

## Audit Report

LPA Audit No. 014 (2006)

Attention: Shangdong XXX Engineering Co., Ltd.

We have audited the attached financial statements of Shangdong XXX Engineering Co., Ltd. including the balance sheet dated on 31<sup>st</sup> December 2005, year 2005 profit and profit distribution statement as well as the cash flow statement. The above mentioned financial statements were compiled by Shangdong XXX Engineering Co., Ltd. The administrative authority of the Company is responsible for the compilation of them while our responsibility is to pronounce the opinion on these financial statements on the basis of the audit implementation.

We plan and implement the auditing work in accordance with China certified public accountant independent auditing standards, so as to assure in a reasonable way that there is no major misstatement existing in the financial statement. The audit includes the inspection of the evidence which supports the amount and disclosure in the financial statement on the basis of the spot check. In addition to it, it covers the work to evaluate the accounting policy adopted by and major accounting estimate made by the administrative authority during the compilation of the accounting statement. It also involves the evaluation on the integral reflection of the financial statement. We believe that our audit provides the reasonable basis for the purpose of the opinion pronouncement.

We confirm that the above financial statements conform to the regulations as set forth in *Accounting Criteria for Enterprises* and *Accounting Policy of Construction Enterprise* which are promulgated by the nation. They fairly reflect the financial status as of 31<sup>st</sup> December of 2005, year 2005 operation achievements and cash flow situation in each major aspect.

Appendix 1: Balance Sheet Dated 31<sup>st</sup> December of 2005

Appendix 2: Profit and Profit Distribution Table Dated 31<sup>st</sup> December of 2005

Appendix 3: Cash Flow Statement Dated 31<sup>st</sup> December of 2005

Appendix 4: Year 2005 Financial Statement Annotations

Shangdong Peony Accounting Firm Co., Ltd.

China Certified Public Accountant

Address: Shandong Province, China

Tel:

Date: 18<sup>th</sup> February 2005

## Balance Sheet

Table 01

Prepared by: Shangdong XXX Engineering Co., Ltd.

31<sup>st</sup> December 2005

Amount Unit: RMB

ASSETS	LINE	AMOUNT FOR YEAR BEGINNING	AMOUNT FOR YEAR-END	LIABILITY AND OWNER'S EQUITY	LINE	AMOUNT FOR YEAR BEGINNING	AMOUNT FOR YEAR-END
Current Assets:				Current liabilities:			
Currency fund	1			Short term borrowing	36		
Current investment	2			Note payable	37		
Note receivable	3			Account payable	38		
Account receivable	4			Account receivable in advance	39		
Minus: dead accountant preparation	5			Other account payable	40		
Net account receivable	6			Salary payable	41		
Advance account	7			Where: packaging wages	42		
Reserve funds	8			Welfare benefits payable	43		
Other account receivable	9			Outstanding tax	44		
Unamortized expenses	10			Outstanding profit	45		
Inventory	11			Other outstanding accounts	46		
Where: project under construction	12			Advanced expense	47		
Other current assets	13			Other current liability	48		
Net loss of current assets to be treated	14			Long term liability with one year expiry	49		
Long term bond investment with one year expiry	15			Total of the current liability	50		
Total of current assets	16			Long Term liabilities:			
Long Term Investment:				Long term borrowing	51		
Long term investment	17			Bond payable	52		
Fixed Assets:				Long term account payable	53		
Original price of fixed assets	18			Other long term liability	54		
Minus: accumulated depreciation	19			Where: special account payable	55		
Net value of fixed assets	20			Housing working fund	56		
Fixed assets liquidation	21			Total of long term liability	57		
Net loss of fixed assets under the treatment	22			Deferred tax			
Total of fixed assets	23			Credit entry of deferred tax	58		
Special Works:				Total of liability	59		
Special Works	24			Owner's Equity:			
Intangible assets and deferred assets				Registered capital (10K RMB)	60		
Intangible assets	25			Capital accumulation	61		
Deferred assets	26			Surplus accumulation	62		
Total of intangible assets and deferred assets	27			Where: public welfare funds	63		
Other Assets				Undistributed profit	64		
Temporary assets	28			Total of owner's equity	65		
Minus: temporary facilities amortization	29						
Net value of temporary facilities	30						
Temporary facilities liquidation	31						
Other long term assets	32						
Total of other assets	33						
Deferred tax							
Debit entry of deferred tax	34						
Total of Assets	35			Total of Liabilities and Owner's Equity	66		

## Profit and Profit Distribution Table

Table 02

Prepared by: Shangdong XXX Engineering Co., Ltd.

December 31<sup>st</sup> 2005

Amount Unit: RMB

DESCRIPTION	LINE	ACTUAL AMOUNT FOR LAST YEAR	ACCUMULATIVE AMOUNT FOR THIS YEAR
I. Project Settlement Income	1		
Minus: Project settlement cost	2		
Project settlement tax and affixation	3		
II. Project Settlement Profit	4		
Plus: Other business profit	5		
Minus: Administrative fee	6		
Financial fee	7		
III. Business Profit	8		
Plus: Investment earnings	9		
Allowance income	10		
Income beyond the business	11		
Minus: Expenditure beyond the business	12		
IV. Total Profit	13		
Minus: Income tax	14		
V. Net Profit	15		
Plus: Undistributed profit for the beginning of the year	16		
Other amount transferred	17		
Profit adjustment of last year	18		
Minus: Income tax adjustment of last year	19		
VI. Distributable Profit	20		
Plus: Surplus Reserve can be used to recover losses	21		
Minus: Withdrawal of Legal Surplus Reserve	22		
VII. Undistributed profit by the end of year	23		

## Cash Flow Sheet

Table 03

Prepared by: Shangdong XXX Engineering Co., Ltd.

Year 2005

Amount Unit: RMB

DESCRIPTION	LINE	AMOUNT	DESCRIPTION	LINE	AMOUNT	DESCRIPTION	LINE	AMOUNT
I. Cash flow produced from the business operation:	1		III. Cash flow produced from the financing	25		Obsolescence loss of the fixed assets	49	
Cash received from the commodity sales and labor provision	2		Absorb the cash received from the investment	26		Financial fees	50	
Tax rebate received	3		Cash received from the borrowing	27		Investment loss (minus: earnings)	51	
Other cash received related to the business operation	4		Other received cash related to the financing	28		Non credit entry of the deferred tax (minus: debt entry)	52	
INFLOWING CASH SUBTOTAL	5		INFLOWING CASH SUBTOTAL	29		The reduction of the inventory (minus: increased amount)	53	
Cash paid for the commodity and labor	6		Cash paid for clearing the debt	30		The reduction of the amount receivable for the business item (minus: increased amount)	54	
Cash paid to employee and cash paid for the employee	7		Cash paid for distributing the dividends, profit or paying the interest	31		The increase of the amount payable for the business item (minus: reduced amount)	55	
All kinds of taxes paid	8		Other paid cash related to the financing	32		Others	56	
Other paid cash related to the business operation	9		OUTFLOW CASH SUBTOTAL	33		Net cash flow produced from the business operation	57	
OUTFLOW CASH SUBTOTAL	10		Net cash flow produced from the financing	34		2. The investment and financing activity which do not involve the cash income and expenses	58	
Net cash flow produced from the business operation	11		IV. Cash influence made by the exchange rate variation	35		Debt transferred into the capital	59	
II. Cash flow produced from the investment:	12		V. Net increase amount of the cash and cash equivalent	36		Transferable company bond with one year expiry	60	
Cash received from the return on investment	13		Supplementary Information:	37		Fixed assets lease through the financing	61	
Where: Cash received from selling the subsidiary	14		1. Adjust the net profit into the cash flow of the business operation	38		Others	62	
Cash received from obtaining the investment benefits	15		Net profit	39		3. Net increase situation of the cash and cash equivalent	63	
Net cash received from the disposal of the fixed assets, intangible assets and other long term assets	16		Plus: Gain and loss of few stockholders	40		Final balance of the cash	64	
Other received cash related to the investment	17		Minus: Unconfirmed investment gain and loss (list it with "+")	41		Minus: Initial balance of the cash	65	
INFLOWING CASH SUBTOTAL	18		Plus: Drawing allowance for depreciation of assets	42		Plus: Final balance of the cash equivalent	66	
Cash paid for the purchase of the fixed assets, intangible assets and other long term assets	19		Fixed assets depreciation	43		Minus: Initial balance of the cash equivalent	67	
Cash paid for the investment	20		Intangible assets amortization	44				
Where: cash used for the purchase of the subsidiary	21		Amortization of the long term unamortized expense	45				
Other paid cash related to the business operation	22		Reduction of the unamortized expense (minus: increased amount)	46		Net increase amount of the cash and cash equivalent	68	
OUTFLOW CASH SUBTOTAL	23		Increase of the pre-withdrawal expense (minus: reduced amount)	47				
Net cash flow produced from the investment	24		Loss resulting from the disposal of the fixed assets, intangible assets and other long term assets (minus: earnings)	48				

# Financial Statement Annotations

## I. Company Background

Founded in October of 1995, Shangdong xxx Highway & Bridge Engineering Bureau was registered in Shangdong Industrial and Commercial Administration Bureau with registered capital of xxx million RMB. The registered number of the enterprise entity business license is xxxxxxxxxxxx. The legal representative is xxx and the legal domicile is located at xxxxxx. The business scope covers construction of high level road and bridge structures, leasing and repairing of construction machinery; R &D, manufacturing and installation of asphalt heating equipment and selling of general mechanical components and related construction materials.

## II. Main Accounting Policy

### 1. Accounting Policy

The Company performs the accounting according to *Accounting Criteria for Enterprises* and *Accounting Policy of Construction Enterprise*

### 2. Fiscal Year

It starts from 1<sup>st</sup> January and terminates on 31<sup>st</sup> December of the solar calendar.

### 3. Account Standard Money

RMB is applied as the account standard money.

### 4. Measurement Basis

The historical cost is adopted as the measurement basis.

### 5. Determination Standard of the Cash Equivalent

It shall be based on the short term investment with the features of short period, high circulation, easy conversion into the known amount, low risk of the value variation.

### 6. Accounting Measures of the Dead Account

It is regarded as the bad account in the case of the following situations:

- A. The debtor is bankrupt or dead. The money still can not be paid off after the liquidation by the debtor's bankruptcy or legacy value;
- B. The debtor fails to perform the obligation of the debt paying within a long period. Moreover, the sufficient evidence indicates that it is no / little possibility to recover the money debited.

## 7. Accounting Measures of the Inventory

- (1) The main inventory includes the goods used for the construction, raw material, mechanical components, finished product, low –value consumable goods ;
- (2) The purchase of the material is to be measured at the actual cost. The method of the first in and first out (FIFO) is adopted when the material is released;
- (3) The finished product is to be measured at the actual cost. The weighted average method is used during the release of the product;
- (4) The primary amortization method is applied to the low-value consumable goods.

## 8. Measurement and Depreciation Method of the Fixed Assets

- (1) The fixed assets includes the building whose service life exceeds one year, the machinery and equipment, transport means and other equipment, machinery, tools etc. related to the production and operation, with the unit value of above 2000RMB and service life above two years, but beyond the main equipment for the production and operation.
- (2) The initial actual cost of the fixed asset is regarded as the original book value.
- (3) The depreciation of the fixed assets shall be in accordance with the regulations as set forth in *Accounting Policy of Construction Enterprise*. The detailed annual depreciation rates are as following: 4.75% for the housing and building, 6-10% for the construction machinery and 7.2-10% for the traffic and transport.

## 9. Income Confirmation Principle

Confirm the income for the labor service which starts and terminates in the same fiscal year upon the labor service is completed. In case that the commencement and completion of the labor service falls in the different fiscal year, the corresponding labor income should be calculated and confirmed at the completion percentage provided that the amount of labor service can be reliably estimated by the end of the service period.

## III. Main Tax / Fee and Tax Rate / Rate

### Business tax:

It is to be paid at 3% of the construction income and generally withheld by the party awarding the contract on behalf of the government;

### Urban maintenance and construction tax:

It is to be calculated and paid at 7% of the actual business tax which is paid;

Education additional expenses:

It is to be calculated and paid at 3% of the actual business tax which is paid;

Income tax:

It is to be calculated and paid at 33% of the total actual profit.

#### IV. Annotations of the Main Item in the Financial Statement

##### 1. Currency Fund

Item	Amount at the year beginning (RMB)	Amount by the year end (RMB)
Cash		
Bank Deposit		
Total		

##### 2. Account Receivable

The balance of the account receivable amounts RMB 76470337.40 by 31<sup>st</sup> December of 2005.

(1) The account age is analyzed as follows:

Account Age	Amount (RMB)	Ratio
Within one year		
Between one year and two years		
Between two year and three years		
Total		

(2) The companies with the large values are listed as follows:

Company	Amount (RMB)
A	
B	
C	
D	

3. Advance Account

The balance of the advance account amounts to RMB XXXXXX by 31<sup>st</sup> December of 2005.

(1) The account age is analyzed as follows:

Account Age	Amount (RMB)	Ratio
Within one year		
Between two year and three years		
Total		

(2) The companies with the large values are listed as follows:

Company	Amount (RMB)
A	
B	
C	
D	
E	

4. Other Account Receivable

The balance of the other account receivable is RMB XXXXX by 31<sup>st</sup> December of 2005.

(1) The account age is analyzed as follows:

Account Age	Amount (RMB)	Ratio
Within one year		
Between one year and two years		
Between two year and three years		
Total		

(2) The units with the large values are listed as follows:

Unit	Amount (RMB)
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A

B

C

D

5. Inventory

The balance of the inventory is RMB XXXX by 31<sup>st</sup> December of 2005. The details are as follows:

Category	Balance at Year Beginning (RMB)	Balance by Year End (RMB)
Construction		
Main Material		
Mechanical Components		
Low-value Consumable Goods		
Finished Product		
Other Material		
Total		

6. Short Term Loan

The balance of the short term loan amounts to RMB XX million by 31<sup>st</sup> December of 2005 with the following details:

The Bank	The Amount (RMB)	Interest Rate (Month)	Mature Date (RMB)
Banker			
Total			

7. Account Payable

The balance of the account payable totals RMB xxxx by 31<sup>st</sup> December of 2005, of which RMB xxxx is for the construction payment payable and RMB xxxx for the material amount payable. The companies or projects with the large values are listed as follows:

Company / Project	Amount (RMB)
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A

- B
- C
- D
- E

8. Account Receivable In Advance

The balance of the account receivable in advance totals RMB XXXX by 31<sup>st</sup> December of 2005. The companies or projects with the large values are listed as follows:

Company / Project	Amount (RMB)
A	
B	
C	

9. Other Account Payable

By 31<sup>st</sup> December of 2005, the balance of the other account payable is RMB XXXX, which means the amount of "San Jin"(annuities, medicare ,housing fund)owned to the employees to be transferred from the municipal highway administration bureau.

10. Wage Payable

The balance of the wage payable is RMB XXXX totally by 31<sup>st</sup> December of 2005. There is RMB XXXX of the employee performance wage among it.

11. Welfare Fee Payable

The balance of the welfare fee payable totals RMB XXX by 31<sup>st</sup> December of 2005. Among it, there is RMB XXXX for the drawing amount of this year and RMB XXXX for the payment.

Shangdong XXX Engineering Co., Ltd.

28<sup>th</sup> January 2006