisition of Chinasoft Resources Beijing was satisfied by the issuance of 34,872,453 ordinary shares of the Company with nominal value per share of HK$0.05 each during the year (the "first portion of consideration shares") and the remaining 23,248,302 ordinary shares (the "second portion of consideration shares") will be issued in the year ending 31 December 2006 subject to the achievement of the Performance Hurdle as described in the circular of the Company dated 6 June 2005. The directors are of the opinion that the Performance Hurdle will be achieved. The fair value of the first and second portion of consideration shares, determined using the published price available at the date of the acquisition at HK$1.01, amounted to RMB37,334,000 (equivalent to HK$35,221,000) and RMB24,420,000 (equivalent to HK$23,481,000) respectively. The amount of the second portion of consideration shares of RMB24,420,000 was presented as issuable shares in the consolidated statement of changes in equity.

The goodwill arising on the acquisition of Chinasoft Resources Beijing is attributable to the anticipated profitability of the distribution of the Group's products in the IT outsourcing market and the anticipated future operating synergies from the combination.

Chinasoft Resources Beijing contributed RMB30,680,000 to the Group's turnover and RMB6,997,000 to the Group's profit for the year between the date of acquisition and the balance sheet date.



If the acquisition had been completed on 1 January 2005, total Group turnover for the period would have been RMB420,800,000, and profit for the year would have been RMB44,374,000. The proforma information is for illustrative purposes only and is not necessarily an indication of turnover and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2005, nor is it intended to be a projection of future results.

## 31. MAJOR NON-CASH TRANSACTIONS

Pursuant to an agreement entered into between CS&S (HK) and Chinasoft (HK), a subsidiary of the Group on 28 April 2005, Chinasoft (HK) acquired 51% equity interest in the registered capital of Chinasoft Resources Beijing from CS&S (HK). The consideration is to be satisfied by the issuance of new shares of the Company (see note 30).

During the year ended 31 December 2004, pursuant to an agreement entered into between CS&S (HK) and Chinasoft (HK), a subsidiary of the Company, on 24 June 2004, Chinasoft (HK) acquired an additional 15% of the registered capital of Chinasoft Beijing from CS&S (HK). The total consideration of the acquisition of RMB44,494,000 was satisfied by the allotment and issue of 57,500,000 new shares of the Company of HK$0.05 each to CS&S (HK), and goodwill arising on the acquisition amounted to RMB27,306,000.

## 32. OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases in respect of land and buildings which fall due as follows:

| | THE GROUP | |
|---|---|---|
| | **2005** | 2004 |
| | **RMB'000** | RMB'000 |
| Within one year | **2,170** | 1,930 |
| In the second to fifth year inclusive | **5,105** | 189 |
| | **7,275** | 2,119 |

Operating lease payments represent rentals payable by the Group for certain office properties. Certain lease agreements for offices properties were replaced by new agreements entered into during the year. Leases are negotiated for lease terms ranging from a half year to six years (2004: one to two years) for the Group and rentals are normally fixed during the lease period.

## 33. SHARE OPTION SCHEME

The Company's share option scheme (the "Share Option Scheme") was adopted pursuant to a resolution passed on 2 June 2003 by the then shareholders for the purpose of providing incentives and rewards to the people and the parties working for the interest of the Group. Under the Share Option Scheme, the board of directors may grant options to eligible participants including the directors, full-time and part-time employees of the Company or any of its subsidiaries or associates, and suppliers and customers of the Company or any of its subsidiaries or associates to subscribe for shares in the Company in accordance with the terms of the Share Option Scheme. An offer for the grant of options must be accepted within 30 days from the date of offer, and a consideration of HK$1.00 is payable by each of the participants on acceptance of the grant of options. The Share Option Scheme will remain valid for a period of ten years commencing on 2 June 2003. An option may be exercised in accordance with the terms of the Share Option Scheme at any time during a period of not more than ten years after the date on which an offer of the grant of an option is accepted. The subscription price for shares under the Share Option Scheme will be a price determined by the board of directors and notified to each grantee and will be no less than the highest of (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date of offer, which must be a trading day; (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five trading days immediately preceding the date of offer and; (iii) the nominal value of a share.

# Notes to the Financial Statements

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## 33. SHARE OPTION SCHEME – Continued

The Company may grant options under the Share Option Scheme and any other share option schemes of the Company entitling the grantees to exercise up to an aggregate of 10% of the total number of shares in issue immediately upon the listing of the shares on the Stock Exchange and subject to renewal with shareholders' approval. However, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other share option schemes of the Company shall not exceed 30% of the total number of shares in issue from time to time. The number of shares in respect of which options may be granted to any individual in aggregate within any 12-month period is not permitted to exceed 1% of the shares of the Company in issue, without prior approval from the Company's shareholders. Options granted to substantial shareholders or independent non-executive directors in any one year exceeding the higher of 0.1% of the Company's shares in issue and with a value in excess of HK$5,000,000 must be approved by the Company's shareholders.

A summary of the movements of share options granted during the year ended 31 December 2005 is as follows:

| | Number of share options | | | | | | |
|---|---|---|---|---|---|---|---|
| Type of participant | Outstanding at 1 January 2004 (note i) | Granted during the year (note ii) | Lapsed during the year | Outstanding at 1 January 2005 | Lapsed during the year | Reclassification | Outstanding at 31 December 2005 |
| Directors | | | | | | | |
| Dr. Chen Yuhong | 1,200,000 | 5,000,000 | – | 6,200,000 | – | – | 6,200,000 |
| Dr. Cui Hui | – | 500,000 | – | 500,000 | – | – | 500,000 |
| Mr. Duncan Chiu | – | 1,000,000 | – | 1,000,000 | – | – | 1,000,000 |
| Mr. Peng Jiang | 800,000 | 3,000,000 | – | 3,800,000 | – | – | 3,800,000 |
| Mr. Wang Hui | – | – | – | – | – | 4,500,000 | 4,500,000 |
| Dr. Tang Zhenming | – | – | – | – | – | 2,920,000 | 2,920,000 |
| | 2,000,000 | 9,500,000 | – | 11,500,000 | – | 7,420,000 | 18,920,000 |
| Employees | 8,890,000 | 43,200,000 | (250,000) | 51,840,000 | (530,000) | (7,420,000) | 43,890,000 |
| | 10,890,000 | 52,700,000 | (250,000) | 63,340,000 | (530,000) | – | 62,810,000 |
| Exercisable at the end of the year | | | | 15,835,000 | | | 31,405,000 |

Notes:

(i) The share options were granted on 13 August 2003 and are exercisable in four equal trenches from 13 August 2004, 13 August 2005, 13 August 2006 and 13 August 2007, respectively, to 12 August 2013 at an exercise price of HK$0.58 per share. The closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheet on the date of grant was HK$0.58 per share.

(ii) The share options were granted on 13 May 2004 and are exercisable in four equal trenches from 13 May 2004, 13 May 2005, 13 May 2006 and 13 May 2007, respectively, to 12 May 2014 at an exercise price of HK$0.65 per share. The closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheet on the date of grant was HK$0.65 per share.

## 33. SHARE OPTION SCHEME – Continued

No share options have been exercised or cancelled during the year.

The estimated fair value of the options granted on 13 May 2004 is RMB9,664,000.

The fair value was calculated using the Black-Scholes pricing model. The inputs into the model were as follows:

| | Share option grant date<br>13 May 2004 |
|---|---|
| Share price on grant date | HK$0.65 |
| Exercise price | HK$0.65 |
| Expected volatility | 44.38% |
| Expected life | 1 to 4 years |
| Risk-free rate | 1.02% to 3.04% |
| Expected dividend yield | 1.3% |

Expected volatility was determined by using the historical volatility of the Company's share price over a period of 260 days. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions and behavioural considerations.

The Group recognised a total expense of RMB3,617,000 for the year ended 31 December 2005 (2004: RMB3,328,000) in relation to share options granted by the Company.

## 34. RETIREMENT BENEFIT SCHEMES

As stipulated by the rules and regulations in the PRC, the Group contributes to state-sponsored retirement plans for its employees in the PRC. The Group is required to contribute a certain percentage of the basic salaries of its employees to the retirement plans, and has no further obligation for the actual payment of the previous or post retirement benefits. The relevant state-sponsored retirement plans are responsible for the entire present obligation to retired employees.

In accordance with the relevant mandatory provident fund laws and regulations of Hong Kong, the Group operates a Mandatory Provident Fund ("MPF") scheme ("MPF Scheme") for all qualifying Hong Kong employees. The assets of the scheme are held separately from those of the Group and under the control of an independent MPF service provider. Under the rules of the MPF Scheme, the employer and its employees are each required to make contributions to the scheme at rates specified in the rules. The only obligation of the Group in respect of the MPF Scheme is to make the required contributions under the scheme.

During the year, the total cost of retirement benefit contributions charged to the income statement of RMB3,214,000 (2004: RMB980,000) represents contributions to the schemes made by the Group at rates specified in the rules of the respective schemes. No forfeited contributions may be used by the employers to reduce the existing level of contributions.

# Notes to the Financial Statements



## 35. RELATED PARTY TRANSACTIONS

(i) During the year, the Group had the following transactions with the following companies:

| | Notes | 2005 RMB'000 | 2004 RMB'000 |
|---|---|---|---|
| Provision of software and installion services for a management system software development and technology project of a customer of CNSS | (a) & (e) | **1,374** | – |
| Subcontracting costs | | | |
| – 鄭州中軟信息技術有限公司 (Zhengzhou Chinasoft Information Technology Co., Ltd.) | (b) | **243** | – |
| – 山東中軟信息技術有限公司 (Shandong Chinasoft Information Technology Co., Ltd.) | (b) (vii) | **96** | – |
| – CNSS | (a) & (e) | **88** | – |
| Rental expenses | | | |
| – CNSS | (a) & (e) | **2,889** | – |
| – CS&S | (c) | **118** | 1,264 |
| Building management fee | | | |
| – 北京中軟仕園物業管理有限公司 (Beijing Chinasoft Shiyuan Property Management Co., Ltd.) | (d) | **1,142** | 484 |



Notes:

(a) CNSS was a holding company of a shareholder of the Company.

(b) Zhengzhou Chinasoft Information Technology Co., Ltd. and Shandong Chinasoft Information Technology Co., Ltd. were subsidiaries of CNSS.

(c) CS&S was a holding company of a substantial shareholder of the Company from 19 August 2004 to 30 September 2004 and a minority shareholder of a subsidiary of the Company from 1 January 2004 to 18 August 2004. During the year ended 31 December 2004, CNSS acquired CS&S and took over its assets and liabilities pursuant to an acquisition agreement dated 18 August 2004 and CS&S was subsequently de-registered under the laws of the PRC on 25 April 2005.

(d) Beijing Chinasoft Shiyuan Property Management Co., Ltd. was an associate of CNSS and CS&S from 1 October 2004 to 31 December 2005 and from 1 January 2004 to 30 September 2004 respectively.

(e) Dr. Chen Yuhong, Ms. Tang Min and Dr. Cui Hui, directors of the Company, are also directors of CNSS.

## 35. RELATED PARTY TRANSACTIONS – Continued

(ii) Pursuant to a trademark license agreement ("Trademark Licence Agreement") entered into between CS&S and the Company on 20 December 2003, CS&S granted to the Company an exclusive right to use a trademark of 中軟總公司計算機培訓中心 as defined on the Trademark Licence Agreement for a period of 25 years pending registration of such trademark with the Trademark Bureau of the PRC for a consideration of RMB2,000,000. Such amount, which is refundable on unsuccessful registration, has been paid to CS&S and was included in the amounts due from a related company at 31 December 2005 and 2004.

(iii) Pursuant to an agreement entered into between CS&S (HK), a subsidiary of CNSS, and Chinasoft (HK) on 28 April 2005, Chinasoft (HK) acquired 51% equity interest in the registered capital of Chinasoft Resources Beijing from CS&S (HK). The consideration of the acquisition was satisfied by the allotment and issue of 58,120,755 new shares of the Company of HK$0.05 each to CS&S (HK). The acquisition was completed on 18 July 2005. The acquisition constituted a connected transaction of the Company under the GEM Listing Rules as CS&S (HK) is a connected person (as defined under the GEM Listing Rules) of the Company. The independent non-executive directors of the Company considered that the terms of the acquisition were fair and reasonable and in the interest of the Company and its shareholders as a whole, and the acquisition was approved by the independent shareholders at an extraordinary general meeting on 22 June 2005.

(iv) Pursuant to an agreement entered into between CS&S (HK), a subsidiary of CNSS, and Chinasoft (HK) on 15 November 2005, Chinasoft (HK) conditionally agreed to acquire the remaining 49% equity interest in the registered capital of Chinasoft Resources Beijing from CS&S (HK). The consideration of the acquisition will be satisfied by cash in a maximum aggregate amount of RMB43,556,000 (equivalent to HK$41,881,000) subject to satisfaction of certain conditions. The acquisition has yet to be completed at the date of approval of the consolidated financial statements. The acquisition constituted a connected transaction of the Company under the GEM Listing Rules as CS&S (HK) is a connected person (as defined under the GEM Listing Rules) of the Company. The independent non-executive directors of the Company considered that the terms of the acquisition were fair and reasonable and in the interest of the Company and its shareholders as a whole, and the acquisition was approved by the independent shareholders at an extraordinary general meeting on 28 December 2005.

(v) Pursuant to a rental agreement entered into between Chinasoft Beijing and CNSS on 1 June 2005, Chinasoft Beijing prepaid a rent of RMB866,000 to CNSS for the lease of office premises for a term commencing from 1 April 2006 to 31 March 2007. At 31 December 2005, the prepaid lease payments were analysed for reporting purposes as a non-current asset of RMB216,000 and current asset of RMB650,000 which was included in trade and other receivables in the consolidated balance sheet.

(vi) Pursuant to an agreement entered into between北京中軟賽博中文信息技術有限公司(Beijing Chinasoft Cyber-Chinese Information Technology Company Ltd.) ("Beijing Cyber-Chinese"), an associate of CNSS, and Chinasoft Beijing on 1 December 2005, Chinasoft Beijing advanced a loan of RMB 1,450,000 to Beijing Cyber-Chinese for a term of 6 months from 1 December 2005 to 31 May 2006. The loan was unsecured, non-interest bearing and fully repaid by Beijing Cyber-Chinese in March 2006.

## 35. RELATED PARTY TRANSACTIONS – Continued

The fair value of the loan at 31 December 2005 approximates to the corresponding carrying amount.

(vii) During the year, Zhenzhou Chinasoft Information Technology Co. Ltd., a subsidiary of CNSS, provided subcontracting service of RMB243,000 to Chinasoft Beijing. At 31 December 2005, an amount of RMB68,000 was included in trade and other payables in the consolidated balance sheet.

**Compensation of key management personnel**

The remuneration of directors and other members of key management during the year was as follows:

| | **2005** | 2004 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Short-term employee benefits | **3,448** | 3,143 |
| Share option expense | **1,257** | 1,141 |
| | **4,705** | 4,284 |



The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

## 36. POST BALANCE SHEET EVENTS

On 6 January 2006, the Company announced that completion of the first subscription of a total of 194,500,000 Series A Preferred Shares of the Company by Microsoft Corporation and International Finance Corporation took place. Under the first subscription arrangement, 97,250,000 Series A Preferred Shares at a price of HK$0.8 each were allotted and issued to each of Microsoft Corporation and International Finance Corporation, raising a total of approximately RMB162,240,000 (equivalent to US$19,999,990) for the Company. Details of proposed issue of Series A Preferred Shares and first subscription were set out in a circular dated 2 December 2005 issued by the Company.

On 27 January 2006, Chinasoft (HK), a wholly-owned subsidiary of the Company, paid approximately RMB19,816,000 (equivalent to HK$19,054,000) to CS&S (HK) as part of the consideration for the acquisition of the remaining 49% equity interest in the register capital of Chinasoft Resources Beijing. Details of the above are set out in a circular dated 9 December 2005 issued by the Company. The acquisition has yet to be completed at the date of approval of the consolidated financial statements.